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Legend:

Taxpayer =

Supported Organization =

Supporting Organization =

Company A =

Company B =

State X =

State Y =

A =

B =

C =

Marital Trust =

Trust 1 =

Trust 2 =

Trust 3 =

Fund =

Stage =

%X1 =

%X2 =

%X3 =

%X4 =

%X5 =

%X6 =  
%X7 =  
%X8 =  
%X9 =  
%X10 =  
\$X1 =  
\$X2 =

Dear \_\_\_\_\_ :

This letter responds to Taxpayer's December 31, 2015, request for a ruling under section 4941 of the Internal Revenue Code.<sup>1</sup>

Facts:

Taxpayer is recognized as a tax-exempt organization described in section 501(c)(3) and classified as a private foundation under section 509(a). Taxpayer is a State X nonprofit nonstock corporation and provides grants to dozens of public charities within State X, State Y, and two neighboring states. Taxpayer's president and chairman is A and its only other trustee is B.

The Supported Organization is a State Y nonprofit nonstock corporation that is recognized as a tax-exempt organization described in section 501(c)(3) and classified as a public charity under sections 509(a)(1) and 170(b)(1)(A)(vi). Supported Organization operates Stage, an outdoor performing arts venue, where it provides an array of arts performances and education, such as dance, live music, theater, and children's programming.

Supported Organization receives financial support from Taxpayer. A is the chairman of the board of directors of Supported Organization and its president. B is a director. A majority of the nine members of the board of directors of Supported Organization are independent of Taxpayer. Taxpayer represents that neither Taxpayer nor any disqualified person with respect to Taxpayer controls Supported Organization within the meaning of section 4942(g) and the regulations thereunder or within the meaning of Treas. Reg. § 53.5942(d)-1(b)(5).

Supporting Organization is also a State Y nonprofit nonstock corporation that is recognized as a tax-exempt organization described in section 501(c)(3) and classified as a public charity under section 509(a)(3) as a Type I supporting organization. Supporting Organization was established last year to support Supported Organization

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<sup>1</sup> The Internal Revenue Code of 1986, as amended, to which all subsequent "section" references are made unless otherwise indicated.

by constructing and owning a new and expanded performing arts stage/center. Its board of directors is elected by Supported Organization. The current board of Supporting Organization is the same as the board of Supported Organization. A is the chair of the board of directors of Supporting Organization and its president. B is a director of Supporting Organization.

Supporting Organization has not accepted and will not accept gifts from any person who directly or indirectly controls the governing body of Supported Organization within the meaning of section 509(f)(2). Supporting Organization receives financial support from Taxpayer. Taxpayer represents that neither Taxpayer nor any disqualified person with respect to Taxpayer controls Supporting Organization within the meaning of section 4942(g) and the regulations thereunder or within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5).

Company A is a real estate development company founded by C and is a State X stock corporation. A is the President and CEO and has a %X1 direct beneficial ownership interest in Company A representing %X2 of the voting power. The remaining ownership interests are %X3 held by Marital Trust, %X4 held by Trust 1, %X5 held by Trust 2, and %X6 held by Trust 3.

Company A, through its many subsidiaries, builds homes, develops residential communities, and owns, develops, and manages commercial space for shopping centers and offices. Company B is a subsidiary company of Company A. A has a %X7 ownership interest in Company B. The remaining ownership interests are %X8 held by Fund, %X9 held by Company A, and %X10 held by Trust 1.

Stage is an outdoor venue that hosts several performances and events each summer, entertaining thousands of visitors. All seating is outdoors in a grassy field, and for many performances guests bring their own lawn chairs and blankets. Limited space means that not everybody who wants to attend performances or events is able to do so, and the size of the existing stage limits the type of performances that Supported Organization can host at the venue. Supported Organization desires to have access to performing space near its current location that would provide greater capacity and more performance options.

Supporting Organization was established to purchase the land and to construct and own the new performing arts stage/center that will be used by Supported Organization. Because of its history and relationships with the community, Supported Organization would like the new performing arts stage/center to be as close to Stage as possible. However, vacant lots of a size sufficient to construct the planned performing arts stage/center are scarce in the neighborhood and the options for suitable space are limited.

To explore its options for expansion, Supported Organization hired a third-party consultant unrelated to Supported Organization, Supporting Organization, Company A,

Company B, Taxpayer, or any disqualified person with respect to Taxpayer. The consultant recommended that Supported Organization construct a new performing arts stage/center on land (Land) currently owned by Company B. The Land is located a little over half a mile away from Stage and is adjacent to a large parking lot that can be used during performances, making it an ideal location. Supported Organization's board of directors, upon extensive evaluation and consideration of the consultant's recommendation, concluded that the Land is the best location for constructing a new performing arts stage/center.

A, in accordance with Supported Organization's conflict of interest policy, did not participate in any of the deliberations or voting on the decision to purchase the Land. The independent members of the board of directors of the Supported Organization voted to recommend to Supporting Organization that it purchase the Land.

Upon consideration of the recommendation by Supported Organization and other facts and information, including the study by the independent consultant, the board of directors of Supporting Organization has decided to proceed with the purchase of the Land. A, in accordance with Supporting Organization's conflict of interest policy, did not participate in any deliberations or voting on the decision to purchase the Land. The independent members of the board of directors of Supporting Organization voted to authorize the purchase. The purchase price for the Land will be determined by an independent third-party appraiser to be hired by an independent committee of directors of Supporting Organization.

Taxpayer plans to grant approximately \$X1 to Supporting Organization for the purpose of constructing a new performing arts stage/center and initial operating expenses of said facility. No portion of the grant will be used to purchase the Land, and the funds from the grant will not be used as a guarantee or as collateral for a loan to purchase the Land. There is no agreement, express or implied, between Taxpayer and Supporting Organization or Supported Organization regarding the purchase of the Land. The grant funds will be placed into a segregated account until they are completely expended.

The entire project cost is anticipated to be approximately \$X2, so additional funding will be raised from the public. The funds used by Supporting Organization to purchase the Land will be raised from the general public, or from government grants, or some combination of both. No portion of the funds used to purchase the Land will be received from the Taxpayer or any disqualified person with respect to Taxpayer.

#### Ruling Requested:

Taxpayer requests a ruling that Taxpayer's proposed grant to Supporting Organization for Supporting Organization to construct and operate a new performing arts stage/center on land Supporting Organization will purchase using other funds from Company B, a disqualified person with respect to Taxpayer, will not constitute an act of direct or indirect self-dealing under section 4941.

Law:

Section 4941 of the Code imposes an excise tax on the disqualified person(s) and each foundation manager who knowingly participates in each act of self-dealing between a private foundation and a disqualified person.

Section 4941(d)(1) defines self-dealing, in part, as including any direct or indirect sale or exchange, or leasing, of property between a private foundation and a disqualified person or agreement by a private foundation to make a payment of money or other property to a government official.

Section 4946(a)(1) provides, in part, that the term “disqualified person” means, with respect to a private foundation, a person who is—

- (A) a substantial contributor to the foundation,
  - (B) a foundation manager (within the meaning of subsection (b)(1)),
  - (C) an owner of more than 20 percent of—
    - (i) the total combined voting power of a corporation,
    - (ii) the profits interest of a partnership, or
    - (iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation,
  - (D) a member of the family (as defined in subsection (d)) of any individual described in subparagraph (A), (B), or (C), and
  - (E) a corporation of which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the total combined voting power.
- ...
- (I) only for purposes of section 4941, a government official (as defined in subsection(c)).

Section 4946(b)(1) defines the term “foundation manager” to include an officer, director, or trustee of a foundation.

Treas. Reg. § 53.4941(d)-1(b)(2) provides that the term “indirect self-dealing” shall not include a transaction engaged in with a government official by an intermediary organization which is a recipient of a grant from a private foundation and which is not controlled by such foundation (within the meaning of subparagraph (5) of Treas. Reg. § 53.4941(d)-1(b)) if the private foundation does not earmark the use of the grant for any named government official and there does not exist an agreement, oral or written, whereby the grantor foundation may cause the selection of the government official by the intermediary organization. That regulation also states that a grant by a private foundation shall not constitute an indirect act of self-dealing even though the foundation had reason to believe that certain government officials would derive benefits from such grant so long as the intermediary organization exercises control, in fact, over the selection process and actually makes the selection completely independently of the private foundation.

Example (3) of Treas. Reg. § 53.4941(d)-1(b)(8) illustrates the preceding provision. The example describes a grant made by a private foundation to a university for the purpose of conducting a seminar to study methods for improving the administration of the judicial system. The university is not controlled by the private foundation. In conducting the seminar, the university made payments to certain government officials. By the nature of the grant, the private foundation had reason to believe that government officials would be compensated for participation in the seminar. The university, however, had completely independent control over the selection of such participants. Thus, the grant by the private foundation was not an indirect act of self-dealing with respect to the government officials.

Treas. Reg. § 53.4941(d)-1(b)(5) provides that an organization is controlled by a private foundation if the foundation or one or more of its foundation managers (acting only in such capacity) may, only by aggregating their votes or positions of authority, require the organization to engage in a transaction which if engaged in with the private foundation would constitute self-dealing.

Treas. Reg. § 53.4946-1(a)(8) provides, generally, that, for purposes of section 4941 only, the term disqualified person shall not include any organization described in section 501(c)(3).

Treas. Reg. § 53.4946-1(d) provides, in part, that, for purposes of applying section 4946(a)(1)(C) and (E), indirect stockholdings shall be taken into account under section 267(c) and the regulations thereunder, subject to certain modifications.

#### Analysis:

Both A and B, as foundation managers of Taxpayer, are disqualified persons under section 4946(a)(1)(B) with respect to Taxpayer. Company A is a disqualified person with respect to Taxpayer under section 4946(a)(1)(E), because A owns stock representing more than 35% of the total combined voting power in Company A. Company B is also a disqualified person with respect to Taxpayer under the attribution rules described in Treas. Reg. § 53.4946-1(d)(1). Any direct purchase of Land by Taxpayer from Company B, which is a disqualified person with respect to Taxpayer, would be considered an act of self-dealing under section 4941(d)(1)(A). However, Taxpayer will not make a direct purchase of the Land from Company B.

Taxpayer will make a grant to Supporting Organization, an intermediary organization, which will be placed into a segregated account for use by Supporting Organization to construct and operate a new performing arts stage/center. Taxpayer's grant will not be used by Supporting Organization to purchase the Land. Rather, the funds used by Supporting Organization to purchase the Land will be raised from the general public and/or from government grants. Additionally, Supporting Organization had complete control over the selection of the Land for purchase. Supporting Organization is not

controlled by Taxpayer, A, or B within the meaning of Treas. Reg. § 53.4941(d)-1(b)(2) or § 53.4941(d)-1(b)(5). There is no agreement, express or implied, between Taxpayer and Supporting Organization or Supported Organization regarding the purchase of the Land.

The reasoning applied in Treas. Reg. § 53.4941(d)-1(b)(2) and Example (3) of Treas. Reg. § 53.4941(d)-1(b)(8) with regard to transactions with a government official may be analogized to a situation in which a grant is provided by a private foundation to an intermediary section 501(c)(3) organization that is not controlled by the private foundation within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5) and the intermediary may independently use the grant to construct and operate a performing arts venue on land purchased from a disqualified person with other funds raised for that purpose. In the absence of the grant funds being earmarked for use in purchasing the Land and the absence of any other control by Taxpayer of the Supporting Organization's decision to purchase the Land, no act of indirect self-dealing occurs.

Ruling:

Based solely on the facts and representations submitted by Taxpayer, we rule that Taxpayer's proposed grant to Supporting Organization for Supporting Organization to construct and operate a new performing arts stage/center on land Supporting Organization will purchase using other funds from Company B, a disqualified person with respect to Taxpayer, will not constitute an act of direct or indirect self-dealing under section 4941. This ruling does not apply if the grant funds are used for purposes other than those specified.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party, as specified in Rev. Proc. 2016-1, 2016-1 I.R.B. 1, § 7.01(15)(b).

This office has not verified any of the material submitted in support of the request for ruling, and such material is subject to verification on examination. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2016-1, § 11.05.

No ruling is granted as to whether Taxpayer qualifies as an organization described in section 501(c), and, except as expressly provided above, no opinion is expressed or implied concerning the federal income tax consequences of any other aspects of any transaction or item of income described in this letter ruling. Because it could help

resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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, showing the deletions that we intend to make on the version that will be made available to the public, is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

In accordance with the Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

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.

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.

Sincerely,

Amy F. Giuliano  
Senior Technician Reviewer  
Exempt Organizations Branch 1  
(Tax Exempt & Government Entities)  
Internal Revenue Service  
Washington, DC 20224

cc: