

The Revenue Service will review mineral property transfers by exempt organizations to controlled corporations and will characterize payments according to the substance of the transaction regardless of its form; The Robert A. Welch Foundation decision will not be followed.

The Internal Revenue Service will not follow the decision of the United States Court of Appeals for the Fifth Circuit in *United States v. The Robert A. Welch Foundation*, 334 F.2d 774 (1964), affirming *per curiam* 228 F.Supp. 881 (1963). That decision held that income consisting of 100 percent of the net profits in certain oil properties, received by a charitable foundation exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 from two corporations controlled by it, constituted income from overriding royalties. Therefore, such income was excluded as 'royalty' income under section 512(b)(2) of the Code in computing unrelated business taxable income.

The Service will continue to review exempt organizations' transfers of mineral properties to controlled corporations and characterize the payments according to the substance of the transaction regardless of its form. Therefore, if in substance the income received by an exempt organization is from a working interest, characterization of the income as 'royalty' by the exempt organization will not be accepted by the Service.