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

200121078

Date: FEB 27 2001

Contact Person:

Identification Number:

Telephone Number:

T:EO:B2

Employer Identification Number:

| LEGEND | UIL Nos. |
|---|---|
| M = | 170.09-02 |
| X = | 501.03-00 |
| Y = | 4941.04-00 |
| | 4942.03-05 |
| | 4945.04-05 |

Dear Applicant:

This letter responds to X's request dated May 2, 2000 for a ruling that a private foundation's grants made to a foreign orphanage will comply with chapter 42 of the Internal Revenue Code.

Facts

X ("the Foundation") is a domestic private foundation described in sections 501(c)(3) and 509(a) of the Code. The Foundation provides support for a variety of charitable endeavors, primarily in the United States.

Y ("the Orphanage") is a home for destitute, homeless, impoverished, diseased, and underprivileged children located in a foreign country, M. The Orphanage has for decades provided food, shelter, medical care, and educational, cultural, and vocational training for children who reside there, and currently serves several dozen children. The Orphanage also trains women in neighboring villages on first aid, home nursing, and nutrition. The Orphanage also provides medical aid to needy children and other needy persons in the community. The Foundation made a grant to the Orphanage in the tax year in which this ruling request was filed, and plans to make grants to the Orphanage in future years. The grants are unrestricted, general-purpose grants to help the Orphanage conduct its activities. The grants will not separately or collectively qualify as a transfer of assets described in section 507(b)(2) of the Code.

The Orphanage has received funds from the M government for its programs of training women but now depends entirely on donations from private sources for its support. Most of its support comes from other charitable organizations.

449
11

The Orphanage is a registered trust created under the laws of M. Like the U.S., the M government exempts charitable organizations from income taxes and allows deductions for charitable contributions to them. The M government has determined that the Orphanage qualifies as a charitable organization under M law. The Foundation has furnished information indicating that the Orphanage is described in sections 501(c)(3) and 509(a)(1)/170(b)(1)(A)(vi) of the Code. The Orphanage has furnished an affidavit satisfying the requirements of section 5.04 of Rev. Proc. 92-94.

The Orphanage is not directly or indirectly controlled by the Foundation or the Foundation's directors. The Orphanage and its trustee are not related to the Foundation or the Foundation's directors.

Rulings Requested

The Foundation requests the following rulings:

1. The grants made by the Foundation to the Orphanage are amounts paid for a charitable purpose.

2. The Orphanage is unrelated to the Foundation, and the grants will not in any way create any self-dealing under section 4941 of the Code.

3. The grants made by the Foundation to the Orphanage constitute qualifying distributions for purposes of meeting the minimum qualifying distribution amount under section 4942 of the Code.

4. The Foundation may treat the grants made to the Orphanage as made to an organization described in section 501(c)(3) (other than section 509(a)(4)) of the Code because the Foundation has made a reasonable judgment that the Orphanage is an organization described in section 501(c)(3) (other than 509(a)(4)).

5. The grants made by the Foundation to the Orphanage to accomplish a purpose described in section 170(c)(2)(B) of the Code will be treated as a distribution made to an organization described in sections 509(a)(1), (2), or (3) or 4942(j)(3) because the Foundation has made a good faith determination that the Orphanage is an organization described in sections 509(a)(1), (2), or (3) or 4942(j)(3).

6. The grants made by the Foundation to the Orphanage are not taxable expenditures under, and not subject to the expenditure responsibility rules of, section 4945 of the Code.

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 4941 of the Code imposes an excise tax on each act of self-dealing between a

450

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 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 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

457

(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, advancement of education, and combatting juvenile delinquency.

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 53.4942(a)-3(a)(2) of the regulations defines a "qualifying distribution" as including any amount (including 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 53.4942(a)-3(a)(6)(i) of the regulations provides generally that distributions for purposes described in section 170(c)(2)(B) of the Code to a foreign organization, which has not received a ruling or determination letter that it is an organization described in section 509(a)(1), (2), or (3) or 4942(j)(3), will be treated as a distribution made to an organization described in section 509(a)(1), (2), or (3) or 4942(j)(3) if the distributing foundation has made a good faith determination that the donee organization is an organization described in section 509(a)(1), (2), or (3) or 4942(j)(3). Such a "good faith determination" ordinarily will be considered as made where the determination is based on an affidavit of the donee organization or an opinion of counsel (of the distributing foundation or the donee organization) that the donee is an organization described in section 509(a)(1), (2), or (3) or 4942(j)(3). Such an affidavit or opinion must set forth sufficient facts concerning the operations and support of the donee organization for the Internal Revenue Service to determine that the donee organization would be likely to qualify as an organization described in section 509(a)(1), (2), or (3) or 4942(j)(3). Section 53.4945-5(a)(5) contains a similar rule.

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

452

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 53.4945-4(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)(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.

Section 53.4945-6(c)(1) of the regulations provides generally that since a private foundation cannot make an expenditure for a purpose other than a purpose described in section 170(c)(2)(B) of the Code, a private foundation may not make a grant to an organization other than an organization described in section 501(c)(3) except under certain circumstances. For purposes of this paragraph, an organization treated as a section 509(a)(1) organization under section 53.4945-5(a)(4) of the regulations shall be treated as an organization described in section 501(c)(3) of the Code.

Section 53.4945-6(c)(2)(ii) of the regulations provides that for purposes of this paragraph, a foreign organization which does not have a ruling or determination letter that it is an organization described in section 501(c)(3) of the Code (other than section 509(a)(4)) will be treated as an organization described in section 501(c)(3) (other than section 509(a)(4)) if in the reasonable judgment of a foundation manager of the transferor private foundation, the grantee organization is an organization described in section 501(c)(3) (other than section 509(a)(4)). The term

"reasonable judgment" shall be given its generally accepted legal sense within the outlines developed by judicial decisions in the law of trusts.

Section 53.4946-1(a)(7) of the regulations provides that for purposes of chapter 42 and certain other purposes, an organization described in sections 509(a)(1), (2), or (3) of the Code (or an organization wholly owned by such organization) is not a disqualified person.

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. Proc. 92-94, 1992-1 C.B. 507, provides a procedure that private foundations may follow in making "reasonable judgments" and "good faith determinations" under sections 53.4945-6(c)(2)(ii), 53.4942(a)-3(a)(6) and 53.4945-5(a)(5) of the regulations, other than a transfer of assets described in section 507(b)(2) of the Code. The grantor must obtain a "currently qualified" affidavit prepared by the grantee. An affidavit is currently qualified if the facts it contains are up to date and the substantive requirements of sections 501(c)(3) and 509 remain unchanged. The facts are up to date if they reflect the grantee organization's latest complete accounting year, or if the affidavit is updated to reflect the grantee organization's current data. Where a grantee's status under section 509(a) depends on financial support, the affidavit must be updated by asking the grantee to provide an attested statement containing enough financial data to establish that it continues to meet the requirements of the applicable Code section.

Rationale

Each of the requested rulings is discussed in turn below.

1. The grants made by the Foundation to the Orphanage will promote charitable purposes under sections 501(c)(3) and 170(c)(2)(B) of the Code. See section 1.501(c)(3)-1(d)(2) of the regulations.

2. Under the facts presented, the Foundation's grant to the Orphanage will not result in a transaction with a disqualified person, as an organization described in section 509(a)(1) or (2) of the Code is not a disqualified person. See section 53.4946-1(a)(7) of the regulations. Moreover, no facts presented indicate any improper indirect benefit to a disqualified person.

3-6. The grants are paid to accomplish charitable purposes. The Orphanage currently qualifies as a public charity described in sections 170(b)(1)(A)(vi) and 509(a)(2); thus, current grants will constitute qualifying distributions under section 4942(g)(1)(A) of the Code and are not subject to expenditure responsibility under section 4945. Since the Orphanage's continued status as a public charity depends on its annual support, X should make reasonable, good-faith determinations that the Orphanage continues to qualify as a public charity before making grants in future years. In so doing, X may rely on an affidavit from the Orphanage with up-to-date information as set forth in Rev. Proc. 92-94 establishing that the Orphanage continues to qualify as a public charity.

454

Rulings

Accordingly, we rule as follows:

1. The grants made by the Foundation to the Orphanage are amounts paid for a charitable purpose under sections 170(c)(2)(B) and 501(c)(3) of the Code.

2. The Orphanage is unrelated to the Foundation, and the grants will not in any way create any self-dealing under section 4941 of the Code.

3. The grants made by the Foundation to the Orphanage constitute qualifying distributions for purposes of meeting the minimum qualifying distribution amount under section 4942 of the Code.

4. The Foundation may treat the grants made to the Orphanage as made to an organization described in section 501(c)(3) (other than section 509(a)(4)) of the Code because the Foundation has made a reasonable judgment that the Orphanage is an organization described in section 501(c)(3) (other than 509(a)(4)).

5. The grants made by the Foundation to the Orphanage to accomplish a purpose described in section 170(c)(2)(B) of the Code will be treated as a distribution made to an organization described in sections 509(a)(1), (2), or (3) or 4942(j)(3) because the Foundation has made a good faith determination that the Orphanage is an organization described in sections 509(a)(1), (2), or (3) or 4942(j)(3).

6. The grants made by the Foundation to the Orphanage are not taxable expenditures under, and not subject to the expenditure responsibility rules of, section 4945 of the Code.

Except as we have ruled above, we express no opinion as to the tax consequences of the grants under the cited provisions of the Code or under any other provisions of the Code. Nor do we rule on the deductibility of a contribution to X earmarked for Y. Rev. Ruls. 63-252, 1963-2 C.B. 101, 66-79, and 75-65, 1975-1 C.B. 79, may be considered in this regard.

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.

455

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

Sincerely yours,

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2

456