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Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:3 PLR-122714-98
Date:
September 24, 1999

LEGEND:

Company =

Trust =

Operating Partnership =

REIT =

National Trust Company =

Dear

This letter responds to your representatives' letter dated December 18, 1998, and subsequent correspondence written on behalf of Company requesting the following rulings concerning a transaction involving a charitable remainder unitrust.

1. Company is a permissible grantor of the Trust.

2. The Trust qualifies as a charitable remainder trust under §§ 664(d)(2) and (3) of the Internal Revenue Code.

3. The transfer of Partnership Units to the Trust and subsequent exchange of the Partnership Units for common stock of REIT should not be recharacterized for federal income tax purposes as the conversion of the Partnership Units into REIT stock by the Company followed by the subsequent contribution of the REIT stock to the Trust by the Company.

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4. The satisfaction of the debt by the Operating Partnership or its general partner during a semi-monthly period for allocating partners' varying shares in partnership items in which the Trust does not hold any Partnership Units prevents the Trust from holding the Partnership Units subject to acquisition indebtedness under § 514.

5. The conversion of Partnership Units to shares of common stock in REIT will not result in unrelated business taxable income (UBTI) to the Trust, and the conversion will therefore not generate a tax liability to the Trust or adversely affect the Trust's federal income tax exemption.

6. On the basis of the facts submitted, the Trust will not recognize UBTI from activities of the Operating Partnership.

7. Neither the ownership nor sale of shares of common stock in REIT results in any UBTI to the Trust.

FACTS

Company, a limited liability company, is treated as a partnership for federal tax purposes. Company proposes to contribute appreciated real property that is encumbered by debt to a limited partnership (the Operating Partnership) for units in the Operating Partnership (Partnership Units). REIT, a non-public real estate investment trust, intended to qualify as a real estate investment trust under § 856 is the general partner of the Operating Partnership.

The Operating Partnership uses an interim-closing-of-the-books allocation method with a semi-monthly convention for allocating partners' varying shares in partnership items. It is anticipated that when encumbered property is contributed to the Operating Partnership, the partnership will almost immediately pay the debt. On the 15th day of each month, the partnership will close its books. Under the Operating Partnership's agreement, encumbered property can only be contributed during the first half of each month, and charitable donations of the interests in the Operating Partnership can be made only during the second half of each month. It is anticipated that a charitable organization will not hold interests in the Operating Partnership during any semi-monthly period in which the Operating Partnership receives contributions of encumbered property.

Section 8.6(a) and Addendum 8.6(a) of the Operating Partnership's agreement provides that a limited partner in the Operating Partnership may not convert its Partnership Units to shares of common stock in REIT for a period of two years from the date the limited partner acquires its Partnership Units. If the limited partner is a non-

profit or charitable remainder trust under § 664 and such entity received the Partnership Units for less than full consideration, the two-year period shall be calculated from the date that the donor of the Partnership Units acquired the units. Compare Example 4 in § 1.701-2(d) of the Income Tax Regulations.

Company anticipates holding the Partnership Units for two years and then transferring them to the Trust. The Trust may then exchange the Partnership Units for common stock in REIT. The Trust would then hold the REIT stock as an investment or for future sale.

The Trust will pay a unitrust amount to Company for 20 years and the remainder to Charity, an organization described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a) . The unitrust amount will initially be the lesser of trust income or six percent of the net fair market value of the Trust's assets. The unitrust amount will flip to a fixed percentage payout of six percent upon the sale or exchange of interests in the Operating Partnership, or the REIT stock, for marketable assets. The REIT stock is not publicly traded. National Trust Company will serve as the CRT's trustee.

LAW AND ANALYSIS

Ruling Request 1

Nothing in § 664 or the applicable regulations prohibits a limited liability company from being a grantor of a charitable remainder unitrust. Thus, Company is a permissible grantor of Trust.

Ruling Request 2

Under § 664(d)(2), a charitable remainder unitrust is a trust that provides for the distribution of the unitrust amount, at least annually for life or a term of years, to one or more persons (at least one of which is not a charitable organization) with an irrevocable remainder interest to be held for the benefit of, or paid over to, a qualified charitable organization. The value of the remainder interest must be at least 10 percent of the net fair market value of the property contributed to the trust.

Under § 664(d)(2), the unitrust amount is a fixed percentage of the net fair market value of the trust's assets valued annually. Instead of the amount in § 664(d)(2), § 664(d)(3) provides that the unitrust amount can be (A) the amount of trust income, if such amount is less than the amount required to be distributed under § 664(d)(2), and (B) any amount of trust income which is in excess of the amount required to be distributed under § 664(d)(2), to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the required amounts.

Section 1.664-3(a)(1)(i)(c) provides that the governing instrument may provide that the trust will pay not less often than annually the amount described in § 664(d)(3) for an initial period and then pay the amount described in § 664(d)(2) for the remaining years of the trust if the governing instrument contains certain requirements described in § 1.664-3(a)(1)(i)(c).

Section 1.664-3(a)(3)(i) provides that the unitrust amount must be payable to or for the use of a named person or persons, at least one of which is not an organization described in § 170(c). Section 1.664-3(a)(5)(i) provides that the period for which the unitrust amount is payable begins with the first year of the charitable remainder trust and continues either for the life or lives of a named individual or individuals or for a term of years not to exceed 20 years. Only an individual or an organization described in § 170(c) may receive an amount for the life of an individual.

Section 7701(a)(1) defines a "person" to include an individual, a trust, estate, partnership, association, company, or corporation.

The Trust will pay a unitrust amount to Company for a term of 20 years with the remainder to Charity. It has been represented that the Company is a partnership for federal tax purposes. Thus, Company is a permissible recipient of the unitrust amount under § 1.664-3(a)(3).

The governing instrument of the Trust contains provisions set forth in Rev. Rul. 72-395, 1972-2 C.B. 340, as modified by Rev. Rul. 80-123, 1980-1 C.B. 205, and Rev. Rul. 82-128, 1982-2 C.B. 71, and clarified by Rev. Rul. 82-165, 1982-2 C.B. 117.

Accordingly, the Trust will qualify as a charitable remainder unitrust, for federal income tax purposes, for any year in which it continues to meet the definition of and functions exclusively as a charitable remainder unitrust. For such year, the Trust will be exempt from taxes imposed by subtitle A unless it has any UBTI under § 512 and the applicable regulations.

Ruling Request 3

The determination of whether the transfer of Partnership Units to the Trust by the Company and subsequent exchange of the Partnership Units for common stock of REIT should be recharacterized for federal income tax purposes as the conversion of the Partnership Units into REIT stock by the Company followed by the subsequent contribution of the REIT stock to the Trust by the Company depends on all the facts surrounding the transfer and can only be decided on examination of the federal income

tax returns of the parties involved by the District Director's office. See Palmer v. Commissioner, 62 T.C. 684 (1974), Blake v. Commissioner, 697 F.2d 473 (2d Cir. 1982), Rev. Rul. 78-197, 1978-1 C.B. 83, and Notice 99-36, 1999-26 I.R.B. 3.

Ruling Request 4

Section 664(c) provides that a charitable remainder unitrust, for any taxable year, is not subject to any tax imposed by this subtitle, unless the trust, for the year, has UBTI (within the meaning of § 512, determined as if part III of subchapter F applied to the trust).

Section 512(a)(1) provides, in part, that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided by § 512(b).

Section 514(a)(1) provides, in part, that in computing under § 512 the UBTI for any year, there shall be included with respect to each debt-financed property as an item of gross income derived from an unrelated trade or business an amount which is the same percentage of the total gross income derived during the taxable year from or on account of such property as (A) the average acquisition indebtedness for the taxable year with respect to the property is of (B) the average amount of the adjusted basis of such property during the period it is held by the organization during such taxable year.

Section 514(c) defines the term "acquisition indebtedness."

If an exempt organization is a member of a partnership that incurs debt to acquire investment property, the proportionate income distributable to the exempt partner is subject to tax under §§ 512 and 514. See Example 4 in § 1.514(c)-1(a)(2).

Any income from debt-financed property held by a partnership is attributed to the partner. Because the debt on the property transferred to the Operating Partnership will be paid and satisfied almost immediately, by the time the Partnership Units are transferred to the Trust, neither the Partnership Units nor the general real estate assets of the Operating Partnership will be subject to debt or constitute debt-financed property. Thus, we conclude, on the basis of the facts and representations of Company (and assuming that Company's representation of the interim-closing-of-the-books method is an accurate description of the tax effect), that the Trust will receive no debt-financed property transferred to it by Company.

Accordingly, we rule that the satisfaction of the debt by the Operating Partnership or its general partner during a semi-monthly period for allocating partners' varying shares in partnership items in which the Trust does not hold any Partnership Units will prevent the Trust from holding the Partnership Units subject to acquisition indebtedness under § 514.

Ruling Request 5

Section 512(b) provides modifications referred to in § 512(a)(1).

Section 512(b)(5) provides that there shall be excluded all gains or losses from the sale, exchange, or other disposition of property other than inventory or property held primarily for sale to customers in the ordinary course of trade or business.

Because the transfer of the Partnership Units by the Trust to REIT for common stock of REIT is a modification under § 512(b)(5), we rule that the conversion of Partnership Units to shares of common stock in REIT will not result in UBTI to the Trust.

We express no opinion as to any other tax liability that may or may not be incurred as a result of the sale or exchange of Partnership Units for common stock of REIT.

Ruling Request 6

Company has represented that for the period that the Trust owns an interest in the Operating Partnership, the Operating Partnership will be operated so as not to generate any UBTI, as defined by § 512, to its partners. Based strictly on such representation, we rule that on the basis of the facts submitted, the Trust will not recognize UBTI from activities of the Operating Partnership.

Ruling Request 7

Section 512(b)(1) excludes from tax under § 512 dividends and other enumerated items of income. As stated above, § 512(b)(5) excludes gain or losses from sale, exchange or other disposition of property.

Rev. Rul. 66-106, 1966-1 C.B. 151, holds that amounts distributed from a real estate investment trust to an exempt organization are treated as dividends and, thus, are excluded from UBTI, assuming that the distributions by the real estate investment trust are made out of its earning and profits, and, therefore, were dividends within the meaning of § 316.

Accordingly, we rule that ownership of shares of common stock in REIT resulting in payments out of the earnings and profits of REIT constituting dividends within the meaning of § 316 will not result in UBTI to the Trust by virtue of § 512(b)(1). Sale of the common stock of REIT by the Trust will not result in UBTI by the Trust by virtue of § 512(b)(5).

We express no opinion on the federal tax consequences of the transaction under the provisions of any other section of the Code. Specifically, we express no opinion on whether REIT is a real estate investment trust under § 856. In addition, no opinion is expressed regarding the federal tax treatment of any conditions existing at the time of, of effects resulting from, the transaction that are not specifically covered by the rulings above.

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

Under a power of attorney on file in this office, we are sending a copy of this letter to your authorized representatives.

Sincerely yours,

Jeff Erickson

Jeff Erickson
Assistant to the Branch Chief,
Branch 3
Office of the Assistant Chief
Counsel
(Passthroughs and Special
Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

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