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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

UIL: 4941.04-00

Contact Person:

Telephone Number:

In Reference to:
OP:E:EO:T:3

Date:
OCT 21 1999

E.I.N.

LEGEND:

V=

W=

X=

Y=

Z=

Dear Sir or Madam:

This is in response to a ruling request dated July 22, 1999, submitted on your behalf by your authorized representatives. You are seeking rulings on the federal income tax consequences of a proposed transaction, as more fully set forth below.

X is an organization that has been recognized as exempt from federal income tax under section 501(c)(3) of the Internal revenue Code, and is a private foundation described in section 509(a).

Y has been recognized as exempt from federal income tax under section 501(c)(3) and is classified as a public charity described in sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code. Of the ten members of Y's board of directors, one is a disqualified person with respect to X.

Z has also been recognized as exempt from federal income tax under section 501(c)(3) of the Code and classified as a public charity described in sections 509(a)(1) and 170(b)(1)(A)(iii) of the Code. Of the twelve members of Z's board of directors, no individual is a disqualified person with respect to X.

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The mission of X is to assist state charities in developing their internal capacity to meet present and future needs. X has historically made grants to charitable organizations in the V area of the state, where X's family is a major employer and intimately involved in community affairs. One family member serves on the board of y. This member's father had served as chairman of the board of Y.

In the last four years, X has provided over $180,000 to organizations that provide medical or health services in or around V. To continue its support of local medical facilities, X has pledged $100,000 to Y for the construction of a new medical facility in V.

At the time of the pledge, Z had not yet chosen a site for the medical facility, but there was a possibility that Z would select property owned by W, a disqualified person with respect to X.

The V community currently lacks a hospital that provides adequate emergency and extended medical care to the residents of the area since its hospital had earlier declared bankruptcy and was forced to merge with Z. Through its operation of several regional health care systems, Z has acquired experience operating a facility in a rural community such as V. The individuals serving on the board of Z are not disqualified persons with respect to X and X has no control over any Board member.

After the merger, Z scaled back the medical services provided in the V area, offering only urgent care, imaging and minimal laboratory work. The closest hospital that provides inpatient care and emergency care is twenty miles away. In addition to limiting medical services available to residents, local businesses were also affected by the closure of the hospital. The hospital had been the largest employer in the area and resulting layoffs brought a downturn in the local economy.

Z is moving forward with plans to reopen the existing facility in V to meet local demands, but long-term success of medical services in the community requires that a new facility be built. The overall economies of operating a modern and efficient building, constructed for present day medical services outweigh the benefits of updating an old facility.

Z investigated the feasibility of building a limited service hospital in V. The analysis revealed that its network of healthcare systems and management experience would help to avert the fiscal problems that occurred with the old hospital.

After the board of Z decided to build a new hospital in the V area, Y began a fundraising campaign to raise a portion of the amount needed for construction of the facility. Y was originally created to raise funds for the V hospital. Now its purpose has expanded to medical services and healthcare organizations in general. Although one member of X's family is a member of the board of Y, neither X or any group of its disqualified persons controls Y.

Y has over 100 volunteers soliciting a list of 200 potential donors to reach its goal. As part of the solicitation process, it submitted a request to X for a $100,000 grant. Prior to the grant request, it had been reported in a local newspaper that Z might consider locating the facility near the interstate highway. X pledged $100,000 towards the campaign goal, regardless of the location selected by Z for the new facility.

Z considered several parcels of land on which to locate the new hospital. To conduct a preliminary search of potential sites for the facility, Z hired a real estate consultant who was not a disqualified person with respect to X nor was it directly or indirectly controlled by X. The consultant was not a vendor to X or any disqualified person with respect to X. The consultant recommended seven parcels of land to the Advisory Committee of Z's board. Two of the seven parcels recommended are owned by W, a partnership and a disqualified person with respect to X. The Advisory Committee forwarded the list of potential sites to Z's Stewardship Committee, which made a recommendation to the full board for final selection.

Although none of the seven properties had been ruled out initially, it was highly unlikely that the W parcels would be chosen because Z did not want to lease the land for its new facility; its preference being to buy a fee outright. However, Z subsequently contacted W and informed them that after a thorough analysis, they are considering a long-term lease of one of the two parcels of land owned by W. Z gave six reasons for choosing the W parcel: (1) it has freeway visibility with access to a larger geographical market; (2) all utilities are accessible at the site; (3) it is located at the north end of town where growth is occurring and is the closest site to one of Z's tertiary care facilities, while maintaining the rural Medicare distance designation of twenty miles; (4) it is free of contaminants; (5) it is ready for construction with the least infrastructure costs; and (6) long-term leasing is now acceptable given the above outlined economies.

If Z chooses one of the parcels, it will be leased at its fair market value, as determined by the parties, using independent appraisers. Over the past several years W has had inquiries from over fifty businesses that have expressed an interest in leasing various parcels in the area of the two parcels that Z is considering.

If Z selects property owned by W for building the new hospital facility, fulfilling the pledge by X is contingent on the approval of this ruling request.

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

Section 4941(d)(1) of the Code, in relevant part, provides that the term "self-dealing" includes 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 for the use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a)(1) of the Code provides in general that, the term "disqualified person" means, with respect to a private foundation, a person who is --

(A) a substantial contributor to the foundation,

(B) a foundation manager (within the meaning of subsection (b)(1)),

(C) an owner of more than 20 percent of --

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(i) the total combined voting power of the corporation,

(ii) the profits interest of a partnership, or

(iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation,

(D) a member of the family (as defined in subsection (d) of any individual described in subparagraph (A), (B), or (C).

Section 53.4941(d)-1(b)(5) of the Foundation and Similar Excise Taxes Regulations provides that an organization is "controlled" by a private foundation if the foundation or one of its foundation managers (acting only in such capacity) may, only by aggregating their votes or positions of authority, require the organization to engage in a transaction which if engaged in with the private foundation would constitute self-dealing. Similarly, an organization is controlled by a private foundation in the case of a transaction between the organization and a disqualified person, if such disqualified person, together with one or more persons who are disqualified persons by reason of such a person's relationship (within the meaning of section 4946(a)(1)(C) through (G)) to such disqualified person, may only by aggregating their votes or positions of authority with that of the private foundation, require the organization to engage in such a transaction.

Example (3) of section 53.4941(d)-1(b)(8) of the regulations provides that:

> Private foundation Y made a grant to M University, an organization described in section 170(b)(1)(A)(ii), for the purpose of conducting a seminar to study methods for improving the administration of the judicial system. M is not controlled by Y within the meaning of subparagraph (5) of this paragraph. In conducting the seminar, M made payments to certain government officials. By the nature of the grant, Y had reason to believe that government officials would be compensated for participation in the seminar. M, however, had completely independent control over the selection of such participants. Thus, such grant by Y shall not constitute an indirect act of self-dealing with respect to the government officials.

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You have represented that Z hired an independent real estate consultant to find the best possible location for the facility and that Z had independent control over the selection of the property for the medical facility. Z's ultimate selection of one of the W properties was based on objective criteria including location, accessibility to the freeway and related tertiary care facilities, accessibility of utilities, and cost-effective infrastructure. In addition, any lease entered into with W would be at arm's length and would be based on the fair market value of the property.

You have further represented that X has no control over Y or over the use that Y makes of the grant funds and has not otherwise earmarked funds to be used for the benefit of disqualified persons. Therefore, the grant by X to Y will not constitute an indirect act of self-dealing. Example 3 of section 53.4941(d)-1(b)(8).

Based on the information submitted and the representations made therein, we rule as follows:

(1) X's grant to Y, which will be distributed to Z in connection with its building program for the V area, does not constitute an act of self-dealing under the provisions of section 4941(d)(1) of the Code.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Because this ruling may help resolve any questions regarding your exempt status, you should keep a copy of this ruling letter in your permanent files.

If you have any questions please call the person whose name and telephone number appear in the heading of this letter.

Sincerely,

Robert C. Harper, Jr.
Chief, Exempt Organizations
Technical Branch 3