200030026

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

Date: APR 26 2000

Contact Person:
ID Number:

Telephone Number:

OP:E:EO:T4

UIL: 170.00-00
509.00-00
501.00-00

LEGEND

R =
S =
T =
U =
V=
W =
X =
Y =
Z =
F =

Dear Applicant:

This is in response to a ruling request dated September 17, 1999, on the application of sections 4942 and 4945 of the Internal Revenue Code with respect to a proposed grant to S to support a "pervasive computing" research project (the "Project") at T.

FACTS

R is a nonprofit corporation organized under the laws of the State of U and is a private non-operating foundation described in sections 501(c)(3) and 509 of the Code. R's only office is located in the City of W.

T is an agency and instrumentality of the State of U that meets the definition of a governmental unit under sections 170(c)(1), 170(b)(1)(A)(v), and 509(a)(1) of the Code, and is an educational organization described in sections 170(b)(1)(A)(ii) and 509(a)(1) of the Code.

S is a nonprofit corporation also organized under the laws of the State of U. S is described in sections 501(c)(3), 170(b)(1)(A)(iv), and 509(a)(1) of the Code, and is organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of the T. S is the preferred vehicle for private gifts and grants for the benefit of T. S has F members on its board of directors. One of its directors, formerly the president of T and now T's chancellor, also serves as a non-

144

voting, emeritus director of R. There is no other direct or indirect relationship between R and S or between R and T.

V is a U nonprofit corporation established exclusively for the benefit of, to provide service and support for, and to carry out the purposes of T, primarily as a vehicle to develop, license, and promote research discoveries and innovations from T. V is a supporting organization of T described in sections 501(c)(3) and 509(a)(3) of the Code. There is no direct or indirect relationship between R and V.

T has for years played a critical educational and research role in the field of information technology (both the collection and refinement of computer data and the ability to access and distribute such data), participating in initiatives sponsored by the National Science Foundation, the United States Department of Energy, the Defense Advanced Research Projects Agency, the National Aeronautics and Space Administration, and other governmental, educational, research, and business institutions. The Internet is a product of these and similar collaborations, and computer and communications advancements into the next century will likely follow the same collaborative path. T's primary goal for the Project is to continue its role in the development of educational and research of information technology by developing in the State of U a world-class educational and research capability in the fundamental computer and communications technologies that will drive the 21st century information economy.

With the Project, T has announced its goal of becoming a national leader in the creation and use of information technology. It will pursue this goal through education, research, and development in the area of "pervasive computing." Pervasive computing refers to a wide-reaching network of intelligent computer instruments, appliances, information sources, and information analysis tools all linked together by high-speed wired and wireless communications systems. Pervasive computing also includes individual (and personal) software service agents that constantly search for, gather, and analyze information important to the user, even when the user is not "logged on."

There remains a great deal of learning (i.e., science and research) and teaching (i.e., education) before the vision of pervasive computing becomes a reality. T conceived the Project as a means of propelling its students and faculty, and the State of U, to the vanguard of this evolution. S has requested financial support from R to further T's effort.

S has emphasized that R's support is critical because the State of U ranks among the lowest in the nation in terms of the proportion of residents with a baccalaureate or higher educational degree and in the percentage of its workforce in professional specialty occupations, including high-technology careers. For T to become the leader in pervasive computing, significant changes in environment, infrastructure, and opportunity in the State must occur. The budget submitted to R by S divides the requested grant into six categories of expenditures.

The first category will be funds used to establish six world-class research laboratories at T addressing different aspects of the pervasive computing equation. Each laboratory will be headed by a distinguished scientist, who will be a researcher of international standing in a particular field of computer or communications technologies. In addition, each laboratory will be staffed, on average, with two junior tenure-track researchers, two postdoctoral fellows, and six graduate students. The laboratories will focus on two broad fields of study regarding pervasive computing – computer software technology and advanced telecommunications.

The laboratories will be located geographically to leverage T's existing facilities and resources in computer and communications technologies. T's campus in W is being established as the center of T's extensive telecommunications infrastructure, so three laboratories in the telecommunications field will be located there. T's main campus at X is already home to the university's core computing and information

facilities, so the remaining three laboratories, focused on computer software technology, will be established on that campus. These physical facilities are or will be funded primarily by T and the State of U.

The second category of grant expenditures will support the position of science director of T for five years. The science director is expected to be a distinguished T faculty member who will serve on the steering committee for the entire Project and will be responsible for oversight and direction of the six laboratories. The grant funds will be used to pay a portion of the science director's salary, thus relieving her or him from other faculty and administrative responsibilities.

The third category will assist T in the creation of a new school within the university (the first in 25 years) to develop new courses and curricula emphasizing the practical application of information technology across a wide variety of academic disciplines. In addition, businesses and industries in U are expected to co-sponsor course development for undergraduate and graduate students and to incorporate the school's offerings into their own workforce training and development programs. Many of the school's teaching functions will be conducted in "virtual classrooms," utilizing the very computer and communications technologies about which the students will learn. The school will award a bachelor of science degree and offer a minor or a certificate to non-majors. In addition, there will be four specialized master of science degrees. Other specialized master's degrees likely will be added over time, and there is substantial faculty interest in soon adding a Ph.D.

The fourth category of expenditures will be funds to support a small portion of the capital cost of the three telecommunications laboratories and space for the new economic development office (discussed below) that will be included in T's already-planned building construction and expansion initiative for the W campus. T expects to finance this cost through educational bonds, but S has asked R for funds to service the bonds during the first five years of the Project. T itself will guarantee the bond payments following this start-up period, as well as providing comparable space for the three separate software computer technology laboratories that will be located on the X campus.

The fifth category of expenditures will fund T's plans to establish a new administrative department focusing on the business impact of research conducted at T, the economic development office. The office will build on the work conducted at the pervasive computing laboratories to:

1) greatly expand the number of T graduates trained in all areas of information technology, and retain graduates of all colleges and universities in the State of U by taking advantage of increased employment opportunities in information technology careers arising out of the Project;
2) identify State resources that could be allocated to leverage federal and private sponsorship of T research;
3) attract new academic and corporate information technology researchers to T and to the State of U generally;
4) assist with the establishment of promising start-up and spin-off companies employing the technologies developed at T's laboratories;
5) provide and coordinate the use of laboratory facilities for business research and development of discoveries, inventions, and innovations at T; and
6) aid in the formation of information technology incubators at T, to provide basic computer, communications, and infrastructure support and management consulting services to small businesses that stem from research at the laboratories or to enterprises that complement and expand upon that research.

These activities of the economic development office will promote and support the scientific research and teaching conducted in T's Project laboratories by identifying and filling gaps between technological development and deployment in real-world situations.

In conjunction with V (as discussed below), the economic development office also will facilitate the eventual transfer of T technology to public uses and private enterprises. It will work to align T's educational disciplines with industry needs to address more effectively regional employment issues and to reduce the number of skilled graduates from the State of U who leave the State for advanced careers elsewhere. Furthermore, business leaders will be consulted and actively engaged in curricular design, the creation of internship opportunities for undergraduates, funding of graduate research fellowships, and mentoring programs. Moreover, the economic development office will collaborate with local governments and the State to ensure that T's research and development efforts complement the public policy and economic growth objectives supported directly by tax dollars.

R is being asked by S to fund the staff and operating expenses of T's economic development office for five years, at a total estimated cost of Y dollars.

Finally, the sixth category is S's request for approximately Z dollars to support the technology transfer activities of V on behalf of T. This funding will support the salary and benefits of a technology transfer officer at V for five years, will pay for technology transfer and business start-up seminars that will be coordinated by V during this same time period, and will establish a capital seed fund (i.e.,a revolving venture capital fund providing loans or equity to information technology businesses) to be administered by V.

In support of T's Project, V's mission is to develop a broad technology transfer assistance program that includes top flight graduate students from a number of T's schools and departments, in addition to undergraduate interns and part-time graduate students. V will develop and conduct seminars and training programs for University researchers and faculty inventors (such as the technology transfer and business start-up seminars) to teach them how to prepare patent and trademark disclosures and similar related skills. V's technology transfer officer will assist T in the technology licensing process and in evaluating new high technology business opportunities created by virtue of T's leadership in the area of pervasive computing.

V also will establish the capital seed fund to provide early stage financing for promising technology successfully developed at the Project laboratories and for related businesses that complement the work and goals of T. V will make loans or equity investments from the fund only with new companies that have a real chance for success in the competitive information technology sector. Prior to making a seed capital investment, V will use knowledge gathered at its seminars and by start-up assistance teams (staffed by graduate students) to assess and qualify the prospects for successful use of technologies developed through the Project and other T research and to assist the businesses that seek to cultivate and advance those technologies in the marketplace. Through V, T will be able to seek outside investment funding, support extended research and development of pervasive computing and other technologies, hold equity in or extend credit to start-up businesses, and engage in other activities that support and enhance the core educational and research efforts of the Project.

R seeks rulings that disbursement of grant proceeds to S targeted for the economic development office and to V's activities:

1) Will not be treated as a taxable expenditure under section 4945(d)(4) or (5) of the Code; and
2) Will constitute a qualifying distribution that satisfies the requirements of section 4942(g).

LAW

Section 4945(d)(4) of the Code defines the term "taxable expenditure" to include amounts paid by a private foundation – as a grant to an organization unless–

(A) such organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation (as defined in section 4940(d)(2)), or

(B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h) . . . .

Section 53.4945-5(a)(6)(i) of the Foundation and Similar Excise Taxes Regulations explains that a grant by a private foundation to a grantee organization which the grantee uses to make payments to another organization (the secondary grantee) shall not be regarded as a grant by the private foundation to the secondary grantee if the foundation does not earmark the use of the grant for any named secondary grantee and there does not exist an agreement, oral or written, whereby such grantor foundation may cause the selection of the secondary grantee by the organization to which the foundation makes the grant. To avoid earmarking to the secondary grantee, the original grantee organization must exercise control, in fact, over the selection process and actually make the selection completely independently of the private foundation.

Section 4945(d)(5) of the Code states that a taxable expenditure is any amount paid by a private foundation "for any purpose other than one specified in section 170(c)(2)(B)." Among the purposes recognized as exempt and described in section 170(c)(2)(B) are "exclusively . . . religious, charitable, scientific, literary, or educational purposes."

Section 4942(g)(1) of the Code defines the term "qualifying distribution" as "any amount . . . paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons . . ., or (ii) a private foundation which is not an operating foundation."

Section 53.4945-6(b)(1)(v) of the regulations states that an expenditure that "constitutes a qualifying distribution under section 4942(g) [of the Code]" ordinarily will not be treated as a taxable expenditure.

ANALYSIS

S is a publicly supported organization raising and administering funds to benefit T, a state university. Neither S nor T are private foundations within the meaning of section 509(a) of the Code. S has requested a grant from R to support T's Project, including funding of T's economic development office and its supporting organization, V which is also not a private foundation. This request is related directly to the exempt purposes and mission of S. No part of the grant will be earmarked for particular secondary grantees or other recipients, and S will make all investment and similar decisions completely independently. Our analysis shows that the grant is being made to an organization which is exempt under section 501(c)(3) and which is not a private foundation. Therefore, R's proposed grant to S for T's economic development office and V will not be a taxable expenditure under section 4945(d)(4)(A) of the Code, even though R will not exercise expenditure responsibility under sections 4945(d)(4)(B) and 4945(h).

For the reasons delineated in the above discussion relating to taxable expenditures, and considering section 53.4945-6(b)(1)(v) of the regulations, the portions of R's grant under consideration, by furthering educational, scientific, and charitable purposes under section 170(c)(2)(B) of the Code, also satisfy the initial requirement of section 4942(g)(1). Neither R nor any of its disqualified persons exercises control, directly or indirectly, over S, and S is not a private foundation. Therefore, the requirement of section 4942(g)(1)(A) are met. Accordingly, R's support of S's proposal to fund T's economic development office and V constitutes a qualifying distribution.

Based on the information you have submitted and as the distributee organization is recognized as exempt under section 501(c)(3) of the Code, under the facts described above we rule that the disbursement of grant proceeds to S targeted for the economic development office and to V's activities:

1) Will not be treated as a taxable expenditure under section 4945(d)(4) or (5) of the Code; and
2) Will constitute a qualifying distribution that satisfies the requirements of section 4942(g).

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 as precedent.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4