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

Date: MAY 26 1999

Contact Person:

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ID Number:

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Employer Identification Number:

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Dear Sir or Madam:

This is in reply to your request of October 9, 1998, and subsequent correspondence, for rulings on whether certain transactions by the District would result in Unrelated Business Taxable Income under sections 511 - 514 of the Internal Revenue Code.

A 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). A's Articles of Incorporation state that it is organized: "To make charitable grants to organizations which have established their tax-exempt status under section 501(c)(3). A was formed to centralize the charitable activities of Mr. and Mrs. B. A makes grants out of income, and out of so much of its principal as the directors determine is appropriate. In the past, A has provided support, in the form of grants, for the programs of tax-exempt nonprofit organizations in arts and culture, religion, education, health, and other charitable purposes.

A has recently, on w, purchased a parcel of land ("Land") in C, D. In furtherance of A's tax-exempt purposes, A intends to construct four buildings on the Land: a church, a school, a parsonage, and a clothing/food bank for the homeless (the "Buildings"). The total costs are anticipated to be approximately x.

A intends to lease the Land and the Buildings to E (the "Church"), a tax-exempt organization within the meaning of sections 501(c)(3) and 170(b)(1)(A)(i) of the Code. A will operate and manage the leasing arrangement with the Church as a direct charitable activity. A will retain legal title to the land and buildings.

Under the proposed transaction, the lease agreement will provide for nominal rent, approximately two percent of fair market value for such a lease. The lease agreement will also provide that the Church will be responsible for paying all taxes, maintenance, insurance and other costs associated

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with the building during the lease term. A is responsible for custodial costs, legal, fiduciary and other professional fees, such as negotiating and drafting the lease.

The lease will further provide that the Church is obligated to use the premises exclusively for the accomplishment of its exempt purposes, and should the Church fail to do so, the lease will terminate. Upon termination of the lease, the Land and Buildings are to revert to A. If the Land and Buildings revert to A, A intends to either lease the Land and Buildings for nominal or no consideration to another organization exempt under section 501(c)(3) of the Code or A will utilize the Land and Buildings itself for a direct charitable activity.

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 income" 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 (j)(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 Tax 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.

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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,(2)(i) 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.

A has purchased Land and is preparing for the construction of Buildings thereon for the purpose of assisting the Church in its exempt activities. Providing such assistance is one of A's exempt purposes. A will lease the Land and the Buildings to the Church for nominal rent. Therefore these assets constitute assets held for use in carrying out the exempt purpose of A within the meaning of section 53.4942(a)-2(c)(3)(i) of the regulations and expenditures for such constitute qualifying distributions within the meaning of section 4942(g) of the Code. Also because these assets are used or held for use in carrying out A's exempt purpose, they are excluded from the value of assets on which the "minimum investment return" is calculated. See sections 4942(e)(1) and 53.4942(b)-1(b).

Because A will lease the Land and Buildings to the Church for a rate of only about two percent of fair market value, it is clear that this action is for the furtherance of A's exempt purposes and that no significant purpose of the purchasing, constructing and leasing of the Land and Buildings to the Church will be for the production of income, or the appreciation of property. As there is no political or legislative action involved, it is apparent that no purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(D) of the Code. Therefore, the Land and Buildings 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.

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

1. The acquisition of land and the construction of buildings thereon for use directly in carrying out purposes described in 170(c)(2)(B) of the Code, as described above, via a lease of such land and buildings will constitute a "qualifying distribution" within the meaning of section 4942(g) of the Code.

2. Land and buildings acquired for lease to a church for use directly in carrying out of purposes described in section 170(c)(2)(B) of the Code will constitute "assets used (or held for use)" in carrying out A's exempt purpose and are thereby excluded in determining A's "minimum investment return" within the meaning of section 4942(e) of the Code.

3. The date on which the cost of acquiring land and constructing buildings for lease to a church for use directly in carrying out purposes described in section 170(c)(2)(B) of the Code will be treated as a "qualifying distribution" and excluded from the determination of "minimum investment return" is the date A expends the funds to acquire the land.

4. The acquisition of land and buildings to be leased for purposes described in section 170(c)(2)(B) of the Code will constitute a "program related investment" within the meaning of section 4944(c) of the Code.

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

We are informing the Ohio EP/EO key district office of this ruling. Because this letter could help resolve any questions about your exempt status and foundation status, you should keep it in your permanent records.

Sincerely,

(signed) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2