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

200123072

Date: MAR 15 2001

Contact Person:

Uniform Issue List Numbers: 4941-04.00
501.03.02
501.03-31

Contact Number:

T:EO:B2

Legend:
B =
F1 =
F2 =

Dear Sir or Madam:

This is in reply to your letters dated April 9, 1999, and September 28, 2000, requesting rulings under sections 501(c)(3) and 4941 of the Internal Revenue Code.

B, a national bank, is a disqualified person under section 4946 of the Code with respect to two private foundations F1 and F2.

F1 and F2 are nonprofit charitable corporations, created and funded by B and its corporate predecessors, that are exempt from federal income tax under section 501(c)(3) of the Code and that are private foundations under section 509(a) of the Code. The activities and operations of F1 and F2 are controlled by directors and officers selected by B. Both F1 and F2 are principally grant-making foundations, and both foundations have historically made community assistance grants as a substantial portion of their grant-making activities. To date, the grant approval process has not taken into account whether Community Reinvestment Act ("CRA") credit could be received by B for a grant.

The CRA legislation was enacted in the 1970's as a result of a perception that banks were engaged in racially discriminatory business and mortgage lending practices. Although the Federal Reserve Board and the Comptroller of the Currency (hereafter "bank regulatory authorities") cannot legally compel banks to make loans or to assist in providing community assistance, the practical effect of the CRA legislation tends toward this result.

The bank regulatory authorities evaluate each federal bank under the CRA standards as to whether it is a good corporate citizen having a sensitivity to the needs of the communities it serves. The mechanism for this evaluation is a CRA rating that is based on the aggregation of scores on three performance tests: a lending test, a service test, and an investment test. The lending test accounts for 50% of the overall rating and involves an evaluation of a bank's lending activities, including geographic distribution of loans, demographics of borrowers, community development lending practices, and the innovative or flexible lending practices that meet the credit needs of low-income and moderate-income individuals. The service test accounts for 25% of the overall rating and involves an evaluation of the bank's activities through branches and other service facilities in the geographic area of its business and of the demographics of individual customers.

387

The final test is the one relevant to this request. It is the investment test, and accounts for 25% of the overall CRA rating. Under the investment test, a bank's "investments" are evaluated to determine whether they meet the needs of low-income and moderate-income individuals in the communities in which it engages in business. The majority of such "investments" typically involve direct equity investments by a bank (and not by an exempt foundation) in low-income housing corporations or partnerships, stock investments in community credit unions and minority-owned financial institutions, support of economic development corporations, and equity investments in other community or small business companies.

As a technical matter, grants or contributions to exempt charities pursuing economic assistance programs made directly by the bank or indirectly through its controlled exempt foundations qualify as an "investment" for CRA purposes. The taxpayers represent that the bank regulatory authorities view grants from controlled foundations to charities pursuing community assistance programs as appropriate "investments" under the CRA guidelines.

The bank regulatory authorities give a written rating (e.g., outstanding, satisfactory, needs to improve, or substantial noncompliance) resulting from the aggregation of scores on the three tests. Banks receive a numerical score under the lending test of 0 through 12, and from 0 through 6 on the other two tests..

Banks do not know what their specific scores are with respect to each test and receive only the written overall CRA rating. The final rating is made in a closed review by the bank regulatory authorities. The ratings are in large part subjective because many factors are involved in each test that cannot be measured mathematically. Further, part of the test involves a comparison to programs of other similarly sized banks. A bank will not be told what the bank regulatory authorities gave credit for under each of the tests. A bank can only surmise the scores for each of the three tests.

B does not know for certain what the bank regulatory authorities will actually look at in future reviews, and so B does not know for certain what grants from F1 or F2 will be taken into account for CRA purposes. Nevertheless, B has made a hypothetical review of past giving by F1 and F2 to evaluate the materiality of grants made in the past as an indication for the future. B believes that grants from F1 and F2 could have constituted less than 6% of total "investments" for purposes of the investment test. Since the investment test constitutes just 25% of the overall rating, B believes that grants from F1 and F2 could have accounted for 1.5% of the overall rating in any given year, and in any event less than 3% of the overall rating.

In a recent evaluation, B received an "outstanding" rating under the CRA.

B believes these percentages could fluctuate in future years, but represents that the percentage of bank investments attributable to F1 and F2 grants will be in the range of 5% to 10% of total B investments for CRA purposes. This would represent between 1.25% and 2.5% of B's overall CRA rating.

B has made certain statements to the bank regulatory authorities, and has publicized these statements to community groups, that it intended to make loans and provide investments in areas of need in communities, particularly where the needs relate to low-income and moderate-income individuals of such communities. B indicated its intent to cause gifts and contributions of a specified sum principally for community assistance to be made over a certain period throughout regions of the United States where B is engaged in business. The program was developed to be consistent with the CRA.

B represents that these statements of intent are not legally enforceable, and are not subject to administrative or judicial enforcement against B by the bank regulatory authorities. B represents that no third party could enforce such expressions against B, in part because the statements were not legally enforceable pledges with respect to any specific charity, and any third party would lack standing in court to enforce such expressions.

B, F1, and F2 ask for the following rulings:

1. Grants for purposes of community assistance and for other areas of priority discussed above, and the characterization of such grants as "investments" for CRA purposes, will not jeopardize the exempt status of either F1 or F2 as organizations organized and operated exclusively for purposes described in section 501(c)(3) of the Code.

2. Grants for purposes of community assistance and for other areas of priority discussed above, and the characterization of such grants as an "investment" for CRA purposes, will not constitute an act of self-dealing under section 4941 of the Code between B and either F1 or F2, or by any foundation manager of either foundation.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-l(d)(1)(ii) of the Income Tax Regulations requires that an organization exempt from federal income tax under section 501(c)(3) of the Code must serve public interests rather than any private interests.

Section 1.501(c)(3)-l(c)(1) of the regulations provides that an organization is not operated exclusively for exempt purposes under section 501(c)(3) of the Code if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Section 509(a) of the Code describes a private foundation that is subject to the private foundation provisions of Chapter 42 of the Code, including section 4941 of the Code.

Section 4941 of the Code imposes excise tax on any act of self-dealing between a private foundation and any of its disqualified persons under section 4946 of the Code. Section 4946 of the Code provides that a private foundation's substantial contributors and foundation managers are disqualified persons with respect to the private foundation.

Section 4941(d)(1) of the Code lists various acts of self-dealing, including any direct or indirect use by, or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 53.4941(d)-2(f)(1) of the Foundation and Similar Excise Taxes Regulations provides that the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation shall constitute an act of self-dealing. If a private foundation makes a grant or other payment that satisfies the legal obligation of a disqualified person, such grant or payment will ordinarily constitute an act of self-dealing.

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 private foundation of its income or assets will not, by itself, make such use an act of self-dealing under section 4941 of the Code. Further, the public recognition which 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.

We note that the term "investments" under the CRA constitutes a category of expenditures that is considerably broader than those that would be consistent with section 501(c)(3) of the Code. A grant will not be considered consistent with section 501(c)(3) purposes merely because it otherwise is considered a CRA "investment". For purposes of this ruling, we are assuming that all grants made by F1 and F2 to other charities will be made for exclusively section 501(c)(3) purposes, whether or not they may also be considered "investments" for purposes of the CRA. Based upon this assumption, no such grant should jeopardize the exemption of either F1 or F2.

B has represented that certain statements it has made concerning B's anticipated future expenditures for community assistance do not give rise to legally enforceable obligations of B. As such, B argues that any resultant obligation of B falls outside the language of section 53.4941(d)-2(f)(1) of the regulations that states that payments of a private foundation that satisfy legal obligations of a disqualified person constitute an act of self dealing. Based upon the legal representations that underlie it, and specifically upon the representation that B has incurred no legal obligation by virtue of these statements, we accept this argument.

The taxpayers represent that future grants by F1 and F2 will generally account for between 1.25% and 2.5% of B's total rating under the CRA. As discussed above, the rating system is to a certain extent "blind". B, F1, and F2 have no certain knowledge as to what extent their CRA "investments" change or improve the rating by bank regulatory authorities. Because of the relatively low apparent impact of F1 and F2 grants on B's rating, and the lack of quantification in the published rating itself, we believe that the benefit to B of grants of F1 and F2 that are characterized as CRA "investments" will be no more than incidental or tenuous. We believe this analysis to be particularly applicable to banks that have historically operated at the high end of the CRA rating system, where a principal result of a higher rating is increased or maintained public recognition. Based on these circumstances, we conclude that the inclusion of the private foundations' grants and investments with those of B under the Community Reinvestment Act does not constitute more than an incidental and tenuous benefit to B, and does not constitute acts of self-dealing between B and either F1 or F2.

Accordingly, we rule, that:

1. Grants for purposes of community assistance and for other areas of priority discussed above, that are otherwise exclusively in furtherance of section 501(c)(3) purposes, and the characterization of such grants as "investments" for CRA purposes, will not jeopardize the exempt status of either F1 or F2 as organizations organized and operated exclusively for exempt purposes described in section 501(c)(3) of the Code.

2. Grants for purposes of community assistance and for other areas of priority discussed above, that are otherwise exclusively in furtherance of section 501(c)(3) purposes, and the characterization of such grants as "investments" for CRA purposes, will not constitute acts of self-dealing between B and either F1 or F2, or by any foundation manager of either foundation.

These rulings are based on the understanding that there will be no legally enforceable obligation of the Bank under federal, state, or local law that will be satisfied, in whole or in part, by any foundation's grant or investment. These rulings are also based on the understanding that all grants made by the foundations under the Community Reinvestment Act will further their exempt purposes under section 501(c)(3) of the Code.

Because this ruling letter could help to resolve any questions, you should keep it in your permanent records.

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

Sincerely,

/S/

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2