PROPOSED JOINT VENTURE EXAMPLES FOR INCLUSION IN A REVENUE RULING

The following Proposed Examples represent the individual views of the members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation.

These Proposed Examples were prepared by individual members of the Committee on Exempt Organizations and its Task Force on Joint Ventures. Principal responsibility was exercised by Victoria B. Bjorklund and Susan A. Cobb. Substantive contributions were made by Michael Burnstein, Gordon Clay and William R. Peck. The Proposed Examples were reviewed by Alfred C. Groff and James F. Warren of the Section’s Committee on Government Submissions and by Douglas M. Mancino, Council Director for the Committee on Exempt Organizations.

Although many members of the Section of Taxation who participated in preparing these Proposed Examples have clients who would be affected by the federal tax principles addressed by these Proposed Examples, or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matters of these Proposed Examples.

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EXECUTIVE SUMMARY

The mission of the Task Force on Joint Ventures (the “Task Force”), chaired by Susan A. Cobb and composed of Michael Burnstein, Gordon Clay and William R. Peck, was to create several non-healthcare joint venture examples of the type that could be used as favorable examples in a revenue ruling. Specifically, the Task Force produced examples of real world joint ventures of a kind encountered by today’s exempt organizations community. To this end, the Task Force prepared several examples of joint ventures between public charities and for-profit organizations in various fact patterns along with a short analysis of each example. Those examples are submitted herewith.

In drafting its examples, the Task Force had several goals in mind. First, the examples were intended to provide guidance in the area between the “good” example and the “bad” example in revenue ruling 98-15.¹ That revenue ruling sets forth and analyzes two examples of healthcare joint ventures. Each joint venture is in the form of a limited liability company with a public charity and a for-profit entity as the only members. The “good” example is referred to as such because virtually all of the material facts are favorable. Exempt organizations practitioners generally regard this example as requiring a structure that is unrealistic in the real world. The “bad” example, conversely, is so known because most of the material facts are unfavorable. As a result, the revenue ruling has been criticized as giving very little meaningful guidance where the facts are not either universally favorable or entirely unfavorable.

Second, some of the Task Force’s examples address situations in which something less than voting control over the joint venture should be acceptable. The I.R.S. made clear in revenue ruling 98-15 that it views voting control over the venture as the most important factor in determining whether the venture furthers charitable purposes. However, in its recently published Exempt Organizations Continuing Professional Education Technical Instruction Program text for 2002, the I.R.S. alluded to the possibility that voting control might not be essential in all cases. The text stated in relevant part:

If the tax-exempt entity lacks majority representation or vote on the board to ensure it controls major decisions, it must have another mechanism to ensure the joint venture will operate for the exempt organization’s charitable purposes.²

The Task Force has attempted to illustrate situations where such other mechanisms exist.

It is the position of the Task Force that, whether or not control over the entity is necessary to ensure charity in the context of healthcare joint ventures, less control can be

appropriate in other kinds of joint ventures. This is because healthcare organizations are held to a community benefit standard (i.e., the entity must to some extent compromise profitability to provide a certain amount of care on a true charitable basis). The community benefit standard, which focuses on a number of factors indicating that the operation of the healthcare facility benefits the community rather than serving private interests, is a necessary element in the determination of the exempt status of a healthcare organization. In other contexts, however, the exempt mission of the charity and the goal of the joint venture are not necessarily in conflict. The relevant legal standard for these purposes is that any benefit in such an arrangement that accrues to a for-profit party must be incidental to the accomplishment of the charitable purpose of the tax-exempt entity. The U.S. Tax Court has ruled that this is a facts and circumstances determination based on numerous factors, none of which is determinative. Thus, in those contexts, all that should be necessary is that the charity have sufficient control over the venture to ensure that its charitable purposes are furthered, and that there are mechanisms integrated in the joint venture’s governing documents that operate to ensure that no more than an incidental benefit is conferred upon any private party to the arrangement. All of our examples contain such safeguards.

Third, our examples address ancillary joint ventures (i.e., joint ventures where something less than all of the public charity’s assets are contributed to the venture). Revenue Ruling 98-15 and Redlands Surgical Services each addressed whole-hospital joint ventures. As a result, there is some uncertainty as to whether and to what extent these authorities apply in the context of ancillary joint ventures.

Finally, we have addressed not only joint ventures utilizing a separate entity, such as a limited liability company, but also “ventures” where no separate entity is utilized and the arrangement is purely contractual. The Task Force believes that while some of the factors delineated in revenue ruling 98-15 are applicable in the context of non-entity ventures, the overall analysis of that revenue ruling is often a poor and inappropriate fit to purely contractual arrangements. As a result, we believe that examples of permissible joint arrangements in a contractual context will be welcome and beneficial.

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4 See, Plumstead Theatre Society, Inc. v. Commissioner, 74 T.C. 1324 (1980), aff’d 675 F. 2d 244 (9th Cir. 1982); Housing Pioneers v. Commissioner, 65 T.C.M. (CCH) 2191 (1993), aff’d 49 F.3d 1395 (9th Cir. 1995), amended, 58 F.3d 401 (9th Cir. 1995).
5 Id.
6 Redlands Surgical Services, Inc. v. Commissioner, 113 T.C. 47 (1999), aff’d 242 F.3d 904 (9th Cir. 2002).
PROPOSED JOINT VENTURE EXAMPLES FOR INCLUSION IN A REVENUE RULING

Situation 1 (Distance Learning)

FACTS

A is a nonprofit corporation that operates a university, and has been recognized as exempt from federal income tax under § 501(c)(3). It is classified as other than a private foundation under § 509(a)(1) and is described in § 170(b)(1)(A)(ii). B is a for-profit corporation that provides Internet-based educational programs. A and B form C, a limited liability company, to deliver and market online courses. It is anticipated that this online venture will constitute an ancillary joint venture in light of A’s overall activities.

A contributes all educational content for the online courses and a limited license to use A’s name and logo in connection with C in exchange for a properly valued 65 percent interest in C. B contributes cash in exchange for a properly valued 35 percent interest in C. C’s articles of organization and operating agreement (“governing documents”) provide that all returns of capital, allocations of income and loss, and distributions of profits made to the owners of C shall be proportional to their ownership interests in C.

The governing documents provide that C is to be managed by a governing board consisting of three individuals chosen by A and three individuals chosen by B. Board decisions require a majority vote. The governing documents provide that all disputes between A and B shall be resolved through arbitration with a presumption in favor of A. The dispute resolution provision indicates that in the event of a deadlock, A’s position will control unless B can prove that the educational purpose of A would not be jeopardized, and that A’s position was arbitrary, capricious or without merit. The governing documents further provide that they may only be amended with the approval of both owners.

The governing documents provide that C is formed for educational purposes, but do not explicitly provide that educational purposes take precedence over profit maximization. The governing documents provide that A has the right to oversee and to approve all educational aspects of C, including content to be delivered, the pedagogical model to be employed, and course requirements. In addition, instructional staff who interact with students must be hired by A, or the hiring of such staff must be approved by A. Any interactions between instructional staff and students must be under the guidance and supervision of A. In addition, other matters relating to students, such as admissions decisions, grading and evaluation, shall be handled in accordance with A’s policies and shall be under the supervision of A. The terms of the governing documents are legal, binding and enforceable under applicable state law.

B will provide overall management for C. The management agreement, which was negotiated at arm’s length, sets a fixed-fee payment for management services for a five-year term that can be renewed for subsequent two-year terms by the agreement of both owners. The fee is comparable to those paid for similar services. B is responsible for day-to-day operations, including the marketing of A’s online courses and for the technical aspects of delivering the
online courses, but its control is subject to the authority of C’s governing board. A may terminate the management agreement for cause.

It is anticipated that X, a key employee of A, will be retained by C in a consulting role. X will also retain her position as a key employee of A. In accordance with A’s conflict of interests policy, however, X did not participate in the decision to create C or in C’s decision to retain X, and X will receive no more than reasonable, fair market value, total compensation for her services to both A and C. None of the directors, officers or key employees of A who were involved in making the decision to form C were promised employment or any other inducement by C or B and their related entities if the transaction were approved. None of A’s officers, directors or key employees, including X, have any interest, including any interest through attribution determined in accordance with the principles of section 318 of the Code, in B or any of its related entities.

Pursuant to § 301.7701-3(b) of the Procedure and Administrative Regulations, C will be treated as a partnership for federal income tax purposes.

ANALYSIS

Because C furthers the exempt educational purposes of A, and because A has retained control over the educational aspects of C, A’s participation in C should not jeopardize A’s status under § 501(c)(3).

First, although the governing documents provide for 50-50 representation of the owners on C’s governing board, the governing documents include numerous safeguards to ensure that C furthers A’s educational mission. For example, the dispute resolution provision in the governing documents ensures that C will further its educational purposes in the event of a dispute between A and B or in the event of a deadlock on the governing board of C. Further, the governing documents provide that A will have control over course content, the pedagogical model to be employed, and all interactions with students.

Similarly, although the governing documents provide that B will provide day-to-day management services, the governing documents include adequate safeguards to ensure control by A of the educational aspects of C, including A’s ability to terminate the management agreement for cause.

In addition, although X, a key employee of A, will provide fee-based consulting services for C, A has taken sufficient precautions to avoid private inurement and private benefit. Indeed, consistent with A’s conflict of interests policy, X did not participate in the decision to create C, and X will receive only reasonable compensation for her services to A and C.

Finally, the governing documents need not explicitly provide that educational purposes will take precedence over profit maximization. Indeed, the exempt educational purposes of colleges and universities, unlike the charitable purposes of hospitals, are not in tension with a profit-making motive. In other words, an educational organization may make a profit from its education activities and still retain its tax-exempt status.
In summary, because A has adequate safeguards under the governing documents to ensure that A maintains control over the educational aspects of C, A’s participation in C does not result in more than incidental private benefit to B. A’s participation in C furthers the exempt educational purposes of A and allows A to be operated exclusively for educational purposes. Although B manages the day-to-day operations of C, A controls all decisions regarding education and can ensure that A’s educational purposes are not compromised.

HOLDING

A’s participation in C will have no effect on A’s continued qualification as an organization exempt under § 501(c)(3) because A has established that C will be operating exclusively for educational purposes and only incidentally for the purpose of benefiting the private interests of B. Further, since C’s activities are substantially related to the exercise of A’s exempt purposes, A’s share of income and deductions from C will not be subject to unrelated business income tax pursuant to § 512(c).

Situation 2 (Distance Learning)

FACTS

D is a nonprofit corporation that operates a university, and has been recognized as exempt from federal income tax under § 501(c)(3). It is classified as other than a private foundation under § 509(a)(1) and is described in § 170(b)(1)(A)(ii). E is a for-profit corporation. D and E enter into a contractual arrangement (the “Agreement”) to deliver and market online courses to employees of E. It is anticipated that this online venture will constitute an ancillary joint venture in light of D’s overall activities.

The Agreement, which was negotiated at arm’s length, provides that D will develop and provide all educational content for the online courses and license such content to E in exchange for a properly valued, fair-market license fee. The Agreement has an initial term of five years and can be renewed for subsequent two-year terms by the agreement of both parties.

The Agreement further provides that D has the right to oversee and to approve all educational aspects of the venture, including content to be delivered, the pedagogical model to be employed, and course requirements. In addition, instructional staff must be hired by D, or the hiring of such staff must be approved by D. Any interactions between instructional staff and students must be under the guidance and supervision of D. In addition, other matters relating to students, such as admissions decisions, grading and evaluation, shall be handled in accordance with D’s policies and shall be under the supervision of D.

E is responsible for the marketing of D’s online courses, for the technical aspects of delivering the online courses, and for the day-to-day management of the venture. E is to receive a fixed fee for its services comparable to those paid for similar services.
D and E will each commit funds to the venture in accordance with mutually agreed-upon budgets. D’s obligations to provide funds to the venture are limited to the amounts set forth in the approved budgets. Profits from the venture will be divided between D and E in proportion to each party’s contributions to the venture. Cost overruns are to be reimbursed before any profits are shared by the parties.

ANALYSIS

Because the above-described venture furthers the exempt educational purposes of D, and because D has retained control over the educational aspects of the venture, the venture should not jeopardize D’s tax-exempt status under § 501(c)(3).

First, although day-to-day management is under the control of E, D has maintained control over all educational aspects of the venture, including course content, the pedagogical model to be employed, and interactions with students. D thus has sufficient safeguards under the Agreement to ensure that control of the exempt aspects of the venture remains with D, notwithstanding E’s control over the administrative aspects of the venture.

In addition, pursuant to the terms of the Agreement, D’s obligations to commit funds are to be provided in approved budgets. This provision should adequately protect against the use of D funds for nonexempt purposes.

HOLDING

D’s participation in the venture will have no effect on D’s continued qualification as an organization exempt under § 501(c)(3). D’s participation in the venture furthers the exempt educational purposes of D and allows D to be operated exclusively for educational purposes. Although E manages the day-to-day operations of the venture, the terms of the Agreement are reasonable and D controls all decisions regarding education and can ensure that D’s educational purposes are not compromised. Because the Agreement contains adequate provisions to ensure that D retains control over the educational aspects of the venture and to ensure that D funds are not used for nonexempt purposes, the arrangement does not result in more than incidental private benefit to E. Further, since D’s participation in the venture is substantially related to the exercise of D’s exempt purposes, D’s income from the venture will not be subject to unrelated business income tax pursuant to § 511.

Situation 3 (Housing)

FACTS

F is a nonprofit corporation engaged in low-income housing projects and other activities, and has been recognized as exempt from federal income tax under § 501(c)(3). It is classified as other than a private foundation under § 509(a)(2). G is a for-profit corporation that invests in low-income housing projects. F and G form H, a limited liability company, in order to construct, own, and operate a low-income rental housing project (the “Project”) financed in part with
proceeds from the low-income housing tax credit under § 42. It is anticipated that the Project will constitute an ancillary joint venture in light of F’s overall activities.

H’s articles of organization and operating agreement (the “governing documents”) stipulate that rent and tenant income levels at the Project must comply with the affordability requirements of the low-income housing tax credit and fall within the numerical safe harbor for the charitability of affordable housing set forth in Rev. Proc. 96-32, 1996-1 C.B. 717. The governing documents can only be amended with the consent of both members. The terms of the governing documents are legal, binding, and enforceable under applicable state law.

Pursuant to the governing documents, F serves as the sole managing member, makes a nominal capital contribution, and owns a 0.01% of the ownership interest in H. G serves as the investor member, makes a substantial capital contribution, and owns a 99.99% ownership interest in H. The ownership interests of F and G are proportional and equal in value to their respective contributions. The governing documents provide that all returns of capital, allocations of income and loss, and distributions of profits made to the owners of H shall be proportional to their ownership interests in H.

The governing documents provide that F, as managing member, maintains sole operational control of H, with the exception of certain specifically enumerated major actions that require G’s approval, such as disposing of the Project, causing the merger, reorganization, or dissolution of H, incurring additional indebtedness, and making expenditures not authorized in the annual budget. G has the power to remove F as managing member under specifically enumerated extraordinary circumstances, including F’s material breach of the governing documents or mismanagement causing the Project to violate laws, default on its loans, or become ineligible to receive the tax credit under § 42.

A provision of the governing documents grants F an option to purchase G’s membership interest at the conclusion of the fifteen-year period during which the Project must comply with the requirements of the low-income housing tax credit program. The option purchase price will be less than the fair market price of the property, as permitted to qualified nonprofits under § 42(i)(7).

F guarantees any Project cost overruns during construction, as well as operating deficits for three years following the achievement of three consecutive months in which Project receipts equal or exceed expenses. F also indemnifies H for certain environmental liabilities, although a Phase I environmental review of the Project has identified no such potential liabilities and H’s insurance includes protection against environmental liabilities. A tax credit adjuster provision in the governing documents requires F to make an additional capital contribution to H to cover any shortfall in the amount of tax credits G is projected to receive. The governing documents provide that upon dissolution of H, distribution will be based on the members’ respective capital accounts. F has secured an opinion of counsel, prepared in accordance with the guidelines on due diligence issues related to tax opinions under ABA Opinion 346, concluding that the bulk of the tax benefits will more likely than not be available to G.
H retains a property manager (the “Property Manager”) to implement the day-to-day operations of the Project. The Property Manager, an unrelated third party, was not selected through open bid, but is one of the region’s most experienced and successful managers of low-income housing tax credit projects. The terms of the property management agreement between H and the Property Manager are fair and reasonable, and the Property Manager’s compensation is comparable to what other management firms receive for managing similarly situated projects. The property management agreement has a one-year term and is renewable for one-year terms with the consent of both parties, at the sole discretion of each. Under the property management agreement, the Property Manager can be removed by H for failure to manage the Project in compliance with the requirements of the tax credit program and the numerical safe harbor under Rev. Proc. 96-32.

None of F’s officers, directors, or key employees has any financial interest, including any interest through attribution determined in accordance with the principles of §318, in G or any of G’s related entities, and none was promised employment with H or any inducement for approving F’s establishment of H and initiation of the Project or G’s participation. The governing documents further provide that all returns of capital, as well as all allocations and distributions of profits and losses, will be made in accordance with each member’s ownership interest in H. All cash flow, residuals, and allocations of profits and losses remain constant for the life of the Project.

Pursuant to § 301.7701-3(b) of the Procedure and Administrative Regulations, H will be treated as a partnership for federal income tax purposes.

ANALYSIS

F’s participation in H furthers its charitable purpose and does not result in impermissible private benefit to G or the Property Manager. F maintains control over H, not through board representation or ownership interest but through another mechanism: its role as the sole managing member of H under the terms of the governing documents and the requirements of the low-income housing tax credit program. Because the return on G’s investment depends on the Project’s compliance with the tax credit requirements, G’s profit motive is not at odds with F’s tax-exempt purpose. Moreover, the governing documents and property management agreement require the Project to be managed so as to fall within the safe harbor of Rev. Proc. 96-32. Stated another way, the governing documents and G’s own interest in complying with the low-income requirements essentially amount to a charitable override of the profit motive. Once the tax credit requirements are no longer binding on the Project, the option ensures that F can maintain the charitable purpose of the Project by acquiring G’s interest at a “bargain” price.

The guarantees are unlikely to put F’s assets at risk. The completion and operating deficit guarantees concern conditions that are within the control of F in its capacities as managing member and developer. The environmental indemnification presents a relatively low risk because the Phase I assessment has already been completed and because H’s insurance protects it against foreseeable liabilities. The tax credit adjuster characterizes any payment by F as a capital contribution, allowing F upon dissolution of H to recover any charitable assets used to cover the shortfall. Moreover, G has received a legal opinion regarding tax benefits that lessens the risk to F.
Finally, $F$ is able to ensure that any benefits to the Property Manager are incidental to the charitable purpose. As the sole managing member, $F$ has control over $H$’s operations, including oversight of the Property Manager and the day-to-day management of the Project. The Property Manager was selected for its expertise as a manager of low-income housing and is contractually obligated to implement the day-to-day operations of the Project in a manner consistent with the charitable purpose. The Property Manager can be removed by $F$, as managing member of $H$, for failure to manage the Project in compliance with the tax credit and Rev. Proc. 96-32 requirements. Not only is the property management agreement fair, reasonable, and comparable to similar agreements, but it also has a short term, and $F$, as the managing member of $H$, can unilaterally decide not to renew it.

**HOLDING**

$F$’s participation in $H$ will have no effect on $F$’s continued qualification as an organization exempt under § 501(c)(3) because $F$ has established that $H$ will be operating exclusively for a charitable purpose and only incidentally for the purpose of benefiting the private interests of $G$ and the Property Manager. Further, since $H$’s activities are substantially related to the exercise of $F$’s exempt purposes, $F$’s share of income and deductions from $H$ will not be subject to unrelated business income tax pursuant to § 512(c).

**Situation 4 (Internet)**

**FACTS**

$I$ is a nonprofit corporation and has been recognized as exempt from federal income tax under § 501(c)(3). It is classified as other than a private foundation under § 509(a)(1) and is described in § 170(b)(1)(A)(vi). $J$ is a for-profit corporation. $I$ and $J$ enter into a sponsorship agreement pursuant to which the parties will jointly develop a co-branded Website (the “Website”), which will be used to raise money for $I$. It is anticipated that the Website will constitute an ancillary joint venture in light of $I$’s overall activities.

Under the terms of the agreement, $I$ is to develop content descriptive of its operations and programs, which content will be displayed on the Website. $I$ will provide a limited license of this content, along with a limited license of $I$’s name and logo, for use only in connection with the online fundraising activities to be undertaken pursuant to the agreement. The agreement provides that any changes to the Website must be approved in advance by $I$. The value of the benefits $I$ will receive as a result of the arrangement will exceed the value of the license.

$J$ will build and maintain the Website and host the Website on $J$’s servers. $J$ will also be responsible for processing credit card contributions made to $I$ by users of the Website, and for forwarding such contributions to $I$. $J$ will retain a small percentage of each contribution as a fee for its services. The amount of the fee is comparable to those paid for similar services. $J$ will also be described on the Website as a sponsor of $I$. 
I and J will each include a link on their respective Internet home pages to the Website, encouraging users to click through to the Website and to make a contribution to I.

ANALYSIS

This example involves a fairly routine fundraising arrangement in the Internet context. Although such a contractual arrangement is, in a way, a type of “joint venture,” it is not the type of venture to which a Revenue Ruling 98-15 analysis should apply. Instead, as long as the arrangement is structured to ensure that more than incidental private benefit does not result, the arrangement should not place I’s § 501(c)(3) status at risk.

In the present example, I has provided a license that may be used only for fundraising on behalf of I. In addition, any changes to the content displayed on the Website must be approved in advance by I. Finally, the fee provided to J for its services will be properly valued and will be representative of fees paid for similar services. Therefore, the agreement contains sufficient safeguards to ensure that I maintains control over the use of its content, name and logo, and to ensure that J is not paid more than a reasonable amount of compensation for its services.

HOLDING

I’s participation in the Website arrangement will have no effect on A’s continued qualification as an organization exempt under § 501(c)(3). Its participation in the Website arrangement furthers the charitable purposes of I and allows I to be operated exclusively for charitable purposes with only incidental private benefit to J. Although J maintains the Website and hosts the Website on J’s servers, I retains control over the display of all content related to I’s programs and operations. Further, since the Website facilitates I’s solicitation of charitable contributions, I’s gross receipts from the Website will not be subject to unrelated business income tax under § 511.

Situation 5 (UBIT)

FACTS

K is an environmental conservation nonprofit corporation and has been recognized as exempt from federal income tax under § 501(c)(3). It is classified as other than a private foundation under § 509(a)(1) and is described in § 170(b)(1)(A)(vi). K is interested in preserving and protecting ecologically sensitive land in the state of X. The particular land K is most interested in protecting is also very desirable to developers who would like to establish a golf course on the land. K believes that it is inevitable that the land will be developed as a golf course and is anxious to influence the project.
K also believes that it can earn a significant return on an investment in the golf course, and thus would like a larger and more active role than is necessary to protect the land. K believes that by jointly purchasing land and participating in the development and operation of a golf course with a developer, K can minimize the harmful effects a golf course would have by, for example, influencing policies relating to the use of pesticides and the layout of the course while also earning substantial profits. Operation of the golf course would constitute an unrelated trade or business if operated by K. K has no other unrelated trade or business activities, and operation of the golf course by K would be insubstantial when compared to K’s exempt activities.

L is one of several for-profit developers that would like to build a golf course on the land. L believes that local officials will select a developer based in part on the impact the course will have on the sensitive land. For this reason, L is eager to demonstrate that it is the most environmentally responsible developer and, as a result, L is willing to develop, own and operate the golf course with N and to operate it in a way that will minimize damage to the land.

K and L agree to form M, a limited liability company, to purchase the land and operate the golf course. It is anticipated that this activity will constitute an ancillary joint venture in light of K’s overall activities. Pursuant to M’s articles of organization and operating agreement (“governing documents”), which are legal, binding, and enforceable under applicable state law, K and L will contribute equal amounts of cash to M, and they will exercise equal control over the development and operation of the golf course. In accordance with the governing documents, K and L will each receive a 50% ownership interest in M equal in value to the amount contributed by each, and all returns of capital, allocations of income and loss, and distributions of profits will be made in accordance with each member’s ownership interest in M.

Under the governing documents, M will be governed by a six-member governing board, and K and L will each elect three members. The governing documents provide that all subcontractors used in developing the course, as well as all course managers used in operating the course, must be unrelated to K and L and must be paid no more than reasonable compensation. Further, the governing documents provide that they may only be amended with the approval of both owners and that a majority of four board members must approve decisions relating to M’s operations, including major decisions relating to M’s annual capital and operating budgets, distributions of M’s earnings, renewal and termination of management agreements, and contracts in excess of $x per year.

Pursuant to § 301.7701-3(b) of the Procedure and Administrative Regulations, M will be treated as a partnership for federal income tax purposes.

ANALYSIS

K and L will make equal contributions to M and will receive equal ownership interests in and voting control over M. K will receive an interest in M equal in value to the property K contributes. The governing documents provide that persons related to K and L cannot be hired as subcontractors or managers, and the governing documents cannot be amended without the
consent of \( K \). As a result, \( K \) can be assured that no impermissible private benefit will inure to \( L \) and other private persons associated with the golf course as a result of \( K \)'s participation.

\( K \) will not have voting control over \( M \), but will share control with \( L \). However, because \( K \)'s participation in \( M \) is unrelated to \( K \)'s exempt purposes, \( K \)'s inability to ensure that assets of \( M \) will be used exclusively in furtherance of \( K \)'s exempt purposes is not critical.

**HOLDING**

\( K \)'s participation in \( M \) will have no effect on \( K \)'s continued qualification as an organization exempt under § 501(c)(3). Even though \( M \)'s activities are not substantially related to \( K \)'s exempt purposes, such activities are insubstantial in relation to \( K \)'s exempt activities. \( K \)'s share of income and deductions from \( M \) will be subject to unrelated business income tax pursuant to § 512(c).