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

Date:
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OP:E:EO:T2

Contact Person:

ID Number:

Telephone Number:

UIL Nos.
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Employer Identification Number:

LEGEND

M =
X =

Dear Applicant:

This letter responds to X's request dated October 21, 1999 for rulings that X's proposed Grant will further its exempt purposes under section 501(c)(3) of the Internal Revenue Code and will comply with requirements under chapter 42.

Facts

X is a private foundation described in sections 501(c)(3) and 509(a) of the Code. X proposes to make a Grant to the Government of M (a foreign country), consisting of disbursements as funds are needed, to finance the construction and rehabilitation of a Highway running through much of M. The Government of M is not a disqualified person with respect to X or controlled by disqualified persons. The project is considered important to improving the economy for the people of M, the majority of whom live below the officially recognized poverty level. The project involves repair or replacement of portions of an existing highway in various stages of disrepair and construction of new roads to reroute traffic around a major city of M, thereby alleviating congestion. Access to the Highway will be made available to the public free of charge for at least 10 years from the date of completion of construction. Under the terms of the Grant, the Government of M must: use the funds exclusively for the purpose of rehabilitating and constructing the Highway; reimburse X for any funds not so used; not disburse any Grant funds to any disqualified person with respect to X or for any purpose prohibited under section 4945(d)(1)-(3); hold Grant funds in a separate segregated account; maintain books and records on the progress of construction, available for inspection by X; make periodic progress reports to X; and use approved standard bidding documents and procedures to secure contractors' services and supplies. X also contemplates retaining the services of an on-site Project Manager (who will not be a disqualified person with respect to X) with expertise in road construction for assistance in supervising the project, monitoring the Government of M's compliance with the terms of the Grant Agreement, and approving requests for grant disbursements as funds are needed.

Rulings Requested

X requests the following rulings:

A. The Grant is for an exclusively charitable, program-related activity as defined in sections 501(c)(3) and 170(c)(2)(B) of the Code because it will be used exclusively in the impoverished country of M to create essential public works for the general public of M.

B. The funds disbursed pursuant to the Grant will not cause the imposition of any of the private foundation excise taxes, and specifically:

1. The tax on net investment income under section 4940 of the Code does not apply because the funds disbursed pursuant to the Grant are program-related and will not produce any income from interest, dividends, rents or royalties or otherwise;

2. The Government of M is unrelated to X, and the funds disbursed pursuant to the Grant to the Government of M will not create any self-dealing pursuant to section 4941;

3. The funds disbursed pursuant to the Grant will be qualifying distributions for purposes of meeting the minimum qualifying distribution amount under section 4942;

4. The funds disbursed pursuant to the Grant are for a program-related activity and will not create any "business holdings" within the meaning of section 4943;

5. The funds disbursed pursuant to the Grant are for a program-related activity and will not result in jeopardizing investments within the meaning of section 4944;

6. The funds provided pursuant to the Grant are for a program-related activity and are not taxable expenditures pursuant to, and are not subject to the expenditure responsibility rules of, section 4945 because the Grant is made to the Government of M; and

C. The Grant will not give rise to unrelated business taxable income under sections 511-513.

D. The payments to the Project Manager are fees for personal services rendered in connection with X's program-related activities, and are not "grants" under sections 53.4945-4(a)(2) and 53.4945-5(a)(2) of the regulations.

Law

Sections 170(c)(2)(B) and 501(c)(3) of the Code both refer to organizations organized and operated exclusively for charitable purposes.

Section 511 of the Code imposes a tax on the unrelated business taxable income of exempt organizations.

Section 512 of the Code defines "unrelated business taxable income" as gross income derived from any unrelated trade or business regularly carried on by it, less certain deductions and modifications.

Section 513(a) of the Code defines "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt purpose or function.

Section 513(c) of the Code provides that "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

Section 4940 of the Code imposes an excise tax on the net investment income of a private foundation.

Section 4941of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1) of the Code defines self-dealing as any direct or indirect--

(A) sale or exchange, or leasing, of property between a private foundation and a disqualified person;

(B) lending of money or other extension of credit between a private foundation and a disqualified person;

(C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;

(D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;

(E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

(F) agreement by a private foundation to make any payment of money or other property to a government official (as defined in section 4946(c)), other than certain employment agreements.

Section 4941(d)(2)(D) of the Code provides that the furnishing of goods, services, or facilities by a private foundation to a disqualified person shall not be an act of self-dealing if such furnishing is made on a basis no more favorable than that on which such goods, services, or facilities are made available to the general public.

Section 4942 of the Code imposes an excise tax on a private foundation's undistributed income, defined as its distributable amount less qualifying distributions.

Section 4942(g)(1)(A) of the Code defines a "qualifying distribution" as including 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 certain contributions to organizations controlled by the foundation or by disqualified persons or to private non-operating foundations.

Section 4943 of the Code imposes an excise tax on the excess holdings by a private foundation in business enterprises.

Section 4944 of the Code imposes an excise tax on a private foundation's making of an investment in such a manner as to jeopardize the carrying out of any of its exempt purposes.

Section 4944(c) of the Code provides that an investment is not jeopardizing if its primary purpose is to accomplish 170(c)(2)(B) purposes and no significant purpose is the production of income or the appreciation of property.

Section 4945 of the Code imposes an excise tax on each taxable expenditure of a private foundation.

Section 4945(d) of the Code defines a "taxable expenditure" by a private foundation as an amount paid or incurred--

(1) to attempt to influence legislation,
(2) to influence a specific public election or carry on a voter registration drive,
(3) to grant funds to an individual for travel, study, or similar purposes unless certain requirements are met,
(4) to grant funds to an organization unless it is described in sections 509(a)(1), (2), or (3) or 4940(d)(2) or unless the private foundation exercises expenditure responsibility with respect to the grant in accordance with section 4945(h), or
(5) for a non-170(c)(2)(B) purpose.

Section 4946 of the Code defines "disqualified persons" with respect to a private foundation as substantial contributors, foundation managers, 20% owners of a substantial contributor, family members of an individual who is one of the above, entities 35% owned by one of the above, and certain government officials.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" includes relief of the poor and distressed or of the underprivileged, and erection or maintenance of public buildings, monuments, or works

Section 1.513-1(b) of the regulations provides that for purposes of section 513 the term "trade or business" has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 53.4941(d)-1(b)(2) of the Foundation and Similar Excise Taxes Regulations provides 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 sections 53.4941(d)-1(b)(5) and (6)) 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 private 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 such 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 independent of the private foundation.

Section 53.4941(d)-2(f)(2) of the regulations provides that the fact that a disqualified person receives an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by

itself, make such use an act of self-dealing. Thus, the public recognition a person may receive, arising from the charitable activities of a private foundation to which such person is a substantial contributor, does not in itself result in an act of self-dealing since generally the benefit is incidental and tenuous. For example, a grant by a private foundation to a section 509(a)(1), (2), or (3) organization will not be an act of self-dealing merely because such organization is located in the same area as a corporation which is a substantial contributor to the foundation, or merely because one of the section 509(a)(1), (2), or (3) organization's officers, directors, or trustees is also a manager of or a substantial contributor to the foundation.

Section 53.4941(d)-3(b)(1) of the regulations provides generally that under section 4941(d)(2)(D) of the Code, the furnishing of goods, services, or facilities by a private foundation to a disqualified person shall not be an act of self-dealing if such goods, services, or facilities are made available to the general public on at least as favorable a basis as they are made available to the disqualified person, so long as such goods, services, or facilities are functionally related to the exercise or performance by a private foundation of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(c)(3).

Section 53.4941(d)-3(b)(2) of the regulations provides that for purposes of this paragraph, the term "general public" shall include those persons who, because of the particular nature of the activities of the private foundation, would be reasonably expected to utilize such goods, services, or facilities. This paragraph shall not apply, however, unless there is a substantial number of persons other than disqualified persons who are actually utilizing such goods, services, or facilities. Thus, a private foundation which furnishes recreational or park facilities to the general public may furnish such facilities to a disqualified person provided they are furnished to him on a basis which is not more favorable than that on which they are furnished to the general public.

Section 53.4942(a)-3(a)(2) of the regulations defines a "qualifying distribution" as including any amount (including program-related investments and reasonable and necessary administrative expenses) paid to accomplish 170(c)(2)(B) purposes, other than certain contributions to organizations controlled by the foundation or one or more disqualified persons or to non-operating private foundations.

Section 53.4943-10(b) of the regulations provides that business holdings do not include program-related investments.

Section 53.4944-3(a)(1) of the regulations defines a "program-related investment" as an investment which possesses the following characteristics:

(i) its primary purpose is to accomplish 170(c)(2)(B) purposes;
(ii) No significant purpose is the production of income or the appreciation of property; and
(iii) No purpose is to accomplish 170(c)(2)(D) purposes.

Section 53.4945-2(a)(5)(i) of the regulations provides that a grant by a private foundation to an organization described in section 509(a)(1), (2) or (3) of the Code does not constitute a taxable expenditure by the foundation under section 4945(d), other than under section 4945(d)(1), if the grant by the private foundation is not earmarked to be used for any activity described in section 4945(d)(2) or (5), is not earmarked to be used in a manner which would violate section 4945(d)(3) or (4), and there does not exist an agreement, oral or written, whereby the grantor foundation may cause the grantee to engage in any such prohibited activity or to select the recipient to which the grant is to be devoted. For purposes of this paragraph (a)(5)(i), a grant by a private foundation is earmarked if the grant is given pursuant to an agreement, oral or written, that the grant will be used for specific purposes.

Section 53.4945-2(a)(5)(ii) of the regulations provides that for purposes of section 53.4945-2, an organization shall be considered a section 509(a)(1) organization if it is treated as such under section 53.4945-5(a)(4) of the regulations.

Section 53.4945-2(a)(6)(ii) of the regulations provides that a grant by a private foundation to fund a specific project of a public charity is not a taxable expenditure by the foundation under section 4945(d)(1) of the Code to the extent that--

(A) The grant is not earmarked, within the meaning of section 53.4945-2(a)(5)(i) of the regulations, to be used in an attempt to influence legislation, and

(B) The amount of the grant, together with other grants by the same private foundation for the same project for the same year, does not exceed the amount budgeted, for the year of the grant, by the grantee organization for activities of the project that are not attempts to influence legislation. If the grant is for more than one year, the preceding sentence applies to each year of the grant with the amount of the grant measured by the amount actually disbursed by the private foundation in each year or divided equally between years, at the option of the private foundation. The same method of measuring the annual amount must be used in all years of a grant. This paragraph (a)(6)(ii) applies without regard to whether the public charity has made the election under section 501(h).

Section 53.4945-2(a)(6)(iii) of the regulations provides that for purposes of determining the amount budgeted by a prospective grantee for specific project activities that are not attempts to influence legislation under section 53.4945-2(a)(6)(ii), a private foundation may rely on budget documents or other sufficient evidence supplied by the grantee organization (such as a signed statement by an authorized officer, director or trustee of such grantee organization) showing the proposed budget of the specific project, unless the private foundation doubts or, in light of all the facts and circumstances, reasonably should doubt the accuracy or reliability of the documents.

Section 53.4945-4(a)(2) of the regulations provides that, for purposes of section 4945 of the Code, the term "grants" shall include, but is not limited to, such expenditures as scholarships, fellowships, internships, prizes, and awards. Grants shall also include loans for purposes described in section 170(c)(2)(B) and "program related investments" (such as investments in small businesses in central cities or in businesses which assist in neighborhood renovation). Similarly, "grants" include such expenditures as payments to exempt organizations to be used in furtherance of such recipient organizations' exempt purposes whether or not such payments are solicited by such recipient organizations. Conversely, "grants" do not ordinarily include salaries or other compensation to employees. For example, "grants" do not ordinarily include educational payments to employees which are includible in the employees' incomes pursuant to section 61. In addition, "grants" do not ordinarily include payments (including salaries, consultants' fees and reimbursement for travel expenses such as transportation, board, and lodging) to persons (regardless of whether such persons are individuals) for personal services in assisting a foundation in planning, evaluating or developing projects or areas of program activity by consulting, advising, or participating in conferences organized by the foundation.

Section 53.4945-4(a)(4)(ii) of the regulations provides that a grant by a private foundation to an organization described in section 509(a)(1), (2), or (3) of the Code, which the grantee organization uses to make payments to an individual for purposes described in section 4945(d)(3), shall not be regarded as a grant by the private foundation to the individual grantee (regardless of the application of section 53.4945-4(a)(4)(i) of the regulations) if the grant is made for a project which is to be undertaken under the supervision of the section 509(a)(1), (2), or (3) organization and such grantee organization controls the selection of the individual grantee. This rule shall apply regardless of whether the name of the individual

grantee was first proposed by the private foundation, but only if there is an objective manifestation of the section 509(a), (1), (2), or (3) organization's control over the selection process, although the selection need not be made completely independently of the private foundation. For purposes of this rule, an organization shall be considered a section 509(a)(1) organization if it is treated as such under section 53.4945-5(a)(4).

Section 53.4945-5(a)(2) of the regulations cross-references section 53.4945-4(a) for the definition of grants for purposes of section 4945(d)(4) of the Code.

Section 53.4945-5(a)(4)(iii) of the regulations provides that a foreign government (or agency or instrumentality) is treated as a 509(a)(1) organization for purposes of section 53.4945-5 even if it is not described in section 501(c)(3) of the Code. However, a grant to any such organization must be made exclusively for 170(c)(2)(B) purposes.

Section 53.4945-5(a)(6)(i) of the regulations 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 the selection of the secondary grantee by the organization to which it has given the grant. For such purpose, a grant described herein 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.

Rev. Rul. 71-29, 1971-1 C.B. 150, held that a grant by a 501(c)(3) organization to a city transit authority for the purpose of maintaining a mass transportation system qualified as a charitable disbursement in furtherance of the grantor's exempt purpose. The Service stated that the charitable element in facilitating public transportation is established in the Statute of Charitable Uses, 43 Eliz. I, c.4 (1601), which recognized as charitable the "repair of bridges, ports, havens, causeways . . . and highways."

Rev. Rul. 71-460, 1971-2 C.B. 231, held that a 501(c)(3) organization may conduct part or all of its charitable activities in a foreign country.

Rev. Rul. 74-125, 1974-1 C.B. 327, held that a private foundation's payments to consultants were not grants under section 4945(d)(3) of the Code. The foundation's activities included disseminating publications and developing and conducting training programs to assist educators in using improved educational methods. The consultants' services included the development of model curricula in a particular educational area and the design of materials to assist educators in the performance of their educational functions. The Service reasoned that the consultants' services were personal services assisting the foundation in planning and developing its projects under section 53.4945-4(a)(2) of the regulations.

Rev. Rul. 76-459, 1976-2 C.B. 369, held that the use of a private foundation museum's private road for access to the adjacent headquarters and manufacturing plant of a corporation (disqualified person) during the same hours the road is used by the general public as a thoroughfare connecting two public streets was not an act of self-dealing under section 4941 of the Code.

Rationale

Each of the requested rulings is discussed in turn below.

A. Although there exist situations where roads are built or maintained for the private purposes of developers, land owners, or others, we are satisfied under the circumstances presented that the Grant will be made exclusively for the charitable purposes under sections 501(c)(3) and 170(c)(2)(B) of the Code of erecting or maintaining public works and helping to alleviate poverty.

B.1. The Grant program as described will not generate any net income or capital gain for X that would be taxable under section 4940 of the Code. A partial return to X of grant funds would not result in net investment income.

B.2. Section 4941 of the Code defines self-dealing as certain direct or indirect transactions between a private foundation and a disqualified person. The Government of M is not a disqualified person with respect to X, and therefore the Grant is not a direct act of self-dealing. Moreover, we find no indirect self-dealing under the facts described.

B.3. A qualifying distribution under section 4942 of the Code generally includes a grant paid to a foreign government to accomplish charitable purposes. Since the foreign government is not controlled by disqualified persons with respect to X, the Grant will be a qualifying distribution.

B.4. X will not receive anything in return for its Grant, including any kind of ownership interest in a business enterprise, that would constitute a business holding under section 4943 of the Code. Moreover, X's making of such Grant is not itself a trade or business that would constitute a sole proprietorship of X or a joint venture with the Government of M.

B.5. X's Grant, in which X does not expect to receive back any principal and will not in any event receive net income or gain, is not an investment in the ordinary financial sense of the term. If the Grant were considered an investment under section 4944 of the Code, then it would constitute a program-related investment.

B.6. The Grant is not earmarked for purposes set forth in section 4945(d)(1), (2), and (3) of the Code, and the Grant Agreement prohibits the use of Grant funds for such purposes. X need not exercise expenditure responsibility under section 4945(h) with respect to the Grant, because the Government of M is deemed a 509(a)(1) organization for such purposes, and the Government of M will make no secondary grants of the funds, but only payments of compensation for goods and services received.

C. X's Grant activity is not a trade or business within the meaning of section 513 of the Code, because there is no expectation of any profit (or even return of capital) from the activity. If the activity were considered a trade or business, then it would be considered a related trade or business, because it contributes importantly to the accomplishment of X's charitable purposes.

D. The services to be provided by the Project Manager are consulting services like those described in Rev. Rul. 74-125 to assist the foundation in planning and developing its projects. Thus, under sections 53.4945-4(a)(2) and 5(a)(2) of the regulations, X's payments to the Project Manager, while qualifying distributions made in furtherance of X's exempt purposes, are compensation and not grants.

Rulings

Accordingly, we rule as follows:

A. The Grant is for an exclusively charitable, program-related activity as defined in sections 501(c)(3) and 170(c)(2)(B) of the Code because it will be used exclusively in the impoverished country of M to create essential public works for the general public of M.

B. The disbursements of funds pursuant to the Grant will not cause the imposition of any of the private foundation excise taxes, and specifically:

1. The tax on net investment income under section 4940 of the Code does not apply because the funds disbursed pursuant to the Grant will not produce any income from interest, dividends, rents or royalties or otherwise;

2. The Government of M is unrelated to X, and the disbursements of funds pursuant to the Grant to the Government of M will not create any self-dealing pursuant to section 4941;

3. The disbursements of funds pursuant to the Grant will be qualifying distributions for purposes of meeting the minimum qualifying distribution amount under section 4942;

4. The disbursements of funds pursuant to the Grant are for a program-related activity and will not create any "business holdings" within the meaning of section 4943;

5. The disbursements of funds pursuant to the Grant are for a program-related activity and will not result in jeopardizing investments within the meaning of section 4944;

6. The disbursements of funds pursuant to the Grant are for a program-related activity and are not taxable expenditures pursuant to, and are not subject to the expenditure responsibility rules of, section 4945 because the Grant is made to the Government of M.

C. The Grant will not give rise to unrelated business taxable income under sections 511-513.

D. The payments to the Project Manager are fees for services rendered in connection with X's program-related activities, and are not "grants" under sections 53.4945-4(a)(2) and 53.4945-5(a)(2) of the regulations.

Except as we have ruled above, we express no opinion as to the tax consequences of the grant under the cited provisions of the Code or under any other provisions of the Code.

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

Because this letter could help resolve any future tax questions relating to X's activities, X should a copy of this ruling in X's permanent records.

We are providing the Ohio Key District Office a copy of this ruling.

Sincerely yours,
(signed) Garland A. Carter

Garland A. Carter
Manager, Exempt Organizations
Technical Group 2