

200434028



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Uniform Issuer List

150.04-00

501.03-22

512.01-00

4942.05-02

Date:

Contact Person:

Identification Number:

Telephone Number:

MAY 25 2004

Employer Identification Number:

Legend:

M =

N =

O =

Dear

This is in response to your ruling request dated December 23, 2003, for rulings concerning the federal income tax consequences of your transfer of obligations and the assets that secure them to a for-profit entity pursuant to section 150(d)(3) of the Internal Revenue Code.

FACTS

You are exempt from federal income tax under section 501(c)(3) of the Code and you are also classified as other than a private foundation under section 509(a)(3). You were originally formed at the request of the city of M, State of N, under the provisions of an identified State statute, pursuant to which you could acquire and service student loan notes which were guaranteed under the provisions of the O, as amended.

You currently are a qualified scholarship funding corporation as defined in section 150(d) of the Code. Your governing board has decided that you could more effectively carry out your charitable and educational purposes by ceasing such status, pursuant to an election under section 150(d)(3) ("Election"). You intend to carry on your charitable purposes as a private foundation within the meaning of section 509(a). You have provided organizing documents to show that you will comply with the private foundation requirements.

You intend to make the Election by transferring all of your student loan notes to a taxable corporation (the "Subsidiary") in exchange for "senior stock" of the Subsidiary within a reasonable period of time after the Election. Immediately after the transfer, you will hold all of the senior stock of the Subsidiary. The senior stock will have rights to dividends, liquidation,

and redemption rights that are not inferior to those of any other class of stock and will (1) participate pro rata and fully in the equity value of any other common stock of the Subsidiary, (2) have the right to payments receivable in liquidation prior to any other stock in the Subsidiary, (3) upon liquidation or redemption, have a fixed right to receive the greater of (a) the fair market value of the stock at the date of liquidation or redemption or (b) the net fair market value of all assets transferred to your Subsidiary, and (4) have a right to require its redemption by a date which is sooner than 10 years after the date that the Election is made.

In addition, the Subsidiary will assume all of your qualified scholarship funding bond indebtedness within a reasonable period after the Election. To the extent permitted by law, the Subsidiary will assume all of the responsibilities and succeed to all your rights under your agreements with the Secretary of Education with respect to student loans. At least 80 percent of the members of your board of directors will be independent of the Subsidiary and receive no compensation from the Subsidiary.

Immediately after the Election, you will continue to be organized and operated exclusively for charitable and educational purposes through the carrying out of educational programs and activities. These programs and activities may include:

(1) The coordination and encouragement of, and assistance for, educational functions and activities, support of innovative and exemplary teaching, and increasing access to higher education in N through the provision of financial support, leadership, and professional expertise.

(2) The establishment of a fund to be used for educational projects or grants throughout N as well as for the benefit of individual students worthy of scholarship assistance.

(3) The provision of financial support to supplement the resources available to schools in N in order to preserve, maintain, and improve education in N.

(4) The promotion of the development of character, integrity, leadership, and citizenship of students in N.

(5) The promotion of literacy, life skills, and family support for education.

RULINGS REQUESTED

1. Your change in activities, purposes, and governance, as described above, will not adversely affect your qualification as a tax exempt organization described in section 501(c)(3) of the Code.
2. Based upon your representations, you will be reclassified as a private foundation under section 509(a) of the Code.
3. Your conduct of the activities described above will not constitute an unrelated trade or business under section 513 of the Code.

LAW

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of organizations that are organized and operated "exclusively" for charitable, religious, educational, or other specified exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to qualify for exemption under Code section 501(c)(3), an organization must be both organized and operated exclusively for one or more exempt purposes. Failure to meet either the organizational or operational test will disqualify an organization from exemption under section 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the 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 one or more exempt purposes under section 501(c)(3). 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)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for a section 501(c)(3) exempt purpose unless it serves a public rather than a private interest. Thus, it is necessary that the organization establish that it is not operated for the benefit of private individuals.

Section 1.501(c)(3)-1(d)(2) of the regulations states that the term "charitable" is used in its generally accepted legal sense. The term includes the advancement of education and lessening of the burdens of government.

Section 509(a) of the Code defines the term "private foundation" to mean an organization described in section 501(c)(3) other than one that is described in sections 509(a)(1), (2), (3), or (4).

Section 511 of the Code imposes a normal tax and surtax on the unrelated business taxable income (defined in section 512) of organizations exempt from tax under section 501(c) of the Code.

Section 512 provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (defined in section 513) regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business.

Section 512(b)(1) of the Code excludes from the definition of "unrelated business taxable income" all dividends, interest, payments with respect to securities loans (as defined in section 512(a)(1)), amounts received or accrued as consideration for entering into agreements to make loans, and annuities, and all deductions directly connected with such income.

Section 512(b)(5) of the Code excludes from "unrelated business taxable income" all gains or losses from the sale, exchange, or other disposition of property other than -

- "(A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or
- (B) property held primarily for sale to customers in the ordinary course of the trade or business."

Section 513(a) provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption.

Section 1.513-1(d)(1) of the regulations provides that gross income derives from "unrelated trade or business" if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. This necessitates an examination of the relationship between the business activities which generate the particular income in question (the activities, that is, of producing or distributing the goods or performing the services involved) and the accomplishment of the organization's exempt purposes.

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 activities has causal relationship to the achievement of exempt purposes (other than through the production of income). Further, it is "substantially related", for purposes of section 513, only if the causal relationship is a substantial one. For this relationship to exist, the production or the performance of the service from which the gross income is derived must contribute importantly to the accomplishment of exempt purposes. Whether the activities productive of gross income contribute importantly to such purposes depends in each case upon the facts and circumstances involved.

Section 4942(j)(4) of the Code provides that the term "functionally related business" means -

- (A) a trade or business which is not an unrelated trade or business (as defined in section 513), or
- (B) an activity which is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which is related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exempt purposes of the organization.

ANALYSIS

The facts above show that you are organized, and after the Election and transfer of student loan notes to the Subsidiary, will continue to be operated exclusively for charitable and educational purposes through your provision of various educational and financial assistance

programs and activities. See section 1.501(c)(3)-1(d)(2) of the regulations. Further, based on your representation that you have made the Election to terminate your status as a qualified scholarship funding corporation, your change in activities, purpose, and governance should not adversely affect the carrying out of your charitable purposes.

You have provided information that you are described in section 501(c)(3) of the Code, and would be described as a private foundation within the meaning of section 509(a) and be subject to the Chapter 42 rules. Based upon your representation that you have made the Election, the holding of the senior stock is a functionally related business within the meaning of section 4942(j)(4).

The information outlined above indicates that you intend to provide a variety of educational programs and services that are substantially related to your exempt purposes. See section 1.513-1(d)(2) of the regulations. Accordingly, your proposed activities will not constitute an unrelated trade or business within the meaning of Code section 513(a).

The transfer of your assets to the Subsidiary in exchange for the senior stock, as well as the subsequent redemption or sale of the stock will constitute a one time sale of the principal asset. Therefore, the modifications of section 512(b)(1) and 512(b)(5) apply in this instance to exclude "senior stock" dividends and gains and losses from unrelated business taxable income under section 512 of the Code.

RULINGS

Based on your representations, and the applicable law, we rule as follows:

1. The changes in your activities, purposes, and governance, as described above, will not adversely affect your tax exempt status under section 501(c)(3) of the Code.
2. You are reclassified as a private foundation within the meaning of section 509(a) of the Code.
3. Your conduct of the activities outlined above will not constitute an unrelated trade or business under section 513(a) of the Code.

Any changes that may have a bearing upon your tax status should be reported to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service Office. The mailing address is: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The telephone number there is (a toll free number).

Pursuant to a Power of Attorney on file in this office, we are sending a copy of this letter to your authorized representative.

We are also sending a copy of this ruling to the Ohio TE/GE Customer Service Office. Because this letter could help resolve any questions about your exempt status, it should be kept with your permanent records.

200434028

- 6 -

If there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

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

Thank you for your cooperation.

Sincerely,

Debra J. Kaweck
Manager, Exempt Organizations
Technical Group 4