



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
WASHINGTON, D.C. 20224

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4945.04-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

A=

B=

C=

D=

E=

F=

G=

H=

M=

Dear

This is in reply to your ruling request regarding the proper treatment of certain grants you wish to make to a foreign organization under sections 4941, 4942 and 4945 of the Internal Revenue Code.

FACTS

You were formed for the purpose of providing support to charitable endeavors primarily, but not exclusively, in the United States. Your charitable focus is broad and includes contributions to relieve the effects of poverty, homelessness and disease, and to benefit the arts, educational and scientific institutions and to promote scholarship. You have been recognized as an organization exempt under section 501(c)(3) of the Code and are classified as a private foundation within the meaning of section 509(a). You are governed by your Board of Directors consisting of A and B, who are husband and wife, and their children C and D.

You wish to make grants to M, a foreign organization that is an irrevocable charitable trust created by A. M was formed for charitable, social and philanthropic work. M is exempt from tax under the charity laws of the foreign country in which it is located. M's Trustees are E and F, brothers of A, G, a cousin of A, and H.

A is both the grantor of and a substantial contributor to M. You state that none of the Trustees of M will be considered disqualified persons under section 4941 of the Code to A's family

because they are not lineal descendants within the meaning of section 4946. You state further that none of the funds you donate will be earmarked for a prohibited activity or used in a manner prohibited by section 4945. In addition, you state that you will exercise expenditure responsibility over any grants to M in accordance with section 4945(h).

You have submitted M's organizational document indicating it is organized and operated for charitable purposes and that upon dissolution its assets will be distributed to another charitable organization. You also submitted an extensive description of the charitable works that M is engaged in along with a financial schedule of M's revenues and expenditures. Based on your review of M's operations and notwithstanding the fact that M has not been recognized by the Internal Revenue Service as exempt, you assert that you have made a good-faith determination that M would be an organization described in section 4942(j)(3) of the Code.

Based on the above facts, you request the following rulings:

1. The grants you intend to make to M will be amounts paid for charitable and educational purposes under sections 501(c)(3) and 170(c)(2)(B) of the Code.
2. The grants you intend to make to M will not be considered self-dealing under section 4941 of the Code.
3. The grants you intend to make to M will constitute qualified distributions for purposes of meeting the minimum qualifying distribution amount under section 4942 of the Code.
4. You may treat the grants to M as made to an organization described in section 501(c)(3) of the Code because you have made a reasonable judgment that M is an organization described in section 501(c)(3).
5. The grants you intend to make to M to accomplish an exempt purpose, described in section 170(c)(2)(B) of the Code, will be treated as a distribution made to an organization described in section 509(a)(1), (2), or (3) or 4942(j)(3) because you have made a good faith determination that M is such an organization.
6. The grants you intend to make to M will not be taxable expenditures under section 4945 of the Code provided you exercise expenditure responsibility under section 4945(h).

LAW

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

Section 1.501(c)(3)-1(d)(1) of the regulations provides that an organization may be exempt as an organization described in section 501(c)(3) of the Code if it is operated exclusively for one or more of the following purposes: religious, charitable, scientific, testing for public safety, literary, educational, or prevention of cruelty to children or animals.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense. The term "charitable" includes the relief of the poor and distressed or of the underprivileged, and combating juvenile delinquency. The promotion of health and the advancement of education have long been recognized as charitable purposes. See Rev. Rul. 69-545, 1969-2 C.B. 117; Restatement (Second) of Trusts, sections 368, 372.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term educational, as used in section 501(c)(3) of the Code, relates to the instruction or training of the individual for the purposes of improving or developing his capabilities or the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 4940(d)(2) of the Code provides that an organization is an "exempt operating foundation" if it is an operating foundation described in 4942(j)(3) that has been publicly supported for at least 10 years, has a governing body that consists of individuals at least 75% of whom are not disqualified persons and is broadly representative of the general public, and does not have an officer who is a disqualified individual.

Section 4941 of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d) of the Code defines self-dealing as any direct or indirect:

- A. sale or exchange, or leasing, of property between a private foundation and a disqualified person;
- B. lending of money or other extension of credit between a private foundation and a disqualified person;
- C. furnishing of goods, services, or facilities between a private foundation and a disqualified person;
- D. payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;
- E. transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation; and
- F. agreement by a private foundation to make any payment of money or other property to a government official (as defined in section 4946(c)), other than certain employment agreements.

Section 4942 of the Code imposes an excise tax on a private operating foundation's undistributed income. Undistributed income is a private foundation's distributable income less any qualifying distributions.

Section 4942(g)(1)(A) of the Code defines a "qualifying distribution" as including any amount

(including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more exempt purposes described in section 170(c)(2)(B), other than certain contributions to organizations controlled by the foundation or by disqualified persons or to private non-operating foundations.

Section 4942(j)(3) of the Code provides that an organization is an operating foundation if it meets certain requirements. Section 4942(j)(3) provides that all operating foundations must meet the "income test." In order to satisfy the "income test" of section 4942(j)(3), substantially all of the lesser of the organization's investment return or its adjusted net income must be spent on charitable activities. In addition to satisfying the "income test," the organization must also satisfy either the "assets test," the "endowment test," or the "support test." The endowment test requires that two-thirds of the investment return be spent on charitable purposes.

Section 53.4942(a)-3(a)(3) of the regulations defines "controlled by the foundation or by disqualified persons" as any time such persons can aggregate their power (voting or otherwise) in order to require an expenditure or to prevent one.

Section 53.4942(a)-3(a)(6)(i) of the regulations provides generally that distributions for purposes described in section 170(c)(2)(B) of the Code to a foreign organization, which has not received a ruling or determination letter that it is an organization described in section 4942(j)(3), will be treated as a distribution to an organization described in section 4942(j)(3) if the distributing foundation has made a good faith determination that the donee organization is an organization described in section 4942(j)(3). Such a "good faith determination" ordinarily will be considered as made where the determination is based on an affidavit of the donee organization or an opinion of counsel (of the distributing foundation or the donee organization) that the donee organization is an organization described in section 4942(j)(3). Such an affidavit must set forth sufficient facts concerning the operations and support of the donee organization for the Internal Revenue Service to determine that it would be likely to qualify as an organization described in section 4942(j)(3). Section 53.4945-5(a)(5) contains a similar rule.

Section 4945 of the Code imposes an excise tax on the taxable expenditures of a private foundation.

Section 4945 of the Code provides that a grant to a foreign organization is considered a taxable expenditure unless the grantor exercises expenditure control over the grant.

Section 4945(d) of the Code defines a "taxable expenditure" by a private foundation as an amount paid or incurred:

- (1) to attempt to influence legislation,
- (2) to influence the outcome of any public election or carry on a voter registration drive,
- (3) to grant funds to an individual for travel, study, or similar purposes unless certain requirements are met,
- (4) to grant funds to an organization unless it is described in section 509(a)(1), (2), (3) or 4940(d)(2) or unless the private foundation exercises expenditure responsibility with

respect to the grant in accordance with section 4945(h), or

(5) for a non-170(c)(2)(B) purpose.

Section 4945(h) of the Code sets forth rules that require the grantor private foundation to exert all reasonable efforts and establish procedures to:

- (1) see that the grant is spent solely for the purposes for which it was made,
- (2) obtain full and complete reports from the grantee regarding how the grant was spent, and
- (3) make full and complete reports to the Internal Revenue Service.

Section 53.4945-5(b)(2)(i) of the regulations states that a pre-grant inquiry should be complete enough to give a reasonable person assurance that the grantee will use the grant for the proper purposes.

Section 53.4945-5(b)(3) of the regulations provides that each grant must be subject to a written commitment signed by an appropriate officer, director, or trustee of the grantee organization. The commitment must specify the purpose of the grant. It must also include provisions relating to the repayment of funds not used for the grant's purpose; the submission of annual reports; and the maintenance of books and records that are to be made available to the grantor at all reasonable times.

Section 53.4945-5(d) of the regulations provides that private foundations must report expenditure responsibility grants to the Internal Revenue Service.

Section 53.4945-6(c)(1) of the regulations provides generally that since a private foundation cannot make an expenditure for a purpose other than a purpose described in section 170(c)(2)(B) of the Code, a private foundation may not make a grant to an organization other than an organization described in section 501(c)(3) except under certain circumstances.

Section 53.4945-6(c)(2)(ii) of the regulations provides that for purposes of that section, a foreign organization which does not have a ruling or determination letter that it is an organization described in section 501(c)(3) of the Code (other than section 509(a)(4)) will be treated as an organization described in section 501(c)(3) (other than section 509(a)(4)) if in the reasonable judgment of a foundation manager of the transferor private foundation, the grantee organization is an organization described in section 501(c)(3) (other than section 509(a)(4)). The term "reasonable judgment" shall be given its generally accepted legal sense within the outlines developed by judicial decisions in the law of trusts. Once the foundation manager has made a "reasonable judgment" that the foreign organization is the equivalent of an organization described in section 501(c)(3), section 4945(h) requires the foundation manager to exercise expenditure control over the grant, unless the foundation manager can make a "good-faith determination" that the organization is described in section 4940(d)(2).

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

- A. substantial contributor,
- B. foundation manager,
- C. an owner of more than 20% of the voting power of a corporation, the profits interest of a partnership, or the beneficial interest of a trust, if those entities are substantial contributors,
- D. a family member of any of the 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 in that year.

Section 4946(b) of the Code defines the term "foundation manager" as used in section 4946(a). The term includes an officer, director or trustee of a foundation (or an individual with similar powers) and the employees of a foundation having responsibility for specific acts, if those acts are at issue.

Section 4946(d) of the Code defines the term "family member" as used in section 4946(a). The term includes a spouse, children, grandchildren, great grandchildren, any spouses thereof, and ancestors.

Section 53.4946-1(h) of the regulations specifies that a sibling relationship is not a "family member" for purposes of section 4946 of the Code.

Rev. Rul. 71-460, 1971-2 C.B. 231 holds that a 501(c)(3) organization may conduct part or all of its charitable activities in a foreign country.

Rev. Proc. 92-94, 1992-1 C.B. 507, provides a procedure that private foundations may follow in making "reasonable judgments" and "good faith determinations" under sections 53.4945-6(c)(2)(ii), 53.4942(a)-3(a)(6) and 53.4945-5(a)(5) of the regulations other than a transfer of assets described in section 507(b)(2) of the Code. The grantor must obtain a "currently qualified" affidavit prepared by the grantee. An affidavit is currently qualified if the facts it contains are up to date and the substantive requirements of section 501(c)(3) and section 509(a) remain unchanged. The facts are up to date if they reflect the grantee organizations latest complete accounting year, or if the affidavit is updated to reflect the grantee organization's

current data. Where a grantee's status under section 509(a) depends on financial support, the affidavit must be updated by asking the grantee to provide an attested statement containing enough financial data to establish that it continues to meet the requirements of the applicable Code section.

Rev. Proc. 92-94 also sets forth specific representations that should be made in the affidavit to support that the organization has made a "good-faith determination." The affidavit should:

- A. be written in English,
- B. contain a financial schedule of the grantee organization,
- C. contain a representation by the grantee organization that they are an organization equivalent of that described within section 501(c)(3) of the Code,
- D. be attested to by the grantee officer,
- E. show that the grantee organization is organized and operated for charitable and educational purposes,
- F. describe the past, present, and future activities of the grantee organization,
- G. show that the grantee organization's income cannot be distributed to the benefit of any private individual,
- H. show that the grantee organization has no directors or officers with a proprietary interest in the grantee organization,
- I. show that if the grantee organization is dissolved the assets are distributed to another section 501(c)(3) or charitable organization,
- J. show that the grantee has little or no political activities, and
- K. show specific information on a financial schedule.

ANALYSIS

RULING 1

M provides educational services within the meaning of section 1.501(c)(3)-1(d)(3) of the regulations by informing the public about the risks of tobacco and about HIV prevention. M accomplishes its educational purpose by coordinating with agencies and doctors that are experts in the field of HIV prevention and tobacco risks. Educating the public about HIV prevention and tobacco risk are activities directed at instructing the public on subjects useful to the individuals and beneficial to the community. M also supports breast and cervical cancer research and health care in the poorest parts of the foreign country. M is furthering an educational purpose by instructing the public about health risks and a charitable purpose by

promoting health in poor communities. See Section 1.501(c)(3)-1(d)(2). Therefore, the grants made by your organization to M, provided the money is used exclusively for M's charitable and educational purposes, are amounts paid to accomplish one or more of the exempt purposes included in section 501(c)(3) and 170(c)(2)(B) of the Code.

RULING 2

In order for an act of self-dealing to occur, there must be a direct or an indirect transaction between you and a disqualified person. You contemplate a grant to M, which is a direct transaction. M is not a disqualified person because, with respect to you, no disqualified person controls M.

The Trustees on M's Board are not disqualified persons within the meaning of section 4946(d) of the Code because E and F are brothers of A. A sibling relationship is not contemplated by section 4946(d). See section 53.4946-1(h) of the regulations. Furthermore, none of the other members of M's Board of Trustees have relationships that are described within section 4946(d). Finally, no facts presented indicate any improper indirect benefit to a disqualified person.

Therefore, your contemplated grant to M is not one that is described as self-dealing within the meaning of section 4941 of the Code because M is not controlled by any disqualified person.

RULING 3

A qualifying distribution is an amount paid for purposes of accomplishing one or more purposes stated in section 170(c)(2)(B) of the Code, provided that such payment is not made (i) to an organization directly or indirectly controlled by the distributing foundation or any disqualified person with respect to the distributing foundation (within the meaning of section 4946), or (ii) to a private non-operating foundation, except as provided in section 4942(g). See section 4942(g)(1)(A). An organization is controlled by a foundation or one or more disqualified persons with respect to the foundation if any such persons may, by aggregating their votes or position 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. See section 53.4942(a)-3(a)(3) of the regulations.

Neither you nor any of your directors controls M within the meaning of section 53.4942(a)-3(a)(3) of the regulations because they hold no votes or positions of authority with M, cannot require M to make expenditures, and cannot prevent M from making expenditures. Rather, the trustees of M, none of whom are directors, officers, or disqualified persons of your organization, make all determinations regarding M's expenditures. Furthermore, your distributions to M will not be treated as distributions to a private non-operating foundation because you have made a good faith determination that M is an organization described in section 4942(j)(3) of the Code. See Rationale-Ruling 4, infra.

M is not directly or indirectly controlled by you and it is not a private non-operating

foundation. Therefore, your contributions to M will be qualifying distributions within the meaning of section 4942 of the Code.

RULING 4

A foreign organization that does not have a ruling or determination letter that it is an organization described in section 501(c)(3) of the Code will be treated as one if, in the reasonable judgment of a foundation manager of the transferor private foundation, the grantee organization is described in section 501(c)(3). The term "reasonable judgment" shall be given its generally accepted legal sense within the outlines developed by judicial decisions in the law of trusts. See section 53.4945-6(c)(2)(ii) of the regulations. In making your judgment, you considered the following factors.

M has not applied for a determination letter from the Internal Revenue Service regarding its status as tax-exempt under section 501(c)(3) of the Code. However, you have submitted documentation that M is a registered irrevocable trust exempt from taxation under the laws of the foreign country. The Director of Income Tax in the foreign country determined that M is a charitable organization and issued it a Certificate of Exemption under the foreign country's Income Tax Act. You have provided a copy of such Certificate of Exemption. The Certificate of Exemption states that donations made to M qualify for a deduction under the foreign country's Income Tax Act.

You have reviewed and submitted documentation that M's activities consist of providing relief to the poor, distressed, or underprivileged through education and screening regarding cancers and HIV/AIDS, and awarding scholarships to poor, distressed or underprivileged students. Such purposes and activities are within the meaning of the terms "charitable" and "educational." See sections 1.501(c)(3)-1(d)(2) and 1.501(c)(3)-1(d)(3) of the regulations; and section 170(b)(2)(B) of the Code. You state that your contribution to M will be used exclusively for these charitable and educational purposes.

We conclude that you have made a "reasonable judgment" that M is an organization described in section 501(c)(3) of the Code. Consequently, your organization's grants to M can be considered distributions to an organization described in section 501(c)(3). However, this ruling does not consist of our own independent determination that M is an organization described in section 501(c)(3) of the code.

RULING 5

You state that you have made a "good-faith determination" that M qualifies as an organization described in section 4942(j)(3) of the Code. You have reviewed and included an affidavit that includes information prescribed by Rev. Proc. 92-94, supra, in making your determination that M would likely qualify as a private operating foundation because it is described within section 4942(j)(3). The affidavit contains a financial schedule for M, a representation that M is an organization described in section 501(c)(3), and information regarding M's activities. M's Articles of Incorporation contain a dissolution clause that allows for the distribution of M's assets upon dissolution to another charitable organization. Additionally,

M represents that it is not engaged in political activities. The affidavit includes all of the required information in the financial statement submitted for M.

We conclude that you have met the requirements of Rev. Proc. 92-94, supra, and have made a "good-faith determination" that M is described in section 4942(j)(3) of the Code. See section 53.4942(a)-3(a)(6)(i) of the regulations. As a result, the grants made to M by you will be treated as grants to an organization described in section 4942(j)(3). However, this ruling does not consist of our own independent determination that M is an organization described in section 4942(j)(3) of the code.

RULING 6

An excise tax is imposed on each taxable expenditure of a private foundation. See section 4945 of the Code. A taxable expenditure is defined in 4945(d) as an amount incurred to or for, among other things, an organization other than an organization described in section 509(a)(1), (2), or (3) or section 4940(d)(2), unless the distributing foundation exercises expenditure responsibility with respect to the amount paid.

M does not meet the requirements of section 509(a)(1), (2), or (3) of the Code. Furthermore, M is not an organization described under section 4940(d)(2). Therefore, you must exercise expenditure control over the grants you make to M to preclude their being classified as taxable expenditures. See section 4945(h); section 53.4945-5(b) of the regulations.

You state that you will establish procedures to ensure that any grant to M is used solely for the purposes for which the grant was made, to obtain reports from M on how such grant was spent, and to make reports regarding the grant to the Internal Revenue Service. See section 4945(h) of the Code. You state that you will also conduct a pre-grant inquiry to obtain reasonable assurances that M will use the grant for proper purposes. See section 53.4945(b) of the regulations. Moreover, you state that M will execute a written agreement specifying the purposes of your grant and promising to use all funds received from you for the purposes stated in the agreement and to return all the funds not so used; annually submit a full and complete financial report to you; maintain adequate books and records to be made available for inspection by you; and not use any funds to influence legislation, carry on propaganda or participate in political elections. See section 53.4945-5(b)(3) of the regulations.

Accordingly, grants made by you to M will not be treated as taxable expenditures under 4945 of the Code, assuming you exercise the requisite expenditure responsibility in accordance with 4945(h). The grants you make to M will be amounts paid for charitable and educational purposes under section 501(c)(3) and 170(c)(2)(B). These grants must be reported on your organization's annual information return. See section 53.4945-5(d) of the regulations.

RULINGS

1. The grants you intend to make to M will be amounts paid for charitable and educational purposes under 501(c)(3) and 170(c)(2)(B) of the Code.

2. The grants you intend to make to M will not be considered self-dealing under section 4941 of the Code.
3. The grants you intend to make to M will constitute qualified distributions for purposes of meeting the minimum qualifying distribution amount under section 4942 of the Code.
4. You may treat the grants to M as made to an organization described in section 501(c)(3) of the Code because you have made a reasonable judgment that M is an organization described in section 501(c)(3).
5. The grants you intend to make to M to accomplish an exempt purpose, described in section 170(c)(2)(B) of the Code, will be treated as a distribution made to an organization described in section 509(a)(1), (2), or (3) or 4942(j)(3) because you have made a good faith determination that M is such an organization.
6. The grants you intend to make to M will not be taxable expenditures under section 4945 of the Code provided you exercise expenditure responsibility under section 4945(h).

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

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,

Steven Grodnitzky
Manager, Exempt Organizations
Technical Group 1

Enclosure
Notice 437