TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201333020**
Release Date: 8/16/2013
Date: May 21, 2013
UIL: 512.04-00
4943.01-00
4944.01-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:
LLC =
State =
Donor =
Investment Advisor =

Dear :

This is in response to your letter dated March 28, 2012, in which you requested certain rulings with respect to I.R.C. §§ 512, 4943, and 4944.

Background:

You are an exempt organization described in § 501(c)(3) and classified as a private foundation under § 509. LLC is a manager-managed LLC under the laws of State and is treated as a partnership for federal tax purposes. LLC's sole activity is the operation of an investment hedge fund. LLC has three classes of membership interests – Class A, Class B, and Class C. LLC uses its funds for the sale, purchase, and trading of financial instruments traded on public financial markets, including stocks, stock indices, exchanged-traded funds, real estate investment trusts, mutual funds, bonds, currencies, and derivatives of these instruments. You represent that at least ninety-five percent of LLC's income is derived from passive sources as that term is defined in § 4943(d)(3). LLC is managed solely by an investment advisor. Investment Advisor, a for-profit limited liability company, manages the investments for LLC and another unrelated company. The Class B membership interest in LLC is owned solely by Donor. Class B membership interests represent ten percent of the income interest of LLC. The income for Class B interests is paid out on a monthly basis. If the Class B interest income is not claimed each month it is attributed to the Class A membership interests.

You represent that your holdings in LLC and LLC's holdings in investment property will not constitute debt-financed property giving rise to unrelated debt-financed income under IRC 512(b)(4) and 514, and that all of your income from LLC will be from passive sources of one or more types excepted under § 512(b) from unrelated business taxable income. You also represent that the holdings of LLC in business enterprises that are attributed to you and to any disqualified person owners of LLC, along with any other holdings of you and of disqualified persons in such business enterprises, will be permitted holdings under § 4943(c).

Donor proposes to contribute all of her Class B membership interest in LLC to you so that you may use the proceeds to further your charitable purpose.

Rulings Requested:

1. The Investment activities conducted by LLC will not generate unrelated business taxable income for you with respect to your Class A membership interest and the proposed gift to you of the Class B membership interest.

2. Your ownership of Class A membership interest in LLC and/or your proposed ownership of a Class B interest in LLC will not cause you to be liable for an excess business holding excise tax under § 4943.

3. Your acceptance of the proposed gift of a Class B membership interest in LLC from Donor will not constitute a jeopardizing investment under § 4944.

Law:

I.R.C. § 512(a)(1) provides that the term "unrelated business taxable income" means the gross income derived by an organization from an unrelated trade or business as defined in § 513 regularly carried on by it, less the deductions allowed for expenses directly connected with the carrying on of such trade or business.

I.R.C. § 512(b) outlines several modifications that remove certain types of income from being included in unrelated business income. The types of income excluded from unrelated taxable income include dividends, interest payments, annuities, royalties, rents, and the gains and losses from the sale, exchange, or other disposition of property other than inventory or property held primarily for sale to customers.

I.R.C. § 513(a) defines "unrelated trade or business" any trade or business the conduct of which is not substantially related (aside from the need for income or funds or the use it makes of the profits derived) to the exercise of performance by such organization of its charitable, educational, or other purpose constituting the basis for its exemption under § 501.

I.R.C. § 4943(a) imposes a ten percent excise tax on the excess business holdings of any private foundation in a business enterprise.

I.R.C. § 4943(c)(1) defines "excess business holdings" as 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.

I.R.C. § 4943(c)(2)(A) defines "permitted holdings" as twenty percent of the voting stock of any corporation reduced by the percentage of stock owned by all disqualified persons.

I.R.C. § 4943(c)(3) provides that for interest in any partnership or joint venture the word "profit interest" should be substituted for the word "voting stock" in the definition of "permitted holdings."

I.R.C. § 4943(d)(1) states that, "In computing the holdings of a private foundation, or a disqualified person (as defined in § 4946) with respect thereto, in any business enterprise, any

stock or other interest owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries."

I.R.C. § 4943(d)(3) stipulates that "business enterprise" does not include a trade or business where at least ninety-five percent of the gross income is derived from passive sources. For purposes of this section, passive income includes income from the sources described in §§ 512(b)(1), (2), (3), and (5).

I.R.C. § 4944(a)(1) imposes a ten percent tax on private foundations that invest any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes.

Treas. Reg. §1.513-1(a) provides that the term unrelated business taxable income means the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the deductions and subject to the modifications provided in section 512 of the Code ... unless one of the specific exceptions of section 512 or 513 is applicable, gross income of an exempt organization subject to the tax imposed by section 511 is includible in the computation of unrelated business taxable income if: (1) It is income from trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Treas. Reg. § 53.4943-10(c)(1) provides that, "the term 'business enterprise' does not include a trade or business at least 95 percent of the gross income of which is derived from passive sources. Thus, stock in a passive holding company is not to be considered a holding in a business enterprise even if the company is controlled by the foundation. Instead, the foundation is treated as owning its proportionate share of any interests in a business enterprise held by such company under § 4943(d)(1)."

Treas. Reg. § 53.4944-1(a)(2)(ii)(a) provides that § 4944 shall not apply to an investment made by any person that is later gratuitously transferred to a private foundation, provided the foundation furnishes no consideration to such person upon the transfer.

Analysis:

RULING 1

Section 512(a) provides that unrelated business income is the gross income derived by an organization from an unrelated trade or business, as defined in § 513, regularly carried on by it, less the deductions allowed for expenses directly connected with the carrying on of such trade or business. Section 513 provides that an unrelated trade or business is any trade or business the conduct of which is not substantially related, aside from the need for income or funds or the use it makes of the profits derived, to the exercise of performance by such organization of its purpose constituting the basis for its exemption under § 501. Under these definitions the income you earn from your investments in LLC would constitute unrelated business income. Section 512(b), however, outlines several modifications to unrelated business income. Given that your income from the LLC will meet one of these exceptions, it will not be unrelated business taxable income.

RULING 2

Section 4943 imposes an excise tax on the excess business holding of private foundations. Section 4943(c)(1) defines excess business holding as the amount of stock in a corporation that a foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in the corporation to be permitted holdings. Section 4943(c)(2) provides that the permitted holdings of a foundation in a corporation are twenty percent of the voting stock, reduce by the percentage of the voting stock owned by all disqualified persons. In any case in which all disqualified persons together do not own more than twenty percent of the voting stock of a corporation, nonvoting stock held by a private foundation is treated as permitted holdings. Section 4943(c)(2)(A) and § 43.4943-3(b)(2). When discussing an entity treated as a partnership, §4943(c)(3) provides that "profit interest" may be substituted for the word "voting stock" in the definition of permitted interest.

Despite the size of your holdings in LLC, such holdings do not constitute excess business holdings under § 4943. Section 4943(a) provides that in order for your holdings to constitute excess business holdings LLC must qualify as a "business enterprise." Section 53.4943-10(c)(1) provides that if a trade or business derives ninety-five percent of its income from passive sources, as demonstrated by sources described in §§ 512(b)(1), (2), (3), and (5), as does LLC, then it is not considered a business enterprise. However, the proportionate share of the holdings of LLC in business enterprises are imputed to you and other owners of LLC under the rules in § 4943(d)(1). Id. In your situation, LLC is not a business enterprise since all of its income is derived from passive sources described in § 512(b). Moreover, the holdings of LLC will not be excess business holdings. Thus, your holdings in LLC will not result in excess business holdings under § 4943.

RULING 3

Section 4944(a)(1) imposes a ten percent tax on private foundations that invest any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes. Section 53.4944-1(a)(2)(ii)(a) provides that when a private foundation receives a gratuitous transfer of investments from any person such investments will not be considered jeopardizing investments under § 4944 as long as the private foundation did not pay for the investments. Here, the Class B membership interest, which has no debt or any other encumbrance, is being transferred to you for no consideration. Therefore, the transfer of Class B membership interest to you is not a jeopardizing investment.

Rulings:

1. The Investment activities conducted by LLC will not generate unrelated business taxable income for you with respect to your Class A investment and the proposed Class B investments.

2. Your ownership of Class A membership interest in LLC and/or your proposed ownership of a Class B interest in LLC will not cause you to be liable for an excess business holding excise tax under § 4943.

3. Your acceptance of the proposed gift of a Class B membership interest in LLC from Donor will not constitute a jeopardizing investment under § 4944.

This ruling supersedes a prior ruling issued on April 23, 2013. 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. 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 described. Specifically, this ruling does not address the issue of self-dealing in regards to the initial investments by you in LLC. 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.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald Shoemaker
Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437