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

200149045

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: AUG 3 2001

Contact Person:

Identification Number:

Telephone Number:

T:EO:B2

Employer Identification Number:

LEGEND:

V =
W =
X =
Y =

UIL Nos.
501.00-00
170.09-02
509.02-02
512.00-00

Dear Sir or Madam:

We have considered your ruling request dated September 25, 2000 pertaining to the consequences under sections 170, 501(c)(3), 509, and 511-514 of the Internal Revenue Code of a 509(a)(3) supporting organization's creation of a donor-advised charitable gift fund.

FACTS:

Y is a broadly based membership organization described in section 501(c)(6) of the Code and supported largely by member dues. It is represented that Y would qualify under section 509(a)(2) if Y were described in section 501(c)(3).

X is described in section 501(c)(3) of the Code and classified as a 509(a)(3) supporting organization of Y. X's membership consists of all members of Y, who are members of X by virtue of their Y membership. A majority of X's board of directors are elected by X's membership, and several Y officers serve ex officio as directors of X. X receives most of its support from contributions from its members. X's primary charitable activity is making grants to V and W, which are 501(c)(3) organizations also established by and affiliated with Y that conduct charitable and educational activities pertaining to the field of Y's membership. X also makes grants to other 501(c)(3) organizations supported by, or similar to, V and W.

X proposes to establish a charitable gift fund ("the Fund") for its members to make contributions for charitable purposes. X will solicit donations to the Fund through Y's periodical sent to members, direct mailings to members, and the Web sites of X and Y. The Fund is expected to appeal primarily to members who wish to provide for the long-term charitable needs

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of V, W, and similar organizations. The Fund will not be a separate legal entity but will be operated as an internal division of X. Contributions to the Fund, and earnings thereon, will be maintained in separate accounts established by X for this purpose. Although X will maintain separate accounts for donors tracking their donations (and earnings on, and distribution of, such funds), the underlying funds themselves will be aggregated for purposes of investment under the direction of X's investment advisors.

Donors may direct their contributions, in whole or part, to two types of accounts: (1) a specific donee account, where one or more charities are named as the ultimate beneficiaries of the account and X determines the amount and timing of distributions (and selects new beneficiaries if those named cease to exist or qualify or to serve the donor's original intent); and (2) a donor-advised account, where the donor (or his or her designees) will be allowed to consult with X as to the charities to be benefitted during the year, with X determining the amount, timing, and distributee of each distribution. X will make distribution decisions through its board of directors or one or more distribution committees appointed by the board. No donor will participate in board or committee decisions regarding an account that the donor created. X will strongly urge donors to designate or recommend that at least 20% of distributions from each account be made to charities of the type supported by X and Y. X will also amend its articles of incorporation to allow distributions to 170(c)(1) governmental units.

The instrument of transfer to X for the Fund and detailed descriptive information furnished by X pertaining to the Fund, including brochures and Web site information, will provide that contributions are irrevocable and will thereafter be under the control of X's board of directors. X will issue a written statement to each donor and distributee organization that distributions may be used only for charitable purposes permitted under section 501(c)(3) of the Code and not for the individual donor's personal benefit. X will investigate distributions where it has reason to believe that grant funds are being used for the donor's private benefit or other non-charitable purpose, and will take the necessary steps (including legal action, if necessary) to prevent such misuse of charitable funds. The instrument of transfer will also provide that distributions will not be made to individuals or organizations other than public charities under section 509(a) of the Code and governmental units (including foreign organizations that can reasonably be determined to be the functional equivalent of a public charity or government instrumentality within the meaning of the relevant provisions of the Code and regulations). X will verify the public charity or governmental status of all distributees prior to distribution. X's By-laws specifically provide that the board has the power to modify any restriction or condition on the distribution of funds if, in the board's discretion, such restriction or condition becomes unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served. X's board has committed itself by resolution to exercise such power.

X contemplates making annual distributions from the Fund commensurate with its assets. X will distribute from the Fund an amount at least equal to 5% of the Fund's average net assets on a fiscal five-year rolling basis. If anticipated grant amounts are not met, recommendations will be sought with respect to accounts where grants have totaled less than 5% of the account's average assets over the same period. If sufficient grant recommendations are not received in 90 days, assets may be transferred to X's unrestricted fund for grantmaking. If neither contributions nor grant recommendations are made during a five-year period, the donor will be contacted to make grant recommendations or contributions. If no recommendations are made within 90 days, some or all assets may be transferred to the unrestricted fund.

X plans to establish several different funds of investment assets into which the amounts donated will be invested, including a money market fund, bond fund, S&P 500 index fund, Wilshire 4500 index fund, and international equities fund. X will periodically withhold from the Fund a specified percentage of earnings or assets to pay for investment managers and other operating costs.

X will establish five investment strategies for the Fund. Donors will be entitled to designate the investment strategy with which they are most comfortable as the initial investment of funds contributed by them. X will retain control over the investment of all assets, however, and X's board of directors will ensure that the allocation of investment assets is consistent with the accomplishment of X's charitable purposes. X retains the right to alter the initial investment strategies and add new strategies and/or funds as the board deems in the best interest of X and its beneficiaries. Donors will be allowed to recommend a shift of the account balance to a different strategy or fund at least once a year. X will not be obligated to follow the recommendation, and will not do so if it determines that the transfer is not in the best interests of X and its beneficiaries.

X represents that all investment income will come from ordinary and routine investments: specifically, interest, dividends, and gains on the sale of assets. X will not hold assets as stock in trade, inventory, or for sale to customers in the ordinary course of a trade or business. X will not incur debt to acquire any investment assets, accept gifts encumbered with debt, or otherwise knowingly incur any acquisition indebtedness with respect to assets in the Fund.

Investment management firms will be given authority over daily asset management, consistent with the investment objectives of the fund and other criteria established by X's board. X's By-laws give the board authority to replace any trustee, custodian, or agent of a fund for any reason, including breach of fiduciary duty or failure to produce a reasonable return of net income over a reasonable period of time. X's board has committed itself by resolution to (1) exercise such power, and (2) obtain information and take other appropriate steps to see that each participating trustee, custodian, or agent administers funds in accordance with the terms of the governing instruments for the Fund and accepted standards of fiduciary conduct to produce a reasonable return of net income (or appreciation where not inconsistent with X's need for current income) with due regard to safety of principal, in furtherance of X's exempt purposes. X reserves the right to terminate its agreements with investment managers upon 30-day's notice.

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RULINGS REQUESTED:

X requests the following rulings:

1. The amendments to the articles of incorporation and by-laws of X that have been approved but not implemented, and the proposed creation and operation of a charitable gift fund in the manner described, will not adversely affect X's exempt status under sections 501(a) and 501(c)(3) of the Code.

2. Donors to X for the proposed charitable gift fund to be created and operated by X will be entitled to charitable deductions pursuant to sections 170(b) and 170(c)(2) of the Code.

3. Following the implementation of the amendments to its articles of incorporation and by-laws and creation and operation of the proposed charitable gift fund, X will continue to be classified as other than a private foundation under section 509(a) of the Code.

4. The unrelated business income tax will not apply to any income or gain realized by X from the assets in the proposed charitable gift fund.

5. The unrelated business income tax will not apply to the portions of the investments or investment earnings on the assets in the proposed charitable gift fund that are withheld by X from the accounts created by specific donors for the payment of the direct and indirect costs of operation of that fund.

6. The proposed charitable gift fund and the separate accounts within the charitable gift fund created by X to identify contributed amounts with specific donors will be treated as integral parts of X and not as separate entities.

LAW:

Section 170(b)(1)(A)(viii) of the Code allows a deduction for a charitable contribution to an organization described in sections 170(c)(2) and 509(a)(3) of the Code.

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 509(a)(3) of the Code describes a supporting organization as one which--

(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).

For purposes of section 509(a)(3), an organization described in section 509(a)(2) shall be deemed to include an organization described in section 501(c)(4), (5), or (6) which would be described in section 509(a)(2), if it were an organization described in section 501(c)(3).

Section 512(b)(1) of the Code excludes from the computation of unrelated business taxable income all dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), 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)(4) of the Code provides that notwithstanding sections 512(b)(1), (2), (3), or (5), 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 512(b)(5) of the Code excludes from the computation of 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.

There shall also be excluded all gains or losses recognized, in connection with the organization's investment activities, from the lapse or termination of options to buy or sell securities (as defined in section 1236(c)) or real property and all gains or losses from the forfeiture of good-faith deposits (that are consistent with established business practice) for the purchase, sale, or lease of real property in connection with the organization's investment activities. This paragraph shall not apply with respect to the cutting of timber which is considered, on the application of section 631, as a sale or exchange of such timber.

Section 1.507-2(a)(8)(i) of the Income Tax Regulations provides that in order to effectuate a transfer of "all of its right, title, and interest in and to all of its net assets," a transferor private foundation may not impose any material restriction or condition that prevents the transferee public charity from freely and effectively employing the transferred assets, or the income derived therefrom, in furtherance of its exempt purposes.

Section 1.509(a)-4(c)(2) of the regulations provides that if the organization by which a supporting organization is operated, supervised, or controlled is a publicly supported section 501(c)(4), (5), or (6) organization (deemed to be a section 509(a)(2) organization for purposes of section 509(a)(3) under the provisions of section 509(a)), the supporting organization will be considered as meeting the requirements of this paragraph if its articles require it to carry on

charitable, etc., activities within the meaning of section 170(c)(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) of the regulations. 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.

Section 1.509(a)-4(e)(2) of the regulations provides that a supporting organization is not required to pay over its income to the publicly supported organizations in order to meet the operational test. It may satisfy the test by using its income to carry on an independent activity or program which supports or benefits the specified publicly supported organizations. All such support must, however, be limited to permissible beneficiaries in accordance with section 1.509(a)-4(e)(1). The supporting organization may also engage in fund raising activities, such as solicitations, fund raising dinners, and unrelated trade or business to raise funds for the publicly supported organizations, or for the permissible beneficiaries.

Section 1.509(a)-4(g)(1)(i) of the regulations provides that a supporting organization is "operated, supervised, or controlled by" one or more publicly supported organizations where a majority of the officers, directors, or trustees of the supporting organization are appointed or elected by the governing body, members of the governing body, officers acting in their official capacity, or the membership of one or more publicly supported organizations.

Section 1.509(a)-4(k)(1) of the regulations provides that for purposes of section 509(a)(3), an organization which is operated in conjunction with an organization described in section 501(c)(4), (5), or (6) (such as a social welfare organization, labor or agricultural organization, business league, or real estate board) shall, if it otherwise meets the requirements of section 509(a)(3), be considered an organization described in section 509(a)(3) if such section 501(c)(4), (5), or (6) organization would be described in section 509(a)(2) if it were an organization described in section 501(c)(3). The section 501(c)(4), (5), or (6) organization, which the supporting organization is operating in conjunction with, must therefore meet the one-third tests of a publicly supported organization set forth in section 509(a)(2).

Rev. Rul. 62-113, 1962-1 C.B. 10, held that monies contributed by a taxpayer to a fund established by a church to support the expenses of missionaries (including the taxpayer's son) were deductible as charitable contributions under section 170 of the Code if the contributions were not earmarked for the son. The Service reasoned that a deduction is allowable where it is established that a gift is intended by the donor for the use of the organization and not as a gift to an individual, and that the test is whether the organization has full control of the donated funds, and discretion as to their use, so as to insure that they will be used to carry out its functions and purposes.

Rev. Rul. 64-182, 1964-1 C.B. 186, involved a corporation organized exclusively for charitable purposes that derived its income principally from the rental of space in a large commercial office building which it owned, maintained, and operated. The charitable purposes of the corporation were carried out by aiding other charitable organizations, selected in the discretion of its governing body, through contributions and grants to such organizations for charitable purposes. The Service held that the corporation met the primary purpose test of section 1.501(c)(3)-1(e)(1) of the regulations and was exempt under section 501(c)(3) of the Code where it was shown to be carrying on through such contributions and grants a charitable program commensurate in scope with its financial resources.

Rev. Rul. 67-149, 1967-1 C.B. 133, held exempt under section 501(c)(3) of the Code an organization formed for the purpose of providing financial assistance to several different types of 501(c)(3) organizations. It carried on no operations other than to receive contributions and incidental investment income and to make distributions of income to such exempt organizations at periodic intervals. The organization did not accumulate its investment income.

Rev. Rul. 76-401, 1976-2 C.B. 175, held that a 501(c)(3) charitable trust whose sole purpose is to grant scholarships to students graduating from both public and private high schools in a city and whose trustees are either officers of, or elected by the membership of, a 501(c)(4) civic league is a 509(a)(3) supporting organization. If the league were an organization described in section 501(c)(3), it would be excluded from the definition of a private foundation by virtue of section 509(a)(2) because of the sources of its financial support. The Service reasoned that in a technical sense, a 509(a)(3) supporting organization cannot be "organized, and . . . operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of" the section 501(c)(4), (5), or (6) organization it is deemed to support. The "supporting" organization is a legal charity and, therefore, cannot be organized and operated to further the general purposes of a noncharitable organization. Thus, the general requirements of sections 1.509(a)-4(c), (d), and (e) of the regulations are inapplicable to organizations supporting section 501(c)(4), (5), and (6) organizations. This is specifically recognized in section 1.509(a)-4(c) in its reference to section 509(a)(3)(A) of the Code wherein it provides that if a supporting organization is operated, supervised, or controlled by a publicly supported section 501(c)(4), (5), or (6) organization, the supporting organization will be considered as satisfying the "organizational test" of section 509(a)(3)(A) "if its articles require it to carry on charitable, etc. activities within the meaning of section 170(b)(2)." Although this rule is not specifically restated in section 1.509(a)-4(e) of the regulations pertaining to the "operational test" of section 509(a)(3)(A), it is equally applicable in determining whether a supporting organization

satisfies that test. Thus, since the trust is organized and operated exclusively for charitable purposes and is controlled by the civic league, it is deemed to satisfy the requirements of section 509(a)(3)(A) of the Code. The trust is "operated, supervised, or controlled by" a publicly supported organization within the meaning of section 1.509(a)-4(g) of the regulations and thus satisfies the requirements of section 509(a)(3)(B) of the Code. Finally, the trust is not controlled directly or indirectly by a disqualified person (as defined in section 4946 of the Code) other than its trustees in their capacity as trustees, and other than an organization described in section 509(a)(2) and thus, the trust meets the requirements of section 509(a)(3)(C).

Rev. Rul. 81-43, 1981-1 C.B. 350, held that a community trust described in section 1.170A-9(e)(11) of the Income Tax Regulations that was created by a community chest to hold permanently endowed charitable funds and to distribute income to support local publicly supported charities qualified as a 509(a)(3) supporting organization, where the publicly supported charities were specified by class rather than name.

RATIONALE:

Each of the requested rulings is discussed in turn below.

1. The proposed Fund is an activity recognized as furthering exclusively charitable purposes. The Fund will operate in a manner similar to a community trust, a public charity described in section 1.170A-9(e)(10)-(14) of the regulations. See also Rev. Rul. 67-149.

2. Because X is described in sections 501(c)(3) and 509(a)(3) of the Code, and such status will not be adversely affected by the Fund, donors to X for the Fund will be entitled to charitable deductions under section 170 of the Code.

3. X is currently described in section 509(a)(3) of the Code. For purposes of section 509(a)(3), Y is a publicly supported organization. Under section 1.509(a)-4(g)(1)(i) of the regulations, X is "operated, supervised, or controlled by" Y, because a majority of X's directors are elected by the membership of Y (which is also the membership of X). Under section 1.509(a)-4(c)(2), X meets the 509(a)(3) organizational test because it is organized and operated exclusively for charitable purposes and "operated, supervised, or controlled by" Y. While making grants to organizations other than the specified publicly supported organizations is ordinarily not permitted under the 509(a)(3) operational test, an exception applies here--under Rev. Rul. 76-401, a supporting organization of a 501(c)(6) organization is deemed to meet the operational test if it is organized and operated exclusively for charitable purposes and operated, supervised, or controlled by the 501(c)(6) organization. Also, X represents that it is not controlled by disqualified persons. The proposed creation and operation of the Fund will not adversely affect this 509(a)(3) status. We express no opinion whether the operation of such a donor-advised fund on such facts would meet the 509(a)(3) operational test if the publicly supported organization were described in section 501(c)(3).

4. Given X's representations that its income from investment of Fund assets will be in the form of dividends, interest, and capital gains, and assuming that X will not have any acquisition indebtedness with respect to any investment property, such income will be excluded from unrelated business taxable under section 512(b)(1) and (5) of the Code.

5. X's withholding of portions of the Fund assets or earnings to pay operating costs is not income from a trade or business distinct from the Fund's investment of assets. Whether such investment activity gives rise to unrelated business income tax is discussed above.

6. The issue raised by X is similar to that dealt with in section 1.507-2(a)(8) of the regulations. While the regulation applies to a specific situation involving a terminating private foundation, the regulation bears in general on the question whether the donee organization exercises dominion and control over an asset so as to be considered its owner. The community trust regulations under section 1.170A-9(e)(11) refer to section 1.507-2(a)(8) for this purpose.

X has not, in form, created separate trusts or other legal entities to operate the Fund. Moreover, X has structured the Fund to operate generally within the guidelines for community trusts to be treated as a single entity, as set forth in the regulations. Under the facts presented, we find that contributions to the Fund will be held directly by X as its own assets.

RULINGS:

Accordingly, we rule as follows:

1. The amendments to the articles of incorporation and by-laws of X that have been approved but not implemented, and the proposed creation and operation of a charitable gift fund in the manner described, will not adversely affect X's exempt status under sections 501(a) and 501(c)(3) of the Code.

2. Donors to X for the proposed charitable gift fund to be created and operated by X will be entitled to charitable deductions pursuant to sections 170(b)(1)(A)(viii) and 170(c)(2) of the Code, subject to the conditions and limitations of section 170.

3. Following the implementation of the amendments to its articles of incorporation and by-laws and creation and operation of the proposed charitable gift fund, X will continue to be classified as other than a private foundation under section 509(a) of the Code.

4. The unrelated business income tax will not apply to any income or gain realized by X from the assets in the proposed charitable gift fund.

5. The unrelated business income tax will not apply to the portions of the investments or investment earnings on the assets in the proposed charitable gift fund that are withheld by X from the accounts created by specific donors for the payment of the direct and indirect costs of operation of that fund.

6. The proposed charitable gift fund and the separate accounts within the charitable gift fund created by X to identify contributed amounts with specific donors will be treated as integral parts of X and not as separate entities.

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,

/s/

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2

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