



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

M =

O =

Dear _____ :

This is in response to your letter of September 1, 2004, in which you requested a private letter ruling that your formation of a single member limited liability company (LLC) for the purpose of fostering more local community involvement in your mission to improve the quality of life for residents in your state will not affect your tax exempt status under section 501(c)(3) of the Internal Revenue Code, or your status as an entity that is not a private foundation under section 509 of the Code. In addition, you requested rulings that the single member LLC will be treated as a disregarded entity for federal income tax purposes and that none of the income attributable to the LLC will result in unrelated business income tax under sections 511 through 513.

You have been recognized as exempt from federal income tax under section 501(a) of the Code by virtue of being an organization described in section 501(c)(3). You have also been classified as a publicly supported organization described in sections 509(a)(1) and 170(b)(1)(A)(vi). You were created for charitable purposes including the promotion of social welfare. In furtherance of your exempt purposes you conduct independent, nonpartisan, public policy research and report on various regional and statewide issues affecting the quality of life in your community. You are headquartered in the state capital and have branch offices in three principal geographical areas.

Following an extensive review by your Governance Committee, you decided the most appropriate way to enhance your charitable mission is to broaden your geographical reach. To do this, you propose to form multiple single member LLCs throughout the state to serve the unique needs of each region. Each of these LLCs will enter into a shared governance structure

with a local educational or civic organization which has charitable purposes similar to yours and which has a strong, established presence in the region to be served. You believe this new structure will encourage and foster local community involvement while maintaining and institutionalizing your traditional standards of excellence.

Your first project will involve the formation of O, an LLC to serve the Southwestern region of your state. You will be the sole member of the LLC with the following reserved powers, rights and responsibilities:

- Exclusive right to receive authorized distributions from the LLC;
- Power to nominate and elect two of the board members;
- Power to remove, with or without cause, all board members;
- Ownership of your brand and all intellectual property created under the your brand, such as manuscripts, software, processes, and data in whatever form stored;
- Power to terminate the LLC;
- Upon termination, to receive and direct all distributions within the geographic area served by the LLC;
- Sole approval power over all amendments to the operating agreement that relate to your reserved powers.

By reserving these powers, rights and responsibilities, you indicate that you can ensure that the LLC furthers your charitable purposes while maintaining your high standards of excellence and professionalism.

O will enter into a shared management agreement with M, located in the Southwestern region of your state. M is exempt under section 501(c)(3) of the Code and shares your charitable purposes on a more limited geographic scale. By aligning with M in this manner, you indicate that O will receive the advantages and support of an organization that has direct first hand experience with the developmental needs of the region while avoiding the unnecessary waste of charitable assets resulting from potential duplication of services and personnel.

Under the shared management agreement, M will appoint all but two board members. Under your state law, this will not make M a member of O. You will be the sole member/owner of O. You believe that allowing M to appoint the majority of board members will result in a strong incentive for M to lend its expertise and development initiatives to O. M will also oversee the ministerial functioning of O and will assume responsibility for the selection of staff and personnel, establishing the operating budget, and overseeing the establishment and maintenance of regional alliances and programs designed to effectuate the charitable mission of O. You indicate that this shared governance structure will allow you to better serve the Southwestern region of your state.

In addition to O, you plan to form operating LLCs in at least three other areas of your state. At this juncture, only O has entered into a shared management agreement with another charitable organization. Any charitable organization that may be selected in the future to join in such a structure will be required to enter into a shared management agreement similar to the

one with M preserving your fundamental control over the relationship and ultimately ensuring that the LLC furthers your charitable purposes.

Section 501(c)(3) of the Code provides, in part, that an organization is exempt from federal income tax if it is organized and operated exclusively for charitable purposes, and if no part of the net earnings of the organization inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the advancement of education as well as relieving the poor, distressed or underprivileged, lessening the burdens of government, and promotion of social welfare by organizations designed to lessen neighborhood tensions, eliminate prejudice and discrimination, defend human and civil rights secured by law, or combat community deterioration and juvenile delinquency.

An organization described in section 170(b)(1)(A)(vi) and 509(a)(1) of the Code is one which: (a) is referred to in section 170(c)(2), and (b) normally receives a substantial part of its support (exclusive of income received in 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(a)) from a governmental unit referred to in section 170(c)(1) or from direct or indirect contributions from the general public.

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c), including those described in section 501(c)(3).

Section 512(a)(1) of the Code defines "unrelated business taxable income" as the gross income an organization derives from any unrelated trade or business (defined in section 513) it regularly carries on, less allowable deductions, with certain modifications.

Section 513(a) of the Code defines "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the organization's need for funds or the use it makes of the profits derived) to the organization's exercise or performance of the purpose or function constituting the basis for its exemption under section 501.

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 production of income); and it is "substantially related" 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 exempt purposes.

Section 1.513-1(d)(4) of the regulations provides that gross income derived from charges for the performance of exempt functions does not constitute gross income from the conduct of an unrelated trade or business.

The "check the box" regulations at section 301.7701 of the Procedure and Administration Regulations allow certain organizations to choose treatment as either a partnership or a corporation, or to be treated as a disregarded entity for federal tax purposes. Announcement 99-102, 1999-43 I.R.B. 545, confirms that a single member limited liability company (LLC) is presumed to be a disregarded entity. Where the sole member is a tax-exempt organization described in section 501(c)(3), the LLC is treated as an activity of the tax-exempt organization.

An organization that accomplishes its charitable purposes through a program of educating the public on subjects useful to the individual and beneficial to the community qualify as exempt charitable organizations. For example, Rev. Rul. 76-455, 1976-2 C.B. 150 holds that an organization that conducts studies into the quality, utilization and effectiveness of health care qualifies for exempt status. Promotion of social welfare is also recognized as a proper charitable purpose. Organizations whose purposes are to combat urban problems, improve the environment and lessen neighborhood tensions qualify as charitable organizations that promote social welfare.

You indicate that neither O nor any other single member LLC you may create will elect to be treated as a corporation. Accordingly, both O and additional single member LLCs you create for the same purposes will be treated as disregarded entities and their activities will be treated as your own pursuant to Announcement 99-102 and section 301.7701 of the regulations.

Your formation of O and your shared management services agreement with M for the purpose of expanding your charitable mission to a wider geographical area, does not change the nature of your activities or their purposes. Since you continue to operate for the promotion of social welfare, you continue to be described in section 501(c)(3) of the Code. In addition, as long as your funding sources continue to meet the criteria set forth in sections 170 (b)(1)(A)(vi) and 509(a)(1), you will continue to be classified as an organization that is not a private foundation.

Because your proposed activities will contribute importantly to the accomplishment of your exempt purposes within the meaning of section 1.513-1(d)(2) of the regulations, they will not be considered "unrelated trade or business" within the meaning of section 513 and the income derived from these activities will not be considered unrelated business taxable income under section 512(a)(1) of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Service.

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.

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,

Debra J. Kawecki
Manager, Exempt Organizations
Technical Group 1

Enclosure
Notice 437