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Date:

August 09, 2016

LEGEND

Foundation =
State =
Supported Organizations =
Development Project =
Company 1 =

Company 2 =
Attorney General =
Year 1 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =

Dear :

This is in response to a letter from the Foundation's authorized representatives dated June 17, 2016, and subsequent correspondence on the Foundation's behalf requesting a ruling exempting the Development Project from application of the excess business holdings tax pursuant to the Secretary's authority under section 4943(f)(2) of the Internal Revenue Code (the "Code").¹

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

FACTS

The Foundation is a trust formed under the laws of State. The Internal Revenue Service has recognized the Foundation as an organization described in section 501(c)(3) and classified it as a Type III non-functionally integrated supporting organization described in section 509(a)(3). The Foundation represents that it has traditionally made grants in excess of 3.5 percent of its net asset value to its Supported Organizations.

In Year 1, the Foundation invested in the Development Project, a business enterprise within the meaning of section 4943(d)(3), as a 70 percent owner through Company 1 and Company 2, both of which are disregarded entities for federal tax purposes (collectively, the “Companies”). The Foundation owns 100 percent of the membership interest in the Companies, which own, indirectly through a series of subsidiaries, the assets of the Development Project.

On Date 1, the Foundation’s ownership in the Development Project (through the Companies) increased to 100 percent as the result of a redemption transaction.

Between Year 1 and Date 1, Congress passed the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006) (the “PPA”), which applied the excess business holding rules of section 4943 to Type III supporting organizations (other than functionally integrated Type III supporting organizations). Transition rules provided Type III supporting organizations a number of years to dispose of excess business holdings held on August 17, 2006 (the date of the PPA’s enactment), or, in certain circumstances, obtained subsequently. The Foundation represents that, if it continues to hold 100 percent of the Development Project, it will have excess business holdings beginning August 17, 2016, with respect to the 70 percent interest it held upon the Act’s enactment and on Date 2 with respect to its 30 percent interest obtained as a result of the redemption.

The Foundation represents that, shortly after the PPA’s enactment, it began planning to dispose of its excess business holdings in the Development Project. Although the redemption on Date 1 increased the Foundation’s excess business holdings, this transaction improved the Foundation’s ability to sell the Development Project. The Foundation states that it has entered into numerous negotiations to sell, and has entertained various offers to purchase, the Development Project.

Currently, the Foundation is in late-stage negotiations with a potential purchaser. However, an unanticipated problem with the proposed financing is impacting the purchaser’s ability to close the sale. Additionally, the purchaser recently discovered that the Foundation is faced with an imminent deadline to dispose of all or part of the Development Project and is using this information as leverage to obtain a below-market price for the project. The Foundation is unsure whether the sale will close prior to

August 17, 2016, if at all, because of the Development Project's value and the complexity of the transactions and organizational structure. The Foundation states that a forced sale of the Development Project at a below-market price will cause it to suffer serious financial consequences and losses. In particular, the Foundation represents that its support of its Supported Organizations would decrease as a result of its endowment's decline in value.

On Date 3, the Foundation obtained a letter from the State Attorney General, who has jurisdiction over the Foundation, concluding that a forced sale of the Development Project would have a severe detrimental impact on the Foundation's community. The Attorney General reached this conclusion after discussing the issues at length with the Foundation's leaders, charitable beneficiaries, and other interested persons. The State Attorney General's letter provides additional detail:

One specific example of such detriments includes reduced funding for [certain] schools. This would result in layoffs and firings of teachers, administrators and staff. Thus, many individuals would become unemployed or underemployed. It would result in fewer and leaner scholarships, causing a considerable impact on the public's access to higher education, including students from [State].

Furthermore, the Foundation's support for [certain] charitable organizations would decline, resulting in less charitable activity in the community, less support to needy organizations in [State] and elsewhere, and less involvement of [State] residents in these activities. Many of [these] organizations, including the schools, give back to the local communities. With funds from the Foundation, the purchase and donate much needed household supplies, food, and educational resources such as books and school supplies to those in need.

Many individuals and organizations within and without [State] depend on the support of the Foundation. This includes members of [certain] churches and congregations in [State]. These local individuals and groups rely and depend on the resources of the Foundation, and a reduction in those resources would place a severe strain on their viability in [State]. . . .

We do not believe that requiring the Foundation to increase its funding above what is required under the Internal Revenue Code is necessary at this time, especially in light of the fact that the Foundation has distributed more than what it was required to distribute for many, many years. The current level of funding is designed to allow the Foundation to exist in perpetuity. Most studies of endowments for situations similar to the Foundation's situation suggest that distributions in the range of 3.5

percent to 4.5 percent of assets would allow the Foundation to continue in perpetuity.

In closing, we feel strongly that if the Foundation were forced to dispose of its . . . investments in a detrimental way in order to avoid the impending federal taxes, there would be a severe detrimental economic and non-economic impact on [certain communities in State] as well as on the residents of, and organizations within, [State] and other states.

The Foundation requests a ruling that, pursuant to the Secretary's authority in section 4943(f)(2), its interest in the Development Project is exempt from the tax on excess business holdings because such holdings are consistent with the purpose or function constituting the basis for the Foundation's exemption under section 501(a). Nonetheless, the Foundation represents that it has no intention of holding the Development Project and proposes to sell it as quickly as possible but, in any case, prior to Date 4. The Foundation also proposes to continue making meaningful distributions to its Supported Organizations and, when possible, to make distributions in excess of the required amount.

LAW

Section 501(a) of the Code provides generally that an organization described in section 501(c) is exempt from federal income taxes.

Section 501(c)(3) provides that an organization organized and operated exclusively for any of various specified charitable purposes is referred to in section 501(a), but only if it also satisfies other stated requirements that are not relevant to this analysis.

Section 509(a)(3) 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 specified organizations described in section 509(a)(1) or (2) (commonly referred to as "public charities"),
- (B) Is –
 - (i) Operated, supervised, or controlled by one or more public charities,
 - (ii) Supervised or controlled in connection with one or more such organizations, or
 - (iii) Operated in connection with one or more such organizations, and
- (C) Is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more or more public charities.

Section 4943(f)(5)(A) defines the term “Type III supporting organization” as an organization that meets the requirements of section 509(a)(3)(A), (B)(iii), and (C).

Section 4943(f)(5)(B) defines the term “functionally integrated Type III supporting organization” as a Type III supporting organization which is not required under regulations established by the Secretary to make payments to its supported organizations (as defined in section 509(f)(3)) due to the activities of the organization related to performing the functions of, or carrying out the purposes of, such supported organizations.

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

Section 4943(c)(1) provides that the term “excess business holdings” means, 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)(A) provides that the permitted holdings of any private foundation in an incorporated business enterprise are 20 percent of the voting stock reduced by the percentage of the voting stock owned by all disqualified persons.

Section 4943(f)(1) and (f)(3)(A) 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(f)(5) provides that rules similar to the rules of section 4943(c)(4), (5), and (6) apply to organizations described in section 509(a)(3) with certain modifications. In particular, section 4943(c)(4)(A)(i) modifies section 4943(b)(2) to permit Type III non-functionally integrated supporting organizations to hold up to 50 percent of the voting stock of an incorporated business enterprise if the supporting organization and all disqualified persons together had excess business holdings in such enterprise in excess of 20 percent of the voting stock on August 17, 2006 (the date of the enactment of the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006) (the “PPA”). However, section 4943(c)(4)(B)(iii) provides that, any interest in a business enterprise held on August 17, 2006, if the supporting organization on such date has excess business holding, shall (while held by the supporting organization) be treated as held by a disqualified person (rather than by the supporting organization) during the 10-year period beginning on such date, in any case in which the supporting organization holds less than 75 percent of the voting stock. Additionally, section 4943(c)(6)(A) provides that, if after August 17, 2006, there is a change in the holdings of in a business enterprise (other than by purchase by the supporting organization or a disqualified person) which causes the supporting organization to have excess business holdings in such enterprise, the interest of the supporting organization in such enterprise

(immediately after such change) shall (while held by the supporting organization) be treated as held by a disqualified person (rather than by the supporting organization) during the 5-year period beginning on the date of such change in holdings. Additionally, section 4943(c)(6)(B) provides that, if after August 17, 2006, there is a change in the holdings of in a business enterprise (other than by purchase by the supporting organization or a disqualified person) which causes the supporting organization to have an increase in excess business holdings in such enterprise (determined without regard to section 4943(c)(6)(A)), section 4943(c)(6)(A) shall apply, except that the excess holdings immediately preceding the increase therein shall not be treated, solely because of such increase, as held by a disqualified person (rather than by the supporting organization).

However, section 4943(f)(2) provides that the Secretary may exempt the excess business holdings of a supporting organization from the application of the excess business holdings tax if the Secretary determines that such holdings are consistent with the purpose or function constituting the basis for its exemption under section 501.

When reviewing a request for exemption under section 4943(f)(2), 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 PPA. 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 of shares to the organization and have no direct or indirect control over the organization and its investments. See 152 Cong. Rec. S8754 – S 8755 (Aug. 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 of 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

The IRS has classified the Foundation as a Type III non-functionally integrated supporting organization. The Foundation (through the Companies) held 70 percent of the Development Project, a business enterprise within the meaning of section 4943(d)(3), on August 17, 2006. Furthermore, the Foundation's interest in the Development Project increased to 100 percent on Date 1 as the result of a redemption transaction. Accordingly, the Foundation has excess business holdings. However, as represented by the Foundation, under the transition rules, the Foundation has until August 17, 2016, and Date 2, respectively, to dispose of its excess business holdings. See section 4943(c)(4)(B)(iii), (c)(6), & (f)(5). Nonetheless, 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 section 501.

The State Attorney General concluded that a forced sale of the Development Project by the Foundation would have a severe economic and non-economic impact on the Foundation's community, as well as on the residents of, and organizations within, the State. Additionally, the Foundation proposes to continue making meaningful distributions and, when possible, to make distributions in excess of the required amount. Finally, the Foundation states that it has no intention of retaining its interest in the Development Project and proposes to sell it as soon as possible, in any event, by Date 4.

RULINGS

Based on the facts and circumstances and the legislative history of the PPA, and assuming the accuracy of the facts and representations set forth herein, we rule that, pursuant to the Secretary's authority under section 4943(f)(2), the Foundation's interest in the Development Project is exempt from the excess business holding excise tax imposed by section 4943.

The rulings contained in this letter are based upon information and representations submitted by or on behalf of the Foundation (accompanied by a penalty of perjury statement executed by an individual with authority to bind the Foundation) and upon the understanding that there will be no material changes in the facts. This office has not verified any of the material submitted in support of the request for rulings, and such material is subject to verification on examination.

No ruling is granted as to whether the Foundation qualifies as an organization described in section 501(c) and/or section 509(a).

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 specifically described, and, except as expressly provided in this letter, no opinion is expressed or implied concerning the federal income tax consequences of any aspects of any transaction or item of income set forth above.

Because it could help resolve questions concerning federal income tax status, this ruling should be kept in the Foundation's permanent records.

A copy of this letter must be attached to any tax return to which it is relevant. Alternatively, if the Foundation files its return electronically, this requirement may be satisfied by attaching a statement to the return that provides the date and control number of this letter.

This ruling will be made available for public inspection under section 6110 after certain deletions of identifying information are made. For details, see the 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 the Notice 437. If the Foundation disagrees with our proposed deletions, it should follow the instructions in the Notice 437.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to each of the Foundation's authorized representatives.

This letter is directed only to the Foundation. Section 6110(k)(3) provides that it may not be used or cited as precedent by anyone else.

For any questions about this letter, please contact the person whose name and telephone number are shown in the heading.

Sincerely,

Don R. Spellmann
Senior Counsel, Exempt Organizations Branch 3
(Tax Exempt & Government Entities)