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INTERNAL REVENUE SERVICE  
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TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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M =  
N =  
P =  
Q =  
Villages =

County =  
Entity 1 =  
Entity 2 =  
Entity 3 =  
Entity 4 =  
Region =  
State =  
Year X =  
PLR =

Dear :

We have considered M's letter dated November 30, 2009, requesting rulings on the federal income tax consequences of the activities described below.

### Facts

M is organized as a nonprofit corporation under state law. According to its Articles of Incorporation, M is organized exclusively for charitable purposes within the meaning of § 501(c)(3) of the Internal Revenue Code. In particular, M exists to:

- (1) Promote local economic development in the A/B area, including fisheries development and protection and conservation of A Fishery resources, within, but not limited to, the purview of the C program (established by the D Council and approved by the United States Secretary of E), the purpose of which is to provide disadvantaged Region communities the ability to develop a sustainable local economy. Under the C program, the communities may lease the harvest quota and use the proceeds for fishery development projects which are clearly identified and lead to the development of a sustainable local economy based upon fishery resources. In this regard, M will provide a forum in which local fishermen's associations (representing the Villages) can coordinate and maximize (as a united group) the economic opportunities available to them under the C program. In part, M will negotiate the terms of the lease of the harvest quota and provide assistance to the fishermen's associations; and
- (2) Submit the proposal to the State of State with regard to the allocation of the harvest quota available to the communities represented by M, and manage the C allocation so received.

M is exempt from federal income taxation under § 501(a) as an organization described in § 501(c)(3). M is classified as a publicly-supported organization described in section 170(b)(1)(A)(vi).

### *The C Program*

The D Council originally established the C program ("the Program") in State. The Council included the C provision based on the determination that Cs could spur economic development in nearby economically depressed coastal communities without greatly impacting the existing fishing industry.

The Program was later incorporated into the F Act through the G Act. The Act establishes the Program in order to—

- 1) Provide eligible Region villages with the opportunity to participate and invest in fisheries in the A and B area;
- 2) Support economic development in Region;
- 3) Alleviate poverty and provide economic and social benefits for residents of Region; and
- 4) Achieve sustainable and diversified local economies in Region.

The committee report on the G Act underlying the Program explains that Region fishermen did not have a fair and equitable opportunity to benefit from the area fishing because they lacked the necessary capital investment.

The F Act was amended by the H Act. The H Act addresses all aspects of the management and oversight of the Program. The Conference Report of the H Act sets forth the intent of Congress that all activities of the groups participating in the Program continue to be considered tax-exempt so that they can more readily address the pressing economic needs of the region.

M is the managing entity of a participating group comprising the Villages (the "member communities"). The amended F Act requires managing entities to be governed by a board of directors composed primarily of resident fishermen from the entity's member communities. The managing entity must make most of its annual investments in fisheries-related projects, but may make a certain portion of investments in other local projects for the benefit of the community.

The federal agency construing and implementing the Program made clear that the requisite "investments" need not be made in other entities but could involve the direct operation of fisheries-related businesses by the participating groups themselves, with the ultimate objective of developing a self-sustaining local commercial industry. See I.

#### *Participating Communities*

The Report of the House Committee, in discussing the Program, describes the participating communities as among the poorest and most underdeveloped in the nation, with high unemployment and social problems and few natural resources other than fisheries to use in developing the economy. Fish allocations are intended to provide them with a sustainable fishing economy.

#### *Allocations*

A federal agency within the Department of E allocates a portion of the annual catch limits for a variety of commercially valuable marine species in the area to the Program. These apportionments are in turn allocated among several non-profit managing organizations representing different affiliations of communities ("Groups"). Groups use the revenue derived from the harvest of their fisheries allocations as a basis for funding economic development activities and for providing employment opportunities.

As one of the managing entities in the Program, M receives fish allocations from the federal agency. Initially, M opted to lease its allocation to outside fish processing companies in which it has either no ownership interest or minority ownership interests. Subsequently, M began to vertically invest in the fisheries, in part, to provide greater employment and training opportunities for residents of its member communities. Specifically, M currently has ownership interests in some of the for-profit taxable entities that harvest its allocations. These ownership interests are through a wholly-owned for-profit subsidiary, P. In addition to the fees it receives for harvesting its allocation, M indirectly receives a share of the net income earned by the for-profit entities based on P's percentage interest in the entity. In the future, M may elect to engage in

harvesting, processing, marketing, and selling some or all of the species it currently leases.

#### *Harvesting of M's Allocations*

M receives income from N LLC for the right to harvest M's allocation of a particular fish species. N LLC is a State limited liability company that owns the FT N, a fishing trawler. FT N harvests, processes, markets, and sells part of that allocation. The harvest agreements are competitive in the industry. P has purchased a substantial ownership interest in N LLC, but neither M nor P is involved in the management of, or provides any personal services to, the N LLC or FT N.

M also receives payments from unrelated third parties for the right to harvest, process, market, and sell M's allocations of certain other fish species. The harvested species are delivered to shoreside processing plants located in M's member communities for processing. The harvest agreements for these species are negotiated and structured substantially the same as the N harvesting agreement.

M's allocations of yet other fish species are harvested by entities in which M has an ownership interest through P. P owns a substantial ownership interest in three State limited liability companies that each own vessels that harvest a part of those allocations. In addition, P maintains a 50 percent interest in two limited liability companies that harvest another part of those allocations. P is not engaged in the management of, nor does it provide services to, any of the companies. M's management negotiates arms-length agreements with the managing partners of the companies at rates that are competitive in the industry. These agreements require that the companies employ qualified residents of M's member communities.

Finally, M's allocations of still another fish species are harvested by vessels that are either owned and managed by Q, a wholly-owned subsidiary of P, or by individuals from M's member communities. Part of the catch is delivered to a shoreside processing plant in the Villages. Another part is harvested by a vessel owned and managed by Q, and delivered to the shoreside processing plant recently constructed in the Villages.

M uses the income it receives from the harvesting of its allocations to promote economic development in its member communities through: (i) training and education grants to stakeholders who live in the communities, (ii) infrastructure development such as docks and shoreside fish processing facilities; and (iii) the purchase of equity interests in various business enterprises associated with the fishing industry in these communities. A substantial portion of such income has been spent directly for scholarships and grants.

#### *Infrastructure Investments*

M has followed a two-pronged approach to infrastructure development: (i) build appropriate infrastructure in each community to support the formation of local businesses, and (ii) utilize capital for opportunistic purchases of harvesting or processing vessels, facilities, and fishing rights. Since all of the member communities are isolated and lack infrastructure, economic development options are largely limited to fisheries-related activities.

M has made a number of infrastructure expenditures in its member communities, including construction of dock facilities, warehouses, boat harbors, road improvements, water systems, hydro-electric facilities, and wind turbines. M has also either directly or through P made a number of infrastructure development investments in its member communities in partnership with local companies, including fish processing facilities and facilities to provide food and lodging to fish industry workers.

#### *Investments in Fishing Vessels and Fishing Rights*

M, through P, has made several investments in fishing vessels and fishing rights to provide training and employment opportunities for local residents, as well as a means to support local infrastructure development through the harvest of fish species either allocated to it under the Program, or purchased by it through the purchase of vessels which have assigned fishing quotas and harvest rights, or through the purchase of fishing quotas and harvest rights on the open market.

M plans to construct two seafood processing plants (much of the funding of which will come from government grants) and a lodge in the Villages. The plants will employ local residents and will process fish purchased primarily from local residents. The lodge will be the cornerstone for the development of a marketing program to launch a tourism economy in the Villages. M also plans to expand a fish processing plant in one of the Villages.

#### *Proposed Transfers from P to M*

It is contemplated that P will distribute its wholly-owned business interests to M in partial liquidation of P. M believes that the activities conducted by such interests are substantially related to its exempt purposes and, thus, would not generate unrelated business taxable income for M. It is not contemplated that P will dissolve, but, instead, will remain in existence and continue to hold its existing ownership stakes in entities jointly owned with unrelated third parties. Specifically, it is proposed that P's interest in the following entities be transferred to M:

- 1) Entity 1 is owned fifty percent by P and fifty percent by a nonprofit fishermen's association within one of the Villages. Entity 1 processes seafood. Nearly all, if not all, of the products processed by Entity 1 are from Program allocations. All of the plant labor, including management, is from local communities, thereby providing work opportunities for residents that would not otherwise be available. Other seafood companies have had opportunities to establish processing facilities in the village, but none have done so because it is not economically feasible.
- 2) Entity 2 is wholly owned by P. Located in one of the Villages, it serves as transient housing for workers who relocate to the area to work either at Entity 1 or on the various state and federal projects for which the village is able to win grants, such as utility improvements and repairs, road work, and other infrastructure projects.
- 3) Q is wholly owned by P. Q operates a number of vessels that are used to harvest a variety of species which often include Program allocations. The vessels are also used to provide tender support for processing operations at Entity 3 and logistical support to other P facilities and operations. These vessels provide the means and opportunities

through which local residents are able to work and become self-sufficient members of society.

- 4) Entity 3 is wholly owned by P. Entity 3 is located in one of the Villages and processes fish. This plant provides local residents with employment opportunities and the means to bring their fish harvests to market.
- 5) Entity 4 is owned fifty percent by P and fifty percent by a government entity in one of the Villages. Entity 4 operates a vessel and gear storage warehouse which employs local residents. It also provides a location at which local residents and non-residents can store their gear and vessels.

M does not contemplate disposing of any of these business interests in the future because they are not readily capable of independent operations due to pervasive economic devastation in the Region, the massive and ongoing capital investment necessary to improve economic conditions in the Region, and the scale of fishing operations and the sophisticated management required to run these operations. Should one of its business investments become profitable, M will use the net proceeds to fund further economic development in the Region, including educational institutions, local infrastructure, and seed capital for the establishment of businesses by local residents.

#### Rulings Requested

M has requested the following rulings:

- 1) The ruling issued by the Internal Revenue Service to M in Year X (PLR) continues in effect notwithstanding any subsequent changes made to date in the Program by the United States Congress.
- 2) The income received by M from the harvest of the other species allocated to it under the expanded Program is not subject to tax under § 511 in that the payments constitute royalty income under § 512(b)(2).
- 3) The income received by M from the harvest of its fisheries allocation is excluded from the computation of unrelated business taxable income under §§ 511 and 512 inasmuch as M's engagement in the harvesting, processing, marketing, and sale of the Program fisheries allocation is substantially related to the exercise or performance of its exempt purposes within the meaning of § 1.513-1(d)(2), and is not merely conducted for the production of income.
- 4) The distributive share of profits, gains, deductions, and losses allocated to, or received by, M from investments made directly or through its wholly owned for-profit subsidiary, P, in: (a) its member communities, and (b) vessels used to harvest its Program allocations are of a type which will not arise from an unrelated trade or business, as defined in § 513, will not result in unrelated business taxable income to M under § 512, and will not be subject to tax under § 511, inasmuch as the investments have a substantial causal relationship to the achievement of M's exempt purposes, as set forth in § 1.513-1(d)(2).
- 5) No gain or loss shall be recognized by M under Subtitle A or Title 26 of the Code with respect to the distribution from P to M of certain property (including property with respect to which there is acquisition indebtedness) in that the distribution will either constitute a

- dividend described in § 512(b)(1), a non-taxable return of capital under §301(c)(2), or a sale of a capital asset described in §§ 301(c)(3) and 512(b)(5).
- 6) P will recognize gain (but not loss) upon the distribution of property to M under § 311(b) in an amount equal to the excess, if any, of the fair market value of the distributed property at the time of the distribution over its adjusted basis in the property as if such property were sold for an amount equal to its fair market value.
  - 7) Payments received by M from investments made by it, which it finances through debt obligations (either directly or indirectly through its ownership interest in joint venture entities) will not be treated as income derived from debt-financed property as defined in § 514 and will be excluded from unrelated business taxable income inasmuch as substantially all of the use of the property is substantially related to the performance by M of its charitable function.
  - 8) The direct ownership and operation of certain assets previously operated by P and distributed to M are substantially related to the exercise or performance of M's exempt purpose, and such ownership and operation shall not jeopardize M's exemption under § 501(c)(3).

### Law

Section 501(a) of the Internal Revenue Code exempts from federal income taxation organizations described in section 501(c).

Section 501(c)(3) of the Code describes corporations, community chests, funds, and foundations organized and operated exclusively for charitable and other specified exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that 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.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized and operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in § 501(c)(3) in its generally accepted legal sense, and includes relief of the poor and distressed or of the underprivileged, lessening of the burdens of government, and promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, and to combat community deterioration and juvenile delinquency.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the

requirements of § 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in § 513.

Section 511 of the Code imposes a tax on the unrelated business taxable income (as defined in § 512) of various tax-exempt organizations, including organizations described in § 501(c)(3).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business (as defined in § 513) regularly carried on by it, less allowable deductions which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in § 512(b).

Section 512(b)(1) of the Code excludes from unrelated business taxable income all dividends, interest, payments with respect to securities loans, amounts received or accrued as consideration for entering into agreements to make loans, and annuities, and all deductions directly connected with such income.

Section 512(b)(2) of the Code excludes from unrelated business taxable income all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income.

Section 512(b)(4) of the Code provides that, notwithstanding paragraph (1), (2), or (5), in the case of debt-financed property (as defined in § 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), and there shall be allowed, as a deduction, the amount ascertained under § 514(a)(2).

Section 1.512(b)-1(d)(1) of the regulations provides that the exclusion from the computation of unrelated business taxable income of gains or losses from the sale, exchange, or other disposition of property does not apply to the gain derived from the sale or other disposition of debt-financed property (as defined in section 514(b)).

Section 512(b)(13)(A) of the Code provides that, if an organization (referred to as the "controlling organization") receives (directly or indirectly) a specified payment from another entity which it controls (referred to as the "controlled entity"), notwithstanding paragraphs (1), (2), and (3), the controlling organization shall include such payment as an item of gross income derived from an unrelated trade or business to the extent such payment reduces the net unrelated income of the controlled entity (or increases any net unrelated loss of the controlled entity).

Section 512(b)(13)(B)(i) of the Code provides that the term "net unrelated income" means—  
(I) in the case of a controlled entity which is not exempt from tax under section 501(a), the portion of such entity's taxable income which would be unrelated business taxable income if such entity were exempt from tax under section 501(a) and had the same

exempt purpose as the controlling organization, or  
(II) in the case of a controlled entity which is exempt from tax under section 501(a), the amount of the unrelated business taxable income of the controlled entity.

Section 512(b)(13)(C) of the Code provides that the term "specified payment" means any interest, annuity, royalty, or rent.

Section 512(b)(13)(D)(i) of the Code provides that the term "control" means—

- (I) in the case of a corporation, ownership (by vote or value) of more than 50 percent of the stock in such corporation,
- (II) in the case of a partnership, ownership of more than 50 percent of the profits interest or capital interest in such partnership, or
- (III) in any other case, ownership of more than 50 percent of the beneficial interest in the entity.

Section 513(a) of the Code provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by § 511, 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 its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501.

Section 513(c) of the Code provides that the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services.

Section 1.513-1(a) of the regulations provides that the term "unrelated business taxable income," as used in §512, means the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the deductions and subject to the modifications provided in § 512. Section 513 specifies with certain exceptions that the phrase "unrelated trade or business" means, in the case of an organization subject to the tax imposed by § 511, 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 its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501. Therefore, unless one of the specific exceptions of § 512 or 513 is applicable, gross income of an exempt organization subject to the tax imposed by section 511 is includible in the computation of unrelated business taxable income if: (1) it is income from trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Section 1.513-1(b) of the regulations provides that the primary objective of adoption of the unrelated business income tax was to eliminate a source of unfair competition by placing the unrelated business activities of certain exempt organizations upon the same tax basis as the nonexempt business endeavors with which they compete. In general, any activity of a § 511 organization which is carried on for the production of income and which otherwise possesses

the characteristics required to constitute trade or business within the meaning of § 162 (and which, in addition, is not substantially related to the performance of exempt functions) presents sufficient likelihood of unfair competition to be within the policy of the tax. Accordingly, for purposes of § 513, the term trade or business has the same meaning it has in § 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 1.513-1(d)(1) of the regulations provides that gross income derives from unrelated trade or business, within the meaning of § 513(a) of the Code, if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question (the activities, that is, of producing or distributing the goods or performing the services involved) and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d)(2) of the regulations provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is "substantially related," for purposes of § 513, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

Section 514(a) of the Code provides that, in computing under § 512 the unrelated business taxable income for any year, there shall be included with respect to each debt-financed property as an item of gross income derived from an unrelated trade or business an amount which is the same percentage of the total gross income derived during the taxable year from or on account of such property as (A) the average acquisition indebtedness for the taxable year with respect to the property is if (B) the average amount of the adjusted basis of such property during the period it is held by the organization during such taxable year.

Rev. Rul. 68-167, 1968-1 C.B. 255, held exempt under § 501(c)(3) an organization that operated a market to sell food and crafts produced by the poor. The organization charged a small sales commission for its services but was not self-supporting and depended on public contributions. The Service reasoned that the organization relieved the poor. See also Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), acq. in result only, 1981-2 C.B. 1, in which the Tax Court determined that an organization that purchased, imported, and sold handicrafts of disadvantaged artisans, with a goal to sell at a profit, was exempt in that it alleviated economic

deficiencies in objectively determined communities of disadvantaged artisans in the United States and abroad.

Rev. Rul. 69-177, 1969-1 C.B. 150, held not exempt under § 501(c)(3) an organization wholly owned by a college that helped students of the college pay for their education by employing them in a business that manufactured and sold wood and metal products and paid the profits to the college.

Rev. Rul. 74-587, 1974-2 C.B. 162, concerns an entity organized for the relief of poverty, the elimination of prejudice, the lessening of neighborhood tensions, and the combating of community deterioration in certain economically depressed areas through a program of financial assistance and other aid designed to improve economic conditions and opportunities. The organization devotes its resources to programs designed to stimulate economic development in high density urban areas inhabited mainly by low-income minority or other disadvantaged groups. Because of the lack of capital for development, the limited entrepreneurial skills of the owners, the social unrest and instability of the area, and the depressed market within which they operate, many of the businesses located in these high density urban areas have declined or fallen into disrepair, and others have ceased to operate. The organization undertakes to combat such conditions by providing funds and working capital to corporations or individual proprietors who are unable to obtain funds from conventional commercial sources because of the poor financial risks involved in establishing and operating enterprises in these communities or because of their membership in minority or other disadvantaged groups. The program is designed to enable the recipient of the funds or capital to start a new business or to acquire or improve an existing business. Depending on the circumstances, the financial assistance may be in the form of low-cost or long-term loans or the purchase of equity interests in the various enterprises. The terms of any loan will be reasonably related to the needs of the particular business. Where the financial assistance takes the form of acquiring an equity interest, the organization disposes of such interest as soon as the success of the business is reasonably assured. In selecting recipients for aid, preference is given to businesses that will provide training and employment opportunities for the unemployed or under-employed residents of the area. The organization is financed by grants from foundations and by public contributions.

The ruling states that the organization, through its program of financial assistance, is devoting its resources to uses that benefit the community in a way that the law regards as charitable. That program promotes the social welfare of the community by lessening prejudice and discrimination against minority groups by demonstrating that the disadvantaged residents of an impoverished area can operate businesses successfully if given the opportunity and proper guidance. The program also helps to relieve poverty and lessen neighborhood tensions and dissatisfaction arising from the lack of employment opportunities by assisting local businesses that will provide a means of livelihood and expanded job opportunities for unemployed and underemployed area residents. Finally, the program combats community deterioration by helping to establish businesses in the area and by rehabilitating existing businesses that have deteriorated. The ruling says that although some of the individuals receiving financial assistance in their business endeavors under the program may not themselves qualify for charitable assistance as such, that fact does not detract from the charitable character of the organization's program. The recipients of the loans and working capital in such cases are

merely the instruments by which the charitable purposes are sought to be accomplished. Accordingly, the ruling holds that the organization is exempt under § 501(c)(3) of the Code.

Rev. Rul. 76-419, 1976-2 C.B. 146, concerns an organization formed to relieve conditions of poverty, dependency, chronic unemployment, and underemployment, and to reduce community tensions in an economically depressed community. In furtherance of those purposes, the organization encourages industrial enterprises to locate new facilities in the economically depressed area in order to provide more employment opportunities for low-income residents of the area. The organization purchases blighted land in the area and converts it into an industrial park. Lots in the park are leased to industrial enterprises on terms sufficiently favorable to attract tenants to the economically depressed area. Tenants are required by their leases to hire a significant number of presently unemployed persons in the area and to train them in needed skills. Enterprises having initial requirements for low skill workers are favored over those with initial high skill job requirements, since the former are of greater immediate benefit to the surrounding depressed community. The organization is funded by the Economic Development Administration of the United States Department of Commerce pursuant to Public Law 90-222, Part D, Section 150, which provides for the establishment of special programs of sufficient size and scope to have an appreciable impact in low-income areas in arresting tendencies toward dependency, chronic unemployment, and rising community tensions. Pursuant to the terms of Public Law 90-222, the area in which the organization is active has been identified as such an area by appropriate governmental authorities. The ruling states that the subject organization, by inducing industrial enterprises to locate in an economically depressed area and to hire and train the underemployed and unemployed in that area, is devoting its resources to uses that benefit the community in ways the law considers charitable. The organization's activities serve not only to relieve poverty, but also to lessen neighborhood tensions caused by the lack of jobs and job opportunities in the area. Further, by creating an industrial park out of a blighted area, the organization is combating community deterioration. Accordingly, the ruling holds that the organization qualifies for exemption under § 501(c)(3).

Rev. Rul. 78-68, 1978-1 C.B. 149, concerns an organization formed as a Model Cities demonstration project under the Demonstration Cities and Metropolitan Development Act of 1966 to provide bus transportation to a community, many of whose residents do not otherwise have any means of transportation. One of the statutory purposes of the Act is to improve the public welfare by establishing better access between homes and jobs. The transportation system provides residents with access to business districts and enables them to maintain employment. The system serves isolated areas of the community not served by any existing city bus system. As a Model Cities project, the organization has been approved by the local government and works in coordination with local governmental agencies. Its income is from fares, contributions, and governmental grants. The ruling states that the organization, by providing bus service under the authority of Federal and local governments, is lessening the burdens of government so long as it is operated as a governmental program. Accordingly, the organization is operated exclusively for charitable purposes and qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 85-2, 1985-1 C.B. 178, concerns an organization created and operated for the purpose of providing legal counsel and training to volunteers who serve as guardians ad litem in

juvenile court dependency and deprivation proceedings. The activity is part of a program operated by the juvenile court of a particular community. The law of the state in which the organization is incorporated authorizes, and the local court's rules of practice require, the appointment of a guardian ad litem to represent a child's interest in a proceeding relating to child abuse. The court was experiencing problems in the appointment of attorneys and decided to initiate the volunteer program. The organization is supported in part by grants from the juvenile court. The ruling states that a determination of whether an organization is lessening the burdens of government requires consideration of whether the organization's activities are activities that a governmental unit considers to be its burdens, and whether such activities actually "lessen" such governmental burden. To determine whether an activity is a burden of government, the question to be answered is whether there is an objective manifestation by the government that it considers such activity to be part of its burden. The fact that an organization is engaged in an activity that is sometimes undertaken by the government is insufficient to establish a burden of government. Similarly, the fact that the government or an official of the government expresses approval of an organization and its activities is also insufficient to establish that the organization is lessening the burdens of government. To determine whether the organization is actually lessening the burdens of government, all of the relevant facts and circumstances must be considered. A favorable working relationship between the government and the organization is strong evidence that the organization is actually "lessening" the burdens of the government. The ruling concludes that the organization's training of lay volunteers is an integral part of the government's program of providing guardians ad litem in juvenile court proceedings. Without the organization's activities, the government could not continue its present program unless it undertook to train lay volunteers itself. Thus, the organization is actually lessening the government's burden within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations.

### Analysis

#### **Issue 1:**

*Whether PLR continues in effect notwithstanding subsequent changes in the Program.*

In PLR, the Internal Revenue Service ruled that payments from a fish processing organization to M for the right to harvest its quota of fish would be royalties excluded under section 512(b)(2) from unrelated business taxable income.

In Issue 3, below, we have determined that the harvesting, processing, marketing, and sale of M's Program allocations is a trade or business that is substantially related to M's exempt purpose, and, consequently, that income derived from such trade or business does not constitute gross income derived from an unrelated trade or business for purposes of § 512(a)(1). Therefore, a determination of whether payments derived from the harvesting of M's allocation constitutes royalties for purposes of § 512(b)(2) is unnecessary. Consequently, this ruling letter supersedes PLR.

#### **Issue 2:**

*Whether the income M receives from the harvest of other species allocated to it under the expanded Program constitutes royalties for purposes of § 512(b)(2).*

In issue 3, below, we have determined that the harvesting, processing, marketing, and sale of M's Program allocations of fish species is a trade or business that is substantially related to M's exempt purpose, and, consequently, that income derived from such trade or business does not constitute gross income derived from an unrelated trade or business for purposes of § 512(a)(1). Therefore, we need not determine whether the income M receives from the harvest of species allocated to it under the Program constitutes royalties for purposes of § 512(b)(2). Consequently, we decline to rule on this issue.

**Issue 3:**

*Whether the harvesting, processing, marketing, and sale of M's Program Fisheries Allocation is substantially related to M's exempt purpose such that income received by M from the harvest of its Allocation is not gross income derived from an unrelated trade or business.*

M receives income from entities that harvest M's allocations. This income is currently in the form of either payments made under harvest agreements negotiated with third-party fish processors or income earned by P from investments in for-profit taxable entities that harvest M's allocations.

To be includible in the computation of M's unrelated business taxable income, § 1.513-1(a) tells us that (1) such income must be from a trade or business; (2) such trade or business must regularly carried on; and (3) the conduct of such trade or business cannot be substantially related (other than through the production of funds) to the performance of M's exempt functions.

M acknowledges that, with respect to the harvesting, processing, marketing, and sale of its allocations, M is involved in a trade or business that is regularly carried on. Thus, the only question is whether such trade or business is substantially related to M's exempt purpose within the meaning of § 1.513-1(d). To be substantially related to M's exempt purpose, the harvesting, processing, marketing, and sale of the allocations must contribute importantly to that purpose.

As discussed below, M has a colorable claim to be accomplishing the charitable purposes of relief of the poor and lessening the burdens of government through its fishery-related business activities that help develop the local economy. More significantly, however, Congress in enacting the H Act expressed its intent that such activities be treated as tax-exempt so that the participating groups in the Program (including M) may more readily address the pressing economic needs of the Region.

M's exempt purpose is to promote local economic development in the B area through fisheries development and the protection and conservation of the area's fisheries resources within the purview of the Program. M accomplishes this purpose, in part, by providing a forum through which representatives of its member communities can coordinate and maximize the economic opportunities available to them under the Program.

An organization that engages in economic development activities will be considered to be organized and operated for charitable purposes within the meaning of § 501(c)(3) if it devotes its resources to uses that benefit the community in a way that the law regards as charitable. This may be done through programs that promote the social welfare of the community by relieving poverty and lessening neighborhood tensions and dissatisfaction arising from the lack of employment opportunities by, for example, assisting local businesses that will provide a means of livelihood and expanded job opportunities for unemployed and underemployed area residents. It may also be done through programs that combat community deterioration by, for example, helping to establish businesses in a disadvantaged area and by rehabilitating existing businesses that have deteriorated. See Rev. Rul. 74-587, Rev. Rul. 76-419.

The Program is established under federal law for the purposes of providing villages in the Region, including M's member communities, with the opportunity to participate and invest in local fisheries; supporting economic development in the Region; alleviating poverty and providing economic and social benefits for residents of the Region; and achieving sustainable and diversified local economies in the Region.

In establishing the Program, Congress envisioned that participating Groups would use the revenue derived from the harvest of their fisheries allocations as a basis both for funding economic development activities and for providing employment opportunities. Congress recognized that the successful harvest of Program allocations is integral to achieving the goals of the Program. In effect, the allocations are the federal "funding" for the economic development activities that are the purpose of the Program.

M's primary activity is to act as the managing entity of a participating Group through which its member communities participate in, and reap the benefits of, the Program. As a threshold matter, it is beyond dispute that M's member communities are "disadvantaged," and that virtually all of the residents of those communities are members of a disadvantaged group. The member communities historically have experienced high rates of unemployment. These communities are very small and isolated, with few natural resources (aside from fisheries) with which to develop their economies. Along with other isolated communities in the Region, they face numerous social issues, including high suicide rates among young men. The small size and remoteness of most villages limit opportunities for market activity and increase the cost of living. There is a virtual absence of opportunity for most residents. Many are unemployed or only seasonally employed. Despite investment in infrastructure and education, in most communities the increase in self-sustaining economic growth has been minimal.

According to Rev. Rul. 74-587 and Rev. Rul. 76-419, a determination of whether a community development organization furthers charitable purposes requires an analysis of the following three factors: (1) whether assistance is being provided to help local businesses or to attract new local facilities of established outside businesses; (2) whether the type of assistance provided has noncommercial terms and the potential to revitalize the disadvantaged area; and (3) whether there is a nexus between the business entities assisted and relieving the problems of the disadvantaged area, or between the businesses and a disadvantaged group in the area.

*(1) Whether the harvest of M's allocations provides help to local businesses or attracts local*

*facilities of established outside businesses.*

M's member communities are too small and isolated to even sustain a fisheries business without investment by M. At the time of M's creation there were no community "businesses" that could harvest M's allocation. Consequently, M, out of necessity, must initially have its allocation harvested by outside business concerns until such time that its investments in its member communities can spawn local fishery harvesters. Nevertheless, much of the actual harvesting of M's allocation, though done by outside businesses, benefits businesses in the member communities and provides employment opportunities to residents of the member communities. With respect to some species, M's allocation is harvested by third parties that deliver the harvested species to shoreside processing plants located in the member communities for processing. With respect to other species, the harvest of M's allocation is done by entities in which M has an ownership interest, which entities (by the terms of their contract with M) are required to employ qualified residents of the member communities. With respect to still other species, the harvest of M's allocations is done by vessels owned either by M's wholly-owned subsidiary, P, or by M's member communities, and the harvest is delivered to shoreside processing plants located in the member communities.

*(2) Whether the harvest of M's allocations is conducted on noncommercial terms and has the potential to revitalize the disadvantaged member communities.*

Because M's member communities have not had the population or the infrastructure to harvest M's allocations without assistance, M, out of necessity, must contract with non-local owners of fishing vessels to harvest some of M's Program-allocated species. M represents that its contracts with these third-parties are at rates that are competitive in the industry.

Regardless, an activity that is not inherently charitable may still accomplish charitable purposes. For example, in Rev. Rul. 74-587, the organization at issue provides funds and working capital to corporations and individual proprietors, thereby enabling them to establish or expand business in an impoverished community. Though some of the entities and individuals receiving assistance from the organization do not themselves qualify for charitable assistance, the ruling tells us that this fact does not detract from the charitable character of the organization's program because it is through these entities and proprietors that the unemployed and underemployed residents of the area are trained and given meaningful employment.

Similarly, although the harvest of some of M's species is conducted by fishing vessels that are owned by non-local entities that do not themselves qualify for charitable assistance, these entities are merely the necessary instruments by which M seeks to accomplish charitable purposes. M's charitable purpose is to promote local economic development of its member communities, including fisheries development and protection and conservation of the area's fishing resources. The harvesting of M's allocations provides the funds by which M supports the development of locally-owned fisheries and related infrastructure. The harvesting of M's allocations also provides employment opportunities for the residents of its member communities.

Furthermore, the harvesting of allocations by third-party fisheries is contemplated in the statute

establishing the Program. If it is clear that, in enacting legislation, Congress' intent and design was to directly authorize and support a program which effects exclusively charitable goals, then we will infer a Congressional determination that the public interest to be served by the program is so significant as to render any attendant private benefits comparatively incidental for purposes of § 1.501(c)(3)-1(d)(1)(ii). Such Congressional determination is evident if: (1) the legislation or its development reveal an intention to accomplish a result that is not merely in the public interest but is also charitable under § 501(c)(3); (2) the authorized program is designed to accomplish charitable goals rather than merely being adaptable to charitable goals; (3) the program is both authorized and supported financially by the government, whether by specific statutory appropriation or through Congress' imposing specific obligations on administrative agencies in furtherance of the program; and (4) the organization at issue is designed to accomplish the charitable end by involvement in the appropriate government-supported program.

It is clear that the legislation that establishes the Program reveals an intention to accomplish charitable results. The legislation specifies that the purpose of the Program is to alleviate poverty and provide economic and social benefits for the residents of the economically depressed Region and to achieve sustainable and diversified local economies. Furthermore, a Committee report on the development of the legislation reveals that Congress thought the Program necessary to provide the fishermen who reside in the Region villages a fair and equitable opportunity to earn a livelihood from the local fisheries. Indeed, in a Conference report to the pertinent legislation, the Committee of Conference expressed the intent that all activities of the participating groups continue to be considered tax-exempt.

Furthermore, the Program that is authorized by the legislation is designed to accomplish charitable ends. The Program redistributes a portion of the local fisheries' economic benefits to depressed Region villages through the Groups. The legislation requires those Groups to use the revenue derived from the harvest of their fisheries allocations to invest primarily in fisheries-related projects in their member communities. In addition, the Program is both authorized and supported financially by the government through the allocation of a portion of the nation's valuable marine fisheries to the Program. Finally, M is designed to accomplish the charitable ends of the Program by operating as the managing entity of its Group.

Consequently, there is sufficient evidence to conclude that the harvesting of M's allocation, even if done by third-parties on commercially-reasonable terms, serves public interests by providing the means to revitalize M's member communities, and that any attendant private benefits are comparatively incidental in light of Congressional intent in establishing the Program.

*(3) Whether there is a nexus between the harvesting of M's allocations and relieving the problems of the member communities.*

Rev. Rul. 74-587 and Rev. Rul. 76-419 identify three characteristics that provide a nexus between the direct recipients of community development assistance and the relief of the problems of a disadvantaged area: (1) assistance recipients conducting their business in the economically disadvantaged area; (2) recipients not being able to obtain assistance from conventional sources because of the depressed nature of the area or affiliation of business

participants with minority or other disadvantaged groups; and (3) assistance recipient selection based on which recipients will offer the greatest potential community benefit by virtue of either their current operations or their promises to take certain actions benefiting the depressed area. While these characteristics, which were derived from examples of assistance to minority business owners in large urban areas, do not translate directly to the very different environment in which M's small, isolated member communities find themselves, the gist of the characteristics is to ask whether M's activities, and particularly the harvesting of its allocations, provide a direct benefit to the member communities that would not otherwise be available absent M's involvement.

The purpose of the Program is to provide eligible villages in the Region the opportunity to take part in the local fisheries and use the resources derived therefrom to develop sustainable local economies and address the problems of poverty and unemployment. The enacting legislation does not allow eligible villages to take part in the Program individually. Rather, eligible villages must be members of one of the participating Groups that are authorized to accept allocations. Each group is managed by a non-profit entity created specifically to manage the Program for its group of eligible villages. Thus, the Villages enjoy the benefits of the Program through the activities of M. But beyond that, M's active participation in harvesting the fish – through contracting with third-party harvesters, harvesting with vessels partially or wholly-owned by M or P, adding value through production efforts at fish processing plants owned by M or P, and marketing and selling the products – provides the member communities and their residents with economic development opportunities that would otherwise be unavailable to them. The need to harvest and process its allocations has given M direction in approaching infrastructure development. M makes expenditures in its member communities for appropriate infrastructure to support the formation of local fisheries-related businesses and to purchase harvesting or processing vessels, facilities, and fishing rights. Commercial for-profit entities would be unlikely to make these kinds of investments because they generally do not produce commercially attractive financial returns. As just one example of the economic development initiatives sparked and financed by the harvesting of M's allocations, two of the member communities have constructed fish processing plants that employ community members. These plants give local residents the opportunity to participate in the harvesting of the allocations, something that most were unable to do before because their small skiffs could not reach the processor vessels to sell their catch. Other local residents have gained employment experience aboard fish processing vessels that harvest M's allocation, experience that gives them the income and knowledge to invest in small vessels or fish quotas for themselves. Consequently, there is a direct nexus between the harvesting of M's allocations and relief of the problems of M's member communities.

Insofar as the harvesting, processing, marketing, and sale of M's allocations support community development in a manner that furthers charitable purposes (within the meaning of § 501(c)(3)) and contributes importantly to the accomplishment of M's exempt purpose of promoting local economic development in its member communities, such activities are substantially related to M's exempt purpose (within the meaning of § 1.513-1(d)(2)). Consequently, the income that M receives from those activities does not derive from an unrelated trade or business for purposes of § 512(a)(1) and, therefore, such income would not be includible in M's unrelated business taxable income.

#### Issue 4

*Whether investments made by M, directly or through its wholly owned for-profit subsidiary, in (a) its member communities; or (b) vessels used to harvest its allocations, are substantially related to M's exempt purpose such that M's distributive share of the profits, gains, deductions, and losses allocated to, and received by, M from such investments is not considered gross income derived from an unrelated trade or business.*

M earns income from its own investments and from investments made by its wholly-owned taxable subsidiary, P. These investments have been made in infrastructure developments in M's member communities, in fishing vessels and fishing rights, and in fishing quotas and harvest rights. These investments provide virtually the only means by which M's member communities and residents are able to participate in the local fisheries. This is because the low or, in some cases, negative returns on investment would not justify an expenditure of funds by a commercial for-profit entity, and financial institutions are reluctant to provide funding for these kinds of activities because of the difficulty in securing and liquidating the collateral if the loans are not repaid. These investments by M, through P, provide opportunities for employment in areas where full-time, long-term jobs are scarce, and contribute importantly to the economic survival of the communities and the achievement of M's exempt purpose.

#### *Charitable Economic Development*

Under Reg. § 1.501(c)(3)-1(d)(2), the term "charitable" includes the relief of the poor and distressed or of the underprivileged, and promotion of social welfare designed to lessen neighborhood tensions, eliminate prejudice and discrimination, or combat community deterioration and juvenile delinquency.

M and its activities are similar to the organization and the activities described in Rev. Rul. 74-587. Like that organization—

- M operates a program of financial assistance and other aid designed to improve economic conditions and opportunities in economically disadvantaged communities;
- M devotes its resources to programs designed to stimulate economic development in communities that lack capital for development and whose residents lack employment opportunities;
- M provides funds and working capital, in the form of loans or the purchase of equity interests, to community businesses that are unable to obtain funds from conventional commercial sources because of the poor financial risks involved in establishing and operating businesses in these communities. These businesses, in turn, provide training and employment opportunities to the unemployed and underemployed residents of the community; and

- M is financed, in part, through funds it derives from participation in a federal program, here the Program.

And like the programs described favorably in Rev. Rul. 74-587, M's programs have the effect of relieving poverty and lessening neighborhood tensions arising from the lack of employment opportunities by investing in local businesses that will provide a means of livelihood and expanded opportunities for unemployed and underemployed village residents. In addition, those programs have the effect of combating community deterioration by funding infrastructure improvements. Though some of the individual and business endeavors in which M makes investments do not, themselves, qualify for charitable assistance, that fact does not detract from the charitable character of M's program. The recipients of the loans and working capital are merely the instruments by which M seeks to accomplish its charitable purposes. This is especially so where, as here, the activities are entered into pursuant to a congressionally mandated program that is expressly designed to achieve charitable goals. While the organization described in Rev. Rul. 74-587 disposes of its equity interest in a business as soon as the success of that business is reasonably assured, most, if not all, entities in which M invests, given their location and the nature of their business, would be unlikely to survive without M's continuing involvement and support.

In addition, M is similar to the organization described in Rev. Rul. 76-419. Like that organization—

- M encourages the growth of business enterprises (fisheries-related businesses) in economically depressed areas (its member communities) to provide more employment opportunities for low-income residents of the area;
- M invests in both public and private infrastructure for the purpose of creating job opportunities for the unemployed and underemployed residents of the member communities; and
- M derives much of its funding from participation in a government program (the Program) that is designed to have an appreciable impact on low-income areas with chronic unemployment.

Thus, like the organizations described in Rev. Rul. 74-587 and Rev. Rul. 76-419, M, in investing directly or through P in its member communities and vessels used to harvest its allocations, is devoting its resources to uses that benefit its member communities in a way the law considers charitable.

#### *Lessening the Burdens of Government*

Under Reg. 1.501(c)(3)-1(d)(2), the term "charitable" includes lessening the burdens of government. In Rev. Rul. 78-68, an organization formed to provide bus transportation to a community so as to enable its residents to gain access to business districts and retain employment, was found to be lessening the burdens of government. The organization conducts its activities pursuant to a federal statute, the purpose of which is to improve the public welfare by establishing better access between homes and jobs.

Similarly, M was formed to provide the means by which the residents of disadvantaged communities in the Region can gain access to jobs in the one viable industry in their region – fisheries. M conducts its activities pursuant to a federal statute the purpose of which is to provide certain Region villages with the opportunity to participate and invest in fisheries, support economic development, alleviate poverty, provide economic and social benefits to residents, and achieve sustainable and diversified local economies. M's use of its allocations to invest in fisheries and other infrastructure gives its member communities opportunities to achieve sustainable and diversified local economies, and gives residents of those communities opportunities to gain or maintain employment, thus providing them with economic and social benefits that work to alleviate poverty. Thus, under the reasoning of Rev. Rul. 78-68, M is lessening the burdens of government by making investments that carry out the purposes of the federal Program.

Furthermore, M is similar to the organization described in Rev. Rul. 85-2 in that it was created to alleviate problems experienced by a government agency in ensuring that Region fishermen were afforded fair and equitable commercial fishing opportunities, problems attributable to the lack of significant capital investment. Like the organization describe in Rev. Rul. 85-2, M lessens the burdens of government by conducting activities that are an integral part of a governmental program – here, the Program – by providing the necessary capital investments to enable member communities to participate in the local fisheries as intended under the Act.

According to Rev. Rul. 85-2, an activity is a burden of government if there is an objective manifestation by the government that it considers such activity to be part of its burden. We have said that the appropriate governmental unit's "attitude" is the only reliable indicator of what the government considers to be its burden. In addition, the sources of an organization's funding may indicate a governmental burden, such as when an organization regularly receives general grants (as opposed to fees for services) for its activities. The F Act is intended to ensure that Region fishermen who historically fished in the local fisheries are treated fairly and equitably. It explicitly recognizes that such fishermen did not have a fair and equitable opportunity to benefit from the fisheries because they lacked the necessary capital investment.

Furthermore, Congress recognized that the Region is one of the poorest and most underdeveloped areas in the United States, and that the residents of the area have been unable to share in the benefits of the fisheries resources off their shores due to lack of capital and opportunity. Congress also realized that, because of their isolation and lack of natural resources other than fisheries, these communities would not be able to address their high unemployment rates and resulting social problems without developing sustainable regionally-based commercial fishing economies. Thus, Congress established the Program as the best means to spur economic development in economically depressed Region communities. The H Act provides for the allocation of annual catch limits in the area to various communities represented by several managing entities. The legislation also establishes the requirements that the managing entities must fulfill to maintain eligibility in the Program, one of which makes each entity accountable to the State for its investments.

The legislation is an objective manifestation of Congress' "attitude" that it considers the

economic development of federally managed fisheries in the area in a manner that is fair and equitable to the residents of the Region to be a burden of the federal government. The allocations of valuable fisheries resources to the Program to pay for the economic development activities carried out by the managing entities – M among them – are similar to general grants, another indication that the activities undertaken by those entities is a governmental burden. The requirement that the managing entities report their investment activities to the State is yet another indication of favorable relationship between the government and the managing entities showing their activities to be a burden of government.

And like the activities of the organization described in Rev. Rul. 85-2, M's activities actually lessen the government's burden because, without M's capital investments, the residents of M's member communities would not be afforded the fair and equitable fishing opportunities that Congress intended to provide.

Since investments made by M in its member communities and in vessels used to harvest its allocations further charitable purposes (for purposes of §§ 1.501(c)(3)-1(c) and 1.501(c)(3)-1(e)) by (1) relieving the poor and distressed, (2) promoting social welfare that lessens neighborhood tensions, eliminates poverty, and combats community deterioration, and (3) lessening the burdens of government, and are substantially related (within the meaning of § 1.513-1(d)) to M's exempt purpose of promoting local economic development in its member communities through fisheries development under the purview of the Program, M's distributive share of the profits, gains, deductions, and losses allocated to, and received by, M from such investments is not considered gross income derived from an unrelated trade or business for purposes of § 512(a)(1), and, therefore, is not taxable as unrelated business taxable income under § 511(a)(1).

The fact that M may receive dividends or interest as a result of investments made by P, an entity controlled by M within the meaning of § 512(b)(13)(D), does not mean that such payments would be considered gross income from an unrelated trade or business by operation of § 512(b)(13)(A). Under that section, such payments would be considered an item of gross income derived from an unrelated trade or business only to the extent that they reduce the net unrelated income of P. As an entity that is not exempt from tax under § 501(a), P's net unrelated income is defined in § 512(b)(13)(B)(i)(I) as that portion of its taxable income which would be unrelated business taxable income if P were exempt from tax under § 501(a) and had the same exempt purposes as M. Since P's activities – which consist of making investments in M's member communities and in vessels used to harvest M's allocations – are substantially related to M's exempt purpose, the income P derives from those activities would not be unrelated business taxable income if P were exempt from tax under § 501(a) and had the same exempt purposes as M. Thus, P has no net unrelated income that could be reduced by any payment to M. Therefore, any payment made by P to M would not be includible in M's unrelated business taxable income by operation of § 512(b)(13)(A).

**Issue 5:**

*Whether M would recognize gain or loss from the distribution from P to M of certain property (including property with respect to which there is acquisition indebtedness).*

It is proposed that P distribute its interest in several entities to M. Public charities generally are not subject to federal tax on the receipt of property, including dividends, return of capital, and gains from the sale or exchange of property. One exception applies to income from debt-financed property. The distribution will not result in income from debt-financed property to M under §§ 512(b)(4) and 514, however, because the property is not debt-financed property: substantially all the use of the property is substantially related to the performance of M's exempt purpose under § 514(b)(1)(A)(i). In some circumstances a tax-exempt corporation is subject to tax under § 337(b)(2)(B)(ii) when it disposes of property received in the liquidation of a subsidiary corporation and used in an unrelated business, but in this case M will not use the property in an unrelated business.

**Issue 6:**

*Whether P will recognize gain (but not loss) upon the distribution of property to M under § 311(b).*

This issue concerns the tax liability of P, not M, and P is not a party to the request for rulings. Furthermore, the issue falls under the jurisdiction of the Associate Chief Counsel (Corporate). Therefore, we decline to rule on this issue. If P still wants a ruling on this issue, it should request the ruling from the Office of Chief Counsel using the procedures set forth in Rev. Proc. 2014-1, 2014-1 I.R.B. 1, or its successor.

**Issue 7:**

*Whether payments received by M from investments that are financed through debt obligations would be treated as income derived from debt-financed property as defined in § 514.*

In issue 4, above, we have determined that investments made by M in its member communities and in vessels used to harvest its allocations are substantially related (within the meaning of § 1.513-1(d)(1)) to M's exempt purposes, and, therefore, that M's distributive share of the profits, gains, deductions, and losses allocated to, and received by, M from such investments is not considered gross income derived from an unrelated trade or business for purposes of § 512(a)(1). Therefore, we need not determine whether payments received from investments financed through debt obligations constitute income derived from debt-financed property for purposes of § 512(b)(4). Consequently, we decline to rule on this issue.

**Issue 8:**

*Whether the direct ownership and operation by M of certain assets previously operated by P and distributed to M would jeopardize M's exemption under § 501(c)(3).*

M is recognized as an organization described in § 501(c)(3). To maintain its exemption, M must operate exclusively for one or more exempt purposes. Section 1.501(c)(3)-1(c)(1) tells us that M will be considered to operate exclusively for exempt purposes if it engages primarily in activities which accomplish one or more of the exempt purposes described in § 501(c)(3).

Further, § 1.501(c)(3)-1(e) tells us that an organization may operate a trade or business as a substantial part of its activities, and still meet the requirements of § 501(c)(3), if the operation of the trade or business is in furtherance of the organization's exempt purpose or purposes.

M accomplishes exempt charitable purposes by promoting local economic development within the purview of the Program, the purpose of which is to provide disadvantaged Region communities the ability to develop a sustainable local economy based on fishery resources. The Program requires a participating entity such as M to invest primarily in fisheries-related projects. It also allows a participating entity to invest in other projects that are not fisheries-related but that are located in its region.

The entities in which P would transfer its interest to M, i.e., the entities described under "Proposed Transfers from P to M", above, engage primarily in fisheries-related projects. These entities, which are sometimes the only going concerns in their locality, employ primarily local residents, thereby providing employment opportunities that would otherwise be unavailable. These entities provide other local residents a means to enter the fisheries economy by giving them a local place to harvest and market their catch. In addition, any non-fisheries-related entity in which P might transfer its interest to M would be located in one of the member communities and would exist for the purpose of stimulating economic growth in the community and providing employment to local residents. Furthermore, such entities, in the aggregate, experience significant operating deficits and require ongoing capital support from M. Separately, none of the entities has generated more than a minimal net profit.

In Rev. Rul. 68-167, an organization that relies on public support and that operates a market where it sells the cooking and needlework of women who are otherwise unable to support themselves and their families was found to serve the charitable purpose of relieving the poor and distressed. Similarly, the entities described under "Proposed Transfers from P to M", above, rely on support from M and provide employment opportunities as well as a market for local residents, who are otherwise unable to support themselves, to harvest and market their catch. Thus, the operation of these entities serves the charitable purpose of relieving the poor and distressed.

Since these entities serve to further M's exempt charitable purpose under § 501(c)(3), the transfer of interests in these entities from P to M would not jeopardize M's exemption under § 501(c)(3).

### Rulings

Therefore, in light of the foregoing we rule as follows:

- 1) PLR is superseded by our ruling in (3), below.
- 2) In light of our ruling in (3), below, we need not consider whether income from the harvest of Program allocations constitutes "royalties" under § 512(b)(2).

- 3) The income that M receives from the harvesting, processing, marketing, and sale of its Program allocations is not considered gross income derived from any unrelated trade or business and, thus, is not unrelated business taxable income within the meaning of § 512(a)(1).
- 4) M's distributive share of the profits, gains, deductions, and losses allocated to, and received by, M from investments made directly or through its wholly owned for-profit subsidiary, P, in: (a) its member communities, and (b) vessels used to harvest its Program allocations are of a type which will not arise from an unrelated trade or business, as defined in § 513, will not result in unrelated business taxable income to M under § 512, and will not be subject to tax under § 511, inasmuch as the investments have a substantial causal relationship to the achievement of M's exempt purposes, as set forth in § 1.513-1(d)(2).
- 5) No gain or loss shall be recognized by M under Subtitle A or Title 26 of the Code with respect to the distribution from P to M of property (including property with respect to which there is acquisition indebtedness) described under "Proposed Transfers from P to M," above..
- 6) We decline to rule on whether P would recognize gain upon the distribution of certain property to M. If P still wants a ruling on this issue, it should address its ruling request to the Office of Chief Counsel following the procedures set forth in Rev. Proc. 2014-1 or its successor.
- 7) In light of our ruling in (4), above, we need not consider whether payments received by M from investments financed through debt obligations would be treated as income derived from debt-financed property for purposes of § 512(b)(4).
- 8) The transfer of P's interest in the entities described under "Proposed Transfers from P to M," above, to M, and M's direct ownership and operations of those entities, would not jeopardize M's status as an organization described in § 501(c)(3).

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,

Steven B. Grodnitzky  
Manager, Exempt Organizations  
Technical Group 1

Enclosure  
Notice 437