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4944.03-00

TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

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

200246036

Date: AUG 22 2002

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

LEGEND

B =
C =
D =
X =

Dear Sir or Madam:

This is in response to a letter dated September 26, 2001, requesting a ruling as to the consequences under Chapter 42 of the Internal Revenue Code of the construction and lease of facilities to be used by the lessee for religious, educational, and charitable purposes.

Statement of Facts

B is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code and is a private foundation described in section 509(a). B's Articles of Incorporation state that it is organized to make charitable grants to organizations that have established their tax-exempt status under section 501(c)(3). B was formed to centralize the charitable activities of Mr. and Mrs. C. B makes grants out of income, and out of its principal as the directors determine is appropriate. B has provided support for the programs of tax-exempt nonprofit organizations in arts and culture, religion, education, health, and other charitable purposes.

B holds legal title to four buildings, which it constructed, situated on a acre tract of land purchased in . The four buildings consist of a and a B leased the land and the buildings to D, a church exempt from federal income tax under section 501(c)(3) of the Code for a fee of $x per month. D is responsible for paying all taxes, maintenance, insurance and other costs associated with the building under the lease agreement. The lease agreement also provides that D is obligated to

use the premises exclusively for the accomplishment of its exempt purposes, and should the church fail to do so, the lease agreement will terminate. Upon termination of the lease the land and buildings will revert back to B. If the land and building revert to B, B intends to either lease the land and buildings for nominal consideration to another section 501(c)(3) organization or B will utilize the land and buildings itself for a direct charitable activity.

B intends to construct build-outs to the The build-outs will consist of classrooms and a gymnasium. B intends to lease the build-outs to D under the same terms as the land and the four buildings for nominal rent and that D will use the build-outs exclusively for its exempt purposes.

B's Board of Directors passed a resolution that, in furtherance of B's tax-exempt purpose, B intends to lease the build-outs to D for nominal or no consideration.

Ruling Requested

Based upon the facts set forth above, and the assumption that the transaction will be carried out as previously described, B requests the following rulings:

1) The construction of the build-outs for the use directly in carrying out purposes described in section 170(c)(2)(B) via a lease of such build-outs will constitute a qualifying distribution within the meaning of section 4942(g).
2) The build-outs acquired for lease to a church for use directly in carrying out of purposes described in section 170(c)(2)(B) will constitute assets used (or held for use) in carrying out B's exempt purpose and are thereby excluded in determining B's minimum investment return within the meaning of section 4942(e).
3) The date on which the cost of constructing the build-outs for lease to a church for use directly in carrying out purposes described in section 170(c)(2)(B) will be treated as a "qualifying distribution" (and the amounts expended excluded from the determination of "minimum investment return") will be the date B's expends the funds to construct the build-outs.
4) The acquisition of the build-outs to be leased for purposes described in section 170(c)(2)(B) will constitute a program related investment within the meaning of section 4644(c).

Law and Analysis

Section 170(c)(2)(B) of the Code describes, in part, purposes of an organization as being organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Section 4942(a) of the Code imposes a tax on the undistributed income of a private foundation for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year (if such first day falls within the taxable period).

Section 4942(c) of the Code provides that the term "undistributed incomen means, with respect to any private foundation for any taxable year as of any time, the amount by which- (1) the

distributable amount for such taxable year, exceeds (2) the qualifying distributions made before such time out of such distributable amount.

Section 4942(d) of the Code provides that the term "distributable amount" means, with respect to any foundation for any taxable year, any amount equal to- (1) the sum of the minimum investment return plus the amounts described in subsection (f)(2)(C), reduced by (2) the sum of the taxes imposed on such private foundation for the taxable year under subtitle A and section 4940.

Section 4942(e)(1) of the Code provides that the minimum investment return for any private foundation for any taxable year is 5 percent of the excess of- (A) the aggregate fair market value of all assets of the foundation other than those which are used (or held for use) directly in carrying out the foundation's exempt purpose, over (B) the acquisition indebtedness with respect to such assets (determined under section 514(c)(1) without regard to the taxable year in which the indebtedness was incurred).

Section 4942(g)(1) of the Code provides that the term "qualifying distribution" means (A) 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 any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons (as defined in section 4946) with respect to the foundation, except as provided in paragraph (3), or (ii) a private foundation which is not an operating foundation (as defined in subsection (1)(3), except as provided in paragraph (3), or (B) any amount paid to acquire an asset used (or held for use) directly In carrying out one or more purposes described in section 170(c)(2)(B).

Section 53.4942(a)-2(c)(3)(i) of the Foundation and Similar Excise Taxes Regulations provides, in part, that an asset is "used (or held for use) directly in carrying out a foundation's exempt purpose" only if the asset is actually used by the foundation in carrying out the charitable, educational, or other similar purpose which gives rise to the exempt status of the foundation.

Section 53.4942(b)-1(b) of the regulations provides that amounts paid to acquire or maintain assets which are used directly in the conduct of the foundation's exempt activities, such as the operating assets of a museum, public park, or historic site, are considered direct expenditures for the active conduct of the foundation's exempt activities.

Section 4944(a) of the Code provides that if a private foundation invests any amount in such manner as to jeopardize the carrying out of any of its exempt purposes, there is hereby imposed on the making of such investment a tax equal to 5 percent of the amount so invested for each year (or part thereof) in the taxable period.

Section 4944(c) of the Code provides that for purposes of this section, investments, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes.

Section 53.4944-3(a)(1) of the regulations provides, in part, that for purposes of section 4944, a "program-related investment" shall not be classified as an investment which jeopardizes the carrying out of the exempt purposes of a private foundation. A "program-related investment" is an investment which possesses the following characteristics: (i) The primary purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(B); (ii) No significant purpose of the investment is the production of income or the appreciation of property; and (iii) No purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(D).

Section 53.4944-3(a)(2), of the regulations provides, in part, that an investment shall be considered as made primarily to accomplish one or more of the purposes described in section 170(c)(2)(B) if it significantly furthers the accomplishment of the private foundation's exempt activities and if the investment would not have been made but for such relationship between the investment and the accomplishment of the foundation's exempt activities.

Revenue Ruling 72-369, 1972-2 C.B. 245, held that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under section 501(c)(3) of the Code; Revenue Ruling 71-529 distinguished.

Revenue Ruling 69-572, 1969-2 C.B. 119, held that a nonprofit organization, created to construct and maintain a building for the exclusive purpose of housing and serving exempt member agencies of a community chest, may be exempt under section 501(c)(3) of the Code

Revenue Ruling 71-529, 1971-2 C.B. 234, held that a nonprofit organization that provides assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualifies for exemption under section 501(c)(3) of the Code.

Revenue Ruling 78-102, 1978-1 C.B. 379, held that the correct conversion date of real property converted by a private operating foundation from nonexempt to exempt uses, for purposes of treating the conversion as a qualifying distribution under section 53.4942(a)-3(a)(5) of the regulations, is the date the foundation adopts and immediately proceeds to implement a plan for the exempt use of the property, even though the actual conversion is not completed until the following year.

B currently leases several buildings including a l it owns to D for nominal rent for the purpose of assisting D in its exempt activities. Providing such assistance is one of B's exempt purposes. B proposes to construct build-outs (additions) to the and lease the build-outs to D for the same purposes and essentially the same terms as the existing buildings. B's expenditures for the construction of the build-outs will accomplish the purposes described in section 170(c)(2)(B) of the Code and will therefore constitute a qualified distribution under section 4942(g). Additionally, to the extent that B's assets are expended during the construction process, they are effectively remove from the value of the assets used to determine B's "minimum investment return."

Because B will lease the build-outs to D for a nominal rate, it is clear that this action is for the

furtherance of B's exempt purposes and that no significant purpose of the constructing and leasing of the build-outs to D will be for the production of income, or the appreciation of property. Therefore, the build-outs are program-related investments within the meaning of sections 53.4944-3(a)(1) and (2) of the regulations for purposes of sections 4942 and 4944.

Ruling

Accordingly, based on the facts as presented and stated above, we have concluded that:

1) The construction of the build-outs for the use directly in carrying out purposes described in section 170(c)(2)(B) via a lease of such build-outs will constitute a qualifying distribution within the meaning of section 4942(g).
2) The build-outs acquired for lease to a for use directly in carrying out of purposes described in section 170(c)(2)(B) will constitute assets used (or held for use) in carrying out B's exempt purpose and are thereby excluded in determining B's minimum investment return within the meaning of section 4942(e).
3) The date on which the cost of constructing the build-outs for lease to a for use directly in carrying out purposes described in section 170(c)(2)(B) will be treated as a "qualifying distribution" (and the amounts expended excluded from the determination of "minimum investment return") will be the date B's expends the funds to construct the build-outs.
4) The acquisition of the build-outs to be leased for purposes described in section 170(c)(2)(B) will constitute a program related investment within the meaning of section 4644(c).

Except as specifically ruled upon above, no opinion is expressed concerning the federal tax treatment of the transaction described above under any other provision of the Code.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative. You should keep a copy of this letter in your permanent records.

This letter 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.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4