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Date:  
April 20, 2018

### Legend

<u>Foundation</u>	=
<u>Brokerage Account</u>	=
<u>Brokerage Account</u>	=
<u>Agreement</u>	
<u>Student(s)</u>	=
<u>Date</u>	=
<u>X</u>	=
<u>Y</u>	=
<u>Z</u>	=

Dear :

We are responding to a letter dated April 19, 2017, and supplemental materials dated September 25, 2017, February 28, 2018, and March 26, 2018, requesting rulings that certain grants to be made by Foundation will not be considered taxable expenditures under section 4945(d) of the Internal Revenue Code<sup>1</sup> (Code), and that such grants will be qualifying distributions for charitable purposes under section 4942(g)(1) of the Code.

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<sup>1</sup> The Internal Revenue Code of 1986, as amended, to which all subsequent "section" references are made unless otherwise indicated.

## FACTS

Based on the documents and representations submitted on behalf of Foundation, the relevant facts on which Foundation's request for rulings is based are as follows. Foundation is a tax-exempt private operating foundation described under section 501(c)(3) with a purpose of providing financial assistance to eligible students to enable them to obtain a four-year college education and graduate free of debt. As part of its activities, Foundation provides financial assistance to Students to attend school cost free through the awarding of scholarships and conducts a mandatory educational program for Students to improve their ability to manage their time and finances.

Students receiving scholarships are high-achieving individuals with financial need that graduate from public high schools in counties throughout the United States having fewer than 50,000 residents. The eligible counties are made up of residents whose average median household income is substantially less than the average median household income for each corresponding state as a whole. Scholarships are awarded on an objective and nondiscriminatory basis under a procedure approved in advance by the Service. For the last five years, based upon the FAFSA (Free Application for Federal Student Aid) reports, Students had an average EFC (Estimated Financial Contribution) of \$2,064, which is only 35% of the Pell Grant eligibility amount (\$5,815). Foundation awards all scholarship applicants based upon financial need. Students must authenticate their financial need each semester to maintain their eligibility for the scholarships.

All Students receiving scholarships must participate in Foundation's educational program ("Program") to provide Students with a practical understanding of important life skills which, in part, involves improving Students' ability to manage their finances and invest for their future financial security. As part of the Program, Students must attend mandatory workshops held in the summer before each school year. Foundation provides the workshops free to Students and also pays for travel and lodging expenses for each Student.

Students must graduate college within four years with a GPA of 3.00 or higher for the first two years and a GPA of 3.25 or higher for the remaining two years. Students must work a minimum of 240 hours in the 12 months prior to the start of each academic year of college. Students must authenticate their financial need each semester. Students must meet these eligibility requirements, participate in the mandatory workshops and spend a substantial amount of time outside the workshops researching, writing reports and interacting with Foundation regarding the Program investing activity, in order to maintain their eligibility for participation in the Program and their continued eligibility for their scholarships.

Foundation maintains a salaried individual staff member and numerous volunteer staff members who conduct the workshops. In the Program's summer workshop before the first year of college, Students learn about the particulars of the scholarship, getting off to a great start in college, managing college finances, managing time, applying study strategies, and applying tips on how to succeed in college.

In the summer workshop before the second year of college, Students learn about investing for financial security, researching common stocks, selecting stocks to purchase, and planning for financial security. During the second workshop, as part of the Program, Foundation will enter into a Brokerage Account Agreement with each Student.

The Brokerage Account Agreement provides that Foundation will deposit X dollars into a separate Foundation sub-account that will be referred to as the Student's Brokerage Account. Students will receive a limited power of attorney over the Brokerage Account; however, Students do not maintain any ownership interests in the Brokerage Account or the funds used for the Students' designated Brokerage Accounts. Students may only invest in common stock of companies from a preselected list. Each company must also meet additional criteria at the time of the purchase of stock. Prior to the purchase and sale of each common stock during the school year, Students must provide Foundation with an analysis report on the company and the company's primary competitors pursuant to guidelines provided by Foundation. Foundation will review each Student's analysis. Students must obtain e-mail approval from Foundation prior to the purchase or sale of each common stock. Students must invest at least Y dollars in three stocks by Date in the fall of each year. Thereafter, at least ninety-five percent of the Brokerage Account assets must be invested in the common stock of three different companies in three different industries at all times. Failure to comply with the terms of the Brokerage Account Agreement will result in the Student's ineligibility for his or her scholarship and participation in the Program, and the loss of Student's Brokerage Account.

In the summer before the third year, the summer workshop covers the following: review of Students' statistics, review of performance of second year workshop stock selections, analysis of investment reports and stock performance, selecting stocks to sell and purchase of replacement stock, planning for retirement, consideration of work/life balance, and career planning (resume, interviews, and internships).

In the summer before the fourth year, the workshop covers the following: evaluation of the Students' performance of stock selections, review of characteristics of a good company to work for, choosing and getting accepted into graduate school, preparing for future employment, and owning versus renting. The Students are also taught how to further analyze portfolios, select a stock to sell, and select a replacement stock.

At the end of each four year period in which Students are expected to graduate, the Students' designated Brokerage Accounts (Foundation sub-accounts) will be closed by Foundation and funds transferred back to Foundation's primary brokerage account.

In the fifth year workshop (after graduation), the workshop covers the following: review of Students' statistics, performance of Brokerage Account portfolios, review of the investment process and guidance, questions and answers, and distribution of certificates of achievement and award plaques. "Graduation Grants" are awarded to Students after Foundation's confirmation of Students graduation from college and confirmation of fulfillment of all Student's other eligibility requirements, including those responsibilities under the Brokerage Account Agreement. Graduation Grants are awarded as recognition of Students' past achievement in successfully utilizing the finance and investment management skills taught through Foundation's program. The number of Graduation Grants awarded and amounts of each Graduation Grant are based on factors including each Student's workshop attendance, ability to defend their choice of investments, GPA, and fiscal performance in Student's designated Brokerage Account. Graduation Grants are awarded without restrictions imposed on how Students use the awards. Graduation Grants are capped at Z dollars and awarded only to the Students with the best performance records.

After the Students graduate, they will all continue to have access to all information that was provided to them while they participated in Program. Furthermore, Foundation will continue to have an optional workshop for all said graduates who wish to continue their education concerning the investing for their financial security.

### **Rulings Requested**

- 1) Graduation Grants will not be considered taxable expenditures under section 4945(d) of the Code.
- 2) Graduation Grants will be qualifying distributions for charitable purposes under section 4942(g)(1) of the Code.

### **Law and Analysis**

Section 501(c)(3) provides, in part, that an organization may be exempted from tax under section 501(a) if it is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

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

Treas. Reg. Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. To meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 4945(a) of the Code imposes a tax on each taxable expenditure, as defined in section 4945(d), made by a private foundation.

Section 4945(d)(3) provides that taxable expenditures include any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirements of section 4945(g).

Section 4945(d)(5) provides that taxable expenditures include any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B).

Section 170(c)(2)(B) describes organizations “organized and operated exclusively for 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.”

Rev. Rul. 68-16, 1968-1 C. B. 246, considers the qualification of an organization under section 501(c)(3). A fund of less than \$10,000 was contributed by a university school of business administration, that is exempt from Federal income tax under section 501(c)(3), to a corporation organized and controlled by its faculty for the purpose of giving students, who are taking or have taken investment courses, experience in the management of a portfolio of securities. Members of the faculty serve as directors of the fund. Investment responsibilities rest with the students. Groups of students continually analyze and evaluate their portion of the portfolio and make changes in the light of theories and principles learned in formal courses of instruction. The earnings of the fund in excess of the needs of the educational program are paid over to the

university that was exempt under section 501(c)(3). The ruling concludes that the fund is used by the students as an adjunct to their course of instruction to obtain knowledge and experience in security portfolio management. The revenue ruling holds that the fund contributes to students' education and the organization is exempt under section 501(c)(3).

Rev. Rul. 75-393, 1975-2 C.B. 251, considers a private foundation that is a trust created for the purpose of encouraging and assisting in the development of a particular field of literary criticism. The annual net income of the trust is paid to the person who has written the best work of literary criticism during the preceding year. The revenue ruling holds that awards to individuals, granted in recognition of past achievements, that are not intended to finance any future activities of the individual grantee and that do not impose conditions on the manner in which the awards may be expended by the student, are not described within the meaning of section 4945(d)(3) as taxable expenditures by a private foundation.

Rev. Rul. 76-460, 1976-2 C.B. 371, considers a private foundation that made grants to students attending schools specializing in teaching a particular craft. The grants were made as awards to raise the quality standards of the students in the craft courses of certain schools and were made for educational purposes within the meaning of section 170(c)(2)(B) in recognition of past achievements. The grants were not intended to finance any future activities of an individual grantee and no conditions were imposed on the manner in which the awards could be expended by the recipients. The entries from all participating schools are then forwarded to a panel of professional people who are independent of the foundation. This panel evaluates the entries. Pursuant to this evaluation, the foundation awards grants to the students whose products the Competition Committee judges to be the best. The revenue ruling holds that the grants were not described within the meaning of section 4945(d)(3) as taxable expenditures (See Rev. Rul. 75-393), and since the grants were made for educational purposes (within the meaning of section 170(c)(2)(B) of the Code), they were not taxable expenditures within the meaning of section 4945(d)(5). The Revenue Ruling specifically clarifies that, to the extent Rev. Rul. 75-393 can be read to imply that a grant falling outside the scope of section 4945(d)(3) need not comply with the requirements of section 4945(d)(5), it is modified.

Rev. Rul. 77-380, 1977-2 C.B. 419, (situation 1), considers a private foundation created for the purpose of encouraging excellence in the art of journalism. Grants of the private foundation's net income were made in recognition of past achievement to an individual whose work represented the best example of investigative reporting. There were no conditions or requirements to be met subsequent to the individual receiving the grants. Thus, the grants were not grants to individuals for travel, study, or other similar purposes by such individuals within the meaning of section 4945(d)(3). Further, the revenue ruling holds that the grants were made for purposes within the scope of section

170(c)(2)(B) of the Code and thus were not taxable expenditures within the meaning of section 4945(d)(5).

Similar to grants in these revenue rulings, Graduation Grants are awarded by Foundation to Students as recognition of past achievement by Students in successfully utilizing the finance and investment management skills taught through Foundation's programs and are made without restrictions on how the Students spend or invest the Graduation Grants. Therefore, Graduation Grants are not considered grants made to individuals for travel, study or other similar purposes under section 4945(d)(3) of the Code because no restrictions are imposed on how the recipient uses the award, and therefore are not taxable expenditures within the meaning of section 4945(d)(3).

However, even if a grant to an individual is for purposes not described in section 4945(d)(3) of the Code, it may still be a taxable expenditure under section 4945(d). Specifically, section 4945(d)(5) of the Code provides that the term "taxable expenditure" includes any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B). Accordingly, Graduation Grants need to further a charitable purpose and not a private interest in order not to be taxable expenditures under section 4945(d)(5).

As part of the Program, Foundation provides Students with a practical understanding of important life skills which include managing time, applying study strategies and in large part improving the Students' ability to manage their finances and invest for their future financial security. Students must attend yearly workshops. In addition, prior to the purchase and sale of each common stock throughout the year, Students must provide Foundation with an analysis report on the company and the company's primary competitors pursuant to guidelines provided by Foundation. Students obtain feedback and must also obtain approval from Foundation prior to the purchase or sale. Analogous to the educational activities in Rev. Rul. 68-16, Students continually analyze and evaluate their portfolios, work with advisors, and make changes in light of theories and principles learned in formal mandatory classes. The Program activity is similar to the activities under Rev. Rul. 68-16.

Like the monetary awards in Rev. Rul. 76-460 and Rev. Rul. 77-380, provided to individuals in recognition of the individuals' efforts and made for the private foundations' exempt purposes within the meaning of section 170(c)(2)(B), Graduation Grants are made in recognition of Students successfully utilizing the finance and investment management skills taught through Foundation's educational programs. Additionally, similar to the awards made for literary and educational purposes in the revenue rulings, Graduation Grants are made for public rather than private interests. Eligible students are scholarship students with financial need and who were selected on an objective and nondiscriminatory basis under a procedure approved in advance by the Service. In addition, determination of the number and amounts of Graduation Grants is based on

an objective pre-determined formula. Accordingly Graduation Grants are made to further Foundation's educational purposes within section 170(c)(2)(B). Thus, Foundation's Graduation Grants are not taxable expenditures within the meaning of section 4945(d)(5).

Section 4942(g)(1) defines a "qualifying distribution" as any amount paid to accomplish one or more purposes described in section 170(c)(2)(B). As discussed above, Foundation will use the Graduation Grants to recognize Students' achievements in successfully utilizing the finance and investment management skills taught through Foundation's educational Program. Accordingly, Foundation's Graduation Grants will be used to further a section 170(c)(2)(B) exempt purpose under section 4942(g)(1).

### **Rulings**

1. Graduation Grants will not be considered taxable expenditures under section 4945(d) of the Code.
2. Graduation Grants will be qualifying distributions for charitable purposes under section 4942(g)(1) of the Code.

The rulings contained in this letter are based upon information and representations submitted by or on behalf of Foundation (accompanied by a penalty of perjury statement executed by an individual with authority to bind Foundation) and upon the understanding that there will be no material changes in the facts. This office has not verified any of the material submitted in support of the request for rulings, 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. 2018-1, § 11.05.

No ruling is granted as to whether Foundation qualifies as an organization described in sections 501(c) and 509(a). 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 set forth in the ruling including any tax consequences to the Students from receipt of the Graduation Grants. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.



In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Foundation's authorized representative.

Sincerely,

Andrew F. Megosh, Jr.  
Senior Tax Law Specialist  
Exempt Organizations Branch 2  
(TEGE Associate Chief Counsel)