**Internal Revenue Service**

Number: **201222011**
Release Date: 6/1/2012

Index Number: 168.00-00, 469.00-00, 1038.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:02
PLR-128114-11
Date:
December 19, 2011

Legend
X =

Fund =

Dear :

This letter responds to a letter dated June 29, 2011, and subsequent correspondence, submitted on behalf of X, by its authorized representative requesting rulings concerning and related to the qualifications of Fund as a pooled income fund under § 642(c)(5) of the Internal Revenue Code. Specifically, you requested the following rulings:

1. The differences between Fund's governing instrument and the sample declaration of trust and instruments for pooled income funds provided in Revenue Procedure 88-53, 1988-2 C.B. 712, do not cause Fund to fail to be a pooled income fund under § 642(c)(5);
2. Fund's cost basis in the building is depreciable over 40 years under the straight-line method;
3. To the extent that the depreciation deduction for a particular year exceeds the income set aside by Fund's trustee for the depreciation reserve, such depreciation deduction will be allocable to Fund's income beneficiaries and X on the basis of the trust income (in excess of the income set aside for the reserve) allocable to each;
4. Amounts distributed from Fund that are includible in an income beneficiary's gross income will be passive income under § 469;
5. Fund will be treated as a split-interest trust under § 4947(a)(2); and

6. The transactions as outlined in the request will not give rise to any direct or indirect self-dealing.

Facts

X is a tax-exempt organization described in §§ 501(c)(3) and 170(b)(1)(A)(iii). X created Fund to raise capital from donations of cash and property to purchase and renovate buildings. X is Fund's sole trustee.

X will sell buildings to Fund and X will lease the land under each building to Fund for 25 years. Each building is nonresidential real property as defined in § 168(e)(2)(B). X represents that Fund will then lease the buildings and land back X for 25 years on a "net-net" lease basis and that the lease agreement will not provide for any renewals of this lease term. X will pay rent in an amount intended to produce to Fund's income beneficiaries a fixed net rate of return. All such net rental income will be distributed to, and entirely taxable to, the income beneficiaries of Fund.

Law and Analysis

Ruling 1. The difference between Fund's governing instrument and the sample declaration of trust and instruments for pooled income funds provided in Rev. Proc. 88-53, 1988-2 C.B. 712, do not cause Fund to fail to be a pooled income fund under § 642(c)(5).

Section 1.642(c)-5(a)(2) of the Income Tax Regulations provides that notwithstanding any other provision of chapter 1, a fund which meets the requirements of a pooled income fund as defined in § 642(c)(5) and § 1.642(c)-5(b), shall not be treated as an association within the meaning of § 7701(a)(3). Such a fund, which need not be a trust under local law, and its beneficiaries shall be taxable under part 1, subchapter J, chapter 1 of that Code, but the provisions of subpart E (relating to grantors and others treated as substantial owners) of such part shall not apply to such fund.

Section 4 of Rev. Proc. 2011-3, 2011-1 I.R.B. 111, lists issues on which the Service ordinarily will not issue letter rulings. The issues include whether a pooled income fund satisfies the requirements of § 642(c)(5) and whether a transfer to a pooled income fund is deductible as a charitable contribution under §§ 170(f)(2)(A), 2055(e)(2)(A), and 2522(c)(2)(A). In lieu of seeking the Service's advance approval of the pooled income funds, taxpayers are directed to follow the sample trust provisions for a pooled income fund in Rev. Proc. 88-53, 1988-2 C.B. 712. Taxpayers who follow the sample trust provisions of Rev. Proc. 85-53 are assured that the Service will recognize the trust as meeting all the requirements for a pooled income fund under § 642(c)(5),

provided the trust operates consistently with the terms of the trust instrument and is a valid trust under local law.

The sample declaration of trust and instruments of transfer in Rev. Proc. 88-53 are intended to meet all the applicable requirements for a pooled income fund under § 642(c)(5). They are not intended, however, to preclude other permissible provisions in the governing instruments. Provisions that vary from the sample provisions will not adversely affect the fund's qualification as a pooled income fund if those provisions are consistent the requirements of § 642(c)(5) and § 1.642(c)-5. In the present case, Fund's declaration of trust contains four provisions not addressed in Rev. Proc. 88-53. Because these provisions are not addressed in Rev. Proc. 88-53, we are ruling on whether these provisions adversely affect the qualification of Fund as a pooled income fund if it otherwise qualifies under § 642(c)(5).

Section 1.2 of Fund's trust agreement provides that a donor may retain in the Donor Agreement the power exercisable only by will to revoke or terminate the income interest of any designated beneficiary other than X. Income interests are otherwise irrevocable.

Section 1 of the sample declaration in Rev. Proc. 88-53 provides that each donor transferring property to the Fund shall contribute an irrevocable remainder interest in such property to Public Charity.

Section 1.642(c)-5(b)(2) provides, in part, that the donor may retain power exercisable only by will to revoke or terminate the income interest of any designated beneficiary other than the public charity.

Section 1.2 of Fund's trust agreement does not impact X as the charitable remainder beneficiary. Therefore, the provision in § 1.2 of Fund's trust agreement will not adversely affect the qualification of Fund as a pooled income fund if it otherwise qualifies under § 642(c)(5) because that provision restricts the power of the donor to revoke or terminate the income interest of any designated beneficiary other than X only by will in accordance with § 1.642(c)-5(b)(2).

Section 3.4 of Fund's trust agreement provides that income for the quarter in which the donor dies, which is attributable to those Units as to which the decedent was beneficiary, shall be prorated to the date of the donor's death.

Section 7 of the sample declaration of trust in Rev. Proc. 88-53 states, in part, that the income interest of any beneficiary of the Fund shall terminate with the last regular payment of income that was made before the death of the beneficiary. The Trustee of the Fund shall not be required to prorate any income payment to the date of the beneficiary's death.

Section 1.642(c)-5(b)(7) provides, in part, that the income interest of any designated beneficiary shall either terminate with the last regular payment which was made before the death of the beneficiary or be prorated to the date of his death.

Section 3.4 of Fund's trust agreement will not adversely affect the qualification of Fund as a pooled income fund if it otherwise qualifies under § 642(c)(5) because that provision terminates the income interest at the death of the beneficiary and in accordance with § 1.642(c)-5(b)(7) allows the final payment to be prorated to the beneficiary's date of death.

Section 7.5.7 of Fund's trust agreement provides that the trustee has the authority to set up and maintain depletion and depreciation reserves in accordance with Generally Accepted Accounting Principles ("GAAP") for any Fund property by setting aside, in its sole and absolute discretion, trust income in a depletion or depreciation reserve. Any depletion or depreciation deduction in excess of the income so set aside as a reserve shall be apportioned between the income beneficiaries and the trustee on the basis of the trust income (in excess of the income to set aside for the reserve) allocable to each. The trust agreement does not prohibit the trustee from investing in depreciable or depletable assets.

Rev. Rul. 90-103, 1990-2 C. B. 159, holds that if a trustee of a trust that otherwise qualifies as a pooled income fund is not required by the governing instrument or state law to establish a depreciation reserve fund with respect to any depreciable property held by the trust, the trust does not meet the requirements for a pooled income fund under § 642(c)(5)(A). The revenue ruling further holds that if the trustee of a trust that otherwise qualifies as a pooled income fund is required by the governing instrument to establish a depreciation reserve fund with respect to any depreciable property held by the trust, but the deprecation to be added to such reserve is not required to be determined in accordance with GAAP, the trust does not meet the requirements for a pooled income fund under § 642(c)(5)(A).

Rev. Rul. 90-103 provides that if the trustee of an otherwise qualifying pooled income fund is not prohibited by state law from accepting or investing in depreciable or depletable property, the governing instrument must provide either that the trustee shall establish a depreciation or depletion reserve in accordance with GAAP or that the trustee shall not accept or invest in any depreciable or depletable assets.

Section 7.5.7 of Fund's trust agreement will not adversely affect the qualification of Fund as a pooled income fund if it otherwise qualified under § 642(c)(5) because as required by Rev. Rul. 90-103 the trustee must maintain any depreciation or depletion fund reserve in accordance with GAAP.

Section 12.1 of Fund's trust agreement states that X shall have the right to amend, in whole or in part, any or all of the provisions of this Agreement. However, no

such amendment shall jeopardize the status of Fund as a pooled income fund within the meaning of § 642(c)(5).

Section 13 of the sample declaration of trust in Rev. Proc. 88-53 states that the Public Charity shall have the power, acting alone, to amend the declaration of trust and the associated instruments of transfer in any manner required for the sole purpose of ensuring that that the Fund qualifies and continues to qualify as a pooled income fund within the meaning of § 642(c)(5).

The amendment power in § 12.1 of Fund's trust agreement will not adversely affect the qualification of Fund as a pooled income fund if it otherwise qualifies under § 642(c)(5).

Ruling 2. Fund's cost basis in the building is depreciable over 40 years under the straight-line method.

Section 167(a) provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business, or property held for the production of income.

The depreciation deduction provided by § 167(a) for tangible property placed in service after 1986 generally is determined under § 168. This section prescribes two methods of accounting for determining depreciation allowances. One method is the general depreciation system in § 168(a) and the other method is the alternative depreciation system in § 168(g). Under either depreciation system, the depreciation deduction is computed by using a prescribed depreciation method recovery period, and convention.

Section 168(g)(1)(B) provides that in the case of any tax-exempt use property, the depreciation deduction allowed under § 167(a) shall be determined using the alternative deprecation system (ADS).

Section 168(g)(2) provides that for purposes of § 168(g)(1), the ADS is depreciation determined by using the straight line method (without regard to salvage value), the applicable convention determined under § 168(d), and a recovery period determined under the table prescribed under § 168(g)(2)(C). Pursuant to this table, nonresidential real and residential rental property have a 40-year recovery period.

Section 168(g)(3)(A) provides that in the case of any tax-exempt use property subject to a lease, the recovery period used for purposes of § 168(g)(2) shall in no event be less than 125% of the lease term.

Section 1.168(i)-2(a) provides that for purposes of § 168, a lease term is determined under all the facts and circumstances. Section 1.168(j)-1T, Q&A 17,

describes certain circumstances that will result in a period of time not included in the stated duration of an original lease (additional period) nevertheless being included in the lease term. These rules do not prevent the inclusion of an additional period in the lease term in other circumstances.

Q&A 17 of § 1.168(j)-1T provides rules relating to what is included in determining the length of a lease term. Paragraph (i) of A-17 provides that the lease term includes not only the stated duration, but also any additional period of time that is within the "realistic contemplation of the parties at the time the property is first put into service." Hokanson v. Commissioner, 730 F. 2d 1245, 1248 (9th Cir. 1984). A subsequent period of time is included in the term of the original lease if the circumstances indicate that the parties, upon entering into the original lease, had informally agreed that there would be an extension of the original lease.

With respect to real property, paragraph (iii) of A-17 provides that the lease term includes all periods for which the tax-exempt lessee or related party has a legally enforceable option to compel its renewal by the tax-exempt entity or a related party, unless the option to renew is at fair market value, determined at the time of renewal. The Hokanson facts and circumstances test may cause the term of a fair market value renewal option to be treated as part of the original lease term.

In this case, X and Fund represent that the lease agreement pertaining to the lease of building by Fund to X will be for a 25-year period and this lease agreement will not provide for any renewals of this 25-year lease term. Based solely on these representations, if building is tax-exempt use property, it must be depreciated under the ADS over the greater of 40 years, as provided in the table under § 168(g)(2)(C), or 31.25 years (125% of the 25-year lease term).

Section 168(h) provides the rules relating to tax-exempt use property. For purposes of § 168, § 168(h)(1)(B)(i) provides that, in the case of nonresidential real property, the term "tax-exempt use property" means that portion of the property leased to a tax-exempt entity in a disqualified lease.

Section 168(h)(1)(B)(ii) provides that for purposes of § 168(h)(1)(B), the term "disqualified lease" means any lease of nonresidential real property to a tax-exempt entity, but only if (I) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under § 103(a) and such entity (or a related entity) participated in such financing, (II) under such lease there is a fixed or determinable price purchase or sale option which involves such entity (or related entity) or there is the equivalent of such an option, (III) such lease has a lease term in excess of 20 years, or (IV) such lease occurs after a sale (or other transfer) of the property by, or lease of the property from, such entity (or related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease [i.e., a sale-leaseback or a lease-leaseback arrangement].

Section 168(h)(1)(B)(iii) provides that § 168(h)(1)(B)(i) shall apply to any property only if the portion of such property leased to tax-exempt entities in disqualified leases is more than 35% of the property.

Section 168(h)(2)(A)(ii) provides that for purposes of § 168(h), the term "tax-exempt entity" includes any organization (other than a cooperative described in § 521) that is exempt from tax imposed by Chapter 1 of the Internal Revenue Code.

Here, the property to be leased back to X is nonresidential real property. Under § 168(h), nonresidential real property is tax-exempt use property if it is leased to a tax-exempt entity under a disqualified lease and the portion of such property leased is more than 35% of the property. Thus, the proposed lease of building will be a disqualified lease if at least one of the four requirements provided in § 168(h)(1)(B)(ii) is met and § 168(h)(1)(B)(iii) is satisfied.

In this case, building will be leased to X, a tax-exempt entity, for a term of 25 years. Accordingly, building will be tax-exempt use property because it will be leased to X, a tax-exempt entity under a disqualified lease, i.e., a lease with a term exceeding 20 years, and at least 35% of such property will be leased to X.

Based solely on X's and Fund's representations and the law and analysis set forth above, we conclude that Fund's cost basis in building is depreciable over 40 years under the straight line method.

Ruling 3. To the extent that the depreciation deduction for a particular year exceeds the income set aside by Fund's trustee for the depreciation reserve, such depreciation deduction will be allocable to Fund's income beneficiaries and X on the basis of the trust income (in excess of the income set aside for the reserve) allocable to each.

Section 642(e) provides in pertinent part that an estate or trust shall be allowed the deduction for depreciation only to the extent not allowable to beneficiaries under § 167(d).

Section 167(d) provides that in the case of property held in trust, the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

Section 1.167(h)-1(b) provides that if property is held in trust, the allowable depreciation deduction is to be apportioned between the income beneficiaries and the trustee on the basis of the trust income allocable to each, unless the governing instrument (or local law) requires or permits the trustee to maintain a reserve for depreciation in any amount. In the latter case, the deduction is first allocated to the

trustee to the extent that income is set aside for a depreciation reserve, and any part of the deduction in excess of the income set aside for the reserve shall be apportioned between the income beneficiaries and the trustee on the basis of the trust income (in excess of the income set aside for the reserve) allocable to each. For example, if under the trust instrument or local law the income of a trust is to be distributed to a named beneficiary, but the trustee is directed to maintain a reserve for depreciation in any amount, the deduction is allowed to the trustee (except to the extent that income set aside for the reserve is less than the allowable deduction). The same result would follow if the trustee sets aside income for a depreciation reserve pursuant to discretionary authority to do so in the governing instrument.

In the instant case, section 7.5.7 of Fund's trust agreement permits the trustee to set up and maintain depreciation reserves in accordance with GAAP for any property of Fund by setting aside, in its sole and absolute discretion, trust income to a depreciation reserve, and provides that any depreciation deduction in excess of the income set aside as a reserve is apportioned between the income beneficiaries and the trustee on the basis of the trust income (in excess of the income to set aside for the reserve) allocable to each.

Accordingly, based solely on such section of Fund's trust agreement and the law set forth above, we conclude that, to the extent that the depreciation deduction for a particular year exceeds the income set aside by the trustee for the depreciation reserve, such depreciation deduction will be allocable to Fund's income beneficiaries and X on the basis of the trust income (in excess of the income set aside for the reserve) allocable to each.

Ruling 4. Amounts distributed from Fund that are includible in an income beneficiary's gross income will be passive income under § 469.

Under § 1.651(a)-1, because amounts in a pooled income fund may be paid or permanently set aside for purposes specified in § 642(c)(5), the fund will be subject to §§ 661 and 662, which apply to complex trusts.

Under § 662(a), a beneficiary of a trust includes in gross income an amount equal to the amount of trust income required to be distributed currently to that beneficiary, plus other amounts properly paid, credited, or required to be distributed, but only up to that beneficiary's ratable portion of the trust's distributable net income (DNI).

Under § 662(b), the amounts determined under § 662(a) have the same character in the hands of the beneficiary as in the hands of the trust. These amounts are treated as consisting of the same proportion of each class of items entering into the computation of DNI as the total of each class bears to the total DNI of the trust unless the governing instrument or local law specifically allocates different classes of income to different beneficiaries.

Section 469(a) provides for the disallowance of passive activity losses. Section 469(c)(2) provides that except as provided in § 469(c)(7), the term "passive activity" includes any rental activity.

Section 469(d)(1) defines a passive activity loss as the amount by which the aggregate losses from all passive activities for the taxable year exceed the aggregate income from all passive activities for that year.

The rental of land and buildings by Fund to X will be a passive activity under § 469(c). Because the excess of aggregate income from all passive activities over the aggregate losses from all passive activities will enter into the computation of DNI, then the characterization rule of § 662(b) will apply. Thus, if Fund's gross income in any year from rental of the land and buildings exceeds its losses (including a ratable portion of Fund's indirect expenses) in that year from rental of the land and buildings, amounts distributed from Fund that are includible in the gross income of an income beneficiary for that year will be income to that beneficiary from a passive activity, within the meaning of § 469, in the same proportion as Fund's DNI for that year bears to Fund's entire DNI for that year.

Ruling 5. Fund will be treated as a split-interest trust under § 4947(a)(2).

Section 508(e) provides in effect that the governing instrument of a private foundation must include language that requires its income for each taxable year to be distributed at such time and in such manner as not to subject the foundation to tax under § 4942, and prohibits the foundation from engaging in any act of self-dealing (as defined in §4941(d)), from retaining any excess business holdings (as defined in § 4943(c)), from making any investments in such manner as to subject the foundation to tax under § 4944, and from making any taxable expenditures (as defined in § 4945(d)).

Section 4941 imposes an excise tax on private foundations and foundation mangers for each act of self-dealing and between a private foundation and a disqualified person. The term "self-dealing" includes any direct or indirect sale of exchange, or leasing, of property between a private foundation and a disqualified person, and lending of money or other extension of credit between a private foundation and a disqualified person.

Section 4946(a)(1)(B) defines "disqualified person" with respect to a private foundation to include trustees of the foundation.

Section 4947(a)(2) applies § 4941 self-dealing rules to § 642(c)(5) pooled income funds as if they were private foundations, where such funds are not exempt from tax under § 501(a), not all of the unexpired interests in which are devoted to one or more of

the purposes described in § 170(c)(2)(B), and have amounts in trust for which a deduction was allowed under § 642(c)(5).

For purposes of § 4941 only, § 53.4946-1(a)(8) deems organizations described in § 501(c)(3) (other than organizations described in § 509(a)(4)) as not disqualified persons.

Section 53.4947-1(d) provides that a § 4947(a)(2) trust is subject to the governing instrument requirements of § 508(e) to the extent that they are applicable.

Fund is a split-interest trust under § 4947(a)(2) because (i) it is not exempt from tax under § 501(a); (ii) not all of the unexpired interests in it are devoted to one or more of the purposes described in § 170(c)(2)(B), and (iii) it has amounts in trust for which a deduction was allowed under § 642(c). Section 4947(a)(2) provides that a split-interest trust is treated as a private foundation for purposes of §§ 508(e), 4941, and 4945 of the Code.

Section 508(e) requires a private foundation to include certain provisions in its governing instruments. These provisions must require the private foundation's income for each taxable year to be distributed at such time and in such manner as not to subject the foundation to tax under § 4942, and also prohibit the private foundation from engaging in any act of self-dealing (as defined in § 4941(d)), from retaining any excess business holdings (as defined in § 4943(c)), from making any investments in such manner as to subject the foundation to tax under § 4944, and from making any taxable expenditures (as defined in § 4945(d)). Fund's trust agreement contains provisions with respect to each of these Code sections. Accordingly, the provisions of Fund's trust agreement conform to the requirements of § 508(e) imposed on private foundations.

Ruling 6. The transactions as outlined in the request will not give rise to any direct or indirect self-dealing.

Section 4941 applies self-dealing rules to certain transactions between disqualified persons and private foundation. X is Fund's sole trustee. Since § 4946(a)(1)(B) defines trustees as disqualified persons with respect to their trusts, X as trustee of Fund is a disqualified person with respect to Fund unless an exception applies. Because X is an organization described in § 501(c)(3) (other than an organization described in § 509(a)(4)) and § 53.4946-1(a)(8) deems such charitable organizations are not disqualified persons for purposes of § 4941 only, then X is not a disqualified person with respect to Fund for purposes of § 4941. Accordingly, the transactions between X and Fund are not direct or indirect self-dealing within the meaning of § 4941, including the sale, loan, and lease transactions.

Except as expressly set forth herein, no opinion is expressed or implied concerning the federal tax consequences of the facts described above under any other

provision of the Code. We specifically do not rule on any tax consequences arising under §§ 4945 or 512(b)(13), or any other subsections of §§ 167 and 168. Further, no opinion is expressed or implied: (i) on whether any portion of Fund's cost basis in building is attributable to any § 1245 property; (ii) concerning the application of § 168(g)(2)(C) and (3)(A) or § 168(h) to any such § 1245 property; or (iii) on whether X and Fund have informally agreed that there would be an extension of the lease agreement to the lease of building by Fund to X. No opinion is expressed concerning any other federal tax consequences of the formation or operation of Fund, including whether the governing instruments meet all of the requirements of § 642(c)(5).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy of this letter should be attached to the first return filed by Fund. A copy is enclosed for that purpose. Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
(Passthroughs & Special Industries)

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

cc: