



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **200731035**

Release Date: 8/3/07

Date: May 11, 2007

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

UIL: 509.02-02, 513.00-00

Legend:

University =

University Foundation =

M =

N =

Dear :

We have considered the ruling requests submitted by M and N to allow an existing supporting organization to support a different organization within the University corporate structure. For the reasons described below, we have ruled as requested.

FACTS

M was formed to administer its assets for the long-term enhancement of the University and the University Foundation, to provide volunteer leadership to the University in its development and fundraising activities, and to provide advice and support to the President of the University and to the University Foundation. M's mission was expanded a few years ago to allow it to provide the same support and assistance to the Regents of the University system and all of the colleges and universities in the system.

The considerable assets of M are principally land, buildings and equipment, construction in process, and bond proceeds restricted for construction. Its main activity has been the acquisition, ownership and development of real estate assets for the benefit of the University and the University Foundation. The taxpayer asserts that all of M's assets, both prior to and after the proposed transaction, are and will be employed directly in its exempt activities.

M is a nonprofit corporation, recognized as exempt under section 501(c)(3) of the Internal

Revenue Code, and is classified as other than a private foundation under section 509(a)(3). It qualifies as a supporting organization (Type I) to the University Foundation, which is its sole member and it also supports the University.

The University Foundation was chartered many years ago, and soon after received a determination letter from the Service recognizing its exempt status. It is classified as a public charity under section 509(a)(3) of the Code. Its purpose is identical to the original purpose of M: to administer its assets for the long-term enhancement of the University and the University Foundation, to provide volunteer leadership to the University in its development and fundraising activities, and to provide advice and support to the President of the University. It specifically manages its funds for scholarships, faculty salary supplements, awards, and lectureships.

N has been recognized as exempt under section 501(c)(3) of the Code. It is a publicly supported organization described in sections 509(a)(1) and 170(b)(1)(A)(vi). It was organized to acquire, construct and equip buildings and facilities for research. It also provides means to identify, copyright, patent and apply discoveries and otherwise promote and encourage research and studies of all kinds.

The University believes that it would be better to affiliate M with an organization whose mission more closely parallels its expanded mission. The proposed transaction would replace the University Foundation with N as the sole member of M and one of its two supported organizations. This realignment would also allow M to centralize support services and lower its costs by combining them with N's support services.

M's articles of incorporation and by-laws would be revised to replace the University Foundation with N. Under the new by-laws, the Board of Trustees of M would consist of: a) the President of the University, b) the Chief Fiscal Officer of the University, c) the Vice Chair of N, d) the Executive Vice President of N, and e) six to seven members nominated and elected by the Board of Directors of N, of whom at least half will be directors or officers of N.

Following the proposed transactions, M will continue to benefit the University and the Regents of the University and the other colleges and universities in the state system along with their affiliated support organizations. It will, in addition, support N. The taxpayer stated that N's sources of public support will not change.

The taxpayer represents that neither N nor M are now, or will be after the transactions, controlled by disqualified persons within the meaning of section 4946(a) of the Code. All of the organizations involved are subject to the conflict of interest provisions under applicable state law.

RULINGS REQUESTED

1. The proposed transactions will not adversely affect the tax-exempt status of M under section 501(c)(3) of the Code.

2. The proposed transactions will not adversely affect the tax-exempt status of N under section 501(c)(3) of the Code.
3. The proposed transactions will not give rise to unrelated business taxable income to either M or N under sections 511 through 514 of the Code.
4. Following the proposed transactions, M will continue to qualify as an organization described in section 501(c)(3) of the Code, and it will continue to be classified as a supporting organization under section 509(a)(3).
5. Following the proposed transactions, N will continue to qualify as an organization described in section 501(c)(3) of the Code, and it will continue to be classified as a publicly supported organization under sections 509(a)(1) and 170(b)(1)(A)(vi).
6. Following the proposed transactions, contributions to M and N will continue to be deductible by the donor under sections 170, 2055, 2106, and 2522 of the Code.

LAW

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities are not in furtherance of an exempt purpose.

Section 509(a)(3) of the Code excludes from the definition of “private foundation” an organization described in section 501(c)(3), which is organized and operated exclusively for the benefit of or to carry out the purposes of one or more specified public charities, has one of three specified relationships with the supported organization, and is not controlled by disqualified persons (other than foundation managers),

Section 1.509(a)-4(c) of the regulations provides the organizational test for supporting organizations. To be organized for the purposes of section 509(a)(3)(A), the articles must: limit an organization’s purpose to supporting one or more organizations described in section 509(a)(1) or 509(a)(2) of the Code; not expressly empower the organization to engage in activities which are not in furtherance of the purposes described in section 509(a)(3)(A); identify the publicly supported organizations on whose behalf the organization is to be operated; and not expressly empower the organization to support or benefit any organization other than the specified publicly supported organizations.

Section 1.509(a)-4(e)(1) of the regulations contains the operational test for supporting

organizations. A supporting organization must engage solely in activities which support the specified publicly supported organization.

Section 1.509(a)-4(g)(1) of the regulations describes the relationship now labeled Type I—“operated, supervised, or controlled by.” The relationship is comparable to that of a parent and subsidiary, where the subsidiary is under the direction of, and accountable or responsible to, the parent. This relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed by the governing body.

Section 511 of the Code imposes a tax on the unrelated business taxable income (defined in section 512) of organizations described in section 501(c).

Section 512(a)(1) of the Code provides that the term “unrelated business taxable income” means the gross income derived from any unrelated trade or business which it carries on regularly.

Section 513 of the Code defines the term “unrelated trade or business” as one that is not substantially related to the exercise or performance by an organization of its charitable purpose or function constituting the basis for its exemption.

Section 514 of the Code distinguishes between debt-financed property held to produce income and property that is used for purposes substantially related to the performance of the organization’s exempt function. Only income from property that is unrelated is subject to the computations in that section.

Section 4946(a)(1) of the Code defines “disqualified individual” with respect to any private foundation as an individual who is—

- (i) a substantial contributor to the foundation,
- (ii) a foundation manager,
- (iii) an owner of more than 20 percent of the total combined voting power of a corporation which is a substantial contributor to the foundation, or
- (iv) a member of the family of any individual described above.

Section 4946(a)(1) of the Code refers to the definition of substantial contributor in Section 507(d)(2) which is a person who contributed or bequeathed an aggregate amount of more than \$5,000 to the private foundation, if the amount is more than 2 percent of the total contributions and bequests received during the taxable year.

ANALYSIS

1. The Service issued a determination letter recognizing M as an exempt organization under section 501(c)(3) of the Code. M’s purposes and activities will continue to be the same after the proposed transactions as before. Because N supports and is closely tied to the University, M will continue to support the University indirectly, through its affiliation with N, in addition to its direct support of the University. Therefore, M will continue to be

organized and operated exclusively for exempt purposes within the meaning of section 501(c)(3). The proposed transactions will not adversely affect M's tax-exempt status.

2. The Service issued a determination letter recognizing N as an exempt organization under section 501(c)(3) of the Code. The proposed transactions will not affect its existing purposes or activities, they will only add the exempt purpose of acting as the member of M. As the member, N's function will include nominating and electing members of the board of M. The Bylaws of M require that some of its board members must be officers and directors of N. Thus, through its officers and directors, N will have a continuing role in the management of M, also an exempt organization supporting the University and the other colleges and universities in its system. Therefore, N will continue to be recognized as exempt after the proposed transactions.
3. The proposed transactions are one-time reorganizations of existing, affiliated exempt entities. The proposed transactions are not trades or businesses nor are they regularly carried on. See section 512, *supra*. The property owned by M is not held for income, but used directly to accomplish its exempt purposes. Thus, any income that might arise will be related. See section 514, *supra*. In sum, the transactions will not give rise to unrelated business taxable income to either M or N under sections 511 through 514 of the Code.
4. Prior to the proposed transactions, M qualified as an organization other than a private foundation by reason of its supporting relationship to the University Foundation. Following the proposed transactions, M will qualify as an organization other than a private foundation by reason of its Type I supporting relationship to N. M will be operated, supervised and controlled by N, a public charity. M's activities will support its two specified, publicly supported organizations, the University and N. M will not be controlled, directly or indirectly, by disqualified persons, other than foundation managers, within the meaning of section 4946(a)(1) of the Code.
5. Prior to the proposed transactions, N qualified as an organization other than a private foundation because its financial support came primarily from public sources. The taxpayer has represented that following the proposed transactions, the sources of its financial support will not change. Therefore, it will continue to qualify as a publicly supported organization under sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code.
6. Because M and N will continue to be recognized as exempt organizations under section 501(c)(3) of the Code for the reasons above, donors may continue to deduct contributions to them under sections 170, 2055, 2106, and 2522 of the Code.

RULINGS

1. The proposed transactions will not adversely affect the tax-exempt status of M under section 501(c)(3) of the Code.

2. The proposed transactions will not adversely affect the tax-exempt status of N under section 501(c)(3) of the Code.
3. The proposed transactions will not give rise to unrelated business taxable income to either M or N under sections 511 through 514 of the Code.
4. Following the proposed transactions, M will continue to qualify as an organization described in section 501(c)(3) of the Code, and it will continue to be classified as a supporting organization under section 509(a)(3).
5. Following the proposed transactions, N will continue to qualify as an organization described in section 501(c)(3) of the Code, and it will continue to be classified as a publicly supported organization under sections 509(a)(1) and 170(b)(1)(A)(vi).
6. Following the proposed transactions, contributions to M and N will continue to be deductible by the donor under sections 170, 2055, 2106, and 2522 of the Code.

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. Except as we have ruled above, we express no opinion as to the tax consequences of the transaction under the cited provisions of the Code or under any other provisions of the Code. We express no opinion as to future activities that any of the organizations may undertake.

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.

Sincerely,

Steve Grodnitzky
Manager, Exempt Organizations
Technical Group 1

Enclosure
Notice 437