



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **201436051**
Release Date: 9/5/2014

Date: June 12, 2014

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

UIL: 501.03-02; 4941.04-00
4942.03-05; 4945.04-00

Legend:

<u>Company</u>	=
<u>Parent Company</u>	=
<u>Charity</u>	=
<u>Project</u>	=
<u>Commission</u>	=
<u>Year A</u>	=
<u>Year B</u>	=
<u>Year C</u>	=
<u>Year D</u>	=
<u>Year E</u>	=
<u>State 1</u>	=
<u>State 2</u>	=
<u>Joint Agreement</u>	=
<u>Monitoring Committee</u>	=

Dear :

We have considered your ruling request on the proper treatment of certain distributions from you under I.R.C. §§ 501(c)(3), 4941(d), 4942(g) and 4945.

FACTS

You are a trust fund established by Company and recognized as a private foundation exempt under § 501(c)(3). Your purpose is to allocate and distribute your income to Project, a program of Charity, which is a publicly supported charity exempt under § 501(c)(3).

Company is a regulated energy utility serving customers in State 1 and State 2. In Year C, Company was acquired by and became a wholly owned subsidiary of Parent Company, also a regulated energy utility serving customers in State 1 and State 2. Company and Parent Company are traditional rate-regulated utilities. You have provided substantial documentation that Company and Parent Company are subject to extensive regulation by Commission and other state and federal regulatory agencies. The rates these companies may charge customers are set by the Commission based on historical operating costs and a fair return on capital

invested in utility assets. The Commission permits the utility's rates to reflect the cost of bad debt, including the uncollectible revenue remaining after diligent efforts to collect on customer bills.

Project is a program established jointly by Company and Charity in Year A in order to provide elderly, severely disabled, and income-eligible residents of State 1 and State 2 with financial assistance for emergency energy related needs. In addition to funding from you, Project is also funded by contributions from the customers and employees of Company and Parent Company. Customers of Company and Parent Company may contribute to Project when paying their bills and employees may make contributions by payroll deductions.

In Year D, Parent Company and Charity entered into Joint Agreement for the administration of the Project. Joint Agreement provides that Project is overseen by Monitoring Committee, which is charged with the authority to conduct independent audits, to advise staff on eligibility criteria, and to establish policies concerning the amount of monetary reserves, limits on grants and similar matters. No officer, director, or employee and no one related to an officer, director or employee of Parent Company or Charity may serve on the Monitoring Committee.

You were established in Year B in order to place into trust certain funds that had previously been accumulated from customers of Company for an energy project which was later terminated. The trust agreement was entered into as a condition of Commission's approval of the distribution of the accumulated funds. Your purpose is to secure income from the trust estate and distribute it in the interest of and for the benefit of Project, to be distributed in the sole discretion of Project for providing assistance to qualified households as determined by Charity, according to guidelines established by Monitoring Committee. The Commission found that the transfer of the accumulated funds to you for the benefit of Project was in the public interest. In Year E the trust agreement was amended and restated to include the additional purpose of administering a second trust share consisting of funds received from an ad valorem tax refund paid to Parent Company. Pursuant to a stipulated agreement, the Commission ordered the funds transferred to you for payment to Project for the purpose of assisting eligible households with payment of their energy bills. Company and Parent Company have not made contributions to you other than these distributions of accumulated funds approved by Commission.

You are managed by a board of trustees composed of five individuals, including the board chair of Charity, board chair of Company, chair of the Charity's planned giving committee, and the chair and another member of the Monitoring Committee. Pursuant to your trust agreement, your trustees have no control or responsibility for the use of the distributions made to Project.

REQUESTED RULINGS

You have requested the following rulings:

1. Distributions by you to Charity for purposes of Project will not adversely affect or jeopardize your tax exempt status under §501(c)(3) inasmuch as no part of your net earnings inures to the benefit of any private individual or shareholder.

2. Distributions by you to Charity for purposes of Project will not constitute acts of self-dealing under § 4941(d).
3. Distributions by you to Charity for purposes of Project are qualifying distributions under § 4942(g).
4. Distributions by you to Charity for purposes of Project are not taxable expenditures under § 4945.

LAW

I.R.C. § 501(c)(3) exempts from federal income tax organizations organized and operated exclusively for charitable, religious, educational and other purposes, provided that no part of the organization's net earnings inures to the benefit to any private shareholder or individual.

I.R.C. § 507(d)(2)(A) defines a substantial contributor as any person who contributed or bequeathed an aggregated amount of more than \$5,000 to a private foundation, if such amount is more than 2 percent 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.

I.R.C. § 4941 imposes an excise tax on acts of self-dealing between a disqualified person, as defined in § 4946, and a private foundation. Section 4941(d)(1) (E) defines "self-dealing" to include any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

I.R.C. § 4942(a) imposes a tax on the undistributed income of a private foundation. Section 4942(g)(1)(A)(i) provides that the term "qualifying distribution" means any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in § 170(c)(2)(B), other than any contribution to an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons.

I.R.C. § 4945 imposes an excise tax on taxable expenditures made by a private foundation. Section 4945(d)(4) provides that the term "taxable expenditure" means any amount paid or incurred to attempt to influence legislation, to influence any specific public election or carry on a voter registration drive, to grant funds to any individual for travel, study or similar purposes unless certain requirements are met, to grant to an organization other than a public charity describe in § 509(a)(1), (2), or (3), unless the private foundation exercises expenditure responsibility, or for a purpose other than specified in § 170(c)(2)(B).

I.R.C. § 4946(a)(1) defines "disqualified person" to include a substantial contributor to a private foundation. Section 4946(a)(2) states that, for this purpose, "substantial contributor" means a person described in § 507(d)(2).

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that to be exempt as an organization described in § 501(c)(3), an organization must be one that is both organized and operated exclusively for

one or more of the purposes specified in that section.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. § 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest and that it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in its generally accepted legal sense and includes relief of the poor and distressed, or of the underprivileged.

Treas. Reg. § 53.4941(d)-1(a) provides that for purposes of § 4941 the term "self-dealing" means any direct or indirect transaction described in § 53.4941(d)-2.

Treas. Reg. § 53.4941(d)-1(b)(5) provides that an organization is controlled by a private foundation if the foundation or one or more of its managers 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.

Treas. Reg. § 53.4941(d)-2(f) provides that the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation constitutes an act of self-dealing.

Treas. Reg. § 53.4941(d)-2(f)(2) provides that the fact a disqualified person receives an incidental or tenuous benefit from a private foundation's use of its income or assets will not, by itself, make the use an act of self-dealing. Thus, the public recognition a disqualified person receives from a foundation's charitable activities does not in itself result in an act of self-dealing, since the benefit generally is incidental and tenuous.

Treas. Reg. § 53.4941(d)-2(f)(9) gives examples illustrating the operation of the self-dealing definitions in § 53.4941(d)-2(f). Example (1) involves a private foundation's grant to a city to alleviate slum conditions in a particular neighborhood. Although the area's general improvement may be an incidental and tenuous benefit to corporation (a substantial contributor), that benefit by itself is not an act of self-dealing under § 4941. Example (2) provides that a private foundation that established a scholarship program that awards grants to children of employees of company (a substantial contributor) is not engaged in indirect self-dealing.

In Rev. Rul. 80-310, 1980-2 C.B. 319, a private foundation made a grant to a university to establish a new educational department providing instruction in manufacturing engineering. A substantial contributor to the foundation, a corporation, would seek to employ graduates of the new program and encourage its employees to enroll in it. The ruling held that because the educational program was of broad public interest, and the substantial contributor would benefit from the program only incidentally to its manufacturing business, the benefit the contributor received was only incidental and tenuous. Therefore, the program did not result in self-dealing under § 4941.

In Rev. Rul. 85-162, 1985-2 C.B. 275, a private foundation financed construction projects in disadvantaged areas. Under its program, the foundation extended an interest-free loan to a publicly supported organization, which in turn loaned the funds to exempt, publicly supported community development organizations. These organizations used the borrowed funds to acquire construction and permanent financing from financial institutions other than disqualified person with respect to the foundation. The community development organizations had sole control over selecting general contractors, subcontractors, and suppliers for projects. Some general contractors, subcontractors, and suppliers, however, had ordinary business relationships with a bank that was a disqualified person with respect to the foundation. The ruling held that any benefits and bank/disqualified person received from this charitable program, resulting from ordinary business relationships, would be incidental or tenuous under § 53.4941(d)-2(f)(2) of the regulations, and therefore no self-dealing would result.

ANALYSIS

Ruling 1: Distributions by you to Charity for purposes of Project will not adversely affect or jeopardize your tax exempt status under § 501(c)(3) inasmuch as no part of your net earnings inures to the benefit of any private individual or shareholder.

An organization exempt under § 501(c)(3) may not be operated to benefit private interests rather than for public purposes, and may not be operated so that there is prohibited inurement of earnings to the benefit of private shareholders or individuals. Charity only makes grants to needy and distressed persons. Specifically, an independent Monitoring Committee has established objective criteria under which it distributes funds to eligible households. Your grants to Charity do not benefit persons having a personal and private interest in your activities and, therefore, do not constitute private inurement. Your grants to Charity do not further private interests. The class is sufficiently large and indeterminate to constitute a charitable class under § 1.501(c)(3)-1(d)(2). Therefore, the distributions as outlined above by you to Charity for purposes of Project will not adversely affect or jeopardize your tax exempt status under § 501(c)(3) because no part of your net earnings benefits any private individual or shareholder related to you.

Ruling 2: Distributions by you to Charity for purposes of Project will not constitute acts of self-dealing under § 4941(d).

Section 4941(a) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation. Under § 4946(a)(1), a disqualified person with respect to a private foundation includes a person who is a substantial contributor to the foundation. Section

507(d)(2) defines a substantial contributor as any person who contributed or bequeathed an aggregate amount of more than \$5,000 to a private foundation. Company's and Parent Company's contributions to you were each more than \$5000 and more than 2 percent of the total contributions received by you before the close of each taxable year in which they were contributed. Company and Parent Company are both substantial contributors to you and, therefore, disqualified persons with respect to you.

The term "self-dealing" includes any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation, as described in § 53.4941(d)-2. Section 53.4941(d)-2(f) describes the transfer to or use of the income or assets of a private foundation by a disqualified person. Your funding of Project is not direct self-dealing, because there is no direct transaction between you and Company or Parent Company.

A majority of your trustees are independent of Company or Parent Company, and you do not exercise control over Charity or Project, as defined in § 53.4941(d)-1(b)(5). The Joint Agreement and your trust agreement provide that neither you nor any disqualified person with respect to you will participate in the selection of any beneficiaries of Project. In addition, because bad debt expense is effectively recovered in the rates set by regulators, there is no economic benefit to Company or Parent Company in receiving payments funded by Project. If the grantees fail to pay their bills, the companies stand to recover the bad debt expense in future years through rates set by the regulator. If grantees use grants to pay their energy bill, there is no bad debt expense to be recovered through the rate process.

The benefit provided is similar to those of the corporations in Example (1) of § 53.4941(d)-2(f)(9) (a general improvement in the neighborhood surrounding the corporation) and Example (2) (scholarship program for employees of corporation). Grants from Project are made to customers of Parent Company and provide incidental and tenuous benefits of increased customer loyalty and good will. Project provides a benefit to Parent Company similar to those provided to the substantial contributors in Rev. Rul. 80-310, *supra*, (holding that an educational program providing training for employees did not constitute self-dealing to substantial contributor company because it was of broad public interest to the community) and Rev. Rul. 85-162, *supra* (holding that project did not constitute self-dealing to bank, a disqualified person, because it was a program of broad public interest). Similarly, Charity is a public charity exempt under § 501(c)(3) and Project's activity of providing financial assistance to help meet the emergency energy related needs of the elderly and severely disabled is a program of broad public interest. Under these circumstances, the benefits to Company or Parent Company from your grants to Project are incidental or tenuous within the meaning of § 53.4941(d)-2(f)(2) and not indirect self-dealing under § 4941(d).

Ruling 3: Distributions by you to Charity for purposes of Project are qualifying distributions under § 4942(g).

Section 4942 imposes a tax on a private foundation that fails to make qualifying distributions. Qualifying distributions are defined in § 4942(g) as amounts paid to accomplish one or more purposes described in § 170(c)(2)(B), other than any contribution to an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons. Your distributions to Charity for Project are paid to accomplish purposes described in § 170(c)(2)(B) because they

further the charitable purpose of providing assistance to the poor or distressed. You have also represented that Charity is not controlled by you or any disqualified persons with respect to you as defined in § 4946. Therefore, distributions to Charity for Project as stated above are qualifying distributions.

Ruling 4: Distributions by you to Charity for purposes of Project are not taxable expenditures under § 4945.

Section 4945 imposes a tax on private foundations and their managers who make taxable expenditures. Taxable expenditures are defined in section § 4945(d) as any amount paid or incurred by a private foundation for certain enumerated purposes, such as influencing legislation, making grants to individuals for travel or study, making grants to certain organizations that are not public charities, or for purposes other than those specified in § 170(c)(2)(B). The distribution of funds to Charity for Project are for purposes specified in § 170(c)(2)(B), providing relief to the poor and distressed, and do not otherwise fall under any of the activities defined under § 4945(d) and Charity is a public charity under § 509(a)(1). Your grants to Charity for Project further exempt purposes and therefore, they are not taxable expenditures.

RULINGS

Based on the information submitted, we rule as follows:

1. Distributions to Charity for purposes of Project will not adversely affect or jeopardize your tax exempt status under §501(c)(3) inasmuch as no part of your net earnings inures to the benefit of any private individual or shareholder.
2. Distributions made by you to Charity for purposes of Project will not constitute acts of self-dealing under § 4941(d).
3. Distributions made by you to Charity for purposes of Project are qualifying distributions under § 4942(g).
4. Distributions made by you to Charity for purposes of Project are not taxable expenditures under § 4945.

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. 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,

Michael Seto
Manager, EO Technical

Enclosure
Notice 437