200315040

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

UIL Numbers: 1001.01-00
4947.02-00

Date:
JAN 16 2003

Contact Person:

Identification Number:

Telephone Number:

T:EO:B3

Employer Identification Number:

Legends:

Trust =
Bank =
Company =
B =
y =

Dear Sir or Madam:

This is in reference to your ruling request dated June 24, 2002 concerning the federal income and private foundation tax consequences of a judicially authorized amendment of the Trust that would eliminate all noncharitable interests in the Trust.

Bank is currently the sole trustee of the Trust. B, one of the founders and a long-time President of the Company, transferred to his sons certain money and securities as a fund to be used by them in such manner as they, in their discretion, determined would best perpetuate his memory and serve the useful purpose of benefiting the employees of Company and such other worthy causes as they, in their discretion, determined deserved financial assistance. In pursuance of that purpose, the sons held and administered said fund as a trust fund.

In desiring to provide a memorial to their father for the permanent administration of the trust fund in the manner consistent with his expressed desires, the sons transferred and assigned all of said fund to themselves, as the Individual Trustees, and a financial institution as the corporate trustee, to hold and administer the trust funds as the Trust in accordance with the provisions set forth in the Agreement of Trust executed on August 15, y by the three sons.

The Trust represents that the Trustee, pursuant to the Agreement of Trust, is authorized to make discretionary distributions of the Trust's income and principal. The Trust also represents that it is authorized on a discretionary basis to make loans to employees of Company to promote employee home ownership or to advance any "other purposes" that the Trustee determines to be of assistance to such employees. If, in any given year, the Trustee has not lent out the full amount available for loans to employees, the Trustee is authorized to make similar loans to "other worthy persons." The Trustee is authorized to make loans that will benefit employees of the Company and "other worthy persons" without regard to charitable criteria such as financial need, lack of access to adequate housing because of local prejudice and discrimination, or the desirability of combating community deterioration.

As a consequence of the Trustee's discretion, not all of the unexpired interests in the Trust are devoted to charitable purposes described in section 170(c)(2)(B) of the Internal Revenue Code ("Code"), and the Trust is therefore a split-interest trust described in section 4947(a)(2) of the Code. The Trust identifies itself as a section 4947(a)(2) trust on its tax returns and does not claim the deduction under section 642(c)(2) for amounts permanently set aside for exclusively charitable purposes, which resulted in the Trust having to pay capital gains tax on its capital gain income. The Trust's fiscal year is the calendar year.

The Trust has obtained a judgment of the appropriate court authorizing the Trustee to amend the Trust in such manner as to qualify the Trust as a charitable foundation qualifying as a tax-exempt organization described in section 501(c)(3) of the Code. The judgment is subject to the Trust obtaining a favorable ruling from the Internal Revenue Service stating that the Trust, as amended and restated will not result in the recognition of taxable income or gain by the Trust or cause a termination of the Trust under section 507.

The proposed amendment, by eliminating all noncharitable interests, is intended to qualify the Trust as a tax-exempt organization described in section 501(c)(3) of the Code that is a private foundation, and the Trust will file Form 1023, Application for Recognition of Exemption, after the receipt of favorable rulings hereunder.

The Trust represents that the pertinent terms of the proposed amendment: (1) provide that the Trust assets are irrevocably dedicated to charitable purposes; (2) prohibit the "inurement" of Trust assets to the benefit of individuals or noncharitable organizations; (3) require compliance with the minimum distribution requirements of section 4942 of the Code, which mandate that a private foundation make qualifying distributions equal to five percent of the fair market value of its net investment assets each year; (4) provide that the Trustee shall not (i) engage in any act of self-dealing as defined in section 4941(d), (ii) acquire or retain any excess business holdings as defined in section 4943(c); (iii) make any investments in such manner as to incur tax liability under section 4944; or (iv) make any taxable expenditures as defined in section 4945(d); (5) impose limitations on lobbying activity and prohibit electioneering
and (6) provide that, upon dissolution, the Trust's assets be distributed to or for the use of such charitable organization or organizations as shall qualify under section 501(c)(3).

The Trust has requested rulings that:

1. The adoption of the proposed amendment will not result in recognition of taxable income or gain by the Trust;

2. The adoption of the proposed amendment will not cause section 507 of the Code to apply to the Trust;

3. Upon the Trust's timely filing of Form 1023 seeking exemption from taxation under section 501(a) after receiving a favorable ruling hereunder, the determination of the Trust's tax-exempt status will be effective as of the effective date of the proposed amendment;

4. The taxable year of the Trust as a taxable trust will end on the day preceding the date the proposed amendment to the Trust is effective and a new taxable year of the Trust as a tax-exempt entity, ending on the last day of the calendar year in which the amendment occurs, will commence on the date the proposed amendment is effective.

Ruling Request 1:

Section 61(a)(3) of the Code provides that gross income includes gains derived from dealings in property.

Section 1001(a) of the Code provides that the gain from the sale or other disposition of property is the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss is the excess of the adjusted basis provided in section 1011 over the amount realized.

Section 1001(c) of the Code, except as otherwise provided in Subtitle A, provides that the entire amount of gain or loss determined under section 1001 on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations ("regulations") provides, as a general rule, that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or loss sustained.

For purposes of section 1001 of the Code, in an exchange of property, each party to the exchange gives up a property interest in return for a new or additional property interest. Such an exchange of property is a disposition under section 1001(a).

An exchange of property results in the realization of gain under section 1001 if the properties exchanged are materially different. Cottage Savings Association v. Comm'r., 499 U.S. 554 (1991). A material difference exists when the exchanged properties embody legal entitlements "different in kind or extent" or if they confer "different rights and powers." Id. at 565.

Based on the information submitted and the representations made in the ruling request, the Trust will be amended pursuant to a judgment of the court solely in order to qualify the Trust as a tax-exempt organization described in section 501(c)(3) of the Code. There will be no change in the assets of the Trust, nor will there be any sale or disposition of Trust property within the meaning of section 1001 as a result of the amendment of the Trust. Accordingly, no gain or loss will be realized by the Trust under sections 61 or 1001 as a result of the amendment of the Trust.

Ruling Request 2:

Section 507(a) of the Code provides that except as provided in section 507(b), a private foundation may terminate its private foundation status only under the specific rules set forth in section 507(a).

Section 4947(a)(2) of the Code provides generally that split-interest trusts are subject to the provisions of sections 507, 4941 and 4945 in the same manner as if such trusts were private foundations, but, under section 4947(a)(2)(A), not with respect to any amounts payable under the terms of such trust to income beneficiaries, unless a deduction was allowed under section 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B).

Section 4947(a)(2)(C) of the Code provides, however, that section 4947(a)(2) shall not apply with respect to any amounts transferred in trust before May 27, 1969.

Section 53.4947-1(c)(5) of the Foundation and Similar Excise Taxes Regulations ("foundation regulations") provides that if an asset which was transferred in trust before May 27, 1969, is sold or exchanged after May 26, 1969, any asset received by the trust upon the sale or exchange shall be treated as an asset which was transferred in trust before May 27, 1969.

Because the Trust was established prior to May 27, 1969, with the initial transfer of funds and securities and no other contributions have been received by the Trust since that time, the Trust will not be treated as a private foundation pursuant to section 4947(a)(2) of the Code. As a result, section 507 does not apply to the Trust.

Ruling Request 3:

Section 501(a) of the Code provides that an organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

Section 53.4947-1(b)(1)(iv)(A) of the foundation regulations provides that a split-interest trust in which all of the unexpired interests are charitable remainder interests and in which some or all of the charitable beneficiaries are not entitled to distributions of corpus shall continue to be treated as a split-interest trust under section 4947(a)(2) of the Code rather than a charitable trust under section 4947(a)(1) for a reasonable period of settlement after the expiration of the noncharitable interest.

Section 53.4947-1(b)(1)(i) of the foundation regulations states that for purposes of satisfying the organizational test described in section 1.501(c)(3)-1(b) of the regulations when a charitable trust seeks an exemption from taxation under section 501(a) of the Code, a charitable trust shall be considered organized on the day it first becomes subject to section 4947(a)(1).

Section 1.508-1(a)(2)(i) of the regulations allows a new organization to obtain a determination that it is a tax-exempt organization described in section 501(c)(3) and such determination will relate back to the date of its organization if its Form 1023 application is filed no later than 15 months from the end of the month of its organization.

During the period of settlement of the Trust, the Trustee represents that it will endeavor to obtain recognition of the Trust as a tax-exempt organization described in section 501(c)(3) of the Code, effective as of the date of the proposed amendment of the Trust, when the Trust will cease to have any noncharitable beneficiaries.

The Trust is governed by section 4947(a)(1) of the Code upon the Trustee completing the ordinary duties of administration necessary for settlement of the Trust caused by the expiration of the noncharitable interest. Since there is no specific current noncharitable Trust beneficiaries, the effective date of the proposed amendment would be the day the Trust first becomes subject to section 4947(a)(1). Therefore, the determination of the Trust's tax-exempt status under section 501(a) pursuant to a timely filed Form 1023 application should be effective as of the effective date of the proposed amendment.

In this ruling, we have not determined whether the Trust will actually meet the requirements of sections 501(a) and 501(c)(3) of the Code. We merely have based our ruling on the fact that the Trust will apply for recognition of exemption from federal income tax under those sections.

Ruling Request 4:

The Trust, which will be a split-interest trust immediately before it is amended by the Trustee under the terms of the proposed amendment, is given a reasonable period of settlement before it is treated as a charitable trust. Upon receipt of a favorable ruling on the Trust's tax-exempt status under section 501(a) of the Code during such period of settlement, the taxable year of the Trust as a taxable trust will end on the day preceding the effective date of the proposed amendment to the Trust and a new taxable year of the Trust as a tax-exempt entity will commence on the date the proposed amendment is effective and end on the last day of the calendar year (the present taxable year of the Trust) in which the proposed amendment to the Trust occurs.

Therefore, we rule as follows:

1. That the adoption of the proposed amendment will not result in recognition of taxable income or gain by the Trust;

2. That the adoption of the proposed amendment will not cause section 507 of the Code to apply to the Trust;

3. That upon the Trust's timely filing of Form 1023 seeking exemption from taxation under section 501(a) after receiving a favorable ruling hereunder, the determination of the Trust's tax-exempt status will be effective as of the effective date of the proposed amendment, if the Trust is otherwise determined to be exempt;

4. That the taxable year of the Trust as a taxable trust will end on the day preceding the date the proposed amendment to the Trust is effective and a new taxable year of the Trust as a tax-exempt entity, ending on the last day of the calendar year in which the amendment occurs, will commence on the date the proposed amendment is effective.

You have added language in the Trust, number (5) above, regarding the general lobbying restriction for section 501(c)(3) of the Code organizations. Be advised that Section 4945(d)(1) specifically restricts private foundations from engaging in legislative activity.

This ruling is limited to the applicability of the Code to the issues ruled on herein. This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited by others as precedent.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert C. Harper Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3