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Person To Contact: _____, ID No.

Telephone Number: _____

Refer Reply To:
CC:TEGE:EOEG:EO1
PLR-101139-17

Date:
March 15, 2017

Grantor =
Grantee =
A =
B =
C =
\$X1 =
\$X2 =
\$X3 =
\$X4 =

Dear _____ :

This letter is being sent to modify our private letter ruling (PLR 201652004), dated September 20, 2016, (the "PLR"). We are modifying the PLR to correct certain statements under the headings "Rulings Requested, Law, and Analysis and "Rulings." The PLR contains, among other rulings, that the proposed grants will not constitute taxable expenditures by Grantor under § 4945(d) and will not result in the imposition of excise tax to Grantor under § 4945. This ruling modifies and supersedes the PLR.

We make the following modifications to the PLR:

All the current paragraphs under "Requested Ruling 5" under the "Rulings Requested, Law, and Analysis" heading are deleted, and new paragraphs inserted to read as follows:

Requested Ruling 5: The proposed grants will not constitute taxable expenditures under § 4945(d), provided Grantor exercises expenditure responsibility to the extent required by § 4945(h) with respect to the grants, and will not result in the imposition of excise tax to Grantor under § 4945.

Section 4945(a) imposes a tax on each taxable expenditure of a private foundation. Section 4945(d)(4) provides that the term “taxable expenditure” includes any amount paid or incurred by a private foundation as a grant to an organization unless (A) such organization is (i) described in § 509(a)(1) or 509(a)(2), (ii) is an organization described in § 509(a)(3) (other than an organization described in § 4942(g)(4)(A)(i) or (ii)), or (iii) is an exempt operating foundation (as defined in § 4940(d)(2)), or (B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h). Section 4945(h) states that the term “expenditure responsibility” means that a private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to see that a grant is spent solely for the purpose for which made, and to obtain full and complete reports from the grantee on how the funds will be spent, and to make full and detailed reports with respect to such expenditures to the Secretary.

Section 4945(d)(5) provides that the term “taxable expenditure” means any amount paid or incurred by a private foundation for any purpose other than one specified in § 170(c)(2)(B).

Grantor represents it will exert all reasonable efforts and establish adequate procedures to see that the proposed grants are spent solely for the purposes made and to obtain full and complete reports from Grantee on how the funds are spent, and will also make full and detailed reports with respect to such expenditures to the Secretary. Further, the purpose of the grants from Grantor to Grantee is to aid Grantee in carrying out its exempt charitable and educational program, which are purposes described in § 170(c)(2)(B).

Therefore, assuming such representations are adhered to by Grantor, Grantor will exercise expenditure responsibility with respect to such grants to Grantee, and will avoid liability for excise tax under § 4945.

The sixth paragraph under the heading “Rulings” is modified to read as follows: 5. The proposed grants will not constitute taxable expenditures under § 4945(d), provided Grantor exercises expenditure responsibility to the extent required by § 4945(h) with respect to the proposed grants, and will not result in the imposition of excise tax under § 4945.

The PLR, as modified, reads as follows:

This letter responds to the letter dated March 23, 2016, and additional submission dated July 5, 2016, in which Grantor’s counsel requested on behalf of Grantor, rulings under §§ 4940, 4941, 4942, 4944, and 4945 of the Internal Revenue Code.¹

¹ The Internal Revenue Code of 1986, as amended, to which all subsequent “section” references are made unless otherwise indicated.

Facts:

Grantor is presently tax exempt under § 501(c)(3) and is further classified as a private non-operating foundation under § 509(a). Grantor's primary purpose is to use its funds exclusively for religious, charitable, scientific, literary, or educational purposes within the meaning § 501(c)(3). Grantor received its assets and contributions from A and B whom both serve as directors in its three person board of directors which manage and control it. A and B are related by marriage.

Grantee is a newly formed tax exempt organization recognized under § 501(c)(3) and classified as a private operating foundation under §§ 509(a) and 4942(j)(3). Grantee's purpose is to devote its funds, assets and resources to the active conduct of religious, charitable, scientific, literary, or educational purposes within the meaning of § 501(c)(3). It is organized to initiate, establish, operate, sponsor, and manage programs that provide educational services and resources to the general public. Grantee will construct, operate, and maintain a community cultural center (Center) in a local suburban city which will make a one-time donation of land to it. It will display traveling cultural and educational exhibits, and will house a museum containing historical artifacts. The Center will be open to the general public and admission will be free.

Grantor represents that Grantee is managed and controlled by eleven directors which include A and B, who also serve on the board of Grantor, and C, who provides various legal, administrative, tax, and accounting services to A and B. C has no relationship to Grantor. Grantor further represents that there are no other family or business relationships among the directors.

It is anticipated for the next five to ten years, Grantee's majority of support will be grants made by Grantor and larger local businesses in the area. Grantor's board proposes to make grants to Grantee of approximately \$X1 in 2016, and \$X2, \$X3, in the respective two subsequent years and up to \$X4 thereafter for each of the remaining two to seven years.

Rulings Requested, Law, and Analysis:

Requested Ruling 1: The proposed grants will not give rise to net investment income to Grantor under § 4940.

Section 4940 (a) imposes on each private foundation which is exempt from taxation under § 501(a) for the taxable year, with respect to the carrying on of its activities, a tax equal to two percent of the net investment income of such foundation.

Section 4940(c)(1) defines the term net investment income as the amount by which the sum of the gross investment income and the capital gain net income exceed the deductions allowed by § 4940(c)(3). Section 4940(c)(2) provides that gross investment income includes the gross amount of income from interest, dividends, rents, payments with respect to securities loans and royalties. Section 4940 does not define “capital gain net income.” However, Treas. Reg. § 53.4940-1(f)(1) provides, in relevant part, that in determining capital gain net income for purposes of the tax imposed by § 4940, there shall be taken into account only capital gains and losses from the sale or other disposition of property held by a private foundation for investment purposes.

Grantor will not receive any consideration from Grantee for its grants, and such grants will not result in gross investment income or capital gain net income to Grantor. The proposed grants do not represent any interest, dividend, rent, or payments with respect to securities loans or royalties pursuant to § 4940(c)(2). Grantor’s proposed grants to Grantee, which lack consideration, will not constitute investments or sales or other dispositions of investment property which would generate investment income subject to excise tax under § 4940.

Therefore, the proposed grants will not give rise to net investment income subject to tax under § 4940(a).

Requested Ruling 2: The proposed grants will not constitute self-dealing transactions with respect to Grantor and will not subject Grantor to excise tax under § 4941.

Section 4941 imposes an excise tax on private foundations and foundation managers for each act of self-dealing and between a private foundation and a disqualified person. Section 4941(d)(1) defines self-dealing to include the direct or indirect sale or exchange, or leasing of property between a private foundation and a disqualified person, the direct or indirect furnishing of goods, services, or facilities between a disqualified person and a private foundation, the direct or indirect payment of compensation by a private foundation to a disqualified person, or the transfer to, or use of the private foundation's assets, by or for the benefit of a disqualified person.

Section 4946(a)(1) provides that the term “disqualified person” with respect to a private foundation, includes amongst others, a person who is a substantial contributor or a foundation manager.

Both the Grantor and Grantee are recognized as organizations exempt from tax under § 501(c)(3). Under Treas. Reg. § 53.4946-1(a)(8), for purposes of § 4941, a “disqualified person” does not include organizations that are exempt under § 501(c)(3). Accordingly, since Grantor is recognized as exempt under § 501(c)(3), and assuming that Grantee continues to be an organization described in § 501(c)(3) at the time of

each of the proposed transfers, the proposed grants from Grantor to Grantee will not be acts of self-dealing by Grantor and will not subject Grantor to excise tax under § 4941.

This letter is directed to Grantor, not to Grantee, A, B, or any other disqualified person with respect to Grantor. Section 6110(k)(3) provides, in part, that unless “the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent.” Accordingly, neither Grantee, A, B, nor any other disqualified persons with respect to Grantor may use or cite this letter as precedent. See § 11.02 of Rev. Proc. 2016-1, 1 I.R.B. 1, 58.

Requested Ruling 3: The proposed grants will constitute qualifying distributions by Grantor for purposes of satisfying Grantor’s minimum distribution requirements pursuant to § 4942.

Section 4942 imposes a tax on the undistributed income of a private foundation. Section 4942(c) provides that the term “undistributed income” means, with respect to any private foundation for any taxable year as of any time, the amount by which – (1) the distributable amount for such taxable year exceeds (2) the qualifying distributions made before such time out of such distributable amount.

Section 4942(g)(1) provides that qualifying distributions include any amount paid to accomplish one or more purposes described in § 170(c)(2)(B). Such distributions include payments to public charities and § 4942(j)(3) operating foundations, but not payments to organizations controlled by the foundation (or disqualified persons) or to private nonoperating foundations, unless the requirements of § 4942(g)(3) are met.

Section 4942(g)(2) provides that an amount of income that is set aside for a specific project within one or more purposes of § 170(c)(2)(B) may be treated as a qualifying distribution if the amount meets the set-aside requirements of § 4942(g)(2)(B).

Section 4942(g)(2)(B) describes, in pertinent part, that an amount set aside for a specific project may be treated as a qualifying distribution if, at the time of the set-aside, the private foundation establishes to the satisfaction of the Secretary that the amount set aside will be paid for the specific project within five years and that the suitability test for a set-aside under § 4942(g)(2)(B)(i) is met.

Section 4942(g)(2)(B)(i) provides a suitability test in which the private foundation at the time of the set-aside must establish to the satisfaction of the Secretary that the specific project is one that can better be accomplished by the set-aside of income rather than by the immediate payment of funds.

Section 4942(g)(3) states that qualifying distributions of assets include contributions to organizations exempt under § 501(c)(3) controlled by one or more disqualified persons, or a private foundation which is not an operating foundation (as defined in subsection

(j)(3)) if the recipient organization distributes not later than the close of the next taxable year after the contribution is received an amount equal to such contribution which is treated under subsection (h) as a distribution out of corpus (or would be so treated if such § 501(c)(3) organization were a private foundation which is not an operating foundation), and the private foundation making the contribution in the first place keeps adequate records or other sufficient evidence showing that it made such a qualifying distribution.

Treas. Reg. Sec. 53.4942(a)-3(a)(2) defines the term "qualifying distribution," in relevant part, to mean any amount paid to accomplish one or more purposes described in § 170(c)(1) or (c)(2)(B), other than any contribution to a private foundation which is not an operating foundation or to an organization controlled (directly or indirectly) by the contributing private foundation or one or more disqualified persons with respect to such foundation.

Treas. Reg. Sec. 53.4942(a)-3(a)(3) states, in part, for purposes of subparagraph (2)(i)(b) of this paragraph, 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. In general, it is the donee, not the distribution, which must be "controlled" by the distributing private foundation for the provisions of subparagraph (2)(i)(b) of this paragraph to apply. Thus, the furnishing of support to an organization and the consequent imposition of budgetary procedures upon that organization with respect to such support shall not in itself be treated as subjecting that organization to the distributing foundation's control within the meaning of this subparagraph. Such "budgetary procedures" include expenditure responsibility requirements under § 4945(d)(4). The "controlled" organization need not be a private foundation; it may be any type of exempt or nonexempt organization including a school, hospital, operating foundation, or social welfare organization.

Treas. Reg. Sec. 53.4942(a)-3(b)(2) describes the suitability test and explains it is satisfied if the private foundation establishes to the satisfaction of the Commissioner that the specific project for which the amount is set aside is one that can be better accomplished by the set-aside than by the immediate payment of funds. Specific projects that can be better accomplished by the use of a set-aside include, but are not limited to, projects in which relatively long-term grants or expenditures must be made in order to assure the continuity of particular charitable projects or program-related investments (as defined in § 4944(c)) or where grants are made as part of a matching-grant program. Such projects include, for example, a plan to erect a building to house the direct charitable, educational, or other similar exempt activity of the private foundation (such as a museum building in which paintings are to be hung), even though the exact location and architectural plans have not been finalized; a plan to purchase an additional group of paintings offered for sale only as a unit that requires an expenditure

of more than one year's income; or a plan to fund a specific research program that is of such magnitude as to require an accumulation of funds before beginning the research, even though not all of the details of the program have been finalized.

Treas. Reg. Sec. 53.4942(a)-3(c)(1)(ii) of the regulations describes the records required by § 4942(g)(3)(B) as a statement by an appropriate officer, director, or trustee of the donee organization showing (a) that the qualifying distribution has been made by such organization, (b) the names and addresses of the recipients of such distribution and the amount received by each, and (c) that the distribution is treated as a distribution out of corpus (or would be so treated if the donee organization were a private foundation which is not an operating foundation).

Grantor represents that the purpose for which the proposed grants will be made is in furtherance of a purpose described in § 170(c)(2)(B), namely, for exempt educational purposes. Grantor states that it will not impose any restrictions on Grantee. Further, Grantor represents that the eleven directors of Grantee manage and control its business affairs and are responsible for determining how the grants received from Grantor will be used in furtherance of its exempt purposes. Only two of the directors of Grantee, A and B, are also directors of Grantor. Grantor represents that the majority of Grantee's board of directors are individuals who lack an association with Grantor, and instead represent community interests. In addition, Grantee is a private operating foundation. See § 4942(g)(1)(A)(ii). Based on the representations, Grantee is not "controlled" by Grantor or by A and B, because they are only two of eleven directors, and even if C's vote is combined with A and B, it is not possible to aggregate their votes or positions of authority to cause or prevent Grantee from making an expenditure.

Even if it could be argued that A and B exercise control, § 4942(g)(3) states that the term "qualifying distribution" includes a contribution to a § 501(c)(3) organization described in § 4942(g)(1)(A), if the recipient organization distributes not later than the close of the next taxable year after the contribution is received an amount equal to such contribution, and the private foundation making the contribution in the first place keeps adequate records or other sufficient evidence showing that it made such a qualifying distribution. If Grantor makes qualifying distributions in the manner required by the pass-through rules within § 4942(g)(3)(A) and also obtains adequate records or other sufficient evidence to satisfy the recordkeeping requirements of § 4942(g)(3)(B) then Grantor may count as qualifying distributions those amounts distributed to Grantee that satisfy the requirements of §§ 4942(g)(3)(A) and (B).

Requested Ruling 4: The proposed grants by Grantor to Grantee will not constitute investments by Grantor that jeopardize the exempt purposes of Grantor under § 4944.

Grantor's proposed grants to Grantee lack consideration and will not constitute investments, sales, or other dispositions of investment property. Accordingly, § 4944(a)

imposes a tax on any amount invested by a private foundation in a manner that jeopardizes the carrying out of any exempt purpose of a § 501(c)(3) private foundation.

Under § 4944(a), Grantor's proposed grants to Grantee will not be investments that jeopardize Grantor's exempt purposes because they will be made for Grantee's exempt purposes under § 501(c)(3), and not for investment purposes.

Requested Ruling 5: The proposed grants will not constitute taxable expenditures under § 4945(d), provided Grantor exercises expenditure responsibility to the extent required by § 4945(h) with respect to the grants, and will not result in the imposition of excise tax to Grantor under § 4945.

Section 4945(a) imposes a tax on each taxable expenditure of a private foundation. Section 4945(d)(4) provides that the term "taxable expenditure" includes any amount paid or incurred by a private foundation as a grant to an organization unless (A) such organization is (i) described in § 509(a)(1) or 509(a)(2), (ii) is an organization described in § 509(a)(3) (other than an organization described in § 4942(g)(4)(A)(i) or (ii)), or (iii) is an exempt operating foundation (as defined in § 4940(d)(2)), or (B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h). Section 4945(h) states that the term "expenditure responsibility" means that a private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to see that a grant is spent solely for the purpose for which made, and to obtain full and complete reports from the grantee on how the funds will be spent, and to make full and detailed reports with respect to such expenditures to the Secretary.

Section 4945(d)(5) provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation for any purpose other than one specified in § 170(c)(2)(B).

Grantor represents it will exert all reasonable efforts and establish adequate procedures to see that the proposed grants are spent solely for the purposes made and to obtain full and complete reports from Grantee on how the funds are spent, and will also make full and detailed reports with respect to such expenditures to the Secretary. Further, the purpose of the grants from Grantor to Grantee is to aid Grantee in carrying out its exempt charitable and educational program, which are purposes described in § 170(c)(2)(B).

Therefore, assuming such representations are adhered to by Grantor, Grantor will exercise expenditure responsibility with respect to such grants to Grantee, and will avoid liability for excise tax under § 4945.

Requested Ruling 6: Grantor's legal, accounting, and other expenses related to this request for rulings and the proposed grants, if reasonable in amount, will be qualifying

distributions by Grantor for purposes of § 4942(g)(1)(A), and will not be taxable expenditures by Grantor for purposes of § 4945.

Section 4942(g)(1)(A) and Treas. Reg. § 53.4942(a)-3(a)(2)(i) provide, in part, that the term "qualifying distribution" means any amount, including "reasonable and necessary administrative expenses," paid to accomplish one or more purposes described in § 170(c)(1) or (2)(B). Section 170(c)(2)(B) lists the following purposes: "religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals." These purposes are the same as the purposes listed in § 501(c)(3). Thus, a grant by a private foundation to another organization described in § 501(c)(3) ordinarily is an amount paid to accomplish a purpose described in § 170(c)(2)(B) and may be considered to be a qualifying distribution.

Assuming that Grantor's legal, accounting, and other expenses incurred in connection with this ruling request and with effecting the proposed grants will be reasonable and consistent with ordinary business care and prudence and paid to accomplish one or more purposes described in § 170(c)(2)(B), such expenses will be considered qualifying distributions under § 4942.

Section 4945(a) imposes a tax on each "taxable expenditure" of a private foundation. Section 4945(d)(5) provides that the term "taxable expenditure" includes any amount paid or incurred by a private foundation for any purpose other than one specified in § 170(c)(2)(B). Treas. Reg. Sec. 53.4945-6(b)(2) provides that legal, administrative, and other expenses incurred by a private foundation are not taxable expenditures if the foundation can demonstrate that such expenses were paid or incurred in good faith belief they were reasonable and the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence. The determination whether an expenditure is reasonable depends upon the facts and circumstances of a particular case. The payment of reasonable legal, accounting and other expenses with respect to the proposed grants from Grantor to Grantee and related matters is represented by Grantor to be consistent with ordinary business care and prudence and, accordingly, should not be considered taxable expenditures under § 4945.

Rulings:

Based solely on the foregoing, and assuming the accuracy of the facts and representations submitted, we rule as follows:

1. The proposed grants will not give rise to net investment income to Grantor under § 4940.

2. The proposed grants will not constitute self-dealing transactions with respect to Grantor and will not subject Grantor to excise tax under § 4941.
3. The proposed grants will constitute qualifying distributions by Grantor for purposes of satisfying Grantor's minimum distribution requirements pursuant to § 4942.
4. The proposed grants by Grantor to Grantee will not constitute investments by Grantor that jeopardize the exempt purposes of Grantor under § 4944
5. The proposed grants will not constitute taxable expenditures under § 4945(d), provided Grantor exercises expenditure responsibility to the extent required by § 4945(h) with respect to the proposed grants, and will not result in the imposition of excise tax under § 4945.
6. Grantor's legal, accounting, and other expenses related to this request for rulings and the proposed grants, if reasonable in amount, will be qualifying distributions by Grantor for purposes of § 4942(g)(1)(A), and will not be taxable expenditures by Grantor for purposes of § 4945.

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 appropriate party, as specified in Rev. Proc. 2016-1, 2016-1 I.R.B. 1, § 7.01(15)(b).

This office has not verified any of the material submitted in support of the request for ruling, and such material is subject to verification on examination. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2016-1, § 11.05.

No ruling is granted as to whether taxpayer qualifies as an organization described in § 501(c) or § 509(a), and, except as expressly provided above, no opinion is expressed or implied concerning the federal income tax consequences of any other aspects of any transaction or item of income described in this letter ruling. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

This ruling will be made available for public inspection under § 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, showing the deletions that we

intend to make on the version that will be made available to the public, is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

In accordance with the Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

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 by others 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.

Sincerely,

Mary Jo Salins
Acting Branch Chief
Exempt Organizations Branch 1
(Tax Exempt and Government Entities)