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

Date:
APR 24 2001

Contact Person:

UIL: 4941.04-00
4945.04-05
4945.04-06

ID Number:

Contact Number:

T:EO:B2

Employer Identification Number:

LEGEND:

X =
Y =
Z =
x =

Dear Sir or Madam:

This is in reply to your letter of October 13, 2000, requesting a ruling concerning a proposed grant to a community trust which will be used to help construct a public library.

You are exempt under section 501(c)(3) of the Internal Revenue Code and are a private foundation within the meaning of section 509(a) of the Code.

You have proposed to make a grant to X which is to be used to provide funding to or for the benefit of Y. X has been recognized as exempt under section 501(c)(3) of the Code and is an organization described in section 509(a)(1) and I70(b)(I)(A)(vi). X is a community trust within the meaning of section I.I70A-9(e)(II) of the Income Tax Regulations. Y will be a fund maintained by X, the assets of which are to be dedicated to the local public library system. The proposed grant will be used in the specific manner determined by the Board of Directors of X. However, X has indicated that it will use funds to assist in the relocation and expansion of the public library discussed below.

The local public library district intends to relocate and expand its main library facility. The public library system has received a ruling from the Service recognizing it as exempt under section 501(c)(3) of the Code and not a private foundation because it is an organization described in section 509(a)(I) and I70(b)(I)(A)(vi).

The project has two separate identifiable components. One is the acquisition of a building which will have to be renovated to make it suitable for use as a library. The other involves the acquisition of a parcel of land, upon which there is an existing surface parking lot, and the construction of a parking

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garage. The two currently contemplated properties are owned by a third party which is totally unrelated to you. However, two corporations, your bank trustee and another company in which the bank trustee holds more than a 35 percent interest, have property interests in the neighborhood within which the library and parking garage are to be constructed. You have represented that both these companies should be considered disqualified persons to you within the meaning of section 4946 of the Code.

The library site is to be initially purchased by a for-profit limited liability company (hereinafter referred to as the LLC). The site upon which the garage is located is intended to be purchased with the receipts of a state bond issuance. You have represented that the sites are to be sold at a price which is less than fair market value.

In addition to your proposed grant to X, financing for the library building will be provided by a combination of sources including the above mentioned for-profit limited liability company. The LLC will be managed by a wholly-owned corporate subsidiary of an organization which has been recognized as exempt under section 501(c)(6). Its membership will include one or more for-profit corporations. It is expected that the for-profit corporation(s) shall be making the bulk of the investments in the LLC. You have represented that the reason for working through the LLC is that renovation of the library building will generate a substantial amount of federal and state historic rehabilitation income tax credits which may be used by the members of the LLC to reduce their income tax liabilities.

You have indicated that the initial Board of Directors of the corporate subsidiary that is the manager of the LLC will include Z, who is a disqualified person as to you. Z is not currently, but could in the future become, a member of the advisory committee for Y. In addition , Z currently is an officer and director of one of your foundation managers and is himself a foundation manager. You have represented that no disqualified person with respect to you will be an investor in the LLC. It is currently anticipated that the LLC will have to borrow additional funds from a commercial lender. This loan will be secured by a first priority mortgage or deed of trust on the library building. If a loan is made one of your foundation managers, the bank that is one of your trustees, might be the lender.

The land and the library building have been purchased. The Library provided the funds to the managing company of the LLC to purchase the land, and then the managing company conveyed the land to the Library. X has made a separate nonrecourse loan to the LLC to purchase the building and it is expected that X will make additional advances on the loan to the LLC in the future to be used to construct improvements to the building. The initial rate of interest on the loan is x, although this may change in the future when additional advances on the loan are made. The loan will be secured by a second priority mortgage or deed of truest and it will become due on the seventh anniversary of the completion date as defined in the Lease and Development Agreement. The completion date is defined in that document as being he date on which a completion certificate has been issued for the new improvements and the appropriate governmental authority as issued a certificate of occupancy. Assuming the Library purchases the library building subject to the loan, X will forgive the loan. Once the Library acquires the building the LLC is out of the picture.

The LLC has entered into the agreement to renovate the library building. After renovation is completed the facility will be leased to the Library with an option at any time from and after six years after the completion date to purchase the building at fair market value. It is contemplated that the Library will exercise this option an purchase the facility. It is contemplated that the Library will exercise this option and purchase the facility. The basic rent is to be established by the parties pursuant to a formula which has generally been agreed to.

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The site upon which the garage is to be located is expected to be purchased with the receipts of a state bond issuance. The garage site will remain owned by the bond issuer, a state instrumentality, until the bonds are paid in full. When the bonds are retired the facility will be transferred to the Library for no consideration. Parking spaces in the garage are to be leased to property owners within the new tax district at market rates. Some space will be reserved for Library use for no consideration. As an alternative, if bond funding is not available, the site will continue to be owned by the Library and continue to be used as a surface parking lot for the benefit of the Library.

It is also possible that a special tax district may be created under state law which will include the land and the library building and other properties which are adjacent to and near such lots. You have represented that that no property owned by a disqualified person with respect to you will be included in this new district. Nor will a disqualified person be entitled to reserve space in the parking garage.

You have requested the following rulings:

1. The grant by you to X will not jeopardize your status as an organization that is exempt under section 50l(c)(3) of the Code.

2. Neither the grant by you to X nor any other transaction described in your ruling request will be or result in any act of "self-dealing" under section 4941 of the Code. In particular neither the ownership by disqualified persons of real estate in the vicinity of the library building and garage nor the fact that disqualified persons may benefit financially from the renovation of the building and construction of the garage nor the fact that your bank trustee may lend monies to the LLC nor any other facts described herein causes such grant to be an act of self-dealing.

3. The grant by you to X will not be a taxable expenditure under section 4945. Further, you will not be required to exercise expenditure responsibility under section 4945(h) with respect to such grant, if made, or with respect to any other transaction described herein.

Section 501(c)(3) of the Code provides, in part, for exemption from federal income tax for a corporation organized and operated exclusively for charitable, scientific or educational purposes provided no part of the corporation's net earnings inure to the benefit of any private shareholder or individual.

Section I.501(c)(3)-l(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense. It includes the erection or maintenance of public buildings, monuments or other works.

Section 509(a) of the Code provides that, unless specifically excepted, a domestic or foreign organization described in section 501(c)(3) is a private foundation and subject to the excise taxes of Chapter 42.

Section 4941(a) imposes a tax on each act of self-dealing between a private foundation and a disqualified person (as defined in section 4946(a)).

Section 4941(d)(1)(E) of the Code provides that the term "self-dealing" includes any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 53.4941(d)-l(a) of the Foundation and Similar Excise Tax Regulations provides that for purposes of section 4941, the term "self-dealing" means any direct or indirect transaction described in

section 53.4941(d)-2. For purposes of this section it is immaterial whether the transaction results in a benefit or detriment to the private foundation.

Section 53.4941(d)-2(f)(2) of the regulations provides, in part, 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. For example, a grant by a private foundation to a section 509(a)(I), (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.

In example (I) of section 53.4941(d)-2(f)(4) of the regulations, M, a private foundation, makes a grant of $50,000 to the governing body of N City for the purpose of alleviating the slum conditions which exist in a particular neighborhood of N. Corporation P, a substantial contributor to M, is located in the same area in which the grant is to be used. Although the general improvement of the area may constitute an incidental and tenuous benefit to P, such benefit by itself will not constitute an act of self-dealing.

Section 4945(a) of the Code imposes an excise tax upon a private foundation's making of any taxable expenditures as defined in section 4945(d) of the Code.

Section 4945(d)(4)(A) of the Code indicates that a taxable expenditure does not include a grant made to an organization described in paragraph (I), (2) or (3) of section 509(a).

Section 4945(d)(5) of the Code provides that the term taxable expenditure means any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B) which defines charitable contributions.

Section 4946(a)(1) of the Code describes a disqualified person as including a foundation manager as that term is described in section 4946(b) and corporation or partnerships in which other disqualified persons hold more than a 35 percent profit interest.

Section 4946(b) of the Code defines a foundation manager as: an officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation), and with respect to any act (or failure to act), the employees of the foundation having authority or responsibility with respect to such act (or failure to act).

Section 7701(a)(1) of the Code defines the term "person" as including an individual, a trust, estate, partnership, association, company or corporation.

Rev. Rul. 67-5,1967-1 CB 123 holds that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities that were beneficial to them, but detrimental to the foundation. This resulted in the foundation's ownership of a non-income producing assets which prevented it from carrying on a charitable program commensurate in scope with its financial resources. The ruling concludes that the foundation was operated for a substantial non-exempt purpose and served the private interest of the creator and his family and therefore was not entitled to exemption under section 501(c)(3) of the Code.

Rev. Rul. 74-287,1974-1 C.B. 327 provides that the employees of a bank designated as the trustee of a private foundation, who have been delegated the responsibility for the day-to-day administration and distribution of the trust funds, are foundation managers within the meaning of section 4946(b)(1) of the Code and are disqualified persons as defined in section 4946(a)(1)(B) even though they are ultimately responsible to the bank directors and officers for their actions with respect to the trust..

Re:

Rev. Rul. 77-259,1977-2 C.B. 387, holds that the purchase by a private foundation of a mortgage from a bank which is a disqualified person engaged in the normal course of its business in acquiring and selling mortgages is not within the exception for general banking services under section 53.4941 (d)-2(c)(4) of the regulations and constitutes an act of self-dealing.

The information you have submitted establishes that you intend to provide funds through a community trust to be used in moving and renovating a site which is to become the main public library building. You are not the primary source of funds for this project. The major source of additional funding is expected to be funds raised through the use of a for-profit LLC. It is expected that those for-profit interests which will invest in the LLC will financially gain by reason of their investment. It is also anticipated that property holders in the area within which the Library and garage will be relocated will enjoy a certain amount of economic benefit. Two of the affected property holders are disqualified persons with respect to you, within the meaning of section 4946 of the Code. Furthermore, Z, another disqualified person may become a member of the advisory committee for Y.

An abuse of the assets of a private foundation could lead to revocation of tax exempt status. See Rev. Rul. 67-5, supra. However, the submitted information establishes that the grant you intend to make for the library project is to a public charity described in section 501(c)(3) that will have direction and control over the funds. It will consequently have no impact upon your continued status as an organization recognized as exempt under section 501(c)(3) of the Code. Likewise, your grant will not be considered a taxable expenditure as that term is defined in section 4945 of the Code.

You have indicated that disqualified persons within the meaning of section 4946 Code are involved in this project and may benefit because of their involvement in it. Generally, an act of self dealing may be present where the assets of a private foundation are transferred to or used by or for a disqualified person. It is not relevant whether the transaction is beneficial or detrimental to the private foundation. It is also well established that a bank or financial institution or its employees may be considered disqualified persons, where that organization or individual is responsible for the day-to-day administration of trust funds. See Rev. Rul. 74-287, supra and Rev. Rul. 77-259, supra Here your grant will provide the potential for economic gains to your bank trustee and the other related corporation by reason of their property holdings in the area. The bank trustee could gain by reason of its position as a lending institution. Furthermore, Z could benefit by reason of his position as a member of the management company of the LLC or as an officer or director of one of your foundation managers. However, the information you have submitted indicates that any benefit you or any of the disqualified persons described in your ruling request may receive is only incidental or tenuous when compared with the benefit the community will receive. See Example (I) of section 53.4941(d)-2(f)(2) of the regulations. Therefore, we believe that the transaction does not result in self-dealing as described in section 4941.

Accordingly, based on the information submitted we rule that:

1. The grant by you to X will not jeopardize your status as an organization that is exempt under section 50l(c)(3) of the Code.

2. Neither the grant by you to X nor any other transaction described in your ruling request will be or result in any act of "self-dealing" under section 4941 of the Code. In particular neither the ownership by disqualified persons of real estate in the vicinity of the library building and garage nor the fact that disqualified persons may benefit financially from the renovation of the building and construction of the garage nor the fact that your bank trustee may lend monies to the LLC nor any other facts described herein causes such grant to be an act of self-dealing.

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3. The grant by you to X will not be a taxable expenditure under section 4945. Further, you will not be required to exercise expenditure responsibility under section 4945(h) with respect to such grant, if made, or with respect to any other transaction described herein.

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. A copy of this ruling should be maintained in your permanent records.

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. For other matters, including questions concerning reporting requirements, please contact the Ohio TE/GE Customer Service Office.

Sincerely Yours,

S

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2