



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Release Number: 200822041

Release Date: 5/30/08

Date: March 6, 2008

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

UIL:

4943.00-00

Legend:

You =

State Z =

Supported Charity =

Donors =

Corporation =

Attorney General =

Dear

We have considered your ruling request dated April 13, 2007, concerning whether the stock holdings in Corporation are exempt from the application of the excess business holdings excise tax under section 4943(f)(2) of the Internal Revenue Code of 1986, as amended (hereafter "Code").

Facts:

You are a charitable trust formed in State Z in                      You provide annual grants to fund a scholarship program operated by Supported Charity, a community foundation. The scholarship program provides educational opportunities for students of State Z who do not have sufficient resources to pursue post-secondary education. You and Supported Charity have selected three State Z colleges and universities for participation in your scholarship program. In the next eight years, you plan to more than triple the size of your scholarship program by adding students and expanding the number of public institutions served from three to eight.

You are recognized by the Internal Revenue Service as an exempt organization under Code section 501(c)(3) and are classified as a Type III Supporting Organization under Code section 509(a)(3). You are governed by seven trustees, four of which are independent of Donors. One of the independent trustees is appointed by Supported Charity. The remaining three trustees are the current President of Corporation and Donors' two daughters. Donors have contributed to you cash and Corporation stock. You fund your scholarship program with

dividends from Corporation stock and cash gifted to you by Donors. The expansion of your scholarship program is to be funded by additional contributions of Corporation stock and cash from Donors, and the corresponding increase in dividends received as a result of additional Corporation stock contributions.

Donors and their daughters own \_\_\_\_\_ percent of the voting stock of Corporation. Donors have contributed to you a total of 2.16 percent of the voting stock of Corporation. By 2014, Donors expect to have made additional annual contributions of Corporation voting stock to you, raising your total holdings of said stock to 3.26 percent. You represent that Donors and their daughters have expressed an intention to donate to you 100 percent of Corporation voting stock currently owned by them. Corporation operates a business as a corporation in State Z and is considered a "business enterprise" within the meaning of section 4943 of the Code.

You are concerned that as your ownership of Corporation stock exceeds 2 percent of the Corporation's total outstanding shares, coupled with the shares held by Donors and their daughters, you would be subject to the excess business holdings excise tax under section 4943 of the Code. You represent that your ability to fund your scholarship program would be severely limited if you are forced to partially dispose of your Corporation stock holdings or limit your retention of future gifts of Corporation stock. You further represent that such a limitation would significantly reduce the aggregate number of scholarships you can award from 2007 through 2014. You state that a significant reduction in the anticipated number of scholarships awarded would impose a considerable restraint on access to higher education for thousands of capable but financially needy students and have a significant impact on State Z and its colleges and universities. You believe that an exemption from the excess business holding provisions will avoid the significant detrimental impact on your scholarship program.

The Attorney General of State Z analyzed the impact on the community of eligible students and participating institutions that would result from your inability to fund your current scholarship program and your planned expansion because of a potential forced disposition of your Corporation stock holdings. The Attorney General also considered the potential economic impact on the community of State Z that such a forced disposition might cause. To evaluate the impact this disposition would cause, the Attorney General's office interviewed and collected information from Supported Charity's staff, financial aid officers at the three participating public institutions, the President of one of the universities, participating students and other charitable organizations. The Attorney General found that your scholarship program has enabled hundreds of students to obtain a college degree and that your plans to triple the program by adding more students and expand the program to eight public institutions would benefit hundreds of more students. The Attorney General's office also considered the expert opinion of an investment banker. The investment banker reported to the Attorney General that because of Corporation's dominant market position, only an out-of-state purchaser would have the resources to enable it to purchase Corporation. Sale to an out-of-state purchaser would result in a loss of jobs within the state, a decrease in the investment of capital in the state and disruption to the scholarship program. Thus, the Attorney General determined that a forced disposition of stock would have a severe detrimental impact on the community of students that would be eligible for scholarships, the public higher education community, and a severe detrimental economic impact on the community.

You entered into a Memorandum of Understanding with the Attorney General of State Z. The Memorandum of Understanding reflects your agreement and commitment to (i) pay annually to Supported Charity a minimum cash amount equal to 5 percent (or a lesser percentage if the Secretary issues regulations establishing a payout rate below 5 percent) of the value of your assets, valued on the last day of the preceding calendar year; (ii) provide prompt written notification to the Attorney General of State Z of any intention to offer for sale shares of Corporation stock other than the repurchase of shares by Corporation; (iii) expand the funding of the Foundation scholarship program; and (iv) submit a yearly report on March 1 each year through 2014 to Attorney General of State Z describing its progress of implementing the expansion of your scholarship program and explaining any material reduction in the planned expansion that may occur in any given year.

**Requested Ruling:**

You have requested a ruling that your Corporation stock holdings are exempt from taxes imposed on excess business holdings pursuant to the Secretary's authority under section 4943(f)(2) of the Internal Revenue Code.

**Statement of the Law:**

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 509(a)(3) of the Code excludes from the term "private foundation" an organization which (A) is organized, and at all times thereafter is operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more organizations described in section 509(a)(1) or (2) (commonly referred to as a "public charity"), (B) is operated, supervised, or controlled by or in connection with, one or more publicly supported organizations, and (C) is not controlled directly or indirectly by one or more disqualified persons.

Section 4943(f)(5)(A) of the Code defines a Type III supporting organization as an organization that meets the requirements of subparagraphs (A) and (C) of section 509(a)(3) and which is operated in connection with one or more public charities.

Section 4943(f)(5)(B) of the Code defines a functionally integrated Type III supporting organization as a Type III supporting organization that is not required under regulations established by the Secretary to make payments to supported organizations due to the activities of the organization related to performing the functions or, or carrying out the purposes of, such supported organizations.

Section 4943(a)(1) of the Code imposes an excise tax on the excess business holdings of any private foundation in a business enterprise during any taxable year.

Section 4943(f)(3) of the Code provides for the application of the excise tax on excess business holdings to a section 509(a)(3) Type III supporting organization (other than a

functionally integrated type III supporting organization) as if it was a private foundation.

Section 4943(c)(1) of the Code defines the term "excess business holdings" to mean, with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the enterprise which the foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

Section 4943(c)(2) of the Code provides that permitted holdings in a corporation are 20 percent of the voting stock, reduced by the percentage of the voting stock owned by all disqualified persons.

Section 4943(c)(2)(C) of the Code provides for a 2 percent de minimis rule where a private foundation shall not be treated as having excess business holdings in any corporation in which it does not own more than 2 percent of the voting stock and not more than 2% in value of all outstanding shares of all classes of stock.

Section 4943(f)(2) of the Code excludes application of the excess business holdings tax to a supporting organization's holdings if the Secretary determines that such holdings are consistent with the purpose or function constituting the basis for its exemption under section 501.

Section 4943(f)(4) of the Code, directly and by reference to section 4958(f)(3) and (4), defines the term "disqualified person."

Section 4958(f)(3)(A)(i) of the Code, as adopted for purposes of section 4943, describes a 35 percent controlled entity as a corporation in which disqualified persons own more than 35 percent of the total combined voting power of the corporation. Such disqualified persons are described in section 4943(f)(4)(A)(i) as persons who for the last five years are in a position to exercise substantial influence over the affairs of the corporation (or any member of such persons' family as defined in section 4958(f)(4)).

When reviewing a request for exemption under section 4943(f)(2) of the Code, the legislative history indicates that the Secretary should consider the views of the State Attorney General, as well as any additional factors that the staff of the Joint Committee on Taxation might enumerate in its Technical Explanation of the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006). Additionally, the legislative history suggests that the Secretary may also consider as additional factors, whether the shares held by donors and related persons are controlling or whether donors and related persons are bound to ultimately contribute all but a de minimis amount shares to the organization and that they have no direct or indirect control over the organization and its investments. See 152 Cong. Rec. S8754 – S8755 (August 3, 2006).

In its Technical Explanation, the staff of the Joint Committee on Taxation listed the following factors that the Secretary should consider in making its determination: (1) a reasoned determination by the State attorney general with jurisdiction over the supporting organization, that disposition of the holdings would have a severe detrimental impact on the community; and (2) a binding commitment by the supporting organization to pay out at least five percent of the

value of the organization's assets each year to its supported organizations. A reasoned determination would require, among other things, evidence that any such determination was made pursuant to a serious study by the State attorney general of the issues involved in disposing the excess holdings, and findings by the State attorney general about the detrimental economic impact that would result from such disposition. If as a result of such State attorney general's study and findings, the State attorney general directed as a matter of State law that permission of the State would be required prior to any sale of the holdings, such a factor should be given strong consideration by the Secretary. Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006 (JCX-38-06) at 361.

**Analysis:**

Generally, under section 4943(c)(2) of the Code, a Type III supporting organization (other than one that is functionally integrated) and all disqualified persons may not hold more than 20 percent of the voting stock of a corporation. You are a Type III supporting organization that is not functionally integrated. You have received and will continue to receive a series of donations of Corporation voting stock from Donors, which places your total holdings of Corporation voting stock in excess of the 2 percent de minimis rule under section 4943(c)(2)(C). Although this would exceed the permitted holdings under section 4943(c)(2), section 4943(f)(2) provides that the Secretary may exempt the excess business holdings of a supporting organization from the excess business holdings excise tax if the Secretary determines that such holdings are consistent with the purpose or function constituting the basis for the organization's exemption under Code section 501.

The Attorney General of State Z has submitted a reasoned determination, supported by findings made pursuant to a serious study. The Attorney General found that limiting your Corporation stock holdings to the permitted holding provisions of section 4943(c)(2) of the Code, would have a severe detrimental impact on higher education in State Z. The Attorney General also found that a potential disposition of the holding would have a severe detrimental economic impact on State Z. You represent that the Donors and their daughters are not in control of the Corporation. They own less than 35 percent of the voting stock of Corporation. An analogous provision, section 4958 of the Code, provides that a corporation is not a controlled entity if disqualified persons own less than 35 percent of the voting stock. You have also made a binding commitment with the attorney general of the State of Z that you would pay-out cash equal to 5 percent (or a lesser amount determined by future Treasury Regulations) of the value of your assets each year to Supported Charity. Finally, you have agreed to notify the Attorney General before you intend to sell any shares of Corporation stock, other than as a repurchase by Corporation.

Accordingly, based upon the information submitted in your ruling request, we rule, subject to the caveats provided below, that you are exempt from the application of the excess business holdings excise tax under section 4943(f)(2) of the Code with respect to your holdings of Corporation stock donated by Donors now or in the future because such holdings are consistent with the purpose or function constituting the basis for your exemption under section 501 of the Code.

This ruling will no longer apply if on an aggregate basis, Donors or their daughters acquire stock in the Corporation that exceeds 35 percent of the combined voting power. Furthermore, this ruling will no longer apply if you fail to make an annual payment to Supported Charity of cash equal to or greater than 5 percent of the aggregate fair market value of your assets.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. 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. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. You must attach a copy of this letter ruling to any tax or information return to which it is relevant.

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.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Robert C. Harper, Jr.  
Manager, Exempt Organizations  
Technical Group 3

Enclosure  
Notice 437