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

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MAR 20 2002

Date:

NO THIRD PARTY CONTACTS

SIN: 4940.00-00
4942.00-00
4947.02-01

T:EO:B4

Employer Identification Number:

Legend:
L =
M Trust =
X =
Y =
P =
Q =
$x =
$y =

Dear Sir or Madam:

This is in reply to L's request dated July 30, 2001, regarding whether L's interest in the assets of the M Trust is to be taken into account in calculating L's net investment income under section 4940(c) of the Internal Revenue Code and L's minimum investment return under section 4942(e).

FACTS

L is a private, grant-making foundation, exempt from federal income tax as an organization described in section 501(c)(3) of the Code and has been classified as a private foundation described in section 509(a).

L was created in 1966 by X and his first wife, Y. Both are deceased. X is survived by his second wife and five children. Y died in 1977. The M Trust was created in 1995, and continued to be amendable and revocable by X during his lifetime. The M Trust became non-revocable upon the death of X on January 12, 2001.

The M Trust has two co-trustees: P, one of X's sons, and Q. The M Trust names L as the beneficiary of the balance of the trust estate after the payment of certain specific gifts, the making of certain distributions to a number of charitable organizations, and the payment of

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debts, claims, expenses of administration, and estate or other death taxes. P is also the administrator of the probate estate. Three of X's other children serve on L's board of eleven directors. L's other eight directors are independent, unrelated parties.

X directed by Will that his estate go to the trustees of the M Trust to be used for the purposes stated therein. On the date of death, the fair market value of the assets distributable to L under the Will were approximately $x and under the M Trust were in excess of $y . The assets consist primarily of shares of publicly traded common stock.

The probate estate and the M Trust are being actively administered and are not yet in a condition to be finally distributed. In addition to the estate tax returns, there may be unanticipated claims, property transfers and valuation issues that require court approval. L does not expect to receive final distribution of the trust estate from the M Trust until sometime after December 31, 2003.

L indicates that for financial purposes, L adopted the accrual method of accounting as set forth in SFAS 116, a Statement of Financial Accounting Standards as adopted by the Financial Accounting Standards Board. This Standard requires the accrual of a promise to give whenever the promise is not subject to a substantial condition. The amount to be recognized is the fair market value of the assets ultimately receivable under the promise.

Under the SFAS 116 standard, L must recognize the bequests from the estate and from the M Trust as gifts received in 2001. If these accounts receivable are treated as L's assets during fiscal 2001, they will have a substantial effect on the calculation of L's net investment income under section 4940(c) and minimum investment return under section 4942(e). For this reason, L requested a ruling that these assets will not be taken into account for purposes of calculating its net investment income and minimum investment return until the actual distributions are received regardless of whether SFAS 116 is employed for financial or other tax accounting purposes.

LAW & ANALYSIS - SECTION 4940

Section 4940(c)(1) of the Internal Revenue Code defines "net investment income" as the amount by which (A) the sum of the gross investment income and the capital gain net income exceeds (B) the deductions allowed by paragraph (3).

Section 4940(c)(2) of the Code defines "gross investment income" as the gross amount of income from interest, dividends, rents, payments with respect to securities loans, and royalties, but not including any such income to the extent included in computing the tax imposed by section 511.

Section 53.4940-1(d)(2) of the Foundation Excise Tax Regulations provides as follows:

> (2) Certain Estate and Trust Disbursements. In the case of a distribution from an estate or a trust described in section 4947(a)(1) or (2), such distribution shall not retain its character in the hands of the distributee for purposes of computing the tax under section 4940;

except that, in the case of a distribution from a trust described in section 4947(a)(2), the income of such trust attributable to transfers in trust after May 26, 1969, shall retain its character in the hands of a distributee private foundation for purposes of section 4940 (unless such income is taken into account because of the application of section 671).

Section 53.4947-1(c)(6) of the Foundation and Similar Excise Taxes Regulations provides in part that an estate from which the executor is required to distribute all of the net assets in trust or free of trust to both charitable and noncharitable beneficiaries will not be considered a split-interest trust under section 4947(a)(2) during the period of estate administration or settlement. Under subsection (iii) a revocable trust that becomes irrevocable upon the death of the decedent-grantor is not considered a split-interest trust under section 4947(a)(2) for a reasonable period of settlement after becoming irrevocable. For purposes of this section, a "reasonable period of settlement" means that period reasonably required by the trustee to perform the ordinary duties of administration necessary for the settlement of the trust.

Under the facts and circumstances and following section 53.4947-1(c)(6)(iii) of the regulations, the M Trust will not be treated as a split interest trust during a reasonable period of administration after becoming irrevocable upon the death of X, the decedent grantor. Accordingly, the income earned by the M Trust during this period of time will not be characterized as investment income (or investment assets) of L until such time as the estate is closed and the actual distributions are made.

LAW & ANALYSIS - SECTION 4942

Section 4942(e)(1) of the Code defines a private foundation's "minimum investment return" to be five percent of the excess of -

(A) the aggregate fair market value of all assets of the foundation other than those which are used (or held for use) directly in carrying out the foundation's exempt purpose over

(B) the acquisition indebtedness with respect to such assets.

Section 53.4942(a)-2(c)(2) of the regulations provides exclusions from the minimum investment return computation base under section 4942(e)(1) for the following:

(i) Any future interest (such as a vested or contingent remainder, whether legal or equitable) of a foundation in the income or corpus of any real or personal property, other than a future interest created by the private foundation after December 31, 1969, until all intervening interests in, and rights to the actual possession or enjoyment of, such property have expired, or, although not actually reduced to the foundation's possession, until such future interest has been constructively received by the foundation, as where it has been credited to the foundation's account, set apart for the foundation, or otherwise made available so that the foundation may acquire it at any time or could have acquired it if notice of intention to acquire had been given;

(ii) The assets of an estate until such time as such assets are distributed to the foundation

or, due to a prolonged period of administration, such estate is considered terminated for federal income tax purposes by operation of paragraph (a) of section 1.641(b)-3 of this chapter;

(iii) Any present interest of a foundation in any trust created and funded by another person;

(iv) Any pledge to the foundation of money or property (whether or not the pledge may be legally enforced); and

(v) Any assets used (or held for use) directly in carrying out the foundation's exempt purpose.

Section 53.4947-1(b)(2)(i) of the regulations provides, in part, that a charitable trust created by will shall be considered a charitable trust under section 4947(a)(1) of the Code as of the date of death of the decedent. However, section 53.4947-1(b)(2)(v) provides that a testamentary trust from which the trustee is required to distribute all net assets in trust to charitable beneficiaries is not considered a charitable trust under section 4947 for a reasonable period of settlement.

At the present time, L's interest in the assets of the M Trust is a future interest as described in section 53.4942(a)-2(c)(2)(i) of the regulations, or an interest in an estate as described in section 53.4942(a)-2(c)(2)(ii) of the regulations. L has no control over the assets it is expecting to receive in the future or any power to direct the investment or disposition of those assets. Under the circumstances, the M Trust should be treated in a manner similar to the probate estate. Thus, unless the estate is terminated under section 1.641(b)-3, assets in the M Trust are not included in the computation of a beneficiary private foundation's minimum investment return.

SFAS 116

There are no regulations in either section 4940 or section 4942 that either recognize the existence of SFAS 116 or require the inclusion of an SFAS 116 accrual in the calculation of L's interest in the M Trust. Similarly, nothing in the instructions accompanying Form 990-PF suggests that such amounts be taken into account in the calculation of L's minimum investment return. SFAS 116 is referenced and expected to be used, however, in presenting L's balance sheets in Part II and in the analysis of changes in net assets or fund balances in Part III. Under the circumstances, only the assets actually distributed to L from the estate (either directly or through M,) would be included in the calculation of the investment income tax or the computation of the minimum investment return.

RULINGS

Based on the information provided and conditioned on the assumption that the Estate is not considered terminated under section 1.641(b)-3 of the regulations, we rule as follows:

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1. The income earned by the M Trust during a reasonable period of administration for the settlement of the affairs of the probate estate and the revocable trust will not be characterized as investment income of L until such time as the estate is closed and the actual distributions are made. L is not required to take into consideration the accrual of this net investment income in its calculation of the tax due under section 4940.

2. None of the assets held by the M Trust and expected to be distributed to L at some future date after 2001 should be taken into consideration in determining L's minimum investment return under section 4942(e) for 2001 or for any subsequent period not beyond a reasonable period of administration for the settlement of the affairs of the probate estate and the revocable trust.

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

This ruling is limited to the applicability of the provisions of section 4940 and 4942 of the Code and does not purport to rule on any facts that were not represented in the ruling request.

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

Sincerely,
(signed) Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4