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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:ITA:2 – PLR-136169-01

Date:

June 3, 2002

Company =

Parent =

Trust =

Church =

Dear

This responds to a private letter ruling request of July 29, 2001, submitted by your authorized representative, seeking rulings that payments made under a promotional program to charitable or civic organizations will be treated as advertising or promotional expenses.

REQUESTED RULINGS

1. All benefit payments made under the Charitable Giving Program to tax exempt charitable and educational organizations (described in § 170 of the Internal Revenue Code) will be deductible by Company as ordinary and necessary business expenses under §162 and will not be treated as charitable contributions under § 170.
2. All benefit payments made under the Charitable Giving Program to civic organizations (not described in § 170), other than political and lobbying organizations described in § 1.162-29 of the Income Tax Regulations, will be deductible by Company as ordinary and necessary business expenses under § 162.
3. All benefit payments made under the Charitable Giving Program to Church or its affiliates will be deductible by Company as ordinary and necessary business expenses under § 162 and will not be treated as constructive dividends under § 301.

CONCLUSIONS

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1. All benefit payments made under the Charitable Giving Program to tax exempt charitable and educational organizations (described in § 170 of the Internal Revenue Code) will be deductible by Company as ordinary and necessary business expenses under § 162 and will not be treated as charitable contributions under § 170. The deduction will be subject to the disallowance provisions of § 162(e) and the regulations thereunder.
2. All benefit payments made under the Charitable Giving Program to civic organizations (not described in § 170), other than political and lobbying organizations described in § 1.162-29 of the regulations, will be deductible by Company as ordinary and necessary business expenses under § 162. The deduction will be subject to the disallowance provisions of § 162(e) and the regulations thereunder.
3. All benefit payments made under the Charitable Giving Program to Church or its affiliates will be deductible by Company as ordinary and necessary business expenses under § 162 and will not be treated as constructive dividends under § 301.

FACTS

Company is a wholly owned corporate subsidiary of Parent, a holding company owning other taxable subsidiaries. Parent files a consolidated U.S. income tax return with Company and all of Parent's subsidiaries. Parent is wholly owned by Trust, an irrevocable trust established and operated for religious, charitable, and educational purposes. Pursuant to § 509(a)(3) and § 1.6033-2(h)(1), Trust is a supporting organization and an integrated auxiliary of Church, a tax-exempt religious organization.

Company is engaged in the business of providing life insurance to customers throughout the United States. Most of Company's insurance contracts are sold individually through its career and independent agent distribution channels.

Church and its nonprofit supporting and subordinate organizations are generally exempt from federal income tax under §§ 501(a) and 501(c)(3).

PROPOSED TRANSACTION

In recent years, Company has come under increasing competitive pressure from larger, national insurance firms. As a new marketing and advertising strategy for its life insurance policies, Company has decided to initiate a promotional program (the "Charitable Giving Program" or "the Program") in which Company would pay, as a policy benefit, an amount generally equal to one percent of the face amount of a life insurance policy to a charitable or civic organization designated by the policy owner, other than organizations engaging in activities for which a deduction is denied under § 162(e), relating to political or lobbying organizations. It is anticipated that most, but not all, of the charitable or civic organizations receiving payments would be organizations described in § 170. These payments would be paid entirely by Company out of its

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business assets and would not come out of the death benefit proceeds of the life insurance contract.

The purpose of the Program is to give Company's insurance products an additional benefit that distinguishes them from the products of other life insurance companies. Company anticipates that the Program will ultimately produce additional sales of insurance products.

Company believes that, when implemented, the Program will provide a significant marketing opportunity for Company. The Program should allow Company to provide a benefit not currently available under most competitors' life insurance policies. The Program will not cost policy owners anything and yet will give them the satisfaction of knowing that, through their insurance contract with Company, they can help the charitable or civic organization of their choice. It is anticipated that this benefit will induce sales by giving Company a marketing advantage. It is also anticipated that, because this benefit would be forfeited if the life insurance policy is allowed to lapse, policy owners will be encouraged to renew and retain their policies over the years. In short, the Program is intended to increase Company's income in the future.

The Program will allow future purchasers of universal or whole life policies to designate, as qualified beneficiaries, § 501(c)(3) charitable organizations as well as civic organizations without regard to their status under § 501(c)(3). Purchasers of term life insurance and prior purchasers of universal or whole life policies will not be eligible for the Program.

While the amount of payments under the Program will generally equal one percent of a policy's face amount, the Program provides for a minimum payment and a maximum payment. Upon the death of the insured, a payment will be made by Company to the designated organization. If the designated organization is no longer able to receive donations at the time of the insured's death, Company will substitute another organization chosen by a designated policy beneficiary. A payment made under the Program will not be a guaranteed benefit for purposes of the life insurance contract. Accordingly, the provisions of the Program may be altered or discontinued in the future.

Company will not provide a list of qualified organizations from which a designated organization must be selected. Instead, policy owners will make their own designations based upon their own interests. A policy owner will be permitted to change the designation at any time prior to the death of the insured.

Because Company sells most of its insurance policies where there are a significant number of members of Church, it is predictable that some policy owners may choose to designate Church or one of its affiliated charitable or educational organizations as a beneficiary under the Program. There is no way to estimate what proportion of the purchasers of life insurance policies might designate Church or its affiliates. Company does not ask the religious affiliation of any of its customers and does not maintain this information in its records. Further, by law, Company is not permitted to inquire into the

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religious affiliation of any of its employees or agents. Even if Company were permitted to obtain this information, any prediction regarding what organizations might be designated under the Program would be quite speculative. Company expects to receive “substantial benefits” from the Program in the form of additional sales of life insurance policies.

LAW AND ANALYSIS

Issue 1:

Section 162(a) allows a deduction for all of the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Section 1.162-1(a) provides that among the items included in business expenses are “advertising and other selling expenses.” Section 162(e) denies a deduction for certain lobbying and political expenditures. See § 1.162-29.

Section 170 allows as a deduction any charitable contribution (as defined in § 170(c)) payment of which is made within the taxable year. Section 1.162-15(b) provides, in part, that donations to organizations other than those described in § 170 which bear a direct relationship to the taxpayer’s business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. See also § 1.170A-1(c)(5).

In Rev. Rul. 72-314, 1972-1 C.B. 44, a stock brokerage firm donated an amount equal to 6 percent of its commissions to a charitable organization whose purpose was to combat local community deterioration. The taxpayer emphasized in advertisements to its customers and to potential customers that these payments would enable the customers to benefit the organization and the community it serves without incurring additional expenses. The taxpayer also advised the organization of the procedure used in soliciting business and that it would pay the organization 6 percent for the privilege to advertise that such procedure was in effect. The taxpayer reasonably expected to derive new business and retain the business of existing customers by implementing this program. Therefore, the payments to the charitable organization were held deductible as ordinary and necessary business expenses under § 162(a).

As stated above, the Program will not permit the purchaser of a life insurance policy to designate as a payment recipient an organization engaging in activities for which a deduction would not be allowed under § 162(e).

Company represents that it expects to receive “substantial benefits” from the Program in the form of additional sales of life insurance policies. In addition, Company anticipates that, because this benefit would be forfeited if the life insurance policy is allowed to lapse, policy owners will be encouraged to renew and retain their policies over the years. The Program is intended to increase Company’s future income. Therefore, the payments (other than payments for lobbying expenses) under the

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Program will be deductible as ordinary and necessary business expenses under § 162(a). See Marquis v. Commissioner, 49 T.C. 695 (1968), acq., 1971-2 C.B. 3.

Issue 2:

As discussed above in our analysis of the first requested ruling, § 162(a) allows a deduction for all of the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Section 1.162-1(a) provides that among the items included in business expenses are “advertising and other selling expenses.” Section 162(e) denies a deduction for certain lobbying and political expenditures. See also § 1.162-29.

As stated in the description of the proposed transaction, the Program will not permit the purchaser of a life insurance policy to designate as a payment recipient an organization which engages in activities for which a deduction would not be allowed under § 162(e).

The same reasoning in our analysis of the first requested ruling applies to benefit payments made under the Program to organizations not described in § 170. Company represents that the purpose of the benefit payments under the Program is to produce additional sales of insurance products. Company also anticipates that, because this benefit would be forfeited if the life insurance policy is allowed to lapse, policy owners will be encouraged to renew and retain their policies over the years. The Program is intended to increase Company’s future income. Therefore, the payments (other than payments for lobbying expenses) under the Program will be ordinary and necessary business expenses under § 162(a). See § 1.162-1(a).

Issue 3:

Section 301(a) states that “a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated” as a dividend. Section 1.301-1(c) states that the property so distributed is treated as a dividend only if “the amount is paid to a shareholder in his capacity as such.” In the present case, benefit payments by Company to Church or organizations affiliated with Church would not be made due to Church’s capacity as the indirect owner of Company. Rather, such a payment would be made because a policy owner chose to designate Church or the affiliated organization as the recipient of the benefit payment under the Program.

Church and its affiliated charitable and educational institutions (affiliates of Company’s indirect shareholder, the Trust) are part of a larger class of organizations eligible for designation as a beneficiary under the Program. Because any payments Church or its affiliated nonprofit entities might receive under the Program would be as a result of their membership in that larger class, and not with respect to Church’s indirect ownership of Company’s stock, these payments would not be treated as dividends.

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A payment by a corporation may be found to be a constructive dividend when the charity controls the corporation or the charity is the beneficiary of a trust controlling the corporation. For example, in Cosby Valve & Gage Co. v. Commissioner, 380 F.2d 146 (1st Cir. 1967), a business attempted to deduct an in-kind payment of property to its sole shareholder, a charitable foundation. While noting that the payment fell within the literal definition of a "charitable contribution," the court concluded that dividend treatment was proper because the charitable foundation controlled the corporation making the payment and any other result would give businesses owned by charities an advantage over businesses owned by non-charities. See also Sid Richardson Carbon and Gasoline Co. v. United States, 416 F.2d 867 (5th Cir. 1969); C.F. Mueller Co. v. Commissioner, 479 F.2d 678 (3d Cir. 1973); Rev. Rul. 68-296, 1968-1 C.B. 105 ("a business corporation that is wholly owned, whether actually or beneficially, by an organization exempt under section 501(c)(3) of the Code as a charitable organization, is not entitled to a charitable contribution deduction for property transferred without consideration to its sole shareholder or beneficial owner").

Payments made by Company under the Program to Church or its affiliated entities are distinguishable from the payments at issue in the cases cited above, since the payments will be a result of a choice made by third parties over whom Church, Church's affiliates and Company have no control and who are not under a legal obligation to act for the benefit of Church or Church's affiliates. The owners of the life insurance contracts will be permitted to designate any charitable or civic organization they wish, and they may change that designation throughout the life of the insurance contract.

Therefore, all benefit payments made under the Program to Church or its affiliates will be deductible by Company as ordinary and necessary business expenses under § 162 and will not be treated as constructive dividends under § 301.

CAVEATS:

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110 of the Internal Revenue Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directed only to the taxpayer requesting it.

Section 6110(k)(3) provides that this letter may not be used or cited as precedent.

Sincerely yours,
CLIFFORD M. HARBOURT
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Income Tax and Accounting)

Enclosures