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

200220028

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Uniform Issue List: 512.00-00

T:EP:RA:T1

OCT 24 2001

Attn:

Legend:

Trust X.....

Company A.....

Company B.....

Dear :

This is in response to a letter dated December 11, 2000, as supplemented by correspondence dated January 24, 2001 and August 17, 2001, submitted on your behalf by your authorized representative regarding a request for a ruling that certain amounts paid to Trust X, a tax exempt organization, are not unrelated business taxable income ("UBTI") under section 512 of the Internal Revenue Code (the "Code"). The following facts and representations were submitted in connection with your request.

Trust X funds a pension plan that is qualified under Code section 401(a) and is therefore tax exempt under section 501(a). Company A, a wholly owned subsidiary of Company B, is a securities lending agent for Trust X. As its lending agent, Company A is authorized by Trust X to lend securities held by Trust X to brokerage firms and other entities that need a particular security for a certain period of time. Securities borrowers often need securities to satisfy deliveries as a result of short sales or as a result of the broker's failure to receive securities it is obligated to deliver. In order to ensure the availability of securities, securities borrowers are often willing to pay amounts to potential lenders to secure the exclusive right to borrow the securities. Company A proposes to enter into exclusive lending commitments on behalf of Trust X as Trust X's securities lending agent.

Under such exclusive lending agreements, the securities borrower will obtain for a fixed term

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the exclusive right to borrow one or more securities from, or a specific set of securities within, a specified securities account of Trust X's portfolio, pursuant to certain conditions. The borrower is required to (1) furnish initial collateral having a fair market value of not less than that of the borrowed securities; (2) furnish additional collateral on demand at any time during the term of the loan in order to maintain the market value of the collateral at a value not less than the market value of the borrowed securities on a daily basis; (3) return securities identical to the borrowed securities on demand of Trust X or its agent within the normal settlement period for the securities in the principal exchange or market in which the securities are traded, within the time agreed upon by both the borrower and Trust X's agent or five business days (whichever period is the least); and (4) pay Trust X amounts equivalent to all interest, dividends and other distributions with respect to the borrowed securities. In addition, minimum borrowing requirements may be imposed on the borrower. Title to the securities will remain with Trust X until the securities are actually borrowed, and amounts equivalent to all distributions with respect to such securities are required to be paid to Trust X even after they are borrowed.

In exchange for the exclusive right to borrow the securities, the borrower will pay Trust X a fixed fee at periodic intervals (Fixed Periodic Fee) based solely on the market value of the specified securities account of Trust X's portfolio, or subset thereof. Collateral will consist of securities, letters of credit, or cash. In the case of cash, Trust X will invest the cash collateral and obtain amounts above the negotiated Fixed Periodic Fee to the extent that the income from such investments exceeds a negotiated rebate fee payable to the borrower. The exclusive lending agreement may be terminated at any time by Company A, as Trust X's lending agent, or the borrower.

Based on the above facts and representations, you request a ruling that the Fixed Periodic Fee amounts paid to Trust X by a potential borrower of securities owned by Trust X in order for Trust X to agree to give such borrower the exclusive right to borrow such securities, are not UBTI under Code section 512.

Code section 511(a) generally imposes a tax on the UBTI of organizations otherwise exempt from federal income tax under section 501(a).

Code section 513 defines the term "unrelated trade or business" as meaning in the case of an organization subject to the tax under section 511, any trade or business that is not substantially related to its exempt purposes, other than through the production of income.

Code section 512(a)(1) generally provides that the term UBTI means the gross income derived by any organization from any unrelated trade or business, as defined in section 513, regularly carried on by it, less certain deductions and subject to the modifications provided in section 512(b).

Code section 512(b)(1) excludes from UBTI all dividends, interest, payments with respect to certain securities loans, amounts received or accrued as consideration for entering into

agreements to make loans, and annuities, and all deductions directly connected with such income.

Section 1.512(b)-1 of the federal Income Tax Regulations (the "regulations") generally provides that whether a particular item of income falls within any of the modifications provided in Code section 512(b) shall be determined by all the facts and circumstances of each case.

Section 1.512(b)-1(a)(1) of the regulations provides that dividends, interest, payments with respect to securities loans (as defined in Code section 512(a)(5)), annuities, income from notional principal contracts, other substantially similar income from ordinary and routine investments to the extent determined by the Commissioner, and all deductions directly connected with any of the foregoing items of income shall be excluded in computing UBTI.

As indicated above, Code section 512(b) excludes from UBTI amounts received or accrued as consideration for entering into agreements to make loans. In this case, Company A will enter into agreements on behalf of Trust X in which a borrower will pay Trust X a Fixed Periodic Fee based on the market value of the securities in exchange for the exclusive right to borrow the securities pursuant to the lending agreement. These fees will be paid as consideration to Trust X for entering into an agreement through Company A to make loans of securities as needed by the borrower and as provided under the terms of the agreement. Thus, they fall within section 512(b). Accordingly, we conclude that the Fixed Periodic Fee amounts paid to Trust X by a potential borrower of securities owned by Trust X in order for Trust X to enter into an agreement that would give the borrower the exclusive right to borrow the securities, are not UBTI under Code section 512(a)(1).

The above ruling does not address whether Trust X is exempt from tax under Code section 501(a). The determination of whether Trust X is a qualified trust under Code section 401(a), and therefore tax exempt under section 501(a), is within the jurisdiction of the Service's Great Lakes Area Office.

This ruling is directed only to the taxpayer who requested it. Code section 6110(k)(3) provides that it may not be relied on or cited by others as precedent.

The original of this letter is being sent to your authorized representative in accordance with a

power of attorney on file with this office. Should you have any concerns regarding this letter, please contact .

Sincerely yours,

John Swieca

John Swieca, Manager
Employee Plans Technical Group 1
Tax Exempt and Government Entities Division

Enclosures:
Deleted copy of this letter
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