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Date:
June 22, 2021

Foundation	=
City	=
Supporting Organization	=
State	=
W	=
H	=
City Act	=
Revenue Committee	=
Future Vision	=
Regional Development	=
A	=
City Foundation	=
Amount	=
Year 1	=
Year 2	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=

Dear _____ :

This letter responds to a request for rulings submitted by Foundation’s authorized representatives dated December 18, 2020, as supplemented by additional submissions dated Date 3, Date 4, Date 5, and Date 6. The requested rulings are under sections 4942 and 4945 of the Internal Revenue Code¹ and relate to certain grants Foundation plans to make, as more fully set forth below.

¹ Section references are to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

FACTS

Foundation is a State nonprofit corporation recognized as an organization described in section 501(c)(3) and classified as a private foundation under section 509(a). Foundation makes grants to numerous public charities in support of its religious, charitable, scientific, literary, and educational purposes. W and H, who are married to each other, are the only substantial contributors to Foundation. W and H are the President and the Secretary/Treasurer, respectively, of Foundation, and they also serve on its board of directors. The other directors of Foundation are children of W and H and the spouse of one of W and H's children.

Background Regarding Supporting Organization

City is a body corporate organized under the City Act. City's governing body is City Commission.

In Year 1, City convened a Revenue Committee to explore and recommend options for addressing City's anticipated revenue shortfalls. The final report of the Revenue Committee made several recommendations regarding improving City's revenues, but it acknowledged that those recommendations did not fully address the anticipated revenue shortfalls. The Revenue Committee did not recommend the imposition of a city income tax.

Shortly thereafter, City also embarked on a community visioning process called Future Vision to identify future directions for City. The goals of the visioning process included the identification of other areas in which resources needed to be spent to achieve City's vision. The combination of existing revenue shortfalls and the need to invest more resources to develop City for the future has made raising revenue a priority for City, but City residents are already subject to a higher tax burden than the residents of many neighboring communities.

As long-term residents of the region that includes City and leaders of Regional Development, a regional not-for-profit economic development agency, H and A were concerned about City's long-term viability, including its ability to continue to meet the basic needs of its residents and to invest in efforts to create a dynamic and growing city. A is not a disqualified person with respect to Foundation.

During Year 2, H and A entered into a Memorandum of Understanding with City, pursuant to which H and A agreed, upon the creation of Supporting Organization, to raise Amount for Supporting Organization to be utilized by City for budget stability, a decrease in the real property tax millage rate, and aspirational projects identified by Future Vision. H and A also agreed to serve as co-chairs of a capital campaign to create an endowment for Supporting Organization.

City formally approved a reduction of its real property tax millage rate on Date 1. Although some of Foundation's disqualified persons have owned real property inside City during the period when the reduced millage rate has been in effect, they have benefitted only incidentally and in the same manner as all of City's other real property owners subject to the millage rate.

On or about Date 2, City incorporated Supporting Organization as a State nonprofit corporation. Supporting Organization's incorporators were the Mayor and City Manager of City. Supporting Organization's sole purpose is to provide support to City. Its primary means of providing support to City will be by soliciting and receiving contributions, grants, and donations of cash, property, and other items. Supporting Organization will invest, manage, and administer the funds and property received, and it will annually make one or more grants to City for purposes consistent with the terms of: (a) any written agreement among City, Supporting Organization, H, and A; and (b) any gift instruments under which contributors have made or will make contributions to Supporting Organization.

On or about the same date that Supporting Organization was incorporated, it entered into a Statement of Donor Intent with H and A. That Statement of Donor Intent recited conversations among H, A, City's Mayor, and City Manager to create a plan that would reduce City's real property tax millage rate, thereby making City more competitive for capital investment and growth. The Statement of Donor Intent also recited the need to invest in aspirational services to accomplish the goal of City's becoming and continuing to be a dynamic and growing city, and it referred to the aspirational programs identified by Future Vision. The Statement of Donor Intent stated that Supporting Organization "shall provide appropriate funding to support these additional aspirational projects."

Governance of Supporting Organization

Supporting Organization's organizational documents, which were drafted jointly by H, A, and City, recite purposes consistent with those reflected in the Statement of Donor Intent and the Memorandum of Understanding, including accomplishing priorities relating to City's future direction, providing budget stability to City resulting from City's reduction of its real property tax millage rate, and funding aspirational projects that City seeks to undertake. Supporting Organization's articles of incorporation state that those aspirational projects may include, but are not limited to: (a) developing and committing resources to address generational poverty, promote youth development, and remove barriers to employment opportunities for youth, underemployed and unemployed individuals, and persons seeking reentry to the City community; (b) addressing capital and human infrastructure improvement and/or maintenance needs of City; and (c) developing and implementing neighborhood improvement efforts and projects that reimagine and reinvest in public spaces to attract and connect people. Supporting Organization's articles of incorporation state that it is organized exclusively to perform charitable, religious, educational, and scientific purposes permitted under section 501(c)(3), including the making of contributions to City exclusively for public purposes.

Supporting Organization applied for and received a determination letter from the Internal Revenue Service recognizing it as an organization described in section 501(c)(3) and a Type III functionally integrated supporting organization under section 509(a)(3).

Supporting Organization is governed by a 15-member board of directors. Pursuant to Supporting Organization's governing documents, the current Mayor and City Manager of City are *ex officio* directors and the remaining 13 directors are elected by the current board of directors upon nomination by City Commission as follows: two individuals are directly nominated by City Commission from among its members; one individual is directly nominated by City Commission from among individuals not directly connected to any stakeholder group and not employees or elected officials of City; and ten individuals are nominated by City Commission upon the recommendation of one of a number of different stakeholder groups. Stakeholder groups may change over time but initially include the following: affinity organizations, the arts community, the business and banking community, local educational institutions, local faith-based organizations, local hospitals or healthcare providers, local affordable housing groups, and local neighborhood associations. A governance facilitator is responsible for coordinating, identifying, and selecting individuals to be nominated from among the various stakeholder groups. Supporting Organization's board contracts with a third party entity, such as City Foundation, to act as governance facilitator. City Commission may reject any nominee from a stakeholder group, in which case the governance facilitator would propose a new candidate.

The business and affairs of Supporting Organization are managed by or under the direction of its board of directors, and all rights, powers, duties, and responsibilities with respect to the management and control of Supporting Organization's property, activities, and affairs are vested in the board of directors. The bylaws do not give any other person or body the right to exercise control over Supporting Organization. However, certain major actions of the board of directors, such as hiring an Executive Director, borrowing funds outside the normal course of business, or amending the bylaws, must be approved by City Commission. Pursuant to the bylaws, Supporting Organization's board of directors has sole authority to authorize distributions to City, the amount and timing of which are subject to certain requirements stated in the bylaws. Neither Foundation nor any disqualified person with respect to Foundation has any approval, veto, or voting rights with respect to Supporting Organization.

No disqualified person with respect to Foundation serves as a director or officer of Supporting Organization. With the possible exception of one member of Supporting Organization's 15-member board of directors who is an employee of an entity that may be a disqualified person with respect to Foundation, no members of Supporting Organization's board of directors have any employment relationship with Foundation or a disqualified person with respect to Foundation.

No disqualified person with respect to Foundation has any position of authority with respect to City.

Proposed Grants by Foundation to Supporting Organization

To date, Foundation has not made any grants to Supporting Organization, but it has made a number of grants directly to City in support of the objectives identified in Future Vision.

In the future, Foundation plans to make grants directly to Supporting Organization. Foundation anticipates that, for the foreseeable future, its grants to Supporting Organization will fund up to 100% of Supporting Organization's budget.

Neither H nor any other disqualified person with respect to Foundation has made any irrevocable, enforceable charitable pledge to City or Supporting Organization. Prior to making grants to Supporting Organization, Foundation will request budgets, financial statements, and plans for the use of funds. Foundation will review grant proposals from Supporting Organization and accept or reject such proposals based on each proposal's support of Foundation's overall mission and Foundation's grant budget for that year. Foundation will not alter the proposed projects or otherwise influence the projects being proposed by Supporting Organization or by City. Foundation will enter into grant agreements with Supporting Organization similar to those grant agreements it has made with City and other grant recipients; such grant agreements will prohibit Supporting Organization from using grant proceeds for any purpose other than one specified in section 170(c)(2)(B). Foundation will not earmark the use of grants it makes to Supporting Organization for any named secondary donee, nor will it retain power to cause the selection of a secondary donee. Once it makes a grant to Supporting Organization, Foundation will have no further influence over how those grant funds are used or allocated. Supporting Organization will exercise control, in fact, over the use of grant funds.

Foundation has represented that Supporting Organization does not contract for services with Foundation or disqualified persons with respect to Foundation, and Supporting Organization does not otherwise provide any economic benefit to Foundation or disqualified persons with respect to Foundation, other than any incidental economic benefit received as a result of being a taxpayer of City.

RULINGS REQUESTED

Foundation has requested the following rulings:

1. Neither Foundation, nor any disqualified person with respect to Foundation, directly or indirectly controls Supporting Organization or City within the meaning of section 4942(g)(1)(A) and Treas. Reg. § 53.4942(a)-3(a)(3).

2. Foundation's grants to Supporting Organization will be qualifying distributions within the meaning of section 4942.
3. Foundation's grants to Supporting Organization will not be taxable expenditures within the meaning of section 4945.

LAW

Section 4942(a) imposes a tax on the undistributed income of a private non-operating foundation for any taxable year.

Section 4942(c) defines "undistributed income" for any taxable year as the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made out of such distributable amount for such taxable year.

Section 4942(g)(1)(A) and Treas. Reg. § 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 (i) a private non-operating foundation, unless the amount paid satisfies the requirements of section 4942(g)(3); (ii) an organization controlled (directly or indirectly) by the private foundation or one or more disqualified persons (as defined in section 4946) with respect to the foundation; or (iii) a supporting organization described in section 4942(g)(4)(A)(i) or (ii), including a Type III functionally integrated supporting organization if a disqualified person of the private foundation directly or indirectly controls such organization or a supported organization (as defined in section 509(f)(3)) of such organization.

Treas. Reg. § 53.4942(a)-3(a)(3) provides that an organization is "controlled" by a foundation or one or more disqualified persons if any of such persons may, by aggregating their votes or positions of authority, require the donee organization to make an expenditure, or prevent the donee organization from making an expenditure, regardless of the method by which the control is exercised or exercisable. "Control" of a donee organization is determined without regard to any conditions imposed upon the donee as part of the distribution or any other restrictions accompanying the distribution as to the manner in which the distribution is to be used, unless the conditions or restrictions are material conditions or restrictions described in Treas. Reg. § 1.507-2(a)(7) that prevent the transferee organization from freely and effectively employing the transferred assets, or the income derived therefrom, in furtherance of its exempt purposes. In general, it is the donee, not the distribution, that must be "controlled" by the transferor private foundation. Thus, the furnishing of support to an organization and the consequent imposition of budgetary procedures upon that organization with respect to such support shall not in itself be treated as subjecting that organization to the transferor foundation's control. Such "budgetary procedures" include expenditure responsibility requirements under section 4945(d)(4). The "controlled" organization need not be a private foundation; it may be any type of exempt or nonexempt organization.

The control standards established in Treas. Reg. § 53.4942(a)-3(a)(3) currently apply in determining whether a disqualified person with respect to a private foundation controls a supporting organization or one of its supported organizations. Notice 2006-109, 2006-2 C.B. 1121.

Section 4946(a) of the Code defines a “disqualified person” with respect to a private foundation as including:

- A. a substantial contributor;
- B. a foundation manager;
- C. an owner of more than 20% of (1) the voting power of a corporation, (2) the profits interest of a partnership, or (3) the beneficial interest of a trust, if such an entity is a substantial contributor;
- D. a family member of any of the individuals described in A - C above;
- E. any corporation if persons described in A - D above own more than 35% of its voting power;
- F. any partnership if persons described in A - D above own more than 35% of its profits interests; and
- G. any trust or estate if persons described in A - D above own more than 35% of its beneficial interests.

Section 4946(a)(2) of the Code defines the term “substantial contributor” as a person described in section 507(d)(2). Section 507(d)(2) defines “substantial contributor” as the creator of a trust and any person who contributed more than \$5,000 to a private foundation, if that amount is more than 2% of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person.

Treas. Reg. § 53.4942(a)-3(c)(4) provides that where a donee of a private foundation uses contributed funds to make a subsequent payment to a “secondary donee,” such subsequent payment will not be treated as a contribution by the private foundation to the “secondary donee if the distributing foundation does not earmark the use of the contribution for any named secondary donee and does not retain power to cause the selection of the secondary donee by the [original donee].” Even where the private foundation “has reason to believe” that a secondary donee would benefit from a contribution, the foundation will not be deemed to have made a contribution to such secondary donee “so long as the original donee organization exercises control, in fact, over the selection process and actually makes the selection completely independently of such foundation.”

Section 4945(a) imposes an excise tax on each taxable expenditure incurred by a private foundation.

Section 4945(d)(4) provides that the term “taxable expenditure” includes a grant paid to an organization unless the grantee is either a public charity described in section

509(a)(1), (2), or (3) (other than certain supporting organizations described in section 4942(g)(4)(A)(i) or (ii)) or an exempt operating foundation described in section 4940(d)(2), or unless the grantor exercises expenditure responsibility over the grant pursuant to section 4945(h).

Under section 4945(d)(4)(A)(ii), a grant made by a private foundation to a Type III functionally integrated supporting organization is a taxable expenditure if a disqualified person with respect to the private foundation directly or indirectly controls the supporting organization or one of its supported organizations (unless the private foundation exercises expenditure responsibility with respect to the grant).

Section 4945(d)(5) provides that the term “taxable expenditure” also includes any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B).

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.” The purposes listed in section 170(c)(2)(B) generally 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).

Treas. Reg. § 1.501(c)(3)-1(d)(2) states that the term “charitable” is used in its generally accepted legal sense and includes, among other things, the erection or maintenance of public buildings, monuments, or works, and lessening of the burdens of government. In the general law of charity, certain purposes beneficial to the community as a whole have been deemed charitable. See Rev. Rul. 71-29, 1971-1 C.B. 150.

Treas. Reg. § 53.4945-5(a)(6)(i) provides that where a grantee of a private foundation uses grant funds to make a subsequent payment to a “secondary grantee,” such subsequent payment will not be treated as a grant by the private foundation to the “secondary grantee if the foundation does not earmark the use of the grant for any named secondary grantee and there does not exist an agreement, oral or written, whereby such grantor foundation may cause the selection of the secondary grantee by the [original grantee].” Even where the private foundation “has reason to believe” that a secondary grantee would benefit from a grant, the foundation will not be deemed to have made a grant to such secondary grantee “so long as the original grantee organization exercises control, in fact, over the selection process and actually makes the selection completely independently of the private foundation.”

Treas. Reg. § 53.4945-6(b)(1)(v) provides that qualifying distributions, as defined in section 4942(g), ordinarily will not be treated as taxable expenditures for purposes of section 4945(d)(5).

Revenue Ruling 62-78, 1962-1 C.B. 86, held that an organization described in section 501(c)(3) could properly make distributions of income to a state or a municipality provided such funds were to be used to carry out purposes described in section 501(c)(3).

Rev. Rul. 71-29, 1971-1 C.B. 150, held that by providing the city transit authority with the funds necessary to ensure that bus service for the city was continued, an organization described in section 501(c)(3) was assisting the municipal government and conferring a benefit on the entire community. Accordingly, the revenue ruling held that a grant to the city transit authority under these circumstances qualified as a charitable disbursement in furtherance of the organization's exempt purposes.

Rev. Rul. 74-246, 1974-1 C.B. 130, held that by providing funds to enable a police department to perform its regular duties, an organization was assisting the government in carrying out its function and making the distributions qualified as a charitable activity.

ANALYSIS

Ruling Requests 1 and 2

As described in more detail above, section 4942(g)(1)(A) and Treas. Reg. § 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 an amount distributed by a private foundation to a controlled organization or certain supporting organizations.

Treas. Reg. § 53.4942(a)-3(c)(4) provides that where a donee of a private foundation uses contributed funds to make a subsequent payment to a “secondary donee,” such subsequent payment will not be treated as a contribution to a secondary donee if the distributing foundation does not earmark the use of the contribution for any named secondary donee or retain power to cause the selection of the secondary donee.

Foundation will not earmark the grants it makes to Supporting Organization for any named secondary donee, nor will it retain power to cause the selection of a secondary donee, and once grants are made, Foundation will have no further influence over how those grant funds are used or allocated, including over whether subsequent grants are made to City. Instead, Supporting Organization will exercise control, in fact, over the use of grant funds. Accordingly, the proposed grants from Foundation to Supporting Organization will be treated as grants from Foundation to Supporting Organization and not grants from Foundation to City.

Supporting Organization is controlled by a board of directors, which has sole authority with respect to Supporting Organization's distributions. Supporting Organization's board includes no disqualified persons with respect to Foundation, and none of

Supporting Organization's officers are disqualified persons with respect to Foundation. Neither Foundation nor any disqualified person with respect to Foundation has any approval, veto, or voting rights with respect to Supporting Organization, nor do such persons have any appointment powers with respect to Supporting Organization's board. Therefore, under the bylaws of Supporting Organization, neither Foundation, nor any disqualified persons with respect to Foundation, has any power to require Supporting Organization to make an expenditure or to prevent it from making an expenditure. Although H was involved in drafting Supporting Organization's organizational documents and entered into the Statement of Donor Intent with Supporting Organization and A, such involvement did not provide H with the authority to require Supporting Organization to make an expenditure, or to prevent Supporting Organization from making an expenditure. Indeed, as described above, Supporting Organization's organizational documents give sole authority over distributions to its board of directors, of which H is not a member. Accordingly, neither Foundation, nor any disqualified person with respect to Foundation, directly or indirectly controls Supporting Organization within the meaning of section 4942(g)(1)(A).

Similarly, because no disqualified person with respect to Foundation has any position of authority with respect to City, no disqualified person with respect to Foundation has any power to require City to make an expenditure or prevent it from making an expenditure. Accordingly, no disqualified person with respect to Foundation, directly or indirectly controls City within the meaning of section 4942(g)(1)(A).

The purposes listed in section 170(c)(2)(B) generally are the same as the purposes listed in section 501(c)(3) and include charitable purposes. Treas. Reg. § 1.501(c)(3)-1(d)(2) states that the term "charitable" is used in its generally accepted legal sense and includes, among other things, the erection or maintenance of public buildings, monuments, or works, and lessening of the burdens of government. In the general law of charity, certain purposes beneficial to the community as a whole have been deemed charitable. See Rev. Rul. 71-29. 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).

Supporting Organization has been recognized as an organization described in Section 501(c)(3) and its sole purpose is to support City, including through making contributions to City exclusively for public purposes. Foundation will enter into grant agreements with Supporting Organization that prohibit grant proceeds from being used for any purpose other than one specified in section 170(c)(2)(B). Supporting Organization's support for City will benefit the community as a whole. Any benefit to disqualified persons with respect to Foundation will be only incidental. Foundation's proposed grants to Supporting Organization therefore will be to accomplish one or more purposes described in section 170(c)(2)(B).

Ruling Request 3

Section 4945(a) imposes an excise tax on each taxable expenditure incurred by a private foundation.

Section 4945(d)(4) defines “taxable expenditure” to include a grant paid to an organization unless the grantee is either a public charity described in section 509(a)(1), (2), or (3) (other than certain supporting organizations described in section 4942(g)(4)(A)(i) or (ii)) or an exempt operating foundation described in section 4940(d)(2), or unless the grantor exercises expenditure responsibility over the grant pursuant to section 4945(h). Foundation’s proposed grants to Supporting Organization will not be taxable expenditures under section 4945(d)(4) because Supporting Organization is classified as a Type III functionally integrated supporting organization described in section 509(a)(3) and, as discussed above, is not described in section 4942(g)(4)(A)(i) or (ii).

Section 4945(d)(5) defines “taxable expenditure” also to include any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B). Foundation’s proposed grants to Supporting Organization will not be taxable expenditures under section 4945(d)(5) because, as discussed above, Foundation’s proposed grants to Supporting Organization will be to accomplish one or more purposes described in section 170(c)(2)(B).

RULINGS

Based solely on the facts and representations submitted in the request for rulings and supplemental submissions, we rule as follows:

1. Neither Foundation, nor any disqualified person with respect to Foundation, directly or indirectly controls Supporting Organization or City within the meaning of section 4942(g)(1)(A) and Treas. Reg. § 53.4942(a)-3(a)(3).
2. Foundation’s grants to Supporting Organization will be qualifying distributions within the meaning of section 4942.
3. Foundation’s grants to Supporting Organization will not be taxable expenditures within the meaning of section 4945.

The rulings contained in this letter are based upon information and representations submitted by or on behalf of Foundation and accompanied by a penalty of perjury statement executed by an appropriate party, as specified in Rev. Proc. 2020-1, 2020-1 I.R.B. 1, § 7.01(16)(b). 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. The Associate Office will revoke or modify a letter ruling and apply the revocation retroactively if: (1) there has been a misstatement or omission of controlling facts; (2) the facts at the time of the transaction are materially different from the controlling facts on which the ruling is based; or (3) the transaction involves a continuing

action or series of actions and the controlling facts change during the course of the transaction. See Rev. Proc. 2020-1, § 11.05.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the proposed transaction under any other provision of the Internal Revenue Code or Treasury Regulations.

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

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

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,

Mike Repass
Senior Technician Reviewer
Exempt Organizations Branch 3
(Employee Benefits, Exempt Organizations,
and Employment Taxes)

cc: