



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

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Number: 200515021

Release Date: 4/15/2005

Date: 01/19/05

Contact Person:

Identification Number:

Telephone Number:

UIL Number:

509.02-03; 170.07-05

Employer Identification Number:

Legend:

A =

aa=

bb=

cc=

Dear :

You request a ruling under sections 509(a)(1) and 170(b)(1)(A)(vi) of the Internal Revenue Code.

Facts

You are exempt under section 501(c)(3) of the Code and presently described in section 509(a)(2). Your principal purposes are: to educate city employees and officials and the general public with respect to issues important to city government and its citizens and to lessen the burdens of government.

Your principal source of funding is contributions from the A. Since your inception, you received total support of aa of which bb represents contributions from A. You also received cc from A for an educational television program. You state these funds have been used for the general support of your programs, and have not been payments for any specific services. Specifically, you state this support has been used for the following programs: a television program that airs on government and local access channels and provides a forum for educating citizens and communities on issues of local interest; development and coordination of a training program for city officials and local government employees, businessmen and interested citizens; promotion of city government month; and encouragement of local governments to develop new ways to improve services and operations. You also receive contributions from individuals, government organizations, and the private sector, as well as payments for programs conducted in pursuit of

your exempt purpose.

A received a ruling from the Internal Revenue Service that its income is not subject to tax under section 115 of the Code. Lastly, A performed significant services for you, including providing administration, support, and exempt functions. You state these services have been provided at fair market value.

Rulings Requested

You request the following rulings:

1. Contributions to you from A constitute public support not subject to the 2 percent limitation described in section 1.170A-9(e)(6) of the Income Tax Regulations.
2. If you become a private foundation, A is not a disqualified person with respect to you for purposes of section 4941 of the Code.
3. If A is a disqualified person with respect to you for purposes of section 4941 of the Code, reasonable payments by you to A as compensation for personal services and reimbursement of expenses reasonable and necessary to carrying out your exempt purpose, shall not be an act of self dealing under section 4941(d)(2)(E) of the Code.

Law

Section 509(a)(1) of the Code provides the term "private foundation" means an organization described in section 501(c)(3) other than an organization described in section 170(b)(1)(A) (other than those described in clauses (vii) and (viii)).

Section 170(b)(1)(A)(vi) of the Code describes one category of organization which is not a private foundation pursuant to section 509(a)(1). That section describes an organization which 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 subsection 170(c)(1) or from direct or indirect contributions from the general public.

Section 1.170A-9(e)(6) of the regulations states that in computing the public support of an organization described in section 170(b)(1)(A)(vi), contributions from anyone individual, trust, corporation or related group exceeding 2 percent of the organization's total support shall not be included in the numerator of the public support test. That section provides further, however, that the 2 percent limitation shall not apply to support received from governmental units referred to in section 170(c)(1) or to contributions from organizations described in section 170(b)(1)(A)(vi), except as provided in subdivision (v) of this subparagraph. For purposes of subparagraphs (2), (3)(i) and (7)(ii)(b) of this paragraph, the term "indirect contributions from the general public" includes contributions received by the organization from organizations (such as section 170(b)(1)(A)(vi) organizations) which normally receive a substantial part of their support from direct contributions from the general public.

Section 1.170-9(e)(8)(ii) of the regulations provides that a payment will be treated as support

from a governmental unit when the purpose of the payment is primarily to enable the organization to provide a service to, or maintain a facility for, the direct benefit of the public, rather than primarily to serve the direct and immediate needs of the payor.

Section 1.509(a)-3(f)(1) of the regulations states in determining whether an organization normally receives more than one-third of its support from permitted sources, all gifts and contributions (within the meaning of section 509(a)(2)(A)(i)) received from permitted sources are includible in the numerator of the support fraction in each taxable year. However, gross receipts (within the meaning of section 509(a)(2)(A)(ii)) from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business are includible in the numerator of the support fraction in any taxable year only to the extent that such gross receipts do not exceed the limitation with respect to the greater of \$5,000 or 1 percent of support which is described in paragraph (b) of this section. The terms gifts and contributions shall, for purposes of section 509(a)(2), have the same meaning as such terms have under section 170(c) and also include bequests, legacies, devises, and transfers within the meaning of section 2055 or 2106(a)(2). Thus, for purposes of section 509(a)(2)(A), any payment of money or transfer of property without adequate consideration shall be considered a gift or contribution. Where payment is made or property transferred as consideration for admissions, sales of merchandise, performance of services, or furnishing of facilities to the donor, the status of the payment or transfer under section 170(c) shall determine whether and to what extent such payment or transfer constitutes a gift or contribution under section 509(a)(2)(A)(i) as distinguished from gross receipts from related activities under section 509(a)(2)(A)(ii).

Section 1.509(a)-3(g)(1) of the regulations states in determining whether an organization normally receives more than one-third of its support from public sources, all grants (within the meaning of section 509(a)(2)(A)(i)) received from permitted sources are includible in full in the numerator of the support fraction in each taxable year. However, gross receipts (within the meaning of section 509(a)(2)(A)(ii)) from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business, are includible in the numerator of the support fraction in any taxable year only to the extent that such gross receipts do not exceed the limitation with respect to the greater of \$5,000 or 1 percent of support which is described in paragraph (b) of this section. A grant is normally made to encourage the grantee organization to carry on certain programs or activities in furtherance of its exempt purposes. It may contain certain terms and conditions imposed by the grantor to insure the grantee's programs or activities are conducted in a manner compatible with the grantor's own programs and policies and beneficial to the public. The grantee may also perform a service or produce a work product which incidentally benefits the grantor. Because of the imposition of terms and conditions, the frequent similarity of public purposes of grantor and grantee, and the possibility of benefit resulting to the grantor, amounts received as grants for the carrying on of exempt activities are sometimes difficult to distinguish from amounts received as gross receipts from the carrying on of exempt activities. The fact that the agreement, pursuant to which payment is made, is designated a contract or a grant is not controlling for purposes of classifying the payment under section 509(a)(2).

Section 1.509(a)-3(g)(2) of the regulations discusses distinguishing factors. For purposes of section 509(a)(2)(A)(ii), in distinguishing the term gross receipts from the term grants, the term gross receipts means amounts received from an activity which is not an unrelated trade or business, if a specific service, facility, or product is provided to serve the direct and immediate needs of the payor, rather than primarily to confer a direct benefit upon the general public. In

general, payments made primarily to enable the payor to realize or receive some economic or physical benefit as a result of the service, facility, or product obtained will be treated as gross receipts with respect to the payee. The fact a profit making organization would, primarily for its own economic or physical betterment, contract with a nonprofit organization for the rendition of a comparable service, facility or product from such organization constitutes evidence that any payments received by the nonprofit payee organization (whether from a governmental unit, a nonprofit or a profit making organization) for such services, facilities or products are primarily for the economic or physical benefit of the payor and would therefore be considered gross receipts, rather than grants with respect to the payee organization. For example, if a nonprofit hospital described in section 170(b)(1)(A)(iii) engages an exempt research and development organization to develop a more economical system of preparing food for its own patients and personnel, and it can be established that a hospital operated for profit might engage the services of such an organization to perform a similar benefit for its economic betterment, such fact would constitute evidence that the payments received by the research and development organization constitute gross receipts, rather than grants. Research leading to the development of tangible products for the use or benefit of the payor will generally be treated as a service provided to serve the direct and immediate needs of the payor, while basic research or studies carried on in the physical or social sciences will generally be treated as primarily to confer a direct benefit upon the general public.

Section 1.509(a)-3(g)(3) of the regulations discusses distinguishing factors between grants and gross receipts. It also lists examples of grants and gross receipts.

Analysis

Contributions from A constitute public support not subject to the 2 percent limitation described in section 1.170A-9(e)(6) of the regulations. This is because the contributions you received from A are for the benefit of the general public. You use A's contributions to fund television programs that air on government and local access channels, to fund development and coordination of training programs for city officials and local government employees, and to fund encouragement of local governments to develop new ways to improve services and operations. Contributions from A are grants for the public benefit and not gross receipts for specific services. See sections 1.509(a)-3(f)(1), 1.509(a)-3(g)(1), 1.509(a)-3(g)(2) and 1.509(a)-3(g)(3) of the regulations. Therefore, you continue to be classified as a public charity but will be reclassified as an organization described in sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code.

Issues number 2 and 3 are moot because you are a public charity and not a private foundation.

Conclusion

1. Contributions from A to you constitute public support not subject to the 2 percent limitation described in section 1.170A-9(e)(6) of the regulations.
2. Since you are a public charity and not a private foundation, A's contributions to you are not subject to section 4941 of the Code.
3. Since you are a public charity and not a private foundation, A is not a disqualified person with respect to you for purposes of section 4941 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 upon the Foundation's tax status should be reported to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service Office, which deals with exempt organizations matters. The mailing address is: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

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 as precedent.

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.

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. Kaweck, Esq.
Manager, Exempt Organizations
Technical Group 1