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Person To Contact:
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Telephone Number:

Refer Reply To:
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PLR-124355-16

Date:
February 1, 2017

TY:

Legend:

Founder	=
Intermediary	=
LLC	=
State	=
X	=
Waste	=

Dear :

This letter responds to the letter dated July 28, 2016, in which Foundation requested rulings under sections 4941 and 4942 of the Internal Revenue Code.

Facts:

Foundation is a nonprofit corporation recognized as an organization described in section 501(c)(3) that is a private foundation under section 509(a). Foundation's directors are Founder, his wife, and their attorney.

The granddaughter (“Disqualified Person”) of Founder and his wife formed Intermediary, which has been recognized as an organization described in section 501(c)(3) that is not a private foundation under section 509. Disqualified Person is represented to have the vested power to cause Intermediary to make expenditures and prevent Intermediary from making expenditures. Disqualified Person owns substantially all of the interests in LLC, a limited liability company taxed as a partnership. Disqualified Person and LLC are disqualified persons with respect to Foundation within the meaning of section 4946.

Foundation proposes to make a grant to Intermediary. Foundation states that Intermediary will use the proposed grant funds to purchase X Waste recycling collection containers that Intermediary will place in various locations across State. Foundation also states that Intermediary periodically will collect Waste from the recycling collection containers and transfer it to LLC, after which LLC will recycle the Waste and seek to profit from its sales of the recycled Waste in the ordinary course of LLC's business. The proposed grant is unrestricted, however, and does not require Intermediary to transfer any Waste to LLC, and another, unrelated, entity could purchase the Waste and process it, rather than LLC. During the teleconference conducted on December 14, 2016, we asked whether LLC will pay anything for any Waste that it receives from Intermediary. Counsel for Foundation said that he did not know the answer and would have to inquire. Counsel never supplied an answer. Accordingly, for purposes of the request for rulings, we assume that LLC will pay nothing for any Waste that Intermediary transfers to LLC. In addition, Foundation represented that Disqualified Person will cause Intermediary to use the full amount of Foundation's proposed grant no later than the end of Intermediary's taxable year after the taxable year of receipt to purchase containers to collect Waste for recycling and provide to Foundation adequate records or other sufficient evidence showing that such purchases were made and that they would be treated under Treas. Reg. Sec. 53.4942(a)-3(d) as a distribution out of corpus if Intermediary were a private foundation that is not an operating foundation in a manner that is compliant with the reporting requirements of section 4942(g)(3).

Rulings Requested, Law, and Analysis:

1. Section 4942 Ruling Requested: Foundation's proposed grant to Intermediary will constitute a qualifying distribution under sections 4942(g)(1) and (3).

Section 4942(g)(1)(A) and Treas. Reg. Sec. 53.4942(a)-3(a)(2)(i) provide, in part, that the term "qualifying distribution" means any amount paid to accomplish one or more purposes described in section 170(c)(1) or (2)(B), other than any contribution to an organization controlled (directly or indirectly) by the foundation or disqualified persons with respect to the foundation, except as provided in section 4942(g)(3). Section 170(c)(2)(B) lists the following purposes: "religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals." These purposes are the same as the purposes listed in section 501(c)(3). Thus, a grant by a private foundation to another organization described in section 501(c)(3) ordinarily is an amount paid to accomplish a purpose described in section 170(c)(2)(B) and may be considered to be a qualifying distribution.

Section 4942(g)(3) provides, in part, that the term "qualifying distribution" includes a contribution to another charitable organization controlled directly or indirectly by the transferor foundation or one or more disqualified persons with respect to the transferor if

two requirements are satisfied. The first such requirement is that the transferee organization must satisfy certain “pass-through” requirements. See, section 4942(g)(3)(A). The second requirement is that the transferor must obtain adequate records or other sufficient evidence from the transferee organization showing that the required pass-through requirements were satisfied. See, section 4942(g)(3)(B).

Generally, preserving the environment can further a charitable purpose. See Rev. Rul. 76-204, 1976-1 C.B. 152, (preserving the natural environment furthers an exempt purpose); Rev. Rul. 80-278, 1980-2 C.B. 175 (litigation to preserve the environment furthers an exempt purpose); Rev. Rul. 80-279, 1980-2 C.B. 176 (legal research concerning resolving international environmental disputes and participating in environmental dispute resolution furthers an exempt purpose); but see, Rev. Rul. 78-384, 1978-2 C.B. 174 (preservation of land without any distinctive ecological significance does not further exempt purposes).

Recycling waste materials to prevent pollution also can further a section 170(c)(2)(B) exempt purpose. In Rev. Rul. 72-560, 1972-2 C.B. 248, the IRS held that recycling waste materials was an essential element in the organization's efforts to combat environmental deterioration because it prevents the pollution of the environment caused by the usual disposition of these materials. Likewise, purchasing and using containers to collect waste for recycling can help prevent pollution by diverting the waste from disposal in landfills and, thereby, further an exempt purpose. See also, Treas. Reg. Sec. 53.4944-3(b) Example 12 (collecting recyclable solid waste materials and delivering those materials to recycling centers that are inaccessible to a majority of the population “significantly furthers the accomplishment of [the private foundation investor's] exempt activities”).

As stated above, Intermediary will use the proposed grant to purchase Waste collection containers, place them around State in various locations, and periodically collect for recycling the Waste that would otherwise be discarded in landfills. Accordingly, Foundation's grant will be used to further a section 170(c)(2)(B) exempt purpose under section 4942(g)(1). However, also as stated above, section 4942(g)(1)(A) and Treas. Reg. Sec. 53.4942(a)-3(a)(2)(i) provide that any contribution to an organization controlled (directly or indirectly) by disqualified persons with respect to the transferor foundation will not be considered to be a qualifying distribution unless the requirements of section 4942(g)(3) are satisfied.

As explained in more detail above, section 4942(g)(3) provides, in part, that the term “qualifying distribution” includes a contribution to another charitable organization controlled directly or indirectly by one or more disqualified persons with respect to the transferor only if the transferee organization satisfies certain “pass-through” requirements and the transferor obtains in a timely manner adequate records or other sufficient evidence from the transferee organization showing that the required pass-through distributions were made.

Treas. Reg. Sec. 53.4942(a)-3(a)(3) provides that an organization is a controlled organization if one or more disqualified persons with respect to a granting private foundation can require the grantee to make an expenditure, or prevent it from making an expenditure, regardless of the method by which the control is exercised or exercisable. Intermediary is a controlled organization because Disqualified Person can cause or prevent its making expenditures. Foundation represented that Disqualified Person will cause Intermediary to use the full amount of Foundation's proposed grant no later than the end of the taxable year after the taxable year of receipt to purchase containers to collect Waste for recycling. Foundation also represented that Foundation will obtain adequate records or other sufficient evidence from Intermediary showing that such purchases were made and that they would be treated under Treas. Reg. Sec. 53.4942(a)-3(d) as a distribution out of corpus if Intermediary were a private foundation that is not an operating foundation, thereby satisfying the section 4942(g)(3) pass-through distribution and reporting requirements for a qualifying distribution to a controlled organization. Accordingly, Foundation may count the proposed grant to Intermediary as a qualifying distribution.

2. Section 4941 Ruling Requested: Intermediary's use of the proposed grant proceeds will not result in any act of self-dealing under section 4941; particularly, that the proposed grant will not constitute an act of self-dealing because Disqualified Person and/or LLC, disqualified persons with respect to Foundation, may benefit from the availability of increased revenue opportunities arising out of the Intermediary recycling program.

Section 4941(a) imposes a tax on each act of self-dealing between a disqualified person and a private foundation, whether direct or indirect. Section 4941(d)(1)(E) defines self-dealing to include the direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Neither the Internal Revenue Code nor the regulations contain a definition of "indirect self-dealing." Rather, the regulations define indirect self-dealing by means of express exceptions or exclusions. For example, Treas. Reg. Sec. 53.4941(d)-1(b)(7) excludes from indirect self-dealing certain transactions between one or more disqualified persons to which a private foundation is not a party where the private foundation could itself directly engage in the transaction without committing an act of self-dealing. Conversely, if a private foundation cannot directly engage in a transaction without committing an act of self-dealing, then it cannot indirectly engage in the transaction without committing an act of self-dealing. If Foundation were to purchase the Waste collection containers and collect and transfer the Waste to LLC, which is a disqualified person with respect to Foundation, then the transfer of Waste by Foundation to LLC would be a direct act of self-dealing under section 4941(d)(1)(E). Therefore, interposing a public charity (Intermediary) between Foundation and LLC will not prevent the proposed transfer of Waste to LLC from constituting an indirect act of self-dealing.

Foundation's representative has argued that the exception from direct or indirect self-dealing under Treas. Reg. Sec. 53.4941(d)-2(f)(2) for benefits that are incidental or tenuous should apply to the proposed transfer of Waste to LLC. Examples of incidental or tenuous benefits include the public recognition a person may receive arising from the charitable activities of a private foundation to which such person is a substantial contributor, the benefit to a substantial contributor from a public charity's performing slum revitalization in the same area as the substantial contributor, or naming a public recreation center or public charity after a substantial contributor. See Treas. Reg. Sec. 53.4941(d)-2(f)(9), Example 4, and Rev. Rul. 73-407, 1973-2 C.B. 383 (naming a public charity after a substantial contributor as a condition of a grant is incidental or tenuous). Non-economic benefits such as public recognition are distinguishable from the economic benefits conferred upon LLC when Intermediary uses Foundation's grant to collect and transfer Waste to LLC.

The authorities holding that specified indirect economic benefits are incidental or tenuous also are distinguishable from Foundation's facts and circumstances. In Rev. Rul. 80-310, 1980-2 C.B. 319, a private foundation made a grant to a section 501(c)(3) public university to establish an engineering program. A substantial contributor encouraged its employees to apply for the program and it recruited graduates of the program. The substantial contributor's employees did not receive any preferential treatment in admissions nor did the substantial contributor receive any preferential treatment in recruiting. Competitors likewise benefitted from the program. The IRS found that the substantial contributor would "receive only an incidental or tenuous benefit from the grant."

In Rev. Rul. 85-162, 1985-2 C.B. 275, the IRS held that an indirect economic benefit to a disqualified person was incidental and tenuous where the private foundation made loans to various independent public charities for their construction projects in disadvantaged areas. The disqualified person was a bank. The public charities used the loans to purchase certificates of deposit to secure construction financing. They were prohibited from purchasing the CDs from the disqualified person bank and were prohibited from obtaining the construction or permanent financing from the disqualified person bank. The terms of the private foundation's loans barred it or any disqualified person from participating in the selection of vendors and suppliers. However, some of the selected vendors had ordinary banking or business relationships with the disqualified person bank or its affiliates but did not receive any preferential treatment. The IRS concluded that if any benefit to the disqualified person bank or some other disqualified person would result from an ordinary banking and business relation with a contractor, subcontractor, supplier, or an employee of those parties in the described construction projects, such benefit would be incidental or tenuous within the contemplation of section 53.4941(d)-2(f)(2).

These authorities do not imply that interposing a public charity controlled by a disqualified person between a private foundation and the disqualified person beneficiary will cause an indirect act of self-dealing to be incidental or tenuous. In every case in which a possible indirect act of self-dealing has been found not to constitute self-dealing because the benefit to the disqualified person was incidental and tenuous, the interposed public charity was fully independent of the foundation and its disqualified persons.

While Treas. Reg. Sec. 53.4941(d)-2(f)(2) does state that a proposed grant to a public charity will not be an act of self-dealing 'merely' because one director of the public charity also is a disqualified person with respect to the grantor private foundation, here Disqualified Person is more than merely a director of Intermediary. In this case, Disqualified Person has the power to cause Intermediary to make expenditures and prevent Intermediary from making expenditures. Accordingly, this regulation does not require Intermediary's proposed transfer of Waste to LLC to be considered incidental or tenuous.

In both of the revenue rulings discussed above, the independent intermediary selected the students, vendors, and suppliers free of influence by the private foundation or disqualified persons, and the students, vendors, and suppliers received the primary benefits of the grants. In this case, a disqualified person with respect to Foundation will cause Intermediary to transfer to LLC the Waste that will be collected by Intermediary, which will be made possible by the proposed grant from Foundation. In both of the referenced revenue rulings, the primary beneficiaries were independent of the disqualified persons. In Rev. Rul. 80-130, the primary economic beneficiaries were students who learned engineering but were not disqualified persons. In Rev. Rul. 85-162, the primary economic beneficiaries were independent vendors and suppliers that were not disqualified persons. In this case, LLC will be the primary beneficiary and a disqualified person.

Intermediary's use of Foundation's proposed grant to acquire the Waste recycling collection containers that will be used to collect Waste to be transferred to LLC, would provide benefits described in section 4941(d)(1)(E) indirectly to LLC that would not be incidental or tenuous.

Rulings:

Section 4942: Foundation's proposed grant to Intermediary will constitute a qualifying distribution under sections 4942(g)(1) and (3).

Section 4941: Intermediary's proposed transfers of Waste to LLC to be made possible by Intermediary's use of the proposed grant proceeds will result in indirect acts of self-dealing under section 4941.

The rulings contained in this letter are based upon information and representations submitted on behalf of Foundation and accompanied by a penalty of perjury statement executed by you as President of Foundation. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Without limiting the generality of the foregoing, we express no opinion as to whether Intermediary's proposed transfer of Waste to LLC constitutes inurement, private benefit, or an excess benefit transaction described in section 4958.

This ruling will be made available for public inspection under section 6110 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 Foundation's authorized representative.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) 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.

A copy of this letter must be attached to any information, income tax, or other return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their returns that provides the date and control number of the letter ruling.

Sincerely,

David M. Repass
Senior Technician Reviewer, Branch 3
(Tax Exempt & Government Entities)

cc: