

Internal Revenue Service

Number: **201626004**
Release Date: 6/24/2016
Index Number: 511.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:EO3
PLR-128513-15

Date:
March 24, 2016

Foundation =
Decedent =
Company =
Estate =
State =
Date 1 =
Date 2 =
X =

Dear :

This letter responds to a letter from your authorized representatives dated August 18, 2015, modified by a letter dated February 4, 2016, requesting a ruling under section 511 of the Internal Revenue Code (Code). The Foundation represents the facts as follows.

FACTS

Before his death, Decedent was the sole member of the Company, a professional limited liability company treated as an S corporation for federal income tax purposes. On Date 1, Decedent established the Foundation, a State non-profit corporation that has been recognized as a private foundation exempt from federal income taxation under section 501(c)(3).

On Date 2, Decedent died. Under Decedent's will, Decedent's membership interest in the Company passed to, and remains in possession of, the Estate. After the Company has been dissolved, Decedent's will provides that the remaining property of the Company is to be distributed to the Foundation.

At the time of Decedent's death, the Company's primary assets were receivables related to legal services provided by the Company in connection with certain lawsuits ("the receivables"). The receivables represent the Company's share of the remaining unpaid balance of the attorney's fees awarded upon settlement of the lawsuits. The fees due to the Company were determined under various settlement agreements and, under the terms of the settlement, payment of fees was deferred over time. Payments are expected to continue for approximately x additional years. The Company's ownership in its share of the attorney's fees payable wholly vested when the lawsuits finally settled, which was prior to Decedent's death. Currently, none of the Estate, the Foundation, or the Company provides any services in relation to the legal services generating the receivables. Furthermore, the Foundation represents that it will not perform any act (including administrative acts) with respect to the receivables other than receiving payments related to satisfaction of the receivables.

The Foundation represents that the receivables:

- Are comprised solely of income from services previously provided by the Company, including Decedent;
- Are not debt-financed property within the meaning of section 514(b) and
- Are not gains or losses from the sale or exchange or other disposition of any property or gains or losses from the lapse or termination of options to buy or sell securities.

RULING REQUESTED

The income recognized by the Foundation upon the satisfaction of the receivables will not be income from an unrelated trade or business for purposes of the tax imposed under section 511 of the Code.

LAW

Section 511(a)(1) imposes a tax for each taxable year on the unrelated business taxable income of every organization described in section 501(c)

Section 512(a)(1) provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the deductions allowed by Chapter 1 which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

Section 513(a) provides that the term "unrelated trade or business" means, in the case of any operation subject to the tax imposed by section 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

Section 513(c) 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.

Treas. Reg. Sec. 1.513-1(a) provides that the term “unrelated business taxable income” 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 section 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 section 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 sections 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 a 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.

Treas. Reg. Sec. 1.513-1(b) provides that, for purposes of section 513 the term “trade or business” has the same meaning it has in section 162 and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Treas. Reg. Sec. 1.513-1(c)(1) provides that, in determining whether trade or business from which a particular amount of gross income derives is “regularly carried on” within the meaning of section 512 regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. This requirement must be applied in light of the purpose of the unrelated business income tax to place exempt organization business activities upon the same tax basis as the nonexempt business endeavors with which they compete. Hence, for example, specific business activities of an exempt organization will ordinarily be deemed to be “regularly carried” on if they manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations.

Treas. Reg. Sec. 1.513-1(d)(1) provides that gross income derives from “unrelated trade or business” within the meaning of section 513(a) 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.

Treas. Reg. Sec. 1.513-1(d)(2) 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 section 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.

In United States v. American Bar Endowment, 477 U.S. 105 (1986), the Supreme Court held that a section 501(c)(3) organization's insurance program constituted both the sale of goods and the performance of services and, therefore, was a trade or business for purposes of the tax on unrelated business income. The organization was the group policyholder and administrator of insurance policies offering life, disability and medical coverage. Its activities included compiling a list of its members and soliciting their insurance business.

In Ohio Farm Bureau Federation, Inc., v. Commissioner, 106 T.C. 222 (1996), the Tax Court concluded that a covenant not to compete did not constitute a trade or business. The Tax Court declined to treat the absence of activity as equivalent to the affirmative conduct of a trade or business in the context of unrelated business income.

ANALYSIS

The Foundation is recognized as exempt from federal income tax as an organization described in section 501(c)(3). Unless one of the specific exceptions of sections 512 or 513 applies, gross income of an exempt organization is includible in the computation of

unrelated business taxable income if: (1) it is income from a 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.

In this case, the legal services provided by the Company that resulted in the receivables would be a trade or business if the legal services were provided by the Foundation and were regularly carried on. Section [513\(a\)](#) and (c); Treas. Reg. Sec. [1.513-1\(a\)](#) (b), and (c). Furthermore, because the Foundation's purposes for which its exemption was granted do not include providing legal services, the provision of legal services would not be substantially related to the accomplishment of the Foundation's exempt purposes. Section [513\(a\)](#) Treas. Reg. Sec. [1.513-1\(a\)](#) and (d)(1).

However, the Company completed provision of the legal services prior to Decedent's death. The Foundation represents that none of the Estate, the Foundation, or the Company currently provides any services in relation to the receivables and, further, that the Foundation will not perform any act (including administrative acts) other than receiving payments related to satisfaction of the receivables. The Foundation is merely the distributee of the assets of the Estate and the recipient of the payments. The Foundation is performing no activity, similar to the organization in Ohio Farm Bureau Federation, Inc., *supra*, other than receiving payments. The Foundation is neither selling goods nor performing any services in order to receive income from the receivables, unlike the organization in United States v. American Bar Endowment, *supra*, that was engaged in a trade or business. See section [513\(c\)](#); Treas. Reg. Sec. 1.513-1(b). Therefore, the income resulting from the receivables is not unrelated business income within the meaning of section [512\(a\)](#) and will not be subject to the tax on unrelated business income described in section [511\(a\)](#).

CONCLUSION

In light of the foregoing, we rule as follows:

The income recognized by the Foundation upon the satisfaction of the receivables will not be income from an unrelated trade or business for purposes of the tax imposed under Section [511](#) of the Code.

This letter does not address the applicability of any section of the Code or Regulations to the facts submitted other than with respect to the sections specifically described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

This letter will be made available for public inspection under [section 6110](#) of the Code after certain deletions of identifying information are made. For details, see the 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 the [Notice 437](#). If you

disagree with our proposed deletions, you should follow the instructions in the [Notice 437](#).

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 and upon the understanding that there will be no material changes in the facts. This office has not verified any of the materials submitted in support of the request for rulings, and such material is subject to verification on examination.

This 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 by others as precedent

A copy of this letter must be attached to any tax return to which it is relevant. Alternatively, if Foundation files its returns electronically, it may satisfy this requirement by attaching a statement to its return that provides the date and control number of this letter.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

If you have any questions about this ruling, please contact the person whose name and phone number are shown in the heading of this letter.

Sincerely,

Virginia Richardson
Senior Tax Law Specialist
Exempt Organizations Branch 3
(Tax Exempt and Government Entities)

Enclosure: [Notice 437](#), Notice of Intention to Disclose

Redacted copy of this letter

cc: