DEPARTMENT OF THE TREASURY 200137061
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

NO THIRD PARTY CONTACTS

SIN: 514.07-00
Date:
JUN 18 2001

Contact Person:

ID Number:

Telephone Number:

T:EO:B4

Employer Identification Number:

Legend:
M =
N =
O =
X =
Y =
Z =

Dear Sir or Madam:

This is in response to a letter dated June 6, 2001, and previous correspondence from M's authorized representatives for a ruling that M is a "qualified organization" within the meaning of section 514(c)(9)(C) of the Internal Revenue Code.

M is exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). M is also a supporting organization described in section 509(a)(3). M was organized for the purpose of conducting and providing research, instruction, and publication in the cultures of several countries located in X and certain adjacent countries. M has always operated to support a specific university directly and various other tax-exempt universities indirectly. M's focus has been the provision of financial and related assistance to scholarly study of the humanities and social sciences in general, and culture in Z in particular. Historically, M has carried out its exempt purposes by:

(a) founding, developing, supporting, maintaining and/or conducting one or more educational institutions;

(b) supporting in whole or in part, co-operating with or joining or affiliating with other institutions to carry on, for properly prepared scholars, research and educational work of the type appropriate to a graduate school of arts and sciences;

(c) preparing scholars for admission to M's work, developing through other institutions undergraduate work primarily in Y; and,

(d) exploring, discovering, collecting and preserving objects of culture and antiquities, and assisting museums or others to do so.

M is governed by nine trustees, who are also its members. Three trustees are selected by N, three are selected by O, and three are chosen by the trustees then in office.

335

N is an organization that is exempt under section 501(a) of the Code as an organization described in section 501(c)(3). N is an educational organization described in sections 509(a)(1) and 170(b)(1)(A)(ii). O is also an organization exempt under section 501(a) as an organization described in section 501(c)(3). O is an organization described in sections 509(a)(1) and 170(b)(1)(A)(vi). O fulfills its exempt purposes by making grants to colleges, universities, and academic programs at selected institutions.

Historically, individuals affiliated with N have filled a majority of M's trustee positions. Over the past ten years, all three "at-large" trustees have been affiliated with N. M's trustees are appointed for an indefinite term and serve until their death or resignation from the Board. It is anticipated that individuals affiliated with N will continue to constitute a majority of the members of M's Board in future years.

M's representatives have stated that its close ties to N and O are based not only on an interlocking corporate structure, but also on their overlapping educational missions. N has a large academic program emphasizing X, which serves both undergraduates and graduate degree candidates. Although O does not directly operate a college or university, it was formed through the consolidation of several universities located in Y and is organized and operated for the purpose of contributing to higher education in Y and throughout X.

M closely coordinates its exempt activities with N. M's funds provide direct support for Z studies at N and support a specialized library. M publishes an authoritative academic journal and numerous books on the literature and history of X, often in conjunction with N's Z Studies Department. In addition to supporting N's library and publications, M provides study-abroad fellowships to N's students.

M indicates that in the future, all grants that were formerly paid to O will be paid directly to N. However, M will continue to work closely with N and O to select recipients of direct grants from N. In this regard, M will continue to identify a number of fellowships for overseas study and research to younger scholars on the faculties of several universities. M will also continue to arrange orientation, supplementary language training, and cultural activities for the fellowship recipients.

M is seeking this ruling so that it will be able to commingle its endowment funds with those of N for investment purposes. M indicates that the N endowment has a better return/risk profile than its own, and that its portfolio could be expected to yield a higher return if commingled with N's. Commingling also would enable M to improve the diversification of its investments. Some of these investments might involve debt-financed property under section 514 of the Code

Section 511 of the Code provides, in part, for the imposition of tax on the unrelated business taxable income of organizations described in section 501(c), including organizations described in section 501(c)(3).

Section 512(a)(1) of the Code provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) that it regularly carries on, less the allowable deductions which are directly connected with the carrying on of such trade or business, and computed with the modifications contained in section 512(b).

Section 512(b)(4) of the Code provides that notwithstanding the exceptions for items such as interest, dividends, royalties, rent from real property, and gains from the sale of property, 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).

Section 514(a)(1) of the Code requires that income derived from "debt-financed property" must be included as an item of gross income derived from an unrelated trade or business.

Section 514(b)(1) of the Code defines "debt-financed property" as any property that is held to produce income and with respect to which there is an acquisition indebtedness (as defined in subsection (c)) at any time during the taxable year.

Section 514(c)(1) of the Code provides, in part, that the term "acquisition indebtedness" means the unpaid amount of the indebtedness incurred by an organization in acquiring or improving such property.

Section 514(c)(9) of the Code provides that, unless certain exceptions relevant to a specific transaction apply, indebtedness incurred by a qualified organization will not constitute acquisition indebtedness.

Section 514(c)(9)(C)(i) of the Code provides that a "qualified organization" is an organization described in section 170(b)(1)(A)(ii) and its affiliated support organizations described in section 509(a)(3).

M is an organization described in section 509(a)(3) of the Code, while N is an organization described in section 170(b)(1)(A)(ii). The question presented is whether M is an affiliated support organization with respect to N as required by section 514(c)(9)(C). The information submitted shows that M's governance structure and operational activities are indicative of the requisite affiliation and support required for purposes of section 514(c)(9)(C)(i). Under the circumstances presented, the presence of O does not detract from M's affiliation and support of N; rather, O's relationship with M and N is complementary in nature. Since M is described in section 509(a)(3) and is an affiliated support organization with respect to N, which is described in section 170(b)(1)(A)(ii), M meets the requirements as a "qualified organization" under section 514(c)(9)(C)(i).

Accordingly, we rule that M is a "qualified organization" within the meaning of section 514(c)(9)(C) of the Code.

Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transactions described above under any other provision of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

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 by others as precedent.

We are informing M's Area Manager of this ruling. A copy of this letter should be kept in M's permanent records. If there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4