



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:

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Identification Number:

Contact Number:
(202)

Employer Identification Number:

Legend:

M =
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Dear _____ :

We have considered your ruling request dated March 24, 2005, relating to the retention of the above organization's (the "Fund") tax exempt status under section 501(c)(3) of the Internal Revenue Code.

FACTS:

The Fund has been determined by the Internal Revenue Service to be exempt from federal income tax as an organization described in section 501(c)(3) of the Code and has also been classified as other than a private foundation because it is described in sections 509(a)(1) & 170(b)(1)(A)(vi) of the Code. The M Fraternity ("Fraternity") is a large national fraternity which has long been recognized by the Service as exempt from federal income tax under section 501(c)(7) of the Code. The Fraternity and the Fund are closely affiliated. The Fund engages directly in its own charitable activities and, subject to the normal controls and guidelines, financially supports the charitable

activities of the Fraternity. The Fund has never transferred money or anything else of value to the Fraternity for its unrestricted use or subsidized the Fraternity's general activities, either directly or indirectly.

In March, 2004, the Fraternity created and became the sole beneficial owner of the "N Trust" (the "Trust"), an O Statutory Trust that is a "grantor trust" within the meaning of sections 671-679 of the Code. On June 23, 2004, the Trust purchased from an unrelated party 6.1 acres of undeveloped land located in P, Q (the "Land"). The total cash price was approximately \$A, all of which was provided to the Trust by the Fraternity. The price resulted from arm's length negotiations and reflects the fair market value of the Land at that time.

After acquiring the Land, the Trust spent approximately \$B in cash on certain expenses (the "Expenses") relating to the development of the Land, e.g., legal costs relating to zoning and variance issues, architectural plans, and engineering studies. This cash was provided by the Fraternity. The Expenses produced assets both tangible, e.g., blueprints and written studies, and intangible, e.g., the right to use such blueprints and studies. The assets produced by the Expenses that did not become inextricably related to the Land will be referred to herein as the "Plans and Specifications." In addition, the Trust and the Fraternity itself entered into contracts relating to the development of the Land with third party providers of architectural, engineering, and general contracting services (the "Services Contracts").

The goal is to construct on the Land a three story building that is expected to incur a total cost of approximately \$C, including the Expenses (the "Improvements"). Accordingly, the Land and Improvements (together, the "Property") will have a total cost of \$D.

The Fund will form and become the sole member of a new limited liability company ("R") that, for federal income tax purposes, will not be an entity separate from the Fund. The Trust will sell the Land and the Plans and Specifications to R, receiving in exchange a \$E non-interest bearing promissory note ("R's Short-Term Note"). The amount of R's Short-Term Note will reflect the Trust's total costs of \$A for the Land and \$B for the Expenses, which is not greater (and probably less) than the total current fair market value of the Land and the Plans and Specifications. R's Short-Term Note will be secured only by the Land and the Plans and Specifications and will not be guaranteed by R or the Fund itself. In addition, R will assume the Services Contracts. R will then begin the construction of the Improvements, borrowing the necessary construction financing from a third party commercial lender.

Before the Improvements are completed and placed in service, the Property will be made subject to a "condominium declaration" as provided under applicable Q law (the

“Condominium Declaration”). The Condominium Declaration will divide the Property into (a) the “Fund Area”, (b) the “Fraternity Area”, and (c) the “Common Area”. The Fund Area will be located on all three floors and will contain approximately 15,241 square feet. The Fraternity Area will be located on part of the second floor and will contain approximately 6,461 square feet. The Common Area (including hallways, stairs, etc.) will be located on all three floors and will consist of approximately 1,398 square feet, plus certain parts of the Land. The use of these Areas is explained below.

R will own the Fund Area, which will consist of (a) administrative offices, including a study, (b) a museum that will focus upon the history of the Fraternity in the context of Greek letter societies and higher education, (c) a library, and (d) a conference area. The entire Fund Area will always be used exclusively for the Fund’s educational purposes, which will include subjects which go beyond the Fraternity and its history. For example, the museum will have exhibits relating to significant historical events.

The Trust will own the Fraternity Area, which will be the Fraternity’s international headquarters. The Fraternity will use it exclusively for its own fraternal and charitable activities.

The Common Area will be shared in the manner that is normal for common areas in improved real property subject to a condominium declaration.

After the Improvements are completed and the Condominium Declaration has been properly recorded, the Trust, for the benefit of the Fraternity, will purchase the Fraternity Area from R for 33% of the total cost of the Property, coming to approximately \$F, using the proceeds received from the pay-off of R’s Short-Term Note as partial payment. Thereafter, R will (a) retain ownership of the Fund Area and hold it on behalf of the Fund, its sole member, or (b) dissolve and transfer the Fund Area to the Fund, or (c) dissolve and transfer the Fund Area to another entity that will hold it for the benefit of the Fund.

The costs of the Property will not be shared on a pro rata basis. Instead, because the Fraternity wants to subsidize the Fund – and to demonstrate that the Fund is not subsidizing the Fraternity – the Fraternity will pay more per square foot than the Fund will pay. Thus, while the Fraternity Area will take up 29.8% of the total area apart from the Common Area, the Fraternity will pay 33% of the total cost of the Property. Also, the Condominium Declaration will state that 33% of the total periodic costs of maintaining the Property will be attributed to the Fraternity Area even though it in fact accounts for only 29.8% of the total area apart from the Common Area.

Both the Fraternity and the Fund will in part finance their acquisitions with borrowed money. Both are in sound financial condition and should have no trouble in obtaining

financing from a commercial lender. In order to reduce costs, however, the Fund alone will obtain from a third party commercial lender a "construction loan", i.e., the money needed to construct the Improvements. Once the construction is completed, the Fund will replace the construction loan with a "permanent" 30-year loan from a commercial lender for approximately \$G (the "Fund's Mortgage"), paying the difference between this amount and the outstanding balance of the construction loan with cash that the Fund now has or will receive as donations in the intervening period. The Trust will then acquire the Fraternity Area, giving the Fund a note for approximately \$H, the difference between the face amount of R's Short-Term Note and the \$F purchase price (the "Fraternity's Note"). The Fraternity Note will be fully recourse to the Fraternity, will be secured by the Fraternity Area, and will bear interest equal to one quarter of one percent (1/4%) over the interest of the Fund's Mortgage. The Fraternity may also be required to agree to certain other terms and conditions that may be required by the commercial lender.

It follows from the above that the Fund will make a small profit from the Fraternity's Note. The interest rate and other terms of the Fraternity's Note will at least be as favorable to the Fund as those that it could obtain from an unrelated party and will not be more favorable to the Fraternity than what it could obtain from a third party commercial lender.

RULING REQUESTED:

You request that we rule that the proposed transaction, as described above, will not adversely affect the Fund's tax exempt status as an organization described in section 501(c)(3) of the Code.

LAW:

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations that are organized and operated "exclusively" for charitable, religious, educational, or other specified exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 501(c)(7) of the Code provides for the exemption from federal income tax of organizations organized and operated for pleasure, recreation, and other non-profitable purposes, substantially all the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term “charitable” is used in Code Section 501(c)(3) in its generally accepted legal sense, and includes the advancement of education.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term “educational”, as used in Code section 501(c)(3), relates to (a) the instruction or training of the individual for the purpose of improving or developing his capabilities, or (b) the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages primarily in activities which accomplish one or more exempt purposes under Code section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for a section 501(c)(3) purpose unless it serves a public rather than a private interest. Thus, it is necessary that the organization establish that it is not operated for the benefit of private individuals.

Rev. Rul. 56-403, 1956-2 C.B. 307, holds that the awarding of scholarships by a foundation solely to undergraduate members of a designated fraternity does not disqualify it from exemption under section 501(c)(3) of the Code as an organization organized and operated exclusively for educational purposes. The fact that scholarships are limited to a particular group did not preclude exemption because there was no specific designation of persons eligible for the scholarships and the purposes of the organization were not so “personal, private, or selfish” as to lack the element of public usefulness.

Rev. Rul. 69-545, 1969-2 C.B. 117, states that the promotion of health, like the relief of poverty and the advancement of education and religion, is one of the purposes in the general law of charity that is deemed beneficial to the community as a whole even though the class of beneficiaries eligible to receive a direct benefit from its activities does not include all members of the community, provided that the class of beneficiaries is not so small that its relief is not of benefit to the community.

Rev. Rul. 75-196, 1975-2 C.B. 155, holds that an organization operating a law library whose rules limit access and use to the members or their designees of a local bar association, and which members are the library’s main source of support, qualifies for exemption under section 501(c)(3) of the Code. The ruling states that the fact that access to and use of the library facilities are limited to a designated class of individuals

is not necessarily a bar to recognition of exemption. What is of importance is that the class benefited is broad enough to conclude that the educational facility or activity is serving a broad public interest rather than a private interest; accordingly, it is considered exclusively educational in nature. The fact that the attorneys who use the facility may derive personal benefit in their law practices from the information garnered at the library is incidental to the educational process.

A section 501(c)(3) public charity may enter into financial transactions and other arrangements with related parties, including section 501(c)(7) organizations, provided that the public charity receives at least fair market value for the consideration it brings to the transaction, that the transaction is not unfair to the public charity, and that the transaction does not result in inurement or private benefit to any of the parties involved.

ANALYSIS :

The evidence in the administrative file establishes that (a) the Fraternity Area will be used by the Fraternity exclusively for activities appropriate for a section 501(c)(7) organization; (b) the Fund Area will be used by the Fund exclusively for activities appropriate for a section 501(c)(3) organization; (c) the Fraternity will bear a disproportionately high share of the acquisition and maintenance costs of the Property and will not be subsidized by the Fund either directly or indirectly; (d) R's Short-Term Note constitutes an interest free non-recourse loan from the Fraternity to the Fund; and (e) the Fraternity's Note provides the Fund with a rate and terms at least as good as what it could obtain in the market and does not provide the Fraternity with a rate or terms that are better than what it could obtain in the market. Thus, in all respects, the arrangement does not result in the Fund subsidizing the Fraternity nor does the arrangement otherwise result in any prohibited inurement or private benefit to private individuals or parties.

RULING:

Based on the foregoing, we rule that the proposed transaction, as described in FACTS above, will not adversely affect the Fund's status as an organization which is tax exempt under section 501(c)(3) 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 Fund's tax exempt status should be reported to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service Office. The mailing address is: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The telephone number there is 877-829-5500 (a toll free number).

Pursuant to a Power of Attorney on file in this office, we are sending a copy of this letter to the Fund's authorized representative.

We are also sending a copy of this ruling to the Ohio TE/GE Customer Service Office. Because this letter could help resolve any questions about the Fund's tax exempt status, it should be kept with the Fund's permanent records.

This ruling supersedes the ruling issued to the Fund on May 19, 2005. The previous ruling mistakenly omitted a legend. In all other respects, however, the rulings are identical.

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

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.

Thank you for your cooperation.

Sincerely,

Jane Baniewicz
Manager, Exempt Organizations
Technical Group 2

Enclosure:
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