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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Contact Person:

S.I.N.: 513.00-00

Telephone Number:

In Reference to:

Date: JAN 13 1999

Employer Identification Number:
Key District:

Legend:

M =
N =
O =
P =
Q =
R =
S =
T =
m =
x =

Dear Applicant:

This letter is in reply to the letter from your authorized representative dated June 18, 1998, in which M and N requested rulings with respect to the tax consequences of a proposed merger and the related transactions described below.

M is an organization recognized by the Internal Revenue Service as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code. M is a publicly supported organization described in section 509(a)(2) of the Code and is the parent organization of a group ruling with subordinates exempt under section 501(c)(3).

N is an organization recognized by the Service as exempt from federal income tax under section 501(c)(6) of the Code. N is the parent organization of a group ruling with subordinates exempt under section 501(c)(6).

M's purpose is to provide educational services to m specializing in a particular field. M conducts extensive educational activities consisting primarily of self-assessment programs, post-graduate courses, audio cassette programs, clinical information management programs, and educational and career development. M lobbies, promotes, and participates in public policy issues including policy development, scientific

affairs, technical assessment programs, secretarial services, and scientific policy research. In addition to its educational and policy activities, M publishes several industry journals, each with a substantial subscriber base. M will amend its Certificate of Incorporation to provide that its name be changed to M-N.

N was established for the purposes of representing m who specialize in a particular field and of addressing pertinent socioeconomic issues to m. N conducts education, certain certifications, and lobbying. N owns all of the stock of P, a for-profit organization, the primary activity of which is the provision of lobbying services for certain specialty organizations. P shares staff and facilities with N, paying N for its share of staff time, its use of facilities, and all other applicable overhead via a cost allocation. P's board of directors is comprised of N senior-level employees. N also holds a 100% stock interest in Q, which, in turn, holds a 1% general partner interest in R. R is a limited partnership which was organized to purchase, develop, and operate an office building with rentable space. N also holds a 50% limited partner interest in R, and an unrelated for-profit third party holds the other 49% limited partnership interest. In addition, N is affiliated with and controls S, a trust exempt under section 501(c)(3) of the Code, which was created to engage in research and educational projects. N also operates a program, T, as a division of its operations, which provides certification and laboratory education for its members and certain of their employees on a fee basis. Through T, N seeks to improve the level of laboratory effectiveness, efficiency, and safety.

O is a newly formed organization that has been recognized as exempt from federal income tax under section 501(c)(6) of the Code. N will merge some of its activities into O.

Both M and N engage in lobbying activities and N controls a political action committee. The political action committee is a segregated fund of N, rather than a separately incorporated entity. N currently expends between $x and $2x annually on this activity. The lobbying activities currently undertaken by N will primarily be conducted by M-N after the merger, but O will also continue to engage in some lobbying through P, and the political action committee will be controlled by O. The parties anticipate that M-N will spend between $x and $2x annually on lobbying subsequent to the merger. This amount will not be substantial relative to all the activities that will be conducted by M-N, which will have an operating budget in excess of $50x.

Both M and N desire to merge the charitable and educational programs of the respective entities into M, merge some of the

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remaining programs into O, and divest themselves of any remaining activities. Specifically, the parties intend that:

1. N will merge into O.

2. The initial directors of O will be those persons who are members of the board of regents of M on the effective date of the merger transaction.

3. The governing structure of M will be changed by:

   a. amendment to M's Certificate of Incorporation to provide that its name will be M-N;

   b. amendment to the bylaws of M such that every current member in good standing of a component society of N at the time of closing will be a member of M-N;

   c. adopting these changes or amendments as of the effective date of the merger transaction; and

   d. causing the election or appointment to its Board of Regents of certain persons, effective no later than the effective date of the merger transaction.

4. The parties expect to cause the appointment of certain officers of M-N and O.

5. Promptly after the effective date of the merger transaction:

   a. those programs of N (and any assets associated therewith) which, in the judgment of the Board of Regents of M-N, are charitable and educational will be transferred without consideration to and become programs of M-N;

   b. those programs of N (and any assets associated therewith) which are in the nature of trade association activities (except most lobbying activities) will remain activities of O and operate to the extent deemed appropriate by the board of O; the stock of P will be owned by O and P will share staff

and facilities with O, paying O for its share of staff time, its use of facilities, and all other applicable overhead via a cost allocation; control over the political action committee will be transferred to O;

c. S will be dissolved; however, prior to its dissolution, S's assets will be transferred to M-N, which will conduct activities similar to those historically performed by S prior to the merger;

d. the majority of the total lobbying activities will be performed at the national level by M-N; a limited number of the local chapters will perform a small percentage of the total lobbying activities; the balance of the total lobbying activities will be performed by P on behalf of O;

e. M-N and O will encourage state chapter/component societies formerly of M and N to merge in a manner similar to the transaction described above concerning M-N and O.

6. O intends to dissolve the political action committee a short specified amount of time after the merger; all existing political action committee funds will be used with respect to the elections by that date; subsequent to the utilization of all remaining political action committee funds, the political action committee will be terminated; in the event that funds remain in the political action committee subsequent to the elections, such funds will be contributed to either another political action committee or to an organization exempt under section 501(c)(3) of the Code.

M-N will maintain control of O through the existence of an identical board of directors with respect to the two entities. It is expected that the top officers of M will be on the new boards of directors with respect to the two entities. A committee of the board of directors will be granted responsibility for the control of O's management team. Such control will be exercised periodically and from time to time as the board of directors deems reasonable. There will be no common officers of the two organizations and the responsibilities for the day-to-day operation of O will be vested in individuals who

do not share such responsibilities with M-N. However, to the extent that there are individuals employed by M-N with specific technical expertise or relevant office management skills which may be needed by O, M-N will contract out such services at a fair and equitable allocation of the appropriate cost to O. These contracted individuals will have no operational authority over O.

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

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense. In the law of charity, the promotion of health is considered to be a charitable purpose.

Section 501(c)(6) of the Code provides for the exemption from federal income tax of business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

Section 509(a)(2) of the Code provides that an organization will be excepted from classification as a private foundation if it normally receives more than one-third of its support from any combination of gifts, grants, contributions, or membership fees; and gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business; and normally receives not more than one-third of its support from the sum of gross investment income and the excess of the amount of the unrelated business taxable income over the amount of tax imposed by section 511.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less certain allowable deductions and modifications.

Section 513(a) of the Code defines the term "unrelated trade or business" as 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 the function constituting the basis of its exemption.

Section 1.513-1(d)(2) of the regulations provides 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; and it is "substantially related" only if the causal relationship is a substantial one. The regulation continues that for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Subsequent to the proposed reorganization, M-N will operate exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code. The transfers and actions described above, in and of themselves, will have no adverse effect on a determination of exempt status or exception from private foundation status. Further, the proposed merger of M and N and the creation of O do not involve the regular carrying on of unrelated trade or business within the meaning of section 513 of the Code.

N is aware that the local chapter under its group ruling will need to seek a new group ruling as a result of its new relationship with O, due to the cessation of N's existence. Under Rev. Proc. 80-27, 1980-1 C.B. 677, the cessation of a parent's existence causes a group exemption to terminate. The local chapters under the group exemption to M will not need to be covered under a new group exemption ruling in light of the fact that their national organization continues to promote its exempt purposes and is thus not considered to have ceased its existence.

It is the position of the Service that a parent organization which holds all of the stock of a taxable subsidiary corporation is not thereby precluded from recognition of exemption under section 501(c)(3) of the Code where the subsidiary is formed for a *bona fide* business purpose and is not a mere instrumentality of the parent organization and where the parent organization does not actively participate in the day-to-day management of the subsidiary. Even considering circumstances where the section 501(c)(3) organization may appoint the subsidiary's board of directors or where the chief executive officer of the section 501(c)(3) organization may sit on the boards of the taxable entities does not alter this position.

Accordingly, based on the facts and circumstances concerning the reorganization and related transactions as stated above, we rule as follows:

(1) After the amendment of the Certificate of Incorporation and bylaws of M and the reorganization, including the proposed transfer of assets and activities and the sharing of personnel, services, facilities, and expenses by and between M-N, O, and P, M-N (formerly named M) will continue to be exempt from income tax under section 501(c)(3) of the Code.

(2) After the proposed transaction, M-N will continue to qualify as an organization that is not a private foundation because it is described in section 509(a)(2) of the Code.

(3) The proposed transfers of assets and activities and the sharing of personnel, services, facilities, and expenses by and between M-N, O, and P, as described above, will not give rise to unrelated business taxable income under sections 511 through 514 of the Code to either M-N, N, or O.

(4) After the amendment of the Certificate of Incorporation and bylaws of M-N and the proposed reorganization, M-N can administer certain activities of behalf of itself and O, such as a single, itemized dues statement for the collection of dues for both organizations (and the local chapters), without loss of M-N's exempt status. The disallowance of a deduction for ordinary and necessary expenses paid or incurred in carrying on a trade or business under section 162(e) of the Code, however, extends to the portion of dues or other similar amounts paid to O, and the dues payor must be notified of the amounts allocable to lobbying or political expenses for which a deduction is disallowed.

(5) After the proposed transaction, the activities (particularly the political activities) of O will not be

attributed to M-N in a manner that will jeopardize the status of M-N under section 501(c)(3) of the Code.

(6) The proposed transaction will have no adverse impact on the group exemption covering the local chapters of M.

(7) The fact that M-N and O will be "affiliated" through common membership will not cause loss of exempt status under sections 501(c)(3) and 501(c)(6), respectively.

(8) The existence of the political action committee controlled by N, being dissolved as described, will not jeopardize the tax exempt status of either M-N or O.

These rulings are based on the understanding that there will be no material changes in the facts upon which they are based. Any such change should be reported to your key District Director. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. A copy of this ruling is being forwarded to your key District Director.

Except as we have specifically ruled herein, we express no opinion as to the consequences of these transactions under the cited provisions or under any other provisions of the Code.

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

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

Sincerely yours,

(Signed) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2