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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200204040

Date: OCT 30 2001

Contact Person:

Identification Number:

Telephone Number:

T:EO:B2

Uniform Issue List
170.07-06
509.02-02

Employer Identification Number:

LEGEND

M =
N =
X =
Y =

Dear Sir or Madam:

This letter responds to X's request dated August 8, 2000 for rulings that funds created within X will be treated as component parts of a community trust, that X's status as a community trust will not adversely affect X's status as a supporting organization and that contributions to X will be fully deductible to the donors as a charitable contribution.

FACTS

Y is a community trust described in sections 501(c)(3) and 509(a)(1)/170(b)(1)(A)(vi) of the Code. Y makes distributions for charitable purposes in the greater M area. This area includes N, a community just 25 miles north of M.

X is recognized as a section 509(a)(3) organization supporting Y and plans to continue in such status. X was established by civic leaders in N to administer charitable funds for the N community. X affiliated itself with Y in order to reduce administrative costs and achieve economies of scale. The members of X's Board of Directors are community leaders in N. Y appoints a majority of X's Board of Directors.

Initially, X was administered as a single fund. However, donors have expressed interest in creating component funds of X (the supporting organization) rather than Y (the supported organization). Thus, X has amended its Articles of Incorporation and By-laws to meet community trust rules. X will hold and administer component funds endowed by many separate

donors for various charitable purposes subject to a common governing instrument (Articles of Incorporation and By-laws). Each fund will be created pursuant to a separate gift instrument. Each gift instrument facilitates the donor transfer of assets to X and sets forth the donor's wishes concerning the use of the assets and income of the fund. Each gift instrument incorporates by reference the provisions of the common governing instrument. X represents that the gift instruments will not subject any funds to a "material restriction or condition" under section 1.507-2(a)(8) of the regulations.

X's Articles of Incorporation provide that it is organized for the benefit of Y. X's charitable program consists of making grants to other organizations and individuals. All grants must be approved by Y's board as consistent with Y's purposes. X's By-laws prohibit disqualified persons from constituting 50% or more of its board or otherwise controlling X.

RULINGS REQUESTED

X requests the following rulings:

(1) X is a community trust as described in Treasury Regulations section 1.170A-9(e)(10);

(2) Component funds established within X, which otherwise meet the requirements of Treasury Regulations section 1.170A-9(e)(11), will be regarded as component funds of a single entity community trust;

(3) The changes to the By-laws and status as a community trust will not adversely affect X's status as a supporting organization described in section 509(a)(3); and

(4) Gifts to X will continue to be fully deductible to the donors as a charitable contribution under section 170(b)(1)(A)(viii) in the case of individual donors and under section 170(b)(2) in the case of corporate donors.

LAW

Section 170(b)(1)(A)(viii) of the Internal Revenue Code provides that in the case of an individual, a charitable contribution to an organization described in section 509(a)(3) (or other organization described in section 170(b)(1)(A)) shall be allowed to the extent that the aggregate of such contributions does not exceed 50% of the taxpayer's contribution base for the taxable year.

Section 170(b)(2) of the Code provides that in the case of a corporation, the total deductions under section 170(a) for any taxable year shall not exceed 10 percent of the taxpayer's taxable income (computed with certain modifications).

Section 1.170A-9(e)(10) of the Income Tax Regulations provides that community trusts have often been established to attract large contributions of a capital or endowment nature for the benefit of a particular community or area, and often such contributions have come initially from a small number of donors. While the community trust generally has a governing body comprised of representatives of the particular community or area, its contributions are often received and

maintained in the form of separate trusts or funds, which are subject to varying degrees of control by the governing body. Section 1.170A-9(e)(11) provides rules for determining the extent to which separate trusts or funds may be treated as component parts of a community trust, fund or foundation (herein collectively referred to as a "community trust," and sometimes referred to as an "organization") for purposes of meeting the requirements of this paragraph for classification as a "publicly supported" organization. Section 1.170A-9(e)(14) contains rules for trusts or funds which are prevented from qualifying as component parts of a community trust by section 1.170A-9(e)(11).

Section 1.170A-9(e)(11) of the Treasury Regulations provides that any organization which meets the requirements of section 1.170A-9(e)(11)(iii) through (vi) will be treated as a single entity rather than as an aggregation of separate funds, and except as otherwise provided, all funds associated with such organization which meet the requirements of section 1.170A-9(e)(11)(ii) will be treated as component parts of such organization.

Section 1.170A-9(e)(11)(ii) of the regulations provides that in order to be treated as a component part of a community trust (rather than as a separate trust or not-for-profit corporation or association) a trust or fund:

(A) Must be created by gift, bequest, legacy, devise or other transfer to a community trust which is treated as a single entity; and

(B) May not be directly or indirectly subjected by the transferor to any material restriction or condition (within the meaning of section 1.507-2(a)(8)) with respect to the transferred assets.

Section 1.170A-9(e)(11)(iii) requires that the organization be commonly known as a community trust, fund, foundation or other similar name conveying the concept of a capital or endowment fund to support charitable activities in the community or area it serves.

Section 1.170A-9(e)(11)(iv) requires that all funds of the organization be subject to a common governing instrument.

Section 1.170A-9(e)(11)(v)(A) requires that the organization must have a common governing body which directs or, in the case of a fund designated for specified beneficiaries, monitors the distribution of all funds exclusively for charitable purposes.

Section 1.170A-9(e)(11)(v)(B) requires that the governing body of a community trust have the power to:

(1) Modify any restriction or condition on the distributions of funds for any specified charitable purpose or to specified organizations if in the sole judgment of the governing body (without the necessity of approval by any participating trustee, custodian or agent) such restriction becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served;

(2) Replace any participating trustee, custodian or agent for breach of fiduciary duty under state law; and

(3) Replace any participating trustee, custodian or agent for failure to produce a reasonable rate of return.

Sections 1.170A-9(e)(11)(v)(E) and (F) of the Treasury Regulations require that the governing body of the community trust commit itself by resolution or otherwise to exercise certain specified powers.

Section 1.170A-9(e)(11)(vi) of the Regulations requires the organization to prepare periodic financial reports treating all of the funds which are held by the community trust, either directly or in component parts, as funds of the organization.

Section 509(a)(3) provides that a "private foundation" does not include an organization that:

(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or (2),

(B) is operated, supervised, or controlled by or in connection with one or more organizations described in section 509(a)(1) or (2), and

(C) 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 section 509(a)(1) or (2).

Section 1.509(a)-4(e)(1) of the regulations provides that a supporting organization will be regarded as "operated exclusively" to support one or more specified publicly supported organizations (hereinafter referred to as the "operational test") only if it engages solely in activities which support or benefit the specified publicly supported organizations. Such activities may include making payments to or for the use of, or providing services or facilities for, individual members of the charitable class benefited by the specified publicly supported organization. A supporting organization may also, for example, make a payment indirectly through another unrelated organization to a member of a charitable class benefited by the specified publicly supported organization, but only if such a payment constitutes a grant to an individual rather than a grant to an organization. In determining whether a grant is indirectly to an individual rather than to an organization the same standard shall be applied as in section 53.4945-4(a)(4). Similarly, an organization will be regarded as "operated exclusively" to support or benefit one or more specified publicly supported organizations even if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3) and is operated, supervised, or controlled directly by or in connection with such publicly supported organizations, or which is described in section 511(a)(2)(B). However, an organization will not be regarded as operated exclusively if any part of its activities is in furtherance of a purpose other than supporting or benefiting one or more specified publicly supported organizations.

In Example (3) of section 1.509(a)-4(e)(3) of the regulations, P is an organization described in section 501(c)(3). Its primary activity is providing financial assistance to S, a publicly supported organization which aids underdeveloped nations in Central America. P's articles of organization designate S as the principal recipient of P's assistance. However, P also makes a small annual general purpose grant to T, a private foundation engaged in work similar to that carried on by S. T performs a particular function that assists in the overall aid program carried on by S. Even though P is operating primarily for the benefit of S, a specified publicly supported organization, it is not considered as operated exclusively for the purposes set forth in section 509(a)(3)(A). The grant to T, a private foundation, prevents it from complying with the operational test under section 509(a)(3)(A).

Section 1.509(a)-4(g) of the regulations provides, in part, that the term "operated, supervised, or controlled by" presupposes a substantial degree of direction over the policies, programs, and activities of a supporting organization by one or more publicly supported organizations. The relationship required under this term is comparable to that of a parent and subsidiary, where the subsidiary is under the direction of, and accountable or responsible to, the parent organization. This relationship is established by the fact that a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing body of one or more publicly supported organizations.

Rev. Rul. 81-43, 1981-1 C.B. 350, held that a community trust (M) described in section 1.170A-9(e)(11) of the Income Tax Regulations that was created by a community chest (S) to hold permanently endowed charitable funds and to distribute income to support local publicly supported charities was a supporting organization under section 509(a)(3) of the Code, even if the publicly supported charities were not specified by name. M was exempt from federal income tax under section 501(c)(3) of the Code and a community trust described in section 1.170A-9(e)(11) of the regulations. M did not qualify as a publicly supported organization described in sections 170(b)(1)(A)(vi) and 509(a)(1). S was a "community chest" operating in Z city and was a publicly supported organization described in sections 170(b)(1)(A)(vi) and 509(a)(1). M was created by S for the purpose of holding permanently endowed charitable funds for use in the Z area. M's governing instrument provided for its income to be distributed to support charitable organizations located in the Z area that were exempt under section 501(c)(3) of the Code and public charities described in section 509(a)(1) or (a)(2). A majority of the trustees of M were appointed by the governing body of S. M was not controlled directly or indirectly by one or more disqualified persons other than foundation managers as defined in section 4946 of the Code.

ANALYSIS

Each of the requested rulings is discussed in turn below.

1. X fits the description of a community trust in section 1.170A-9(e)(10) of the regulations, in that it has been established to attract large contributions for an endowment to benefit the W community; has a governing body of representatives of the W community or area; and will receive and maintain contributions in the form of separate trusts or funds subject to some degree of control by the governing body.

2. Sections 1.170A-9(e)(11)(ii) through (vi) of the regulations provide the requirements that X must meet in order to be treated as a single entity rather than as an aggregation of separate funds.

Regarding section 1.170A-9(e)(11)(ii), X has represented that its funds will not be subjected by the transferor to any material restriction or condition under section 1.507-2(a)(8). X's common governing instrument and the proposed gift instruments contain language that tends to prohibit the imposition of such material restrictions or conditions.

Regarding the other requirements, X satisfies the name requirement of section 1.170A-9(e)(11)(iii) of the regulations. As required by section 1.170A-9(e)(11)(iv), X's common governing instrument states that all funds of X shall be subject to the provisions of X's common governing instrument and that each donor, by making a gift to X, shall be deemed to accept and agree to such terms. The gift instruments similarly reference X's common governing instrument. X's Board of Directors will direct (or in the case of a fund designated for specified beneficiaries, monitor) the distribution of all funds exclusively for charitable purposes, in compliance with section 1.170A-9(e)(11)(v)(A). X's Board has the powers specified in section 1.170A-9(e)(11)(v)(B), and has committed itself to exercise these powers and to otherwise ensure that the funds are administered in accordance with the terms of X's governing instrument and accepted fiduciary standards of conduct, and that the funds produce a reasonable financial return, in accordance with sections 1.170A-9(e)(11)(v)(E) and (F). X will also meet the reporting requirements of section 1.170A-9(e)(11)(vi).

3. Rev. Rul. 81-43 establishes that a community trust may qualify under section 509(a)(3) of the Code. X's Articles of Incorporation meet the organizational test of section 509(a)(3)(A) because it is organized for the benefit of Y. X's making of grants to organizations other than Y does not violate the 509(a)(3) operational test where, as here, Y's board may disapprove any such grant--such procedure is substantially similar to the making of grants to Y. X meets the relationship test of section 509(a)(3)(B) through Y's control of X. Also, X represents that it meets the disqualified person control test of section 509(a)(3)(C). We do not rule whether disqualified persons will indirectly control X--such determination is inherently factual and depends on such facts and circumstances as the nature, diversity, and income yield of its holdings, the length of time particular stocks, securities, or other assets are retained, and its manner of exercising voting rights with respect to stocks in which members of its governing body also have some interest.

4. Given that X is described in section 509(a)(3) of the Code, it follows that contributions to X (including X's component parts) will continue to be deductible as provided in section 170 for contributions to an organization described in section 509(a)(3).

RULINGS

Accordingly, we rule as follows:

(1) X is a community trust as described in Treasury Regulations section 1.170A-9(e)(10);

(2) Component funds established within X, which otherwise meet the requirements of Treasury Regulations section 1.170A-9(e)(11), will be regarded as component funds of a single entity community trust;

(3) The changes to the By-laws and status as a community trust will not adversely affect X's status as a supporting organization described in section 509(a)(3); and

(4) Gifts to X will continue to be fully deductible to the donors as a charitable contribution under section 170(b)(1)(A)(viii) in the case of individual donors and under section 170(b)(2) in the case of corporate donors.

Except as we have ruled above, we express no opinion as to the tax consequences of the transaction under the cited provisions of the Code or under any other provisions of the Code.

This ruling is directed only to X. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Because this letter could help resolve any future questions about the tax consequences of X's activities, X should keep a copy of this ruling in its 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.

Sincerely,

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2