GIVE & TAKE

[Net-Income From Charitable Donations]

by

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Introduction

"Petitioner rests its case largely upon the line of authority which establishes the principle that a taxpayer has the right to conduct his affairs in such a manner as to minimize and even avoid taxation if legally permissible." [*Maysteel Products, Inc. v. Commissioner of Internal Revenue Service*: 33 T.C. 1021 : *Chamberlin v. Commissioner IRS*, 207 F. 2d 462)]

SAVIORG, a California non-profit corporation founded in 1990 (C-1675399: FEIN:77-0298874), offers this collection of unique income-tax minimizing strategies, gleaned from a decade of research, to assist corporations, partnerships, and individual persons in their efforts to legally minimize federal, state, and county taxation.

GIVE & TAKE strategies are legal, well researched and highly effective financial pro- cedures that have been, and will be, respected by professionals, executives, business owners and other cognizant persons including, of course, Counsel at IRS and Tax Court and District / Appellate Court judges.

Probably the reason you have not had access heretofore to these, or similar, concepts (if you have not) is fact, in the past, especially knowledgeable persons (usually rich conservatives) have quietly and inexorable made tons of money employing them. Nevertheless, SAVIORG (more liberal than conservative) believes it is time to publish its findings for the benefit of a larger cross-section of citizens.

WELCOME, be our guest and enjoy the interesting information contained in this book. Should you wish more depth and/or interaction from SAVIORG (author), personal and corporate access points are included herein for that purpose. We love email.

When a State incorporated charitable organization, which has already received an exemption from State taxation, applies for and receives a Letter-of-Determination from the federal Internal Revenue Service (IRS) it is designated a "501(c) 3" organization. This name refers to Title 26, section 501 of the IRS Codes; subsections (c) 3. Thereafter, all *bona fide* and qualified donations to that organization are guaranteed to be federally tax-deductible. A review of this award is conducted every four years. A *bona fide* Letter-of-Determination is extremely valuable in the right hands.

Giving money to a 501(c) 3 organization is tantamount to giving money to the United States government because only about 40% of the cash that donors give to a charity is actually subtracted from U.S. Treasury revenues. (A tax-deduction multiplied by a taxpayer's combined tax bracket equals cash no longer due and payable to federal and state revenue services.) Nevertheless, 100% of donated cash or assets goes to performing donee's charitable works (tax-exempt purpose).

Since every charity's organization and operation is carefully reviewed and evaluated by IRS during the Letter-of-Determination application period, there obtains a certain "good deal" (40% discount) for the government in its' on-going subsidy of well-determined charities [509(a)2] and private foundations performing necessary tasks for society.

Charities are effectively subsidized (1) by the government's grant of a tax-exemption form non-profit income, and (2) corresponding tax-deductibility of all bona fide gifts made to a qualified non-profit organization. Repeating for emphasis, a donor can save the federal government about $0.60 by donating $1.00 to charity because the government gets $1.00 worth of necessary work done for about $0.40 in tax revenue subtracted from cash receipts via donor's tax-deduction of $1.00 realizing $0.40 (cash) when multiplied by donor's combined tax brackets (about 42%: 7% state and 35% federal).

Because charities are usually staffed by dedicated and professionally experienced persons, they tend to be better providers of socially beneficial services than comparable government agencies and their employees. Consequently, donor support of 501(c)3 organizations can be well justified beyond a tax-deduction rationale.

SAVIORG is a fully qualified and certified 501(c) 3 corporation, and a 509(a) 2 public charity, performing charitable and economically beneficial works described in numerous publications.

"Taxpayers in the 31 percent tax bracket operate almost across the board under the mistaken belief that because they are in that tax bracket, 31 percent of their income is being taxed. This is absolutely not true. A taxpayer in that tax bracket is actually getting taxed *less* than 31 percent. Even though you are in a 31 percent tax bracket, you pay less than that percentage because you get the benefit of being taxed at lower rates on the amounts you earn in the tax brackets that precede the bracket you are in.

Thus, a single taxpayer with $64,000. of taxable income, in the 31 percent bracket, is taxed this way: The first $25,350. of income is taxed at 15 percent, or $3,802. 50. The next $36,050. is taxed at 28 percent, or $10,094. Only the remaining taxable income of $2,600. is taxed at 31 percent, or $806. So, even

though a taxpayer is in the “31 percent tax bracket”, the tax she pays is actually just under 23 percent of $64,000., or $14,702.

Your total income tax bill accumulates as you climb up the tax rate ladder. While you are on the lower rungs, the rates being charged against your income are correspondingly lower."

(Reference: "What The IRS Doesn't Want You To Know", Martin Kaplan, CPA and Naomi Weiss:)

Using the following strategies, corporations and private persons can obtain significant tax and other financial advantages heretofore unpublished in popular or professional media.

If you are not familiar with the concept of the Charitable Remainder Trust (CRT) please immediately go to APPENDIX XI., and read our brief article. It will add immeasurably to your grasp of exciting content to follow.

GIVE & GET

A) DONATION-REDEMPTION-DISPOSITION

Any stockholder of a "closely-held" or publicly-held corporation can donate appreciated stock in their corporation to a qualified related or unrelated private foundation or charity for a full FMV tax-deduction (limited to 50% AGI-carryover for five subsequent years). At any time following the donation, if the donor's corporation, without evidence of a binding prearrangement with donee, redeems its stock for cash or tangible assets, the stock will have a "stepped-up" basis, equal to FMV at time of redemption.

However, even if a binding agreement for redemption is not provable, if the redeeming corporation uses a promissory note to redeem the stock "soon after" the donation, donor's tax-deductions may be taken only when, and in correspondence with, the note's cash payments tendered to donee.

Additionally, many "soon after" redemptions will not result in a step-up of the stock's basis if a note is used to redeem. (See a specialist.)

For these reasons, SAVIORG is recommending only the use of cash, stocks, tangible assets (appraised FMV) or credit-line draws to redeem donated stock "soon after" a stockholder(s) donation.

In order for this strategy to work for a publicly-held corporation, a resolution for the plan must pass at the board of directors meeting prior to transaction.

[See APPENDIX I.(A):]

B) DONATED STOCK OPTIONS SOLD AND EXERCISED BY UNRELATED DONEE

Any corporation having publicly traded stock, may give non-qualified-stock-options (NQSO), discounted or valued at FMV, to a related, tax-exempt non-profit corporation. However, the corporation may not take a tax-deduction for the gift without becoming liable for a charge of "self-dealing" if/when the donee exercises the option(s).

When the related non-profit (donee) sells the donated NQSO to an unrelated non-profit, that organization can exercise the options and sell the stock. Corporate donor may then legally take tax-deductions even if NQSO's were donated at 15% below FMV. Below that, we cannot say.

Note: Only a "509(a) - Public Charity" can, with absolute safety, be an *unrelated* non-profit corporation in this and similar transactions. A "501(c) private foundation" a/k/a "non-profit corporation" cannot afford to be involved in a transaction where there exists significant probability that IRS will discover the existence of "excess benefits" to donor/donee. Donations to a public charity are, under normal circumstances, immune from "excess benefits" liability. (26 USC, sec. 4958 (e)2)

When a transaction is done right, the following benefits accrue.

1. At exercise/sale the unrelated non-profit will receive the *spread* (FMV of the stock minus the exercise price) minus the cost of the NQSO and associated broker's fees.

2. The related non-profit will receive the proceeds from the sale of the NQSO to the related non-profit as tax-free income.

3. Donor corporation will receive a tax-deduction for the entire spread at time of exercise/sale by the unrelated organization.

4. Under certain circumstances (where proof of no prior arrangement is certain), the donor corporation can be directly capitalized (benefited) if the unrelated non-profit exercises/acquires donor corporation's treasury stock (or section 144 stock) instead of common shares sold in the marketplace.

[See APPENDIX V.(A):]

C) HEDGE STOCK PERFORMANCE WITH NQSO

If a corporation's common stock begins to "drop" radically in price, it may have difficulty selling treasury shares (or section 144 shares) for a respectable price. To hedge against a radical drop in stock value, a corporation can donate *discounted* NQSO to an unrelated non-profit that agrees (with a non-legally binding, but definite "gentleman's agreement") to exercise/sell stock proceeds when the market price of the stock drops to X% of the FMV at time of donation.

The corporation, wishing to take a chance, may be able to provide exercise cash (with or without associated fees) in exchange for donee's uncompelled purchase of treasury stock (or section 144 stock) in lieu of acquiring stock traded on public markets.

D) RELATED FOUNDATION BUYS 100% VOTING-RIGHTS AND 100% DIVIDENDS ON 75% MARGIN

A corporation can cause its' related private foundation or non-profit corporation to purchase common stock effectively on 75% margin, and, even though at least 50% of the shares are assigned (collateralized) to the brokerage which extends the margin, it can still enjoy 100% voting and dividend rights via the non-profit's related officers.

Dividends and stock sales can help pay margin calls as well as corporation(s) expenses. All voting can be controlled by corporation's control group without reference to any unrelated party. (A cash fund to secure margin calls is required by brokers for this transaction.)

E) FORGIVENESS OF REDEMPTION DEBT OK: NO TAX

If a non-profit receives a donation of stock from any registered stockholder, and the corporation that issued the stock redeems less than 100% of the stock with an unsecured, long-term promissory note (or similar form of debt), the otherwise unrelated donee can, as a new, bona fide stockholder of the company (under normal circumstances) legally forgive stock redeemer's debt without disturbing donor's tax-deductions or imparting tax liability to the redeemer. [USTC, *Putoma* 1966]

F) RECEIPTS OF DEPOSIT

You must see this very hypothetical, potentially useful, invention by SAVIORG. Conceivably, RD's can replace Certificates of Deposit (CD's).

[See APPENDIX VI.(C):]

G) THE SAVIORG BARGAIN SALE

1. Corporation (C) and its' related private foundation or other non-profit corporation (F) agree that (C) will buy A% of property (P) when it is sold to (F).

2. (F), and (P)'s seller (S), execute a classic Bargain Sale: A% of selling price is paid by (F) in cash, and (selling price) minus (A% selling price) equals (S)'s tax-deductions.

3. (C) immediately pays A% of (P) to (F) with cash which repays (F)'s loan, if one was necessary.

4. (F) holds full title under (C)'s management.

Why not create your own flowchart of this exciting transaction? Sure glad we did.

[See APPENDIX V.(E):]

H) PARTIAL, UNDIVIDED PROPERTY INTEREST DONATIONS

Donate any portion (fraction) of your property to a private foundation, non-profit or public charity (related or unrelated). A private person or corporation may redeem the donated fractional-interest at will. Percentage of property's FMV donated is the amount of tax-deductions for donor.

I) REMAINDER INTEREST DONATIONS

Any property, including but not limited to real property, has a Remainder Interest (RI) value relative to an owner's duration of ownership and normal depreciation. Land does not depreciate. Bona fide (RI) donations, usuall in the form of Charitable Remainder Trust creation, can be made at any time. Immediate donation to a qualified foundation/charity of the property's (RI) at close of escrow can effectively return a buyer's down payment (and then some). This fact can be an inducement to make the purchase in the first place.

Remainder Interest donations can usually be constructed and finalized expeditiously by any qualified professional at moderate cost relative to potential benefits.

The primary drawback to (RI) donations is that the owner may never thereafter sell, trade or exchange the donated property during the specified term of years. However, if a sufficiently long term of years is assigned to the donation (up to 40 years is possible), an heir will be able to inherit the property, and have exclusive use of same until the term is reached. Then title passes to the donee (remainderman). Terms of two (2) entire lifetimes are legal and acceptable at IRS, but SAVIORG does not use "lifetime" terms for reasons beyond the scope of this brief. [See APPENDIX VI.(B):]

J) AIR RIGHTS DONATIONS

The air space above commercial real estate may be legally and profitably sold, traded or donated to a private foundation, non-profit or charity.

Hey, don't laugh!

Baron's 4th Edition of Real Estate Licensing Examinations, at page 6., states, "AIR RIGHTS/ The right to use, control or occupy the space above a designated property. Example: The PAN AM Building in New York City is built on air rights above the Grand Central Railroad Station. Importance: Most property ownership rights include air rights up to the skies; however, it is possible that air rights are limited to a certain height, or, conversely, that air rights are the only property owned, having a floor that begins a stated number of feet above the ground."

Most commercial buildings, especially large ones in downtown areas, have valuable air rights that are both tradable and donatable. State and Federal court rulings have determined (without overturning the determinations to date) the value of Air Rights to be at least 33% of the current FMV of the land upon which the building is erected.

Somebody is going to revolutionize their city (town) with this one!

[See APPENDIX: I.(F):]

K) MOTION PICTURE: LETTER OF CREDIT DONATIONS

1. A motion picture company (ABC) donates a letter-of-credit ($X.) to any public charity. A "gentleman's agreement" at time of donation (not legally binding) stipulates that no more than 3.5% of the $X. will ever be drawn annually by the charity.

2. Prior to the donation, charity granted one position of Director on its board of directors to ABC. Charity's bylaws call for certain special powers to obtain for any motion picture company representatives on the board of directors.

All donated letter-of-credit draws made by the charity will be approved by the Board of Directors and, although ABC has only one vote on the board for all *regular* business, in matters concerning motion picture production or other motion picture related business, ABC will exercise 50% of all votes cast on those specific matters. According to the bylaws, all donated letters-of-credit will be used only for motion picture project finance.

Note 1: Tax Mem. K-3053: CONTRIBUTIONS TO PRIVATE FOUNDATION: DONOR CONTROLS

"Contributions made by a donor to a private foundation were deductible even where the donor was on the board of directors of the foundation and voted on the use of the foundation's funds. The dual status of donor and board member didn't, by itself, deny the deduction." (IRS Letter Ruling 9113025)

Note 2: Tax Mem. K-3058: INDIRECT BUSINESS BENEFITS

"An indirect business benefit, such as that gained from public recognition of its act of generosity, doesn't disqualify a transfer by a business from being a charitable contribution." [*U.S v. Transamerica Corp.*, 392 F2d 522, (1968)]

Note 3: Tax Mem. K-3060: CONTRIBUTIONS THAT PARTIALLY BENEFIT CONTRIBUTOR

"Contributions that partially benefit the contributor may be deductible charitable contributions, to the extent that the contributed amount exceeds the monetary value of the benefits." [Considine, Charles (1980)74 TC 955 : Transamerica v. U.S., 902 F2d 1540, 90-1 USTC, sec. 50255]

The charity's benefit from its 3.5% annual draw must and will exceed financial benefits enjoyed by ABC. Donee's "self dealing" and/or "excess benefits" liability will not be an objection in this transaction.

[See APPENDIX IX.(A),(B):]

Note 1: Film makers please read above referenced appendix as if your future depended on it. Only a public-charity, controlled by a cognizant chairman and/or president, is legally exempt from "self dealing" and/or "excess benefits" liability.

Note 2: CHARITABLE INTENT NOT REQUIRED

"It does not seem appropriate, however, to demand of a corporate entity such impulses as affection, respect or admiration. Further, an absolute requirement of detached and disinterested generosity or lack of any business purpose would tend to render (ultra vires) substantially all charitable contributions and thus to frustrate the congressional intent that corporations should enjoy such deductions."[See *Citizens & Southern Nat'l Bank of South Carolina v. United States*, 243 F. Supp. 900, 904 (W.D.S.C. 1965); Garrett, Corporate Donations, 22 Business Lawyer 297 (1967)]

Note 3: Of course, an IRS charge of "excess benefits" against donor re (26 USC, sec. 4941) can be avoided since the public charity will not directly employ

ABC in motion picture production or related business following donation of ABC's letter-of-credit to charity.

The Letter-of-credit ($X. face value) as an immediate tax-deduction is sufficient, but not excessive, benefit for ABC considering its loss of 3.5% LC annually.

Note 4: The charity may use its 3.5% of $X. annual draw to amortize loans obtained to finance motion picture projects if/when project funds are otherwise insufficient. Loan contracts are collateralized by the letter-of-credit and call for the 3.5% annual draw to be automatically transferred to lender(s) for term of the loan (not to exceed term of the LC).

Note 5: Repeating for emphasis: ABC obtains federal/state tax-deductions for the entire $X. letter-of-credit donation in the year of donation even though the donee draws only 3.5% annually. [See IRS Letter Ruling: 8420002 and APPENDIX III.(C), IV.(A)]

L) MOTION PICTURE COMPANY: (Donation/Redemption/Exhibition)

A certain charity will sell, rent, broadcast and/or exhibit a motion picture even though it is not probable that it will "make money" (net income). Films are obtained by the charity as tax-deductible, charitable donations. Because the charity wants only to effectively perform its' tax-exempt purposes, and not be in the for-profit film business, a "breakeven" point is usually the goal and the following donor/redeemer benefits can be projected accordingly.

Pursuant to a definite, but not legally binding or otherwise compelled prearrangement, a motion picture company executive donates her personally held, appreciated stock in the company (the stock must be currently traded on one or more established USA stock markets) to a public charity and the executive's company can immediately redeem the stock using operating cash, loan or credit-line proceeds or tangible assets having an appraisable FMV.

Any film in the redeeming company's inventory, having current FMV, is an acceptable "tangible asset" for redemption purposes.

The redemption obtains for the redeemer his/her own stock with a new, "stepped-up" basis, while the executive/donor enjoys (a) 100% FMV tax-deductions and (b) any associated benefits company wishes to impart, immediately or eventually, to its' co-operative executive or other persons, related or unrelated.

Note 5: It is not necessary that a film used for redemption purposes be useable by the charity according to its tax-exempt purpose(s). The charity can sell or rent or otherwise dispose of the film at its' discretion.

Note 6: Although provision of a direct, secondary benefit by the charity to any of its' donors is not legal, the sale, rental, or broadcast/exhibition of a donation-redeeming film will (a) tend to augment the film company's exposure, production credits, artistic reputation, etc., and (b) aggrandize numerous inter industry businesses with various associated benefits accruing from the donor's gift of stock and the redeemer's tender of a film. And so, indirect, secondary benefits not exceeding the benefit(s) to the donee can be (legally) anticipated by the donor and his company.

Finally, let us not discount the "PR" value of a high-profile gift to a reputable charity ...well publicized.

M) YACHTS & PLANES BARGAIN SALE

If you charter and/or sell new and/or used yachts or airplanes, and a public charity or other non-profit organization can find someone to lease one or more of your inventory for a minimum of five (5) years, just maybe you can cut a deal.

A certain charity may be willing to Bargain Sale purchase your inventory with about 65% FMV in cash and about 35% FMV as tax-deductions. You, or a pre-contracted third party, will lease the vehicle(s) for at least five (5) years, and secure each lease payment (which will amortize the 65% FMV loan if one is required) with a major bank's letter-of-credit.

Note 1: This technique can be used for any asset that will lease for a continuous five (5) year period, even if two or more succeeding lessees are necessary.

N) SALE OF CONTRIBUTED PROPERTY BACK TO DONOR

"Where the charitable donee sells the contributed property back to the donor, and there is no evidence that: (a) the sale was contractually or tacitly agreed to as a condition of the gift, or (b) the donee couldn't sell the property to third parties, there is a deductible property contribution."

Citations: FEDERAL TAX COORDINATOR 2d:(K-3214):

Makoff, Richard (1967) TC Memo 1967-13, PH TCM sec. 670713, 26 CCH TCM 83

"Thus, taxpayer was considered to have contributed a house to charity, when he, as an individual, contributed the house and, on the same day, had his corporation offer to buy the house from the charity for its fair market value.

The charity accepted the offer without shopping around for a better offer because they trusted taxpayer's corporation to have made a fair bid. The court noted that taxpayer had given the property away without condition. The donee could have sold to someone else or refused to sell." [*Sheppard, Lawrence v. U.S.* (1966 Ct Cl) 17 AFTR 2d 1184, 176 Ct Cl 244, 361 F2d 972, 66-1 USTC sec. 9461: Rev. Rule 67-178, 1967-1 CB 64]

Suggestion:

Once donated real property title is redeemed by an S-corp, one or more shareholders can donate their S-corp stock to the same (or different) donee for a FMV tax-deduction. (The donor's stock FMV is revalued by the real property's FMV as well as established revenues, assets, accounts receivable, etc. of the S-corp). The same donee, if/when made a substantial shareholder of the S-corp, may be able to forgive a portion or all of the redemption note without characterization of the transaction as a taxable event.

See [610 F.Supp. 933 (D.C. Ark 1985)] for stock valuations when not publicly traded.

Out of sincere gratitude, and without any legally binding or otherwise provable compulsion, the donee/stockholder may, under certain circumstances that can be engineered and managed, legally forgive the promissory note (debt) as a *bona fide* gift-contribution to donor's capital with no taxation liability accruing to any of the concerned parties.

[Putoma (1966), Federal Tax Coordinator 2d: (J-7300)]

Summary of Benefits:

1. Donor gets FMV (minus mortgage) as a tax-deduction.

2. Donee gets X% FMV cash down-payment on the promissory note tendered by donor/redeemer and any retained portion of note payments due.

3. Corp gets title to the real property, free and clear.

4. Donor(s), via controlling interest of S-corp, get use of real property as a gift, bonus or income benefit (taxable).

O) PREARRANGEMENT OF DONEE'S DISPOSITION OF CONTRIBUTED PROPERTY

"Where a donor contributes appreciated stock to a charitable organization under a 'gentleman's agreement' which allows him to reacquire the stock one month later at its then fair market value, the cash paid to the organization in reacquiring the stock, and not the stock, is a charitable contribution. The significance is that the basis of the stock in the hands of the donor remains the same as it was before he transferred the stock; it is not stepped up to the higher fair market value he paid when he repurchased it."

Citations: FEDERAL TAX COORDINATOR 2d:(K-3215):

Can you state how the donor, in this situation, can avoid loss of a stepped-up basis ?

Rev. Rule 67-178, 1967-1 CB 64

This transaction has potential for cost-effective delivery on Put Options because terms for redemption can be made quite flexible.

Qualification:

The word "cash" found in the above quoted statement, made by a private tax analysis service, is misleading. The official Revenue Ruling (67-178) does not stipulate cash as the only form of payment determining the tax-deduction. What is clearly implied in the IRS ruling is that any legal redemption payment determines the tax-deduction, and not the stock's FMV at time of contribution (donation).

Each cash payment on a legal promissory note (used to redeem) will determine a comparable (on-going) tax-deduction in the case, above cited. However, the donee can also arrange to receive tangible assets other than cash and, thereby, enable donor to amortize the note and enjoy tax-deductions with or without cash .

P) NOT DEBT-FINANCED INVESTMENT

1. Any domestic corporation, partnership or sole-proprietorship can donate appreciated stock, or other assets, to a Charitable Remainder Unitrust of their own creation/management. A third party trustee is not legally required for the CRUT.

2. CRUT sells the donated stock, and buys one, or more, life insurance policy: donor, or any other related or unrelated person, may be designated the beneficiary.

3. The life insurance policy's cash value is used by the CRUT trustee to secure one, or more, conventional loan(s).

4. Loan proceeds may be invested by the CRUT trustee in the CRUT's charitable remainderman's annuity and/or corporate bonds.

NOTE: The investment of loan proceeds in the annuity and/or corporate bonds of the charitable remainderman conforms to the tax-exempt purpose of the CRUT which is to benefit the charitable remainderman. Only a substantial benefit clearly accruing to the charitable remainderman will cause the transaction to escape "debt financed" qualification (tax liability).

NOTE: The spouse of a CRUT donor, if she/he is the only non-charitable beneficiary of the CRUT, can (under certain circumstances) receive all the CRUT payments entirely tax-free due to the unlimited marital gift-tax exemption.

Q) CORP BUILDS UP RELATED FOUNDATION

Any domestic corporation, partnership or sole-prop wanting to build-up its related private foundation can, donate appreciated stock (or other assets) to a CRUT where the related remainderman can receive up to 85% of corpus at term and a charitable (unrelated) remainderman receives the balance. There is a 1980's Letter Ruling on this, but the author has not been able to relocate it.

NOTE: The for-profit corporation's officer may be the chairman, director or executive officer of the related private foundation (remainderman).

POSSIBILITY: The corporation may redeem its' stock from the related and/or unrelated remainderman (following term and distribution) using a long-term, unsecured, non-recourse promissory note(s). However, only redemption payments in cash or tangible assets having current FMV can immediately result in a stepped-up basis to the redemption price.

R) REIT IS RIGHT

A corporation, partnership or sole-proprietorship that

1. Has created a 501(c)3 foundation

2. Has created a Real Estate Investment Trust (REIT) (Nevada or other tax-free state preferred) with 99% of the REIT shares owned by the entity and 1% sold to 100 investors (or more) within one year of commencement

3. Has purchased performing mortgage notes, and lodges same in the REIT.

4. Has donated X% of the REIT shares to its' related 501(c)3 foundation or 509(a)2 organization (same COB/Officers/Directors are ok)

5. Uses annual dividend income from the donated REIT shares to amortize purchased assets (planes, boats, vehicles, etc.)

6. Leases the 501(c)3 assets by paying FMV with promissory notes (non-recourse, unsecured): Each payment due can be paid-in-kind (PIK).

May enjoy the following benefits.

1. Get 100% tax-deduction for FMV of the X% (REIT) shares donated: (Note: If mortgages earn $1.0m annually then a standard 20:1 P/E allows a $20.m total shares value. $20.m, times the percentage X% of shares is of the total REIT shares, is the donation value. This value, times the organizations' combined tax brackets, equals savings from tax payments.)

2. Total dividend income minus that from the donated X% REIT shares is capital gain income for the organization.

3. Enjoys legal, socially beneficial use of the non-profit assets.

S) BARGAIN SALE AMORITZATION OF VACATION RENTALS

1. A commercial (vacation rental) property manager contractually agrees to manage property to be sold for a New Owner (a non-profit corporation) for the term of the mortgage or subsequent sale of the property.

2. Property manager agrees to rent property on a quarterly basis until $X. of rental income is obtained and distributed to creditors. The $X. includes (a) mortgage payments due, (b) prorated property taxes due, and (c) management fees due.

Once $X. is obtained/distributed in a given quarter, the New Owner is notified, and may occupy the property or authorize continuance of renting for the completion of the quarter.

Note: All the New Owner's rental income is, and will be, entirely tax-free.

3. Prior to close of escrow Seller secures the New Owner's mortgage payments, management fees and property tax payments with a bank issued Letter-of-Credit renewable for the term of the mortgage. If quarterly rental income does not cover expenses, a draft for $X. will be taken by the property manager to cover shortfalls.

Nature of Security: FORCED SAVINGS

From the property's sale proceeds in escrow, $4X. is taken, and placed in an interest bearing account at the Letter-of-Credit issuing bank, and a Letter-of-Credit is issued for $4X. to secure the New Owner's $X. per quarter payments, year-to-year. When property is sold, the cash balance, plus interest, is returned to the original Seller. If arrears ever reach $4X. property is foreclosed.

4. Considering the property's record of income and carefully projected income potential in the relevant market(s), drafts from the Letter-of-Credit are highly unlikely (low risk).

5. The New Owner's mortgage (65% FMV) is also secured, conventionally, by the lender's encumbrance on property's title.

[See APPENDIX VI.(A):]

Just a thought:

"Congress may be strict or lavish in its allowance of deductions or tax benefits. The formula it writes may be arbitrary and harsh in its applications. But where the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the taxpayer though they represent an unexpected windfall." [Lewyt Corporation v. Commissioner of Internal Revenue, 349 U.SW. 237, 240, 75 S.Ct. 736, 99 L.Ed. 1029 (1955)]

T) DOWNSIZED BUT NOT DOWN & OUT

If you must take a lump-sum withdrawal from a corporate pension fund before reaching age 59.5

1. Create a Charitable Remainder Unitrust (CRUT) and designate yourself sole trustee or co-trustee with a co-operative attorney and/or bank.

2. Establish (create if not already existing) a non-profit corporation under your personal control, and designate up to 85% of new CRUT's remainder interest to the non-profit (balance of remainder interest to one, or more, favorite charity).

3. Donate your lump-sum (minus penalties for early withdrawal) into the CRUT, (Suggestion: 10% annual payout for 10 year term), and get about 25% FMV as your tax-deduction.

4. Your annual X% payout from Trust Corpus (growing tax-free) is taxable, but only after exhausting your tax-deductions from the donation(s).

5. At term of CRUT, up to 85% of CRUT corpus goes to your non-profit organization (tax-free) and the balance to the designated remainderman.

6. NOTE: 5%, or more, stock owners of companies who are approaching 70.5 years old should also consider this strategy for mandatory IRA and pension-fund withdrawals. (Reference: "What IRS Does Not Want You To Know": by Martin Kaplan, CPA, pages 18-19.) [see APPENDIX XI. (A):]

U) GIVE: GET YOUR MONEY BACK: BUILD FOUNDATION

1. Create your own Private Foundation or fully tax-exempt non-profit corporation.

2. Create your own Charitable Remainder Unitrust (CRUT) (Note: Any competent trust attorney will setup a CRUT for about $1,500.)

3. Irrevocably donate appreciated stock (or other assets) into your CRUT. [Terms and Payout Rates are flexible: Up to two (2) lifetimes: and 15% maximum annual payout]

SAVIORG Suggestion:

Designate your non-profit as the 85% Remainderman and one or more favorite charity(s) as the 15% Remainderman. You can change these Remaindermen any time, at will, during the term of the trust. Establish, irrevocably, a CRUT with a 10 year term and a 10% annual payout rate. Get about 25% FMV tax-deductions:

4. As trustee, capitalize the CRUT by selling the stock (gain tax-free in trust).

5. Trustee invests 90% of corpus (cash and other assets in trust) in secure investments. SAVIORG suggests the Federal Mortgage Corporation's "Fannie Maes", and placement of 10% of corpus into a bank's money market fund. (Since CRUT is tax-free, government securities are not tax advantaged.)

6. Year 1: Trustee withdraws 10% of original FMV donated to CRUT from the money market account (minus appreciation which goes to CRUT corpus), and

gives the cash to his/her spouse. This gift is tax-free due to the unlimited marital gift-tax exclusion. Investment growth was tax-free in trust.

7. Year 2 thru end of trust term: Repeat process exactly unless trustee chooses, arbitrarily, to exercise rights to vary types of investments and/or distribution to remainder recipients.

Question: Keep spouse on the hook?

End of CRUT: All remaining corpus goes to the designated remaindermen. Your non-profit receives up to 85% of corpus, entirely tax-free, to be exclusively managed under the bylaws of your corporation.

V) TAX-FREE DIVERSIFICATION USING ESOP AND A LIMITED PARTNERSHIP

This transaction assumes you have established a C-corporation:

1. You sell X% of your C-corp stock to the C-corp's ESOP. (Note: The ESOP can use specially discounted finance from conventional lenders to make this purchase.)

2. You escape capital gains tax on the sale by purchasing Qualifying Replacement Property (QRP) within time limits.

3. You gift one-half of your remaining C-corp stock to your spouse.

4. You and spouse create a Limited Partnership, and transfer all personally held C-corp stock to it.

5. The L.P. sells the C-corp stock to the same ESOP.

6. Ownership of the C-corp should be a certain percentage of shares for each principle and 1.0% for a related non-profit organization. Y% of C-corp shares are contributed to the new L.P. following the gift to spouse.

7. Limited Partnership's G.P. donates L.P. interests from time-to-time to the related non-profit.

Note: There is a holding period of three (3) years for C-corp stock to escape gain in sale to ESOP. This period can include not only time prior to the transaction noted above, but also...(email for more details)

[IRS Letter Ruling: 9846005]

W) DONOR'S INSURANCE

1. Donor donates $X. in cash or assets to a 509(a)2 charity.

2. Charity invests $X., minus Y% fees, in a life insurance policy written on the Donor's life.

3. Charity sells the policy to the Donor (discounted from appreciated face value?)

Note: Charity should be a licensed Insurance broker.

[IRS Letter Ruling: 8820061]

X) BUY STOCK, VOTING RIGHTS AND DIVIDENDS, ON 75% MARGIN

1. Pay $X. to a Margin Account at Broker (A), and buy $2X. stock on 50% Margin.

2. Deposit $2X. stock in Broker (B)'s Margin Account as collateral, but retain full voting and dividend rights. Borrow $X. cash, and buy $2X. stock on 50% Margin.

3. Deposit $2X. stock in Broker (C)'s Margin Account as collateral, but retain full voting and dividend rights. Borrow $X. cash, and buy $2X. stock on 50% Margin.

4. Deposit $2X. stock in Broker (D)'s Margin Account as collateral, but retain full voting and dividend rights...etc., etc.

Result: Receive Voting Rights and Dividends on $Z. stock held at your brokers' place of business, and pay only $(d)Z. cash. (d) = *de minis*. Pay Margin Interest with dividends, and hold your breath on Margin Call(s) liability.

[IRS Letter Ruling: 8636056]

Y) DONATION OF S-CORPORATION STOCK

"The Small Business Job Protection Act of 1996 made two changes to the law relevant to gifts of S stock to charities. First, certain charitable entities are now permitted to hold S stock. Specifically, Section 1361(b) (1) (B) was amended to

permit charitable organizations described in Section 501(c)3 that are exempt from taxation under Section 501(a) to be S corporation shareholders.

To maximize the income tax benefits to the donee charity, even a donor who wishes to make gifts to an established public charity (which is probably organized in corporate form) should instead consider creating a trust that will qualify as a supporting organization under Section 509(a)3. The donor will be able to take advantage of the same favorable income tax deduction limitations that apply to contributions to public charities, and will avoid application of the onerous private foundation rules while ensuring that the maximum charitable deduction is available to protect (against) the Unrelated Business Income Tax (UBTI) associated with the S stock. Alternatively, existing public charities might wish to consider setting up such trusts to be available to receive gifts of S stock, and educating their solicitors and others about the importance of using such a trust where S stock is involved."

[*When S Corps. Meet Charities*: by Carlyn S. McCaffrey, T. Randolph Harris, and Barbara A. Sloan: Journal of Taxation, March, 1999, p.181.]

AA) REIT CORNERSTONE

1. Your corporation gets a commercial loan for $X., and buys a *proven* profitable urban garage (preferably with a carwash, and/or travel agency, and/or x facility)

2. Create a Real Estate Investment Trust (REIT).

3. Sell corporate stock on at least a 20:1 P/E basis: Proceeds = $1.2x and pays off commercial loan: Balance equals $.2x.

4. Your stock investors, contractually, must exchange their stock for your REIT shares.

5. REIT sells the corporate stock, that was exchanged for its shares, and sale proceeds purchase the corporation's garage.

6. REIT issues "reit shares" based on garages' secure, projectable income, which can therefore be capitalized on 20:1 P/E.

Option:

REIT uses stock asset sale proceeds to buy Y% interest in your garage, and invests X% of proceeds in Mortage Backed Securities. You, then, have $(Y) times (.2X) to make a "go" of the garage, retaining Z% of REIT shares.

BB) DOUBLE DEDUCTIONS

If a C-corporation donates property to a private foundation or charity, in many cases it gets two tax-deductions. Of course, the charitable donation imparts a 100% FMV tax-deduction, and, the corporation may also deduct its' adjusted basis in the property from Earnings & Profits because an asset has been subtracted from its' holdings.

[See Appendix I.(B):]

CC) NON-PROFIT CAN WORK PRIMARILY THRU A FOR-PROFIT

Any non-profit organization can transfer its' principle activities, and assets, to a "pass-through" entity, such as an S-corporation or a REIT, and continue to maintain its' exempt status. [See Appendix I.(C):]

DD) INVENTORY DONOR GETS BASIS PLUS 50% FMV

[See APPENDIX: I.(E):]

EE) A SECOND COMPANY REDEEMS STOCK DONATION

If, for some adequate reason, transactions [I.(A), I.(B) DONATION-REDEMPTION-DISPOSITION], are not feasible for your company perhaps the transaction that follows will be considered workable by the board.

Under the rules of attribution, section 318(a) of the IRS Code (Title 26),
Taxpayers "own" 100% of Corporation E stock.

Taxpayers also own 79.95% of the common and 79.9% of the preferred stock of a corp- oration named J.

Pursuant to a prearranged, but not legally or otherwise compelling agreement, taxpayers donate all or a portion of Corporation J stock to a public charity. The public charity immediately sells the stock to Corporation E for a nominal down-payment and a long-term note.

[See APPENDIX V.(D):]

FF) AUCTION TRIGGERED BARGAIN-SALE-BACK

Dear Executive;

If an item is purchased at an auction the buyer does not owe gift tax on the differential between the average of recent retail selling prices for that item and the current auction selling price.

Using the average retail price and/or a formal appraisal to determine FMV is merely making an educated guess at the FMV, today.

If an item is sold at auction the selling price is, arguably, the FMV for that day of sale in that locality. If we buy an item using a legal Bargain-sale on the following terms: 70% FMV (cash) and 30% FMV (tax-deductions): the seller must have a reasonable assurance that the item will be used for the tax-exempt purpose(s) of the donee/buyer.

That is all. No time of possession limits or specific functional limits exist in the law, regulations or tax-court precedent. A "reasonable assurance" that the donee/buyer will use the item for charitable purposes...QED.

Most non-profit corporations willing to deal with you, will give you absolute assurance that they will use every item purchased at bargain-sale for tax-exempt, charitable purpose(s). If they buy (X) using a bargain-sale, as suggested, they can sell (X) after substantial use for their tax-exempt, charitable purpose.

Scenerio:

1. A cooperative non-profit contracts (conditioned upon the success of step 2. below) to bargain-sale purchase a new (or pre-owned) (X): 65% FMV cash, 35% FMV (federal/state tax-deductions), within 30 days. Note: the bargain sale of a (X), whether new or pre-owned, that is ordinary income property (inventory) must use the Adjusted Basis rather than FMV.

2. In the interim, via online auction(s) or other types of auctions or private offers, the non-profit offers the (X) at a minimum price of 70% FMV.

3. Highest qualified bidder is closed by contract to establish a bank's irrevocable letter-of-credit for the 70%+ FMV selling price to be drawn in 90-120 days following date of purchase.

4. The non-profit uses the (X) for its express, tax-exempted purposes for 90-120 days under the supervision of the selling company/broker.

Note: Any non-profit corporation can submit an IRS Lettering Ruling Request for this transaction.

[See APPENDIX VI.(A)]

GG) BARGAIN SALE-LEASEBACK-RESIDUAL SALE

1. Company (A) buys a vehicle for $X. (FMV)

2. A public charity buys the vehicle for 65% $X. (35% $X. tax-deductions for seller).

3. Charity leases the vehicle to Company (A) for $Y. per month for a (3-5) year term.

4. Lessee's payments are fully tax-deductible for term. Total of payments, $Y. x (36-60 mos.), subtracted from the appraised FMV at term, and the balance (if any) is paid by Lessee for title.

APPENDIX I

(A): DONATION-REDEMPTION-DISPOSITION

1967-1 C.B. 64, 1967 WL 15392 (I.R.S.)

Internal Revenue Service (I.R.S.)

Revenue Ruling: 78-197

Published: 1967

(Also Section 1012; 1.1012-1.)

When a donor transfers, without consideration, stock to a charitable organization under a 'gentlemen's agreement' which allows him to reacquire the stock one month later at its then fair market value, the amount of the cash paid to the organization in reacquiring the stock, and not the fair market value of the stock when transferred, is a charitable contribution within the meaning of section 170 of the Internal Revenue Code of 1954, and is deductible to the extent provided by such section. The basis of the stock in the hands of the donor remains the same as it was before he transferred the stock.

Advice has been requested whether, under the circumstances described below, a taxpayer who transfers shares of stock to a charitable organization without consideration, and who later reacquires them from the organization at their fair market value at the time of reacquisition, is entitled to a charitable contribution deduction based on the fair market value of the stock at the time of his transfer, or on the cost of reacquisition, and whether such transaction will affect the basis of his stock.

The taxpayer in the instant case transferred, without consideration, 300 shares of stock in M Corporation, having a fair market value of 4x dollars per share, to an organization described in section 170(c) of the Internal Revenue Code of 1954. The taxpayer's adjusted basis in the stock was 2x dollars per share.

During the month following the transfer and in the same taxable year, the taxpayer repurchased the 300 shares at 4x dollars per share. The books of M reflected both changes in ownership. The charitable organization had in its possession a large number of shares of stock of M which had been received from other donors. While such shares were allegedly held for sale to any prospective purchaser, the majority of them (as well as the shares acquired from the

taxpayer) were, in fact, held under a 'gentlemen's agreement' for resale to the donors. The transactions were handled in this manner for the purpose of enabling the donors to obtain a charitable deduction and to acquire a stepped-up basis for the stock while avoiding the recognition of gain.

Section 170(a) of the Code provides, in part, as follows: (1) *General Rule*. There shall be allowed as a deduction any charitable contribution payment of which is made within the taxable year. It is clear that the taxpayer has made a charitable contribution within the taxable year. The questions, however, are (1) in which of the transactions was the contribution effected, and (2) whether the transfer and repurchase of the stock under such a 'gentlemen's agreement' should affect the basis of the stock.

It is well settled that the Internal Revenue Service will look to the substance of a transaction. *Commissioner v. Court Holding Co.*, 324 U.S. 331 (1945), Ct. D. 1636, C.B. 1945, 58. Upon a determination that the form employed to carry out a transaction is unreal or a sham, the Service may disregard its effect. *Higgins v. John Thomas Smith*, 308 U.S. 473 (1940), Ct. D. 1434, C.B. 1940-1, 127.

In the instant case title to the stock was actually transferred on the books of the corporation. Nevertheless, the facts indicate that the taxpayer had no intention of relinquishing his rights of ownership in the stock; that the stock was held by the donee under an agreement for return to the donor in the form of a sale; and that by means of this device the donor hoped to obtain a stepped-up basis for such stock.

On the basis of these facts, the transfer and repurchase of the stock are to be disregarded. However, the amount paid in order to reacquire the stock is a charitable contribution within the meaning of section 170 of the Code and is deductible in the year paid in the manner and to the extent provided by such section. The basis of the stock in the hands of the taxpayer after his reacquisition remains the same as it was before he transferred the stock. Rev. Rul. 67-178, 1967-1 C.B. 64, 1967 WL 15392 (I.R.S.)

26 CFR 1.302-1: General

Redemption; charitable contribution followed by prearranged redemption. A taxpayer with voting control of a corporation and an exempt private foundation who donates shares of the corporation's stock to the foundation and, pursuant to a prearranged plan, causes the corporation to redeem does not realize income as a result of the redemption. The Service will treat the proceeds as income to the donor under facts similar to those in the *Palmer* decision only if the donee is legally bound, or can be compelled by the corporation, to surrender the shares for redemption.

1978-1 C.B. 83, 1978 WL 42302 (I.R.S.)

I. (B): DONATION-REDEMPTION-DISPOSITION (continued)

Published: 1978

26 CFR 1.302-1:

General. Redemption; charitable contribution followed by prearranged redemption. A taxpayer with voting control of a corporation and an exempt private foundation who donates shares of the corporation's stock to the foundation and, pursuant to a prearranged plan, causes the corporation to redeem the shares from the foundation does not realize income as a result of the redemption. The Service will treat the proceeds as income to the donor under facts similar to those in the *Palmer* decision only if the donee is legally bound, or can be compelled by the corporation, to surrender the shares for redemption.

In *Palmer v. Commissioner*, 62 T.C. 684 (1974), aff'd on another issue, 523 F.2d 1308 (8th Cir. 1975), the United States Tax Court held that the Internal Revenue Service incorrectly treated a gift of stock to an organization exempt from income taxation pursuant to section 511(c)(3) of the Internal Revenue Code of 1954, followed by a prearranged redemption of the stock, as a redemption of the stock from the donor followed by a gift of the redemption proceeds to the donee. The Service will follow *Palmer* on this issue, acq., page 6, this Bulletin. In *Palmer*, the taxpayer had voting control of both a corporation and a tax- exempt private foundation. Pursuant to a single plan, the taxpayer donated shares of the corporation's stock to the foundation and then caused the corporation to redeem the stock from the foundation. It was the position of the Service that the substance of the transaction was a redemption of the stock from the taxpayer, taxable under section 301 of the Code, followed by a gift of the redemption proceeds by the taxpayer to the foundation. The United States Tax Court rejected this argument and treated the transaction according to its form because the foundation was not a sham, the transfer of stock to the foundation was a valid gift, and the foundation was not bound to go through with the redemption at the time it received title to the shares.

Also see, *Grove v. Commissioner*, 490 F.2d 241 (2nd Cir. 1973); *Behrend v. United States*, No. 72-1153, 72-1156 (4th Cir. 1972); and *Carrington v. Commissioner*, 467 F.2d 704 (5th Cir. 1973).

The Service will treat the proceeds of a redemption of stock under facts similar to those in *Palmer* as income to the donor only if the donee is legally bound, or can be compelled by the corporation, to surrender the shares for redemption.

I. (C): DOUBLE DEDUCTIONS

Section 312. *Effect on Earnings and Profits*

26CFR 1.312-1: Adjustment to earnings and profits reflecting distributions by corporations. (Also Section 170; 170A-1.)

Earnings and profits; charitable contribution of appreciated property. A corporation that donates appreciated property to a city may reduce its current earnings and profits under section 312 of the Code only by the adjusted basis of the property, even though in computing its taxable income it may deduct under section 170 an amount equal to the property's fair market value.

Rev.Rul. 78-123

Advice has been requested regarding the effect of a charitable contribution upon the current earnings and profits of a corporation, under the circumstances described below.

The taxpayer, a domestic corporation, is the lessee of certain land under a 99-year lease agreement with state X. In 1976, the taxpayer donated to city Y its leasehold interest in the land for a civic betterment program that benefited the entire community. The land is unimproved and has never been utilized in the taxpayer's business. The leasehold interest, which had been held in excess of 2 years by the taxpayer, had appreciated in value. In 1976 the taxpayer had current earnings and profits in excess of the fair market value of the donated property.

The specific question is whether the taxpayer may reduce its current earnings and profits by the fair market value of the leasehold donated to city Y.

Section 170 (a) of the Internal Revenue Code of 1954 provides, in part, that there shall be allowed as a deduction any charitable contribution, payment of which is made within the taxable year.

Section 1.170A-1(c)(1) of the Income Tax Regulations provides that if a charitable contribution is made in property other than money, the amount of the

contribution is the fair market value of the property at the time of the contribution reduced as provided in section 170 (e) (1) of the Code and section 1.170A-4(a).

Section 312(a) (3) of the Code provides that on the distribution of property, other than cash and obligations of the distributing corporation, by a corporation with respect to its stock, the earnings and profits of the corporation shall be decreased by the adjusted basis of the other property so distributed.

Section 1.312-1(b) of the regulations provides that the adjustment provided in section 312(a) (3) of the Code shall be made notwithstanding the fact that such property has appreciated or depreciated in value since acquisition.

Under section 1.312-6(b) of the regulations, the effect of a transaction upon earnings and profits is not necessarily dependent upon the tax treatment of the transaction in determining net taxable income for a given year.

Rev. Rul. 75-515, 1975-2 C.B. 117, provides, in part: "In general, the computation of earnings and profits of a corporation for dividend purposes is based upon reasonable accounting concepts that take into account the economic realities of corporate transactions as well as those resulting from the application of tax law. Thus, losses and expenses that are disallowed as a deduction for Federal income tax purposes, charitable contributions in excess of the limitations provided therefore, and other items that have actually depleted the assets of the corporation, even though not reflected in the income computation, are allowable as deductions in computing earnings and profits."

When a corporation makes a disposition of property with respect to stock, such as a dividend paid in property, earnings and profits must be reduced by the adjusted basis of the distributed property rather than its fair market value because it is the adjusted basis that is reflected in the earnings and profits of the taxpayer. The unrealized appreciation in the value of the property distributed is not reflected in the earnings and profits and therefore does not constitute a reduction of earnings and profits available for the payment of dividends, *See* section 312(a)(3) of the Code and section 1.312-1(b) of the regulations. Likewise, when a charitable contribution is made in property other than money, the adjusted cost basis of the property in the hands of the donating taxpayer is the amount reflected in earnings and profits. The fact that the taxpayer may be allowed to take a deduction for Federal income tax purposes based on the fair market value of the donated property does not mean that the fair market value is also used to reduce earnings and profits.

In *Kaplan v. Commissioner*, 43 T.C. 580 (1965), the Tax Court of the United States allowed earnings and profits to be reduced by the fair market value of appreciated property given as a charitable contribution The Internal Revenue Service will not follow the decision in *Kaplan*. See non-acquiescence, page 2, this Bulletin.

The effect on earnings and profits in the instant situation is as follows: In computing its taxable income, the taxpayer is allowed to deduct, under section 170 of the Code, an amount equal to the fair market value of the property other than money contributed to a recognized charity. This deduction reduces the corporation's taxable income and results in a corresponding lesser amount of income being included in the current earnings and profits. However, under section 312, the unrealized appreciation in value of the property may not reduce earnings and profits. Therefore, current earnings and profits must be increased by the difference between the fair market value of the donated property and the taxpayer's adjusted basis of the donated property. Consequently, the final result, for earnings and profits purposes, is that current earnings and profits have been decreased by the taxpayer's adjusted basis of donated property.

Accordingly, in the instant situation, the taxpayer may not reduce its current earnings and profits by the fair market value of the leasehold interest donated to city Y.

I. (D): NON-PROFIT WORKS PRIMARILY AS A FOR-PROFIT

Rev Rul. 98-15 provides long-overdue precedential guidance to the effect that an exempt organization can satisfy the operational test through its participation in a pass-through entity, such as a partnership or LLC. This is the approach endorsed, essentially in *Plumstead Theatre Society, Inc.* 675 F.2d 244, 49 AFTR2d 82-1390 (CA-9, 1982), almost 20 years ago and accepted, grudgingly, by the Service during the ensuing period. In addition, *Rev. Rul. 98-15* provides welcome clarification concerning the continued public charity status of organizations that carry on their principal, if not only, exempt activity through a pass-through entity. In this Ruling, the principal activity was the operation of a hospital, and thus the Service acknowledged the continued public charity status of the transferor organization as a Section 170(b) (1) (A) (iii) organization. In other instances, however, such as the operation of skilled nursing facilities or low-income housing, a similar approach would seem appropriate for purposes of Section 509(a)(2) based on this Ruling.

Additionally, *Rev. Rul.98-15*, provides a relatively straight-forward example of an arrangement where an organization transfers its principal activities and assets to a pass-through entity, and is entitled to continue its exempt status. A very safe template for operations is thus set forth in the ruling.

I. (E): INVENTORY DONOR GETS BASIS PLUS 50% PROJECTED GAIN

Charitable contributions; dated products. A corporation that donates products to a charitable organization immediately prior to their expiration date is allowed as a charitable contribution deduction an amount equal to the corporation's basis in the property plus one-half of the unrealized appreciation, not to exceed twice the corporation's basis in such property.

Rev. Rul. 83-29

Thus, as a general rule, the deduction for charitable contributions of appreciated inventory property is limited to the taxpayer's basis in the contributed property.

However, section 170(e)(3) (A) of the Code provides an exception to the general rule regarding qualified corporate contributions of inventory to be used for the care of the ill, the needy, or infants.

Section 170(e)(C)(B) of the Code provides that the amount of the charitable contribution deduction for qualified contributions of inventory is equal to the taxpayer's basis in the property plus one-half of the unrealized appreciation, not to exceed twice the taxpayer's basis in such property.

I. (F): AIR-RIGHTS DONATIONS

In *Mattie Fair v. Commissioner of Internal Revenue*, 27 T.C. 866 (1957), the Taxpayers owned a two-story building which had been constructed with a view to subsequent expansion, the walls and columns being adaptable to the addition of several stories above the existing building. The Taxpayers later transferred to a charity the right to use the air space above the existing two stories for the construction of several stories to be used by the charity for its charitable purposes. In the transfer agreement it was provided that if the first two floors should ever be destroyed by casualty of any nature, the rights of the charitable foundation would end at that time. Nevertheless, the Tax Court held this was a transfer of a 'present irrevocable interest' and determined that the Taxpayers were entitled to a deduction measured by the present value of the air space and the right to build on the existing building.

It has long been the position of this Court that air above land may constitute a property right separate from the land itself. *Sexton v. Commissioner*, 42 T.C. 1094 (1964); *Fair v. Commissioner*, 27 T.C. 866, 872 (1957). In *Sexton v. Commissioner*, supra, the taxpayer sought to depreciate air rights consumed in the operation of a garbage dump on land purchased for that purpose.

The site was a manmade excavation created by the digging of clay for bricks prior to the time that the taxpayer acquired the land. Records were kept of the amount of space utilized each year through annual surveys. This Court held that "Since rights in space have been recognized as property subject to transfer separately from the related land, we perceive no reason why such rights should not be the subject of depreciation as wasting assets in the business of this taxpayer." (42 T.C. at 1102.)

The Court in *Sexton* allowed unit depreciation since the taxpayer had proved the amount of space exhausted each year and the value of each cubic yard of space consumed. The respondent argues that a fatal difference exists between *Sexton* and the instant litigation since the O'Neill tract was not purchased solely for use as a dump site. Respondent concedes that such a use was "an important consideration in the selection" of the O'Neill tract, but argues that the petitioners' development motive precludes the *Sexton* exception to the general rule that land is not depreciable.

We disagree. The facts make it abundantly clear that petitioners' overwhelming purpose in the acquisition of the O'Neill tract was for use as a dump site. They never would have purchased it had they been able to lease it. Respondent argues that petitioners' attempt to rezone the O'Neill tract indicates a development purpose. We think it only reasonable that petitioners would want to increase the residual commercial attractiveness of the O'Neill tract for sale or development once it was no longer useful as a dump site. Respondent argues further that the instant case differs from Sexton v. Commissioner, supra, since the O'Neill tract was not a manmade excavation. This is a distinction without a difference. It is clear that the O'Neill tract was particularly well suited for a dump site due to its size, location, and shape. We see no real difference between the two factual patterns. In both situations, the primary objective of the purchase was to acquire usable space for dumping. The holding in Sexton did not depend upon a manmade excavation nor, in fact, any excavation. Of primary importance there, was that the property was purchased for use as a dump site. Air rights may be a separate property right from the land whether the property is flat or concave. See *Fair v. Commissioner*, supra.

Charitable contributions are recognized as paid and deductible even though made in property. *Priscilla M. Sullivan*, 16 T.C. 228, 231; *Mattie Fair*, 27 T.C. 866; *Champlin v. Broderick*, 38 A.F.T.R. 1533, 48-2 U.S.T.C.par. 9332; Regs. 111, sec. 29.23(o)-1; sec. 1.170-1, Income Tax Regs. (T.D. 6285, 1958-1 C.B. 127, 131).

A payment need not be cash and even a debt can be paid in property if the debtor is willing to accept the property as payment. There is no reason why a contribution to a pension trust could not be made in property and still be deductible. The transfer which the petitioner made to its pension trust bore no resemblance to a promissory note nor was it a mere promise to pay something in the future. It was a present transfer of an asset worth at least $389,165.52. The petitioner was not obligated to repurchase the bank site or to pay anything on the purchase price fixed in the option. The stipulation shows that the trust could have sold the real estate subject to the lease and option for at least $389,165.52. There was nothing in the agreement between the petitioner and the pension trust to prevent such a sale. The transfer was immediately and irrevocably beneficial to the trust and the donee.

In *Mattie Fair*, 27 T.C. 866 (1957), acq. 1957-2 C.B. 4, a gift was made to a charitable foundation of the right to build and maintain a five-story addition above an existing two-story building. We upheld the right of the donors to claim a deduction for a charitable contribution of the value of the rights and interests so conveyed. We there said (p. 872): The right to use the air space superjacent to the ground is one of the rights in land. These air rights are frequently the most valuable rights connected with the ownership of land since the value of commercial property consists almost exclusively of the right of the owner to erect business and industrial structures thereon. Cf. *Piper v. Ekern*, 180 Wis. 586, 194 N. W. 159, 161 (1923). The sale or lease of superjacent air space is not at all uncommon in large cities. Attempts to subdivide the superjacent air space into horizontal strata or air lots poses difficult questions. But there does not seem to be any policy of the law prohibiting these transactions and their validity has been recognized. (Footnotes omitted.) See special ruling letter dated April 10, 1964 (C.C.H. par. 6636, P.-H. par. 54, 951), and Rev. Rul. 64-205, promulgated July 27, 1964 (I.R.B. 1964- 30), wherein it was held that the gratuitous conveyance to the United States of a restrictive or 'scenic' easement in real property is a charitable contribution and entitled the taxpayer to a deduction under section 170 of the 1954 Code to the extent of the fair market value of the restrictive easement. The restrictions in question included limitations on the height of buildings which might be constructed on such real property. In effect these rulings recognize a property right in the airspace super adjacent to real property which is subject to separate evaluation and conveyance. The rulings further provide for the adjustment of the taxpayer's basis in the real property by eliminating that part of the total basis which is properly allocable to the restrictive easement granted. The State of Illinois, by statute, specifically allows railroads to subdivide, improve, and sell the super adjacent airspace. Ill. Ann. Stat., ch. 114, sec. 174(a)(Smith-hurd). 42 T.C. 1094 ------------ Excerpt from pages 42 T.C. 1094, 42 T.C. 1094,

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II. (A): AIR-RIGHTS DONATIONS (continued)

Rev. Rul. 71-286

MATTIE FAIR, PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

R. W. FAIR, PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT. Docket Nos. 49033, 49034. Tax Court of the United States.

Filed February 27, 1957.

Allen E. Pye, Esq., and Weldon J. Squyers, Esq., for the petitioners. Graham R. E. Koch, Esq., for the respondent.

Petitioners, the owners of a commercial lot with a 2-story building thereon located in Tyler, Texas, conveyed, without consideration to the Foundation, a charitable corporation, the perpetual right to build, own, and maintain 5 additional stories on the existing 2-story building, plus the rights of access and support. In the event of destruction of the 2-story building the petitioners did not obligate themselves to rebuild it, but if they did elect to rebuild, the Foundation would also have the right to rebuild. The petitioners claimed a charitable contribution of $70,000 for the rights and interests conveyed and deducted that amount to the extent provided in section 23(o), I.R.C. 1939. The respondent disallowed the entire deduction on the ground that the rights and interests contributed were not of such a nature as to give rise to a deduction under section 23(o). Held, that the rights and interests contributed were property with a fair market value of not less than $70,000, and such gift was deductible to the extent provided in section 23(o). Held, further, that respondent's alternative claim, presented by an amendment to the answer, that the basis of the 2-story building retained by the petitioners should be reduced by the amount held to be contributed does not properly present the issue since there is no showing how such adjustment, if made, will bear upon the deficiency or the petitioners' tax liability for the taxable year. The respondent has determined

deficiencies in income tax of R. W. Fair and Mattie Fair (husband and wife) for the fiscal year ended November 30, 1948, as follows:

Docket No. Petitioner Deficiency

49033 .... Mattie Fair---- $11,887.01

49034 .... R.W. Fair------ 11,887.01

These proceedings have been consolidated. The petitioners each reported one-half of their community income on separate returns. The commissioner made several adjustments to the net income as reported. The only adjustment that is in issue is the disallowance of a charitable contribution in the amount of $70,000, which was deducted to the extent provided in section 23(o), Internal Revenue Code of 1939. The petitioners claimed a charitable contribution of that amount, which they contend is the fair market value of a gift to the Fair Foundation, a charitable corporation, of a building site on top of a 2-story building owned by them, in addition to rights of access and support.

The deficiency notices explained the disallowance to each petitioner, as follows:

(b) Contributions deductible under Section 23(o) have been adjusted as follows:

Amount claimed .. $28,856.46

Allowed 8,886.98

Disallowed $19,969.48

It has been determined that you are not entitled to a deduction in any amount for the alleged contribution of $70,000.00 made to the Fair Foundation, Tyler, Texas.

By an amended answer the respondent contends, in the alternative, that if the Court should determine that the rights conveyed by the petitioners to the Fair Foundation had any value, then the basis of the 2-story building retained by the petitioners should be reduced by a like amount.

FINDINGS OF FACT.

A stipulation of facts has been filed and is incorporated herein by reference.

The petitioners, R. W. Fair and Mattie Fair, are husband and wife and reside in Tyler, Texas. The petitioners each reported one-half of their community income on separate income tax returns.

The Fair Foundation, hereinafter referred to as the Foundation, is, and was at all times material herein, a charitable and tax-exempt organization within > section 101(6), Internal Revenue Code of 1939. At all times material, contributions made to the Foundation were deductible by donors in arriving at taxable net income to the extent provided by > section 23(o). Mattie Fair and R. W. Fair were, and at all times have been, sole trustees of the Foundation.

Petitioners, on June 16, 1931, purchased for a consideration of $25,307.75 a tract of land 100 feet wide and 127 1/2 feet deep and being a part of lots 11 and 12, block 7, city of Tyler, Texas. The tract of land was located in the business district of Tyler, Texas. In 1942, on the tract of land purchased in 1931, and occupying all of same, petitioners built a building (known as the Sears building) consisting of 2 floors and a mezzanine floor, which building was completed in August 1942 at a cost of $158,217.72. On September 1, 1942, petitioners leased all of the building except a portion out of the southeast corner, 13 feet 8 inches wide by 42 feet deep, to Sears, Roebuck and Company for a period of 20 years from that date, which lease is still in force and effect according to its original terms. The lease agreement between the petitioners and Sears, Roebuck and Company provides for a monthly payment of $833.33, plus an additional yearly payment equal to 2 1/2 per cent of the gross sales of the lessee over $400,000. The remainder of the building was rented to the Flower Box, a florist shop, from September 1942 through February 1948, for a monthly rental of $65, but which was raised to $75 per month on March 1, 1943.

The rentals paid each year from 1942 through 1954 were as follows:

Year	Sears, Roebuck and Company	Flower Box	Total
1942	3,799.04	207.75	4,006.79
1943	13,077.72	880.00	13,957.72
1944	15,472.50	900.00	16,372.50
1945	16,047.19	900.00	16,947.19
1946	25,698.39	900.00	26,598.39
1947	33,683.97	900.00	34,583.97

1948 .... 39,901.82 150.00 40,051.82

1949 .... 39,578.06 ---------- 39,578.06

1950 .... 43,778.21 ---------- 43,778.21

1951 .... 40,354.18 ---------- 40,354.18

1952 .... 39,826.29 ---------- 39,826.29

1953 .... 40,573.56 ---------- 40,573.56

1954 .... 39,906.74 ---------- 39,906.74

Total $391,697.67 $4,837.75 $396,535.42

At the time the petitioners constructed the Sears building it was anticipated that additional stories would subsequently be added to the top of that building. In the construction of the Sears building, the foundation was built to support not only 2 floors and a mezzanine, but also at least 5 additional stories on top thereof.

On July 1, 1948, the petitioners executed a document conveying to the Foundation certain rights and interests in the above-described property. The document recited that the petitioners owned certain lots in Tyler, Texas, upon which was located the Sears building. In the conveying instrument the petitioners expressly retained title to these lots and to the Sears building to themselves, their heirs, and assigns, subject, however, to the express terms of the grant made to the Foundation. Petitioners conveyed to the Foundation the right to enter on the subject premises and construct, maintain, own, and operate 5 additional stories to the Sears building using the existing walls, foundation and columns. The document also recited that the Foundation could, with the written consent of the petitioners, add 1 or more *869 additional stories if structurally feasible and safe. The petitioners, as grantors, agreed to do nothing to weaken the walls, top, columns, or foundation then existing, but were under no duty to maintain such supporting members. The instrument granted to the Foundation an easement to and the right to use so much of the Sears building designated as 119 South Broadway, an area 13 feet 8 inches wide and 42 feet long, as might be necessary for a lobby and for the installation and maintenance of elevators and stairways to the additional stories to be erected. The Foundation was given exclusive control over this area. The Foundation was granted the full right to make such openings in the walls or roof of the Sears building as might be necessary and required for the erection of the additional stories, and the

installation of pipes, and gas, water, electrical, and sewage lines, as well as all other conduits, required for the proper erection and maintenance of the additional stories. The instrument provided that the petitioners would make the necessary arrangements with the tenant of the Sears building so that the grant might be carried into effect. The Foundation was granted the full right to use such sufficient space in the basement of the Sears building.

In Mattie Fair v. Commissioner of Internal Revenue, 27 T.C. 866 (1957), the Taxpayers owned a two-story building which had been constructed with a view to subsequent expansion, the walls and columns being adaptable to the addition of several stories above the existing building. The Taxpayers later transferred to a charity the right to use the air space above the existing two stories for the construction of several stories to be used by the charity for its charitable purposes. In the transfer agreement it was provided that if the first two floors should ever be destroyed by casualty of any nature, the rights of the charitable foundation would end at that time. Nevertheless, the Tax Court held this was a transfer of a 'present irrevocable interest' and determined that the Taxpayers were entitled to a deduction measured by the present value of the air space and the right to build on the existing building.

It has long been the position of this Court that air above land may constitute a property right separate from the land itself. Sexton v. Commissioner, 42 T.C. 1094 (1964); Fair v. Commissioner, 27 T.C. 866, 872 (1957). In Sexton v. Commissioner, supra, the taxpayer sought to depreciate air rights consumed in the operation of a garbage dump on land purchased for that purpose. The site was a manmade excavation created by the digging of clay for bricks prior to the time that the taxpayer acquired the land. Records were kept of the amount of space utilized each year through annual surveys. This Court held that "Since rights in space have been recognized as property subject to transfer separately from the related land, we perceive no reason why such rights should not be the subject of depreciation as wasting assets in the business of this taxpayer." (42 T.C. at 1102.) The Court in Sexton allowed unit depreciation since the taxpayer had proved the amount of space exhausted each year and the value of each cubic yard of space consumed. The respondent argues that a fatal difference exists between Sexton and the instant litigation since the O'Neill tract was not purchased solely for use as a dump site. Respondent concedes that such a use was "an important consideration in the selection" of the O'Neill tract, but argues that the petitioners' development motive precludes the Sexton exception to the general rule that land is not depreciable. We disagree. The facts make it abundantly clear that petitioners' overwhelming purpose in the acquisition of the O'Neill tract was for use as a dump site. They never would have purchased it had they been able to lease it. Respondent argues that petitioners' attempt to rezone the O'Neill tract indicates a development purpose. We think it only reasonable that petitioners would want to increase the residual commercial attractiveness of the O'Neill tract for sale or development once it was no longer useful as a dump site. Respondent argues further that the instant case differs from Sexton v.

Commissioner, supra, since the O'Neill tract was not a manmade excavation. This is a distinction without a difference. It is clear that the O'Neill tract was particularly well suited for a dump site due to its size, location, and shape. We see no real difference between the two factual patterns. In both situations, the primary objective of the purchase was to acquire usable space for dumping. The holding in Sexton did not depend upon a manmade excavation nor, in fact, any excavation. Of primary importance there, was that the property was purchased for use as a dump site. Air rights may be a separate property right from the land whether the property is flat or concave. See Fair v. Commissioner, supra. Respondent also maintains that Lorton did not hold a depreciable interest in the O'Neill tract because it was merely a contract vendee under an executor.

Charitable contributions are recognized as paid and deductible even though made in property. Priscilla M. Sullivan, 16 T.C. 228, 231; Mattie Fair, 27 T.C. 866; Champlin v. Broderick, 38 A.F.T.R. 1533, 48-2 U.S.T.C.par. 9332; Regs. 111, sec. 29.23(o)-1; sec. 1.170-1, Income Tax Regs. (T.D. 6285, 1958-1 C.B. 127, 131). A payment need not be cash and even a debt can be paid in property if the debtor is willing to accept the property as payment. There is no reason why a contribution to a pension trust could not be made in property and still be deductible. The transfer which the petitioner made to its pension trust bore no resemblance to a promissory note nor was it a mere promise to pay something in the future. It was a present transfer of an asset worth at least $389,165.52. The petitioner was not obligated to repurchase the bank site or to pay anything on the purchase price fixed in the option. The stipulation shows that the trust could have sold the real estate subject to the lease and option for at least $389,165.52. There was nothing in the agreement between the petitioner and the pension trust to prevent such a sale. The transfer was immediately and irrevocably beneficial to the trust and the

In Mattie Fair, 27 T.C. 866 (1957), acq. 1957-2 C.B. 4, a gift was made to a charitable foundation of the right to build and maintain a five-story addition above an existing two-story building. We upheld the right of the donors to claim a deduction for a charitable contribution of the value of the rights and interests so conveyed. We there said (p. 872): The right to use the air space superjacent to the ground is one of the rights in land. These air rights are frequently the most valuable rights connected with the ownership of land since the value of commercial property consists almost exclusively of the right of the owner to erect business and industrial structures thereon. Cf. Piper v. Ekern, 180 Wis. 586, 194 N. W. 159, 161 (1923). The sale or lease of superjacent air space is not at all uncommon in large cities.3 Attempts to subdivide the superjacent air space into horizontal strata or air lots poses difficult questions.4 But there does not seem to be any policy of the law prohibiting these transactions and their validity has been recognized. (Footnotes omitted.) See also special ruling letter dated April 10, 1964 (C.C.H. par. 6636, P.-H. par. 54, 951), and Rev. Rul. 64-205, promulgated July 27, 1964 (I.R.B. 1964- 30), wherein it was held that the gratuitous conveyance to the United States of a restrictive or 'scenic' easement in real

property is a charitable contribution and entitled the taxpayer to a deduction under section 170 of the 1954 Code to the extent of the fair market value of the restrictive easement. The restrictions in question included limitations on the height of buildings which might be constructed on such real property. In effect these rulings recognize a property right in the airspace superadjacent to real property which is subject to separate evaluation and conveyance. The rulings further provide for the adjustment of the taxpayer's basis in the real property by eliminating that part of the total basis which is properly allocable to the restrictive easement granted. The State of Illinois, by statute, specifically allows railroads to subdivide, improve, and sell the super adjacent airspace. Ill. Ann. Stat., ch. 114, sec. 174(a)(Smith-hurd).

42 T.C. 1094

------------ Excerpt from pages 42 T.C. 1094, *1100-42 T.C. 1094, *1101

The bank places reliance upon the case of Mattie Fair v. Commissioner, 27 T. C. 866, 1957 CCH TAX DECISIONS [page] 2151, CCH Dec. 22,269, where a deduction was allowed under Section 23(o) of the Internal Revenue Code of 1939, for the value attributable to a charitable gift of the right to construct additional stories in the space above the roof of a building the foundation of which was adequate to support the increased burden. The Tax Court, it is true, ruled that the donated air rights constituted property; 58-1 USTC P 9301

1971-2 C.B. 263, 1971 WL 26755 (I.R.S.) AIR-RIGHTS

Internal Revenue Service (I.R.S.)

Revenue Ruling 71-286

Published: 1971

26 CFR 1.856-3: Definitions.

Air rights over real property are considered 'interest in real property' and 'real estate assets' within the meaning of section 856(c) of the Code for purposes of qualifying a trust as a real estate investment trust

Advice has been requested whether, for purposes of qualifying a trust as a real estate investment trust, air rights over the real property are considered 'interests in real property' within the meaning of section 856(c)(6)(C) of the Internal Revenue Code of 1954 and 'real estate assets' within the meaning of sections 856(c)(5)(A) and 856(c)(6)(B) of the Code.

An unincorporated trust, otherwise qualifying as a real estate investment trust under section 856 of the Code, plans to invest in air rights over real property along with other real estate assets. The term air rights as defined by the trust means the long-term leasehold or fee simple ownership of the space above the ground that a landowner can occupy or use in connection with the land, plus necessary easements on the surface for support of structures erected in such air space. The interests in air space are described by metes and bounds and normally entitled the lessee or owner thereof to free and unrestricted use of the air space subject to zoning laws, non-interference with structures constructed upon the land surface, easements and restrictions of records, and the like. Normally investments in air rights will take the form of long-term leaseholds (i.e., 50 years to 100 years). Section 856(c) of the Code provides that for a trust to qualify as a real estate investment trust for Federal income tax purposes, certain percentages of the trust's gross income must be derived from specified sources, such as real property (including interests in real property). In addition a certain percentage of the trust's assets must be represented by specified items including 'real estate assets.'

The term 'interests in real property' is defined in section 856(c)(6)(C) of the Code to include 'fee ownership and co-ownership of land or improvements thereon and leaseholds of land or improvements thereon, but does not include mineral, oil, or gas royalty interests.' The term 'real estate assets' is defined in section 856(c)(6)(B) of the Internal Revenue Code of 1954 to mean real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interests) in other qualified real estate investment trusts.

Section 1.856-3(d) of the Income Tax Regulations provides that the term 'real property' means land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures). In addition, the term 'real property' includes interests in real property. Local law definitions will not be controlling for purposes of determining the meaning of the term 'real property' as used in section 856 and the regulations there under. The Tax Court of the United States in the case of Mattie Fair v. Commissioner. 2 T.C. 8676 (1957), acquiescence, C.B. 1957-2, 4, stated that the right to use the air space superjacent to the ground is one of the rights in land and that these air rights are frequently the most valuable rights connected with the ownership of land since the value of commercial property consists almost exclusively of the right of the owner to erect business and industrial structures thereon.

Accordingly, in the instant case, the air rights over real property are considered 'interests in real property' within the meaning of section 856(c)(6)(C) of the Code and 'real estate assets' within the meaning of sections 856(c)(5)(A) and 856(c)(6)(B) of the Code. Therefore any gain from the sale or disposition of the air rights is gain from the sale or other disposition of an interest in real property

within the meaning of section 856(c)(2)(D) of the Code, and any income derived from rental of the air rights is gross income derived from an interest in real property within the meaning of sections 856(c)(2)(C) and 856(c)(3)(A) of the Code.

Rev. Rul. 71-286, 1971-2 C.B. 263, 1971 WL 26755 (I.R.S.)

END OF DOCUMENT

APPENDIX III

(A): CAPITAL GAIN TRUST INCOME

1986 WL 370320 (I.R.S.)

Internal Revenue Service (I.R.S.)

[IRS Letter Ruling: 8636056]

June 10, 1986

Section 642 -- Special Rules for Credits and Deductions 642.00-00 Special Rules for Credits and Deductions-Estates, Trusts, etc. 642.03-00 Charitable Contributions

Section 671 -- Trust Income, Deductions, and Credits Attributable to Grantors and Others As Substantial Owners 671.00-00 Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners

Section 674 -- Power to Control Beneficial Enjoyment 674.00-00 Power to Control Beneficial Enjoyment 674.04-00 Power Over Enjoyment of Charitable Beneficiaries

Section 677 -- Income for Benefit of Grantor 677.00-00 Income for Benefit of Grantor

Section 2503 -- Taxable Gifts (Annual Exclusion Allowed v. Not Allowed) 2503.00-00 Taxable Gifts (Annual Exclusion Allowed v. Not Allowed)

Section 2522 -- Charitable and Similar Gifts (Deductible v. Not Deductible) 2522.00-00 Charitable and Similar Gifts (Deductible v. Not Deductible) 2522.01-00 Transfers Not Exclusively for Charitable, etc., Purposes (Remainders, Additional Gifts, etc.)

LEGEND:

Dear * * * This is in reply to your letter dated February 24, 1986, in which you request a ruling for federal income tax purposes with respect to the creation of a proposed trust. X, a corporation organized and operating under the laws of the

state of S, proposes to create Trust, an irrevocable trust which will have a term of more than ten years from the date of the last contribution to Trust. No additional contributions will be made after Trust is funded. Upon termination, the principal of Trust will revert to X. All of the net income of Trust will be distributed before the close of the taxable year succeeding the year in which the net income is received by Trust. The net income will be distributed to charitable organizations described in sections 170(c) and 2522(a) of the Internal Revenue Code. Based on the information supplied and the representations made, our conclusions are as follows:

Trust will be classified as a trust within the meaning of section 301.7701- 4(a) of the Procedure and Administration Regulations. X will not be treated as the owner of any portion of the Trust for federal income tax purposes under sections 673, 674, and 676 of the Code. None of the circumstances that cause administrative controls to be considered exercisable primarily for the benefit of the grantor under section 675 of the Code are authorized under the terms of the trust agreement. Whether X will be treated as the owner under section 675 will depend on the circumstances attendant upon the operation of Trust. This is a question of fact, the determination of which must necessarily be deferred until the federal income tax returns of the parties involved have been examined by the office of the district director that has jurisdiction over the returns.

X will not be treated as the owner of the ordinary income portion of Trust under section 677 of the Code. Items of gross income, deductions and credits allocable to the ordinary income portion of Trust will, with the exception of amounts that represent accretion of discount or amortization of premium on securities held by Trust, be subject to the provisions of subparts A, C and D, part I, subchapter J, chapter 1, subtitle A of the Code. See section 1.671-3 of the Income Tax Regulations. Thus, no deduction will be allowed to X for any amount of Trust's income paid to charitable organizations. Because the corpus of Trust will revert to X upon termination of Trust, X will be treated as an owner of a portion of Trust under section 677(a)(2) of the Code. Items of income, deduction, and credits allocable to corpus, such as capital gains and losses, will be included in the portion X owns. Section 1.673(a)-1(a)(2) of the regulations. Therefore, items such as capital gains and losses allocable to the corpus portion of Trust will be includible in X's gross income when realized by Trust.

Rev. Rul. 79-223, 1979-2 C.B. 254. Except to the extent that Trust has unrelated business income within the meaning of section 681(a) of the Code, Trust will be allowed a deduction in accordance with section 642(c)(1) for amounts of gross income paid during the taxable year (or by the close of the following taxable year if the trustee so elects) to charitable organizations described in section 170(c). Section 2501(a)(1) of the Code provides for the imposition of a gift tax on the transfer of property by gift. Section 2503(a) of the Code defines the term 'taxable gifts' as the total amount of gift made during the calendar year, less the deductions provided in section 2522 et seq. Section 2522(a) of the Code

provides that in computing taxable gifts for the calendar year, there shall be allowed as a deduction the amount of all gifts made during such year to or for the use of certain charitable organizations described therein. Section 2522(c)(2)(B) provides, in general, that where a donor transfers an income interest in property to charity and the remainder interest therein is either retained by the donor or is given to a non-charitable beneficiary, no deduction is allowable for the present value of the charitable income interest unless such interest is in the form of a guaranteed annuity or unitrust interest. Section 25.2511-2(b) of the Gift Tax Regulations provides that as to any property of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete and, therefore, subject to the gift tax. Section 25.2511-2(c) provides that a gift is incomplete in every instance in which a donor reserves the power to reinvest the beneficial title to the property in himself. A gift is also stated to be incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves, unless the power is a fiduciary power limited by a fixed or ascertainable standard.

In Rev. Rul. 77-275, 1977-2 C.B. 346, the settler created a trust that provided for the distribution of the annual income there from to charitable organizations described in sections 170(c) and 2522 of the Code. Settler reserved the power to designate the charitable organizations which would receive the income for the year. If the settler did not make the designation prior to the beginning of the year, the trustee was empowered to select the charitable organizations at the end of the year and distribute the year's income to the selected organizations. The trust provided for reversion of principal to the settler or the settler's estate after ten years and one month. In the revenue ruling, it was concluded that the gift of the income interest was incomplete upon creation of the trust, in view of section 25.2511-2(c) of the regulations. It was held that although a completed gift of future income resulted from the settler's exercise of his beneficial power of designation, no deduction was allowable for the present value of the interest since the trust was not in the form required under section 2522(c)(2) of the Code. The revenue ruling states that if the trust had provided for the settler's designation to be made after the end of the year in which the income was earned, the gift occurring by reason of such designation, or by the lapse of the right to designate, would be a gift of money, separate from the trust property itself, and thus a deduction would be allowable under section 2522 of the Code. Section 6019(a) of the Code provides that any individual who in the calendar year makes any transfer of gifts for such year (subject to certain exceptions) shall make a return for such year with respect to the gift tax imposed by subtitle B.

In the present case, the situation is similar to that in Rev. Rul. 77-275, except that X's designation power here extends until the time income is actually distributed to the charitable organizations. Prior to actual distribution, X may revoke any charitable designation previously made. A completed gift, therefore, occurs when

income is actually paid to the charitable organizations, rather than upon creation of Trust or upon any designation by X.

Pursuant to Rev. Rul. 77-275, a deduction is allowable under section 2522 of the Code for this gift of money, which is separate from the trust property itself. Therefore, we conclude that neither X nor its shareholders will be treated as making taxable gifts under section 2503 of the Code on the transfer of assets to Trust. Additionally, X's shareholders will be allowed a gift tax charitable deduction under section 2522(a) of the Code for amounts of Trust's income paid to charitable organizations described in sections 170(c) and 2522(a) of the Code. See section 25.2511-1(h)(1) of the Gift Tax Regulations. The requirement, if any, to report such amounts on a gift tax return pursuant to section 6019 of the Code will be imposed on the shareholders of X.

Except as specifically ruled upon above, no opinion is expressed as to the federal income tax consequences of the transaction described above under any other provision of the Code. A copy of this letter should be attached to the first return filed by Trust. The enclosed copy may be used for that purpose. This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. Sincerely yours, Richard H. Manfreda Chief Individual Income Tax Branch This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code. PLR 8636056, 1986 WL 370320 (I.R.S.) END OF DOCUMENT

(B) STOCK OPTIONS DONATED, SOLD AND EXERCISED BY THIRD PARTY

1999 WL 50719 (I.R.S.)

Internal Revenue Service (I.R.S.)

Private Letter Ruling

Issue: February 5, 1999

November 12, 1998

Section 4940--Excise Tax on Net Investment Income (Applicable v. Not Applicable) 4940.00-00 Excise Tax on Net Investment Income (Applicable v. Not Applicable) 4940.02-00 Computation of Net Investment Income

Section 4941--Excise Taxes on Acts of Self-Dealing 4941.00-00 Excise Taxes on Acts of Self-Dealing 4941.04-00 Definition of Self-Dealing

Section 4942--Taxes on Failure to Distribute Income 4942.00-00 Taxes on Failure to Distribute Income 4942.01-00 Initial 15% Tax on Undistributed Income 4942.01-02 Other Special Cases of Non-Application

Section 511--Tax on Unrelated Business Income of Charitable, etc, Organizations (Taxable v. Not Taxable) 511.00-00 Tax on Unrelated Business Income of Charitable, etc, Organizations (Taxable v. Not Taxable)

Section 512--Unrelated Business Taxable Income (Taxable v. Not Taxable) 512.00-00 Unrelated Business Taxable Income (Taxable v. Not Taxable) 512.01-00 Exception, Additions, and Limitations on Unrelated Income

Dear Sir or Madam:

This is in response to a ruling request dated July 29, 1998, submitted on your behalf by your authorized representatives. You are seeking rulings on the federal income tax consequences of a proposed transaction, as more fully set forth below. X is a for-profit corporation whose common stock is publicly held and traded. X is the common parent of an affiliated group of corporations filing consolidated federal income tax returns. X, together with its affiliates, maintains its consolidated books and records, and files its consolidated tax returns on the accrual basis with a December 31 taxable year end. Through unrelated mergers, V and W became members of X's affiliated group of corporations. Y is a non-profit corporation that has been recognized as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code and as a private foundation described in section 509(a). X is a "substantial contributor" to Y and as such is a "disqualified person" with respect to Y pursuant to section 4946(a). Y makes grants in accordance with its charitable purpose and targets, though not exclusively, programs relating to certain areas of health care, children's issues, quality of life, self-sufficiency, culture and arts.

X has recently pledged the Option to Y which provides Y with an option to purchase shares of X common stock at an option price representing the closing price of a share of Common Stock on the date that the pledge of the Option was made.

The Option is exercisable in whole or in part at any time and from time to time during the period specified in the "Stock Option Pledge Agreement". Y may transfer and assign the Option or any portion thereof only to one or more unrelated charitable organizations described in sections 170(c)(2) and 501(c)(3) of the Code. The transferee may not transfer or assign the Option or any portion thereof without the written consent of X.

It is expected that Y will transfer the Option to an unrelated charitable organization and that the unrelated charitable organization transferee will pay to Y a price for the Option equal to the difference between the fair market value of

the Common Stock subject to the Option on the date of the transfer and the exercise price of the option, less an agreed upon discount.

It is represented that these terms will be negotiated at arms-length. It is further expected that the unrelated charitable organization transferee will thereafter exercise the Option prior to its expiration.

It is further represented that the business purpose of the pledge of the Option is to further the charitable purposes of Y and other charitable organizations.

Section 4941(a) of the Code imposes a tax on each act of self-dealing between a disqualified person and a private foundation. Section 4941(d)(1)(B) of the Code provides that the term "self-dealing" includes any "lending of money or other extension of credit between a private foundation and a disqualified person."

Section 53.4941(d)-2(c)(3) of the Foundation and Similar Excise Taxes Regulations provides that the making of a promise, pledge, or similar arrangement to a private foundation by a disqualified person, whether evidenced by an oral or written agreement, a promissory note, or other instrument of indebtedness, to the extent motivated by charitable intent and unsupported by consideration, is not an extension of credit (within the meaning of this paragraph) before the date of maturity. Section 53.4941(d)-1(b)(1) of the regulations provides that the term "indirect self-dealing" includes any transaction between a disqualified person and an organization "controlled" by a private foundation within the meaning of section 53.4941(d)-1(b)(5). Section 53.4941(d)-1(b)(5) of the regulations provides that for purposes relative to acts of indirect self-dealing under section 4941(d) of the Code, two basic tests for determining whether an organization is "controlled" by a private foundation. There is control if: (1), the foundation or one of its foundation managers (acting only in such capacity) may, only by aggregating their votes or positions of authority, require the organization to engage in a transaction which if engaged in with the private foundation would constitute self-dealing; or, (2) in the case of a transaction between the organization and a disqualified person, if such disqualified person, together with one or more persons who are disqualified persons by reason of such a person's relationship (within the meaning of section 4946(a)(1)(C) through (G)) to such disqualified person, may only by aggregating their votes or positions of authority with that of the private foundation require the organization to engage in such a transaction. The regulation also provides that an organization will be considered to be controlled by a private foundation or by a private foundation and disqualified persons if such persons are able, in fact, to control the organization (even if their aggregate voting power is less than 50 percent of the total voting power of the organization's governing body) or if one or more of such persons has the right to exercise veto power over the actions of such organization relevant to any potential acts of self-dealing.

Section 4942 of the Code imposes a tax on the undistributed income of a private foundation. The undistributed income is defined, in part, as the amount by which qualified distributions are less than a "minimum investment return" of five percent of the "aggregate fair market value of all assets of the foundation," other than specifically excluded assets.

Section 53.4942(a)-2(c)(1) of the regulations further explains the computation of the minimum investment return. Section 53.4942(a)-2(c)(2)(iv) of the regulations state that any pledge to the foundation of money or property (whether or not the pledge may be legally enforced) is not to be included in determining the minimum investment return.

Section 511(a)(1) of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c) of the Code. Section 512(a)(1) of the Code defines unrelated business taxable income as the gross income earned by an organization from an unrelated trade or business which is regularly carried on, less applicable deductions.

Section 512(b)(5) of the Code excludes from unrelated business taxable income gains or losses from the sale, exchange or other disposition of property other than (A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or (B) property held primarily for sale to customers in the ordinary course of the trade or business.

In Zemurray Foundation v. United States, 755 F.2d 404 (5th Cir. 1985), the court held that gain from the sale of timberland was excluded from the computation of an organization's capital gain net income. The court stated that property that produces capital gain through appreciation is not an independent category of property whose disposition will be taxable and that the regulations, to the extent that they imply it is, are invalid because they exceed the scope of the Code provisions.

Because the pledge of the Option was given, without any consideration, for the purpose of furthering the charitable purposes of Y and other unrelated charitable organizations, the pledge of the Option by X to Y does not constitute an act of self dealing between X and Y. Regs. 53.4941(d)-2(c)(3). Furthermore, assuming that the transferee unrelated charity will not be controlled by Y (as defined in section 53.4941(d)-1(b)(5) of the regulations), the exercise of the pledged stock option by the unrelated charitable organization will not constitute an act of self-dealing between X and Y.

The transfer of the option by Y to the unrelated charity will not be an act of self-dealing since the cancellation of the enforceable pledge will be for consideration paid by the unrelated charity. The consideration will be an amount equal to the difference between the fair market value of the stock subject to the option on the

date of the transfer less an agreed-upon discount. Also, the transfer will not be an act of self-dealing since the transfer will be to a charitable organization. The Option will be excluded from the assets taken into account in computing the amount of the minimum investment return of Y for purposes of determining the tax on failure to distribute income under section 4942 of the Code since section 53.4942(a)-2(c)(2) of the regulations provides that pledges of property are not included in computing the minimum investment return.

As concluded in Zemurray Foundation v. U.S., cited above, the tax on capital gain through appreciation applies only to non-charitable assets susceptible to use to produce interest, dividends, rents and royalties. Stock options are not such assets. Accordingly, Y's proceeds from the sale of the Option to an unrelated organization exempt under section 501(c)(3) of the code would be excluded from the computation of Y's net investment income under section 4940 of the Code.

Sale of the options by Foundation will not produce any unrelated business taxable income because the sales come within the exclusion under section 512(b)(5) of the Code. The exceptions to the exclusion do not apply because Y does not resemble a merchant who acquires or produces property to sell to customers.

Based on the information submitted and the representations made therein, we rule as follows: (1) The pledge of the Option by X to Y does not constitute an act of self- dealing between X and Y under the provisions of section 4941 of the Code. (2) The exercise of the Option by an unrelated charitable organization to whom the Option will be transferred will not constitute an act of self- dealing between Y and a disqualified person under section 4941 of the Code. (3) We have referred your third ruling request, which concerned section 170 of the Code, to the office of the Associate Chief Counsel (Domestic), Income Tax and Accounting, for consideration. They will respond directly to you. (4) The Option will be excluded from the assets taken into account in computing the amount of the minimum investment return of Y for purposes of determining the tax on failure to distribute income under section 4942 of the Code. (5) Y's proceeds from the sale of the Option to an unrelated organization exempt under section 501(c)(3) of the Code are excluded from the computation of Y's net investment income under section 4940 of the Code. (6) Gain on Y's sale of the Option to unrelated section 501(c)(3) organizations will not be subject to the tax on unrelated business taxable income imposed by section 511(a)(1) of the Code.

These rulings are directed only to the organization that requested them. Section 6110(j)(3) provides that they may not be used or cited as precedent. Because these rulings may help resolve any questions regarding your exempt status, you should keep a copy of this ruling letter in your permanent files. If you have any questions please call the person whose name and telephone number appear in the heading of this letter.

Sincerely,

Kenneth Earnest

Acting Chief, Exempt Organizations Technical Branch 3

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

PLR 199905038, 1999 WL 50719 (I.R.S.) END OF DOCUMENT

(C) MOTION PICTURE: LETTER OF CREDIT DONATIONS

1984 WL 265431 (I.R.S.)

Internal Revenue Service (I.R.S.)

Technical Advice Memorandum

February 16, 1984

Section 170 -- Charitable, Etc. Contributions and Gifts 170.00-00 Charitable Contributions and Gifts (Deductible v. Not Deductible)

ISSUE:

Whether an irrevocable banker's letter of credit is a payment for purposes of section 170(a) of the Internal Revenue Code.

FACTS:

On August 27, 1982, the Taxpayer established an irrevocable banker's letter of credit in favor of a Children's Home, a charitable organization under section 501(c)(3) of the Code. The letter of credit was for an aggregate amount of $150,000, payable by drafts drawn by the Children's Home. The Taxpayer was not required to deposit $150,000 with the bank because of his credit reputation. The entire $150,000 was distributed to the Children's Home in four distributions. The first distribution was in November, 1982 in the amount of $40,000. The second distribution was in the amount of $60,000, the drafts were drawn and mailed to the bank on December 30, 1982. These drafts were received by the bank on January 3, 1983, and paid on January 4, 1983. Third distribution was for $40,000 in February, 1983, and the final distribution was for $10,000 in June,

1983. The Taxpayer deducted the entire $150,000 on the 1982 income tax return.

APPLICABLE LAW:

Section 170(a) of the Code provides, subject to certain limitations, a deduction for contributions and gifts to or for the use of organizations described in 170(c), payment of which is made within the taxable year. Section 1.170A-1(b) of the Income Tax Regulations provides that ordinarily, a contribution is made at the time delivery is effected. The unconditional delivery or mailing of a check which subsequently clears in due course will constitute an effective contribution on the date of delivery or mailing. Rev. Rul. 78-38, 1978-1 C.B. 67, holds that a contribution made by a charge to a bank credit card is deductible as a charitable contribution deduction in the year the charge is made regardless of when the bank is repaid. In Watson v. Commissioner, 69 T.C. 544 (1978), aff'd 613 F.2d 594 (5th Cir. 1980), the United States Tax Court held that an irrevocable banker's letter of credit was the equivalent to cash.

RATIONALE:

The phrase 'payment of which is made within the taxable year' in section 170(a) modifies and controls the phrase 'to or for the use of' in section 170(c) because subsection (c) is specifically incorporated in subsection (a). Therefore, there must be a payment to a charitable organization before the deduction can be allowed. The income tax regulations have consistently required that a charitable contribution be actually paid before the deduction can be taken, regardless of the taxpayer's method of accounting. When the Taxpayer in this case arranged for an irrevocable banker's letter of credit in favor of the Children's Home, he made the full amount ($150,000) available without restriction to the Children's Home. The fact that the Children's Home only withdrew $40,000 in 1982 is immaterial, because it could have withdrawn the full amount.

CONCLUSION:

Under the circumstances in this case, the irrevocable banker's letter of credit is a payment for purposes of section 170(a) of the Code.

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

TAM 8420002, 1984 WL 265431 (I.R.S.)

END OF DOCUMENT

APPENDIX IV

(A): MOTION PICTURE: LETTER OF CREDIT DONATIONS (continued)

See: 361 F.2d 972: *Sheppard, Lawrence v. U.S. (1966)*

1986 WL 369872 (I.R.S.)

Internal Revenue Service (I.R.S.)

Technical Advice Memorandum

April 24, 1986

Section 465 -- Deductions Limited to Amount at Risk 465.00-00 Deductions Limited to Amount at Risk 465.01-00 Amounts Considered at Risk 465.01-01 Borrowed Amounts

Section 752 -- Treatment of Certain Liabilities 752.00-00 Treatment of Certain Liabilities 752.01-00 Increase in Partner's Liabilities

TR-32-30003-86

ISSUES (1) Whether a limited partner, as a result of his contribution to P of a Letter of Credit and his Assumption Agreement with respect to a loan made to P by a third party, has increased his basis under section 752(a) of the Internal Revenue Code in his partnership interest. (2) Whether a limited partner is 'at risk' under section 465 of the Internal Revenue Code with respect to his contribution to P of the Letter of Credit and the Assumption Agreement.

FACTS

P is a limited partnership Organized under the Uniform Limited Partnership Act of the State of X. P's certificate of limited partnership was filed on October 26, 1981. The purpose of P is to engage in the exploration and production of oil and gas. P has two general partners, A, an individual, and B, a corporation. In addition, P has 85 limited partners.

The minimum required investment of a limited partner was x dollars, which consisted of y units at z dollars per unit. The Certificate and the Agreement of Limited Partnership of P ('Agreement') provides that the subscription price was payable under two different methods at the option of the investor. The method at issue in this Technical Advice Memorandum involved the following: 20% cash payment, 20% personal, recourse promissory note (due August 1, 1982), and execution and delivery of an irrevocable and transferable bank letter of credit ('Letter of Credit') in an amount equal to 66% of the subscription price. Section 5.2.1 of the Agreement.

Section 5.2.2 of the Agreement provides that the Letter of Credit shall be in the appropriate amount drawn on an Issuing Bank acceptable to the general partners and the Lending Bank. The Letter of Credit must name P as beneficiary and may be for either a nonrenewable term expiring on or before December 31, 1985, or for a term expiring on or before December 31, 1982, and renewable annually thereafter to December 31, 1985. Section 5.2.2 of the Agreement also provides that the Letters of Credit shall be used as the primary sources of repayment of the Letter of Credit Loan ('Loan ') and will be pledged to the Lending Bank for the purpose of securing repayment of such loan. Further, if an Issuing Bank does not renew a renewable Letter of Credit (a Letter of Credit expiring on or before December 31, 1982, or annually thereafter) within 60 days prior to the date of its expiration, the Lending Bank will draw down the Letter of Credit prior to its expiration in an amount equal to the applicable Limited Partner's pro rata share of the principal amount of, accrued interest on, and other charges incurred under, the Loan. Section 5.2.3 of the Agreement provides that each limited partner electing the Letter of Credit alternative shall also execute and deliver to the general partners upon subscription an Assumption Agreement by which the limited partner shall assume and promise to pay his proportionate share of principal, interest and other charges, if any, due under the Loan. The Assumption Agreement will be pledged to the Lending Bank as security for the Loan.

The Assumption Agreement provides that the partner unconditionally assumes and promises to pay the Lending Bank, and to reimburse and pay P to the extent of its payment of all sums of principal, interest and other charges or expenses of any kind whatsoever now or hereafter due with respect to the Loan; provided, however, that the liability of the undersigned hereunder shall not in any event exceed the face amount of his Letter of Credit. The Assumption Agreement also provides that the obligations of the partner are independent of any obligations of P, and a separate action or actions may be brought and prosecuted against the undersigned whether action is brought against P or whether P is joined in any such action or actions. Lending Bank is authorized to review, extend, accelerate or otherwise change the time or payment of, or otherwise change the terms of, the Letter of Credit Loan or any part thereof, including increase or decrease of the rate of interest thereon.

The Letter of Credit Loan Agreement ('Loan Agreement') states the term and conditions with respect to the Loan made by Lending Bank to P. It states that Lending Bank agrees to lend to P up to the principal sum of $b. It also states that the loan shall be evidenced and repaid in accordance with P's promissory note.

The Loan Agreement provides that the Letters of Credit and the Assumption Agreements are to be given as security for the Loan pursuant to the Pledge Agreement. Neither A nor B, the general partners of P, are personally liable to repay any portion of the principal, interest or related charges due under the note or to fulfill otherwise any payment or performance obligation under the Note, the Loan Agreement, the Letters of Credit or the Assumption Agreements. The Loan Agreement provides that Lending Bank is entitled to enforce all rights, benefits and privileges afforded under the Assumption Agreements and to take any action provided for under the terms and provisions of the Assumption Agreement.

The Loan Agreement also provides that if Lending Bank receives notice that a Letter of Credit will expire or be cancelled prior to full payment of the Loan, Lending Bank has the right to draw down the entire face amount of the Letter of Credit and, in its sole discretion, apply the funds to repay a portion of the Loan or purchase a certificate of deposit to serve as collateral.

The Term Note ('Note') evidences that P promises to pay Lending Bank the lesser of the borrowed amount or the principal sum of b dollars payable on or before October 31, 1985. The Note specifies that it is subject to the terms and provisions of the Loan Agreement dated as of October 26, 1981, (and, if amended, all amendments thereto) between P and Lending Bank. The Note was executed in the State of Y and was made under and governed by the laws of the State of Y.

The Note requires interest only payments on a fiscal quarterly basis with the first payment due January 31, 1982. The unpaid principal balance of the note is payable on or before October 31, 1985, two months prior to the expiration date of any of the Letters of Credit. The Loan Agreement provides that if all or part of any installment of interest is not paid within 30 days after it becomes due, Lending Bank in its sole discretion, may declare the entire balance of principal and accrued but unpaid interest on the Note immediately due and payable.

Pursuant to the General Pledge Agreement, P delivered to Lending Bank the Letters of Credit and the Assumption Agreements of the limited partners as security and collateral for the Loan.

In a Technical Advice Memorandum dated October 13, 1983, the Internal Revenue Service concluded that a limited partner did not increase the basis of his interest in P under section 752 of the Code as a result of his contribution to P of a Letter of Credit and his Assumption Agreement. Because an adverse

determination was made on this issue, no decision was rendered concerning the issue presented under section 465.

LAW AND RATIONALE: ISSUE (I)

The issue ruled on in the Technical Advice Memorandum of October 13, 1983, concerning section 752 of the Code is under review. Under the circumstances, it is appropriate to await the completion of the review before expressing an opinion on the issue. Therefore, the conclusion expressed in said Technical Advice Memorandum concerning the subject taxpayer is withdrawn. However, since the conclusion expressed in the Technical Advice Memorandum concerning section 752 made any consideration of the application of section 465 of the Code to the transaction unnecessary, this issue will now be considered.

LAW AND RATIONALE: ISSUE (2)

Section 465(a)(1) of the Code provides that in the case of an individual engaged in an activity to which this section applies, any loss from such activity for the taxable year shall be allowed only to the extent of the aggregate amount with respect to which the taxpayer is at risk at the close of the taxable year. Section 465(b)(1) of the Code provides that a taxpayer shall be considered at risk for an activity with respect to amounts including (A) the amount of money and the adjusted basis of other property contributed by the taxpayer to an activity and (B) amounts borrowed with respect to an activity (as determined under section 465(b)(2)).

Section 465(b)(2) of the Code provides that for purposes of this section, a taxpayer shall be considered at risk with respect to amounts borrowed for use in an activity to the extent that he (A) is personally liable for the repayment of such amounts, or (B) has pledged property, other than property used in such activity, as security for such borrowed amount (to the extent of the net fair market value of the taxpayer's interest in such property).

In this case, the limited partners who chose the method under discussion of acquiring their interests were obligated to pay for their interests partly in cash, partly by a personal promissory note and partly in the form of a Letter of Credit and Assumption Agreement. The Agreement specifically sets out the understandings with respect to the contributions of the Letters of Credit and Assumption Agreements, in particular, the fact that they will be pledged to Lending Bank as security and collateral for the Loan, and that such partners thereby assume unconditional personal liability for their share of the Loan.

The Letter of Credit is irrevocable, and reflects an unconditional promise to pay P with respect to the Loan. The Letter of Credit is assignable and was pledged to Lending Bank as security for the Loan.

The Assumption Agreements are unconditional promises to pay to Lending Bank, or to reimburse P, with respect to payments due on the Loan. There are no time limitations on the Assumption Agreements. The liability of the partners is personal, up to the face amount of each partner's Letter of Credit.

The Loan Agreement imposes an unconditional obligation on P to repay the Loan without subjecting the general partners to personal liability to repay the Loan. However, the Loan Agreement grants Lending Bank all rights afforded under the Assumption Agreements to enforce the limited partners' promise to repay the Loan.

In this case, the economic effect of the arrangement is that the limited partners who chose the method under discussion of acquiring their interest became personally liable for the repayment of the partnership's obligation to the extent of the total sum of the face amount of each partner's Letter of Credit. The provisions of the Loan Agreement, Agreement, Letters of Credit and Assumption Agreements are interrelated and contemplate that each such partner thereby assumes unconditional personal liability for his pro rata share of the Loan. These limited partners ultimately bear the economic risk associated with the repayment of the Loan because Lending Bank can bring legal action directly against such partners to enforce their promise to pay the Loan pursuant to the provisions of the Assumption Agreement and Loan Agreement and such partners are not protected against any loss that would result from Lending Bank's action to enforce their promise to repay the Loan.

CONCLUSION

Each limited partner who used the Letter of Credit and Assumption Agreement method of making his contribution to P is 'at risk' under section 465 of the Code to the extent of the face amount of the Letter of Credit contributed to P.

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(j)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

TAM 8636003, 1986 WL 369872 (I.R.S.)

END OF DOCUMENT

1958-1 C.B. 143, 1958 WL 10678 (I.R.S.)

Internal Revenue Service (I.R.S.)

Revenue Ruling

Published: 1958

The amount paid by a taxpayer to purchase building bonds issued by a church is not a gift made to the church, and the taxpayer is not entitled to deduct the price paid for the bonds as a contribution to or for the use of the church for Federal income tax purposes. However, in the event of a subsequent gift of such bonds to the church, the donor is entitled to a charitable deduction for their fair market value at the time of the gift, subject to the limitations of section 170(b) of the Internal Revenue Code of 1954, provided also that the church qualifies as an organization described in section 170 of the Code.

Advice has been requested whether an amount paid for bonds issued by a church, an organization referred to in section 170 of the Internal Revenue Code of 1954, is deductible by the purchaser as a charitable contribution, and whether the fair market value of such bonds when donated to the church may also be deducted as a contribution by the donor for Federal income tax purposes.

Section 170 of the Internal Revenue Code of 1954 provides, in part, that in computing taxable income an individual may deduct, subject to certain limitations, charitable contributions or gifts payment of which is made within the taxable year to or for the use of a corporation, trust, community chest, fund, or foundation which is organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals.

In order for a contribution to be deductible under the provisions of section 170 of the Code, it must, in addition to meeting the above requirements, be made without any consideration or benefit coming to the donor by reason of making the contribution. Thus, the purchase price of bonds issued by a church does not constitute a contribution to the church, since the purchaser clearly receives something of value in return for payment of the purchase price. However, a subsequent gift of the bonds by the taxpayer to the church will constitute, within certain limitations, a deductible charitable contribution. In the case of a gift made in property other than money, the amount of the contribution is determined by the fair market value of the property at the time of the gift.

In view of the above, it is held that the amount paid by a taxpayer to purchase building bonds issued by a church, an organization referred to in section 170 of the Code, is not a gift made to the church, and the taxpayer is not entitled to deduct the price of the bonds as a contribution to or for the use of the church for Federal income tax purposes. However, in the event of a subsequent gift of such bonds to the church, the donor is entitled to a charitable deduction for their fair market value at the time of the gift, subject to the limitations of section 170(b) of the Code, provided the church qualifies as an organization described in section

170 of the Code. Rev. Rul. 58-262, 1958-1 C.B. 143, 1958 WL 10678 (I.R.S.)
END OF DOCUMENT

APPENDIX V

(A): STOCK OPTIONS DONATED, SOLD AND EXERCISED BY THIRD PARTY

1999 WL 220188 (I.R.S.)

Internal Revenue Service (I.R.S.)

Private Letter Ruling

Issue: April 16, 1999

January 12, 1999

Section 170 -- Charitable, Etc. Contributions and Gifts 170.00-00 Charitable, Etc. Contributions and Gifts 170.01-00 Time of Making Contribution

Dear Sir or Madam:

This responds to a letter of July 29, 1998, submitted on your behalf by your authorized representatives requesting certain rulings. Requested ruling number 3, which is in our jurisdiction, is that Company will be entitled to a charitable contribution deduction under section 170 of the Internal Revenue Code upon the exercise by an unrelated charity of an option to purchase Company common stock that the charity acquired from Foundation. The other requested rulings were issued by the Exempt Organizations Division in a letter dated November 12, 1998. For ease of discussion, we have divided ruling number 3 into two issues.

ISSUES

(1) If Company, the maker of an option to buy shares of its own common stock, contributes the option to Foundation and Foundation sells it to an unrelated charity described in section 501(c)(3) of the Code, may Company take a charitable contribution deduction under section 170 of the Code upon the exercise of the option by the charity? (2) If so, what is the amount of Company's charitable contribution deduction?

CONCLUSIONS

(1) Company may take a charitable contribution deduction under section 170 of the Code upon the exercise of the option by the unrelated charity. (2) The amount of Company's charitable contribution deduction will equal the difference

between the fair market value of the stock when the option is exercised and the exercise price.

FACTS

Company is a for-profit organization incorporated under state law. Company's common stock is publicly held and listed on an established securities market. Foundation is a non-profit corporation incorporated under state law. Foundation is exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). Foundation has been recognized by the Internal Revenue Service as a private foundation as defined in section 509(a) of the Code.

Company pledged a stock option to Foundation which when exercisable will give Foundation an option to purchase a specified number of shares of Company's common stock at the closing price of the stock on Date A, the date of the pledge agreement. Under the terms of the pledge agreement, the option will become exercisable only if on or before December 31, 1999, Company receives certain rulings from the Service, including the ruling that is the subject of this request. If Company receives the rulings by that date, the option will be exercisable by Foundation, in whole or in part, at any time during the period commencing on the date Company receives the last of the rulings and ending on Date B. Foundation may transfer or assign the option or any portion thereof, but only to one or more unrelated charitable organizations described in sections 170(c)(2) and 501(c)(3) of the Code. It is expected that an unrelated charitable organization described in sections 170(c)(2) and 501(c)(3) of the Code will purchase the option from Foundation for a price equal to the difference between the fair market value of Company common stock subject to the option as of the date of the purchase of the option and the exercise price of the option, less an agreed upon discount.

ANALYSIS

Section 170(a) of the Code provides, subject to certain limitations, a deduction for contributions and gifts to or for the use of organizations described in section 170(c), payment of which is made within the taxable year. Section 170(b)(2) of the Code provides that the total deduction allowed a corporation under section 170(a) is limited to 10 percent of the corporation's taxable income, computed without regard to certain deductions. Under section 1.170A-1(a) of the Income Tax Regulations, a deduction is allowed to a corporation (with one exception not applicable here) for any charitable contribution actually paid during the taxable year, irrespective of the date on which the contribution is "pledged."

Rev. Rul. 75-348, 1975-2 C.B. 75, holds that a corporation that donates an option to purchase shares of its common stock at a specified price to an educational organization described in section 501(c)(3) of the Code is entitled to a charitable contribution deduction, in the taxable year the option is exercised, for the excess

of the fair market value on the date of exercise over the exercise price. See also Rev. Rul. 82-197, 1982-2 C.B. 72, holding that an individual who grants an option to purchase real property to a charitable organization described in section 501(c)(3) of the Code is allowed a charitable deduction for the year in which the organization exercises the option, in the manner and to the extent provided by section 170, for the excess of the property's fair market value on the date of exercise over the option's exercise price.

Where a charitable contribution is made in property other than money, section 1.170A-1(c) of the regulations provides, in part, that the amount of the deduction is the fair market value of the contributed property at the time of the contribution. A property's fair market value is the price at which it would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of the relevant facts. Where a property is sold to a charity for less than its fair market value, section 1011(b) of the Code provides for the adjustment of the donor's basis for purposes of computing its gain from portion of the property sold in the bargain sale. See also sections 1.1011-2 and 1.170A-4(c)(2) of the regulations. In addition, section 170(e) of the Code provides in certain circumstances for a reduction in the amount of the charitable contribution if at the time of the contribution a sale of the property at its fair market value would have resulted in gain. Section 1032 of the Code provides that no gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation.

In this case, the bargain sale provisions of section 1011(b) of the Code and sections 1.1011-2 and 1.170A-4(c)(2) of the regulations and the contribution reduction provisions of section 170(e) do not apply. This is because under section 1032 of the Code no gain is recognized by Company on the bargain sale of its stock to the unrelated charity and no gain would be recognized by Company even if it sold its stock to the unrelated charity for its full fair market value.

Under the reasoning set forth in Rev. Rul. 75-348 and Rev. Rul. 82-197, we conclude that Company is treated as making a charitable contribution described in section 170 of the Code in the year the option is exercised by an unrelated charity described in section 501(c)(3) of the Code, and the amount of Company's charitable contribution equals the excess of the fair market value of the shares on the date of exercise over the exercise price. In addition, under the reasoning set forth in Rev. Rul. 75-348 and Rev. Rul. 82-197, we conclude that Company will be entitled to a charitable contribution deduction under section 170 of the Code with respect to the charitable contribution in the manner and to the extent provided by section 170.

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

Company must attach a copy of this letter to any income tax return to which it is relevant. Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter under any provision of the Code other than section 170.

Sincerely,

Assistant Chief Counsel (Income Tax & Accounting)

Karin G. Gross

Senior Technician Reviewer, Branch 3

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

PLR 199915037, 1999 WL 220188 (I.R.S.)

END OF DOCUMENT

(B): TAX-FREE DIVERSIFICATION USING ESOP, L.P., AND CHARITY

1998 WL 789749 (I.R.S.)

Internal Revenue Service (I.R.S.)

Private Letter Ruling

Issue: November 13, 1998

August 6, 1998

Section 1042--Sales of Stock to Employee Stock Ownership Plans or Certain Cooperatives 1042.00-00 Sales of Stock to Employee Stock Ownership Plans or Certain Cooperatives

Dear ***

This responds to your letter dated January 23, 1998, and subsequent communications requesting a ruling concerning the purchase and disposition of qualified replacement property for purposes of section 1042 of the Code. C Corp

was formed as a holding company to consolidate six separate operating companies. Taxpayer acquired 666,363 shares of C Corp stock in 1995 as a result of a corporate reorganization. C Corp is the sponsor of the C Corp Employee Stock Ownership Plan ("ESOP"). Taxpayer represents that ESOP is qualified under section 401(a) of the Code and satisfies the requirements of section 4975(e)(7).

On April 30, 1997, ESOP purchased 309,478 shares of C Corp stock from Taxpayer. Taxpayer represents that the shares of C Corp stock purchased by ESOP constitute "qualified securities" within the meaning of Section 1042(c)(1). As a result of the ESOP purchase of C Corp stock from Taxpayer, ESOP owned in excess of 30% of the outstanding C Corp stock.

Taxpayer represents that he will have purchased securities that constitute qualified replacement property ("QRP") within the meaning of Section 1042(c)(4) with the ESOP sales proceed by April 29, 1998. Taxpayer represents that he will file with his 1997 Federal Individual Income Tax Return a Statement of Election, pursuant to Section 1042(a)(1), for the C Corp stock sale to ESOP.

Taxpayer proposes to make a gift to his spouse of one-half of his remaining C Corp stock. Taxpayer proposes to transfer, along with his spouse, their C Corp stock and certain other property to a newly-formed limited partnership (the Partnership). Taxpayer represents that Partnership will not constitute an investment company under section 721(b).

Taxpayer proposes that Partnership will then sell its C Corp stock to ESOP. The other contributing partner to the Partnership will be S Corp. S Corp is owned 49.5% by Taxpayer, 49.5% by Taxpayer's Spouse and 1% by a charity. In consideration of their contributions to the Partnership, Taxpayer will receive a 49.5% limited partnership interest, Taxpayer's spouse will receive a 49.5% limited partnership interest, and S Corp will receive a 1% general partnership interest.

Taxpayer proposes to make gifts of limited partnership interests to third parties from time to time.

On behalf of Taxpayer, you have requested rulings on the following: 1) whether, for purposes of the holding period requirement of section 1042(b)(4), Partnership's holding period in the C Corp stock contributed by Taxpayer to the Partnership will include the period during which it was held by Taxpayer as well as the period it was held by Partnership; 2) whether Partnership is the proper taxpayer to elect to defer gain under section 1042 for C Corp stock sold by Partnership to the ESOP; 3) whether a gift transfer by Taxpayer of a limited partnership interest in Partnership is a taxable disposition under section 1042(e) of QRP owned by Partnership.

ANALYSIS

ISSUE #1

Section 1042(a) of the Code provides that a taxpayer or executor may elect in certain cases not to recognize long-term capital gain on the sale of "qualified securities" to an ESOP (as defined in section 4975(e)(7)) or eligible worker owned cooperative if the taxpayer purchases "qualified replacement property" (as defined in section 1042(c)(4)) within the replacement period of section 1042(c)(3) and the requirements of section 1042(b) and section 1.1042-1T of the Temporary Income Tax Regulations are satisfied.

Section 1042(c)(1) of the Code provides that the term "qualified securities" means employer securities (as defined in section 409(l)) which (a) are issued by a domestic C corporation that has no stock outstanding that is readily tradable on an established securities market, and (b) were not received by the taxpayer in a distribution from a plan described in section 401(a), or in a transfer pursuant to an option or other right to acquire stock to which section 83, 422 or 423 applied.

Section 1042(b)(4) of the Code provides that, the taxpayer's holding period with respect to the qualified securities is at least 3 years (determined as of the time of sale).

Taxpayer proposes to transfer C Corp stock to Partnership. Subsequently, it is proposed that Partnership will sell the C Corp stock to ESOP and will elect to defer gain under section 1042.

Taxpayer has requested a determination of whether, for purposes of the holding period requirement of section 1042(b)(4), Partnership's holding period in the C Corp stock contributed by Taxpayer to the Partnership will include the period during which it was held by Taxpayer as well as the period it was held by Partnership.

Section 1223(2) of the Code provides that in determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under this chapter such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

Section 723 of the code provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under section 721(b) to the contributing partner at such time.

Thus, by application of sections 723, and 1223(b), and assuming that section 721(b) is inapplicable, Partnership's holding period in the C Corp stock will include the periods during which it was held by Taxpayer and Partnership.

ISSUE #2

Taxpayer has requested a ruling as to whether Partnership is the proper taxpayer to elect to defer gain under section 1042 for C Corp stock sold by Partnership to the ESOP.

Section 1042(a) of the Code provides that a taxpayer or executor may elect in certain cases not to recognize long-term capital gain on the sale of "qualified securities" to an ESOP if the taxpayer purchases "qualified replacement property."

Section 703(b) of the Code provides that any election affecting the computation of taxable income derived from a partnership shall be made by the partnership, except that any election under--(1) section 108(b)(5) or 108(c)(3) (relating to income from discharge of indebtedness), (2) section 617 (relating to deduction and recapture of certain mining exploration expenditures), or (3) section 901 (relating to taxes of foreign countries and possessions of the United States), shall be made by each partner separately.

In the present case, Partnership will sell the C Corp stock to the ESOP. The election under section 1042 to defer the recognition of capital gain from the sale of the stock affects the computation of Partnership's taxable income. Therefore, under section 703(b), Partnership, rather than the partners, must make the election under section 1042 to defer recognition of the gain from the sale of stock to the ESOP. The section 1042 election is not one of the statutorily excepted elections listed under section 703(b). See Demirjian v. Commissioner, 54 T.C. 1691 (1970) and Rev. Rul. 66-191, 1966-2 C.B. 300.

ISSUE #3

Taxpayer requests a ruling that a gift transfer by Taxpayer of a limited partnership interest in Partnership is not a taxable disposition under section 1042(e) of QRP owned by Partnership.

Section 1042(e)(1) of the Code provides that "if a taxpayer disposes of any qualified replacement property, then, notwithstanding any other provision of this title, gain (if any) shall be recognized to the extent of the gain which was not recognized under subsection (a) by reason of the acquisition by such taxpayer of such qualified replacement property."

Section 1042(e)(3) of the Code provides that (e)(1) shall not apply to any transfer of qualified replacement property-- (A) in any reorganization (within the meaning

of section 368) unless the person making the election under subsection (a)(1) owns stock representing control in the acquiring or acquired corporation and such property is substituted basis property in the hands of the transferee, (B) by reason of the death of the person making such election, (C) by gift, or (D) in any transaction to which section 1042(a) applies.

For purposes of section 1042, Taxpayer's gift of a limited partnership interest in Partnership is not a taxable disposition under section 1042(e).

Based on the specific facts of this case and representations made by the taxpayer, we conclude that: 1) For purposes of the holding period requirement of section 1042(b)(4), Partnership's holding period in the C Corp stock contributed by Taxpayer to the Partnership will include the period during which it was held by Taxpayer as well as the period it was held by Partnership; 2) Partnership is the proper taxpayer to elect to defer gain under section 1042 for C Corp stock sold by Partnership to the ESOP; and 3) A gift transfer by Taxpayer of a limited partnership interest in Partnership is not a taxable disposition under section 1042(e) of QRP owned by Partnership. Except for the specific ruling provided above, no opinion is expressed concerning the federal tax consequences of the transactions described under any other provisions of the Code. We neither express nor imply any opinion regarding the estate and gift tax consequences of the above described transactions. This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

JAMES L. BROKAW

Chief, Branch 5

Office of the Associate Chief Counsel

(Employee Benefits and Exempt Organizations)

Enclosures:

Copy for section 6110 purposes

Copy of this letter

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

PLR 9846005, 1998 WL 789749 (I.R.S.)   END OF DOCUMENT

(C): INTRODUCTION

Taken from Sheppard, Lawrence v. U.S. (1966), 361 F.2d 972:

"The court is not unmindful of the tax benefits which flow from affording full recognition to the plaintiff's admittedly tax-motivated transactions in this case. Such motivation demands special analysis and scrutiny, but its presence is essentially immaterial except as an eye-opening mechanism or interpreter of equivocal conduct. It will not negative the effect of transactions which have really occurred." [Commissioner v. Brown, 380 U.S. 563, 85 S.Ct. 1162, 14 L.Ed.2d 75 (1965).]

As Mr. Justice Douglas has said: 'I do not understand that a taxpayer must sit by idly twirling his thumbs until a tax liability alights upon him. If he is warned of its approach, if he sees it coming, he may seek such shelter as the law offers in an effort to escape it or diminish its blow. Of course, by examination, it must be determined whether the shelter he reaches is really constructed of statutory material, and by close scrutiny of the facts it must be determined whether the taxpayer really got himself and his transactions within it. But he should not be counted out merely because the shelter lies off his beaten path and he scurries for it.'

"Congress may be strict or lavish in its allowance of deductions or tax benefits. The formula it writes may be arbitrary and harsh in its applications. But where the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the taxpayer though they represent an unexpected windfall." [Lewyt Corporation v. Commissioner of Internal Revenue, 349 U.S. 237, 240, 75 S.Ct. 736, 739, 99 L.Ed. 1029 (1955).]

Accordingly, for all of the foregoing reasons, the plaintiff should prevail on the charitable contributions issue."

(D): A SECOND COMPANY REDEEMS STOCK DONATIONS

PLR 8431014

Internal Revenue Service (I.R.S.)

Private Letter Ruling

April 27, 1984

Section 302 -- Distributions in Redemption of Stock 302.00-00 Distributions in Redemption of Stock v. Sale of Property

Section 304 -- Redemption Through Use of Related Corporations 304.00-00 Redemption Through Use of Related Corporations (Distribution v. Sale)

Dear Mr. * * *

This is in reply to your request for a ruling regarding the contribution of J Company stock to a charity and the subsequent redemption of the stock by E Company, a related corporation. The Taxpayers propose to donate all of their stock in J Company to a recognized public charity. The Taxpayers own 79.95% of the common stock and 79.9% of the preferred stock of J Company. However, under the attribution rules of section 318(a) of the Internal Revenue Code the Taxpayers "own" 100% of the Stock of J Company. After the donation of the J Company stock, the charity will enter into negotiations with E Company for the sale and purchase of the J Company stock by E Company. The Taxpayers own only one share of E Company preferred stock; however, under the attribution rules of section 318(a) of the Code, the taxpayers "own" 100% of the stock of E Company. Section 170 of the Code provides, subject to certain limitations, a deduction for contributions and gifts to or for the use of organizations described in section 170(c), payment of which is made within the taxable year.

Section 302 of the Code provides that if a corporation redeems its stock under one of the four rules given in the section, the redemption will be treated as a distribution in part or full payment in exchange for the stock and will not be treated as a dividend.

The general rule of section 304 of the Code is that, for purposes of section 302, if one or more persons are in control of each of two corporations and in return for property, one of the corporations acquires the stock in the other corporation from the person (or persons) in control, then the property shall be treated as a distribution in redemption of the stock of the corporation acquiring the stock.

Revenue Ruling 69-608, 1969-2 C.B. 42, holds that a corporation's redemption of its stock from a retiring shareholder results in a constructive dividend to the remaining shareholder only if the redemption is in satisfaction of the remaining shareholder's primary and unconditional obligation to purchase such stock.

Revenue Ruling 78-197, 1978-1 C.B. 83, holds that a taxpayer with voting control of a corporation and control of an exempt private foundation who donates shares of the corporation's stock to the foundation and, pursuant to a prearranged plan,

causes the corporation to redeem the shares from the foundation does not realize income as a result of the redemption, only if the foundation is not legally bound, or can be compelled by the corporation to surrender the shares for redemption.

In this case, the use of the charity as an intermediary precludes the application of section 304 of the Code and, therefore, the acquisition of the J Company stock from the charity by E Company will not cause the transaction to be subject to section 304 of the Code.

Based on the facts submitted and the above rationale the following rulings are applicable:

(1) The taxpayers will be allowed a charitable contribution deduction under section 170 of the Code equal to the fair market value of the J Company stock donated to the charity, subject to the applicable limitations in section 170.

(2) Provided that the charity is not legally obligated under state or federal law, to sell or redeem the shares of J Company stock, the subsequent sale or redemption by the charity will not result in a constructive dividend to the Taxpayers.

(3) Provided that no continuing shareholder of J Company or E Company is under a primary, unconditional obligation to purchase the J Company shares, the subsequent sale or redemption by the charity of the J Company shares will not result in a constructive dividend to any continuing shareholder of J Company or E Company.

(4) Provided that at the time of the gift of the stock to the charity, there exists no obligation on the part of the charity to subsequently redeem or sell such gifted shares, section 304 of the Code will not apply to the subsequent sale by the charity to E Company of J Company stock unless the charity is also in "control" of E Company as defined in section 304(c).

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

No opinion is expressed as to the federal income tax consequences of the transaction described above under any other provision of the Code.

No opinion is expressed regarding the existence of an "obligation" on the part of the charity as to the subsequent disposition of the gifted shares at the time of such gift. Obligations enforceable under state law, express or implied, such as those enforceable through promissory estoppel or detrimental reliance, which obligates the charity with respect to the subsequent disposition of the gifted shares may result in constructive receipt by the donor of the proceeds from the

subsequent disposition of the gifted stock (See Rev. Rul. 78-197, 1978-1 C.B. 83; Blake v. Commissioner, 697 F.2d 273 (2d Cir.1982)). The above rulings are void if the District Director finds that the charity is obligated or can be compelled by the corporation to redeem the stock transferred by the donor to the charity. If such obligation is found to exist, the stock redeemed will be treated as if it were redeemed by the donor followed by a gift of a portion of the net proceeds to the charity by the donor; the redemption by the donor will be treated as a dividend by the corporation to the donor under section 301 of the Code and the subsequent sale of the gifted shares to E Company will be treated as an acquisition by a related corporation under section 304 of the Code.

You should attach a copy of this ruling to your tax return for the taxable year in which the transaction covered by this ruling is consummated. We are enclosing a copy for that purpose.

Sincerely yours,

Richard H. Manfreda

Chief

Individual Income Tax Branch

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

PLR 8431014, 1984 WL 266965 (I.R.S.)

APPENDIX VI

(A): BARGAIN SALES

A so-called "bargain sale to charity" occurs when a taxpayer sells property (stocks, bonds, real estate, etc.) to a charitable organization for an amount less than the fair market value of the property, resulting in a charitable contribution. If the sale is not for less than fair market value, there is no contribution. In that case, the sale is treated as any other sale, and gain or loss is determined from the seller's basis.

PLR 8939014

If the property sold at a bargain price is ordinary income property, the amount of any contribution is determined by reducing the property's fair market value by the amount that would have been ordinary income from the contributed portion if it had been sold at its fair market value (Code Sec. 170(e)(1); see // 11,686A.04). That calculation involves allocating to the contributed portion of the property the portion of the adjusted basis of the entire property that bears the same ratio to the total adjusted basis of the entire property that the fair market value of the contributed portion bears to the FMV of the entire property (Reg. sec. 1.170A-4(c) and 1.1011-2).

Example: In 1998, Mr. Jones sells to a church for $4,000. ordinary income property with a fair market value of $10,000. and an adjusted basis of $4,000. Mr. Jones has adjusted gross income of $20,000. for 1998 and makes no other contributions. The FMV of the contributed part of the property is $6,000. ($10,000. total FMV minus $4,000. sales price). The adjusted basis of the contributed portion is $2,400. ($4,000. basis times [$6,000. FMV/$10,000. total FMV]). Because the $6,000. FMV must be reduced by the amount that would be ordinary income, $3,600. ($6,000. FMV minus $2,400. adjusted basis), the amount Mr. Jones may deduct as a charitable contribution is $2,400.

With long-term capital gain property, the fair market value of the contributed property is frequently used to determine the donor's charitable deduction (//11,686A.045). A reduction from fair market value is only required under Code Sec. 170(e)(1)(B) if the property is contributed to certain private non-operating foundations, if the capital gain property is tangible personal property that the donee organization uses in a manner that is unrelated to its exempt status, or if

the donor elects to disregard the special 30% of adjusted gross income limitation in favor of the 50% limitation (see//11,690.01 et seq.).

Thus, the amount deductible as a charitable contribution for a bargain sale of capital gain property is usually the difference between the fair market value and the sales price. However, the adjusted basis must still be allocated, under Reg. sec. 1.1011-2, between the contributed portion and the non-contributed portion of the property in order to determine the donor's gain on the sale of the non-contributed portion.

Example: Mrs. Smith sells appreciated, capital gain property with a fair market value of $10,000. and an adjusted basis of $2,000. to a qualified charity for $9,000. She, thus, made a contribution of $1,000. ($10,000. fair market value - $9,000. sales price), which is 10% of the value of the property. The amount realized on the bargain sale is 90% of the value of the property. Adjusted basis in the amount of $1,800. ($2,000. adjusted basis X 90%) is allocated to the non-contributed portion. Accordingly, Mrs. Smith recognizes $7,000. ($9,000. amount realized less $1,800. adjusted basis) of long-term capital gain.

Mortgaged Property: The bargain sale rules (see//11,686A.05) are not restricted to cash sales. If property is transferred subject to an indebtedness, the amount of the indebtedness must be treated as an amount realized for purposes of determining whether a bargain sale has occurred and in determining the sale and charitable allocations, even though the charity does not agree to assume or pay the indebtedness (Reg. sec. 1.1011-2(a)(3)). In addition, the pooled income fund regulations indicated that the bargain sale rules also apply where a taxpayer transfers mortgaged property to such a fund (Reg. sec. 1.642(c)-(5)(a)(3)).

It is unclear whether the bargain sale rules apply to transfers of mortgaged property to a charitable remainder trust. In the case of charitable remainder trusts, the transfer of mortgaged property to a trust may lead to the disqualification of the trust because such a trust cannot pay amounts other than the annuity or unitrust amounts (see Code Sec. 170(f)(2)(b) and Reg. sec. 1.664-2(a)(4) and 1.664-3(a)(4) or because the property might be considered debt-financed property to the trust.

(B): REMAINDER INTEREST DONATIONS

PLR 8418079

1984 WL 266785 (I.R.S.)

Internal Revenue Service (I.R.S.)

Private Letter Ruling

January 31, 1984

Section 170 -- Charitable, Etc. Contributions and Gifts 170.00-00 Charitable Contributions and Gifts (Deductible v. Not Deductible) 170.00-07

*** In re: Donors: *** SSN: *** Date ***

Dear ***

This is in reply to a letter written on your behalf by your representative, *** requesting the computation of the charitable remainder interest in your personal residence transferred by you to the *** for Federal tax purposes. You executed the Quit Claim Deed on ***

You and your spouse retained the right to reside at your residence until the death of the survivor of the two of you. Upon such death your residence is to by transferred to the Mayo Foundation. On the above date you are 88 years old and your wife is 86 years old. At the date of gift, the non-depreciable portion of the real property has an appraised value of $39,237. The house has an appraised value of $250,763 including a salvage value of $25,076. Consequently, the depreciable portion has a value of $225,687 ($250,763 less $25,076). The house has an estimated useful lifetime of 40 years.

The factor for valuing the charitable remainder interest in the non-depreciable portion of the real property is contained in Table LT6 of IRS Publication 723A, 'Actuarial Values II'. From Table LT6 the present worth of $1.00 payable at the death of the last to die of a female aged 86 and a male aged 88 is $0.72989.

The factor for valuing the charitable remainder interest in the depreciable portion of the real property is computed by the formula found in section 1.170A-12(e)(2) of the Income Tax Regulations. Accordingly, the present worth of the right to receive at the death of the last to die of a female aged 86 and a male aged 88 the balance of a fund, initial value of $1.00 that decreases by 1/40 of $1.00 each year, is $0.63626.

The present value of the remainder interest is $190,537.02, determined as follows:

Property Amount Factor Present Value

Non-depreciable $ 39,237.00 X $0.72989 = $ 28,638.69

Non-depreciable $ 25,076.00 X 0.72989 = $ 18,302.72

Depreciable $ 225,687.00 X 0.63626 = $ 143,595.61

------------- Total $190,537.02 : Should the estimated useful lifetime of the house, the ages of the donors, or the fair market value of the house and land be different from that assumed, then the factors and values provided are not applicable and a recomputation would be necessary.

It is important that a copy of this letter be attached to the Federal income and gift tax returns when filed. Accordingly, two copies are enclosed for those purposes. A copy is being sent to the District Director. A copy is also being sent to your representative.

Sincerely yours,

Norman Greenberg

Chief

General Actuarial Branch

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

PLR 8418079, 1984 WL 266785 (I.R.S.)

(C): SPLIT BONDS

PLR 8939014

1989 WL 596322 (I.R.S.)

Internal Revenue Service (I.R.S.)

Private Letter Ruling

Issue: September 29, 1989

Section 170 -- Charitable, Etc. Contributions and Gifts 170.00-00 Charitable Contributions and Gifts (Deductible v. Not Deductible)

Dear * * *

This is in reply to your request for a ruling regarding the donation of debt instruments issued by the Association and whether taxpayers will be entitled to a charitable contribution deduction under section 170 of the Internal Revenue Code.

The Association, a nonprofit corporation, was created for the purpose of establishing and conducting a school of ballet and subsequently to include establishing and maintaining a ballet company. The Internal Revenue Service has determined that the Association is exempt from federal income taxation under section 501(a) as an organization described in section 501(c)(3) and is described in section 170(c)(2) as a qualified donee for charitable contributions.

Under the proposed plan, the Association will raise funds through a transaction that, in form, resembles the issuance of a debenture with a principal amount of at most $5,000,000. The debenture, an unsecured debt of the Association, will mature in ten years and will pay interest semiannually. The interest rate on the debenture will equal a market rate of interest as of its issuance date. The debenture will be secured by and payable pursuant to a letter of credit to be issued by a bank. Under the letter of credit agreement, the Association will reimburse the bank upon draws, if any, on the letter of credit.

The proceeds from the debenture will be used (1) to finance or refinance a portion of the cost of the acquisition and construction of a ballet facility, (2) to fund working capital requirements, and (3) to establish a capitalized interest fund that will provide a source of funds to pay interest on the debenture.

The Association plans to enter into a purchase agreement with Underwriter in which the Underwriter will market the debenture through a best efforts public offering. Under the agreement, the Underwriter will deposit the debenture with a custodian, who will then issue debenture receipts to the Underwriter. The Underwriter will then sell the debenture receipts to investors and the sale proceeds less the Underwriter's commission will be transferred to the Association. Each debenture receipt represents, in form, the right to receive specific future interest or principal payments on the debenture. Accordingly, the debenture receipts will be denominated as coupon receipts and principal receipts. Each coupon receipt will represent the right to receive a single payment at the date of a specific interest payment on the debenture. Each principal receipt will represent the right to receive a specific payment of principal on the debenture. No payments, however, will be made on any debenture receipt prior to the date on which the specific payment of interest or principal, respectively, is made on the debenture.

The debenture will include the following provisions: (1) upon an event of default in the payment of principal or interest on the debenture, holders of coupon and

principal receipts will be entitled to a proportionate share of any default payments based upon the relative accreted value of the outstanding debenture receipts; (2) upon an acceleration of the principal of the debenture, payments will be allocated among the holders of the coupon and the principal receipts in proportion to the relative accreted value of the outstanding debenture receipts; (3) any amendments to any of the debenture's terms will require the requisite consent of holders of coupon and principal receipts; and (4) all interest payments on the debenture will continue to be due and owing at their scheduled payment dates, regardless of whether the principal of the debenture has been discharged through a contribution of the principal receipts to the Association or otherwise.

The Underwriter will offer the debenture receipts for sale to prospective investors pursuant to an offering circular. The debenture receipts will be offered and sold at a substantial discount from their face amounts. Although prospective buyers will be urged to purchase principal receipts and the corresponding coupon receipts, the debenture receipts will be offered and may be sold as separate securities. Holders may sell, transfer, or assign the debenture receipts without limitation. Although not required to under the agreement, the Underwriter intends to make a market for the debenture receipts.

The Association (through the Underwriter and otherwise) intends to solicit gifts of charitable contributions from prospective investors and holders of debenture receipts. Holders will be asked to donate their debenture receipts to the Association. In fact, the Association will not sell the debenture to the Underwriter unless it believes (through formal and informal commitments) that a substantial portion of the debenture receipts will be contributed to the Association. Moreover, the Association represents that a principal receipt will not be sold to an investor unless the Association is reasonably certain that the investor will immediately donate the principal receipt to the Association.

Upon the donation of a debenture receipt, the Association will be relieved of its obligation to make the respective interest or principal payment to the holder of the receipt. The Association hopes that most, if not all, of the holders will donate the receipts to the Association. The Association represents that the offering and sale of debenture receipts and the solicitation of contributions of the debenture receipts has been designed to enable the Association to raise the necessary funds to continue and expand its operations while maximizing the receipt of charitable contributions. If the plan succeeds, then the Association will have the use of the entire proceeds from the sale of the debenture receipts with little or no obligation to make payments on the receipts in the future. The Association also represents that the sale of the debenture in 'stripped' form is merely a marketing method to attract investors willing to invest in stripped obligations. In addition, by selling the debenture in 'stripped' form, holders of the debenture receipts will have more flexibility in arranging their charitable donations to the Association. For example, the purchaser of a principal receipt and the corresponding twenty interest receipts can donate all or some of the receipts to the Association at any

time over the next ten years. Moreover, the sale of the debenture receipts will allow the Association greater ease in soliciting contributions over the next ten years.

Section 170(a)(1) of the Code provides, subject to certain limitations, a deduction for any charitable contribution (as defined in section 170(c) of the Code) payment of which is made within the taxable year. Section 170(c) includes in the definition of a charitable contribution a contribution or gift to or for the use of an organization described in section 170(c)(2).

Section 170A-1(c)(1) of the Income Tax Regulations provides that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in section 170(e)(1) of the Code and paragraph (a) of section 1.170A-4 of the regulations or section 170(e)(3) of the Code and paragraph (c) of section 1.170A-4A of the regulations.

Section 170(f)(3) generally denies a deduction in the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in the property. One of the exceptions is for a contribution of an undivided portion of the taxpayer's entire interest in property.

Section 1272 of the Code generally provides for the inclusion in the gross income of the holder of a debt instrument having original issue discount an amount equal to the sum of the daily portions of the original issue discount that accrues during the taxable year during which the obligation is held by the taxpayer. Section 1273 of the Code provides specific rules for determining the amount of the original issue discount of a debt instrument. Section 1273(b) provides that the 'issue price' of a publicly offered debt instrument not issued for property is the initial offering price to the public, at which price a substantial amount of debt instrument was sold.

Section 1286(e) provides that the term 'stripped bond' means a bond, debenture, note, or certificate or other evidence of indebtedness issued at any time with interest coupons where there is a separation in ownership between the bond and any coupon which has not yet become payable.

In form the proposed sale of the debenture receipts by the Underwriter resembles a stripping transaction subject to section 1286 of the Code. Under section 1286, a stripped obligation generally arises if there is a separation in ownership between the interest and principal components of a debt instrument or other evidence of indebtedness. Based on this general definition of a stripped obligation, it is arguable that the Underwriter will be stripping the Association's debenture because an investor could purchase a principal or coupon receipt without purchasing any of the principal or coupon receipts associated with that receipt.

However, we do not believe that the sale of the debenture receipts will be a stripping transaction under section 1286 of the Code. In general, when the underlying principal of a debt instrument is discharged, any unaccrued interest coupons are extinguished and no payment is made to the coupon holders. In the present case, however, the holders of the coupon receipts will receive payments on the coupon receipts even if the debenture's principal is prematurely discharged through the donation of the principal receipts to the Association or otherwise. Under these circumstances, we believe that the principal and coupon receipts, rather than representing interrelated ownership interests in a single debenture, instead will constitute separate, independent evidences of indebtedness issued by the Association to investors.

As separate evidences of indebtedness, the principal and coupon receipts will be, in substance, zero coupon bonds issued by the association. Because the receipts will be purchased at a discount from their face amount (the stated redemption price at maturity of the receipt), the receipts will be issued with original issue discount. See section 1273 of the Code. Therefore, a holder of a receipt generally will have to include in taxable income any original issue discount on the receipt that accrues while the receipt is held by the holder. See section 1272.

Also, because the principal and coupon receipts are separate evidences of indebtedness, a contribution of a debenture receipt, either a principal or a coupon receipt, will not be a contribution of an interest in property which consists of less than the contributor's entire interest in the property. Accordingly, contributions of a debenture receipt to the Association will be deductible in an amount equal to the fair market value of the debenture receipt at the time of contribution, subject to the limitations of section 170(b) of the Code and reduced as provided in section 170(e) of the Code.

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

No opinion is expressed as to the federal income tax consequences of the transaction described above under any provision of the Code.

Sincerely yours,

Assistant Chief Counsel

(Income Tax & Accounting)

By: Michael D. Finley

Chief, Branch 3

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

PLR 8939014, 1989 WL 596322 (I.R.S.)

APPENDIX VII

VII. (A): SELF DEALING

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26 U.S.C.A. S 4941

UNITED STATES CODE ANNOTATED

TITLE 26. INTERNAL REVENUE CODE

SUBTITLE D--MISCELLANEOUS EXCISE TAXES

CHAPTER 42--PRIVATE FOUNDATIONS; AND CERTAIN OTHER TAX-EXEMPT ORGANIZATIONS

SUBCHAPTER A--PRIVATE FOUNDATIONS

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Current through P.L. 105-394, approved 11-13-1998

S 4941. Taxes on self-dealing

(a) Initial taxes.--

(1) On self-dealer.--There is hereby imposed a tax on each act of self- dealing between a disqualified person and a private foundation. The rate of tax shall be equal to 5 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period. The tax imposed by this paragraph shall be paid by any disqualified person (other than a foundation manager acting only as such) who participates in the act of self-dealing. In the case of a government official (as defined in section 4946(c)), a tax shall be imposed by this paragraph only if such disqualified

person participates in the act of self-dealing knowing that it is such an act.

(2) On foundation manager.--In any case in which a tax is imposed by paragraph (1), there is hereby imposed on the participation of any foundation manager in an act of self-dealing between a disqualified person and a private foundation, knowing that it is such an act, a tax equal to 2 1/2 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period, unless such participation is not willful and is due to reasonable cause.

The tax imposed by this paragraph shall be paid by any foundation manager who participated in the act of self-dealing.

(b) Additional taxes.--

(1) On self-dealer.--In any case in which an initial tax is imposed by subsection (a)(1) on an act of self-dealing by a disqualified person with a private foundation and the act is not corrected within the taxable period, there is hereby imposed a tax equal to 200 percent of the amount involved. The tax imposed by this paragraph shall be paid by any disqualified person (other than a foundation manager acting only as such) who participated in the act of self-dealing.

(2) On foundation manager.--In any case in which an additional tax is imposed by paragraph (1), if a foundation manager refused to agree to part or all of the correction, there is hereby imposed a tax equal to 50 percent of the amount involved. The tax imposed by this paragraph shall be paid by any foundation manager who refused to agree to part or all of the correction.

(c) Special rules.--For purposes of subsections (a) and (b)--

(1) Joint and several liability.--If more than one person is liable under any paragraph of subsection (a) or (b) with respect to any one act of self- dealing, all such persons shall be jointly and severally liable under such paragraph with respect to such act.

(2) $10,000 limit for management.--With respect to any one act of self- dealing, the maximum amount of the tax imposed by subsection (a)(2) shall not exceed $10,000, and the maximum amount of the tax imposed by subsection (b)(2) shall not exceed $10,000.

(d) Self-dealing.--

(1) In general.--For purposes of this section, the term "self-dealing" means any direct or indirect--

(A) sale or exchange, or leasing, of property between a private foundation and a disqualified person;

(B) lending of money or other extension of credit between a private foundation and a disqualified person;

(C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;

(D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;

(E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation; and

(F) agreement by a private foundation to make any payment of money or other property to a government official (as defined in section 4946(c)), other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating his government service within a 90-day period.

(2) Special rules.--For purposes of paragraph (1)--

(A) the transfer of real or personal property by a disqualified person to a private foundation shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the foundation assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer;

(B) the lending of money by a disqualified person to a private foundation shall not be an act of self-dealing if the loan is without interest or other charge (determined without regard to section 7872) and if the proceeds of the loan are used exclusively for purposes specified in section 501(c)(3);

(C) the furnishing of goods, services, or facilities by a disqualified person to a private foundation shall not be an act of self-dealing if the furnishing is without charge and if the goods, services, or facilities so furnished are used exclusively for purposes specified in section 501(c)(3);

(D) the furnishing of goods, services, or facilities by a private foundation to a disqualified person shall not be an act of self-dealing if such furnishing is made on a basis no more favorable than that on which such goods, services, or facilities are made available to the general public;

(E) except in the case of a government official (as defined in section 4946(c)), the payment of compensation (and the payment or reimbursement of expenses) by a private foundation to a disqualified person for personal services which are reasonable and necessary to carrying out the exempt purpose of the private foundation shall not be an act of self-dealing if the compensation (or payment or reimbursement) is not excessive;

(F) any transaction between a private foundation and a corporation which is a disqualified person (as defined in section 4946(a)), pursuant to any liquidation, merger, redemption, recapitalization, or other corporate adjustment, organization, or reorganization, shall not be an act of self- dealing if all of the securities of the same class as that held by the foundation are subject to the same terms and such terms provide for receipt by the foundation of no less than fair market value;

(G) in the case of a government official (as defined in section 4946(c)), paragraph (1) shall in addition not apply to--

(i) prizes and awards which are subject to the provisions of section 74(b) (without regard to paragraph (3) thereof), if the recipients of such prizes and awards are selected from the general public,

(ii) scholarships and fellowship grants which would be subject to the provisions of section 117(a) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) and are to be used for study at an educational organization described in section 170(b)(1)(A)(ii),

(iii) any annuity or other payment (forming part of a stock-bonus, pension, or profit-sharing plan) by a trust which is a qualified trust under section 401,

(iv) any annuity or other payment under a plan which meets the requirements of section 404(a)(2),

(v) any contribution or gift (other than a contribution or gift of money) to, or services or facilities made available to, any such individual, if the aggregate value of such contributions, gifts, services, and facilities to, or made available to, such individual during any calendar year does not exceed $25,

(vi) any payment made under chapter 41 of title 5, United States Code, or

(vii) any payment or reimbursement of traveling expenses for travel solely from one point in the United States to another point in the United States, but only if such payment or reimbursement does not exceed the actual cost of the transportation involved plus an amount for all other traveling expenses not in excess of 125 percent of the maximum amount payable under > section 5702 of title 5, United States Code, for like travel by employees of the United States; and

(H) the leasing by a disqualified person to a private foundation of office space for use by the foundation in a building with other tenants who are not disqualified persons shall not be treated as an act of self-dealing if--

(i) such leasing of office space is pursuant to a binding lease which was in effect on October 9, 1969, or pursuant to renewals of such a lease;

(ii) the execution of such lease was not a prohibited transaction (within the meaning of section 503(b) or any corresponding provision of prior law) at the time of such execution; and

(iii) the terms of the lease (or any renewal) reflect an arm's-length transaction.

(e) Other definitions.--For purposes of this section--

(1) Taxable period.--The term "taxable period" means, with respect to any act of self-dealing, the period beginning with the date on which the act of self- dealing occurs and ending on the earliest of--

(A) the date of mailing a notice of deficiency with respect to the tax imposed by subsection (a)(1) under section 6212,

(B) the date on which the tax imposed by subsection (a)(1) is assessed, or

(C) the date on which correction of the act of self-dealing is completed.

(2) Amount involved.--The term "amount involved" means, with respect to any act of self-dealing, the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the other property received; except that, in the case of services described in subsection (d)(2)(E), the amount involved shall be only the excess compensation. For purposes of the preceding sentence, the fair market value--

(A) in the case of the taxes imposed by subsection (a), shall be determined as of the date on which the act of self-dealing occurs; and

(B) in the case of the taxes imposed by subsection (b), shall be the highest fair market value during the taxable period.

(3) Correction.--The terms "correction" and "correct" mean, with respect to any act of self-dealing, undoing the transaction to the extent possible, but in any case placing the private foundation in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.

CREDIT(S)

1989 Main Volume

(Added Pub.L. 91-172, Title I, S 101(b), Dec. 30, 1969, 83 Stat. 499, and amended Pub.L. 94-455, Title XIX, SS 1901(b) (8) (H), 1906(b) (13) (A), Oct. 4, 1976, 90 Stat. 1795, 1834; Pub.L. 96-596, S 2(a) (1) (A), (B), (2) (A), (3) (A), Dec. 24, 1980, 94 Stat. 3469, 3471; Pub.L. 96-608, S 5, Dec. 28, 1980, 94 Stat. 3553; Pub.L. 99-234, Title I, S 107(c), Jan. 2, 1986, 99 Stat. 1759; Pub.L. 99-514, Title I, S 122(a)(2)(A), Title XVIII, S 1812(b)(1), Oct. 22, 1986, 100 Stat. 2110, 2833; Pub.L. 100-647, Title I, S 1001(d)(1)(A), Nov. 10, 1988, 102 Stat. 3350.)

General Materials (GM) - References, Annotations, or Tables >

HISTORICAL AND STATUTORY NOTES

Revision Notes and Legislative Reports

1969 Act. House Report No. 91-413, Senate Report No. 91-552, and House Conference Report No. 91-782, see 1969 U.S.Code Cong. and Adm.News, p. 1645.

1976 Act. House Report Nos. 94-658, 94-1380, Senate Report No. 94-938, and House Conference Report No. 94-1515, see 1976 U.S.Code Cong. and Adm.News, p. 2897.

1980 Acts. Senate Report No. 96-1034, see 1980 U.S.Code Cong. and Adm.News, p. 7189.

Senate Report No. 96-1031, see 1980 U.S.Code Cong. and Adm.News, p. 7332.

1986 Act. House Conference Report No. 99-841 and Statement by President, see 1986 U.S.Code Cong. and Adm.News, p. 4075.

1988 Act. Senate Report No. 100-445 and House Conference Report No. 100-1104, see 1988 U.S.Code Cong. and Adm.News, p. 4515.

References in Text

The date of the enactment of the Tax Reform Act of 1986, referred to in subsec. (d)(2)(G)(ii), means the date of enactment of Pub.L. 99-514, 100 Stat. 2085, which was approved on Oct. 22, 1986.

Chapter 41 of title 5, United States Code, referred to in subsec. (d)(2)(G)(vi), is S 4101 et seq. of Title 5, Government Organization and Employees.

Section 5702 of title 5, United States Code, referred to in subsec. (d)(2)(G)(vii), is S 5702 of Title 5.

Amendments

1988 Amendment. Subsec. (d)(2)(G)(ii). Pub.L. 100-647 substituted "would be" for "are" and inserted "(as in effect on the day before the date of the enactment of the Tax Reform Act of 1986)" following "section 117(a)".

1986 Amendments. Subsec. (d)(2)(B). Pub.L. 99-514, S 1812(b)(1), substituted "without interest or other charge (determined without regard to section 7872)" for "without interest or other charge".

Subsec. (d)(2)(G)(i). Pub.L. 99-514, S 122(a)(2)(A), substituted "section 74(b) (without regard to paragraph (3) thereof)" for "section 74(b)".

Subsec. (d)(2)(G)(vii). Pub.L. 99-234 substituted "5702" for "5702(a)".

1980 Amendments. Subsec. (b) (1). Pub.L. 96-596, S 2(a) (1) (A), substituted "taxable period" for "correction period".

Subsec. (d) (2) (H). Pub.L. 96-608 added subpar. (H).

Subsec. (e) (1). Pub.L. 96-596, S 2(a) (2) (A), added subpar. (B) and redesignated former subpar. (B) as (C).

Subsec. (e) (2) (B). Pub.L. 96-596, S 2(a) (1) (B), substituted "taxable period" for "correction period".

Subsec. (e) (4). Pub.L. 96-596, S 2(a) (3) (A), struck out par. (4), which defined correction period, with respect to any act of self-dealing, as the period beginning with the date on which the act of self-dealing occurs and ending 90 days after the date of mailing of a notice of deficiency with respect to the tax imposed by subsec. (b) (1) of this section under section 6212 of this title, extended by any period in which the deficiency cannot be assessed under section 6213(a) of this title and any other period which the Secretary determines is reasonable and necessary to bring about correction of the act of self-dealing.

1976 Amendment. Subsec. (d)(2)(G)(ii), Pub.L. 94-455, S 1901(b)(8)(H), substituted "educational organization described in section 170(b)(1)(A)(ii)" for "educational institution described in section 151(e)(4)" following "study at an".

Subsec. (e)(4)(B). Pub.L. 94-455, S 1906(b)(13)(A), struck out "or his delegate" following "Secretary".

Effective Dates

1988 Act. Amendment by Pub.L. 100-647 effective as if included in the provisions of Pub.L. 99-514 to which such amendment relates, except that no addition to tax shall be made under section 6654 or 6655 of this title for any period before Apr. 16, 1989 (Mar. 16, 1989 in the case of a taxpayer subject to section 6655 of this title) with respect to any underpayment to the extent such underpayment was created or increased by any provision of Title I or II of Pub.L. 100-647, see section 1019 of Pub.L. 100-647, set out as a note under section 1 of this title.

1986 Acts. Amendment by section 122(a)(2)(A) of Pub.L. 99-514 applicable to prizes and awards granted after Dec. 31, 1986, see section 151(c) of Pub.L. 99-514, set out as a note under section 1 of this title.

Amendment by section 1812(b)(1) of Pub.L. 99-514 effective as if included in the provisions of the Tax Reform Act of 1984, Pub.L. 98-369, Div. A, to which such amendment relates, except as otherwise provided, see section 1881 of Pub.L. 99-514, set out as a note under section 48 of this title.

Amendment by Pub.L. 99-234 effective on the effective date of regulations to be promulgated not later than 150 days after Jan. 2, 1986, or 180 days after Jan. 2, 1986, whichever occurs first, see section 301(a) of Pub.L. 99-234, set out as a note under section 5701 of Title 5, Government Organization and Employees.

1980 Act. For effective date of amendment by Pub.L. 96-596 with respect to any first tier tax and to any second tier tax, see section 2(d) of Pub.L. 96-596, set out as a note under section 4961 of this title.

1969 Act. Section effective Jan. 1, 1970, see S 101(k)(1) of Pub.L. 91-172, set out as a note under S 4940 of this title.

Savings Provisions

Exceptions to applicability of section, see S 101(l)(2) of Pub.L. 91-172, set out as a note under S 4940 of this title.

Applicability to Determination of Status as Substantial Contributor for Purposes of Taxes on Self-dealing of Contributions Made Prior to October 9, 1969

Determination of status as substantial contributor within S 507(d)(2) of this title for purposes of applying this section, see S 3 of Pub.L. 95-170, set out as a note under S 507 of this title.

Tax on Self-Dealing Not to Apply to Certain Stock Purchases

Pub.L. 98-369, Title III, S 312, July 18, 1984, 98 Stat. 786, provided that:

"(a) General rule. Section 4941 of the Internal Revenue Code of 1954 [this section] (relating to taxes on self-dealing) shall not apply to the purchase during 1978 of stock from a private foundation (and to any note issued in connection with such purchase) if--

"(1) consideration for such purchase equaled or exceeded the fair market value of such stock,

"(2) the purchaser of such stock did not make any contribution to such foundation at any time during the 5-year period ending on the date of such purchase,

"(3) the aggregate contributions to such foundation by the purchaser before such date were less than $10,000 and less than 2 percent of the total contributions received by the foundation as of such date, and

"(4) such purchase was pursuant to the settlement of litigation involving the purchaser.

"(b) Statute of limitations.--If credit or refund of any overpayment of tax resulting from subsection (a) is prevented at any time before the close of the 1-year period beginning on the date of the enactment of this Act [July 18, 1984] by the operation of any law or rule of law, refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefore is filed before the close of such 1-year period."

CROSS REFERENCES

Abatement of first tier taxes, see 26 USCA S 4962. Burden of proof in foundation manager cases, see 26 USCA S 7454. Civil actions for refund, see 26 USCA S 7422. Governing instruments of exempt organizations, see 26 USCA S 508. Suspension of filing period, see 26 USCA S 6213.

LIBRARY REFERENCES

Encyclopedias

34 Am Jur 2d, Federal Taxation (1995) P 20957.

34 Am Jur 2d, Federal Taxation (1996) PP 20957, 20958.

American Digest System

Taxes on private foundations and disqualified persons dealing with them, see Internal Revenue K4270 to 4280.

Encyclopedias

Taxes on private foundations and disqualified persons dealing with them, see C.J.S. Internal Revenue S 1016(1).

Law Review and Journal Commentaries

Current tax issues affecting religious organizations. Howard M. Schoenfeld, 36 Cath.Law. 335 (1996). Residences and farms--Charitable remainders. Conrad

Teitell, 211 N.Y.L.J. 3 (Jan. 24, 1994). Roundup on charitable lead trusts. Conrad Teitell, 214 N.Y.L.J. 3 (Nov. 27, 1995). Self-dealing transactions in nonprofit corporations. Deborah A. DeMott, 59 Brook.L.Rev. 131 (1993). Tax-exempt entities: Achieving and maintaining special status under the Internal Revenue Service. I. Richard Gershon, 16 Cumb.L.Rev. 301 (1985- 1986). Tax-exempt public charities: Increasing accountability and compliance. Robert C. DeGaudenzi, 36 Cath.Law. 203 (1996).

Texts and Treatises

20 Fed Proc L Ed, Internal Revenue S 48:874.

NOTES OF DECISIONS

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Administrative Decisions: IRS decisions available on WESTLAW. See WESTLAW Directory.

1. Constitutionality--Generally

Provision of this section imposing a tax on each act of self-dealing between a disqualified person and a private foundation is a constitutional exercise of congressional taxing power where, although this section has a regulatory effect on activities of charitable organizations and might not raise any revenue, it insures that revenue will be collected under income, estate, and gift tax laws which otherwise might have gone uncollected. Rockefeller v. U.S., E.D.Ark.1982, 572 F.Supp. 9, affirmed 718 F.2d 290, certiorari denied 104 S.Ct. 2180, 466 U.S. 962, 80 L.Ed.2d 562.

2. ---- Self-incrimination

Where taxpayer's wholly owned corporation X purchased Blackacre adjacent to Whiteacre which X had previously purchased, sold both properties to Y, nonexempt wholly owned subsidiary of private foundation defined in S 509 of this title, of which taxpayer was trustee, with understanding that taxpayer or X would satisfy outstanding mortgages on both properties, and foundation donated both properties, which it received upon Y's liquidation, to Yale, Tax Court determined that payment by taxpayer of excise taxes imposed by this section would not violate his rights under U.S.C.A.Const. Amend. 5. Adams v. Commissioner of Internal Revenue, U.S.Tax Ct.1978, > 70 T.C. 373, on reconsideration 72 T.C. 81, affirmed in part, appeal dismissed in part 688 F.2d 815.

3. Rules and regulations

Treasury regulation promulgated to implement this section imposing a tax on each act of self-dealing between a disqualified person and a private foundation is both consistent with this section and reasonable, even though regulation covers transactions during administration of an estate or revocable trust while this section only refers to transactions between disqualified persons and private foundations, and never mentions estates. Rockefeller v. U.S., E.D.Ark.1982, 572 F.Supp. 9, affirmed 718 F.2d 290, certiorari denied 104 S.Ct. 2180, 466 U.S. 962, 80 L.Ed.2d 562.

4. Conditional transfers

Where individual's commitment to contribute to law school was conditioned upon his being able to deduct all of his contributions for federal income tax purposes, and where it was determined by Internal Revenue Service that $29,622.72 of contributions made by individual to foundation established to facilitate individual's contributions to law school were not so deductible, return by foundation to individual of $29,622.72 was not act of self-dealing by individual within meaning of this section prohibiting self-dealing, and assessment against individual of "willful and flagrant" penalties with respect to return of contribution, and "failure to file" penalties for failure to report liability for excise taxes stemming from alleged

act of self-dealing was wrongful and erroneous. Underwood v. U. S., N.D.Tex.1978, 461 F.Supp. 1382.

4A. Corporations

For purposes of rules governing excise taxes on acts of self-dealing between a disqualified person and a private foundation, a corporation which was a disqualified person was not required to include in a redemption program those shares held by its officers and directors. Deluxe Corp. v. U.S., C.A.Fed.1989, 885 F.2d 848.

5. Nature of title conveyed

Letter in which individual indicated to trustee of charitable foundation that he was giving his one-half interest in tract of land to foundation conveyed only equitable title and not legal title to foundation, and collection of federal excise taxes for self-dealing with respect to such gift on ground that it was donation of property subject to mortgage, and assessment of "willful and flagrant" penalties and penalties for failure to file report of excise tax liability with respect to that gift were wrongful and erroneous. Underwood v. U. S., N.D.Tex.1978, 461 F.Supp. 1382.

Where taxpayer's wholly owned corporation X purchased Blackacre adjacent to Whiteacre which X had previously purchased, sold both properties to Y, nonexempt wholly owned subsidiary of private foundation defined in S 509 of this title, of which taxpayer was trustee, with understanding that taxpayer or X would satisfy outstanding mortgages on both properties, and foundation donated both properties, which it received upon Y's liquidation, to Yale, Tax Court determined that X, which was disqualified person with respect to foundation under S 4946 of this title, engaged in act of self-dealing within meaning of this section on sale of Whiteacre, but not on sale of Blackacre, since X held title to Blackacre as mere conduit or nominee for Y. Adams v. Commissioner of Internal Revenue, U.S.Tax Ct.1978, > 70 T.C. 373, on reconsideration 72 T.C. 81, affirmed in part, appeal dismissed in part 688 F.2d 815.

APPENDIX VIII

VIII. (A) : SELF DEALING (Continued)

Satisfaction of mortgage liability

Where taxpayer's wholly owned corporation X purchased Blackacre adjacent to Whiteacre which X had previously purchased, sold both properties to Y, nonexempt wholly owned subsidiary of private foundation defined in S 509 of this title, of which taxpayer was trustee, with understanding that taxpayer or X would satisfy outstanding mortgages on both properties, and foundation donated both properties, which it received upon Y's liquidation, to Yale, Tax Court determined that failure to satisfy outstanding mortgage liabilities on both properties constituted act of self-dealing by X upon conveyance of property to Y and by taxpayer upon liquidation of X. Adams v. Commissioner of Internal Revenue, U.S.Tax Ct.1978, > 70 T.C. 373, on reconsideration > 72 T.C. 81, affirmed in part, appeal dismissed in part > 688 F.2d 815.

Satisfaction of trust

Even though actions of conservatee and his wife as cotrustees in selling assets to themselves would qualify as an act of self-dealing, court would not satisfy trust on ground that trustees specifically violated terms of the trust, which prohibited trustees from engaging in any act of self-dealing, in that transfer might fall within exemption to definition of self-dealing, which was a question of fact to be resolved in a plenary hearing, and, even if sale was an act of self-dealing, which might subject conservatee's estate to substantial tax penalties, potential consequences of these acts would not cause court to satisfy trust but, rather, it will cause court to void transaction and uphold the trust. Application of Newlin, N.Y.Sup.1982, > 465 N.Y.S.2d 102, 119 Misc.2d 815.

Transfers to disqualified persons

Alleged reduction from $75,000 to $60,000 in proceeds of sale of parcel of land which was subject to interest of individual who by letter promised his interest to private foundation and stated that this interest would bring foundation "about $75,000" was not "transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation" within meaning of this section because individual never conveyed land to foundation and foundation, therefore, had no pro rata interest in cash and notes received from sale; because no act of self-dealing took place, assessment of penalties against individual for "willful and flagrant" violation of this title and for failure to report excise tax liability stemming

from alleged act of self-dealing was wrongful and erroneous. Underwood v. U. S., N.D.Tex.1978, > 461 F.Supp. 1382.

Failure to correct act of self-dealing

Where taxpayer, who was heretofore held liable under this section for several acts of self-dealing with private foundation, had also been charged in same deficiency notice with "second level" sanction equal to 200 percent of "amount involved," Tax Court determined that no additional deficiency existed under this section because this section provided for "second level" tax after failure of taxpayer to correct act of self-dealing within correction period, which time had not elapsed at mailing of deficiency notice, "amount involved" could not be determined at the time. Adams v. Commissioner of Internal Revenue, U.S.Tax Ct.1979, > 72 T.C. 81, affirmed in part, appeal dismissed in part > 688 F.2d 815.

After filing of earlier opinion (> 70 T.C. 373) upon its own motion Tax Court directed parties to submit briefs addressing issue as to whether Court has statutory authority to determine deficiency in tax under this section, which provides for additional 200 percent-tax where initial 5 percent-excise tax under this section is imposed on act of self-dealing between disqualified person and private foundation and such act is not corrected within correction period, since deficiency cannot exist for Court's redetermination until tax is imposed under this section, and such tax is not imposed, assuming no correction occurs, until this Tax Court's decision is final. Adams v. Commissioner of Internal Revenue, U.S.Tax Ct.1978, > 70 T.C. 446.

Special transition rules

Chapter 41 of title 5, United States Code, referred to in subsec. (d)(2)(G)(vi), is S 4101 et seq. of Title 5, Government Organization and Employees.

Section 5702 of title 5, United States Code, referred to in subsec. (d)(2)(G)(vii), is S 5702 of Title 5.

Amendments

1988 Amendment. Subsec. (d)(2)(G)(ii). Pub.L. 100-647 substituted "would be" for "are" and inserted "(as in effect on the day before the date of the enactment of the Tax Reform Act of 1986)" following "section 117(a)".

1986 Amendments. Subsec. (d)(2)(B). Pub.L. 99-514, S 1812(b)(1), substituted "without interest or other charge (determined without regard to section 7872)" for "without interest or other charge".

Subsec. (d)(2)(G)(i). Pub.L. 99-514, S 122(a)(2)(A), substituted "section 74(b) (without regard to paragraph (3) thereof)" for "section 74(b)".

Subsec. (d)(2)(G)(vii). Pub.L. 99-234 substituted "5702" for "5702(a)".

1980 Amendments. Subsec. (b) (1). Pub.L. 96-596, S 2(a) (1) (A), substituted "taxable period" for "correction period".

Subsec. (d) (2) (H). Pub.L. 96-608 added subpar. (H).

Subsec. (e) (1). Pub.L. 96-596, S 2(a) (2) (A), added subpar. (B) and redesignated former subpar. (B) as (C).

Subsec. (e) (2) (B). Pub.L. 96-596, S 2(a) (1) (B), substituted "taxable period" for "correction period".

Subsec. (e) (4). Pub.L. 96-596, S 2(a) (3) (A), struck out par. (4), which defined correction period, with respect to any act of self-dealing, as the period beginning with the date on which the act of self-dealing occurs and ending 90 days after the date of mailing of a notice of deficiency with respect to the tax imposed by subsec. (b) (1) of this section under section 6212 of this title, extended by any period in which the deficiency cannot be assessed under section 6213(a) of this title and any other period which the Secretary determines is reasonable and necessary to bring about correction of the act of self-dealing.

1976 Amendment. Subsec. (d)(2)(G)(ii), Pub.L. 94-455, S 1901(b)(8)(H), substituted "educational organization described in section 170(b)(1)(A)(ii)" for "educational institution described in section 151(e)(4)" following "study at an".

Subsec. (e)(4)(B). Pub.L. 94-455, S 1906(b)(13)(A), struck out "or his delegate" following "Secretary".

Effective Dates

1988 Act. Amendment by Pub.L. 100-647 effective as if included in the provisions of Pub.L. 99-514 to which such amendment relates, except that no addition to tax shall be made under section 6654 or 6655 of this title for any period before Apr. 16, 1989 (Mar. 16, 1989 in the case of a taxpayer subject to section 6655 of this title) with respect to any underpayment to the extent such underpayment was created or increased by any provision of Title I or II of Pub.L. 100-647, see section 1019 of Pub.L. 100-647, set out as a note under section 1 of this title.

1986 Acts. Amendment by section 122(a)(2)(A) of Pub.L. 99-514 applicable to prizes and awards granted after Dec. 31, 1986, see section 151(c) of Pub.L. 99-514, set out as a note under section 1 of this title.

Amendment by section 1812(b)(1) of Pub.L. 99-514 effective as if included in the provisions of the Tax Reform Act of 1984, Pub.L. 98-369, Div. A, to which such

amendment relates, except as otherwise provided, see section 1881 of Pub.L. 99-514, set out as a note under section 48 of this title.

Amendment by Pub.L. 99-234 effective on the effective date of regulations to be promulgated not later than 150 days after Jan. 2, 1986, or 180 days after Jan. 2, 1986, whichever occurs first, see section 301(a) of Pub.L. 99-234, set out as a note under section 5701 of Title 5, Government Organization and Employees.

1980 Act. For effective date of amendment by Pub.L. 96-596 with respect to any first tier tax and to any second tier tax, see section 2(d) of Pub.L. 96-596, set out as a note under section 4961 of this title.

1969 Act. Section effective Jan. 1, 1970, see S 101(k)(1) of Pub.L. 91-172, set out as a note under S 4940 of this title.

Savings Provisions

Exceptions to applicability of section, see S 101(l)(2) of Pub.L. 91-172, set out as a note under S 4940 of this title.

Applicability to Determination of Status as Substantial Contributor for Purposes of Taxes on Self-dealing of Contributions Made Prior to October 9, 1969

Determination of status as substantial contributor within S 507(d)(2) of this title for purposes of applying this section, see S 3 of Pub.L. 95-170, set out as a note under S 507 of this title.

Tax on Self-Dealing Not to Apply to Certain Stock Purchases

Pub.L. 98-369, Title III, S 312, July 18, 1984, 98 Stat. 786, provided that:

"(a) General rule.--> Section 4941 of the Internal Revenue Code of 1954 [this section] (relating to taxes on self-dealing) shall not apply to the purchase during 1978 of stock from a private foundation (and to any note issued in connection with such purchase) if--

"(1) consideration for such purchase equaled or exceeded the fair market value of such stock,

"(2) the purchaser of such stock did not make any contribution to such foundation at any time during the 5-year period ending on the date of such purchase,

"(3) the aggregate contributions to such foundation by the purchaser before such date were less than $10,000 and less than 2 percent of the total contributions received by the foundation as of such date, and

"(4) such purchase was pursuant to the settlement of litigation involving the purchaser.

"(b) Statute of limitations.--If credit or refund of any overpayment of tax resulting from subsection (a) is prevented at any time before the close of the 1-year period beginning on the date of the enactment of this Act [July 18, 1984] by the operation of any law or rule of law, refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefore is filed before the close of such 1-year period."

CROSS REFERENCES

Abatement of first tier taxes, see > 26 USCA S 4962. Burden of proof in foundation manager cases, see > 26 USCA S 7454. Civil actions for refund, see > 26 USCA S 7422. Governing instruments of exempt organizations, see > 26 USCA S 508. Suspension of filing period, see > 26 USCA S 6213.

LIBRARY REFERENCES

Encyclopedias

34 Am Jur 2d, Federal Taxation (1995) P 20957.

34 Am Jur 2d, Federal Taxation (1996) PP 20957, 20958.

American Digest System

Taxes on private foundations and disqualified persons dealing with them, see Internal Revenue K4270 to 4280.

Encyclopedias

Taxes on private foundations and disqualified persons dealing with them, see C.J.S. Internal Revenue S 1016(1).

Law Review and Journal Commentaries

Current tax issues affecting religious organizations. Howard M. Schoenfeld, > 36 Cath.Law. 335 (1996). Residences and farms--Charitable remainders. Conrad Teitell, 211 N.Y.L.J. 3 (Jan. 24, 1994). Roundup on charitable lead trusts. Conrad Teitell, 214 N.Y.L.J. 3 (Nov. 27, 1995). Self-dealing transactions in nonprofit corporations. Deborah A. DeMott, > 59 Brook.L.Rev. 131 (1993). Tax-exempt entities: Achieving and maintaining special status under the Internal Revenue Service. I. Richard Gershon, > 16 Cumb.L.Rev. 301 (1985- 1986). Tax-exempt public charities: Increasing accountability and compliance. Robert C. DeGaudenzi, > 36 Cath.Law. 203 (1996).

Texts and Treatises

20 Fed Proc L Ed, Internal Revenue S 48:874.

NOTES OF DECISIONS

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Administrative Decisions: IRS decisions available on WESTLAW. See WESTLAW Directory.

1. Constitutionality--Generally

Provision of this section imposing a tax on each act of self-dealing between a disqualified person and a private foundation is a constitutional exercise of congressional taxing power where, although this section has a regulatory effect on activities of charitable organizations and might not raise any revenue, it insures that revenue will be collected under income, estate, and gift tax laws

which otherwise might have gone uncollected. Rockefeller v. U.S., E.D.Ark.1982, 572 F.Supp. 9, affirmed > 718 F.2d 290, certiorari denied > 104 S.Ct. 2180, 466 U.S. 962, 80 L.Ed.2d 562.

2. ---- Self-incrimination

Where taxpayer's wholly owned corporation X purchased Blackacre adjacent to Whiteacre which X had previously purchased, sold both properties to Y, nonexempt wholly owned subsidiary of private foundation defined in S 509 of this title, of which taxpayer was trustee, with understanding that taxpayer or X would satisfy outstanding mortgages on both properties, and foundation donated both properties, which it received upon Y's liquidation, to Yale, Tax Court determined that payment by taxpayer of excise taxes imposed by this section would not violate his rights under > U.S.C.A.Const. Amend. 5. Adams v. Commissioner of Internal Revenue, U.S.Tax Ct.1978, > 70 T.C. 373, on reconsideration > 72 T.C. 81, affirmed in part, appeal dismissed in part > 688 F.2d 815.

3. Rules and regulations

Treasury regulation promulgated to implement this section imposing a tax on each act of self-dealing between a disqualified person and a private foundation is both consistent with this section and reasonable, even though regulation covers transactions during administration of an estate or revocable trust while this section only refers to transactions between disqualified persons and private foundations, and never mentions estates. Rockefeller v. U.S., E.D.Ark.1982, > 572 F.Supp. 9, affirmed > 718 F.2d 290, certiorari denied > 104 S.Ct. 2180, 466 U.S. 962, 80 L.Ed.2d 562.

4. Conditional transfers

Where individual's commitment to contribute to law school was conditioned upon his being able to deduct all of his contributions for federal income tax purposes, and where it was determined by Internal Revenue Service that $29,622.72 of contributions made by individual to foundation established to facilitate individual's contributions to law school were not so deductible, return by foundation to individual of $29,622.72 was not act of self-dealing by individual within meaning of this section prohibiting self-dealing, and assessment against individual of "willful and flagrant" penalties with respect to return of contribution, and "failure to file" penalties for failure to report liability for excise taxes stemming from alleged act of self-dealing was wrongful and erroneous. Underwood v. U. S., N.D.Tex.1978, > 461 F.Supp. 1382.

5. Corporations

For purposes of rules governing excise taxes on acts of self-dealing between a disqualified person and a private foundation, a corporation which was a

disqualified person was not required to include in a redemption program those shares held by its officers and directors. Deluxe Corp. v. U.S., C.A.Fed.1989, > 885 F.2d 848.

6. Nature of title conveyed

Letter in which individual indicated to trustee of charitable foundation that he was giving his one-half interest in tract of land to foundation conveyed only equitable title and not legal title to foundation, and collection of federal excise taxes for self-dealing with respect to such gift on ground that it was donation of property subject to mortgage, and assessment of "willful and flagrant" penalties and penalties for failure to file report of excise tax liability with respect to that gift were wrongful and erroneous. Underwood v. U. S., N.D.Tex.1978, > 461 F.Supp. 1382.

Where taxpayer's wholly owned corporation X purchased Blackacre adjacent to Whiteacre which X had previously purchased, sold both properties to Y, nonexempt wholly owned subsidiary of private foundation defined in S 509 of this title, of which taxpayer was trustee, with understanding that taxpayer or X would satisfy outstanding mortgages on both properties, and foundation donated both properties, which it received upon Y's liquidation, to Yale, Tax Court determined that X, which was disqualified person with respect to foundation under S 4946 of this title, engaged in act of self-dealing within meaning of this section on sale of Whiteacre, but not on sale of Blackacre, since X held title to Blackacre as mere conduit or nominee for Y. Adams v. Commissioner of Internal Revenue, U.S.Tax Ct.1978, > 70 T.C. 373, on reconsideration > 72 T.C. 81, affirmed in part, appeal dismissed in part > 688 F.2d 815.

7. Satisfaction of mortgage liability

Where taxpayer's wholly owned corporation X purchased Blackacre adjacent to Whiteacre which X had previously purchased, sold both properties to Y, nonexempt wholly owned subsidiary of private foundation defined in S 509 of this title, of which taxpayer was trustee, with understanding that taxpayer or X would satisfy outstanding mortgages on both properties, and foundation donated both properties, which it received upon Y's liquidation, to Yale, Tax Court determined that failure to satisfy outstanding mortgage liabilities on both properties constituted act of self-dealing by X upon conveyance of property to Y and by taxpayer upon liquidation of X. Adams v. Commissioner of Internal Revenue, U.S.Tax Ct.1978, > 70 T.C. 373, on reconsideration > 72 T.C. 81, affirmed in part, appeal dismissed in part > 688 F.2d 815.

8. Satisfaction of trust

Even though actions of conservatee and his wife as co-trustees in selling assets to themselves would qualify as an act of self-dealing, court would not satisfy trust

on ground that trustees specifically violated terms of the trust, which prohibited trustees from engaging in any act of self-dealing, in that transfer might fall within exemption to definition of self-dealing, which was a question of fact to be resolved in a plenary hearing, and, even if sale was an act of self-dealing, which might subject conservatee's estate to substantial tax penalties, potential consequences of these acts would not cause court to satisfy trust but, rather, it will cause court to void transaction and uphold the trust. Application of Newlin, N.Y.Sup.1982, > 465 N.Y.S.2d 102, 119 Misc.2d 815.

9. Transfers to disqualified persons

Alleged reduction from $75,000 to $60,000 in proceeds of sale of parcel of land which was subject to interest of individual who by letter promised his interest to private foundation and stated that this interest would bring foundation "about $75,000" was not "transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation" within meaning of this section because individual never conveyed land to foundation and foundation, therefore, had no pro rata interest in cash and notes received from sale; because no act of self-dealing took place, assessment of penalties against individual for "willful and flagrant" violation of this title and for failure to report excise tax liability stemming from alleged act of self-dealing was wrongful and erroneous. Underwood v. U. S., N.D.Tex.1978, > 461 F.Supp. 1382.

10. Failure to correct act of self-dealing

Where taxpayer, who was heretofore held liable under this section for several acts of self-dealing with private foundation, had also been charged in same deficiency notice with "second level" sanction equal to 200 percent of "amount involved," Tax Court determined that no additional deficiency existed under this section because this section provided for "second level" tax after failure of taxpayer to correct act of self-dealing within correction period, which time had not elapsed at mailing of deficiency notice, "amount involved" could not be determined at the time. Adams v. Commissioner of Internal Revenue, U.S.Tax Ct.1979, > 72 T.C. 81, affirmed in part, appeal dismissed in part > 688 F.2d 815.

After filing of earlier opinion (> 70 T.C. 373) upon its own motion Tax Court directed parties to submit briefs addressing issue as to whether Court has statutory authority to determine deficiency in tax under this section, which provides for additional 200 percent-tax where initial 5 percent-excise tax under this section is imposed on act of self-dealing between disqualified person and private foundation and such act is not corrected within correction period, since deficiency cannot exist for Court's redetermination until tax is imposed under this section, and such tax is not imposed, assuming no correction occurs, until this Tax Court's decision is final. Adams v. Commissioner of Internal Revenue, U.S.Tax Ct.1978, > 70 T.C. 446.

11. Special transition rules

Where taxpayer's wholly owned corporation X purchased Blackacre adjacent to Whiteacre which X had previously purchased, sold both properties to Y, nonexempt wholly owned subsidiary of private foundation defined in S 509 of this title, of which taxpayer was trustee, with understanding that taxpayer or X would satisfy outstanding mortgages on both properties, and foundation donated both properties, which it received upon Y's liquidation, to Yale, Tax Court determined 5-percent excise tax imposed by this section was applicable to acts of self-dealing by taxpayer and X to extent such acts did not come within special transition rules provided by regulations. Adams v. Commissioner of Internal Revenue, U.S.Tax Ct.1978, > 70 T.C. 373, on reconsideration > 72 T.C. 81, affirmed in part, appeal dismissed in part > 688 F.2d 815.

12. Deficiency notice

Issuance of deficiency notice to self-dealer was not prerequisite to issuance of notice to foundation manager, under subsecs. (a)(2) and (b)(2) of this section. Wasie v. C.I.R., U.S.Tax Ct.1986, > 86 T.C. 962.

26 U.S.C.A. S 4941

26 USCA S 4941

END OF DOCUMENT

APPENDIX IX

IX. (A): TAXATION OF EXCESS BENEFITS

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26 U.S.C.A. S 4958

UNITED STATES CODE ANNOTATED

TITLE 26. INTERNAL REVENUE CODE

SUBTITLE D--MISCELLANEOUS EXCISE TAXES

CHAPTER 42--PRIVATE FOUNDATIONS; AND CERTAIN OTHER TAX-EXEMPT ORGANIZATIONS

SUBCHAPTER D--FAILURE BY CERTAIN CHARITABLE ORGANIZATIONS TO MEET CERTAIN QUALIFICATION REQUIREMENTS

Copr. C West 1999. No Claim to Orig. U.S. Govt. Works Current through P.L. 105-394, approved 11-13-1998

S 4958. Taxes on excess benefit transactions

(a) Initial taxes.--

(1) On the disqualified person.--There is hereby imposed on each excess benefit transaction a tax equal to 25 percent of the excess benefit. The tax imposed by this paragraph shall be paid by any disqualified person referred to in subsection (f)(1) with respect to such transaction.

(2) On the management.--In any case in which a tax is imposed by paragraph (1), there is hereby imposed on the participation of any organization manager in the excess benefit transaction, knowing that it is such a transaction, a tax equal to 10 percent of the excess benefit, unless such participation is not willful and is due to reasonable cause. The tax imposed by this paragraph shall be paid by any organization manager who participated in the excess benefit transaction.

(b) Additional tax on the disqualified person.--In any case in which an initial tax is imposed by subsection (a)(1) on an excess benefit transaction and the excess benefit involved in such transaction is not corrected within the taxable period,

there is hereby imposed a tax equal to 200 percent of the excess benefit involved. The tax imposed by this subsection shall be paid by any disqualified person referred to in subsection (f)(1) with respect to such transaction.

(c) Excess benefit transaction; excess benefit.--For purposes of this section--

(1) Excess benefit transaction.--

(A) In general.--The term "excess benefit transaction" means any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit. For purposes of the preceding sentence, an economic benefit shall not be treated as consideration for the performance of services unless such organization clearly indicated its intent to so treat such benefit.

(B) Excess benefit.--The term "excess benefit" means the excess referred to in subparagraph (A).

(2) Authority to include certain other private inurement.--To the extent provided in regulations prescribed by the Secretary, the term "excess benefit transaction" includes any transaction in which the amount of any economic benefit provided to or for the use of a disqualified person is determined in whole or in part by the revenues of 1 or more activities of the organization but only if such transaction results in inurement not permitted under paragraph (3) or (4) of section 501(c), as the case may be. In the case of any such transaction, the excess benefit shall be the amount of the inurement not so permitted.

(d) Special rules.--For purposes of this section--

(1) Joint and several liability.--If more than 1 person is liable for any tax imposed by subsection (a) or subsection (b), all such persons shall be jointly and severally liable for such tax.

(2) Limit for management.--With respect to any 1 excess benefit transaction, the maximum amount of the tax imposed by subsection (a)(2) shall not exceed $10,000.

(e) Applicable tax-exempt organization.--For purposes of this subchapter, the term "applicable tax-exempt organization" means--

(1) any organization which (without regard to any excess benefit) would be described in paragraph (3) or (4) of section 501(c) and exempt from tax under section 501(a), and

(2) any organization which was described in paragraph (1) at any time during the 5-year period ending on the date of the transaction.

Such term shall not include a private foundation (as defined in section 509(a)).

(f) Other definitions.--For purposes of this section--

(1) Disqualified person.--The term "disqualified person" means, with respect to any transaction--

(A) any person who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization.

(B) a member of the family of an individual described in subparagraph (A), and

(C) a 35-percent controlled entity.

(2) Organization manager.--The term "organization manager" means, with respect to any applicable tax-exempt organization, any officer, director, or trustee of such organization (or any individual having powers or responsibilities similar to those of officers, directors, or trustees of the organization).

(3) 35-Percent controlled entity.--

(A) In general.--The term "35-percent controlled entity" means--

(i) a corporation in which persons described in subparagraph (A) or (B) of paragraph (1) own more than 35 percent of the total combined voting power,

(ii) a partnership in which such persons own more than 35 percent of the profits interest, and

(iii) a trust or estate in which such persons own more than 35 percent of the beneficial interest.

(B) Constructive ownership rules.--Rules similar to the rules of paragraphs (3) and (4) of section 4946(a) shall apply for purposes of this paragraph.

(4) Family members.--The members of an individual's family shall be determined under section 4946(d); except that such members also shall include the brothers and sisters (whether by the whole or half blood) of the individual and their spouses.

(5) Taxable period.--The term "taxable period" means, with respect to any excess benefit transaction, the period beginning with the date on which the transaction occurs and ending on the earliest of--

(A) the date of mailing a notice of deficiency under section 6212 with respect to the tax imposed by subsection (a)(1), or

(B) the date on which the tax imposed by subsection (a)(1) is assessed.

(6) Correction.--The terms "correction" and "correct" mean, with respect to any excess benefit transaction, undoing the excess benefit to the extent possible, and taking any additional measures necessary to place the organization in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.

CREDIT(S)

1998 Electronic Update

(Added Pub.L. 104-168, Title XIII, S 1311(a), July 30, 1996, 110 Stat. 1475.)

General Materials (GM) - References, Annotations, or Tables>

HISTORICAL AND STATUTORY NOTES

Revision Notes and Legislative Reports

1996 Acts. House Report No. 104-506, see 1996 U.S. Code Cong. and Adm. News, p. 1143.

Effective Dates

1996 Acts. Section shall apply to excess benefit transactions occurring on or after Sept. 14, 1995 and shall not apply to any benefit arising from a transaction pursuant to any written contract which was binding on Sept. 13, 1995, and at all times thereafter before such transaction occurred, see section 1311(d)(1), (2), of Pub.L. 104-168, set out as a note under section 4955 of this title.

CROSS REFERENCES

Reporting by organizations of certain excise taxes and other information, see > 26 USCA S 6033.

LIBRARY REFERENCES

Law Review and Journal Commentaries

Comments concerning new > section 4958 of the Internal Revenue Code of 1986. ABA Section of Taxation, Committee on Exempt Organizations, 50 Tax Lawyer 817 (1997). IRS closely examines insider 'excess benefit' deals. Meri-Beth Robertson, 146 N.J.L.J. S-12 (1996).

IX.(B): PUBLIC CHARITY DEFINED

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26 U.S.C.A. S 509

UNITED STATES CODE ANNOTATED

TITLE 26. INTERNAL REVENUE CODE

SUBTITLE A--INCOME TAXES

CHAPTER 1--NORMAL TAXES AND SURTAXES

SUBCHAPTER F--EXEMPT ORGANIZATIONS

PART II--PRIVATE FOUNDATIONS Copr. C West 1999. No Claim to Orig. U.S. Govt. Works

Current through P.L. 105-394, approved 11-13-1998

S 509. Private foundation defined

(a) General rule.--For purposes of this title, the term "private foundation" means a domestic or foreign organization described in section 501(c)(3) other than--

(1) an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii));

(2) an organization which--

(A) normally receives more than one-third of its support in each taxable year from any combination of--

(i) gifts, grants, contributions, or membership fees, and

(ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business (within the meaning of section 513), not including such receipts from

any person, or from any bureau or similar agency of a governmental unit (as described in section 170(c)(1)), in any taxable year to the extent such receipts exceed the greater of $5,000 or 1 percent of the organization's support in such taxable year,

from persons other than disqualified persons (as defined in section 4946) with respect to the organization, from governmental units described in section 170(c)(1), or from organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)), and

(B) normally receives not more than one-third of its support in each taxable year from the sum of--

(i) gross investment income (as defined in subsection (e)) and

(ii) the excess (if any) of the amount of the unrelated business taxable income (as defined in section 512) over the amount of the tax imposed by section 511;

(3) an organization which--

(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in paragraph (1) or (2),

(B) is operated, supervised, or controlled by or in connection with one or more organizations described in paragraph (1) or (2), and

(C) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) or (2); and

(4) an organization which is organized and operated exclusively for testing for public safety.

For purposes of paragraph (3), an organization described in paragraph (2) shall be deemed to include an organization described in section 501(c)(4), (5), or (6) which would be described in paragraph (2) if it were an organization described in section 501(c)(3).

(b) Continuation of private foundation status.--For purposes of this title, if an organization is a private foundation (within the meaning of subsection (a)) on October 9, 1969, or becomes a private foundation on any subsequent date, such organization shall be treated as a private foundation for all periods after October 9, 1969, or after such subsequent date, unless its status as such

is terminated under section 507.

(c) Status of organization after termination of private foundation status.-- For purposes of this part, an organization the status of which as a private foundation is terminated under section 507 shall (except as provided in section 507(b)(2)) be treated as an organization created on the day after the date of such termination.

(d) Definition of support.--For purposes of this part and chapter 42, the term "support" includes (but is not limited to)--

(1) gifts, grants, contributions, or membership fees,

(2) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in any activity which is not an unrelated trade or business (within the meaning of section 513),

(3) net income from unrelated business activities, whether or not such activities are carried on regularly as a trade or business,

(4) gross investment income (as defined in subsection (e)),

(5) tax revenues levied for the benefit of an organization and either paid to or expended on behalf of such organization, and

(6) the value of services or facilities (exclusive of services or facilities generally furnished to the public without charge) furnished by a governmental unit referred to in section 170(c)(1) to an organization without charge.

Such term does not include any gain from the sale or other disposition of property which would be considered as gain from the sale or exchange of a capital asset, or the value of exemption from any Federal, State, or local tax or any similar benefit.

(e) Definition of gross investment income.--For purposes of subsection (d), the term "gross investment income" means the gross amount of income from interest, dividends, payments with respect to securities loans (as defined in section 512(a)(5)), rents, and royalties, but not including any such income to the extent included in computing the tax imposed by section 511.

CREDIT(S)

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General Materials (GM) - References, Annotations, or Tables

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"Applicable tax-exempt organization" as not including private foundation as defined under this section for purposes of taxes on excess benefit transactions, see 26 USCA S 4958.

Charitable contribution deductions generally, see 26 USCA S 170.

Charitable trust unexpired non-exempt interests treated as exempt, see 26 USCA S 4947.

Declaratory judgments relating to private foundation classifications, see 26 USCA S 7428.

Employment not including services performed by student employed by or attending courses at organization under this section--

Federal Insurance Contributions Act, see 26 USCA S 3121.

Social Security Act, see 42 USCA S 410.

Grants to organizations under this section by private foundation not taxable, see 26 USCA S 4945. Inspection of records--

Returns, see 26 USCA S 6104.

Written determination of organization as private foundation, see 26 USCA S 6110.

Investment income excise tax not imposed on publicly supported exempt operating private foundation, see 26 USCA S 4940. Notice of exempt status application not required for organizations defined under this section, see 26 USCA S 508. Personal holding company definition, organization described in this section as individual for purposes of, see 26 USCA S 542. Political organization contributions to organizations under this section not deductible, see 26 USCA S 527. Returns required to be filed--

Generally, see 26 USCA S 6033.

Returns regarding liquidation, dissolution, termination, or contraction, see 26 USCA S 6043. Transfer to, or operation as, public charity, see 26 USCA S 507. Undistributed income of private operating foundation not taxable, see 26 USCA S 4942. Unrelated business taxable income not including real property acquisition or improvement indebtedness of qualified organization under this section, see 26 USCA S 514.

Works of art transferred to private foundations under this section deductible, see 26 USCA S 2055.

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Declaration of status, see West's Federal Practice Manual S 619. Private foundation, definition, see West's Federal Practice Manual S 632 et seq.

American Digest System

Private foundations, see Internal Revenue K4063.

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Texts and Treatises

20 Fed Proc L Ed, Internal Revenue SS 48:109, 48:125, 48:129, 48:130, 48:191.

15 Fed Tax Coord 2d P K-3545.

2A Estate Plan & Tax Coord, Income Tax PP 41,410, 41,440.

7 Fed Tax Coord 2d PP D-8000-8042.

2 Tax Action Coord, Tax Planning P 190-N.

24A Fed Tax Coord 2d PP U-3803, 4107.

1 Hoops, Family Estate Planning Guide 3d S 147.

Rasch, Handling Federal Estate and Gift Taxes 4th SS 6:99, 17:43.

NOTES OF DECISIONS

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Administrative Decisions: IRS decisions available on WESTLAW. See WESTLAW Directory.

1. Generally

Tax-exempt organization is private foundation unless it comes within one of four specified exceptions. Change-All Souls Housing Corp. v. U. S., Ct.Cl.1982, 671 F.2d 463, 229 Ct.Cl. 380.

2. Support organizations--Generally

Tax-exempt organization qualified as non-private, supporting organization under "organizational" and "operational" tests so as to be exempt from definition of "private foundation" where effectuation of its purposes resulted only in carrying

out of specific aspect of stated purposes of supported non-private organization and there existed historic work relationship and identity of interest between plaintiff organization and supported organization. Change-All Souls Housing Corp. v. U. S., Ct.Cl.1982, > 671 F.2d 463, 229 Ct.Cl. 380.

For purposes of determining status of taxpayer as supporting organization for taxation purposes, organization which is merely "operated in connection with" a publicly supported organization must meet two tests; a responsiveness test which is met if supporting organization is a charitable trust and the named beneficiary can enforce an accounting, or if there is an overlap of officers so that publicly supported organization has some voice in the operation or supporting organization, and an integral part test which is satisfied if the attentiveness of the publicly supported organization to the operations of the supporting organization is assured by the nature or magnitude of the supporting organization's contributions. William F. Quarrie, Mable E. Quarrie and Margaret K. Quarrie v. C.I.R., C.A.7 1979, 603 F.2d 1274.

3. ---- Specification of beneficiary

In order for taxpayer to have status of supporting organization rather than of private foundation, beneficiary organizations of a taxpayer must be specified by name, and such requirement is more narrowly drawn for taxpayers which are "operated in connection with" the beneficiary organizations. William F. Quarrie, Mable E. Quarrie and Margaret K. Quarrie v. C.I.R., C.A.7 1979, > 603 F.2d 1274.

Under Charitable Trust Act, trustee of testamentary trust, terms of which were drafted prior to change in federal law, was authorized to amend terms to avoid private foundation status through specification of an organization as income and principal beneficiary of trust in order to qualify as supporting organization. Flanagan State Bank v. Bromenn Healthcare, Ill.App. 4 Dist.1986, 487 N.E.2d 1180, 94 Ill.Dec. 303, 140 Ill.App.3d 137, appeal denied.

4. ---- Substitution of beneficiary

Articles of supporting organization which is merely "operated in connection with" a publicly supported organization must without exception designate the specified beneficiary organizations by name; substitution of specified organization is permitted if possible substitutes are named or designated by class if such substitution is conditioned upon occurrence of event which is beyond control of the supporting organization. William F. Quarrie, Mable E. Quarrie and Margaret K. Quarrie v. C.I.R., C.A.7 1979, > 603 F.2d 1274.

Where will of decedent, who died in 1964, established charitable trust, which was to terminate either upon publication of designated book by organization specified in subsec. (a)(1) of this section, which organization was then to receive trust

estate, or upon expiration of 21 years after death of survivor of three persons named in will, in which event trust estate was to be distributed equally between two other organizations named in will, Tax Court determined that taxpayer trust was not "supporting organization" within meaning of subsec. (a)(3) of this section, since its terms expressly empowered it to benefit organizations other than specified publicly supported organization described in subsecs. (a)(1) or (2) of this section. Trust Under Will of Mabury v. Commissioner of Internal Revenue, U.S.Tax Ct.1983, 80 T.C. 718.

5. ---- Miscellaneous support organizations

Tax-exempt organization which operated in conjunction with two other organizations, only one of which was publicly supported, was "operated in connection with one or more publicly supported organizations" within purview of this section governing qualification as non-private, supporting organization exempted from definition of "private foundation." Change-All Souls Housing Corp. v. U. S., Ct.Cl.1982, 671 F.2d 463, 229 Ct.Cl. 380.

6. Public charities

Public charities are excepted from private foundation status for taxation purposes on theory that their exposure to public scrutiny and their dependence on public support will keep them from abuses to which private foundations are subject. William F. Quarrie, Mable E. Quarrie and Margaret K. Quarrie v. C.I.R., C.A.7 1979, 603 F.2d 1274.

7. Religious organizations

Where petitioner, church's auxiliary formed to construct housing at church's conference and retreat center, sought declaratory judgment that it was not private foundation, Court determined petitioner was not private foundation under subsec. (a)(3) of this section, and Commissioner's silence on such classification in his final adverse determination letter did not deprive petitioner of its right to invoke jurisdiction of Court; but petitioner's classification under such subsection did not remove controversy as to its status under subsec. (a)(1) of this section, and that issue was properly before Court; moreover, petitioner was not organization described in subsec. (a)(1) of this section, since its was not church in its own right. Junaluska Assembly Housing Inc. v. C.I.R., U.S.Tax Ct.1986, 86 T.C. 1114.

Where taxpayer applied for Service ruling that it was tax exempt as section 501(c) (3) organization and that it was not private foundation under subsec. (a) of this section on ground that it was church under section 170(b) (1) (A) (i) of this title and subsec. (a) (1) of this section, and Commissioner refused to rule that taxpayer was church but issued advance ruling that taxpayer would not be treated as private foundation, conditional upon meeting public support

requirements, Tax Court denied Commissioner's motion to dismiss taxpayer's declaratory judgment action and determined Court had jurisdiction under section 7428 of this title to consider whether taxpayer was entitled to definite ruling that it was non-private foundation under subsec. (a) (1) of this section and section 170(b) (1) (A) (i) of this title, since jurisdiction is limited to actual controversies involving section 170(c) (2), 501(c) (3) of this title, subsec. (a) of this section, or section 4942(j) (3) of this title, and advance ruling was not favorable and constituted adverse ruling under subsec. (a) of this section. Friends of Society of Servants of God v. Commissioner of Internal Revenue, U.S.Tax Ct.1980, 75 T.C. 209.

8. Educational organizations

Where taxpayer testamentary trust, a qualified tax-exempt organization created in 1968, provided scholarships for students attending Oregon colleges, with preference to those attending Northwest Christian College, Tax Court determined, on facts, that taxpayer was not liable for excise tax imposed on private foundations, since it was supporting organization, within meaning of subsec. (a)(3) of this section, which was "operated in connection with" colleges and universities in Oregon. Cockerline Memorial Fund v. C.I.R., U.S.Tax Ct.1986, 86 T.C. 53.

Where taxpayer was charitable testamentary trust created to pay its income for college scholarships to selected graduates of Winterset high school; trustees, who were not initially connected with school system, were required under Iowa law to make annual public reports on investments and activities; and 53 students received direct aid during first 9 years of operation of trust, Tax Court determined in declaratory judgment action that, contrary to Commissioner's contention, taxpayer was a supporting organization within meaning of subsec. (a) (3) of this section and not a private foundation, since it was "operated in connection with" Winterset high school, in that it satisfied "responsiveness test" of reg. 1.509(a)-4(i) (2) and "integral part test" of reg. 1.509(a)-4(i) (3). Nellie Callahan Scholarship Fund v. Commissioner of Internal Revenue, U.S.Tax Ct.1980, 73 T.C. 626, nonacq.,.

26 U.S.C.A. S 509

26 USCA S 509

END OF DOCUMENT

APPENDIX X

X. (A): Margin Account Agreements:

1986 WL 370319 (I.R.S.)

Internal Revenue Service (I.R.S.)

Private Letter Ruling

June 10, 1986

Dear * * *

This is in reference to your April 21, 1986 letter, and prior correspondence, that you submitted on behalf of the Corporation and two of its wholly owned subsidiaries. You seek rulings concerning the federal income tax consequences of the transfer of certain stock to a Broker under the Margin Account Agreements described below.

The Corporation has extended qualified incentive stock options, described in section 422A of the Internal Revenue Code, to its employees. In addition, the Corporation has assumed the qualified incentive stock options of its two subsidiaries as part of two corporate mergers described in section 368(a)(1)(A) of the Code.

Following the exercise by an employee of an option, the employee may enter into a Margin Account Agreement with either Broker A or Broker B. Under either Margin Account Agreement, the employee would transfer legal title to the optioned stock to the Broker as collateral for a margin account. The Broker would become the holder-of-record for the stock, but the stock would be held in an account for the employee. The employee would remain the beneficial owner of the stock, thereby retaining voting rights and dividend rights. The Broker would have the power to dispose of the employee's stock; but upon doing so would be obligated to replace the employee's optioned stock with stock of the same kind and amount.

The Margin Account Agreements will afford the employees the opportunity to use qualified option stock as collateral on a margin account. In some cases, the proceeds from such a margin account could pay for all or a portion of the

exercise price for a subsequently exercised option, or to pay, in whole or in part, any outstanding balance on a loan incurred by the employee to acquire the qualified optioned stock deposited in the margin account. Moreover, the Margin Account Agreements will enable the employee and Broker to facilitate a possible transfer of the optioned stock by eliminating the need to execute and deliver the stock at the time of transfer.

Section 425(c) of the Code states that the term 'disposition' includes a sale, exchange, gift, or transfer of legal title, but does not include an exchange to which section 1036 applies. Section 1036(a) provides that no gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

Section 425(c)(1)(C) of the Code, and section 1.425-1(c)(1)(iii) of the Income Tax Regulations provide that a 'disposition' does not include a mere pledge or hypothecation of stock. However, a disposition of the stock pursuant to a pledge or hypothecation is a 'disposition' for purposes of section 425(c) of the Code.

Rev. Rul. 57-451, 1957-2 C.B. 295, illustrates three situations involving the issue of whether a shareholder has made a disposition of stock. In the second situation, which is relevant here, a shareholder endorses stock certificates and deposits them with a broker in a 'safekeeping' account. The shareholder authorized the broker to 'lend' such certificates to the broker's other customers in the ordinary course of business. The broker has the certificates cancelled and has new certificates issued in the broker's name. All incidents of ownership pass to the broker, and then to the 'borrowing customer'. The Revenue Ruling concludes that a disposition has occurred UNLESS the broker replaces the original certificates with new certificates representing shares of the same kind and amount as contemplated under section 1036 of the Code.

Based solely on the facts submitted and assuming that the Brokers will, in fact, replace the employee's optioned stock with the Corporation's stock of the same kind and amount, we conclude that the transfer of stock to a Broker pursuant to the above described Margin Account Agreements will not result in a 'disposition' of such stock under section 425(c) of the Code. In addition, such a transfer of optioned stock to be used as collateral on a margin account, the proceeds of which margin account are to be used by the employee to pay all or a portion of the exercise price for a subsequently exercised option or to pay in full or reduce any loan incurred by the employee to acquire the optioned stock, will not result in a disposition of such stock under section 425(c).

No opinion is expressed regarding whether options granted or assumed by the Corporation qualify as incentive stock options as defined in section 422(A) of the Code. Except as specifically ruled upon above, no opinion is expressed as to the

federal income tax consequences of the transaction described above under any other provision of the Code.

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

A copy of this ruling should be attached to the Corporation's tax return for the next taxable year in which the Corporation files. We are enclosing a copy for that purpose.

Sincerely yours,

Richard H. Manfreda

Chief

Individual Income Tax Branch

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

PLR 8636055, 1986 WL 370319 (I.R.S.)

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APPENDIX XI

(A): Charitable Remainder Trust Solutions:

This article was originally written in 2002 geared to affluent persons of retirement age. However, it can serve just about anyone interested in Charitable Remainder Trusts. If you're not currently an owner of valuable assets...why not pretend you are?

Are you hanging on to any low-basis, highly appreciated assets that you would gladly sell if you could avoid paying the capital-gains tax? One solution might be an estate planning arrangement known as a Charitable Remainder Trust (CRT). This type of trust can provide you with income tax breaks, while enabling you to convert just about any appreciated asset - stocks, bonds, real estate, artwork, etc. - into an income stream for life or a certain number of years.

With a CRT, you transfer assets into trust and thereby receive charitable income-tax deductions (state/federal) in amounts subject to calculations based on the terms of the trust (often worth around 20% FMV in cash). Because asset remains in trust at term will not pass to one or more designated "remaindermen" (qualified 501(c)3 organizations) for a number of years, tax-deductions must be less than donated assets' current fair market value.

The CRT trustee may, at any time, sell assets and transfer proceeds into a wide range of income-producing investments. Trustee pays you the donor a certain fixed amount of money (or fixed percentage of principle) each year for a certain number of years -usually twenty years or the donor's lifetime.

At term of trust, your trustee turns over all remaining principal in trust (known as the "remainder interest") to one or more pre-designated non-profit corporations that have not been income beneficiaries of the CRT. Remaindermen can be your alma mater, a museum, church, or any other qualified charitable institution.

See how it works?

When the CRT sells an asset prior to term of trust, it pays no tax on the gain so all proceeds can be reinvested to produce maximum income for you and any other trust beneficiary consistent with investment performance. If you had sold the asset outright instead of giving it to the CRT, you would not only have missed

substantial tax-deductions, you would have paid IRS, and your state revenue service, capital gains taxes on the entire profit from the transaction.

Sometimes you need as much cash as an asset will yield and sometimes it's a lot wiser to take a trust generated income-stream.

There are two kinds of charitable remainder trusts to choose from; both are irrevocable, meaning they can't be cancelled once the trust document is executed. The Charitable Remainder Annuity Trust (CRAT) provides a steady annual income of a fixed amount - usually $5,000 or some higher amount. A CRAT tends to be more popular with people in their seventies or older who want the security of guaranteed payout in retirement and don't want to risk stock or money market dips eroding payments based on principal growth somewhere down the road.

The Charitable Remainder Unitrust (CRUT) pays beneficiaries a variable, percentage based return - annual distributions fluctuate with the fortunes of the investment portfolio. While annuity trusts are appraised just once, unitrusts must be revalued each year which can drive up administrative expenses, especially with hard-to-value assets such as closely held securities, real estate or art work. However, unitrusts, unlike annuity trusts, permit additional contributions of cash or property at any time into trust corpus. Obviously, this fact allows donor-beneficiaries to receive greater income when desired (possible).

Suppose a 65-year old entrepreneur owns $100,000. worth of ABC Company stock that he bought some years before for $20,000. He wants to unload the low-yielding shares and invest the proceeds in U.S. Treasury bonds. But by simply selling the stock, he would pay federal capital gains tax of $16,000. on his $80,000. profit. So he transfers the stock into a CRAT instead, and elects to receive $7,000. annual income for the rest of his life. At decease, CRAT principal will go to one or more favorite cause(s) tax-free.

CRAT trustee sells the irrevocably donated shares, and buys 7% Treasure bonds paying no capital gains tax on the $80,000 gain. Annual CRAT payment of $5,000 will be considered a distribution of ordinary income on which the entrepreneur will pay normal income-tax. Remember, he also has available income tax deductions accruing when the CRAT was funded in an amount equal to the remainder value of trust principal at term. Deductions may be carried over for up to five additional, consecutive years as taxpayer's financial factors require.

Number one estate planning idea: Whether you choose to make a gift of an asset directly to a charity or through a CRT, the value of the asset, together with any future appreciation, will effectively be removed from your taxable estate - this will reduce heirs estate tax liability at your death. With a CRT, you can shrink your taxable estate by the cash value of assets in trust at decease of beneficiary.

Note on art donations: Donating art, antiques, collectibles or other such tangible personal property is subject to a special rule, which affects the size of your upfront income tax-deduction. Donating such property which you have owned for over one year usually generates a charitable deduction equal to the object's fair market value at the time of the gift if the donee uses the object in a manner related to its charitable purpose.

Thus, donating a Picasso to an art museum which plans to display it in its gallery would clearly meet the "related use" rule. But giving the painting to the United Way which, in turn, sells it and uses the proceeds to support homeless shelters would not be a related use. If the charity does not intend to use the art work to further its charitable mission, your income tax deduction is limited to your *basis* (generally, what you originally paid for the object) - not its current, appreciated value. Your deduction may be similarly limited if collecting art is your business, because the art work would be considered part of your inventory. The amount of deductions you are allowed in any one year are further limited by your adjusted gross income and the type of charitable organization to which you are contributing. Generally, gifts to public charities generate larger tax deductions than gifts to private charities.

Properly drafted, a charitable remainder trust may be successfully used to achieve numerous tax and financial planning objectives. Consult with a professional adviser to determine whether charitable giving should be a part of your financial planning strategy.

When setting up a CRT with your attorney (always recommended), you may name yourself as trustee, this enables you to personally manage sales and/or investments inter CRT . Alternatively, by using a professional trustee such as a bank or trust company donor-beneficiaries can be certain that the trust agreement and execution complies with codes and other rules that must be closely followed to enjoy full tax and income benefits.