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Department of the Treasury
Washington, DC 20224

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CC:EEE:EOET:EO2
PLR-104507-20

Date:
August 14, 2020

LEGEND:

Taxpayer =
Year 1 =
Subsidiary =
Organization =
Date 1 =
State =
X =

Dear :

This letter ruling is in response to a request from your authorized representatives dated January 13, 2020 and subsequent documentation dated June 16, 2020 requesting rulings under sections 501(c)(3), 512, and 4958 of the Internal Revenue Code.

FACTS

Taxpayer is a State nonstock, nonprofit corporation described in section 501(c)(3) and classified as a public charity under section 509(a)(2). Taxpayer's purposes are to engage exclusively in charitable activities within the meaning of section 501(c)(3), including:

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Taxpayer's members, consisting of

elect Taxpayer's board of trustees.

Taxpayer engages activities in furtherance of its section 501(c)(3) purposes. ,

Through these activities, Taxpayer currently concentrates its work in broad areas of focus -

Prior to Year 1, Taxpayer engaged in

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Accordingly, following the receipt of a favorable private letter ruling from the Internal Revenue Service in Year 1, Taxpayer transferred the assets and liabilities associated with its activities to Subsidiary, a wholly owned for-profit State stock corporation. Taxpayer did not incur any debt in connection with this transaction and Taxpayer has represented that it has had no acquisition indebtedness, within the meaning of section 514(c), with respect to its shares in Subsidiary.

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Taxpayer has identified a pressing need for and intends to significantly expand its work to address that need. However, Taxpayer recognizes that its activities must continue to serve as an important tool in protecting
Many of Taxpayer's

Taxpayer has concluded that expanding its program while maintaining the same quality and relevance of its activities will be best accomplished by transferring its operations to a separate tax-exempt organization. This will allow each organization to be dedicated to its mission-specific work.

To accomplish this separation, Taxpayer created Organization, a State nonstock, nonprofit corporation, on Date 1. Taxpayer is the sole member of Organization and has the power to elect the members of Organization's board of directors.

. Organization's purposes mirror those of Taxpayer and Organization has applied for recognition as an organization described in Taxpayer intends to transfer the assets associated with its activities to Organization as a restricted grant that will require Organization to carry out such activities in a manner consistent with Taxpayer's charitable mission.

Taxpayer has also determined that Subsidiary, as a , is more closely aligned with Taxpayer's activities than its activities.

. To that end, Taxpayer proposes to transfer its Subsidiary stock to Organization, in part by restricted grant and in part by sale to fund Taxpayer's expanded activities and its activities.

The amount of Subsidiary stock that Taxpayer will sell to Organization will be determined based on Taxpayer's projected funding needs and Taxpayer will receive fair market value, as determined by an independent third party, for its sale of Subsidiary stock. Taxpayer tentatively plans to sell enough Subsidiary stock to generate $X, which Taxpayer expects will provide sufficient funding to support the expansion of its

activities and its activities following the transaction. Taxpayer anticipates that it will accept a short-term note for the sale to allow Organization to arrange for financing for its acquisition. Organization's use of the proceeds of the Subsidiary stock acquired by purchase will not be restricted.

Taxpayer will also make a restricted grant to Organization of the assets associated with its activities along with the remainder of the Subsidiary stock,

pursuant to a written grant agreement. The grant agreement will restrict the use of the assets, to carrying out activities and engaging in other activities consistent with Taxpayer's exempt purposes. Similarly, the grant agreement will restrict the use of the Subsidiary stock transferred by grant to carrying out activities and engaging in other activities consistent with Taxpayer's exempt purposes. Specifically, the grant agreement will require Organization to hold and apply all proceeds (e.g., dividends, income from disposition) from that stock to further the activities and other purposes consistent with Taxpayer's charitable mission. The grant agreement will also require Organization to provide reports to Taxpayer and will require Organization to maintain records showing that the grant proceeds are used in a manner consistent with Taxpayer's exempt purposes and pursuant to the terms of the grant agreement.

The grant agreement will prohibit Organization from using the grant proceeds for any purposes other than those set forth in the grant agreement and will require Organization to return to Taxpayer any funds not used for the specified purposes. Taxpayer has represented that its grant of Subsidiary stock and assets to Organization will be consistent with the requirements set forth in Rev. Rul. 68-489, 1968-2 C.B. 210, and the expenditure responsibility requirements of section 4945(h).

Taxpayer's governance structure and the manner in which Taxpayer's trustees are elected will not change as a result of the restructuring. As Organization will be the sole shareholder of Subsidiary after the restructuring, Organization will have the right to elect Subsidiary's board of directors. Taxpayer has further represented that after the restructuring, Taxpayer's president will not be an officer of Organization or Subsidiary, and Organization's executive director – who will oversee Organization's day-to-day management – will not be a director of Organization or an officer or director of Taxpayer or Subsidiary. None of Taxpayer, Subsidiary, or Organization will control the day-to-day management of any of the others.

Based on the documentation submitted and the facts and representations described above, Taxpayer requested the following rulings.

RULINGS REQUESTED

1. Taxpayer's sale of a portion of the Subsidiary shares to Organization will not result in unrelated business taxable income under section 512(a).
2. Taxpayer's restricted grant to Organization of assets associated with its activities and the remainder of the Subsidiary shares will further exempt purposes under section 501(c)(3).
3. Taxpayer's sale of the Subsidiary shares to Organization at fair market value and Taxpayer's restricted grant to Organization of the assets and

the remaining shares of Subsidiary will not result in an excess benefit transaction under section 4958(c)(1).

LAW

Ruling Request 1

Section 511(a)(1) imposes a tax for each taxable year on the unrelated business taxable income ("UBTI") of every corporation described in section 501(c)(3) and exempt from taxation under Subtitle A by reason of section 501(a).

Section 512(a)(1) provides that UBTI consists of the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the deductions allowed by Chapter 1 that are directly connected with the carrying on of such trade or business.

Treas. Reg. section 1.513-1(c)(1) states that for purposes of determining whether an activity is "regularly carried on," 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. This requirement must be applied in light of the purpose of the unrelated business income tax to place exempt organization business activities upon the same tax basis as the nonexempt business endeavors with which they compete. For example, specific business activities of an exempt organization will ordinarily be deemed to be regularly carried on if they manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations.

Treas. Reg. section 1.513-1(c)(2)(ii) provides 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 that 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.

Treas. Reg. section 1.513-1(c)(2)(iii) provides that certain intermittent income-producing activities occur so infrequently that neither their recurrence nor the manner of their conduct will cause them to be regarded as trades or businesses regularly carried on. For example, income-producing or fundraising activities lasting only a short period of time will not ordinarily be treated as regularly carried on if they recur only occasionally or sporadically.

The court in *Museum of Flight Foundation v. United States*, 63 F. Supp. 2d 1257 (W.D. Wash. 1999), applied the regularly carried on requirement in the context of a one-time lease of a donated Boeing 747 jet by the Museum of Flight Foundation to Boeing.

Boeing donated the jet to the museum in 1990 and the museum began work to restore the aircraft for permanent display. Shortly after Boeing donated the aircraft, Boeing identified the need for a test bed airframe for new jet engines. Boeing did not have a usable model of its own, nor could it obtain one from a commercial leasing company because the aircraft would not have been airworthy after modifications that had to be made for the testing. Boeing sought to lease the jet back from the museum, which would not be concerned about the jet's subsequent airworthiness, and the museum agreed to lease the jet back to Boeing for a two-year term, which was extended slightly. The museum had never before or since leased aircraft for testing or any other purpose. The court concluded that the lease was not an activity that was regularly carried on because it was a one-time, completely fortuitous lease of unique equipment that was unavailable on the open market.

Section 512(b)(4) provides that in the case of debt-financed property (as defined in section 514) there shall be included, as an item of gross income derived from an unrelated trade or business, the amount ascertained under section 514(a)(1), and there shall be allowed, as a deduction, the amount ascertained under section 514(a)(2).

Section 514(b)(1) defines "debt-financed property" as any property held to produce income and with respect to which there is an acquisition indebtedness at any time during the taxable year (or, if the property was disposed of during the taxable year, with respect to which there was an acquisition indebtedness at any time during the 12-month period ending with the date of such disposition).

Section 514(c)(1) provides that "acquisition indebtedness" means, with respect to any debt-financed property, the unpaid amount of:

(A) The indebtedness incurred by the organization in acquiring or improving such property;
(B) The indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and
(C) The indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

Ruling Request 2

Rev. Rul. 68-489 provides that an organization exempt from federal income tax under section 501(c)(3) will not jeopardize its tax-exempt status by distributing funds to organizations not themselves described in section 501(c)(3), provided the organization:

- Retains control and discretion as to the use of the funds;
- Maintains records establishing the funds were used for section 501(c)(3) purposes; and
- Limits distributions to specific projects that further its own exempt purposes.

Rev. Rul. 68-489 was published before the enactment of the Tax Reform Act of 1969, Pub. L. 91-172, which added certain provisions governing grantmaking by private foundations, including section 4945.

Section 4945(a) imposes an excise tax on each taxable expenditure of a private foundation.

Section 4945(d)(4) provides that the term "taxable expenditure" includes any amount paid or incurred by a private foundation as a grant to a noncharitable organization unless the foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h).

Section 4945(h) states that the term "expenditure responsibility" means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to see that the grant is spent solely for the purpose for which made, to obtain full and complete reports from the grantee on how the funds are spent, and to make full and detailed reports with respect to such expenditures to the Secretary. *See also* Treas. Reg. section 53.4945-5.

Ruling Request 3

Section 4958(a)(1) imposes an excise tax on each excess business transaction between an applicable tax-exempt organization and a disqualified person.

Section 4958(c)(1)(A) defines an "excess benefit transaction" as any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.

Section 4958(e) defines "applicable tax-exempt organization," in part, as any organization that (without regard to any excess benefit) would be described in paragraph (3), (4), or (29) of section 501(c) and exempt from tax under section 501(a). Such term does not include a private foundation (as defined in section 509(a)).

Section 4958(f)(1)(A) defines a "disqualified person" with respect to any transaction as including any person who was, at any time during the five-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization. Treas. Reg. section 53.4958-3(c) lists certain persons deemed to be in a position to exercise substantial influence over the affairs of an organization, Treas. Reg. section 53.4958-3(d) lists certain persons deemed not to be in a position to exercise substantial influence over the affairs of an organization, and Treas. Reg. section 53.4958-3(e)(1) provides that in all other cases, whether a person is in a position to exercise substantial influence over an applicable tax-exempt

organization depends upon all relevant facts and circumstances.

Treas. Reg. section 53.4958-3(c)(1), (2), and (3) provide, in relevant part, that the following persons are deemed to be in a position to exercise substantial influence over the affairs of an applicable tax-exempt organization:

(1) Voting members of the governing body;
(2) Presidents, chief executive officers, and chief operating officers, including any person who, regardless of title, has ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration, or operation of the organization; and
(3) Treasurers and chief financial officers, including any person who, regardless of title, has ultimate responsibility for managing the finances of the organization.

Treas. Reg. section 53.4958-3(e)(2) provides that facts and circumstances tending to show that a person has substantial influence over the affairs of an organization include, but are not limited to, the following:

(i) The person founded the organization;
(ii) The person is a substantial contributor to the organization (within the meaning of section 507(d)(2)(A)), taking into account only contributions received by the organization during its current taxable year and the four preceding taxable years;
(iii) The person's compensation is primarily based on revenues derived from activities of the organization, or of a particular department or function of the organization, that the person controls;
(iv) The person has or shares authority to control or determine a substantial portion of the organization's capital expenditures, operating budget, or compensation for employees;
(v) The person manages a discrete segment or activity of the organization that represents a substantial portion of the activities, assets, income, or expenses of the organization, as compared to the organization as a whole;
(vi) The person owns a controlling interest (measured by either vote or value) in a corporation, partnership, or trust that is a disqualified person; or
(vii) The person is a nonstock organization controlled, directly or indirectly, by one or more disqualified persons.

Treas. Reg. section 53.4958-3(e)(3) provides that facts and circumstances tending to show that a person does not have substantial influence over the affairs of an organization include, but are not limited to, the following:

(i) The person has taken a bona fide vow of poverty as an employee, agent, or on behalf, of a religious organization;
(ii) The person is a contractor (such as an attorney, accountant, or investment manager or advisor) whose sole relationship to the organization is providing professional advice (without having decision-making authority) with respect to transactions from which the contractor will not economically benefit either

directly or indirectly (aside from customary fees received for the professional advice rendered);

(iii) The direct supervisor of the individual is not a disqualified person;

(iv) The person does not participate in any management decisions affecting the organization as a whole or a discrete segment or activity of the organization that represents a substantial portion of the activities, assets, income, or expenses of the organization, as compared to the organization as a whole; or

(v) Any preferential treatment a person receives based on the size of that person's contribution is also offered to all other donors making a comparable contribution as part of a solicitation intended to attract a substantial number of contributions.

ANALYSIS

Ruling Request 1

Taxpayer is a corporation described in section 501(c)(3) and exempt from taxation under Subtitle A by reason of section 501(a), and therefore is subject to the unrelated business income tax imposed by section 511(a)(1) on its UBTI. Specifically, Taxpayer is subject to the unrelated business income tax on gross income derived from any unrelated trade or business regularly carried on, less certain allowable deductions directly connected with that trade or business.

Taxpayer formed Subsidiary in Year 1 and owns 100 percent of Subsidiary's stock. As part of a proposed restructuring, Taxpayer intends to fully divest of Subsidiary by transferring the Subsidiary stock to Organization, in part by restricted grant and in part by sale at fair market value.

The proposed sale does not manifest a frequency and continuity and is not being pursued in a manner similar to comparable commercial activities of nonexempt organizations. *See* Treas. Reg. section 1.513-1(c)(1). Instead, like in *Museum of Flight Foundation v. United States*, Taxpayer's sale will be a one-time, fortuitous event involving a unique asset. *See also* Treas. Reg. section 1.513-1(c)(2)(iii). Further, Taxpayer's proposed sale does not feature the competitive and promotional efforts typical of commercial endeavors. *See* Treas. Reg. section 1.513-1(c)(2)(ii). Accordingly, Taxpayer's sale of Subsidiary stock is not an activity that is regularly carried on.

Because Taxpayer's sale of Subsidiary stock at fair market value is not an activity that is regularly carried on, and because the Subsidiary stock is not debt-financed property, gain or loss from Taxpayer's sale of Subsidiary shares to Organization will not be included in Taxpayer's UBTI under section 512(a).

Ruling Request 2

Taxpayer's grant to Organization will be subject to a written grant agreement restricting the use of the assets, the Subsidiary stock, and the proceeds from the

Subsidiary stock (e.g., dividends, income from disposition) to activities consistent with Taxpayer's exempt purposes. Additionally, Taxpayer has represented that its grant will be consistent with the requirements set forth in Rev. Rul. 68-489 and the expenditure responsibility requirements of section 4945(h), both of which require that grants further section 501(c)(3) purposes. Therefore, Taxpayer's restricted grant of assets and the Subsidiary stock to Organization will further section 501(c)(3) purposes.

Ruling Request 3

As an organization described in section 501(c)(3) and classified as a public charity under section 509(a)(2), Taxpayer is an applicable tax-exempt organization. *See* section 4958(e)(1). Organization is not a person deemed to be in a position to exercise substantial influence over the affairs of Taxpayer, nor is Organization deemed not to be in a position to exercise substantial influence over the affairs of Taxpayer. *See* Treas. Reg. section 53.4958-3(c), (d). Therefore, whether Organization is in a position to exercise substantial influence over Taxpayer depends upon all relevant facts and circumstances. *See* Treas. Reg. section 53.4958-3(e)(1). Taxpayer is Organization's sole member and has the power to elect the entirety of Organization's board of directors; as such Organization is not in a position to exercise substantial influence over the affairs of Taxpayer. Accordingly, Organization is not a disqualified person with respect to Taxpayer and Taxpayer's sale of the Subsidiary shares to Organization at fair market value and Taxpayer's restricted grant to Organization of the assets and the remaining shares of Subsidiary will not constitute excess benefit transactions.

RULINGS

Based solely on the facts and representations submitted by Taxpayer, we rule as follows:

1. Taxpayer's sale of a portion of the Subsidiary shares to Organization will not result in unrelated business taxable income under section 512(a).
2. Taxpayer's restricted grant to Organization of assets associated with its activities and the remainder of the Subsidiary shares will further exempt purposes under section 501(c)(3).
3. Taxpayer's sale of the Subsidiary shares to Organization at fair market value and Taxpayer's restricted grant to Organization of the assets and the remaining shares of Subsidiary will not result in an excess benefit transaction under section 4958(c)(1).

The rulings contained in this letter are based upon information and representations submitted by or on behalf of Taxpayer and accompanied by penalty of perjury statements executed by an individual with authority to bind Taxpayer and upon the understanding that there will be no material changes in the facts. While this office has not verified any of the material submitted in support of the request for these rulings, it is

subject to verification on examination. The Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes) 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. 2020-1, 2020-1 I.R.B. 1, section 11.05.

This letter does not address the applicability of any section of the Code or Regulations to the facts submitted other than those sections specifically described. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. For example, no opinion is expressed as to whether the short-term note that Organization may issue in connection with its acquisition of Subsidiary stock is bona fide debt, nor is any opinion expressed with respect to the implications of such a characterization. Further, no opinion is expressed regarding the treatment or consequences of any shared services or facilities agreements between Taxpayer, Subsidiary, and/or Organization.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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 Taxpayer’s authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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,

James Zelasko
Branch Chief
Exempt Organizations Branch 2
Employee Benefits, Exempt Organizations, and
Employment Taxes

cc: