Internal Revenue Service

Department of the Treasury

Washington, DC 20224

SIN
501.00-00
4941.04-00
4942.03-05
7872.00-00

No Third Party Contact

Contact Person:

Telephone Number:

In Reference to:

Date: FEB 0 2 1999

199917079

Employer Identification Number:
Key District:

Legend:

X =

Y =

Z =

Dear Taxpayer:

This ruling revokes and supersedes our prior ruling that was issued to you as PLR 9314058 on January 14, 1993. The ruling was issued in response to your letter dated October 9, 1991 regarding the establishment of a program to provide employer-related emergency hardship grants and loans to employees of X and its subsidiaries.

You state that a few years after PLR 9314058 was issued, your employer sponsor, Y, merged with Z Corporation and the resulting corporation was X. You and the Z corporation Foundation merged, resulting in your present structure.

The October 9, 1991 request indicated that you are exempt under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3) and classified as a private foundation under section 509(a).

Your sole member is X, a for profit enterprise. Your employees may also be employees of X and its subsidiaries. X and its subsidiaries are disqualified persons within the meaning of section 4946 of the Code with respect to you.

You established and administer an employer related emergency hardship grant and loan program to provide relief to employees of X and its subsidiaries and their eligible dependents. Officers and directors of X and its subsidiaries and members of their families are not eligible for grants or loans under the hardship prog

Under the hardship program, grants and interest-free loans will be made to persons (1) who suddenly incur extraordinary medical expenses on their own behalf or on behalf of members of their families, (2) to pay for funeral or burial expenses, or (3) who encounter other unusual, sudden and severe financial hardship. Consideration will be limited to (1) medical emergencies and funeral and burial expenses not covered by insurance or other resources available to the applicant; (2) emergencies arising from natural disasters such as hurricanes, tornadoes, fires, floods, or earthquakes not covered by insurance or other resources. In each case, demonstration of financial need will be required.

Individuals who are disqualified persons with respect to you within the meaning of section 4946 of the Code are not eligible. The initial eligible class of recipients encompassed 30,000 persons. You anticipated that grants and loans would constitute less than five percent (5%) of the amounts distributed annually by you for charitable purposes. You stated that you would not provide grants or loans under the hardship program to more than ten percent (10%) of the eligible class of employees.

You stated that an applicant need not have been employed by X or any of its subsidiaries for any minimum time period to be eligible to receive a grant or loan under the hardship program and no grant or loan will be terminated if the applicant terminates employment with X or any of its subsidiaries. Also, eligibility for grants or loans under the hardship program is not related to any other employment related factors, such as an employee's position, services or duties. Selection of grant or loan recipients will be based solely upon an objective standard of a demonstrated sudden and severe financial hardship or need that is completely unrelated to the employment status of the recipient or his or her family.

Availability of the grants or loans under the hardship program will be publicized through corporate newsletters, the "employee assistance programs" of X and its subsidiaries, and by word of mouth. Information concerning the hardship program will also be available at employment counselling offices.

You stated that you would establish a Hardship Program Review Board, which would be independent of X. You would recruit individuals from the community who had no affiliation with you or X. You stated that employees or members of your Board of Directors or X's Board of Directors would not be eligible for consideration to the Review Board. The Review Board members will have no economic or other ties to X or you other than the possible ownership of an incidental amount of X's publicly traded

stock. The Review Board will be responsible for (1) accomplishing the day-to-day administrative operation of the hardship program, (2) reviewing applications received by you, and (3) making final determinations regarding to whom such grants or loans should be made and the amount of such grant or loan. You will annually determine the maximum amount available to be awarded under the program and the criteria for such awards. The Review Board will have the sole decision making authority with respect to the selection of the eligible recipients and the amount of each individual award.

In order to receive a grant or loan, eligible recipients will generally file a written application with you, which will be reviewed by the Review Board. The application will indicate the amount requested, the intended use of the funds, and the reason why the funds are needed. Applicants will also provide information concerning financial status. In emergency situations, however, the formal written application procedure may be waived if, in the discretion of the Review Board, the formal application procedure and selection process would leave the applicant in an untenable financial position or would defeat the hardship program's purpose to provide funds quickly on an emergency basis. In all instances, recipients of grants or loans made by you under the hardship program must subsequently demonstrate to the Review Board's satisfaction the purposes for which the funds were spent.

Based on the information you furnished, we concluded in our January 14, 1993 letter that the establishment and administration of the program furthers charitable purposes within the meaning of section 501(c)(3) and section 170(c)(2)(B) of the Code. Consequently, we ruled in our January 14, 1993 letter that:

1. Grants or loans made by you to eligible hardship applicants will constitute qualifying distributions for the purposes of section 4942 of the Code.

2. Grants or loans made by you to eligible hardship applicants under the hardship program will not constitute taxable expenditures within the meaning of section 4945(d) of the Code.

3. Interest-free or below-market loans made by you under the hardship program will not be subject to the provisions of section 7872 of the Code.

1. Charitable Purposes and Sections 501(c)(3) and 170(c)(2)(B) of the Code.

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax of organizations that are organized and operated exclusively for, among others, charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 170(c)(2)(B) of the Code provides that for purposes of section 170, the term "charitable contribution" means a contribution or gift to or for the use of a corporation, trust, or community chest, fund, or foundation organized and operated exclusively for, among others, charitable purposes. Subparagraph (C) adds "no part of the net earnings of which inures to the benefit of any private shareholder or individual."

Section 1.501(a)-1(c) of the Income Tax Regulations defines private shareholders or individuals within section 501 as persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(a)(2) of the regulations defines the term "exempt purpose or purposes" as any purpose or purposes specified in section 501(c)(3), as defined and elaborated in paragraph (d) of this section.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides, in relevant part, that the term "charitable" is used in section 501(c)(3) of the Code (and, thus, in section 170(c)(2)(B)) in its generally accepted legal sense. Such term includes, among other things, relief of the poor and distressed or of the underprivileged.

Section 1.170A-4A(b)(2)(ii)(D) of the regulations defines needy as being a person who lacks the necessities of life, involving physical, mental, or emotional well-being, as a result of poverty or temporary distress.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), the Court held that the presence of a single non-exempt purpose, if substantial in nature, will preclude exemption regardless of the number or importance of statutorily exempt purposes.

Revenue Ruling 75-199, 1975-1 C.B. 160, provides that an organization that restricts its membership to individuals of good moral character and health belonging to a particular ethnic group residing in a stated geographical area and provides sick benefits to members and death benefits to their beneficiaries is not exempt under section 501(c)(4) of the Code (and by extension is not exempt under section 501(c)(3)). The organization's income is derived principally from membership dues and is used for the payment of benefits and operating expenses. The revenue ruling further states that the membership organization described is essentially a mutual, self-interest type of organization. Its income is used to provide direct economic benefits to members and any benefit to the larger community is minor and incidental.

Revenue Ruling 81-58, 1981-1 C.B. 331, amplifies Revenue Ruling 75-199, supra. Revenue Ruling 81-58 describes an association composed of officers of a police department in a particular community. The association was created for educational purposes and to provide a lump sum payment to each member upon retirement or a lump sum payment to beneficiaries upon the member's death. The membership benefits program constitutes the association's primary activity. The organization's primary sources of income are from contributions by the general public and through fund raising events. Members are also required to pay a nominal, one-time membership fee upon joining the organization. Its income is used to provide direct economic benefits to members. Although the class of employees benefitted by the organization consists of police officers engaged in the performance of essential and hazardous public services and there is an incidental benefit provided by the organization to the larger community, the fact remains that the primary benefits from the organization are limited to its members. Therefore, the organization is not operated exclusively for the promotion of social welfare within the meaning of section

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501(c)(4) (nor by extension for exempt purposes within the meaning of section 501(c)(3)).

A disaster relief or emergency hardship organization may be formed for the benefit of distressed individuals but may also overly serve the private interests of its founders, principals, or even contributors, thereby failing to achieve an exempt purpose despite otherwise good intentions. For example, in Wendy Parker Rehabilitation Foundation, Inc. v. Commissioner, T.C. Memo 1986-348, the organization was created by the Parker family to aid an open-ended class of "victims of coma." However, the organization stated that it anticipated spending 30 percent of its income for the benefit of Wendy Parker, significant contributions were made to the organization by the Parker family, and the Parker family controlled the organization. Wendy's selection as a substantial recipient of funds substantially benefitted the Parker family by assisting with the economic burden of caring for her. The benefit did not flow primarily to the general public as required under section 1.501(c)(3)-1(d)(1)(ii) of the regulations. Therefore, the Foundation was not exempt under section 501(c)(3) of the Code.

X and its subsidiaries are your sponsors and financial supporters. You are controlled by X. You have established and administer an emergency assistance fund to provide relief through grants and loans to all of X's and its subsidiaries' eligible employees, retirees and those employees' and retirees' dependents who experience severe financial hardship for reasons beyond their control which are not covered by insurance or other resources.

By providing an employee assistance program to provide relief to X's and its subsidiaries' employees who have suffered losses due to natural disasters or financial hardship as described above, the program is accomplishing two purposes. The program provides relief to persons who are distressed or otherwise proper objects of charity. However, it also affords X and its subsidiaries with a significant benefit. X and its subsidiaries benefit because the program provides employees with funds and goods not otherwise available except by reason of their employment by X and its subsidiaries. Employees realize a real and significant benefit because they have recourse to funds in times of financial hardship when other avenues have been exhausted. Potential employees will consider the advantages of such a program while employees will find it an enhancement to financial security and an incentive to continue employment. In this respect, the provision of financial assistance to employees in times of financial hardship, whether from natural disasters or financial emergencies, is a program similar to other employee benefit programs such as sick, life, death and accident benefits.

Even though an employee would have no legal right to funds from a disaster or emergency hardship relief fund, employees would be eligible for disaster and hardship benefits provided they are employed by a particular employer upon the occurrence of a disaster or financial emergency and they are in need of such assistance. Essentially, the employee assistance funds operate to provide protection from events that cannot be readily guarded against. In this respect, it is a significant benefit of the job. Moreover, employees of a particular employer that has an employer established, controlled and funded disaster relief benefit program would have an important advantage over other similarly situated victims of the disaster in having access to assured assistance. Thus, the presence of the equivalent of a benefits package, even if not availed of, would constitute a significant benefit derived from an employment relationship. A fund dedicated to employees' welfare is a significant employment benefit in the same way that a life, severance, or legal assistance benefit provides protection and security whether or not used.

While these programs do benefit persons who may be needy or distressed, they also serve the private interests of X and its subsidiaries who utilize such benefit programs to recruit and retain a more stable and productive workforce. In this respect, your employee assistance program accomplishes activities that are not exclusively in furtherance of one or more exempt purposes because they further the private purposes of X and its subsidiaries more than unsubstantially. Through their control and funding, X and its subsidiaries are able to direct your assistance programs to serve their private purposes by limiting disaster and hardship assistance solely to their employees. Any public benefit is significantly outweighed by the private benefit realized by rewarding persons based on their employment with X and its subsidiaries in terms of recruitment, retention, ensuring a stable workforce, and engendering goodwill and loyalty.

While there is some public benefit in ensuring that individuals are provided for in times of disaster or financial crisis, there is no assurance that selection of beneficiaries solely among employees of a particular employer serves the best interests of the public. The public interest may very well be better served by providing resources to persons who may be in much more dire conditions than persons who happen to be employed by a particular employer. Also, by imposing an employment related eligibility criteria, the general welfare of the public is placed at a disadvantage compared with the significant benefit afforded employees of the particular employer. Therefore, such a program does not further an exempt purpose within the meaning

of the regulations under section 501(c)(3) of the Code, Better Business Bureau, supra, and section 170(c)(2)(B).

The benefit conferred on X and its subsidiaries by the disaster relief and emergency hardship program also gives rise to inurement contrary to the requirements under sections 501(c)(3) and 170(c)(2)(B) of the Code which provide for the qualification for exemption and charitable contributions only if, in addition to other factors, "no part of the net earnings of [the organization] inures to the benefit of any private shareholder or individual."

Accordingly, we rule that the establishment and administration of the disaster relief and emergency hardship program, as described, does not further charitable purposes within the meaning of section 501(c)(3) and section 170(c)(2)(B) of the Code.

2 & 3. Qualifying Distributions and Taxable Expenditures - Sections 4942 and 4945 of the Code.

Section 4942(a) of the Code imposes a tax on the undistributed income of a private foundation.

Section 4942(g)(1)(A)(i) of the Code provides, in relevant part, that the term "qualifying distribution" means 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 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.

Section 4945 of the Code imposes a tax on each "taxable expenditure" of a private foundation as defined in section 4945(d) of the Code.

Section 4945(d)(3) of the Code provides that a "taxable expenditure" includes any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or other similar purposes by such individual, unless it satisfies the requirements of subsection (g).

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).

Section 4945(g) of the Code provides, in relevant part, that section 4945(d)(3) shall not apply to an individual grant awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary of the Treasury, if it is demonstrated to the satisfaction of the Secretary that-

(1) the grant constitutes a scholarship or fellowship grant which would be subject to the provisions of section 117(a) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii),

(3) the purpose of the grant is to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee.

Section 53.4945-4(a)(2) of the Foundation and Similar Excise Taxes Regulations provides a definition of "grants." It states that for purposes of section 4945, 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. Similarly, grants include such expenditures as payments to exempt organizations to be used in furtherance of their exempt purposes.

Section 170(c)(2)(B) of the Code describes, in relevant part, an organization that is organized and operated exclusively for charitable or educational purposes or for the prevention of cruelty to children.

Section 53.4945-6(b)(1)(v) of the regulations provides, in relevant part, that any payment which constitutes a qualifying distribution under section 4942(g) will not be treated as a taxable expenditure under section 4945(d)(5) of the Code.

For the purpose of resolving the issues under sections 4942 and 4945, the determination of whether the employer related hardship program comes within one of the purposes described under section 170(c)(2)(B) of the Code is fundamental. Any amount paid by a private foundation to accomplish any purpose other than one specified in section 170(c)(2)(B) is not a qualifying distribution under section 4942(g)(1)(A) and is a taxable expenditure under IRC 4945(d)(5).

Neither the employer related disaster relief nor the emergency hardship program furthers an exempt purpose within the meaning of section 1.501(c)(3)-1(d)(1)(i) of the regulations and section 170(c)(2)(B) of the Code. Therefore, grants and loans made by you are not qualifying distributions within the meaning of section 4942(g)(1)(A)(i) of the Code. Consequently, since the grants and/or loans do not accomplish a purpose described in section 170(c)(2)(B) of the Code and do not result in qualifying distributions pursuant to section 4942(g), such payments made by you are taxable expenditures pursuant to section 4945(d)(5) of the Code.

Accordingly, we rule that grants and loans paid by you under the disaster relief and emergency hardship program do not accomplish an exempt purpose under section 170(c)(2)(B) of the Code, are not qualifying distributions within the meaning of section 4942(g)(1)(A)(i) and are taxable expenditures under section 4945(d).

4. Treatment of Loans with Below-Market Interest Rates - Section 7872 of the Code.

Section 7872 of the Code governs the tax treatment of certain loans with below market interest rates. Loans subject to section 7872 include certain gift loans and compensation related loans, among others.

Section 1.7872-5T(b)(11) of the Temporary Income Tax Regulations provides that section 7872 of the Code does not apply to loans made by a private foundation or other organization described in section 170(c), the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B).

As discussed previously, loans made pursuant to the hardship program do not accomplish one or more of the purposes described in section 170(c)(2)(B) of the Code. Therefore, we rule that the hardship loans do not qualify for the exemption from section 7872 of the Code provided in section 1.7872-5T(b)(11) of the temporary regulations.

5. Employer Related Scholarship Programs and Employer Related Disaster Relief and Emergency Hardship Programs.

With respect to scholarship programs provided by private foundations to children of employees of substantial contributors, section 53.4941(d)-2(f)(2) of the regulations states that such grants will be considered incidental or tenuous only if the program is consistent with the foundation's exempt status, the

deductibility of contributions under section 170, and the requirements under section 4945(g). There is no similar specific provision for disaster relief and hardship programs.

Section 4945 of the Code addresses taxes on taxable expenditures of private foundation. Section 4945(d)(3) provides that "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirements of subsection (g). Subsection (g)(1) provides that subsection (d)(3) shall not apply to an individual grant awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary, if it demonstrated to the satisfaction of the Secretary that the grant constitutes a scholarship or fellowship grant which would be subject to the provisions of section 117(a) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii).

Revenue Procedure 76-47, 1976-2 C.B. 670, and Revenue Procedure 80-39, 1980-2 C.B. 772, provide guidelines under which employer-related private foundations that make scholarship or educational loans will be considered to further a purpose consistent with section 4945 of the Code. The key criterion is that scholarships and educational loans are awarded to no more than 10 percent of the number of employees of a particular employer who were eligible, were applicants for such grants, and were considered by the selection committee in selecting the recipients of grants in that year. This criterion assures that the scholarships or loans do not overly serve the private interests of the employer because there is no significant probability that employment will make scholarships or loans available to a qualified employee.

However, your disaster relief and hardship programs are available to all employees who satisfy the eligibility criteria and are limited only by the amount of funding that X and its subsidiaries may provide. Thus, the principles set forth in the area of scholarships and educational loans are not directly applicable to your situation since there is a high probability that employment will make disaster and hardship assistance available and there is no specific exception for such programs under chapter 42 as there is for scholarships.

This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described above.

The Assistant Commissioner (Employee Plans and Exempt Organizations) has granted you relief under section 7805(b) of the Code from retroactive application of this ruling for disaster relief or emergency hardship payments made up to six months from the date of this ruling and for any such payments made after six months from the date of this ruling under a legal obligation incurred prior to the end of the six month period.

We are providing your key District Director with a copy of this ruling. You should keep a copy for your permanent records.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading. For other matters, including questions concerning reporting requirements, please contact your key District Director.

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

Sincerely,
Marvin Friedlander

Marvin Friedlander
Chief, Exempt Organizations
Technical Branch 1

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