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Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:EO1
PLR-109422-16

Date:
October 05, 2016

Legend

Foundation =
State =
City =

Dear :

This letter responds to a letter from your authorized representative dated March 18, 2016, as well as subsequent correspondence, submitted on behalf of the Foundation, requesting rulings that:

- (1) Fees received by the Foundation for technical assistance services described in the ruling request will not cause the Foundation to be treated as being engaged in an unrelated trade or business as defined in section 513 of the Internal Revenue Code (Code), because the services have a substantial causal relationship to the achievement of the Foundation's exempt purpose;
- (2) The income derived from such fees will not be subject to unrelated business income tax imposed by section 511 of the Code;
- (3) The services will not constitute a "business enterprise" within the meaning of section 4943(d)(3) of the Code because they will qualify as a "functionally related business" within the meaning of section 4942(j) of the Code; and

(4) Because the services will not be a business enterprise within the meaning of section 4943(d)(3) of the Code, the Foundation's provision of the Services will not subject the Foundation to excise taxes on excess business holdings under section 4943 of the Code.

FACTS

The Foundation is a tax-exempt organization described in section 501(c)(3) of the Code and classified as a private operating foundation under sections 509(a) and 4942(j)(3). It was formed for the charitable purpose of improving the lives of low income children and their families in State. The Foundation represents that, among other exempt activities, it furthers this charitable purpose through the collection, analysis, interpretation, and sharing of City metro region neighborhood data to improve community decision-making.

The Foundation represents that the data usage agreements entered into with government agencies and school districts give the Foundation access to raw data that is not typically available in the public domain and is not available to commercial ventures. The Foundation maintains a repository containing the usage agreement data, along with publicly available data obtained from the U.S. Census Bureau, Internal Revenue Service (Service), and U.S. Department of Housing and Urban Development, which enables it to conduct proactive, in-depth analysis of community issues and cover a wide array of information about the people, education, and health of the metro City area. The Foundation maintains on its website a free, user-friendly searchable database tool of neighborhood indicators based on information in its repository, but the searchable database does not reveal raw usage agreement data. The searchable database allows users to find information on key social issues affecting the City metro region neighborhoods.

In addition to collecting and making neighborhood data publicly available through its searchable database tool, the Foundation offers technical assistance to "social sector organizations" – nonprofits, foundations, government agencies, and community organizations. The Foundation defines "technical assistance" as a request that cannot be met through independent review of the tools on the Foundation's website. The Foundation represents that a client social sector organization seeks technical assistance because it does not have the in-house technical or subject-matter expertise to run the type of analysis it is requesting.

A social sector organization seeking the Foundation's services initiates a project request to the Foundation. The Foundation represents that it administers an extensive screening process similar to its grantmaking screening process to ensure that each project it agrees to undertake for a client social sector organization will provide information and insight to advance the Foundation's mission, in addition to ensuring that the services will be provided only to those specific social sector organizations that are focused on improving the lives of low-income children and their families.

The Foundation represents that, except in the case where there are privacy restrictions on the data source, all of the data and information provided by the client for the project is added to the Foundation's repository for use in other projects as needed by the Foundation. The Foundation represents that these projects provide the Foundation with data about the health and well-being of City metro region children, their families, and their communities so that the Foundation can better understand community needs and highlight the greatest potential for impact. The additional data informs the Foundation's grantmaking activities and assists the Foundation with tracking community change occurring as a result of its funding efforts. The Foundation represents that completed projects are made available to the public on its website.

The Foundation previously absorbed all costs of providing technical assistance, but absorbing all costs severely limits the number of projects that the Foundation engages in each year. In order to enable it to engage in more projects that bring in valuable new data and identify research questions not previously explored, the Foundation proposes to charge a "reasonable fee" for technical assistance requests. The Foundation will not charge for requests that require less than four hours of staff time. In addition, the Foundation represents that it will scope its pricing in alignment with clients' ability to pay. The Foundation represents that, on a case by case basis, it will charge fees less than cost.

The Foundation will continue to perform certain data activities without charge, including making data publicly available through its web-based searchable database tool, engaging in local and national partnerships to improve the data repository, and encouraging data-based decision-making.

The Foundation represents that, if it accepts a technical assistance request, the contract between the Foundation and the client social sector organization will provide that the client will not use the resulting product or information for any purpose other than the exempt purpose for which the Foundation agreed to provide the product or information, and will not resell the product or information.

LAW AND ANALYSIS

Ruling Requests 1 & 2

Section 511 of the Code imposes a tax on a section 501(c)(3) organization's unrelated business taxable income (as defined in section 512 of the Code). Section 512 defines the term "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less allowable deductions, both computed with the modifications provided in section 512(b). Generally, income will be treated as derived from the conduct of an "unrelated trade or business" 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. See §1.513-1(a) of the regulations.

Under §1.513-1(d)(2) of the regulations, a substantial causal relationship must exist between the conduct of the organization's trade or business activities that generated the income and the achievement of the organization's exempt purpose. A substantial causal relationship exists where the production or distribution of the goods or the performance of the services (from which the income is derived) contributes importantly to the accomplishment of the organization's exempt purpose. See §1.513-1(d)(2). Therefore, where the goods or services do not contribute importantly to the accomplishment of the organization's exempt purposes, the income earned is not derived from the conduct of related trade or business. See §1.513-1(d)(2).

Rev. Rul. 72-369, 1972-2 C.B. 245, held not exempt under section 501(c)(3) of the Code an organization formed to provide managerial and consulting services at cost to unrelated section 501(c)(3) organizations. The services consisted of writing job descriptions and training manuals, recruiting personnel, constructing organizational charts, and advising organizations on specific methods of operation. These activities were designed for the individual needs of each client organization. Receipts of the organization were from services rendered. Disbursements were for operating expenses. The Service reasoned that providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services were provided at cost and solely for exempt organizations was not sufficient to characterize the activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacked the donative element necessary to establish the activity as charitable. The case was distinguished from Rev. Rul. 71-529, where an organization controlled by a group of exempt organizations provided investment management services for a charge substantially less than cost solely to that group.

Similarly, in B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court concluded that a corporation formed to provide consulting services to nonprofit organizations was not exempt under section 501(c)(3) of the Code because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial. The court explained that the corporation had completely failed to demonstrate that its services were not in competition with commercial businesses. Also, the organization's financing did not resemble that of the typical organization described in section 501(c)(3) of the Code. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs, and to produce a profit. Moreover, it did not appear that the corporation ever

planned to charge a fee less than “cost.” And finally, the corporation had failed to limit its clientele to organizations that were section 501(c)(3) exempt organizations.

In this case, the Foundation’s technical assistance services are substantially related to the performance of its exempt functions. The services are part of the organization’s exempt data activities. The Foundation’s screening process ensures that it only undertakes projects that will provide valuable research and data to serve its charitable mission of improving the lives of low income children and their families. Performing the data analysis and interpretation services related to each project gives the Foundation access to new data and identifies new research questions related to its charitable mission. The Foundation makes the results of each project publicly available on its website. It also requires that its clients never sell the results of any project or use the results for any purpose other than the exempt purpose for which the Foundation agreed to provide its products or services; namely, to improve the lives of low income children and their families.

The Foundation is not like the organizations in B.S.W. Group, Inc. v. Commissioner and Rev. Rul. 72-369, because its technical assistance services have a primarily charitable purpose and differ from those available through commercial ventures. In B.S.W. Group, Inc., as in Rev. Rul. 72-369, the consulting services served the individual needs of the clients, but the services themselves were not inherently charitable, nor did they further the charitable purpose of the organization itself. In this case, the technical assistance services themselves further charitable purposes. Further, providing the technical assistance furthers the Foundation’s own charitable purposes because the Foundation uses resulting data and analysis for its own research and grantmaking purposes, in addition to assisting client social sector organizations to perform their own charitable activities. In addition, the Foundation’s services differ from those commercially available because the Foundation has access to raw data that is not available to commercial ventures and its activities are performed by employees of the Foundation who have developed particular knowledge and extensive understanding of issues facing low income children and their families in City metro region and perform such functions as part of other activities that further the Foundation’s exempt purposes. Finally, unlike the organization in B.S.W. Group, Inc., which did not appear to charge any fee less than cost, and the organization in Rev. Rul. 72-369, which charged fees at cost, the Foundation will determine on a case-by-case basis whether to charge a fee below cost to complete the project.

Therefore, the Foundation’s technical assistance services will not constitute an unrelated trade or business under section 513 of the Code. Furthermore, the income derived from those activities will not be subject to the unrelated business income tax imposed by section 511.

Ruling Requests 3 & 4

Section 4943(a) of the Code imposes a tax equal to 10 percent of the value of any excess business holdings of a private foundation in a business enterprise. Section 4943(d)(3) provides that the term “business enterprise” does not include a functionally related business (as defined by section 4942(j)(4)). Section 4942(j)(4) defines a “functionally related business” as: (1) a trade or business which is not an unrelated trade or business (as defined in section 513); or (2) an activity which is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which is related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exempt purposes of the organization.

In this case, the technical assistance services constitute a “functionally related business” because they are a trade or business which is not an unrelated trade or business as defined in section 513 of the Code. Thus, the Foundation will not be subject to tax under section 4943(a).

CONCLUSION

Based solely on the facts and representations submitted, we rule that the Foundation’s technical assistance services are substantially related to the Foundation’s exempt purpose and will not be subject to unrelated business income tax under section 511 of the Code or excess business holdings tax under section 4943(a).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an individual with authority to bind the taxpayer, as specified in Rev. Proc. 2016-1, 2016-1 I.R.B. 1, § 7.01(15)(b). The office has not verified any of the material submitted in support of the request for rulings, and such material is subject to verification on examination. The Associate Office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling is based; or in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2016-1, § 11.05.

No ruling is granted as to whether Foundation qualifies as an organization described in section 501(c) of the Code or section 4942(j)(3), and, except as expressly provided above, no opinion is expressed or implied concerning the federal income tax consequences of any other aspects of any transaction or item of income set forth in the ruling letter.

This ruling letter is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code 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 your authorized representative.

Sincerely,

Mary Jo Salins
Acting Branch Chief
Exempt Organizations Branch 1
Associate Chief Counsel
(Tax Exempt and Government Entities)

cc: