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

UIL: 512.00-00
Date:
MAY 11 2000

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T3

Employer Identification Number:

LEGEND:

A=

B=

C=

D=

E=

Dear Sir or Madam:

We have considered your ruling request dated March 14, 2000, in which you sought the federal income tax consequences of a proposed transfer of assets from A to certain other foundations supporting constituent institutions of D, as more fully set forth below.

A is a corporation that has been recognized as exempt from federal income tax pursuant to section 501(c)(3) of the Internal revenue Code and as other than a private foundation because it is described in sections 509(a)(1) and 170(b)(1)(A)(iv).

A's exempt purpose is to hold and administer money and other property and make distributions to or for the benefit of D and its thirteen constituent institutions. D and all of its constituent institutions are instrumentalities of E.

E recently enacted a law authorizing the constituent institutions of D to establish campus-based foundations without the approval of the Board of Regents of D. The new law further provides:

> That the campus-based foundations are to operate subject to policies adopted by the Board of Regents of D (A, too operates subject to these same policies);
>
> The campus-based foundations may not be considered agencies or instrumentalities of E or a unit of the Executive branch for any purpose.

Both B and C were created by their respective constituent institutions, and both have applied, and

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have been recognized as exempt under section 501(c)(3) of the Code. B is a public charity described in section 170(b)(1)(A)(iv). C has an advance ruling under section 170(b)(1)(A)(vi). It is anticipated that other constituent institutions of D will create entities authorized by the new law to hold and administer money and other property and to make distributions to or for the benefit of their particular constituent institution.

Private entities already exist to support several of the constituent institutions. These foundations existed prior to the creation of D, and for all relevant purposes are identical to C and D except that they support their respective constituent institutions.

A donor has made substantial contributions to A over the years to establish an endowed fund for the benefit of one of D's constituent institutions. The endowed fund that was created presently has a fair market value of approximately twice the original donations. The donor's gift was complete in that total ownership of the money or other property donated was transferred to A. The donor retained no right of control as regards the gift. However, the donor has expressed a wish that A transfer the gift, plus earnings thereon, minus expenses to B, restricted in such a manner that the gift's use by B would be identical to the gift's use by A.

It is anticipated that other donors who have made gifts to A to benefit a specific constituent institution of D will express a wish that A transfer their gift, plus earnings thereon, minus expenses, to the foundation that has been created, or may be created, to support solely that specific constituent institution.

It is also contemplated that, absent a specific donor request, constituent institutions themselves may request that funds held by A and earmarked for their benefit be transferred to their respective foundations.

A wishes to honor its donor's request and other requests made by other living donor(s) who execute appropriate documentation relating to the transfer. Moreover, absent specific donor requests, A may honor requests by constituent institutions to transfer funds held for their benefit to their respective foundation. By honoring any such request, ownership of certain cash, securities and other property would be transferred by A to the foundation(s) that support specific institutions of D. Alternatively, A may convert sufficient assets to cash and transfer cash to the foundation(s) that support specific constituent members of D.

After the transfers are made, B and C have indicated that they want A to manage their endowments and C has indicated that it will ask A to undertake certain additional administrative services for it. It is possible that additional, possibly all, institutional foundations may request that A perform these services on their behalf as well. A wishes to perform these services for them and will be compensated for its services in doing so.

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

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the advancement of education.

Section 509(a) of the Code excludes from the term "private foundation" organizations described in section 170(b)(1)(A)(iv).

Section 170(b)(1)(A)(iv) of the Code describes organizations that are organized and operated exclusively to receive, hold, invest, and administer property and make expenditures to or for the benefit of a college or university referred to in clause (ii) which is an agency or instrumentality of a State or political subdivision thereof, or which is owned or operated by a State or political subdivision thereof or by an agency or instrumentality of one or more States or political subdivisions.

Section 170(b)(1)(A)(vi) of the Code generally describes an organization exempt under section 501(c)(3) that normally receives a substantial part of its support from a governmental unit referred to in section 170(c)(1) or from direct or indirect contributions from the general public.

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

Section 512(a)(1) of the Code defines "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of the trade or business, with certain modifications.

Section 512(b)(5) of the Code excludes from the computation of unrelated business taxable income all gains and losses from the sale exchange or other disposition of property.

Section 513(a) of the Code provides 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 513(a)(2) of the Code provides an exception for any trade or business carried on by an organization described in section 501(c)(3) that is primarily for the convenience of its members, students, patients, officers, or employees. This exception also applies to any college or university that is an agency or instrumentality of any government or that is owned or operated by a government.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes, in the relevant sense, only when the conduct of the business activities has 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. Section 1.513-1(d)(2) further provides that for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Revenue Ruling 67-149, 1967-1 C.B. 133, provides that an organization providing only financial assistance to organizations exempt under section 501(c)(3) of the Code may qualify for exemption under section 501(c)(3).

Rev. Rul. 58-194, 1958-1 C.B. 240, held that an organization operating a book and supply store and a cafeteria and restaurant on the campus of a state university for the convenience of the student body and faculty qualified for exemption under section 501(c)(3) of the Code. The facilities of the organization were available to everyone connected with the university, and the profits were used solely for the benefit of

the students and faculty of the university. Because the organization served almost exclusively the members of the faculty and student body and since it was performing functions for their benefit and convenience and in furtherance of the university's educational program, it was for all intents and purposes an integral part of the university.

Revenue Ruling 78-41, 1978-1 C.B. 148, provides that a trust created by an exempt hospital for the sole purpose of accumulating and holding funds to be used to satisfy malpractice claims against the hospital is operated exclusively for charitable purposes, and, is exempt under section 501(c)(3) of the Code.

Rev. Rul. 81-19, 1981-1 C.B. 353, discussed an organization formed to assist a university by receiving contributions on its behalf, providing financial management assistance to the university's academic departments, and managing the university's vending machine and laundromat facilities. The ruling concluded that the organization's activities were an integral part of the exempt activities of the university, and therefore furthered the exempt purposes of the university.

The proposed transaction will not adversely affect A's exemption under section 501(c)(3) of the Code nor its classification as other than a private foundation described in sections 509(a)(1) and 170(b)(1)(A)(iv) because A will continue to perform the same activities for the same purposes for which it was originally recognized as exempt. A will be holding and administering property on behalf of related section 501(c)(3) entities which is itself an activity described in section 501(c)(3). See, Rev. Ruls. 67-149, 71-529, 78-41 and 81-19,all cited above.

An exempt organization described in section 170(b)(1)(A)(iv) of the Code may make distributions to other organizations without jeopardizing its foundation classification if the distributions are clearly "to or for the benefit of" of organizations described in section 170(b)(1)(A)(ii). In this case, D, and all the constituent institutions are described in section 170(b)(1)(A)(ii). D, its constituent institutions and the supporting foundations are all, by law, subject to the control of D's Board of Regents. This control assures that the supporting foundations, regardless of foundation classification are organized and will be operated for the benefit of or to carry out the normal functions of its respective constituent 170(b)(1)(A)(ii) institution.

Like the organization discussed in Rev. Rul. 58-194, A's activities are an integral part of the exempt activities of D, and therefore A furthers the exempt purposes of D. If D conducted the activities itself, the income would not be subject to the tax on unrelated business income because the activity would be carried on for the convenience of D or its members. The basis for A's exemption is its purpose of furthering D's exempt purpose by aiding D in performing its various administrative functions. Thus, A's activities are substantially related to the exempt purpose or function constituting the basis for A's exemption under section 501(c)(3).

A's disposition of investment assets, some or all of which are appreciated, and all of which are used by A to generate income to support the pursuit of its exempt function, by selling those assets and transferring the proceeds, or transferring the investment assets in kind, to another institution affiliated with D, will not cause the appreciation of those assets to be subject to unrelated business income tax. See section. 512(b)(5) of the Code.

Since A's exempt purposes are in essence, to hold and invest money and other property and make distributions to or on behalf of D and its constituent institutions, A is indirectly fulfilling those purposes by providing fund management and other administrative services for other foundations whose charitable purposes are to hold and administer money and other property directly for specific institutions

that are affiliated with D. Although A and the other Institutional foundations are not under common control, they are by law subject to the policies adopted by D's Board of Regents. The control exercisable by the Board of Regents creates a relationship among A and the constituent institutions similar in nature to relationships among the groups discussed in Rev. Rul. 71-529. Accordingly, A's income from providing management and administrative services to the constituent institution's foundations will be income related to the performance of A's exempt function and will not be subject to unrelated business income tax.

Based on the information submitted and the representations made therein, we rule as follows:

(1) A transfer of money, securities and other property by A to another foundation created to support a specific constituent institution of D (which was the intended beneficiary of the interested donor) will not jeopardize the status of A as a public charity and as other than a private foundation pursuant to sections 509(a)(1) and 170(b)(1)(A)(iv) of the Code.

(2) A transfer of money, securities and other property by A to another foundation created to support a specific constituent institution of D (which was the intended beneficiary of the interested donor) will not give rise to unrelated business income tax for A pursuant to sections 511-514 of the Code.

(3) Compensation received by A for providing management and administrative services to another foundation created to support a specific constituent institution of D will not be subject to unrelated business income tax pursuant to sections 511-514 of the Code.

These rulings are based on the understanding that there will be no material changes in the facts upon which they are based.

Because these rulings could help resolve future questions about your federal income tax status, you should keep a copy in your permanent records.

These rulings are directed only to the organization that requested them. Section 6110(k)(3) of the Code provides that they may not be used or cited as precedent.

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

Sincerely,

Robert C. Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3

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