TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

200134025

Date:

S I N # 514.07-00

MAY 2 2 2001

Contact Person:

Identification Number:

Telephone Number:

T:EO:B1

Legend:

M =
T =
N =
w=
x =
y =

Dear Sir or Madam:

This is in reply to your legal representative's letter requesting rulings regarding the federal tax consequences associated with the transactions described below. Ruling requests 2 and 4 will be answered directly by Assistant Chief Counsel (Income Tax and Accounting) since they are within the jurisdiction of that office.

M is a T nonprofit corporation and is recognized as exempt from federal income tax under section 501(a) of the Internal Revenue Code (the Code) as an organization described in section 501(c)(3) of the Code. M is also classified as a supporting organization under section 509(a)(3). You state that M serves as the primary fundraising, gift management, and project support agency for N, a state university. M is governed by a volunteer Board of Trustees composed of community leaders, while a professional staff conducts its various programs and day-to-day programs.

You represent that M typically processes in excess of w in gifts for all purposes to N each year. M also manages funds; acquires, holds, and disposes of real property; builds facilities; and conducts other activities on behalf of N. You further state that M manages an endowment fund of approximately x, which generates an annual income solely for the use of N and its

150

programs. You additionally indicate that M also holds and manages another y in other funds on behalf of N. These funds have been given to N through M for specific programs and activities at N. M holds these funds until the appropriate official at N requests that the funds be transferred to an N account.

You state that historically, property contributions made to M have been held with the intent of converting the contributions into liquid assets. However, in order to better serve the needs of N, M contemplates that it will hold, develop, and manage certain real property contributed to M for the benefit of N. You believe that the risks associated with holding title to such real property (such as environmental liabilities and premises tort liabilities) are matters of significant concern, particularly as far as those risks may affect other assets of the M. Therefore, M will use wholly owned Single Member Limited Liability Companies (SMLLCs) as a vehicle to receive and hold each contribution of property separately, thus obtaining the liability protection desired.

You indicate the utilization of the SMLLC structure will provide M with the most administrative ease and flexibility. In addition, it will allow M to isolate and insulate the N endowment fund and other assets held from any unforeseen liabilities associated with the contributions, including the holding and operation of real property, intellectual property and the like, which will be put into the SMLLCs.

You state that the SMLLCs will be separate legal entities created under the laws of T. The Articles of Organization and Operating Agreement for each SMLLC (sample copies of which were provided) will include provisions which limit and restrict the purposes of the SMLC to activities which are carried on for the exclusive benefit of M and will include provisions which will mandate that the SMLLC will only exercise powers which are in furtherance of M's exempt purposes. Specifically, organizational limitations will be included to insure that assets will be used for the benefit of M consistently with the requirements of section 501(c)(3) of the Code. Such requirements will include preventing inurement to any private shareholder or individual, prohibiting substantial activities carrying on propaganda or otherwise attempting to influence legislation, and prohibiting participation or intervention in political campaigns.

The donors will have no current or future right to, management of, or control of assets contributed to the SMLLCs, consistent with M's current policy for all contributions. The Operating Agreement to be entered into between M and each SMLLC contains specific language regarding distributions of property from the SMLLCs (both liquidating and nonliquidating distributions), which provide that any distributions will be made only to M or, if M is no longer in existence, another organization exempt under section 501(c)(3) of the Code, the purposes of which are similar to those of M. Each SMLLC will elect to be treated as a disregarded entity for federal income tax purposes.

Based on the above, you have requested the following rulings:

1. An SMLLC, the single member of which is exempt under section 501(c)(3) of the Code, will not be required to file an application for exemption (Form 1023).

2. The contribution of property directly to an SMLLC whose single member is exempt under

section 501(c)(3) of the Code (M) will be deductible as a charitable contribution under section 170(a), subject to the same percentage limitations and other restrictions that would apply to deductible contributions made directly to the exempt entity.

3. If the SMLLC receives property encumbered by debt, it will be afforded the exemptions under sections 514(b)(1)(A) and (c)(9) of the Code for purposes of determining unrelated debt-financed income, as long as the single member is an organization described in section 511(a)(2)(B) of the Code.

4. When property contributed to a disregarded entity is treated as given directly to the single member for purposes of section 170 of the Code, the single member may provide the substantiation required under section 170(f)(8)(A) of the Code.

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c)(3), including organizations that are organized and operated exclusively for charitable, educational or scientific purposes.

The "check the box" regulations at section 301.7701 of the Income Tax Regulations (T.D. 8697, 1997-1 C.B. 215, 61 F.R. 66584), effective January 1, 1997, allow certain organizations to choose treatment as either a partnership or a corporation, or to be treated as a disregarded entity for federal tax purposes. Announcement 99-102, 1999-43 I.R.B. 545, confirms that a single member limited liability company (LLC) is presumed to be a disregarded entity. Where the sole member is a tax-exempt organization described in section 501(c)(3), the limited liability company is treated as an activity of the tax-exempt organization. Announcement 99-102 requires that for purposes of the filing requirement the exempt owner of a disregarded limited liability company shall treat the operations and finances of the limited liability company as its own. Accordingly, the disregarded entity is not required to file an application for tax exemption (Form 1023).

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

Section 511(a)(2)(B) of the Code specifically allows for the imposition of tax on unrelated business income in the case of state colleges and universities. "Such tax shall also apply in the case of any corporation wholly owned by one or more such colleges or universities."

Section 513(a) of the Code defines an unrelated trade or business as any trade or business the conduct of which is not substantially related to the exercise of the organization's exempt purpose or function.

Section 512(a)(1) of the Code defines the term "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 514(a) of the Code imposes unrelated business income tax on income derived from

debt-financed property.

Section 514(b)(1) of the Code states that for purposes of this section, "debt-financed property" means any property which is held to produce income and with respect to which there is an acquisition indebtedness (as defined in subsection (c)) at any time during the taxable year, (or, if the property was disposed of during the taxable year, with respect to which there was an acquisition indebtedness at any time during the 12-month period ending with the date of such disposition).

Section 514(c)(9) of the Code provides an exception for recognition of income from debt-financed property in cases where indebtedness is incurred by a qualified organization (as defined under section 514(c)(9)(C)(i)) when acquiring or improving any real property.

Section 514(c)(9)(C)(i) of the Code includes in the definition of qualified organization an organization described in section 170(b)(1)(A)(ii) and its affiliated support organizations described in section 509(a)(3).

The "check the box" regulations provide that an entity wholly owned by a single owner may be disregarded as an entity separate from the owner. When an entity is disregarded as separate from its owner, its operations are treated as a branch or division of the owner. Therefore, an owner that is exempt from taxation under section 501(a) of the Code must include, as its own, information pertaining to the finances and operations of a disregarded entity in its annual information return. In the circumstances described in your ruling request, the sole member of each SMLLC is M, a tax-exempt organization described in section 501(c)(3) of the Code. Each SMLLC is treated as an activity of the tax-exempt organization for purposes of the filing requirement (Announcement 99-102). Further, M is a qualified organization described in section 514(c)(9)(C)(i) because it is a supporting organization described in section 509(a)(3) of an educational institution described in section 170(b)(1)(A)(ii). Therefore, provided that the requirements of section 514(c)(9) are met, M will not have acquisition indebtedness with respect to real property held by each SMLLC.

Accordingly, based upon the facts and circumstances presented herein, we rule that:

1. An SMLLC, the single member of which is exempt under section 501(c)(3) of the Code, will not be required to file an application for exemption (Form 1023).

3. If the SMLLC receives real property encumbered by debt, it (and M) will be afforded the exemptions under sections 514(b)(1)(A) and (c)(9) of the Code for purposes of determining debt-financed income, to the extent the requirements of those provisions are met.

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

These rulings do not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

These rulings are directed only to the organization that requested it. Section 6110(j)(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,

Manager, Exempt Organizations
Technical Group

154