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4944.03-00

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

199947038

Date: AUG 3 0 1999

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T:2

Employer Identification Number:

Legend: A =

Dear Sir or Madam:

This is in reply to your letter of October 12, 1998, regrading the effect on your tax status of providing funding to and assisting A in carrying out its program.

You are exempt under section 501(c)(3) of the Internal Revenue Code and are a private operating foundation within the meaning of section 4942(j)(3) of the Code. You also represent that you are an exempt operating foundation within the meaning of section 4940(d)(2).

A is exempt under section 501(c)(3) of the Code and has a ruling treating it as a public charity within the meaning of sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code during a 5 year advance ruling period. Its charitable purpose is to improve opportunities for at-risk youth to live meaningful, successful lives in the community. A is to provide housing and a continuum of services to help prepare these youths to live on their own.

You were established to provide long-term care to children primarily through foster homes. You are actively involved in this program, have several offices in various parts of the country and have a large number of employees including 135 social workers. One of your offices is located in the same city as A. You have indicated that you were influential in establishing A. In addition one of A's initial directors is the Director of your office located in the same region as A. Your director is also the chairperson of A and will spend a portion of her time working for A. You will also be providing direct assistance to A's clients and will help coordinate services provided to them by other agencies. You will provide leadership and technical assistance to help develop A's program and will provide training as needed.

In addition to the active assistance you will be providing A you have entered into what you refer to as a "Program-Related Investment Agreement" (hereinafter referred to as the Agreement. Under this agreement you will be providing monies to A over a set period of time. These funds are restricted and must be used exclusively by A in furtherance of the purposes for which you have been recognized as exempt.

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You have requested the following rulings:

1. Your distribution to A under the Agreement is a program related investment within the meaning of section 4944(c) of the Code.

2. Your distributions to A are qualifying distributions within the meaning of section 4942(g)of the Code and have been made directly for the active conduct of your activities, within the meaning of section 4942(j)(3)(A).

Section 501(c)(3) of the Code exempts from Federal income tax organization organized and operated exclusively for charitable or educational purposes.

Section 509(a) of the Code provides that, unless specifically excepted, a domestic or foreign organization described in section 501(c)(3) is a private foundation and subject to the excise taxes of Chapter 42.

Section 4942(a) of the Code imposes a tax on the undistributed income of a private foundation.

Section 4942(c) of the Code defines undistributed income as the amount by which the distributable amount exceeds the qualifying distributions of the foundation.

Section 4942(g)(l) of the Code provides, in general, that qualifying distributions are direct expenditures for 170(c)(2)(B) charitable purposes or for assets to be used for these purposes. Such distributions include payments to public charities and operating foundations but not payments to organizations controlled by the foundation (or disqualified persons) or to private nonoperating foundations unless the requirements of section 4942(g)(3) are met.

Section 4942(j)(3) of the Code defines an operating foundation as any organization which makes qualifying distributions directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated equal to substantially all or the lesser of its adjusted net income or its minimum investment return. In addition it must satisfy the requirements of the assets, endowment or support test described in the applicable sections of the regulations.

Section 53.4942(a)-(a)(2) of the Foundation and Similar Excise Tax defines qualifying distribution as

(i) Any amount (including program-related investments, as defined in section 4944(c), and reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(1) or (2)(B), other than any contribution to--

(a) A private foundation which is not an operating foundation (as defined in section 4942(j)(3)), except as provided in paragraph (c) of this section, or

(b) An organization controlled (directly or indirectly) by the contributing private foundation or one or more disqualified persons with respect to such foundation, except as provided in paragraph (c) of this section.

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Section 53.4942(a)-2(c)(3)(ii) of the regulations provides examples of assets which are 'used (or held for use) directly in carrying out the foundation's exempt purpose' include, (a) . . . and (b) any interest in a functionally related business (as defined in subdivision (iii) of this subparagraph) or in a program-related investment (as defined in section 4944(c).

Section 53.4942(b)-1(a)(l)(ii) of the regulations defines an operating foundation as any private foundation which, in addition to satisfying the assets test, the endowment test or the support test set forth in Section 53.4942(b)-2(a), (b) and (c), makes qualifying distributions (within the meaning of Sec. 53.4942(a)-3(a)(2)) directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose equal in value to substantially all of the lesser of the foundation's adjusted net income (as defined in Sec. 53.4942(a)-2(d)) or minimum investment return (as defined in Sec. 53.4942(a)-2(c)).

Section 53.4942(b)-l(b)(l) of the regulations provides that qualifying distributions are not made by a foundation 'directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose' unless such qualifying distributions are used by the foundation itself, rather than by or through one or more grantee organizations which receive such qualifying distributions directly or indirectly from such foundation. Thus, grants made to other organizations to assist them in conducting activities which help to accomplish their charitable, educational, or other similar exempt purpose are considered an indirect, rather than direct, means of carrying out activities constituting the charitable, educational, or other similar exempt purpose of the grantor foundation, regardless of the fact that the exempt activities of the grantee organization may assist the grantor foundation in carrying out its own exempt activities. However, amounts paid to acquire or maintain assets which are used directly in the conduct of the foundation's exempt activities, such as the operating assets of a museum, public park, or historic site, are considered direct expenditures for the active conduct of the foundation's exempt activities. Likewise, administrative expenses (such as staff salaries and traveling expenses) and other operating costs necessary to conduct the foundation's exempt activities (regardless of whether they are 'directly for the active conduct' of such exempt activities) shall be treated as qualifying distributions expended directly for the active conduct of such exempt activities if such expenses and costs are reasonable in amount.

Section 53.4942(b)-l(b)(2) of the regulations provides that if a foundation makes or awards grants, scholarships, or other payments to individual beneficiaries to support active programs conducted to carry out the foundation's charitable, educational, or other similar exempt purpose, such grants, scholarships, or other payments will be treated as qualifying distributions made directly for the active conduct of exempt activities for purposes of paragraph (a) of this section only if the foundation, apart from the making or awarding of the grants, scholarships, or other payments, otherwise maintains some significant involvement (as defined in subdivision (ii) of this subparagraph) in the active programs in support of which such grants, scholarships, or other payments were made or awarded. Whether the making or awarding of grants, scholarships, or other payments constitutes qualifying distributions made directly for the active conduct of the foundation's exempt activities is to be determined on the basis of the facts and circumstances of each particular case. The test applied is a qualitative, rather than a strictly quantitative, one. Therefore, if the foundation maintains a significant involvement (as defined in subdivision (ii) of this subparagraph) it will not fail to meet the general rule of subparagraph (1) of this paragraph solely because more of its funds are devoted to the making or awarding of grants, scholarships, or other payments than to the active programs which such grants, scholarships, or other payments support. However, if a foundation does no more than select, screen, and investigate applicants for grants or scholarships, pursuant to which the recipients perform their work or studies alone or exclusively

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under the direction of some other organization, such grants or scholarships will not be treated as qualifying distributions made directly for the active conduct of the foundation's exempt activities. The administrative expenses of such screening and investigation (as opposed to the grants or scholarships themselves) may be treated as qualifying distributions made directly for the active conduct of the foundation's exempt activities.

Section 53.4942(b)-l(b)(l)(ii) of the regulations provides for the purposes of this subparagraph, a foundation will be considered as maintaining a 'significant involvement' in a charitable, educational, or other similar exempt activity in connection with which grants, scholarships, or other payments are made or awarded if--

(A) An exempt purpose of the foundation is the relief of poverty or human distress, and its exempt activities are designed to ameliorate conditions among a poor or distressed class of persons or in an area subject to poverty or national disaster (such as providing food or clothing to indigents or residents of a disaster area), the making or awarding of the grants or other payments to accomplish such exempt purpose is direct and without the assistance of an intervening organization or agency, and the foundation maintains a salaried or voluntary staff of administrators, researchers, or other personnel who supervise and direct the activities described in this subdivision (A) on a continuing basis; or

(B) The foundation has developed some specialized skills, expertise, or involvement in a particular discipline or substantive area (such as scientific or medical research, social work, education, or the social sciences), it maintains a salaried staff of administrators, researchers, or other personnel who supervise or conduct programs or activities which support and advance the foundation's work in its particular area of interest, and, as a part of such programs or activities, the foundation makes or awards grants, scholarships, or other payments to individuals to encourage and further their involvement in the foundation's particular area of interest and in some segment of the programs or activities carried on by the foundation (such as grants under which the recipients, in addition to independent study, attend classes, seminars, or conferences sponsored or conducted by the foundation, or grants to engage in social work or scientific research projects which are under the general direction and supervision of the foundation).

Section 53.4942(b)-l(c) of the regulations provides that for purposes of this section, the term 'substantially all' shall mean 85 percent or more.

Section 4944(a)(l) of the Code imposes a tax on a private foundation that invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes.

Section 4944(c) of the Code provides that program related investments are not considered investments which jeopardize the carrying out of exempt purposes. This section defines program-related investments as investments, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property.

Section 53.4944-3(a)(l) of the regulations provides that for purposes of section 4944 and Secs. 53.4944-1 through 53.4944-6, a 'program-related investment' shall not be classified as an investment which jeopardizes the carrying out of the exempt purposes of a private foundation.

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A program-related investment is further defined as an investment which possesses the following characteristics:

(i) The primary purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(B);

(ii) No significant purpose of the investment is the production of income or the appreciation of property; and

(iii) No purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(D).

Section 53.4944-3(a)(2)(i) of the regulations provides that an investment shall be considered as made primarily to accomplish one or more of the purposes described in section 170(c)(2)(B) if it significantly furthers the accomplishment of the private foundation's exempt activities and if the investment would not have been made but for such relationship between the investment and the accomplishment of the foundation's exempt activities. For purposes of section 4944 and Secs. 53.4944-1 through 53.4944-6, the term 'purposes described in section 170(c)(2)(B)' shall be treated as including purposes described in section 170(c)(2)(B) whether or not carried out by organizations described in section 170(c).

The submitted information establishes that you are distributing funds to A and that A has been recognized as exempt under section 501(c)(3) of the Code and is currently being treated as a publicly supported organization. These funds are to be used by A to accomplish section 170(c)(2)(B) purposes. In addition, to providing economic support to A, you are actively involved in both its management and assisting it to accomplish its exempt purposes through the provision of both personnel and technical assistance.

The information you have submitted establishes that the primary purpose of your distribution to A is to accomplish one or more of the purposes described in section 170(c)(2)(B), the investment does not envision the production of income and it will not be used to accomplish one or more of the purposes described in section 170(c)(2)(D). An investment shall be considered as made primarily to accomplish one or more of the purposes described in section 170(c)(2)(B) even if carried out by an organization not described in section 170(c). See section 53.4944-3(a)(2)(i) of the regulations. Accordingly, based on the information you have submitted we have concluded that your investment in A is both a qualifying distribution and a program related investment. See section 53.4942(a)-3(a)(2)(i) of the regulations.

An operating foundation, in addition to satisfying the assets test, the endowment test or the support test must make qualifying distributions directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose equal in value to substantially all of the lesser of the foundation's adjusted net income or minimum investment return. See section 53.4942(b)-1(a)(l)(ii) of the regulations. Section 53.4942(b)-l(c) of the regulations provides that for purposes of this section, the term 'substantially all' means 85 percent or more. Section 53.4942(b)-l(b)(l) of the regulations provides that qualifying distributions generally are not made by a foundation 'directly for the active conduct of activities constituting its . . . . exempt purpose' unless such qualifying distributions are used by the foundation itself, rather than by or through one or more grantee organizations. However, even where a private foundation has made a grant to another organization, if it maintains some significant involvement in the active conduct of

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the program the distributions will be considered having been made directly for the active conduct of its exempt purposes and the foundation will be considered a private operating foundation. See section 53.4942(b)-I(b)(2) of the regulations.

The information you have submitted indicates that you are maintaining a "significant involvement" in the activities carried on by A both through your direct involvement in various aspects of its program and your role in directing its activities. Therefore, both your initial investment in A and subsequent expenditures you shall make to assist A in carrying on its program are considered qualifying distributions made "directly for the active conduct of activities constituting [your] . . . . exempt purpose" within the meaning of section 53.4942(b)-I(b)(I) of the regulations.

Accordingly, based on the information submitted and upon the representations you have made we have concluded that:

1. Your distribution to A under the Agreement is a program related investment within the meaning of section 4944(c) of the Code.

2. Your distributions to A are qualifying distributions within the meaning of section 4942(g) of the Code and have been made directly for the active conduct of your activities, within the meaning of section 4942(j)(3)(A).

This letter is limited to the code sections discussed herein. It cannot be relied upon as a ruling that you qualify as a private operating foundation within the meaning of section 4942(j)(3) of the Code or an exempt operating foundation described in section 4940(d)(3).

Because this letter could help resolve any questions about your private foundation tax liability, you should keep it in your permanent records. We are sending a copy of this letter to your key District Director.

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

If you have any question about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter. For other matters, including questions concerning reporting requirements, please contact your key District Director.

Sincerely

(signature) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2