

Internal Revenue Service**Department of the Treasury**

Number: **200230005**
Release Date: 7/26/2002
Index No.: 170.09-00; 170.18-00;
501.32-00; 513.00-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:ITA:3 PLR-111975-01

Date:

April 11, 2002

LEGEND:

Charity =

Local Chapter =

LLC =

Corporation =

Month/Year =

Dear

This letter responds to a ruling request submitted on behalf of Charity by a letter dated February 20, 2001, which was forwarded by a transmittal letter dated February 23, 2001, and supplemented by letters dated May 8, 2001, and February 27, 2002. The request relates to a property donation program operated with a third party. The specific issues are whether donations made through the property donation program may qualify for a charitable contribution deduction under § 170 of the Code, whether Charity's exempt status under § 501(c)(3) is adversely affected by this program, and whether this program constitutes an unrelated trade or business under §§ 511-513.

FACTS**Description of Relevant Parties**

Charity is a charitable entity exempt from federal income tax under § 501(c)(3) and is not a private foundation; it normally receives a substantial part of its support from a governmental unit or from the general public under § 170(b)(1)(A)(vi). Charity received its determination letter in Month/Year. Charity's primary purpose is to find a cure for certain illnesses. Charity engages in programs for research, patient and community service, public health education, and professional education.

Local Chapter is one of the local chapters of Charity and is not a separate legal entity. Local Chapter is included in Charity's group exemption filing of Form 990 (Return of

PLR-111975-01

Organization Exempt from Income Tax). Charity expects to enter into a written agreement with LLC to solicit, process, and accept property donations on behalf of Charity within the area served by Local Chapter. Charity proposes to enter into the relationship because it does not currently have the resources to process property donations and meet the federal and state reporting requirements. Additionally, Charity believes it is more cost efficient to enter into this relationship than to attempt to solicit and process property donations itself. Charity will use the proceeds from the sale of donated property to support and further its purposes. Almost all of the donated property is expected to be in the form of automobiles and trucks, but property donations may include boats and other personal property.

LLC is a charitable fundraiser registered under state law. LLC is engaged in the for-profit business of buying, storing, maintaining, dismantling, and selling used motor vehicles and vessels and other personal property. LLC is owned by Corporation (a for-profit entity) (99%) and an individual (1%). The individual is the managing member of LLC and the president of Corporation. No director or officer of Charity (which includes Local Chapter) has a proprietary or familial relationship with LLC, Corporation, or the individual. Charity is fully informed of the relationship between LLC, Corporation, and the individual.

Description of Proposed Written Agreement

Charity has represented that the future course of dealing between the parties will be in accord with the written agreement described below.

The agreement is entitled Agency Agreement. The agreement includes as a recital that Charity desires to appoint LLC as its agent for the purpose of assisting Charity in the solicitation, acceptance, processing, and sale of donated motor vehicles, vessels, and other personal property donated by the general public to Charity, and LLC desires to accept its appointment as agent for such purposes, on the terms and conditions set forth in the agreement. Within a specified geographic area, LLC is the exclusive agent for Charity, but LLC also may be an agent for others.

The agreement states that Charity appoints LLC as its authorized agent pursuant to certain state agency laws to act in Charity's name, place, and stead for the following purposes: (1) to advertise and otherwise solicit donations of motor vehicles, vessels, and other personal property from the general public in the name and on behalf of Charity; (2) to pick up and/or accept donations of motor vehicles, vessels, and other personal property from the general public in the name and on behalf of Charity; (3) to arrange for qualified appraisals, process, provide minor repairs, and sell motor vehicles, vessels, and other personal property donated by the general public in the name and on behalf of Charity; and (4) to do and perform any act necessary, requisite, and proper to be done, and to do all things that Charity might or could do or cause to be done, to further the purposes of the agency set forth in (1) through (3).

PLR-111975-01

Subject to the review and approval of Charity, LLC agrees to do the following: (1) to pick up and/or accept donations of the property; (2) to the extent necessary or desirable as determined by LLC in the exercise of its reasonable business judgment, to pay all costs and expenses pertaining to the property so as to result in the cost-efficient sale thereof (including the towing and repairing of vehicles); and (3) to pay all costs and expenses of selling, auctioning, or otherwise disposing of the property. These activities shall be performed by LLC, and/or its agents, contractors, subcontractors, and/or third parties, whether related to LLC and/or its principals or not, as determined by LLC in its sole and absolute discretion, according to the terms of the agreement. LLC reserves the right to refuse to accept a vehicle that LLC determines, in the exercise of its reasonable business judgment, is not saleable at a price at least adequate to cover LLC's related costs and expenses.

Subject to the review and approval of Charity, all property shall be sold or disposed of as determined by LLC in its reasonable business judgment, and LLC agrees to use its best efforts in connection with the sale of the property to obtain the greatest price therefor. LLC may enter into a consignment agreement or other subcontract with an auction company or any other business entity (including any affiliate and/or related person or entity) and pay such person or entity a fee for any services rendered. All property shall be sold "AS-IS" and in compliance with all applicable laws, rules, and regulations. Corporation, or any other person or entity related to LLC, may purchase any vehicle provided that the purchase price shall be comparable to the purchase price anticipated in the regular course of business. LLC has an option and right of first refusal to process, but not to purchase, any property donated to and received directly by Charity.

Charity is and shall remain the equitable owner of the property until an authorized sale occurs. Upon the sale of the donated property, the proceeds shall become the property of Charity, net of the fee payable to LLC. Until such sale, the risk of accidental loss, damage, or destruction of the donated property shall be borne by Charity, subject to LLC's obligation to pay the cost and expenses of insurance coverage described later in the agreement.

LLC agrees to provide advertising on behalf of Charity, which may include radio, television, newspapers, and direct mail. The placement and content of advertising shall be determined by LLC, subject to Charity's review and approval. LLC will pay for all the costs and expenses of the advertising. The parties have agreed to an approximate monthly sum that LLC will spend on advertising. LLC agrees to provide a toll-free telephone number on behalf of Charity for vehicle donations. Charity may provide its own toll-free telephone number for vehicle donations if it pays the associated costs.

For donated property valued above \$5,000, LLC will arrange for professional appraisals by an unaffiliated appraiser. Donors are solely responsible for paying the costs of their appraisals. LLC may, when requested by Charity, provide signatures for Forms 8283

PLR-111975-01

(Noncash Charitable Contributions) on behalf of Charity pursuant to a Power of Attorney described later in the agreement.

LLC will provide the donor of a vehicle with a “blue book” (used car price guide) printout along with a disclosure that the printout does not in any way represent the opinion of LLC or Charity. Donors will sign a Certificate of Donation, together with a Bill of Sale, Statement of Facts, and a Limited Power of Attorney. LLC will send copies of the Certificates of Donation to Charity. On behalf of Charity, LLC will send a “thank you letter” to each donor upon receipt of a vehicle. LLC agrees to send to a donor, within 40 days after donation of a vehicle, an “official receipt” from Charity on forms provided by Charity.

On behalf of Charity, LLC will process all Department of Motor Vehicles (DMV) documents according to DMV rules and regulations. Charity will provide a Power of Attorney to LLC in order to complete DMV title transfers.

LLC will provide monthly accounting reports to Charity, in a form and in detail satisfactory to Charity. LLC will provide weekly advertising reports to Charity.

Charity agrees to pay LLC a fee based on a specified percentage of gross proceeds received from the sale or disposition of donated property. On a monthly basis, LLC shall remit a payment to Charity in an amount equal to the preceding month’s gross proceeds less LLC’s percentage.

Charity reserves the right to audit and inspect LLC’s property donation program financial statements for Charity at any time during normal business hours.

Description of Vehicle Classification and DMV Titling Process

An interested donor will call the toll-free number, and a pick-up of the vehicle will be scheduled. Donors will be informed that LLC is acting on behalf of Charity. Vehicles will be classified as either “acquisition” or “clear title” by LLC, based on guidelines determined in advance by LLC in consultation with Charity.

A “clear title” vehicle complies with the state antipollution and safety requirements and has enough value to be sold to the public. The chain of title goes from the donor to Charity to LLC (as a dealer) then to the buyer. DMV will collect transfer fees for each of the transfers in the chain of title. LLC appears in the chain of title because LLC sells all donated vehicles under its dealer license. State DMV rules provide that a charitable organization is exempt from the dealer license requirement, but all of the proceeds from the sale of the vehicle must go to the charity. Consequently, this rule is not applicable here because some of the sale proceeds will go to LLC as its fee.

An “acquisition” vehicle does not meet the state antipollution and safety requirements and is destined to go to an automobile dismantler. The chain of title goes from the

PLR-111975-01

donor to Charity to LLC (as a dealer) then to the buyer. DMV considers these transactions as multiple transfers, but no DMV transfer fees are imposed when an acquisition vehicle is processed by a licensed automobile dismantler. The vehicle's DMV record will reflect a "junk" status, with the name of the automobile dismantler and the date the vehicle was acquisitioned. It is expected that the buyer generally will be Corporation, and it has been represented that this is so because Corporation pays more for acquisition vehicles than the other automobile dismantlers that are potential buyers.

Description of State Donation Law

State donation law provides, in part, that if a person donates a motor vehicle, aircraft, or vessel to a nonprofit organization or commercial fundraiser for charitable purposes, the nonprofit organization or commercial fundraiser must send to the donor a receipt for that property within 90 days from the date of the donation. The receipt must describe the donated property in terms of its model, age, level of use, including, but not limited to, the mileage, in the case of a vehicle, and condition, and whether a visual inspection indicated that there were any readily apparent defects that would materially reduce the value of the property. The receipt must also include the date the donation was made and must indicate whether the property was operable or inoperable at the time of donation. Additionally, if the donated property is sold prior to the issuance of the receipt, the receipt must also include all of the following: (1) the date the property was sold, (2) if the property was sold to a dismantler, the amount paid to the nonprofit organization or commercial fundraiser, and (3) if the property was altered subsequent to the donation and the alteration affected the value of the property, a statement that the property was altered and whether the alteration increased or decreased the value of the property. The nonprofit organization or commercial fundraiser must retain a copy of the receipt for its records.

ANALYSIS

Issue 1 – Whether donations made through the property donation program may qualify for a charitable contribution deduction under § 170 of the Code.

- a. Whether LLC is the agent for Charity and whether donations are made "to" Charity through LLC.

Section 170(a)(1) of the Code provides the general rule that, subject to certain limitations, there shall be allowed as a deduction any charitable contribution payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary. See also § 1.170A-1 of the Income Tax Regulations.

Section 170(c)(2) provides that the term "charitable contribution" includes a contribution or gift to or for the use of a corporation, trust, or community chest, fund, or foundation (A) created or organized in the United States or in any possession thereof, or under the

PLR-111975-01

law of the United States, any State, the District of Columbia, or any possession of the United States; (B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals; (C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and (D) which is not disqualified for tax exemption under § 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. See also § 1.170A-1(j)(5).

A taxpayer may claim a deduction for a charitable contribution only if the contribution is made “to or for the use of” a qualified organization. A contribution is “for the use of” a qualified organization when it is held in a legally enforceable trust for the qualified organization or in a similar arrangement. Davis v. United States, 495 U.S. 472, 485 (1990). Because the contributions in the property donation program are not made in trust or similar arrangement, they cannot be “for the use of” Charity. Therefore, we need to determine whether contributions in the property donation program are made “to” Charity.

It is well established that an organization described in § 170(c)(2) may receive contributions through its agent. Section 1.170A-1(b) provides, in part, that if a taxpayer unconditionally delivers or mails a properly endorsed stock certificate to a charitable donee or the donee’s agent, the gift is completed on the date of delivery or, if such certificate is received in the ordinary course of the mails, on the date of mailing. In Rev. Rul. 85-184, 1985-2 C.B. 84, a utility company was authorized by a charitable organization to act as its agent in receiving contributions from customers of the utility company.

The examples of an agency relationship in the revenue ruling and regulation described above cover the situation where the agent receives contributions on behalf of a qualified organization. Nevertheless, in appropriate circumstances, a qualified organization may use an agent to perform other functions. Cf. Kaplan v. Commissioner, 43 T.C. 663 (1965), acq. 1965-2 C.B. 5 (describes a property donation program operated by a for-profit corporation on behalf of a hospital; issue of agency was not raised).

Agency has been defined as the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act. Restatement (Second) of Agency § 1 (1957); see also Black’s Law Dictionary 62 (7th ed. 1999). The one for whom action is to be taken is the principal, and the one who is to act is the agent. Some of an agent’s general fiduciary duties to the principal include the duty to account for profits arising out of the employment, the duty not to act as (or on account of) an adverse party without the principal’s consent, the duty not to compete with the principal on his own account or

PLR-111975-01

for another in matters relating to the subject matter of the agency, and the duty to deal fairly with the principal in all transactions between them. Restatement (Second) of Agency § 13.

While the contract terms setting forth the parties' rights and obligations are of major importance, the designation of the parties in an agreement as having (or not having) a principal/agent relationship is not binding on the Service or other third parties; instead, all the facts and circumstances must be considered. See State Police Ass'n of Massachusetts v. Commissioner, 125 F.3d 1, 7 (1st Cir. 1997).

In the property donation program described above, Charity desires to appoint LLC as its agent for the purpose of assisting Charity in the solicitation, acceptance, processing, and sale of personal property donated by the general public to Charity. In order to determine whether there is a valid agency relationship, we must look to the proposed written agreement and the surrounding facts and circumstances. Because this ruling covers the future implementation of a property donation program pursuant to the terms of the written agreement, and Charity has represented that the future course of dealing between the parties will be in accord with the written agreement, our analysis will focus primarily on the terms of the written agreement.

The written agreement clearly purports to establish an agency relationship pursuant to certain state agency laws. Throughout the agreement, the provisions show that LLC will be acting on Charity's behalf and subject to its control in the general performance of the activities, such as solicitation, acceptance, processing, and sale of donated property. The amount of discretion that LLC will exercise is not in conflict with an agency relationship. Also, Charity is and shall remain the equitable owner of the property until an authorized sale occurs. In other words, LLC will hold the property in the capacity of the agent for Charity. The DMV titling process is in accord with this treatment. Upon the sale of the donated property, the proceeds shall become the property of Charity, net of the fee payable to LLC based on a specified percentage of gross proceeds. Until such sale, the risk of accidental loss, damage, or destruction of the donated property shall be borne by Charity, subject to LLC's obligation to pay the cost and expenses of insurance coverage. LLC will provide monthly accounting reports to Charity, in a form and in detail satisfactory to Charity. LLC will provide weekly advertising reports to Charity. Charity reserves the right to audit and inspect LLC's property donation program financial statements at any time during normal business hours.

We note that the fact that LLC will pay certain costs and expenses (such as advertising and insurance) under the written agreement does not preclude a determination that there is a valid agency relationship. Cf. Restatement (Second) of Agency § 439 comment e. We also note that the fact that Corporation, or any other person or entity related to LLC, may purchase any vehicle, provided that the purchase price shall be comparable to the purchase price anticipated in the regular course of business, does

PLR-111975-01

not by itself preclude a determination that there is a valid agency relationship, provided that LLC acts in accordance with its fiduciary duty to Charity.

We believe that, if the actual course of dealing between the parties is in accord with the terms of the written agreement, there will be a valid agency relationship. Charity will have the requisite degree of control and supervision. Accordingly, based on the facts submitted and the representations made, we conclude that LLC will be the agent for Charity and donations can be made “to” Charity through LLC.

b. Whether the thank you letter or receipt letter sent to a donor includes the information required by § 1.170A-13(b)(1).

Section 1.170A-13(b) provides rules concerning recordkeeping and return requirements for charitable contributions of property other than money. Section 1.170A-13(b)(1) provides the general rule that, except for cases covered by § 1.170A-13(c), any taxpayer who makes a charitable contribution of property other than money shall maintain for each contribution a receipt from the donee showing the following information: (i) The name of the donee; (ii) The date and location of the contribution; and (iii) A description of the property in detail reasonably sufficient under the circumstances. Although the fair market value of the property is one of the factors to be taken into account in determining the amount of detail to be included on the receipt, such value need not be stated on the receipt. A letter or other written communication from the donee acknowledging receipt of the contribution, showing the date of the contribution, and containing the required description of the property contributed constitutes a receipt for purposes of this paragraph.

Under the property donation program described above, LLC, on behalf of Charity, will send a “thank you letter” to each donor upon receipt of a vehicle. A copy of this type of letter was submitted with the ruling request. It contains detailed information (some of which is apparently to meet the requirements of the state donation law) and is on the letterhead of the LLC. LLC agrees to send to a donor, within 40 days after donation of a vehicle, an “official receipt” from Charity on forms provided by Charity. An example of this type of receipt letter was submitted. It contains less detailed information than the thank you letter and is on the letterhead of Charity.

The thank you letter includes all of the information required by § 1.170A-13(b)(1) and meets the requirements of a “letter or other written communication from the donee.” As previously discussed with your authorized representative, the receipt letter does not meet these requirements.

c. Whether the thank you letter satisfies the requirements of § 170(f)(8).

Section 1.170A-1(c)(1) provides that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in § 170(e)(1) and § 1.170A-4(a), or

PLR-111975-01

§ 170(e)(3) and § 1.170A-4A(c). Section 1.170A-1(c)(2) provides that the fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.

Section 170(f)(8)(A) provides the general rule that no deduction shall be allowed for any contribution of \$250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization that meets the requirements of § 170(f)(8)(B). Section 170(f)(8)(B) provides that an acknowledgment must contain the following information: (i) The amount of cash and a description (but not value) of any property other than cash contributed; (ii) Whether the donee organization provided any goods or services in consideration, in whole or in part, for any property described in clause (i); and (iii) A description and good faith estimate of the value of any goods or services referred to in clause (ii) or, if such goods or services consist solely of intangible religious benefits, a statement to that effect. Section 170(f)(8)(C) provides that an acknowledgment shall be considered to be contemporaneous if the taxpayer obtains the acknowledgment on or before the earlier of (i) the date on which the taxpayer files a return for the taxable year in which the contribution was made, or (ii) the due date (including extensions) for filing such return.

Section 1.170A-13(f) provides rules for substantiation of charitable contributions of \$250 or more. Section 1.170A-13(f)(1) provides, in part, that no deduction is allowed under § 170(a) for all or part of any contribution of \$250 or more unless the taxpayer substantiates the contribution with a contemporaneous written acknowledgment from the donee organization. Section 1.170A-13(f)(2) provides that, except as otherwise provided in § 1.170A-13(f)(8) through (f)(11) and (f)(13), a written acknowledgment from a donee organization must provide the following information: (i) The amount of any cash the taxpayer paid and a description of any property other than cash the taxpayer transferred to the donee organization; (ii) A statement of whether or not the donee organization provides any goods or services in consideration, in whole or in part, for any of the cash or other property transferred to the donee organization; (iii) If the donee organization provides any goods or services other than intangible religious benefits, a description and good faith estimate of the value of those goods or services; and (iv) If the donee organization provides any intangible religious benefits, a statement to that effect.

Section 1.170A-13(f)(3) provides that a written acknowledgment is contemporaneous if it is obtained by the taxpayer on or before the earlier of (i) the date the taxpayer files the original return for the taxable year in which the contribution was made, or (ii) the due date (including extensions) for filing the taxpayer's original return for that year.

The thank you letter could satisfy the requirements of § 170(f)(8) but for the fact that it does not currently indicate whether any goods or services were provided in consideration for the contribution. Because LLC is properly authorized by Charity, it

PLR-111975-01

may issue on behalf of Charity a thank you letter appropriately modified to comply with the statutory and regulatory requirements, and such a letter would satisfy the requirements of § 170(f)(8), assuming it is received by a donor within the prescribed time periods. We have enclosed a copy of the advanced text of Publication 1771, Charitable Contributions – Substantiation and Disclosure Requirements, which is currently available on the IRS website. This publication provides examples of written acknowledgments that satisfy the requirements of § 170(f)(8) and also discusses how an organization can provide the acknowledgment electronically, such as by e-mail.

d. Whether the appraisal summaries for property valued in excess of \$5,000 will be signed in accordance with § 1.170A-13(c)(4)(iii).

Section 1.170A-13(c) provides rules concerning recordkeeping and return requirements for deductions in excess of \$5,000 claimed for certain charitable contributions of property. Section 1.170A-13(c)(1)(i) provides, in part, the general rule that no deduction under § 170 shall be allowed with respect to a charitable contribution to which this paragraph applies unless the substantiation requirements of § 1.170A-13(c)(2) are met.

Section 1.170A-13(c)(2)(i) provides the general rule that (except as provided in § 1.170A-13(c)(2)(ii)) a donor who claims or reports a deduction with respect to a charitable contribution to which § 1.170A-13(c) applies (deductions in excess of \$5,000) must comply with the following three requirements: (A) Obtain a qualified appraisal for such property contributed; (B) Attach a fully completed appraisal summary to the tax return on which the deduction for the contribution is first claimed (or reported) by the donor; and (C) Maintain records containing the information required by § 1.170A-13(b)(2)(ii).

Pursuant to § 1.170A-13(c)(4)(i)(B), the appraisal summary is signed and dated by the donee. Section 1.170A-13(c)(4)(iii) provides that the person who signs the appraisal summary for the donee shall be an official authorized to sign the tax or information returns of the donee, or a person specifically authorized to sign appraisal summaries by an official authorized to sign the tax or information returns of such donee. The signature of the donee on the appraisal summary does not represent concurrence in the appraised value of the contributed property. Rather, it represents acknowledgment of receipt of the property described in the appraisal summary on the date specified in the appraisal summary and that the donee understands the information reporting requirements imposed by § 6050L and § 1.6050L-1. In general, § 1.6050L-1 requires the donee to file an information return with the Internal Revenue Service in the event the donee sells, exchanges, consumes, or otherwise disposes of the property (or any portion thereof) described in the appraisal summary within two years after the date of the donor's contribution of such property.

In the property donation program described above, the parties acknowledge that an authorized representative of Charity may sign Forms 8283. LLC may, when requested by Charity, provide signatures for Forms 8283 on behalf of Charity pursuant to a Power of Attorney. This arrangement, when properly implemented, will result in appraisal

PLR-111975-01

summaries signed in accordance with § 1.170A-13(c)(4)(iii). As a general matter, we note that even if a claimed charitable deduction is not in excess of \$5,000 and therefore not subject to the above described rules, a taxpayer still may need to use a Form 8283 because Schedule A (Itemized Deductions) for Form 1040 (U.S. Individual Income Tax Return) requires a taxpayer to complete and attach Form 8283 if the deductions for the claimed gifts to charity other than by cash or check are more than \$500.

With respect to Issue 1, based on the facts submitted and the representations made, we conclude that donations made through the property donation program may qualify for a charitable contribution deduction under § 170 of the Code, subject to the limitations of that section.

Issue 2 – Whether Charity’s exempt status under § 501(c)(3) is adversely affected by this program.

Section 501(c)(3) of the Code provides that to qualify for exemption from federal income tax under this Code section an organization must be organized and operated exclusively for charitable purposes. Such an organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. See § 1.501(c)(3)-1(c)(1) of the Income Tax Regulations. The presence of a single non-exempt purpose will preclude exemption under § 501(c)(3). See Better Business Bureau v. United States, 326 U.S. 279 (1945). The proposed vehicle donation program raises two issues: whether it violates the inurement or private benefit prohibitions under § 501(c)(3).

An organization is not operated exclusively for exempt purposes if the organization’s net earnings inure to the benefit of any private shareholder or individual. See § 1.501(c)(3)-1(c)(2). The term “private shareholder or individual” is defined as persons having a personal and private interest in the activities of the organization. See § 1.501(a)-1(c). Inurement occurs where earnings of an exempt organization are provided to insiders. Inurement includes any compensation for services provided to insiders unless the compensation is not excessive or unreasonable. See United States v. Dykema, 666 F.2d 1096 (7th Cir. 1981), and Unitary Mission Church v. Commissioner, 74 T.C. 507 (1980), aff’d without published opinion, 647 F.2d 163 (2d Cir. 1981). Reasonable compensation is a question of fact. See Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1996).

In the proposed written agreement, Charity is to compensate LLC under a contingent compensation arrangement. LLC is compensated on a specified percentage of gross proceeds received from the sale or disposition of the donated property. Because LLC is the agent of Charity, we conclude that LLC is an insider or private individual within the meaning of § 1.501(a)-1(c) of the regulations. The issue then is whether the contingent compensation provision in the agreement constitutes prohibited inurement to LLC.

PLR-111975-01

A contingent compensation agreement may create a conflict of interest between serving the personal interest of the service provider and maximizing the donated funds for the charitable organization. Nevertheless, such an agreement does not constitute inurement if certain factors are present. First, the agreement was negotiated at arm's length, and the service provider has no participation in the management or control of the exempt organization. Second, the agreement serves a real and discernible business purpose of the exempt organization independent of any purpose to operate the organization for the direct or indirect benefit of the service provider. Third, the amount of the compensation is not dependent principally upon incoming revenue of the exempt organization, but is dependent on the accomplishment of the objectives described in the agreement. Fourth, there is no evidence of abuse or unwarranted benefits.

In this situation, the first factor is satisfied because the agreement between LLC and Charity was negotiated at arm's length. Charity represents that no director or officer of Charity and Local Chapter has a proprietary or familial relationship with LLC, Corporation, or the individual who owns 1% of LLC. We note that neither Corporation nor the individual serves in any capacity as board member or officer of Charity or Local Chapter. The second factor is satisfied because the agreement serves a real purpose, not merely to confer financial benefit to LLC, Corporation, or the individual. Specifically, Charity represents that it and Local Chapter lack resources to process donated property, and LLC has the ability and resources to accomplish Charity's objectives for its property donation program. Further, almost all of the donated property is expected to be in the form of used motor vehicles, and there are no indications that the method of compensation is not customary in the buying, dismantling, and selling of used motor vehicles. The third factor is satisfied because LLC's compensation is dependent on LLC accomplishing its duties as agent and not on Charity's other sources of funding. The final factor is satisfied because there are no indications that the benefit to LLC under the agreement is unwarranted. Hence, we conclude that the compensation provision in the agreement does not constitute inurement under § 501(c)(3) of the Code. See Rev. Rul. 69-383, 1969-2 C.B. 113.

An organization also does not operate exclusively for exempt purposes if it operates for the benefit of private interests. See § 1.501(c)(3)-1(d)(1)(ii). The proscription against private benefit also includes benefits conferred on unrelated or disinterested persons. See American Campaign Academy v. Commissioner, 92 T.C. 1053, 1068 (1989). Hence, private benefit also occurs where non-incidentally benefits that serve private interests are conferred on unrelated or disinterested individuals. The issue is whether the property donation program benefits Corporation or the individual more than incidentally. We note that Charity and Local Chapter are not created by Corporation or the individual. No board member or officer of Charity and Local Chapter, as described previously, is a board member or officer of Corporation or the individual, or vice versa. Hence, Charity and Local Chapter are not captive organizations of Corporation or the individual. Further, the agreement was negotiated at arm's length. The property donation program would occur without Corporation or the individual since Charity and Local Chapter could appoint another agent to operate this fundraising program. Thus,

PLR-111975-01

we conclude that the property donation program does not benefit Corporation or the individual more than incidentally.

Because we conclude that the contingent compensation provision in the agreement and the property donation program described in the agreement do not violate the inurement and private benefit prohibitions under § 501(c)(3) of the Code, we conclude that Charity's exempt status under § 501(c)(3) is not adversely affected.

Issue 3 -- Whether this program constitutes an unrelated trade or business under §§ 511-513.

Section 511 of the Code provides, in part, for the imposition of tax on the unrelated business taxable income of organizations described in § 501(c), including § 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 (defined by § 513) regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business.

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 the 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 or function that constitutes the basis for its exemption under § 501.

However, § 513(a)(3) of the Code provides that the term "unrelated trade or business" does not include any trade or business, which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions. See § 1.513-1(e)(3).

In the situation here, Charity and Local Chapter plan to receive donated property and resell it to generate funds. Also, there are no indications that the donated property items are not gifts. Hence, we conclude that revenue derived from the sales of donated property will not constitute unrelated trade or business under the exception described in § 513(a)(3) of the Code and § 1.513-1(e)(3) of the regulations.

CAVEATS:

The rulings contained in this letter are based upon information and representations submitted by the organization and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings, and it is subject to verification on examination.

Because this letter could help resolve any future questions about your income tax responsibility, please keep a copy of this letter ruling in your permanent records.

PLR-111975-01

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directed only to the organization requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,
KARIN GROSS
Senior Technician Reviewer, Branch 1
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures:

Copy of this letter
Copy for section 6110 purposes
Publication 1771