



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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- UIL Nos.
501.03-08
501.03-30
4941.04-00
170.00-00
162.00-00
513.00-00

Dear *****:

This letter responds to your request for guidance on tax laws that affect corporate giving to charities for educational training programs whose trainees may go on to work for the corporate donors. We understand that ***** is conducting a ***** on ***** , and will be conducting a workshop on ***** that will encourage corporations to invest in local training programs conducted by charities.

Section 501(c)(3), Educational Purposes, and Private Benefit

Organizations described in section 501(c)(3) of the Internal Revenue Code ("charities") may be operated for educational purposes. The conduct of vocational training programs is generally regarded as an appropriate educational activity for charities. The Internal Revenue Manual, sections 7.25.3.7.8 and 7.25.3.7.9 (available online at http://www.irs.gov/irm/part7/), discusses vocational training and educational organizations affiliated with businesses and professions.

One of the requirements of section 501(c)(3) is that the organization be operated exclusively for exempt purposes. An organization is not operated exclusively for exempt purposes if it serves a private interest rather than a public interest. See section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations. Any private benefit derived from the operation of a charity must be incidental to the accomplishment of exempt purposes and not substantial in relation to the public benefit.

In the context of corporate sponsorship of training programs, the question is not simply whether the training program is educational. A training program may be educational, but yet operated in a manner that substantially benefits a corporate employer. In such case, the charity would not be operated exclusively for educational purposes. This could be the case if, for instance, the training program was not available to the public but limited to employees of the particular corporate donor, or if the trainees were obligated in some manner to go on to work for the corporate donor.

Rev. Rul. 68-504, 1968-2 C.B. 211, held exempt under section 501(c)(3) a nonprofit organization that conducted an educational program for bank employees in a particular urban area. Students were required to be members of the organization, but membership was open to

employees of all banks in the area.

Section 4941—Self-Dealing

501(c)(3) organizations that are private foundations must, in addition to avoiding private benefit, not engage in acts of self-dealing, as defined in section 4941 of the Code. Self-dealing includes use of private foundation assets for the benefit of a disqualified person, such as a corporate sponsor, but not where the benefit to the disqualified person is merely incidental or tenuous.

Rev. Rul. 80-310, 1980-2 C.B. 319, held that a private foundation's grant to a university to establish a department providing instruction in manufacturing engineering did not constitute an act of self-dealing under section 4941. A disqualified person manufacturing corporation was located in the same city as the foundation and university and intended to employ graduates of the new program and encourage its employees to enroll in the program. However, the corporation and its employees would not receive preferential treatment in admissions or recruitment. It was expected that a number of other manufacturers and their employees, including competitors of the corporation, would seek admissions and recruitment.

Sections 170 and 162

Taxable corporations may claim a deduction under section 170 (limited to 10% of taxable income) for charitable contributions. Corporations may also claim a deduction under section 162 for ordinary and necessary business expenses. The question sometimes arises whether a transfer by a corporation is a charitable contribution or a business expense. Under section 162(b), charitable contributions do not qualify as business expenses. Section 1.170A-1(c)(5) of the regulations provides that transfers of property to a charity which bear a direct relationship to the taxpayer's trade or business and which are made with a reasonable expectation of financial return commensurate with the amount of the transfer may constitute allowable deductions as trade or business expenses rather than as charitable contributions.

McDonnell Aircraft Corp. v. Commissioner, 16 T.C. 189 (1951), held not deductible as a business expense a cash donation to a university intended for conducting an aeronautical engineering course, over half the students of which were employees of the donor, where there was no binding obligation on the university to use the funds for the course. The court reasoned that the donation was in the nature of a charitable contribution.

Singer Co. v. U.S., 449 F.2d 413 (Ct.Cl. 1971), involved a sewing machine company's discount sales of sewing machines to schools and other charities. The company claimed a section 170 deduction for the gift element of all sales. The court noted that the company historically controlled 90% of the U.S. school market for sewing machines, although foreign competition was increasing. The court agreed with the Commissioner's finding that the sales to the schools were not of a charitable nature because the predominant purpose was to encourage the schools to interest and train young women in the art of machine sewing, and on Singer machines, thereby enlarging the potential market for the company's products. Sales to the other charities were deductible because the company did not expect the same type of benefits in return and the primary purpose was to assist the charitable organizations. The court noted the legislative history of section 162(b) that gifts are contributions made with no expectation of financial return commensurate with the amount of the gift. The court set forth a standard that if the contributor's benefits received, or expected to be received, are substantial, and meaning by that, benefits greater than those that inure to the general public from transfers for charitable

purposes (which benefits are merely incidental to the transfer), then the transferor has received a quid pro quo precluding a 170 deduction.

Another question that arises in the context of charitable contributions is whether the contribution is really to the charity, or to another person. If a contribution made to a charity is earmarked for the benefit of a particular person or non-charitable organization under an express or implied agreement, then the contribution is not deductible as a charitable contribution to the charity. The charity must have discretion and control over the use of the funds. See, e.g., Rev. Rul. 62-113, 1962-2 C.B. 10. It is permissible to recommend that the contribution be used to support a particular program of the charity (such as a training program), but the contribution cannot be designated for the tuition of particular individuals.

Section 513(i)--Qualified Sponsorship Payments

Charities, although tax-exempt under section 501(c)(3), may still owe tax on income from the conduct of an unrelated business under sections 511-514. Section 513(i) of the Code, pertaining to sponsorship payments, deals with the question whether a payment by a corporation to a charity constitutes taxable income to the charity from an unrelated business. There is no taxable income to the charity if the payment is a qualified sponsorship payment—i.e., there is no arrangement or expectation that the charity will receive any substantial return benefit other than the use or acknowledgement of the name or logo (or product lines) of such corporation's trade or business in connection with the activities of the charity. Such use or acknowledgement does not include advertising such corporation's products or services (including messages containing qualitative or comparative language, price information, or other indications of savings or value, an endorsement, or an inducement to purchase, sell, or use such products or services). The fact that a payment is a qualified sponsorship payment does not, however, determine whether the payment is deductible by the corporation under section 162 or 170.

We hope this general information is helpful to you in the conduct of your program. This letter is not, however, a ruling, and may not be relied on as such. Taxpayers may wish to request a letter ruling from the IRS regarding the tax consequences of a transaction they plan to engage in, under the procedures of Rev. Proc. 2006-1 or 2006-4 (available online at www.irs.gov/irb/2006-01_IRB/index.html).

If you need further assistance, please call me at _____ or _____ at _____.

Sincerely,

David L. Fish
Manager
Exempt Organizations
Technical Guidance & Quality
Assurance Group 2