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

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Date: AUG 10 2001

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Dear Sir or Madam:

This is in reply to a letter dated May 25, 2001, from your legal representative in which he requested rulings concerning the income tax consequences of certain transactions arising from a recent corporate reorganization.

B is exempt from federal income tax under section 501(c)(3) of the Code with classification as not a private foundation under section 509(a)(1). Since its founding, B has directly provided wide-ranging services to children including residential care at its C Campus, a school at the C Campus, substance abuse services for children, emergency housing for abused children, a number of satellite (off campus) special education schools, and other programs.

By 1999, B had experienced a significant development and expansion of its programs. Its Board of Directors therefore decided to restructure by creating two new subsidiary corporations, D and E, with B becoming a parent holding company. Both D and E would be controlled by B as a sole member. D would take over the C campus-based programs, and E would take over the off-campus special education schools and other activities providing services directly to children in community settings. We have determined in separate correspondence that D is entitled to recognition of exemption under section 501(c)(3) of the Code and classification as a nonprivate foundation under sections 509(a)(1) and 170(b)(1)(A)(ii). We have also determined in separate correspondence that E is entitled to recognition of exemption under section 501(c)(3) of the Code and classification as a nonprivate foundation under section 509(a)(2).

On November 24, 1999, B amended and restated its Charter and Bylaws to reflect that it is now a supporting organization for D and E. The Charter was amended to provide that the

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nature of B's activities and purposes to be promoted would be exclusively charitable and educational within the meaning of section 501(c)(3) and would include only those permitted for a section 509(a)(3) supporting organization for D and E. The purposes clause provides that B will, consistent with its general purposes, continue to perform the historical functions of B either directly or indirectly through either D or E. In addition, the Charter provides that B will benefit, perform the functions of, carry out the purposes of and uphold, promote and further the welfare, programs and activities of D and E.

B is now governed by a Board of Directors of not less than seven nor more than twenty-one directors. The Bylaws of B provide that at least one B director must be also a director of D and at least one B director must also be a director of E so that both D and E has at least one director on the Board of B. Moreover, the corporate documents of D and E provide that each corporation has one member, B, which has the right to elect the Board of Directors of D and E and make decisions on major matters.

When the transfers of operations and assets are complete, D will have assumed the existing comprehensive campus-based activities, which include residential treatment programs, a fully accredited special education school providing services both to residential children and other children, extended day treatment, health care, independent living training, and after care. E will have responsibility for B's community-based programs throughout F. It will own and operate in some cases and, in other cases, manage special education schools serving children in public school districts throughout F. E will also have responsibility for the therapeutic foster care program, post legal adoption services, collaborative programs with the F court system, youth mentoring, and certain clinical services related to special education programs.

As previously mentioned, to implement the reorganization, B will transfer assets necessary for the operation of D and E. These assets include real property (in the case of the C campus), tangible personal property including furniture and furnishings, equipment, and supplies, leases of both real estate and cars and equipment, and contracts. B will also transfer cash to D and E to fund working capital and operations. B will retain endowment and other charitable funds as well as any other assets it deems appropriate for its purposes. B will continue to employ all personnel and will lease appropriate personnel to D and E, which will pay B for the personnel based on reasonable cost. B, D and E may share some facilities, personnel and services in order to reduce cost and improve the quality of services being delivered to children. There may also be additional gratuitous transfers of cash and assets among B, D and E as may be necessary or appropriate to insure effective operation of D and E.

B represents that the proposed corporate reorganization will establish a multi-entity holding company structure with the flexibility and resources to promote more effective and directed management of the varied programs and activities of B. This will permit B to respond to the changing and evolving needs of F's children and communities for specialized services.

Section 170 of the Internal Revenue Code, in part, provides, subject to certain limitations, for the allowance of a deduction for charitable contributions to corporations, trusts, funds or foundations that are organized and operated exclusively for charitable, scientific or educational purposes as set forth in Section 170(c).

Section 501 (c) (3) of the Code provides for the exemption from federal income tax of an organization organized and operated exclusively for educational and charitable 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 is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of the other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions.

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c) (3).

Section 512(a) (1) of the Code defines unrelated business taxable income generally as gross income received by an exempt organization from an unrelated trade or business regularly carried on by it, less allowable deductions.

Section 513 (a) of the Code defines an unrelated trade or business, in the case of any organization subject to the tax imposed by Section 511, 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 exempt purposes.

Section 509 (a) of the Code provides that a section 501 (c) (3) organization shall be a private foundation unless it is described in sections 509 (a) (1) through 509 (a) (4).

Section 509 (a) (3) (A) of the Code describes an organization that is organized and operated to support or benefit one or more specified section 509 (a) (1) or (2) organizations which have a degree of control or supervision over the supporting organization.

Section 1. 509 (a)-4 (c) (1) of the regulations provides that an organization is organized exclusively for one or more of the purposes specified in section 509 (a) (3) (A) only if its articles of organization:

(i) Limit the purposes of such organization to one or more of the purposes set forth in Section 509 (a) (3) (A);

(ii) Do not expressly enpower the organization to engage in activities which are not in furtherance of the purposes referred to in subdivision (i) of this subparagraph;

(iii) State the specified publicly supported organizations on whose behalf such organization is to be operated (within the meaning of paragraph (d) of this section); and

(iv) Do not expressly enpower the organization to operate to support or benefit any organization other than the specified publicly supported organizations referred to in subdivision (iii) of this subparagraph.

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Section 1. 509 (a)-4 (e) (1) of the regulations provides in part that a supporting organization "will be regarded as 'operated exclusively' to support one or more specified publicly supported organizations (herein after referred to as the 'operational test') only if it engages solely in activities which support or benefit the specified or publicly supported organizations."

Section 509 (a) (3) (B) of the Code sets forth three different types of relationships, one of which must be met in order for a Section 501 (c) (3) organization to qualify under the provisions of Section 509 (a) (3). A supporting organization may be:

1. operated, supervised, or controlled by,

2. supervised or controlled in connection with, or

3. operated in connection with, one or more publicly supported organizations.

Section 1. 509 (a)-4 (i) (1) of the regulations provides that an organization is "operated in connection with" a publicly supported organization if it satisfies a "responsiveness test" and an "integral part test." The responsiveness test is satisfied if one or more of the trustees of the publicly supported organization are also trustees of, or hold important offices in, the supporting organization. The integral part test is satisfied if the activities engaged in by the organization for or on behalf of the supported organization are activities to perform the functions of, or to carry out the purposes of the supported organization and, but for the supporting organization, such activities would normally be performed by the supported organization.

Section 509 (a) (3) (c) of the Code excludes from the definition of private foundations an organization which is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) or (2).

B qualifies as public charity described in section 509 (a) (3) of the Code by reason of being a supporting organization of D and E within the meaning of section 509 (a) (3) of the Code and regulations. B satisfies the organizational and operational tests of section 509 (a) (3) (A) of the Code in that its activities are carried out to support and benefit D and E, both organizations described in section 509 (a) (1) and 509 (a) (2) of the Code; and the Articles of B have been amended to state that it supports D and E. Moreover, B satisfies the responsiveness and integral parts tests of section 1.509 (a)-4 (i) (1) of the regulations, which must be met in order to be considered "operated in connection with" a publicly supported organization. These tests are met in that one or more of the members of the board of D and E are also directors of B, and B will perform functions of D and E which would normally be performed by D and E if not for the existence of B.

The facts and circumstances of this case indicate that the proposed transfer of cash and other assets and the sharing of personnel services among B, D and E serve to facilitate their exempt activities and promote the achievement of the exempt purposes of each related organization. Therefore, these transactions do not adversely affect the tax exempt status of B,

D or E.

To the extent that income is realized as a result of the sharing of assets and services among B, D and E, it will not give rise to unrelated business income so long as these business activities are substantially related to the exercise and performance of the exempt purpose of B, D and E.

Moreover, because the reorganization will not effect the continued exempt status of B, D and E under section 501 (c) (3), contributions to B, D and E will continue to be deductible by donors under section 170.

Accordingly, based on the facts and circumstances as stated above, we rule that:

1. After the amendment of its Charter and Bylaws and the proposed reorganization, B will continue to qualify as an organization described in section 501 (c) (3) and qualifies under section 509 (a) (3) as a supporting organization of D and E.

2. The proposed transfers of cash and other assets and the sharing of personnel and services, by and between B, D and E will not (a) jeopardize the continued tax-exempt status of B, D and E as organizations described in section 501 (c) (3) or (b) give rise to unrelated business taxable income under sections 511-514 to B, D or E.

3. After the amendments to the Charter and Bylaws of B and the proposed reorganization, contributions to B, D and E will be deductible by donors as provided in section 170.

This ruling is based on the understanding that there will be no material changes in facts upon which it is based.

This ruling is directed only to the organization that requested it. Section 6110 (k) (3) of the Internal Revenue Code provides that it may not be used or cited by others as precedent.

We are informing the Ohio TE/GE office of this action. Please keep a copy of this ruling in your organization's permanent records.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

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