Internal Revenue Service

Number: **201644019**
Release Date: 10/28/2016

Index Number: 513.00-00, 501.03-08,
512.01-00, 512.01-01

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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Refer Reply To:
CC:TEGE:EOEG:EO1
PLR-140249-15

Date:
August 02, 2016

Organization =
Mission B =

Mission D =

E Assets =

F Assets =

G Research =
H =
J Activities =

K =
L =
M Projects =

N =
O Activity =

P =
Q Activities =

S =
Partnership =

Y =
DRE 1 =
DRE 2 =
w =
x =
y =
z =

Dear

This letter responds to a letter from your authorized representative dated December 10, 2015, and subsequent correspondence, requesting rulings regarding a certain sale, transfers and related transactions, as described below. Organization represents the facts as follows.

FACTS

Organization is a nonprofit corporation recognized by the Internal Revenue Service as an exempt organization described in § 501(c)(3) of the Internal Revenue Code of 1986, as amended ("Code"). Organization was founded over y years ago to Mission B and engages in educational and charitable activities in support of its exempt purposes. Such purposes included increasing and disseminating within the United States and throughout the world knowledge of Mission D.

Organization owns all of the stock of S, a taxable "C" corporation. S owns all of the membership interests in DRE 1 and DRE 2, both of which are disregarded entities. Y is an unrelated corporation. S and subsidiaries of Y have formed a new limited liability company, Partnership. Partnership is treated as a partnership for U.S. federal income tax purposes.

Organization has sold its E Assets to Partnership in exchange for $z in cash; S, through DRE 1 and DRE 2, has contributed F Assets to Partnership in exchange for a membership interest therein; Y, indirectly, has contributed certain assets to Partnership in exchange for membership interests therein; and Organization has licensed to Partnership certain of its trademarks, trade names, and other intellectual property in

exchange for annual royalty payments. After these transactions, S owns w% of the membership interests in Partnership and Y, through a subsidiary, owns x% of the membership interests in Partnership. Organization represents that the asset sale was negotiated at arm's-length and that Organization received at least fair market value ("FMV"). This ruling request was submitted prior to the filing of the Form 990 for the year in which the sale took place.

Following the sale of the E Assets to Partnership, Organization has begun and plans to accomplish, among other purposes, the continuation and expansion of grant-making and programs in support of Organization's efforts for Mission B and the purposes of increasing and disseminating within the United States, and throughout the world to the public at large, knowledge of Mission D. The plan is to more than double the total amount of funding by Organization to grant programs, educational activities in and outside the classroom, and for scientific and "[G] Research" activities. These will enable Organization to create new centers of core competencies in Q Activities, story-telling, and education. Organization has directly commenced or proposed various enhanced mission-related activities from the proceeds of the sale. The following are examples of such activities.

I. Grant Making

Organization is currently reviewing its entire portfolio of grant-making programs. As mentioned above, Organization intends to substantially increase its investment in grant-making. Since the closing of the sale, Organization has:

- Hired a H to oversee all grant-making initiatives. This position is new to Organization.

- Increased the quantity and value of grants programs focused on J Activities and education.

- Expanded internationally to include a broader base of diverse applicants and grantees.

- Established a fellowship program funding scientists and teachers in a residency program.

- Made grants and sponsorships in connection with workshops and conferences at home and abroad, featuring workshops on how K can build successful careers and grant awards to L who submit prize-winning work.

II. Programs Expansion

Organization has engaged and will undertake larger and more impactful programs, such as M Projects.

III. Outreach Programs

Organization will engage in the following outreach programs and activities in furtherance of its mission and purposes.

- Build out Organization's website to communicate the programs in which Organization is engaged and report on their impact. Inspire members to contribute and fund N programs.

- Planned expansion of public exhibit and museum space at Organization headquarters to express and disseminate Organization's work in supporting its mission and history of O Activity.

- Build a teacher community and educational program through a learning framework that encourages students to "think like [P]." Teachers will experience a workshop, followed by activities and concluding with a capstone project.

Trademark License Agreement

Organization licensed to Partnership, pursuant to a trademark license agreement, a non-transferable, limited purpose license to certain Organization trademarks, domain names, and social media handles necessary or appropriate for Partnership to use in connection with the E Assets. In return for the license, Partnership will pay a royalty to Organization negotiated at arm's-length and based upon the net revenue attributable to use of the licensed property or a ceiling amount and including a minimum guaranteed royalty amount for the initial years.

Under the trademark license agreement, Partnership must adhere to a Standards Guide that articulates the principles of Organization as well as its content vision. This ensures that the content, publications and activities of Partnership remain supportive of the mission of Organization and consistent with the "Organization" brand. The trademark

license agreement does not require any services from Organization, including no endorsement, promotion, or marketing services.

Organization represents that it will not provide services to Partnership in connection with the use of the brands, but rather Organization will exercise only quality control rights pursuant to the Standards Guide that Organization developed to assure the high quality and mission-relatedness for which Organization has become known and respected.

Organization may choose to list in its publications and on its website Partnership's articles, programs, films, products, etc., that result from Organization's M Projects, educational efforts or other work funded or sponsored by Organization in support of its mission ("Results"), and provide a link to Partnership's website. Partnership will not compensate Organization for such listings or link. Organization further represents that such references to Results offered by Partnership are primarily intended to further Organization's section 501(c)(3) exempt purposes. In this regard, Organization represents that it also intends to reference on its website and in its publications information about unrelated third parties—whether § 501(c)(3) exempt organizations, governmental instrumentalities, or for-profit entities—whose products and services are consistent with, complementary to and/or further Organization's § 501(c)(3) exempt purposes.

Lease Agreement

Organization will lease office space in its headquarters to Partnership under a lease agreement. Organization represents that it owns the office space subject to the lease in fee simple, without acquisition indebtedness. The rental will be fixed, i.e., not based on the income or profits of Partnership, and the amount determined on an arm's-length basis, based on market-based rates and terms.

Representations Regarding Attribution

Organization represents that there is no understanding or agreement (oral or written) that Organization will direct or actively participate in the day-to-day management of S (or any S subsidiary or affiliate) or Partnership. Organization intends to exercise only the normal rights of a shareholder directly in S, or indirectly in any S subsidiary or affiliate, including but not limited to Partnership. S is a bona fide holding company that will provide strategic planning in support of Organization's historical and ongoing exempt functions, including through ownership of the LLC membership interests in Partnership.

Agreements

Organization and the parties involved with the sale and Partnership have entered into a number of contracts, including, but not limited to, the Organization Trademark License Agreement, the Organization-Partnership HQ Lease Agreement, the Amended and Restated Operating Agreement, a General Service Agreement and a Content License Agreement.

RULINGS REQUESTED

- Ruling 1 – Organization's post-closing enhanced activities to nurture core competencies in Q Activities, story-telling and education further Organization's § 501(c)(3) exempt purposes.

- Ruling 2 – The sale of the E Assets will not result in unrelated business taxable income to Organization under § 512(a) of the Code.

- Ruling 3 - Payments by Partnership to Organization pursuant to the trademark license agreement for Organization brands will constitute royalties within the meaning of § 512(b)(2) of the Code.

- Ruling 4 - Payments by Partnership to Organization pursuant to the lease agreement for use of space as office premises in Organization's headquarters will constitute rents within the meaning of § 512(b)(3) of the Code.

- Ruling 5 - Subsequent to the formation of Partnership, the activities of S and its subsidiaries and affiliates, including but not limited to Partnership, will not be attributed to Organization, whether by virtue of (i) Organization's ownership interest in S, (ii) the Organization Trademark License Agreement, (iii) the Amended and Restated Operating Agreement among Y, Partnership and S, (iv) the Organization-Partnership HQ Lease Agreement, or (v) the Content License Agreement and/or General Services Agreement, or any combination of (i)-(v), above.

LAW & ANALYSIS

Section 501(c)(3) of the Code describes as exempt from federal income tax organizations that are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 512(a)(1) of the Code provides that the term “unrelated business taxable income” means the gross income derived by any organization from any unrelated trade or business (defined in § 512 of the Code) regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business, both computed with the modifications in subsection (b).

Section 512(b)(2) of the Code provides that there shall be excluded all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income.

Section 512(b)(3) of the Code provides that all rents from real property shall generally be excluded from unrelated business taxable income, provided that rental payments are (i) not based on the income or profits of any person from the property leased (other than an amount based on a fixed percentage(s) of receipts or sales) and (ii) attributable to real property, or personal property leased with real property, where such rents for personal property are an incidental amount of the total rents.

Section 512(b)(13) of the Code provides, in part, that unrelated business table income shall include, in its calculation, royalties and rents from a “controlled entity.” It further provides that “control” of an entity means ownership of more than 50% of (i) the stock (by vote or value) of a corporation, (ii) either the profits or capital interests of a partnership, or (iii) beneficial interests in any other entity. Control can be direct or indirect, or constructively by attribution pursuant to the constructive stock ownership principles of § 318 of the Code.

Section 513(a) of the Code defines “unrelated trade or business” as any trade or business the conduct of which is not substantially related (aside from the need for income or funds or the use it makes of the profits derived) to the exercise of performance by such organization of its charitable, educational, or other purpose constituting the basis for its exemption under § 501 of the Code.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (“regulations”) provides that in order to be exempt under § 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the exempt purposes specified in that section.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term “charitable” is used in § 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 §501 (c)(3) of the Code of other tax-exempt purposes which may fall within the broad outlines of “charity” as developed by judicial decisions. Such term includes the “advancement of education or science.”

Section 1.501(c)(3)-1(d)(3) of the regulations defines educational as the instruction or training of the individual for the purpose of improving or developing his capabilities, and the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.513-1(b) of the regulations provides, in part, that for purposes of § 513 of the Code the term “trade or business” has the same meaning it has in § 162 of the Code, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 1.513-1(c)(1) of the regulations provides that in determining whether a trade or business from which a particular amount of gross income derives is “regularly carried on” within the meaning of § 512 of the Code, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued.

Section 1.513-1(c)(2)(ii) of the regulations provides, in part, that in determining whether or not intermittently conducted activities are regularly carried on, the manner of conduct of the activities must be compared with the manner in which commercial activities are normally pursued by nonexempt organizations. In general, exempt organization business activities which are engaged in only discontinuously or periodically will not be considered regularly carried on if they are conducted without the competitive and promotional efforts typical of commercial endeavors.

Section 301.7701-2(c)(2)(i) of the regulations provides that a business entity that has a single owner and is not a corporation is disregarded as an entity separate from its owner.

Rev. Rul. 81-178, 1981-2 C.B. 135, considered the application of § 512(b)(2) of the Code to two situations in which payments were received by an exempt organization from third party licensees for use of the organization’s trademarks, trade names and service marks. Holding in Situation (1) that the licensing payments constituted royalties, the Service found that the retention and exercise of quality control rights by the licensor did not change this result, citing Lemp Brewing Co. v. Comm’r, 18 T.C. 586 (1952) [CCH Dec. 19,050], acq. 1952-2 C.B. 2. The organization has the right to approve the quality or style of the licensed products and services. The agreements also require the businesses to refrain from engaging in any activity that would adversely affect the reputation of the organization or its members or the value of the licensed product. However, in Situation (2), the holding is that payments for personal appearances and interviews are not royalties, but are compensation for personal services.

In Sierra Club, Inc. v. Comm'r, 86 F.3d 1526, 1532 (9th Cir. 1996), the court determined that a royalty under § 512(b)(2) of the Code is defined as a payment for an intangible property right and that royalties are by definition passive and cannot include compensation for services rendered by the owner of the intangible property right.

In Moline Properties, Inc. v. Comm'r, 319 U.S. 436, 438-439 (1943), the Supreme Court stated that

> [t]he doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity [footnotes omitted].

Only minimal business activities are needed for a corporation to be respected as a distinct taxable entity. For example, the Service has taken the position that a corporation formed as a holding company that performs various administrative duties can meet the business activity standard. See FSA 200122007, 2001 WL 587796 (IRS FSA). However, if the corporation owns no assets and does not in fact carry on any business, it can be ignored. Britt v. United States, 431 F.2d 227, 237 (5th Cir. 1970); Strong v. Comm'r, 66 T.C. 12, 24 (1976), aff'd, 553 F.2d 94 (2nd Cir. 1977).

A corporation also may be disregarded if there is an absence of an intention to form the corporation for some real business purpose or to actually engage in business. Robucci v. Comm'r, T.C. Memo 2011-019 (2011); Jackson v. Comm'r, 233 F.2d 289, 290 (2nd Cir. 1956); Bass v. Comm'r, 50 T.C. 595, 600 (1968). In Bass, the court explained that the intent element is not the personal purpose of a taxpayer in creating a corporation, but rather is whether that purpose is intended to be accomplished through a corporation carrying out substantive business functions. If the purpose of the corporation is to carry out substantive business functions, or if it in fact engages in substantive business activity, it will not be disregarded for federal tax purposes. 50 T.C. at 601.

RULING 1 – IN FURTHERANCE OF

Section 1.501(c)(3)-1(c)(1) of the regulations states 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 of such exempt 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.

Organization has and will undertake a broad range of activity that continues and enhances its missions and purposes. The specific activities include increased grant-making, more impactful programs such as M Projects and new outreach programs, which nurture core competencies in Q Activities, story-telling and education. These all further Organization's § 501(c)(3) exempt purposes and are charitable, educational, and/or scientific within the meaning of the regulations.

RULING 2 - NOT REGULARLY CARRIED ON

In determining whether the sale of the E Assets from which Organization derived $z is "regularly carried on" for purposes of determining whether Organization has unrelated business taxable income, consideration must be given to whether the activity that produced the income manifested a frequency and continuity, and was pursued in a manner, generally similar to comparable commercial activities of non-exempt organizations. See Treas. Reg. § 1.513-1(c)(1) and (2)(i). When the business activities of an exempt organization are engaged in only discontinuously or periodically, they will not be considered regularly carried on if they are conducted without the competitive and promotional efforts typical of commercial endeavors. On the other hand, where the sales are not merely casual, but are systematically and consistently promoted and carried on by the organization, they meet the definition of "regularly carried on" for purposes of § 512 of the Code. See Treas. Reg. § 1.513-1(c)(2)(ii).

Organization's sale was a one-time sale, which was neither systemically nor consistently promoted nor carried on by Organization. It was not a part of any ongoing income-producing activity. Thus, Organization's sale will not result in unrelated business taxable income to Organization because the sale is not a business that is regularly carried on within the meaning § 512(a)(1) of the Code.

RULING 3 – ROYALTIES

Computation of unrelated business taxable income under § 512(a)(1) of the Code is modified to generally exclude royalty income and directly related deductions. See I.R.C. § 512(b)(2). A royalty is a payment that relates to the use of a valuable right. Payments for the use of trademarks, trade names, service marks, or copyrights, whether or not payment is based on the use made of such property, are ordinarily classified as royalties for federal tax purposes. See Rev. Rul. 81-178, 1981-2 C.B. 135. Similarly, payments for the use of a professional athlete's name, photograph, likeness, or facsimile signature are ordinarily characterized as royalties. Royalties do not include payments for personal services.

Organization has represented that it will not provide any services in connection with the trademark license agreement other than quality control. It is licensing to Partnership the

use of the brands. Organization will exercise only quality control rights pursuant to the Standards Guide that Organization developed to assure the high quality and mission-relatedness for which Organization has become known and respected. Organization can require Partnership to refrain from engaging in any activity that would adversely affect the reputation of Organization.

Consistent with Situation 1 in Rev. Rul. 81-178 and the decision in Sierra Club, the arrangement under the trademark license agreement is that of a license of intangible property. Partnership will pay Organization FMV for the use of the brands. Therefore, payments by Partnership to Organization pursuant to the trademark license agreement for Organization brands will constitute royalties within the meaning of § 512(b)(2) of the Code.

RULING 4 - RENTS

Organization owns in fee simple real property housing its headquarters and used in the conduct of its exempt functions, with no outstanding "acquisition indebtedness" within the meaning of § 514 of the Code. Organization is leasing certain office space within its headquarters to Partnership. As to such space, the rental will be fixed, i.e., not based on the income or profits of Partnership or any third party and the amount thereof was determined on an arm's-length basis. There is not rental attributable to personal property located at such property. Accordingly, the lease payments from Partnership to Organization shall be excluded from unrelated business taxable income pursuant to § 512(b((3) of the Code.

As noted above, Organization's wholly-owned subsidiary, S, owns a w% interest in Partnership. Thus, since Organization does not own directly, indirectly or constructively more than 50% capital or profits interest in Partnership, § 512(b)(13) of the Code does not apply to override the general exclusions from unrelated business taxable income for § 512(b)(2) and (3) of the Code.

RULING 5 – ATTRIBUTION

After the transaction, Organization continued to own all of the stock of S, and S owned a w% interest in Partnership. The question is whether S's business activities can be attributed to Organization. As noted above, the authorities are clear that a corporation's status as a corporation will be respected even if the corporation engages in minimal business activities. See Moline Properties. As further noted above, the Service has taken the position that a holding company that administers its ownership interest in a lower-tier entity meets the business activity requirement of Moline Properties. See FSA 200122007. Organization has represented that S engages in strategic planning with

respect to its ownership of Partnership. Therefore, the activities of S would not be attributed to its owner, Organization.

This ruling is limited to providing that S meets the test of Moline Properties. We decline to extend the ruling to S's subsidiaries and affiliates because such an extension is not necessary in this case. Since S's activities are not attributed to its owner, Organization, neither would the activities of S's subsidiaries and affiliates be attributed to Organization.

Except as ruled in this letter, we express no opinion on the validity of the various contractual agreements described above. To the extent they represent valid business arrangements, we see no reason to treat them separately from the business operations of the entities to which they relate.

CONCLUSION

Based solely on the facts and representations submitted, we rule, subject to the above caveats:

1. Organization's post-closing enhanced activities to nurture core competencies in Q Activities, story-telling and education further Organization's § 501(c)(3) exempt purposes.

2. Organization's sale of the E Assets will not result in unrelated business taxable income to Organization because the sale is not a business that is regularly carried on within the meaning of § 512(a).

3. Payments by Partnership to Organization pursuant to the trademark license agreement for Organization brands will constitute royalties within the meaning of § 512(b)(2) of the Code.

4. Payments by Partnership to Organization pursuant to the lease agreement for use of space as office premises in Organization's headquarters will constitute rents within the meaning of § 512(b)(3) of the Code.

5. S is engaged in business activity that is sufficient to satisfy the business activity requirement of Moline Properties and therefore it will be respected as an entity separate from Organization and its activities will not be attributed to Organization.

Except as stated, we are not ruling on the terms and conditions of the various contracts entered into by and between the parties, including, but not limited to, the Organization Trademark License Agreement, the Organization-Partnership HQ Lease Agreement, the

Amended and Restated Operating Agreement, a General Service Agreement and a Content License Agreement. Also, this ruling letter expresses no opinion on the terms and conditions of any current or future Partnership allocations or distributions.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party, as specified in Rev. Proc. 2016-1, 2016-1 I.R.B. 1, § 7.01(15)(b). This office has not verified any of the material submitted in support of the request for ruling, and such material is subject to verification on examination. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2016-1, § 11.05.

No ruling is granted as to whether Organization qualifies as an organization described in § 501(c) of the Code and/or § 509(a)(1) or (2) or (3) of the Code, and, except as expressly provided above, no opinion is expressed or implied concerning the federal income tax consequences of any other aspects of any transaction or item of income described in this letter ruling.

This letter 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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Mary Jo Salins
Acting Branch Chief
Exempt Organizations Branch 1
(Tax Exempt & Government Entities)

cc: