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

Date: FEB 29 2000

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T2

UIL Nos.
501.03-33
501.04-00
513.00-00

Employer Identification Number:

Legend:

X =
Y =

Dear Applicant:

This letter responds to X's request dated December 30, 1998, as amended, for rulings regarding the exempt status of X and Y under sections 501(c)(4) and (3) of the Internal Revenue Code and the unrelated business income tax consequences of X's provision of services to Y.

X and Y are recognized as exempt under sections 501(c)(4) and 501(c)(3) of the Code, respectively. X operates a large park facility used for special events by civic organizations. X formed Y to build and operate a multi-purpose civic or convention center on the grounds of X. The local mayor appoints one of the directors of Y. X appoints the other directors of Y, subject to the approval of the local city council. Y anticipates funding from the city to help build and operate the center.

X and Y have entered into an agreement for X to share with Y, for a fee, X's personnel and assets (including office space, equipment, and supplies) during the development of the center and prior to its operation. It is represented that all payments by X will be fair and reasonable. The agreement is terminable by Y upon 30 days' notice.

X requests the following rulings:

1. The formation of Y with X as the sole member of Y will not adversely affect the exempt status of X under section 501(c)(4) of the Code.

2. Y qualifies for exemption under section 501(c)(3) of the Code.

3. The following transactions between X and Y undertaken during the planning, development, and construction of the convention or civic center by Y will neither adversely affect the exempt status of X or Y under sections 501(c)(4) and 501(c)(3) of the Code nor result in the recognition of unrelated business taxable income to X:

(i) X's transfer to Y and sharing with Y of X's assets (including office space, equipment and

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supplies), and the reimbursement to X by Y in an amount equal to the cost of the shared assets; and

(ii) X's sharing with Y of a general manager and other personnel employed by X, and the reimbursement to X by Y of the proportionate share of the cost of employing the general manager and other personnel employed by Y.

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable purposes.

Section 501(c)(4) of the Code exempts from federal income tax organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 513(a) of the Code generally defines "unrelated trade or business" as 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 or other purpose or function constituting the basis for its exemption under section 501.

Section 1.501(c)(4)-1(a)(2)(i) of the Income Tax Regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements. A "social welfare" organization will qualify for exemption as a charitable organization if it falls within the definition of "charitable" set forth in section 1.501(c)(3)-1(d)(2) and is not an "action" organization.

Section 1.502-1(b) of the Income Tax Regulations provides that if a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax-exempt educational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations. For purposes of this paragraph, organizations are related only if they consist of:

(1) A parent organization and one or more of its subsidiary organizations; or
(2) Subsidiary organizations having a common parent organization.

An exempt organization is not related to another exempt organization merely because they both engage in the same type of exempt activities.

Rev. Rul. 54-243, 1954-1 C.B. 92, and Rev. Rul. 58-293, 1958-1 C.B. 146, held that a

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501(c) organization may set up a separate 501(c)(3) fund.

Each of the requested rulings is discussed in turn below.

1. Y will conduct activities that would be permissible for X to conduct as a 501(c)(4) organization. Therefore, X's formation of Y and relationship with Y will not adversely affect X's exemption.

2. The Service has already ruled, with knowledge of the above facts, that Y qualifies under section 501(c)(3) of the Code.

3. X's contractual dealings with Y will not result in inurement of its net earnings or unduly benefit X, given that X will not receive more than a reasonable fee for X's provision of goods, services, and use of facilities to Y. We note that Y must maintain records and bank accounts separate from X, including detailed records of the time of shared employees allocable to each organization. Because of the close structural relationship between X and Y, and the fact that Y conducts activities that promote X's social welfare purposes, X's contractual dealings with Y will not constitute unrelated trade or business.

Accordingly, we rule as follows:

1. The formation of Y with X as the sole member of Y will not adversely affect the exempt status of X under section 501(c)(4) of the Code.

2. Y qualifies for exemption under section 501(c)(3) of the Code.

3. The following transactions between X and Y undertaken during the planning, development, and construction of the convention or civic center by Y will neither adversely affect the exempt status of X or Y under sections 501(c)(4) and 501(c)(3) of the Code nor result in the recognition of unrelated business taxable income to X:

(i) X's transfer to Y and sharing with Y of X's assets (including office space, equipment and supplies), and the reimbursement to X by Y in an amount equal to the cost of the shared assets; and

(ii) X's sharing with Y of a general manager and other personnel employed by X, and the reimbursement to X by Y of the proportionate share of the cost of employing the general manager and other personnel employed by Y.

Except as we have ruled above, we express no opinion as to the tax consequences of the proposed transaction under the cited provisions of the Code or under any other provisions of the Code.

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

Because this letter could help resolve any future questions about X's tax liability, X should keep a copy of this ruling in X's permanent records.

We are informing the Key District Director of this ruling.

Sincerely yours,

(signed) Garland A. Carter
Garland A. Carter
Manager, Exempt Organizations
Technical Group 2

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