



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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UIL Index
501.03-08
501.03-21
501.03-24

Legend:

L =

M =

N =

O =

P =

Year a =

Year b =

Date c =

Date d =

Date e =

Date f =

State g =

Dear _____ :

This letter is in response to your ruling request under section 501(c)(3) of the Internal Revenue Code.

FACTS

In Year a, L was created under M as an N under the laws of State g. L's purpose, as stated in M, is education in connection with, and the encouragement of, creative research work, the making of discoveries and inventions in connection with O. In Year b, L was incorporated as a State g nonprofit corporation. On Date c, L adopted

Amended and Restated Articles of Incorporation that provided that L is organized exclusively for charitable, educational and scientific purposes.

On Date d, the Internal Revenue Service issued L a determination letter recognizing L as an organization described in section 501(c)(3) of the Code and as a public charity described in sections 509(a)(1) and 170(b)(1)(A)(vi).

Under L's amended and restated Code of Regulations (the "Bylaws"), L's Board of Directors (the "Board") is self-perpetuating and consists of no more than nine and no fewer than six persons, each of whom is elected for a term of no more than three years. The Bylaws also provide that, at all times, at least a majority of the members of the Board, including the Chairman, must consist of independent directors. L's Board adopted a "Resolution of the Board of Directors Governing Director Independence," which defines "independent directors."

The Bylaws provide that the Board may appoint an executive committee or any other committee or committees of the Board. The Board has not established an executive committee. However, by resolution adopted on Date e, the Board established two standing committees: the Personnel and Compensation Committee, subsequently known as the Human Resources and Compensation Committee (the "Compensation Committee"), and the Audit Committee.

L's Board adopted by resolution a conflicts of interest policy that expressly applies to all officers, members of the Board and members of any committee with Board-delegated powers.

L's Board adopted a resolution amending the Human Resources and Compensation Committee Charter (the "Charter"). The principal provisions of the Charter, as amended, are:

- The Compensation Committee consists of at least three members, all of whom must be independent members of the Board, as defined in the "Resolution of the Board of Directors Governing Director Independence."
- The purpose of the Compensation Committee is to discharge the Board's responsibilities to ensure the health of human capital of L, including compensation of L's executives, the review and assessment of overall L strategies for attracting, developing, retaining, and motivating management and employees, and to assure a succession of leadership talent for L.
- The Compensation Committee may request the services of any employee of L in carrying out its duties and responsibilities.
- To assist the Compensation Committee in carrying out its duties and responsibilities, the Compensation Committee may hire outside accountants, lawyers, compensation experts and other advisors

(collectively, “Consultants”), provided that the Compensation Committee determines in advance that the Consultants are independent.

Effective Date f, L proposes to adopt a Long-Term Incentive Bonus Program (the “Program”) in order to provide financial incentives for senior managers of L to achieve the specific measurable goals that will continue and advance L’s tax-exempt purposes by maintaining the level of human and capital assets necessary to achieve its strategic agenda. The Program is intended to provide financial incentives to, and rewards for, eligible employees who make key contributions to L’s core operations and to the development by P of commercial uses for L’s science and technology discoveries. The principal provisions of the Program will be:

- Employees eligible to participate in the Program will be senior management employees of L who have primary responsibility for the success of L’s core operations delivering outstanding science and high value technology and/or who are capable of facilitating the flow of technology.
- Each fiscal year, from among L’s eligible senior management employees who are not executive officers, the executive officers will nominate individuals to be eligible to receive a bonus for that fiscal year upon satisfactory completion of the requirements for the award of a bonus.
- The executive officers will make their recommendations to the Compensation Committee, which will make its recommendations to the Board.
- Each fiscal year, from among L’s eligible employees who are executive officers, the Compensation Committee will nominate individuals to be eligible to receive a bonus for that fiscal year upon satisfactory completion of the requirements for the award of a bonus.
- The Compensation Committee will make its recommendations to the Board of Directors.
- For each fiscal year:
 - As to each participant who is a not an executive officer, the executive officers will recommend individual performance objectives to the Compensation Committee, which will establish individual performance objectives for each participant;
 - As to each participant who is an executive officer other than the CEO, the Compensation Committee will establish individual performance objectives for each participant; and
 - As to the CEO, the Board will establish the CEO’s individual performance objectives.

- Following the conclusion of each fiscal year,
 - As to each participant who is not an executive officer, the executive officers will document each participant's objective performance and assign each participant a performance score reflecting the participant's level of achievement of the participant's individual performance objectives. Based upon the performance score, the Compensation Committee will determine the potential bonus award for each participant for the fiscal year.
 - As to each participant who is an executive officer other than the CEO, the Compensation Committee will document each participant's objective performance and will assign each participant a performance score reflecting the participant's level of achievement of the participant's individual performance objectives. Based upon the performance score, the Compensation Committee will determine the potential bonus award for each participant for the fiscal year.
 - The Board will document the objective performance of the CEO and will assign the CEO a performance score reflecting the CEO's level of achievement of his/her individual performance objectives. Based on the performance score, the Board will determine the potential bonus award for the CEO for the fiscal year.
- The potential bonus award will be based upon a percentage of the participant's base salary.
 - The Compensation Committee and the Board will be prohibited from granting a potential bonus award which, when added to the participant's base salary and all other compensation and benefits, would exceed an amount that is determined by the Board and the Compensation Committee to be reasonable compensation.
- L will not actually pay a bonus to any participant unless and until L receives the return of its capital contribution to P and a return on its capital contribution to P that is equal to its weighted annual cost of capital. Upon satisfaction of this objective and a participant's individual performance objective, L will pay a participant a bonus equal to the lesser of the participant's share of 25 percent of future P cash distributions to L or the participant's aggregate potential bonus award.
- The Board, in its sole discretion, may cancel or reduce potential bonus awards at the time of payment if payment of such awards would be in violation of any law, would jeopardize L's ability to meet its obligations under the N, would jeopardize L's ability to carry out its tax-exempt purposes or would otherwise not be in the best interest of L.

- The Compensation Committee will administer the Program and will have the sole authority and discretion to interpret the Program and to issue such rules or regulations as it deems appropriate.
- The Compensation Committee will have the duty and responsibility to maintain records, make the requisite calculations, and disburse payments under the Program.
- The Compensation Committee's interpretations, determinations, rules, regulations, and calculations will be final and binding on L, its employees, and its contractors.
- The Compensation Committee may hire consultants to assist the Compensation Committee in carrying out its duties and responsibilities under the Program, provided that the Compensation Committee determines in advance that any consultants hired are independent.
- The Compensation Committee may delegate the performance of any ministerial duties and responsibilities to any employee of L to assist the Compensation Committee in carrying out its duties and responsibilities under the Program.

L proposes to enter into a written agreement with a compensation consultant relating to the Program.

RULING REQUESTED

L's adoption and operation of the Program is consistent with the requirement that an organization described in section 501(c)(3) of the Code operate exclusively for one or more exempt purposes and will not jeopardize L's tax-exempt status under section 501(c)(3).

APPLICABLE LAW

Section 501(c)(3) of the Code describes as exempt from federal income tax, as provided under section 501(a), organizations organized and operated exclusively for various exempt purposes, including charitable, scientific, or educational purposes, and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as operated exclusively for exempt purposes only if it engages primarily in activities which accomplish such exempt purposes specified in 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 may be exempt as an organization described in section 501(c)(3) of the Code if it is organized and operated exclusively for one or more of exempt purposes, which include charitable and scientific.

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

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and that this term includes the advancement of education or science.

Section 1.501(c)(3)-1(d)(5) of the regulations provides that a "scientific" organization must serve a public rather than a private interest, and must be organized and operated in the public interest, as described in section 1.501(c)(3)-1(d)(5)(iii).

Rev. Rul. 97-21, 1997-1 C.B. 121, addressed several situations where hospitals described in section 501(c)(3) of the Code provided various types of financial recruitment incentives to physicians to encourage them to work for the hospital. The hospital was located in a rural area or in an economically depressed inner-city area. In each of these situations, the Internal Revenue Service concluded that under the circumstances, the provision of these incentives furthered the charitable purposes served by each hospital and was consistent with the requirements for exemption as an organization described in section 501(c)(3).

RATIONALE

Under the regulations, an organization that is organized and operated exclusively for charitable, or scientific or educational purposes may qualify for exemption under section 501(c)(3) of the Code. The regulations provide that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense. The regulations also provide that the term "scientific" includes carrying on scientific research in the public interest.

L proposes to adopt the Program in order to provide financial incentives for senior managers to achieve specific measurable goals that will continue and advance L's tax-exempt purposes by maintaining the level of human and capital assets necessary to achieve its strategic agenda. The Program is intended to provide financial incentives to, and rewards for, eligible employees who make key contributions to L's core operations and to the development by P of commercial uses for L's science and technology discoveries. The Program is designed to ensure that these financial incentives constitute reasonable compensation. As a result, it is similar to the situations described in Rev. Rul. 97-21, supra, in that the bonus payments under the Program will further L's tax-exempt purposes and will be consistent with the requirements for exemption as an organization described in section 501(c)(3) of the Code.

As a result, L's adoption and operation of the Program will not adversely affect L's ability to continue to operate exclusively for one or more tax-exempt purposes under section 1.501(c)(3)-1(c)(1) of the regulations. In addition, L's adoption and operation of the Program will not adversely affect its ability to serve a public rather than a private interest under section 1.501(c)(3)-1(d)(1). Therefore, L's adoption and operation of the Program will not adversely affect the status of L as an organization described in section 501(c)(3) of the Code.

RULING

L's adoption and operation of the Program is consistent with the requirement that an organization described in section 501(c)(3) of the Code operate exclusively for one or more exempt purposes and will not jeopardize L's tax-exempt status under section 501(c)(3).

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

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.

In this letter, we are not ruling as to whether the total compensation and benefits paid to any eligible employee, including bonus payments under the Program, is reasonable. In addition, we are not ruling as to whether L has satisfied any of the conditions of the rebuttable presumption described in section 53.4958-6 of the Foundation and Similar Excise Taxes Regulations with regard to the Program.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

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.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see 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 Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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.

In accordance with the Powers of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Lawrence M. Brauer
Acting Manager
Exempt Organizations
Technical Group 1

Enclosure
Notice 437