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

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Date:

MAR 30 2001

Contact Person:

ID Number:

Contact Number:

T:EO:B2

Employer Identification Number:

LEGEND:

X =

Dear Sir or Madam:

This is in reply to your letter of August 2, 1999, as modified by your letters of November 16, 2000, and February 16, 2001, requesting various rulings concerning your proposed establishment of a facility for the care of cats.

You are exempt under section 501(c)(3) of the Internal Revenue Code and are a private foundation within the meaning of section 509(a) of the Code. You have been recognized as a private operating foundation as that term is described in section 4942(j)(2).

You currently carry on an educational program dedicated to furthering entrepreneurship. You expect to continue this program, however, you have proposed to expand your activities into other areas. You are establishing a program designed to provide for the care and adoption of cats. In particular, you propose to educate the public about the problems encountered by the elderly regarding the disposition of their companion cats at their illness or institutionalization or by their families at the death of an elderly cat owner. You have purchased a facility and expect to have regularly scheduled workshops and seminars to educate the public on all aspects of cat ownership. This program is referred to, in general, as TLC.

As set forth in your letter of August 2, 1999, and your letter of November 16, 2000, there are various separate aspects to this new program. You expect to establish a life care center for orphaned cats or displaced senior companion cats. You expect to charge a fee for this service. You will operate a center for cats which have been displaced because of their owners' inability to continue to maintain the cats and for occasional temporarily displaced feral cats. You propose to work with local animal shelters and with the admissions directors of nursing homes and assisted living facilities to counsel future residents on alternative ways of providing care for their soon to be displaced cats and promote the adoption of cats by seniors or the facilities. You will provide support services and subsidize some of the

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expenses incurred where a senior citizen cannot afford to continue to meet the necessary expenses of cat ownership. You will also work to find adoptive families for cats. You propose to establish a special program to provide funds for and assist in the neutering of feral and stray cats and their kittens. In addition, you propose to establish a directory of cat retirement communities and develop standards for such communities. Finally, you propose to make cats available for non-invasive behavioral research.

You have also indicated that you will have a gift shop at your center where you will sell various items of merchandise with cat themes. You do not expect sales to be a substantial activity. You have also represented that you will not sell any mass merchandise items such as cat food or liter through this outlet.

In addition to being actively involved in caring for cats, you also expect to provide tuition assistance and grants to individuals who are interested in veterinary medicine for cats and training as animal technicians. You have represented that you expect to be directly involved in the active conduct of this proposed grant making program within the meaning of section 4942(j)(3) of the Code and the regulations. You expect scholarship recipients to conduct research for you under your guidance and that this research will be used by you to further the goals of the TLC program. You also propose to pay tuition costs for any undergraduate student who works in a feline life care program. Selection of applicants is to be based on academic ability and need and grantees are to be selected by your Board of Directors or by a committee they may appoint. The selection of scholarship grant recipients will be by application and be premised, in part, on their participation in your program and working for your life care center or any other center for animal care operated by organizations which have been recognized as exempt from tax under section 501(c)(3). You have represented that you will maintain records on the grants and scholarships you make. Similarly you may provide grants for students to conduct activities at other feline life centers to enable you to continue to enlarge your expertise pertaining to your mission. You expect to be actively involved in reviewing the papers produced by scholarship recipients, critiquing them, and suggesting areas of additional research. It appears that this scholarship and grant program will be a relatively minor part of your overall activities.

You have represented that some or all of the TLC program including various administrative and management functions will be carried out by X, who is represented as being a disqualified person within the meaning of section 4946(a) of the Code. You have indicated that you expect to compensate her for her work in this program. You have represented that the compensation, if paid, will be based upon amount of time expended, the nature of the services provided, and will be at or below fair market rates. You have represented that X's compensation will not be excessive or unreasonable.

You have requested the following rulings:

1. That the addition of the TLC program will not adversely affect your tax-exempt status under section 501(c)(3) and that you will continue to qualify as a private operating foundation under section 4942(j)(3);

2. Approval of your proposed scholarship program under section 4945(g)(1) or (3) and recognition that these grants will not be deemed taxable expenditures and that such grants be classified as distributions for the active conduct of your exempt purposes in accordance with section 53.4942(b)-l(b)(ii) of the regulations.

3. The receipt of fees for services will not result in unrelated business income within the meaning of section 513 of the Code and the sale of cat-related merchandise will not adversely affect your tax-exempt status under section 501(c)(3) of the Code or your status as a private operating foundation under section 4942(j)(3).

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4. Compensation of X for management and administrative services rendered directly in furtherance of the exempt purpose of the Foundation will not constitute self-dealing under section 4941 or a taxable expenditure under section 4945.

Section 501(c)(3) of the Code provides, in part, for exemption from federal income tax for a corporation organized and operated exclusively for charitable, scientific or educational purposes provided no part of the corporation's net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term charitable is used in its generally accepted legal sense. The prevention of cruelty to animals and the care and housing for abandoned animals has traditionally been recognized as a charitable activity. As have the promotion of education and the granting of scholarships.

Section 1.501(c)(3)-1(e) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513.

Section 509(a) of the Code provides that, unless specifically excepted, a domestic or foreign organization described in section 501(c)(3) is a private foundation and subject to the excise taxes of Chapter 42.

Section 511(a) of the Code imposes a tax on the "unrelated business taxable income" of organizations described in section 50l(c).

Section 512(a)(l) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less certain allowable deductions, and computed with the modifications listed in section 512(b).

Section 513(a) of the Code defines the term "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 profit derived) to the exercise or performance by such organization of the functions constituting the basis for its exemption.

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 where 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" only if the causal relationship is a substantial one. Thus, 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.

Section 4941(a) imposes a tax on each act of self-dealing between a private foundation and a disqualified person (as defined in section 4946(a)).

Section 4941(d)(2)(E) of the Code provides that the payment of compensation by a private foundation to a disqualified person for personal services which are reasonable and necessary to carry out the exempt purpose of the foundation shall not be an act of self-dealing if the compensation is not

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excessive.

Section 4942(a) of the Code imposes an excise tax on a private foundation which fails to meet the distributions requirements set forth in section 4942(d).

Section 4942(g)(l)(A) of the Code provides that the term qualifying distribution includes any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)((B).

Section 4942(j)(3) of the Code defines an operating foundation, in general, as any organization which makes qualifying distributions directly for the active conduct of the activities constituting the purpose or function for which it is organization and operated. The organization must satisfy the income test under section 4942(j)(3)(A), as modified by section 53.4942(b)-1 and one of the following three supplemental tests: (l) the assets test under section 4942(j)(3)(B)(i), the endowment test under section 4942(j)(3)(B)(ii) or (3) the support test under section 4942(j)(3)(B)(iii).

Section 53.4942(b)(l) of the Foundation and Similar Excise Tax Regulations provides that in general qualifying distributions are not made by a foundation directly for the active conduct of activities constituting its charitable, education, or other similar exempt purpose unless such qualifying distributions are used by the foundation itself.

Section 53.4942(b)(2)(i) of the regulations provides that in general, if a foundation makes or awards grants, scholarships, or other payments to individual beneficiaries to support active programs conducted to carry out the foundation's charitable, educational, or other similar exempt purpose, such grants, scholarship or other payments will be treated as qualifying distributions made directly for the active conduct of exempt activities for purpose of section 4942(j)(3). However, the foundation must maintain some significant involvement in the active programs in support of which such grants scholarships or other payments were made or awarded. This active involvement is to be determined on the basis of the facts and circumstances of each particular case.

Section 53.4942(b)(2)(ii) of the regulations provides that significant involvement may be found where the foundation has developed some specialized skills, expertise or involvement in a particular discipline or substantive area, it maintains a salaried staff of administrators, researchers or other personnel who supervise of conduct programs or activities which support and advance the foundation's work in its particular area of interest, and, as a part of such programs or activities the foundation makes or awards grants, scholarship or other payments to individuals to encourage their involvement in the foundation's particular area of interest.

Section 4945(a) of the Code imposes an excise tax upon a private foundation's making of any taxable expenditures as defined in section 4945(d) of the Code.

Section 4945(d)(3) of the Code provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or similar purposes by such individual, unless such grant satisfies the requirements of section 4945(g).

Section 4945(d)(5) of the Code provides that the term taxable expenditure means any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B) which defines charitable contributions.

Section 4945(g)(1) of the Code provides that section 4945(d)(3) shall not apply to an individual grant awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the

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Secretary, if it is demonstrated to the satisfaction of the Secretary that the grant constitutes a scholarship or fellowship grant which would be subject to the provisions of section 117(a) and is to be used for study at an educational organization described in section I70(b)(I)(A)(ii).

Section 4945(g)(3) of the Code provides that section 4945(d)(3) shall not apply to an individual grant where the purpose of the grant is to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific teaching, or other similar capacity skill or talent of the grantee.

Section 53.4945-4(b)(1) of the regulations sets forth standards for determining whether grants to individuals awarded under section 4945(g) of the Code are made on "an objective and nondiscriminatory basis."

Section 4946(a)(I) defines the term "disqualified persons" with respect to a private foundation as including a substantial contributor to the foundation, a foundation manager, and an owner of more than 20 percent of the total combined voting power of a corporation which is a substantial contributor to the foundation. It also includes a member of the family of any individual described above.

Section 4946(d) provides that the term "a member" of the family of a disqualified person include the spouse, children of and grandchildren of a disqualified person.

The information you have submitted establishes that you are classified as a private operating foundation. You expect to continue to carry on your current program and are also to dedicate some of your resources in a new program designed to prevent cruelty to animals.

This new program involves you establishing and operating a facility to house, care and protect orphaned or displaced senior companion cats and reducing the population of feral cats by neutering strays and feral cats. Your activities will include both education programs for cat owners and the general public and the placement or adoption programs for cats. Prevention of cruelty to animals includes the care and maintenance of animals in the manner you have described your program and are qualifying charitable and educational activities within the meaning of section 501(c)(3) of the Code. Therefore, your involvement in such activities will not adversely affect your qualification for recognition of exemption under section 501(c)(3) of the Code.

In addition, based on our presumption that your prior program established that you satisfied the requirements of a private operating foundation, we have concluded that after the addition of your new program you will continue to qualify as a private operating foundation. This is based upon the information you have submitted which represents that over 85 percent of your activities are directly involvement in the active conduct of charitable and educational activities. Please be advised that you will only continue to be considered a private operating foundation if you continue to meet the income test and either the assets, endowment, or support test in later years. Data related to the above tests must be submitted with you annual information return, Form 990, PF.

You also have represented that you expect to make scholarships and grants to individuals interested in veterinary medicine specializing in cats or to study to be animal technicians. This aspect of your new program will include having the grantees work directly for you or other similar institutions and do research and prepare papers to assist you in the TLC program. You have represented that your involvement will satisfy the "significant involvement" requirement of section 53.4942(b)(I) and (b)(2)(i) of the regulations. Satisfaction of these requirements is based on the facts and circumstances of each case and we have concluded that you have made reasonable representations that you can be expected to satisfy the requirements and that the scholarship and grant-making aspects of the TLC program will not adversely

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impact on your continued qualification as a private operating foundation within the meaning of section 4942(j)(3).

We have also considered your grant-making procedures under section 4945(g) of the Code. Based on the information submitted and assuming your scholarship programs will be conducted as proposed, with a view to providing objectivity and nondiscrimination in awarding grants, we rule that your procedures in awarding of scholarship grants comply with the requirements of section 4945(g)(1). Expenditures made in accordance with these procedures will not constitute "taxable expenditures" within the meaning of section 4945(d)(3) of the Code, and as such are eligible for the exclusion from income provided for in section 117(a) of the Code to the extent that such grants are actually used for qualified tuition and related expenses within the meaning of section 117(b)(2) of the Code. Similarly we have concluded that the procedures you have described for awarding grants to individuals for study or similar purposes meet the requirements of section 4945(g)(3) and grants or awards made pursant to these procedures will not be taxable expenditures within the meaning of section 4945(d)(3).

This approval of your scholarship and grant-making program is conditioned on the understanding that there will be no material change in the facts upon which it is based. It is further conditioned on the premise that no scholarships or grants will be awarded to your organization's creators, officers, directors, trustees, or members of the selection committee, or for a purpose that is inconsistent with the purposes described in section 170(c)(2)(B).

The approval of your grant-making procedures is a one time approval of your system of standards and procedures for selecting recipients of grants that meet the requirements of sections 4945(g)(l) and 4945(g)(3). Thus, approval will apply to succeeding grant programs only as long as the standards and procedures under which they are conducted do not differ materially from those described in your request.

You have indicated that you will charge some fees for your services provided in your facility. An exempt organization may charge fees for the services it provides so long as the costs do not preclude a substantial portion of the community from participating in the program or otherwise obtaining the services which are the purpose of your exemption. In this situation the services provided through your facility and the other aspects of your programs are directly related to the accomplishment of your charitable programs and do not appear to be so costly that a significant segment of the community cannot avail themselves of your services. Therefore, even if your program or a portion thereof, is considered a trade or business exemption is not precluded by charging a fee for the services you provide. See section 1.501(c)(3)-1(e) of the regulations. Similarly, this activity is not an unrelated trade or business within the meaning of section 513(a) because, it is substantially related to the accomplishment of your exempt section 50l(c)(3) purposes.

Similarly, we have concluded that the sale of cat theme items will not adversely impact on your status as an organization which has been recognized as exempt under section 50l(c)(3). You have represented that your sales program will not involve the sale of cat food or liter and you expect this aspect of your program to be insubstantial. An exempt organization may carry on activities to an insubstantial degree which are unrelated to the accomplishment of its exempt purposes and not jeopardize its tax exempt status. Therefore, we have concluded that this minor sales activity will not preclude exemption under section 50l(c)(3) of the Code.

In addition, an exempt organization even a private foundation, may pay reasonable salaries to its employees. Furthermore, section 4941(d)(2)(E) of the Code recognizes that the payment of reasonable salaries, even to disqualified persons such as X, is not an act of self dealing.

Accordingly, based on the information submitted we rule that:

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1. The addition of the TLC program will not adversely affect your tax-exempt status under section 501(c)(3) and you will continue to qualify as a private operating foundation under section 4942(j)(3).

2. Your proposed scholarship program satisfies the advance approval requirements of section 4945(g)(1) or (3) and these grants will not be deemed taxable expenditures and that such grants be classified as distributions for the active conduct of your exempt purposes in accordance with section 53.4942(b)-I(b)(ii).

3. The receipt of fees for services provided through the TLC program will not result in unrelated business income within the meaning of section 513 of the Code and the sale of cat-related merchandise will not adversely affect your tax-exempt status under section 501(c)(3) of the Code or your status as a private operating foundation under section 4942(j)(3).

4. Compensating X for management and administrative services rendered directly in furtherance of your exempt purpose will not constitute self-dealing under section 4941 or be a taxable expenditure under section 4945.

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. A copy of this ruling should be maintained in your permanent records.

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. For other matters, including questions concerning reporting requirements, please contact the Ohio TE/GE Customer Service Office.

Sincerely Yours,

/S/

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2

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