Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:02
PLR-128106-11
Date:
December 19, 2011

Legend
X =

Fund =
Date =
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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 relating to Fund. Specifically, you requested the following rulings:

1. The reacquisition of certain buildings by X will be governed by § 1038 and the regulations thereunder;
2. The transaction described in the request will not cause Fund to cease to qualify as a pooled income fund under § 642(c)(5); and
3. The reacquisition of the buildings by X will not give rise to any direct or indirect self-dealing between Fund and X.

Facts

X is a tax-exempt organization described in §§ 501(c)(3) and 170(b)(1)(A)(iii). X created Fund to qualify as a pooled income fund under § 642(c)(5) to raise capital from donations of cash and property to purchase and renovate buildings. X is Fund's sole trustee.

On Date 1, X sold buildings to Fund via separate special warranty deeds with reversionary interests. Fund purchased the buildings with a promissory note in favor of X, which was secured by trust deeds on each of the buildings. Although the notes are not in default, X will reacquire certain undivided interests in the buildings in partial satisfaction of the note in order to restructure and redesign fundraising efforts in various geographic areas. X will not receive any money or other property from Fund on the reacquisition of the buildings, and X will not pay any consideration to Fund for the reacquisition of the buildings.

X plans to create new pooled income funds, which will also be controlled and administered by X. X plans to sell its reacquired interests in the buildings to the new pooled income funds in accordance with X's new fundraising program. The buildings will ultimately be owned by Fund and one or more of the new pooled income funds controlled and administered by X.

Law & Analysis

Ruling 1. The reacquisition of certain buildings by X is governed by § 1038 and the regulations thereunder.

Section 1038 of the Internal Revenue Code provides for the tax treatment of certain reacquisitions of real property by the seller of property in partial or full satisfaction of the indebtedness to the seller that arose from the sale.

Under § 1038(a), if a sale of real property gives rise to indebtedness to the seller that is secured by the real property sold, and the seller of such property reacquires the property in partial or full satisfaction of the indebtedness, then except as provided in § 1038(b) and (d), no gain or loss results to the seller from the reacquisition, and no debt becomes worthless or partially worthless as a result of the reacquisition.

Section 1038(b)(1) provides that, in the case of a reacquisition of real property to which § 1038 applies, gain from the reacquisition is the excess of (A) the amount of money and the fair market value of other property (other then obligations of the purchaser) received, prior to the reacquisition, from the sale of such property, over (B) the amount of the gain on the sale of the property returned as income for periods prior to the reacquisition.

Section 1038(d) provides that if, prior to a reacquisition of real property to which § 1038(a) applies, the seller has treated indebtedness secured by the property as having become worthless or partially worthless –

(1) the seller is considered to have received, upon the reacquisition of the property, an amount equal to the amount of such indebtedness treated by him as having become worthless, and

(2) the adjusted basis of the indebtedness is increased (as of the date of reacquisition) by an amount equal to the amount considered received by the seller.

Section 1.1038-1(a)(3)(ii) of the Income Tax Regulations provides, in part, that the manner of reacquisition is generally immaterial. The property may be reacquired by agreement or by process of law. A voluntary conveyance from the purchaser is a type of reacquisition within the purview of § 1038.

Under § 1.1038-1(b)(1)(i), the seller's gain in a reacquisition to which § 1.1038-1(a) applies is the excess of the amount of money and the fair market value of other property (other than obligations of the purchaser arising from the sale) received by the seller prior to reacquisition, from the sale over the amount of the gain derived by the seller on the sale of the property that is returned as income for periods prior to the reacquisition. However, the amount of gain will in no case exceed the amount determined under § 1.1038-1(c) from the reacquisition.

Section 1.1038-1(b)(2)(i) provides that amounts of money and other property received by the seller from the sale of the property include payments made by the purchaser for the seller's benefit, as well as payments made and other property transferred directly to the seller. Under § 1.1038-1(b)(2)(iii), amounts received by the seller as interest stated or unstated are excluded from the computation of gain on the sale of the property and are not considered amounts of money or other property received from the sale.

Section 1.1038-1(c)(1) provides, in general, that the amount of the gain on reacquisition of real property, as determined under § 1.1038-1(b), cannot exceed –

(i) The amount by which the price at which the real property was sold exceeded is adjusted basis at the time of the sale, as determined under § 1.1011-1, reduced by,
(ii) The amount of gain on the sale of the real property returned as income for periods prior to the reacquisition, and by
(iii) The amount of money and the fair market value of other property (other than obligations of the purchaser received from the sale of the real property) paid or transferred by the seller in connection with the reacquisition of the real property.

The applicability of § 1038 of the Code depends upon two conditions. First, there must be a sale of real property that gives rise to indebtedness to the seller secured by the real property sold. An indebtedness is secured by the real property whenever the seller has the right to take title or possession, or both, in the event that the purchaser defaults on the obligation. Second, the seller of the property must reacquire the property in partial or full satisfaction of the indebtedness.

Here, as represented by X, all the elements of § 1038(a) have been satisfied. X sold the buildings to Fund giving rise to Fund's indebtedness to X, which was secured

by the buildings. X will require an interest in the buildings in partial satisfaction of Fund's indebtedness and in furtherance of X's security rights in the building.

Accordingly, § 1038 will apply to the reacquisition of the buildings by X. The amount of gain, if any, resulting from the reacquisition is determined under § 1038(b) and (d) and §§ 1.1038-1(b) and 1.1038-1(c). Further, the entire amount of the gain must be recognized notwithstanding any other provision of subtitle A of the Code. The examples in § 1.1038-1(h) illustrate the computation of the gain in a reacquisition to which § 1038 applies.

Ruling 2. The transaction, as described herein, will not cause Fund to cease to qualify as a pooled income fund under § 642(c)(5).

Section 1.642(c)-5(b)(3) provides, in part, that a pooled income fund shall not be disqualified as a pooled income fund because any portion of its properties is invested or reinvested jointly with other properties, not a part of the pooled income fund, which are held by, or for the use of, the public charity which maintains the funds. Where such joint investment or reinvestment of properties occurs, records must be maintained which sufficiently identify the portion of the total fund which is owned by the pooled income fund and the income earned by, and attributable to, such portion.

Fund will not be disqualified as a pooled income fund because any portion of its properties is invested or reinvested jointly with other properties, not a part of Fund, which are held by, or for the use of X which maintains the fund. Where joint investment or reinvestment of properties occurs, records must be maintained which sufficiently identify the portion of the total fund which is owned by Fund and the income earned by, and attributable to, such portion.

Ruling 3. The reacquisition of the buildings by X will not give rise to any direct or indirect self-dealing between Fund and X.

Section 4941 imposes an excise tax on private foundations and foundation managers for each act of self-dealing between a private foundation and a disqualified person. The term "self-dealing" includes any direct or indirect sale or 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 the § 4941 self-dealing rules to § 642(c)(4) pooled income funds as if they were private foundation, 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).

For purposes of § 4941 only, § 4946-1(a)(8) provides that the term "disqualified person" shall not include organizations described in § 501(c)(3) (other than organizations described in § 509(a)(4)).

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 which 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). Split-interest trusts are treated as private foundations by § 4947(a)(2) which applied § 4941 self-dealing rules to certain transactions between disqualified persons and private foundation. X is the sole trustee of Fund. Since § 4946(a)(1)(B) defines such trustees as disqualified persons, X is a disqualified person with respect to Fund unless an exception applies.

X is also an organization described in § 501(c)(3) (other than an organization described in § 509(a)(4)), and since § 53.4946-1(a)(8) defines such charitable organizations as not disqualified persons for purposes of § 4941 only X is not a disqualified person with respect to Fund. Accordingly, the proposed transactions between X and Fund are not self-dealing within the meaning of § 4941.

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. 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. 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: