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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: SEP 0 9 2003

Contact Person:

Identification Number:

Telephone Number:

U.I.L. Nos.
501.03-00
501.03-33
511.00-00
512.00-00
513.00-00

T:EO:BR 2

Employer Identification Number:

LEGEND:

X=
Y=

Dear Sir or Madam:

This is in response to a letter from your authorized representative dated August 21, 2003, which amends your letter dated November 27, 2001, requesting a series of rulings on your behalf regarding the tax consequences associated with the transactions described below. In the amended letter, you have amended ruling request number three as set forth and withdrawn ruling requests number four and five.

You were established by Congress by Enabling Legislation.

Your purposes as identified in the Enabling Legislation are:

(1) to encourage, accept, and administer private gifts of property for the benefit of, or in connection with, the activities and services of X and Y, for the conservation and management of natural resources;
(2) to undertake and conduct such other activities as will further the conservation and management of the resources of the United States, and its territories and possessions, for present and future generations of Americans; and,
(3) to participate with, and otherwise assist, foreign governments, entities, and individuals in undertaking and conducting activities that will further the conservation and management of the resources of other countries.

Among the powers granted to you under the Enabling Legislation are these:

(1) to invest any funds provided to you by the Federal Government in obligations of the United States or in obligations of the United States or in obligations or securities that

are guaranteed or insured by the United States;
(2) to deposit any funds provided to you by the Federal Government into accounts that are insured by an agency or instrumentality of the United States;
(3) to make use of any interest of investment income that accrues as a consequence of actions taken under (1) or (2) to carry out your purposes;
(4) to use Federal funds to make payments under cooperative agreements entered into with willing private landowners to provide substantial long-term benefits for the restoration or enhancement of natural resources on private land;
(5) unless otherwise required by the instrument of transfer, to sell, donate, lease, invest, reinvest, retain or other wise dispose of any property or income therefrom;
(6) to enter into contracts for other arrangements with public agencies and private organizations and persons and to make such payments as may be necessary to carry out its function; and,
(7) to do any and all acts necessary and proper to carry out your purposes.

Your Bylaws state that you shall hold and may exercise all such powers as conferred upon you by the Enabling Legislation and as may be necessary or expedient for the administration of the affairs and attainment of your purposes.

You received your determination letter as a section 501(c)(3) organization, effective March 1984, on July 25, 1986. You state that in furtherance of your exempt purposes, you conduct projects related to conservation education, habitat protection and restoration, and natural resource management.

Two of your funding sources are from permit fees and enforcement generated funds. Where selected environmental laws require a party to apply for and receive a permit or license from a government agency that has regulatory authority over affected natural resources, an agency may choose to have money received for the permit fees and licenses deposited into accounts controlled by you rather than into the government's general fund. The agency enters into a contractural agreement ("fund agreement") with you governing the receipt, administration and expenditure of the funds at issue. You agree to disburse the fund at the direction of the government party or parties to accomplish conservation objectives identified in the fund agreement. You invest the funds under the fund agreement, typically subject to investment limitations approved or specified by the government agency.

Federal and state agencies may also choose to have payments of civil or criminal damages or restitution resulting from the enforcement of environmental laws directed to you. Funds delivered to you are generally used to fund restoration and conservation projects related to the underlying violations. The ultimate funding decision is made by the government party consistent with the court order. The contractural arrangements used to administer enforcement-generated funds may be in the form of fund agreements, similar in form and implementation to the fund agreements for permit fees, or trust agreements. A fund agreement may cover only permit fees or enforcement-generated funds or it may cover both. Some fund agreements relate to payments from a single payor while others consist of payments from a number of payors.

Under a trust agreement, a federal or state government agency creates a trust, in most circumstances under the supervision of a court, and appoints you as trustee to invest and disburse the trust funds. The purpose of each trust is to receive, manage, and disburse funds for restoration projects related to the underlying incident. The trusts may involve one or more state government agencies and some may also involve one or more federal government agencies. Each trust agreement provides that all interest and earnings accruing to the trust are to be reinvested in the trust and used for the purpose of the trust.

You have historically retained a one-time payment equal to a modest percentage of the amount involved, which you use to defray your operating costs. You had stated that for fund agreements related to permit fees, you may modify this feature in the future to provide for multiple payments and differing amounts more reflective of your operating costs. You submitted a draft copy of a Memorandum of Agreement that is to serve as a template for agreements that you enter into with agencies. This document, which may be modified based upon the circumstances, will replace the various fund agreements and trust agreements previously used by you.

Based on the foregoing facts and representations, the following rulings have been requested:

1. Your participation in the Agreements does not adversely affect your exempt status.
2. Your participation in the Agreements is substantially related to your exempt purposes.
3. Earnings on amounts held under the Agreements to be expended at the direction of federal and state government agencies are income derived from and related to an exempt function and not unrelated business taxable income.

Section 501(a) of the Internal Revenue 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.

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax of organizations that are organized and operated exclusively for religious, charitable, scientific, or educational purposes, provided no part of their net earnings inures to the benefit of any private shareholder or individual.

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations exempt from federal income tax under section 501(c).

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

Section 512(b)(1) of the Code excludes from unrelated business taxable income dividends and interest.

Section 513 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 the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of the purpose or function constituting the basis for its exemption.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish such purposes. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and includes lessening the burdens of government.

Section 1.513-1(a) of the regulations provides that gross income of an exempt organization subject to the tax imposed by section 511 of the Code is includible in the computation of unrelated business taxable income if: (1) it is income from a trade or business, (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes only where the conduct of the business activity has a causal relationship to the achievement of an exempt purpose, and is "substantially related" for purposes of section 513, only if the causal relationship is a substantial one. Thus, for income from a trade or business 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 1.513-1(d)(4) of the regulations provides that gross income derived from charges for the performance of exempt functions does not constitute gross income from the conduct of an unrelated trade or business.

Rev. Rul. 67-292, 1967-2 C.B. 184, holds that an organization formed for the purpose of purchasing and maintaining a sanctuary for wild birds and animals for the benefit of the public may qualify as exempt from Federal income tax under section 501(c)(3).

Rev. Rul. 70-186, 1970-1 C.B. 128, holds that an organization formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 76-204, 1976-1 C.B. 152, holds that a nonprofit organization formed for the purpose of preserving the natural environment by acquiring, by gift or purchase, ecologically significant undeveloped land, and either maintaining the land itself with limited public access or transferring the land to a government conservation agency by outright gift or being reimbursed

by the agency for its cost, qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 85-2, 1985-2 C.B. 178, holds that an organization is lessening the burdens of government if its activities are activities that a governmental unit considers to be its burdens, and, the activities actually lessen such governmental burden. To determine whether an activity is a burden of government, the question to be answered is whether there is an objective manifestation by the government that it considers such activity to be part of its burden.

The Enabling Legislation provides for you to undertake and conduct activities that further the conservation and management of natural resources of the United States. Such activities are considered to be charitable within the meaning of section 501(c)(3) of the Code. See, Rev. Rul. 67-292, supra; Rev. Rul. 70-186, supra; and, Rev. Rul. 76-204, supra.

You have been granted recognition for exemption as an organization described in section 501(c)(3) of the Code. In order for you to continue to meet the requirements for recognition of your exemption, you must be organized and operated exclusively for charitable purposes. Section 1.501(c)(3)-1(c)(1) of the regulations.

Under your Bylaws, you have the authority to exercise all such powers as may be necessary or expedient for attaining your charitable purposes. Your agreements with the Federal and state governments are the type of activities contemplated by the Enabling Legislation. You assist federal and state agencies in creating funds for managing the monies that the agencies receive for conservation programs. The Agreements allow you to use your expertise and experience to effectively manage the funds for conservation purposes. In addition, by assuming responsibility for administering the funds, some of which may involve multiple payors or several government agencies, you advance the charitable purpose of lessening the burden of the participating government agencies. Section 1.501(c)(3)-1(d)(2) of the regulations; Rev. Rul. 85-2, supra. Thus, the activities undertaken by you in connection with the Agreements come within the charitable purposes under which you are organized and operated.

Organizations exempt under section 501(c)(3) of the Code are subject to a tax on their unrelated business income under section 511. Section 513 of the Code defines an "unrelated trade or business" as one whose conduct is not substantially related to the organization's exercise or performance of the purpose or function constituting the basis for its exemption.

The Agreements that you enter into with the government agencies are substantially related the accomplishment of your exempt purposes, and contribute importantly to the accomplishment of these purposes. Section 1.513-1(d)(2) of the regulations. The money deposited into the funds by the government agencies are specifically identified for use in activities related to the conservation of natural resources. Such activities are in furtherance of the charitable purposes for which you are organized and operated. The payments withheld by you are received in exchange for your management of the funds and are used to defray operating costs. Therefore, your participation in the Agreements does

not constitute an unrelated trade or business under section 513 of the Code and so does not subject it to tax under section 511. Section 1.513-1(a) of the regulations; Section 1.513-1(d)(4) of the regulations.

The income generated by your investment activity is earned from the exercise or performance of exempt functions and therefore is not subject to the unrelated business income tax. Section 1.513-1(a) of the regulations. You are required to invest the money in the funds. The investments generally are subject to investment limits specified or approved by a government agency or you may be required to reinvest the interest and earnings and use them for the purposes for which a particular fund was established.

Accordingly, based on all the facts and circumstances described above, we rule as follows:

1. Your participation in the Agreements does not adversely affect your exempt status.
2. Your participation in the Agreements is substantially related to your exempt purposes.
3. Earnings on amounts held under the Agreements to be expended at the direction of federal and state government agencies are income derived from and related to an exempt function and not unrelated business taxable income.

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.

We are informing your key District Office of this action. Please keep a copy of this ruling in your permanent records.

This ruling is directed only to the taxpayer who requested it. 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 tax consequences of your activities, you should keep a copy of this ruling 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.

Sincerely,

Terrell M. Berkovsky

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2