Internal Revenue Service

Department of the Treasury

Washington, DC 20224

200131034

Uniform Issue List No. 511.00-00

Contact Person:

Telephone Number:
T:EP:RA:T2

In Reference to:
(202)

Date:
MAY 9 2001

Attn:

LEGEND:

Employer A =

Plan X =

State B =

Employer C =

Division D =

Employer E =

Dear

This is in response to a request for a private letter ruling, dated , and supplemented by correspondence dated and which your authorized representative submitted on your behalf. Your request concerns the federal tax consequences of a proposed reversion of assets to you upon termination of your defined benefit pension plan. In a letter dated you withdrew the portion of your ruling request relating to excise tax imposed under section 4980 of the Code.

In support of your ruling request your authorized representative has presented the following facts:

Employer A sponsors Plan X, a defined benefit pension plan. Employer A was formed in as a nonprofit corporation under the laws of State B. Employer A is classified as a private operating foundation under section 509(a) and 4942(j)(3) of the

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Internal Revenue Code (the "Code") and is also classified as an exempt operating foundation under section 4940(d) of the Code. Employer A has been exempt from federal income taxation, under what is now section 501(c)(3) of the Code, since the enactment of federal income tax laws.

Employer A operates various academic science conferences, aids in the publishing of scientific studies and papers, and makes research grants to university and college faculty members, as well as funding high school science teacher programs.

In , Employer A established a retirement annuity plan, under which it purchased retirement annuity contracts for its employees. In , Employer A established Plan X, which has been amended and restated several times. Plan X meets the requirements for qualification under section 401(a) of the Code. Employer A has not (and could not have) deducted any contributions to, or derived any tax benefit from, Plan X, because Employer A was tax exempt and incurred no unrelated business taxable income after

In the fiscal years ending in and Employer A reported unrelated business taxable income and paid unrelated business income tax with respect to Division D. In 1954 Division D was transferred to Employer C, a separate taxable subsidiary. Since , Employer A has not received or generated any unrelated business taxable income and Employer A no longer owns any interest in Employer C. Employer A did incur unrelated debt-financed income under section 514 of the Code in which is taxed as if it were an "item of gross income derived from an unrelated trade or business". The amount of the tax on this unrelated debt-financed income was not affected by Plan X; because of the overfunded status of Plan X, no contributions were required or permitted under the minimum funding rules and the full funding limit.

Plan X has not received any transfer of assets or liabilities from Employer A's previous retirement annuity plan and contracts. However, Plan X did provide for an offset of the new benefit amount by an amount projected to be paid under those annuity contracts.

In , Employer E, a non-profit corporation, was established and spun off from Employer A. Employer E was not and is not under common control with Employer A. Employer E pays full corporate taxes. As part of the spin off of Employer E,

assets and liabilities of Plan X were transferred to a pension plan established by Employer E.

Beginning in , Employer A has annually made asset transfers under section 420 of the Code to a section 401(h) account to fund retiree health benefits.

The projected assets of Plan X exceed the projected liabilities of Plan X and actuarial projections indicate that the excess will continue to grow indefinitely. Employer A proposes to terminate Plan X and use a portion of the assets in excess of the liabilities for Employer A's tax-exempt charitable purposes. Employer A also intends to transfer a portion of the excess assets to a replacement plan to maintain the current retirement formula for its employees. The replacement plan would provide a benefit, at that outset, equal to the amount employees would have received had Plan X continued to cover employees under the current benefit formula, minus the amounts actually payable from annuity contracts purchased for participants upon Plan X's termination.

Based on the above facts, you request a ruling that the reversion of assets from the terminating Plan X to Employer A is not subject to unrelated business (or other) income tax.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated "exclusively" for charitable, educational, scientific, or other specified exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and which does not engage in proscribed legislative or political activities.

Section 511 of the Code provides for a tax on the "unrelated business taxable income" of organizations described in Code section 401(a) and 501(c), which are exempt from federal income taxation by reason of section 501(a) of the Code.

Section 512(a)(1) provides, in general, that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by the organization, less certain deductions and subject to modifications provided in subsection (b).

Section 513(a) provides, in relevant part, that the term "unrelated trade or business" means, in the case of any

organization subject to the tax imposed by section 511, 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 of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 1.513-1(b) of the Income Tax Regulations provides that, for purposes of section 513, the term "trade or business" has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 1.513-1(c)(1) of the regulations provides that in determining whether a trade or business from which a particular amount of gross income derives is "regularly carried on," within the meaning of section 512, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued.

Section 1.513-1(d)(1) of the regulations provides that gross income derives from "unrelated trade or business," within the meaning of section 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purpose for which exemption is granted.

1.513-1(d)(2) of the regulations provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income) and it is "substantially related" for purposes of section 513 of the Code, only if the causal relationship is a substantial one.

Plan X was established by Employer A to provide pension benefits for its employees. The operation of Plan X is an administrative function that is part of Employer A's overall operations. The funds that will revert to Employer A upon termination of Plan X are a one-time source of income based on the investment history of the plan that resulted in overfunding.

Further, Plan X is not established or maintained by Employer A for the production of income from the sale of goods or the performance of services within the meaning of section 513(c) nor does the activity possess the characteristics required to

constitute a "trade or business" within the meaning of section 162. Accordingly, we conclude that the asset reversion to Employer A following the termination of Plan X will not constitute unrelated business taxable income under section 512(a)(1).

This ruling is based on the assumption the Plan X is qualified under section 401(a) of the Code and its related trust is exempt under section 501(a) of the Code.

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

In accordance with a power of attorney on file in this office, a copy of this ruling is being sent to your authorized representative.

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd
Manager, Employee Plans
Technical Group 2
Tax Exempt and Government
Entities Division

Enclosures:
Deleted copy of letter
Notice of Intention to Disclose

cc: