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April 5, 2023

LEGEND

Organization	=
State	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Year 5	=
Year 6	=
V	=
W	=
X	=
Y	=
Z	=

Dear :

This letter ruling responds to a letter from your authorized representatives dated September 30, 2022 and supplemental documentation dated January 6, 2023 and February 14, 2023 requesting a ruling under section 501(c)(3) of the Internal Revenue Code.[1]

FACTS

Organization is a State nonprofit public benefit corporation recognized as described in sections 501(c)(3) and 170(b)(1)(A)(ii). Organization's purpose since inception has been

[1] Unless otherwise noted, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").

to “manage, operate, guide, direct and promote [State] public charter schools established by [Organization] and perform and undertake all activities and functions related to its charter school program in [State].” Organization operates V charter schools in State. State charter schools are: 1) part of State’s single statewide public school system; 2) tuition-free and open to all students; 3) operated under the oversight of State school districts or county boards of education; and 4) operated in accordance with a charter petition approved by a school district or county for periods of W years, subject to renewal.

Organization operates its own student meal program for its V schools, including preparation and delivery of meals, supervision of students, and related services, all accomplished by Organization staff. Organization has historically participated in the following federal programs (the “Federal Meal Programs”):

- The School Breakfast Program, which reimburses the costs of providing before-school breakfasts;
- The National School Lunch Program, which reimburses the costs of providing school lunches; and
- The Child and Adult Care Food Program, which reimburses the costs of providing after-school meals.

State charter schools may participate in the Federal Meal Programs only by becoming certified as a School Food Authority (“SFA”) or by contracting with another SFA—such as a chartering school district or another charter school certified as an SFA—for the provision of meals. An SFA must be a public entity (for example, a school district) or an organization described in section 501(c)(3). SFAs are licensed through the State Department of Education, which has been delegated authority to administer the Federal Meal Programs in State and is overseen by the United States Department of Education and the United States Department of Agriculture. Organization became a State-certified SFA in Year 1.

Federal law requires SFAs in State to enter into a Permanent Single Agreement (the “PSA”) with the State Department of Education outlining the SFA’s obligations and the conditions under which the SFA may participate in the Federal Meal Programs. Organization’s PSA with the State Department of Education contains provisions ensuring that Organization’s participation in the Federal Meal Programs complies with State and federal laws requiring significant State and federal oversight of Organization’s SFA operations. This oversight includes regular reporting and audit responsibilities and a requirement that Organization make all facilities, accounts, and records pertaining to its SFA operations available to the State Department of Education, the United States Department of Agriculture, and other officials for inspection, audit, and review. State also reviews, approves, and audits Organization’s vendor procurement process. Organization’s vendors are unrelated third parties that, with the exception of vending

arrangements with Organization, have no financial relationships with Organization or persons affiliated with Organization.

The onerous administrative obligations and financial costs of becoming certified and operating as an SFA prevent many charter schools from becoming SFAs. State recognizes the burdens associated with becoming an SFA and, to foster greater efficiency, encourages charter schools to enter into intergovernmental agreements with existing SFAs for the provision of meals. Intergovernmental agreements contain provisions required by State's Department of Education and, to secure State's approval of any intergovernmental agreement, the SFA must verify that the participating school is a public entity or described in section 501(c)(3). An SFA providing Federal Meal Programs meals to students at non-SFA charter schools by intergovernmental agreement must annually apply to State on behalf of the non-SFA charter schools to participate in the SFA.

Beginning with the Year 2-Year 3 school year, all charter schools in State were required to provide at least one "nutritionally adequate free or reduced-price meal" per day to their "needy pupils." The nutritionally adequate meals to be provided must qualify for federal reimbursement under the Federal Meal Programs. In Year 3, various unaffiliated State charter schools asked Organization to serve as their SFA. The schools sought Organization's assistance because they could not bear the administrative and financial burdens associated with becoming an SFA and either the schools' school districts refused to serve as SFA or charged prohibitively expensive fees to serve as SFA. Organization amended and restated its articles of incorporation in Year 3 to include the following purpose:

> Participate in government-funded programs to provide food service to the students attending [Organization schools] and other [State] public charter schools, including without limitation the U.S. Department of Agriculture's National School Lunch Program and the Child and Adult Care Food Program, and any successor programs.

Organization entered into intergovernmental agreements with these schools to serve as their SFA commencing with the Year 4-Year 5 school year. All charter schools for which Organization serves as SFA are described in section 501(c)(3).

In Year 4, State enacted a law establishing a universal state meal mandate commencing with the Year 5-Year 6 school year. This mandate requires all State public schools, including charter schools, to provide breakfast and lunch daily for any student requesting these meals, regardless of need and at no cost to the student. State's mandate requires the schools to provide meals that qualify for reimbursement under the Federal Meal Programs, and State reimburses schools for the cost of the meals provided to students who do not qualify for free or reduced-price meals under the

Federal Meal Programs. A charter school that does not meet this requirement is in violation of State law and risks revocation of its charter.

As the SFA assisting other charter schools in providing legally required meals to students (the “SFA Meal Program”), Organization:

- Assigns employees at each participating school with responsibility for certain compliance requirements and monthly check-ins with Organization;
- Requires school staff at each participating school to annually attend at least two trainings provided by Organization;
- Performs announced and unannounced inspections to assess school needs and compliance with the SFA Meal Program at each school; and
- Procures and coordinates vendors, performs auditing tasks, submits reimbursement requests to State, and periodically furnishes compliance reports to State.

Organization does not charge charter schools any fee to participate in the SFA Meal Program and all SFA Meal Program meals are free to students at participating charter schools. SFA Meal Program expenses, including staff and administrative costs (for example, the cost of audits, applications, and training), are paid through State and federal reimbursements based on the number of meals served. Additional SFA Meal Program expenses, such as the cost of providing kitchen equipment to schools, are funded by grants. Participating schools are responsible for ordering the number of meals they will serve to students, however, taking into account factors like average daily attendance, and if a school wastes in excess of W percent of the total meals ordered for the month, the school is responsible for the price charged by vendors for meals wasted in excess of the W-percent threshold. Organization pays for wasted meals up to W percent of the total meals ordered for the month. Organization estimates that for the Year 5-Year 6 school year, X charter schools will participate in the SFA Meal Program, providing more than Y students with access to two free, nutritionally adequate meals per day. Organization expects to serve more than Z meals monthly through the SFA Meal Program.

Organization represents that reimbursements received for providing meals rarely result in surplus resources. To the extent there is a surplus from the SFA Meal Program, Organization complies with its PSA and with federal law, which require that any revenues received from the SFA Meal Program be used only for the operation of the SFA Meal Program or to improve its operation. Federal law empowers State to ensure SFAs stay within prescribed limitations on net cash reserves. To enforce these limitations, State may require Organization to reduce surplus resources by deploying such surplus in a meal service activity or by distributing the surplus consistent with Organization’s SFA status.

RULING REQUESTED

Organization's SFA Meal Program furthers an exempt purpose described in section 501(c)(3).

LAW

Section 501(c)(3) describes organizations organized and operated exclusively for charitable, educational, and certain other purposes enumerated therein.

Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that the term "charitable" in section 501(c)(3) is used in its generally accepted legal sense and includes, among other purposes, the advancement of education.

Rev. Rul. 67-217, 1967-2 C.B. 181, describes a nonprofit organization formed to provide housing and food service exclusively for students and faculty of a section 501(c)(3) university that lacked adequate student and faculty housing. The organization built the housing facility near the university and the facility was managed by a commercial firm in accordance with the rules and regulations of the university. Housing was made available to the student body generally at rates comparable to those charged by the university for similar facilities. Each room was equipped with an outlet for the university-sponsored educational television series and counseling, tutoring, and special courses were provided as a supplement to the university's activities. The organization's income was derived from rents and charges for food and its expenditures consisted of operating expenses and debt retirement. Any surplus from operations was annually donated to the university and the university had an option to purchase the facility at any time for an amount equal to the outstanding indebtedness. The ruling concluded that by providing a housing facility under these circumstances the organization advanced education within the meaning of section 501(c)(3) and Treas. Reg. § 1.501(c)(3)-1(d)(2).

Rev. Rul. 76-336, 1976-2 C.B. 143, describes a nonprofit organization formed by community leaders to provide student housing for students of an area college that itself provided no housing because it was financially unable to do so. The community in which the college was located did not have suitable housing available at a reasonably affordable rate to meet the needs of the students. All students were eligible to apply for the housing with applications accepted on a first come, first served basis and rental fees approximated costs, including debt retirement. The organization was not controlled by the student-residents or by the college but did consult with the college to ensure the needs of the college and its students were served by the operation of the housing facility. The organization's income was from rental fees and contributions and its expenditures were for operating expenses and debt retirement. The ruling concluded that by providing necessary student housing not otherwise available, the organization was helping the college fulfill its educational purposes and aiding students in attaining

an education and that those activities advanced education within the meaning of section 501(c)(3) and Treas. Reg. § 1.501(c)(3)-1(d)(2).

Rev. Rul. 72-369, 1972-2 C.B. 245, describes an organization formed to provide managerial and consulting services on a cost basis for unrelated section 501(c)(3) organizations to improve the administration of their charitable programs. The organization's receipts were from services rendered and its expenditures were for operating expenses. The ruling concluded that the organization's activities did not further a section 501(c)(3) purpose because providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit and the fact that the services were provided at cost and solely for section 501(c)(3) organizations was insufficient to characterize the activity as charitable within the meaning of section 501(c)(3).

Rev. Rul. 71-529, 1971-2 C.B. 234, describes a nonprofit organization that managed and invested the endowment funds of participating colleges and universities. Membership in the organization was restricted to colleges and universities described in section 501(c)(3) and the organization charged nominal fees to the participating universities that were substantially below the organization's operating costs. The ruling concluded that by providing this service the organization was performing an essential function for its section 501(c)(3) members at a charge that was substantially below cost; thus, the organization was conducting a charitable activity within the meaning of section 501(c)(3).

In *B.S.W. Group, Inc. v. Commissioner of Internal Revenue*, 70 T.C. 352 (1978), the Tax Court held that an organization formed to provide consulting services to tax-exempt organizations and nonprofit organizations (some of which may not be tax-exempt) was not operated exclusively for section 501(c)(3) purposes. The fact that the organization's activity may have constituted a trade or business was not disqualifying, provided the activity furthered a section 501(c)(3) purpose; rather, "the critical inquiry is whether [the organization's] primary purpose for engaging in its sole activity is an exempt purpose, or whether its primary purpose is the nonexempt one of operating a commercial business producing net profits . . . ." The court noted the following factors in concluding the organization's sole activity constituted the conduct of a consulting business "of the sort which is ordinarily carried on by commercial ventures organized for profit": 1) the organization failed to demonstrate that its services were not in competition with commercial businesses, and "[c]ompetition with commercial firms is strong evidence of the predominance of nonexempt commercial purposes"; 2) the organization's services were not inherently charitable, educational, or scientific; 3) the organization received no voluntary contributions from the public and its only source of income was fees for services; 4) the organization's fee policy was generally to recoup its costs and to realize a profit; and 5) the organization's clientele was not limited to section 501(c)(3) organizations.

In *Airlie Foundation v. Internal Revenue Service*, 283 F. Supp. 2d 58 (D.D.C. 2003), the District Court for the District of Columbia held that an organization that organized, hosted, conducted, and sponsored educational conferences at its facilities was not described in section 501(c)(3). The organization derived substantial income from weddings and special events and competed with commercial and noncommercial entities which constituted "strong evidence, pursuant to *B.S.W. Group*, of a commercial nature and purpose." The organization also maintained a commercial website and paid significant advertising and promotional expenses and, like the organization in *B.S.W. Group*, the organization's clientele was not limited to section 501(c)(3) organizations. Though the organization fully or partially subsidized some of its conferences, the court found that there was a "distinctive 'commercial hue' to the way [the organization] carries out its business" and that "the nature of its clients and competition, its advertising expenditures and the substantial revenues derived from weddings and special events on the premises, strongly suggest that the [Internal Revenue Service] was correct in revoking the foundation's tax-exempt status."

ANALYSIS

Like the organizations in Rev. Rul. 67-217 and Rev. Rul. 76-336, Organization performs an essential function for participating section 501(c)(3) charter schools by serving as their SFA and the SFA Meal Program assists participating schools by assuming a burden these schools have difficulty meeting or in some cases are unable to meet due to the onerous administrative obligations and financial costs of becoming certified and operating as an SFA. For the Year 5-Year 6 school year, Organization estimates that X charter schools will participate in the SFA Meal Program, resulting in two free, nutritionally adequate meals being made available each day to Y students, while simultaneously ensuring these charter schools meet the universal state meal mandate and thus are able to remain open and continue educating students.

Organization provides meals at no cost to students and section 501(c)(3) charter schools are charged no fees to participate in the SFA Meal Program, though such schools are responsible for the cost of meals wasted in excess of W percent of the total meals ordered for the month. Similar to the organization providing investment management services in Rev. Rul. 71-529, and unlike the organization providing managerial and consulting services in Rev. Rul. 72-369, to the extent the SFA Meal Program results in participating schools bearing any cost at all such cost is substantially below the cost of operating the SFA Meal Program. *Cf*. *B.S.W. Group, Inc.*, 70 T.C. at 359 (in which the organization's fee policy was generally to recoup its costs and to realize a profit).

Organization's SFA Meal Program operations are, by definition, not "of the sort which is ordinarily carried on by commercial ventures organized for profit"—like the activities at issue in *B.S.W. Group, Inc.* and *Airlie Foundation*—because the meals provided through the SFA Meal Program may only be provided by an SFA and an SFA must be a public

entity or an organization described in section 501(c)(3). *B.S.W. Group, Inc.*, 70 T.C. at 358. This restriction ensures that Organization cannot compete with for-profit firms and commercial enterprises in conducting the SFA Meal Program. Moreover, Organization receives no fees for its work in operating the SFA Meal Program and participating schools are limited to section 501(c)(3) charter schools that are part of State's single statewide public school system. *Cf*. *B.S.W. Group, Inc.*, 70 T.C. at 358, 360 (in which the organization charged fees intended to recoup costs and realize a profit and clientele was not limited to section 501(c)(3) organizations); *Airlie Foundation*, 283 F. Supp. 2d at 65 (in which the organization's clientele was not limited to section 501(c)(3) organizations).

Organization's SFA Meal Program is an outgrowth of charitable activities Organization historically conducted for the benefit of students at Organization's V charter schools. The SFA Meal Program helps participating section 501(c)(3) charter schools fulfill their educational purposes and aids students in attaining an education by providing free, nutritionally adequate meals. Through audits, compliance reporting, and other mechanisms the SFA Meal Program is subject to close scrutiny by the State and federal governments. Under these circumstances, and by operating the SFA Meal Program for a charge that is substantially below cost and in a manner that is not of the sort ordinarily carried on by commercial ventures organized for profit, Organization's conduct of the SFA Meal Program advances education within the meaning of Treas. Reg. § 1.501(c)(3)-1(d)(2).

RULING

Organization's SFA Meal Program furthers an exempt purpose described in section 501(c)(3).

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The ruling contained in this letter is based upon information and representations submitted by or on behalf of Organization and accompanied by penalties of perjury statements executed by an individual with authority to bind Organization and upon the understanding that there will be no material changes in the facts. *See* Rev. Proc. 2023-1 § 7.01(16), 2023-1 I.R.B. 1; Rev. Proc. 2022-1 § 7.01(16), 2022-1 I.R.B. 1. This office has not verified any of the material submitted in support of the request for this ruling, and such material is subject to verification on examination. The Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes) will revoke or modify a letter ruling and apply the revocation retroactively if: 1) there has been a misstatement or omission of controlling facts; 2) the facts at the time of the transaction are materially different from the controlling facts on which the letter ruling was based; or 3) the transaction involves a continuing action or series of actions and the controlling facts change during the course of the transaction. *See* Rev. Proc. 2023-1 § 11.05, 2023-1 I.R.B. 1; Rev. Proc. 2022-1 § 11.05, 2022-1 I.R.B. 1.

This letter does not address the applicability of any section of the Code or Treasury regulations other than those sections specifically described. Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any fact or issue discussed or referenced in this letter.

This letter is directed only to Organization. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Organization's authorized representatives.

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.

Sincerely,

Randall Thomas
Senior Counsel
Exempt Organizations Branch 2
(Employee Benefits, Exempt Organizations, and Employment Taxes)

cc: