



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **201219024**

Release Date: 5/11/2012

Date: February 16, 2012

Uniform Issue List Number:

501.00-00

511.00-00

513.00-00

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

<u>Taxpayer</u>	=
<u>State</u>	=
<u>Program</u>	=
<u>Brand</u>	=
<u>International Corporation</u>	=
<u>Program Affiliates</u>	=
<u>Date 1</u>	=
<u>Date 2</u>	=
<u>Date 3</u>	=
<u>x1</u>	=
<u>x2</u>	=
<u>x3</u>	=

Dear

This is in response to your letter dated November 8, 2010, requesting a ruling that your reorganization will not adversely affect your tax-exempt status under § 501(c)(3) of the Internal Revenue Code (Code); will not adversely affect your public charity status under §§ 509(a)(1) and 170(b)(1)(A)(vi); will not revoke or terminate your group tax exemption for the benefit of subordinate organizations operating in the United States; and will not generate any unrelated business taxable income under §§ 511 through 514.

FACTS:

You, Taxpayer, are a nonprofit corporation organized under the laws of State. You are recognized as an organization described in § 501(c)(3) of the Code and as a public charity described in §§ 509(a)(1) and 170(b)(1)(A)(vi). You educate youth in productive enterprise in industry, commerce, and business through concepts and practices of work readiness,

entrepreneurship, financial literacy, business, ethics, and related educational materials and methods.

In furtherance of these purposes, you operate the Program in the United States and throughout the world. For the five year period ending Date 1, your total revenues averaged \$x1 and your support from gifts and grants, exclusive of contributions from any person in excess of 2 percent of your total support, averaged \$x2, or 83% of your total revenue.

You implement the Program through Program Affiliates that are incorporated separately in the United States and internationally. Each Program Affiliate formed within the United States is operated as a separate charitable organization, and you are the central organization charged with administering a group tax exemption under Rev. Proc. 80-27, 1980-1 C.B. 677, for these Program Affiliates. Program Affiliates formed and operating outside the United States are formed as charitable organizations under the applicable law of their jurisdiction, and they are not included in your group exemption.

All Program Affiliates implement the Program in their geographic area in accordance with the terms and conditions of your standard "operating agreement." Under this agreement, each Program Affiliate is granted the right to use the Brand and carry out the Program in the geographic area designated in the agreement, and each is required to operate in conformity with your policies and procedures. You agree under the agreement to develop and make the Program and Program materials available to the Program Affiliate, and you are granted certain financial review and governance rights, including the right to remove Program Affiliate board members, receive financial and operational reports from the Program Affiliate, and inspect Program Affiliate books and records. You plan to make some changes to your U.S. operating agreement, most of which are either for clarification purposes, to incorporate and memorialize past practices, or to increase the accountability of Program Affiliates to you.

In the last 15 years, as part of your expanded mission to educate students all across the world, you have established Program Affiliates in more than x3 countries. Your relationship with each of these affiliates is also governed by an operating agreement that provides you with the same financial review and governance rights as you have with domestic Program Affiliates. International Program Affiliates are subordinate to you by virtue of these operating agreements.

To enhance the development of the Program internationally, your board of directors on Date 2 established a new entity, International Corporation, whose principal purpose is to oversee the implementation and operation of the Program outside of the United States. On Date 3, the Service determined that International Corporation is exempt from federal income tax under § 501(c)(3) and is a public charity described in § 170(b)(1)(A)(vi), effective Date 2.

Pursuant to a series of transactions in your reorganization, you will transfer certain assets to International Corporation for no consideration. Specifically, you will transfer the following:

- (1) Program brands, logos, trademarks, service marks, trade names, goodwill, and other related branding, subject to a right of reversion (in the event of, e.g., International Corporation's bankruptcy or dissolution). International Corporation will have the right to sub-license the Brand to Program Affiliates outside of the United States. No for-profit entity or person will be granted the right to use the Brand for any purpose;

- (2) The operating agreements that you have with Program Affiliates located outside the United States;
- (3) All rights and obligations under grant and other funding agreements for programs outside the United States; and
- (4) All funds, which by virtue of grant agreements and other transfer documents, restricted for use in your international programs.

International Corporation will assume certain liabilities relating to these transferred assets. Pursuant to written agreements, International Corporation will use all transferred assets and conduct its operations exclusively to carry out the Program in accordance with all requirements necessary to maintain its status as an organization described in § 501(c)(3).

International Corporation will grant a license back to you to use, sublicense, and otherwise enjoy the Brand, with the intent that you will sublicense (or continue to sublicense) the Brand to U.S. Program Affiliates. You intend to treat any of the royalty payments received from the U.S. Program Affiliates as "within unrelated business taxable income except to the extent provided under Code Section 512(b)(13)."

In exchange for this license, you will pay a fee to International Corporation equal to one percent of your gross revenue and that of all U.S. Program Affiliates. You will pay this fee to provide International Corporation with a relatively stable funding stream to advance your goal of continuing the implementation of the Program internationally. Without this funding, International Corporation and international Program Affiliates would be unable to maintain the Program at their existing levels.

You will also create six "Regional Operating Centers" to permit oversight and governance and administration of the Program on a region-by-region basis throughout the world. You will serve as the Regional Operating Center for U.S. Program Affiliates. The regional centers will be formed under the laws of the United States or the foreign country within which they serve. Some of the centers may seek recognition as charitable organizations under § 501(c)(3). International Corporation will ensure that the centers operate for your charitable purposes, it will expend funds in accordance with Service expenditure responsibility requirements applicable to gifts to foreign charities, and it will enter appropriate agreements with the centers to effectuate these provisions. Regional Operating Centers will engage in a variety of activities relating to Program Affiliates within their region, including enforcing the duties of the affiliates under operating agreements, registering trade names, providing oversight and direction, developing a strategic plan to implement the Program in their region, and exercising expenditure responsibility over grants made to Program Affiliates in their region.

You will amend and restate your articles of incorporation and bylaws. Under these changes, you will revise the composition and manner of the appointment of your board of directors, International Corporation will have certain rights to approve amendments to your articles and bylaws, will have the right to approve changes in your standard operating agreement, and its president/chief executive officer will serve as a non-voting, ex-officio member of your board of directors. International Corporation will not have the right to appoint or elect your directors.

Following the reorganization:

- (1) International Corporation will oversee the implementation and operation of the Program outside the United States. Pursuant to operating agreements International Corporation will have with non-U.S. Program Affiliates, the affiliates will carry out the Program per Program policies and procedures, provide International Corporation with annual financial accounting information, and permit International Corporation to audit their operations. International Corporation will also control the actions of those affiliates by approving their board members.
- (2) You will oversee the implementation and operation of the Program within the United States.
- (3) You will maintain a close working relationship with International Corporation.
- (4) International Corporation will make grants to international Program Affiliates, and it will exercise control and discretion over those grants. It will ensure that funds for international grants have been expended in accordance with the charitable purpose of the grants, through audit and financial review rights contained under operating agreements with international Program Affiliates.
- (5) You will continue to serve as the central organization administering your group tax exemption for all U.S. Program Affiliates under Rev. Proc. 80-27, supra. You will continue to assure that U.S. Program Affiliates qualify as charitable organizations under § 501(c)(3) of the Code and that they operate consistently with the requirements of § 501(c)(3). You will remove from your group exemption any U.S. Program Affiliate that fails to comply with these requirements. None of the Regional Operating Centers will be included in your group exemption.
- (6) Your sources of support are not expected to materially change, and you anticipate that more than 75 percent of your total support will come from public sources.

RULINGS REQUESTED:

- (1) The reorganization and the proposed changes to your activities will not adversely affect your exempt status under § 501(c)(3);
- (2) The reorganization and proposed changes to your activities will not adversely affect your public charity status under §§ 509(a)(1) and 170(b)(1)(A)(vi);
- (3) The reorganization will not revoke or terminate your group exemption for the benefit of U.S. Program Affiliates under Rev. Proc. 80-27, supra; and
- (4) The reorganization itself will not give rise to unrelated business taxable income attributable to you within the meaning of § 512(a)(1).

LAW:

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for religious, charitable, or educational purposes.

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

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 functions constituting the basis for its exemption.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (regulations) provides that to be exempt as an organization described in § 501(c)(3), an organization must be both organized and operated exclusively for one or more purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for exempt purposes only if it engages primarily in activities that accomplish one or more of the 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.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that "charitable" is used in its generally accepted legal sense and includes the advancement of education.

Section 1.513-1(a) of the regulations defines "unrelated business taxable income" to mean gross income from any unrelated "trade or business" regularly carried on.

Section 1.513-1(b) of the regulations states that the phrase "trade or business" includes activities carried on for the production of income and which possess the characteristics of a trade or business within the meaning of § 162.

Section 1.513-1(c) of the regulations explains that "regularly carried on" has reference to the frequency and continuity of the conduct of an activity and the manner in which the activity is pursued.

Rev. Proc. 80-27, 1980-1 C.B. 677, provides the procedures under which recognition of exemption from federal income tax under § 501(c) may be obtained on a group basis for subordinate organizations affiliated with and under the general supervision or control of a central organization.

ANALYSIS:

Ruling 1

Currently, you are recognized as exempt from taxation under § 501(c)(3). You operate the Program, which educates youth in productive enterprise in industry, commerce, and business through concepts and practices of work readiness, entrepreneurship, financial literacy, business, ethics, and related educational materials and methods. After the reorganization, you will engage in the same activities and perform the same functions as you did before the reorganization, but will simply be limiting your responsibility to the implementation of the Program within the United States. You will retain substantially the same duties and responsibilities in relation to U.S. Program Affiliates as you had before the reorganization. International Corporation, an organization also recognized as exempt under § 501(c)(3), will oversee the implementation and operation of the Program outside the United States. You will maintain a close working relationship with International Corporation, and International Corporation will assume your duties and responsibilities in relation to non-U.S. Program Affiliates pursuant to the same operating agreements you currently have with those affiliates.

To effectuate the reorganization, you will transfer assets to International Corporation to carry out what were your pre-reorganization international activities. Pursuant to written agreements, International Corporation will use all transferred assets and conduct its operations exclusively to carry out the Program in accordance with all requirements necessary to maintain its status as an organization described in § 501(c)(3). You have instituted safeguards within your reorganization documents to ensure that International Corporation (and the Regional Operating Centers) will use all transferred assets to further your exempt purposes. Your creation of Regional Operating Centers will further facilitate the delivery of the Program internationally, by providing for an additional layer of oversight and organization of international Program Affiliates.

While you will make these transfers to International Corporation for no consideration and pay a fee to use the Program license within the United States, you are making these transfers to another § 501(c)(3) organization to further your exempt purposes. The license fee you will pay to International Corporation will provide it with a relatively stable funding stream to advance your goal of continuing the implementation of the Program internationally. Without this funding, International Corporation and its international Program Affiliates will be unable to maintain the Program at their existing levels.

In all, you will engage in each reorganization-related activity for the purpose of expanding the delivery of your Program and your exempt activities throughout the world. Your proposed reorganization will not adversely affect your tax-exempt status under § 501(c)(3).

Ruling 2

You will continue to qualify as a public charity under §§ 509(a)(1) and 170(b)(1)(A)(vi) of the Code, given that you will receive a substantial part (i.e., an estimated 75 percent) of your financial support in the form of contributions from a governmental unit, the general public, or a combination of these sources.

Ruling 3

You will continue to serve as the central organization administering your group exemption under the provisions of Rev. Proc. 80-27, supra. You will continue to assure that U.S. Program Affiliates qualify as charitable organizations under section 501(c)(3) of the Code and that they operate consistently with the requirements of section 501(c)(3). You will remove from your group exemption any U.S. Program Affiliate that fails to comply with these requirements. Program Affiliates located outside the United States will not be included in your group exemption. Assuming that you and your U.S. Program Affiliates continue to satisfy all other requirements of Rev. Proc. 80-27, your reorganization will not revoke or terminate your group exemption for the benefit of your U.S. Program Affiliates.

Ruling 4

You have requested a ruling that the reorganization will not give rise to unrelated business taxable income under § 512(a)(1). This request was not "intend[ed] to address the issue of whether royalty payments to be received by [you] will themselves be treated as unrelated business income." Therefore we are not ruling specifically on the effect of § 512(b)(13) on unrelated business taxable income (if any) arising from the reorganization. You do acknowledge that you will treat "royalty payments received from the [U.S. Program Affiliates] as within unrelated business taxable income except to the extent provided under [§] 512(b)(13)."

The reorganization itself will not result in unrelated business income attributable to you under § 512(a)(1). Section 511(a) imposes a tax on the "unrelated business taxable income" of organizations described in § 501(c). Pursuant to § 512(a)(1) "unrelated business taxable income" is defined as "gross income derived by an organization from any unrelated trade or business that is regularly carried on by the organization."

In analyzing whether income from a trade or business is unrelated business income, you must determine whether that trade or business is "regularly carried on." Whether a trade or business is "regularly carried on" within the meaning of § 512 depends on the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. § 1.513-1(c)(1). Because your reorganization, as well as all related transactions, will occur only on a one-time basis, it does not possess the characteristics of a trade or business regularly carried on within the meaning of § 512(a)(1).

RULINGS:

Based on the information submitted, including the facts and circumstances described above, we rule as follows:

- 1) The reorganization and the proposed changes to your activities will not adversely affect your exempt status under section 501(c)(3) of the Code;
- 2) The reorganization and proposed changes to your activities will not adversely affect your public charity status under sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code;
- 3) The reorganization will not revoke or terminate your group tax exemption for the benefit of U.S. Program Affiliates under Rev. Proc. 80-27, supra; and

- 4) The reorganization will not give rise to unrelated business taxable income to you under section 511.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald Shoemaker
Manager, Exempt Organizations
Technical Group 2

Enclosure

Notice 437

cc: