



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Date: September 30, 2008
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Contact Person:
Identification Number:
Telephone Number:
Employer Identification Number:

Dear :

This is in response to your revised request for rulings under sections 501(m), 512 and 514 of the Internal Revenue Code.

Facts

You are an organization described in section 501(c)(3) of the Code and a public charity. Your purpose is to operate two facilities, each of which serves as a home away from home for seriously ill children and their families. The houses are a haven for families who live too far away from the hospital to go home each night, while their children are receiving medical treatment.

Both of these facilities serve families of patients at a number of hospitals located in the area you serve. The programs offered in these facilities are supported by volunteers, staff and a wide base of community support.

Although other programs and facilities similar to yours exist throughout the United States, you are not controlled by any other outside entity. You are responsible for your own fundraising, and you support your programs and activities primarily by charitable gifts and contributions. In order to maintain your programs and activities, you are seeking new ways to increase charitable giving to support those programs.

As a means to increase funding of your programs, you have proposed to utilize a charitable gift annuity ("CGA") program. This program will be made available through an insurance broker and a major insurance company ("Insurer"). The Insurer is a highly rated affiliate of one of the leading international insurance organizations in the world.

You described the proposed CGA program as follows:

1. You will offer a charitable gift annuity to an individual ("Donor"), based on the life or lives of one or two individuals in being (the "Annuitant") at the time the annuity is issued ("CGA Contract"). The CGA Contract will be the sole consideration you give to the Donor in exchange for the cash or property you receive from Donor. The value of the CGA Contract will be less than 90 percent of the amount of cash or the value of other

property you receive from Donor. The CGA Contract will specify the amount of each periodic payment but will not guarantee a minimum number or specify a maximum number of periodic payments to the Annuitant. The CGA Contract also will not specify a minimum or maximum aggregate amount of payments the Annuitant will receive, and will not provide for any adjustment of the amount of the annuity payments by reference to the income received from the property transferred to you by Donor or from any other property.

2. The CGA Contract will provide that each periodic annuity payment is payable from your general assets; however, Donor and Annuitant will be aware that you will purchase an annuity from Insurer to match your liability associated with the CGA Contract.
3. You will purchase an annuity policy from Insurer ("Commercial Annuity") based on the Annuitant's life and with the same periodic payment amount and frequency as specified in the CGA Contract. You will purchase the Commercial Annuity with a single premium and a payout starting date commencing no later than one year from the date the Commercial Annuity is purchased. The Commercial Annuity will pay you a series of substantially equal periodic payments (to be made not less frequently than annually), which will match your obligation to the Annuitant during the CGA Contract payout period. You may receive an additional payment upon the death of the Annuitant, as explained in paragraph 6 below.
4. The amount you receive from Donor as consideration for the CGA Contract will exceed the Insurer's market rates for a commercial annuity with the same payout period and periodic payment amount. The difference between the amount you receive from Donor for the CGA Contract and the premium you will pay to Insurer for the Commercial Annuity you will retain for your immediate and unrestricted use.
5. The broker will receive a commission from Insurer for the sale to you of the Commercial Annuity. You will pay no compensation to the broker for Donor's entering into the CGA Contract and will pay no fees to the broker, Insurer or to any other party.
6. At your option, and for additional consideration that you would pay to Insurer, the Commercial Annuity may provide that if Annuitant dies before the total annuity payments you receive from Insurer equal or exceed the original premium payment you made to Insurer, you will receive a guaranteed lump sum cash refund equal to the premium you paid to Insurer minus the total periodic payments you received from Insurer.

Rulings Requested

1. Your sale of annuities through the CGA Contracts will not constitute the provision of commercial-type insurance under section 501(m) of the Code.
2. The following amounts will not constitute income from an unrelated trade or business within the meaning of section 513 of the Code:

- a. The difference between (i) the premium you will receive from Donor for the CGA Contract and (ii) the premium you will pay to Insurer for the Commercial Annuity;
- b. The periodic annuity payments you will receive from Insurer; and
- c. Any lump sum you will receive from Insurer upon the death of the last Annuitant under the guaranteed cash refund feature of the Commercial Annuity.

Law

Section 72(a) of the Code provides that in general, gross income includes any amount received as an annuity under an annuity, endowment, or life insurance contract.

Section 102(a) of the Code provides that gross income does not include the value of property acquired by gift, bequest, devise or inheritance.

Section 501(m)(1) of the Code provides that an organization described in section 501(c)(3) shall be exempt from tax under section 501(a) only if no substantial part of its activities consists of providing commercial-type insurance.

Section 501(m)(2) of the Code provides that, in the case of an organization described in section 501(c)(3) which is exempt from tax under section 501(a) after application of section 501(m)(1), the activity of providing commercial-type insurance shall be treated as an unrelated trade or business as defined in section 513(a).

Section 501(m)(3)(E) of the Code provides that the term "commercial-type insurance" shall not include charitable gift annuities.

Section 501(m)(5) of the Code provides that for purposes of section 501(m)(3)(E), the term "charitable gift annuity" means an annuity if (i) a portion of the amount paid in connection with the issuance of the annuity is allowable as a deduction under section 170 or 2055, and (ii) the annuity is described in section 514(c)(5) (determined as if any amount paid in cash in connection with such issuance were property).

Section 511(a) of the Code imposes a tax upon the unrelated trade or business income of tax-exempt organizations.

Section 512(a)(1) of the Code provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less allowable deductions which are directly connected with the carrying on of such trade or business, both computed with certain modifications.

Section 512(b)(1) of the Code provides an exclusion from unrelated business taxable income for all annuities and all deductions directly connected with such income.

Section 513(a) of the Code provides that the term “unrelated trade or business” means any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes from the profits derived) to the exercise or performance by such organization of its charitable or other purpose or function constituting the basis for its exemption under section 501.

Section 1.513-1(b) of the regulations states in part that where an activity does not possess the characteristics of a trade or business within the meaning of section 162, such as when an organization sends out low-cost articles incidental to the solicitation of charitable contributions, the unrelated business income tax does not apply since the organization is not in competition with taxable organizations.

Section 514(a)(1) of the Code provides that, in computing the unrelated business taxable income for any taxable year, a percentage of net income derived from debt-financed property should be included.

Section 514(b)(1) of the Code provides that the term “debt-financed property” means any property which is held to produce income and with respect to which there is an acquisition indebtedness at any time during the taxable year.

Section 514(c)(5) of the Code provides that the term “acquisition indebtedness” does not include an obligation to pay an annuity which:

(A) is the sole consideration issued in exchange for property if, at the time of the exchange, the value of the annuity is less than 90 percent of the value of the property received in the exchange;

(B) is payable over the life of one individual in being at the time the annuity is issued, or over the lives of two individuals in being at such time; and,

(C) is payable under a contract which:

(i) does not guarantee a minimum amount of payments or specify a maximum amount of payments, and

(ii) does not provide for any adjustment of the amount of the annuity payments by reference to the income received from the transferred property or from any other property.

The legislative history accompanying The Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100-647, H.R. Rep. No. 795, 100th Cong., 2d Sess. 116 (1988), in adding section 501(m)(3)(E) to the Code, stated: “[t]he present-law exception to the debt-financed property rules had historically exempted from tax any income resulting from the issuance of charitable gift annuities.”

Analysis

Ruling No. 1

An activity that otherwise constitutes providing commercial-type insurance, within the meaning of section 501(m)(2) of the Code, will not constitute commercial-type insurance if it involves "charitable gift annuities." This term is defined in section 501(m)(5), and means an annuity if: (A) a portion of the amount paid is deductible under section 170, and (B) the annuity is described in section 514(c)(5).

You received a separate letter ruling from the Office of Associate Chief Counsel, Passthroughs & Special Industries that included the ruling that a charitable contribution deduction will be allowable under section 170 of the Code when a donor purchases from you a CGA Contract of the type described above. Thus, based on this letter ruling, the CGA Contract meets the first requirement of section 501(m)(5).

An annuity is described in section 514(c)(5) of the Code if it meets several requirements. For the following reasons, the annuity in the CGA Contract meets all of these requirements, and therefore the CGA Contract meets the second requirement of section 501(m)(5). Your obligation to pay Donor an annuity under the CGA Contract will be the sole consideration you will provide to Donor in return for the amount you will receive from Donor. The value of the annuity you will pay Donor will be less than 90 percent of the amount you will receive from Donor. Under the CGA Contract, you will make annuity payments to Donor based on the life or lives of one or two individuals at the time the annuity is issued. The CGA Contract does not guarantee a minimum or maximum amount of payments to the Donor. Finally, the CGA Contract does not provide for any adjustment of the amount of the annuity payments by reference to the income received from the funds transferred by Donor to you or from any other property.

Thus, the annuities under the CGA Contracts will meet both requirements for charitable gift annuities under section 501(m)(5) of the Code, and therefore, will constitute charitable gift annuities within the meaning of section 501(m)(3)(E). As a result, your sale of the annuities through the CGA Contracts will not constitute the provision of commercial-type insurance under section 501(m).

Ruling No. 2

Your principal purpose for selling CGA Contracts to Donors is to solicit charitable gifts to raise funds to finance your tax-exempt activities. A program that involves the issuance of charitable gift annuities has traditionally been treated as a borrowing of money by the issuing organization rather than a trade or business. Therefore, the provisions of section 511 through 513 of the Code are not applicable because this activity is not a trade or business under section 1.513-1(b) of the regulations.

Inasmuch as there is an underlying financial obligation, the property could be considered debt-financed within the meaning of section 514 of the Code. However, section 501(c)(5) states that the rules concerning debt-financed property do not apply to the sale of annuities that satisfy the requirements in that section of the Code. As stated above, you intend to structure your program in such a way so as to meet these requirements. Therefore, income derived from this program is not unrelated business taxable income.

Even if this activity constituted a trade of business, for the following reasons, the revenues you will receive from the sale of CGA Contracts would not constitute unrelated business taxable income under section 512 of the Code.

(a) You will insure your annuity obligation to the Annuitant during the CGA Contract payout period by purchasing from Insurer the Commercial Annuity to pay you amounts that will match your annuity obligation to the Annuitant. Thus, the difference between the premium you will receive from Donor for the CGA Contract and the premium you will pay to Insurer for the Commercial Annuity will represent the gift element of the transaction. Under section 102(a) of the Code, because gifts are not included in gross income, this difference will not be included in unrelated business taxable income under section 512(a)(1).

(b) Section 512(b)(1) of the Code provides that various items of income, including annuities, are excluded from unrelated business taxable income. Thus, the periodic annuity payments you will receive from Insurer under the Commercial Annuity will be excluded from unrelated business taxable income.

(c) In some situations, if Annuitant dies before the total annuity payments you receive from Insurer equal or exceed the original premium payment you made to Insurer, you will receive a guaranteed lump sum cash refund equal to the premium you paid to Insurer minus the total periodic payments you received from Insurer. We have been advised by the Office of Associate Chief Counsel, Financial Institutions & Products that the presence of this refund feature in the Commercial Annuity will not adversely affect the status of CGA Contracts as an annuity under section 72 of the Code. Thus, based on this advice, any lump sum you receive from Insurer upon the death of the last Annuitant under the guaranteed cash refund feature of the Commercial Annuity will constitute an annuity. As a result, it will be excluded from unrelated business taxable income under section 512(b)(1) of the Code.

Under the CGA Contract, the annuity is payable over the lifetime of one or two individuals in being at the time the annuity is issued. In addition, the CGA program will meet all the other requirements in section 514(c)(5) of the Code. Therefore, the annuities under the CGA Contracts will not be debt-financed property within the meaning of section 514. Therefore, interest income you derive from the annuity will be excludable from unrelated business taxable income under section 512(b)(1).

Rulings

Accordingly, based on the information furnished, we rule as follows:

1. You sale of annuities through the CGA Contracts will not constitute the provision of commercial-type insurance under section 501(m) of the Code.
2. The following amounts will not constitute income from an unrelated trade or business within the meaning of section 513 of the Code:
 - a. The difference between (i) the premium you will receive from Donor for the CGA Contract and (ii) the premium you will pay to Insurer for the Commercial Annuity;
 - b. The periodic annuity payments you will receive from Insurer; and
 - c. Any lump sum you will receive from Insurer upon the death of the last Annuitant under the guaranteed cash refund feature of the Commercial Annuity.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Manager, Exempt Organizations
Technical Group 1