200319009

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

UIL No. 4941.00-00
4942.00-00
4945.00-00

Date: FEB 12 2003

Contact Person:

Identification Number:

Telephone Number:

T:EO:B3

Employer Identification Number:

Legends:

Foundation =
LLC =
Charity =
A =
B =
x =

Dear Sir or Madam:

This is in reference to your ruling request dated March 11, 2002, as supplemented by your October 9, 2002 letter, concerning the treatment of a proposed grant by the Foundation to a public charity involving sections 4941, 4942 and 4945 of the Internal Revenue Code ("Code").

Facts:

Foundation has received a determination letter stating it is exempt from federal income tax as an organization described in section 501(c)(3) of the Code and is classified as a private foundation under section 509(a). The purposes for which the Foundation is organized, as stated in its Articles of Incorporation, are "reaching the world for Christ by supporting Christian missionary activities here and abroad, making scholarship grants in accordance with and after approval under section 4945(g) . . . and making distributions to or for the use of organizations exempt at the time under Section 501(c)(3)..."

Foundation proposes to make a grant of $x to Charity to be paid in four installments over a period of three years. Charity is exempt from federal income tax as an organization described in section 501(c)(3) of the Code and is classified as a public charity under sections 509(a)(1) and 170(b)(1)(A)(vi). Charity's purposes, as stated in its Declaration of Trust, are "operating of a training facility for pastors, preservation of a historic home, and distributions to or for the use of organizations exempt at the time under section 501(c)(3)."

A and B, in addition to being substantial contributors to Foundation, also control LLC, a limited liability company. A, B and LLC are disqualified persons with respect to Foundation within the meaning of section 4946 of the Code.

Charity proposes to pay, at fair market value, a lease payment to LLC for real property that LLC owns. The property includes an historic home and approximately 1200 acres of land. It is represented that Charity will use this property as a training facility for pastors in furtherance of its exempt purposes.

Foundation represents that the proposed grants to Charity will specify that the funds are not to be used for any payments to or for LLC, and that the grant will only be used by Charity for purposes and expenses unrelated to the lease. Foundation has represented that Charity has agreed to such restriction, and has agreed to use the funds accordingly, as a condition of the proposed grant. Therefore, Charity will lease the property using independent sources of funds. It is represented that Charity has sufficient funds without the grants to pay for the lease.

Foundation represents that neither A nor B, or anyone related to A or B, is a trustee, director, employee or officer of Charity, and will not be so long as Charity receives and has not expended grant funds from the Foundation. A and B are advisory non-voting trustees of Charity, and are entitled to attend the meetings of trustees, but would not be able to vote or otherwise control Charity. Foundation also represents that A and B will not participate in any discussion involving the property or lease or any other dealings the Foundation has with LLC.

It is represented that Charity will maintain the grant funds in a separate account until the first to occur of: (i) complete expenditure by Charity of the granted funds; or (ii) the expiration or termination of the lease.

Rulings Requested:

The Foundation has requested the following rulings:

1. The proposed grants from Foundation to Charity will not result in self-dealing as defined in section 4941 of the Code and the regulations thereunder.

2. The proposed grants from Foundation to Charity will not be taxable expenditures as defined in section 4945 of the Code and the regulations thereunder.

3. The proposed grant from Foundation to Charity will be qualifying distributions as defined in section 4942 of the Code and the regulations thereunder.

Law:

Section 4941 of the Code provides for the imposition of tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(E) of the Code states that the term "self dealing" means any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a)(1) of the Code provides, in part, that the term "disqualified person" shall not include any organization, which is described in section 501(c)(3) (other than an organization described in section 509(a)(4)).

Section 4942(a) of the Code imposes an excise tax on a private foundation that fails to meet the distribution requirements set forth in section 4942(d).

Section 4942(g)(1) of the Code provides that a "qualifying distribution" means (A) any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons (as defined in section 4946) with respect to the foundation, except as provided in section 4942(g)(3), or (ii) a private foundation which is not an operating foundation (as defined in section 4942(j)(3)), except as provided in section 4942(g)(3), or (B) any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c)(2)(B). Section 170(c)(2)(B) purposes include religious, educational and charitable purposes.

Section 4945(a)(1) of the Code imposes certain excise taxes on the amount of each taxable expenditure made by a private foundation.

Section 4945(d)(4) of the Code provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to an organization unless such organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation, or the private foundation exercises expenditure responsibility with respect to such grant.

Section 4945(d)(5) of the Code provides that the term "taxable expenditure" does not include amounts paid or incurred by a private foundation as a grant to another organization for purposes specified in section 170(c)(2)(B).

Section 4945(h) of the Code provides that the expenditure responsibility referred to in subsection (d)(4) means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to see that the grant is spent solely for the purpose for which made, to obtain full and complete reports from the grantee on how the funds are spent, and to make full and detailed reports with respect to such expenditures to the Secretary.

Section 53.4941(d)-1(b)(2) of the Foundation and Similar Excise Taxes Regulations ("regulations") states that the term "indirect self-dealing" shall not include a transaction engaged in with a government official by an intermediary organization which is a recipient of a grant from a private foundation and which is not controlled by such foundation (within the meaning of subparagraph (5) of this paragraph) if the private foundation does not earmark the use of the

grant for any named government official and there does not exist an agreement, oral or written, whereby the grantor foundation may cause the selection of the government official by the intermediary organization. A grant by a foundation is earmarked if such grant is made pursuant to an agreement, either oral or written that the grant will be used by any named individual. Thus a grant by a private foundation shall not constitute an indirect act of self- dealing even though the foundation had reason to believe that certain government officials would derive benefits from such grant so long as the intermediary organization exercises control, in fact, over the selection process and actually makes the selection completely independently of the private foundation. Example (3) of section 53.4941(d)-1(b)(8) illustrates the application of this provision.

Section 53.4941(d)-2(f)(2) of the regulations provides, in part, that the fact that a disqualified person receives an incidental or tenuous benefit from the use of a foundation of its income or assets will not, by itself, make such use an act of self dealing.

Section 53.4942(a)-3(a)(3) of the regulations provides that an organization is "controlled" by a foundation or one or more disqualified persons with respect to the foundation if any of such persons may, by aggregating their votes or positions of authority, require the donee organization to make an expenditure, or prevent the donee organization from making an expenditure, regardless of the method by which the control is exercised or exercisable.

Section 53.4942(a)-3(e) of the regulations provides that excess qualifying distributions may be carried over and used to reduce the private foundation's minimum distribution requirement for any subsequent taxable year within the specified five-year adjustment period.

Section 53.4946-1(a)(8) of the regulations provides that for purposes of section 4941 of the Code only, the term "disqualified person" does not include any organization described in section 501(c)(3) (other than an organization described in section 509(a)(4)).

Like section 4941, section 4945 employs similar language regarding the earmarking of grants by a private foundation to an intermediary. With respect to certain "earmarked" grants section 53.4945-5(a)(6) provides that a grant by a private foundation to a grantee organization, which the grantee organization uses to make payments to another organization (the secondary grantee) shall not be regarded as a grant by the private foundation to the secondary grantee if the foundation does not earmark the use of the grant for any named secondary grantee and there does not exist an agreement, oral or written, whereby such grantor foundation may cause selection of the secondary grantee by the organization to which it has given the grant. For purposes of this subdivision, a grant described therein shall not be regarded as a grant by the foundation to the secondary grantee even though such foundation has reason to believe that certain organizations would derive benefits from such grant so long as the original grantee organization exercises control, in fact, over the selection process and actually makes the selection completely independently of the private foundation.

If a grant is earmarked and the intermediary grantee does not exercise control over the funds, the grant is treated for purposes of section 4945 of the Code as if it had been made directly by the donor to the secondary grantee. Unlike the regulations under section 4941, the regulations under section 4945 do not include an example of the use of intermediaries and government officials.

In 1969, the clear intent of Congress, with the enactment of Chapter 42, was to put an end to transactions using an intermediary. Congress, in enacting section 4941 of the Code, intended to replace the then existing arms-length standards regarding certain self- dealing transactions with a general prohibition on such transactions. S. Rep. No. 91-552, 91st Cong., 1st Sess. 28-29 (1969), 1969-3 C.B. 442-443.

Indirect self-dealing is not defined in section 4941 of the Code or the regulations thereunder. It was not feasible to draft a comprehensive definition because of the great variety of possible situations which could be called indirect self-dealing. Memorandum dated December 5, 1972 from Johnnie M. Walters, Commissioner, to the Assistant Secretary for Tax Policy (T.D. 7270. LR-1611) as noted in G.C.M. 39445, July 11, 1985. Instead, the regulations provide four examples of situations that do not constitute indirect self-dealing.

Section 53.4941(d)-1(b) of the regulations provides four exceptions in areas that otherwise would be considered indirect self-dealing. One of the exceptions under section 53.4941(d)-1(b)(2) provides for an intermediaries exception that is limited to government officials, a separate and distinct class of disqualified persons under section 4946 of the Code. Government officials do not otherwise have a vested familial or economic interest with a related private foundation. There is no stated exception from indirect self- dealing under the regulations for private foundation grants to intermediary organizations where other types of disqualified persons are involved similar to the special exception and example describing government officials under section 53.4941(d)-1(b) of the regulations. Indirect self-dealing, therefore, may result in transactions between other disqualified persons and intermediary organizations that involve the use of private foundation assets. Otherwise, an intermediary organization could be used to avoid section 4941 and thereby undermine congressional intent to prohibit self-dealing.

The proposed grants do not result in the imposition of tax as direct acts of self-dealing under section 4941 of the Code. The excise tax on self-dealing is imposed where a private foundation and a disqualified person engage in prohibited transactions such as the sale or exchange of property. An organization described in section 501(c)(3) is not a disqualified person for purposes of section 4941. The proposed grants are not acts of self-dealing because the Charity has received a determination letter stating that it is a tax-exempt organization under section 501(c)(3). The proposed grants are also not indirect acts of self-dealing because Foundation will restrict the use of the grant funds to Charity's general charitable purposes and Charity will use separate funds to lease the property from LLC.

The proposed grants do not result in the imposition of tax for a taxable expenditure under section 4945 of the Code because the grants will be to an organization described in paragraph (1) of section 509(a) of the Code and will be used exclusively for purposes specified in section

170(c)(2)(B). In addition, because the grants will not be earmarked for a secondary grantee, Foundation need not exercise expenditure responsibility under section 4945(h).

In order to be a qualifying distribution, the expenditure must be, among other things, be in pursuit of a charitable purpose, pursuant to section 4942(g) of the Code. Here, the grants are made to Charity, a publicly supported organization, and since Charity is not controlled by A and B, the contributions are qualifying distributions under section 4942.

Therefore we rule that:

1. The proposed grants from Foundation to Charity will not result in self-dealing as defined in section 4941 of the Code and the regulations thereunder.

2. The proposed grants from Foundation to Charity will not be taxable expenditures as defined in section 4945 of the Code and the regulations thereunder.

3. The proposed grants from Foundation to Charity will be qualifying distributions as defined in section 4942 of the Code and the regulations thereunder.

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

This ruling is limited to the applicability of the provisions of the sections of the Code as noted above. This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

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.

Sincerely,

Robert C. Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3