TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

200313024

UIL: 513.00-00

Date: JAN - 2 2003

Contact Person:

Identification Number:

Telephone Number:

T:EO:B3

Employer Identification Number:

T =
X =

Dear Sir or Madam:

This is in response to T's request for a ruling that certain distributions to it from the redemption of tuition certificates under a private prepaid tuition program qualified under section 529 of the Internal Revenue Code as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16 (the "Act") will not constitute unrelated business taxable income to T.

T is an operating educational organization described in Section 481 of the Higher Education Act of 1965. T has a faculty and a student body. T has been recognized by the Internal Revenue Service as an organization exempt under section 501(c)(3) of the Code and described in section 170(b)(1)(A)(ii) of the Code.

X was organized on April 1, 1999, as a Delaware limited liability company. X was organized for the purpose of establishing and maintaining a prepaid tuition program (the "Program") that sells Tuition Certificates which entitle a designated beneficiary to the waiver or payment of certain qualified higher education expenses at one or more private colleges or universities participating in the Program. The Program operates under a "Consortium Agreement" in which only members of X are eligible to participate in the Program. Each member is required to qualify as an "eligible educational institution" within the meaning of section 529(e)(5) of the Code and satisfy other requirements set forth in the Consortium Agreement. X has received a ruling from the Internal Revenue Service that it is a qualified tuition program described in section 529.

T is presently the only member of X. X has received indications of interest from a large number of tax exempt private colleges and universities within the United States which have supported its efforts. X anticipates that because it has received a ruling from the Service, most of the colleges and universities supporting X will become its members and participate in the Program.

The Program documents provide for the establishment of a trust (the Program Trust) to hold, for the exclusive benefit of designated beneficiaries, the funds received by the Program. The Program documents provide that the amounts paid for Tuition Certificates and investment earnings thereon, as well as any other funds or credits allocable to the Program Trust, shall be promptly deposited or credited by the administrator to the Program Trust. X represents that the trustee of the Program Trust will be a federally chartered savings bank which is also an investment adviser registered with the Securities and Exchange Commission.

Upon presentation of a Certificate to T (or another eligible educational institution that is a member of consortium X), the designated beneficiary under such Certificate will be entitled to waiver or payment of qualified higher education expenses in the form of tuition and required fees upon enrollment at T (or another eligible educational institution that is a member of consortium X). Each of the participating colleges and universities, including T, agree that upon enrollment of the designated beneficiary as a student and utilization of the Tuition Certificate, the institution will credit the student as having paid the cost of tuition and required fees set forth in the Certificate.

Upon granting tuition credit under a tuition Certificate to a designated beneficiary, any eligible educational institution that is a member of consortium X, including T, will present the Tuition Certificate (or a portion thereof) to the administrator of the Program for redemption. Under the Program, T (or another eligible educational institution that is a member of consortium X) will receive a payment from the Program Trust equal to the purchase price for the Tuition Certificate (or portion thereof), increased or decreased by the net investment return of the Program. This amount, in substance, represents the original purchase price of the Certificate plus investment earnings and less various program related charges.

You have requested the following ruling:

Distributions to T from the Program Trust for Tuition Certificate Proceeds pursuant to the Program in consideration for educational services provided by T, to a designated beneficiary will not constitute unrelated business taxable income to T.

Section 511 of the Code, in substance, imposes federal income tax on the unrelated business taxable income of organizations described in section 401(a) and section 501(c) of the Code and on any college or university which is an agency or instrumentality of any government or any political subdivision thereof, or which is owned or operated by a government or any political subdivision thereof.

Section 512(a) of the Code provides, in part, that the term "unrelated business taxable income" means the gross income derived by an organization from any unrelated trade or business (as defined in section 513) regularly carried on by it.

Section 513(a) of the Code provides, in part, that the term "unrelated trade or business" means, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose.

Section 1.513-1(d)(2) of the Income Tax Regulations provides, in part, that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is "substantially related," for purposes of section 513, only if the causal relationship is a substantial one.

Section 1.513-1(d)(4)(i) of the Regulations provides, in part, that gross income derived from performance of exempt functions does not constitute gross income from the conduct of unrelated trade or business.

Section 529(b)(1) of the Code provides, in part, that the term "qualified tuition program" means a program established and maintained by a state or agency or instrumentality thereof or by one or more eligible educational institutions - -

(A) under which a person-

(i) may purchase tuition credits or certificates on behalf of a designated beneficiary which entitle the beneficiary to the waiver of payment qualified higher education expenses of the beneficiary, . . . and

(B) which meets the other requirements of this subsection.

Except to the extent provided in regulations, a program established and maintained by one or more eligible educational institutions shall not be treated as a qualified tuition program unless such program provides that amounts are held in a qualified trust and such program has received a ruling or determination that such program meets the applicable requirements for a qualified tuition program. For purposes of the preceding sentence, the term "qualified trust" means a trust which is created or organized in the United States for the exclusive benefit of designated beneficiaries and with respect to which the requirements of paragraphs (2) and (5) of section 408(a) are met.

Section 529(e)(5) of the Code provides that the term "eligible educational institution" means an institution –

(A) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on the date of the enactment of this paragraph (enacted Aug. 5, 1997), and

(B) which is eligible to participate in a program under title IV of such Act.

Tuition and required fees paid by a student to attend a college or university for purposes of obtaining higher education do not constitute income from the conduct of unrelated trade or business. It makes no difference whether the tuition and fees are paid directly to the school or paid under a qualified tuition program within the meaning of section 529 of the Code. In either case, the payment of tuition and required fees to a college or university in exchange for the education of students constitutes gross income from charges by the college or university for the performance of its exempt function, that of educating students, within the meaning of section 1.513-1(d)(4)(i) of the Regulations. Accordingly, amounts paid by the Program Trust as distributions to T for purposes of qualified higher education expenses does not constitute unrelated business income to T.

Accordingly, we rule as follows:

Distributions to T from the Program Trust of Tuition Certificate Proceeds under the Program in consideration for educational services provided by T to a designated beneficiary will not constitute unrelated business taxable income to T within the meaning of section 511 of the Code.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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

Sincerely,

(signed) Robert C Harper, Jr

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3