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

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Date: MAR 30 2000

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T3

Significant Index Number
4945.04-05
Third Party Contacts
None

Legend
X =
Y =
M =
N =

Employer Identification Number:

Dear Taxpayer:

We have considered your ruling request with regard to the federal income tax consequences of the proposed grants to X to establish a scholarship and fellowship program. The purpose of the scholarship program is designed to expand access to higher education and increase the number of outstanding low income African-American, American Indian/Alaska Native, Asian Pacific American and Hispanic students enrolling in and completing undergraduate and graduate degree programs.

Preliminary Expenditures

Y undertook a variety of preliminary activities to identify ways to address the need for access to higher education in America to foster new leaders, and especially leaders from groups that historically have been denied higher education opportunities. Preliminary activities included a review and study by foundation officers and employees of the literature addressing higher education opportunities. Officers and employees interviewed numerous nationally recognized leaders in education to discuss scholarship programs in general and the types of specific scholarship programs that might address Y's concerns. In addition, Y commissioned a study from a research and consulting firm to learn about the costs of higher education, the types of financial aid programs presently available, and the need for additional financial support for future leaders. Y incurred or paid the costs described above in the good faith belief that such costs were reasonable and that the payment or incurrence of such expense in such amounts was consistent with ordinary business care and prudence.

Grants to Establish the Program and Supporting Expenditures

On receipt of the grants X, a public charity described in section 501(c)(3), with the assistance of its partner 501(c)(3) organizations will administer and supervise the program under the terms of the grant agreement. Under the terms of the Agreement, Y will make annual contributions to X of up to $M over N years to fund the scholarships and the costs associated with the administration of the program. X will prepare and furnish scholarship nomination forms, receive all nominations, determine the recipients and amount to be awarded to each recipient, notify the recipients of the

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award, confirm enrollment in an educational institution, make payment of the award and supervise and investigate the use of the grant funds by the recipients in their educational programs.

Recipients will be determined under the supervision of X, based on criteria set forth in the nomination guidelines and forms prepared by X. Y will not control the selection of scholarship recipients although Y will have a representative on the selection committee.

In the first year, individuals will be eligible for nomination if they (i) are African-American, American Indian/Alaska Native, Asian Pacific American, or Hispanic citizens/permanent residents of the United States who have (ii) attained a cumulative grade point average of 3.3 on a 4.0 scale, (iii) have applied to, have been accepted into or are enrolled full-time in an accredited college or university for the academic year 2000-2001 at the time of the award or have applied to, have been accepted into or are enrolled in a graduate degree program in mathematics, science (including life sciences, physical sciences and computer science), engineering, education or library science for the academic year 2000-2001 at the time the nomination is complete; (iv) have significant financial need as defined by the Federal Needs analysis formula; and (v) have demonstrated leadership ability through participation in community service, extracurricular activities or other activities.

Scholarships or fellowships will only be awarded to students who have been accepted to or are enrolled in institutions that meet the requirements of Section 170(b)(1)(A)(ii) of the Code. The scholarships and fellowships will not be employer-related grants. No scholarships or fellcwships will be awarded to creators, officers, directors, trustee or members of the selection committee or for a purpose inconsistent with the purposes described in Section 170(c)(2)(B) of the Code.

In addition to providing X with the grants, Y will provide advisory and oversight support to X and its partners to develop the administrative details (e.g. nomination forms and program materials) and effect the implementation of the program. This oversight and support will continue over the life of the program. Y will also aid X and its partners in educating the public about the existence of the program.

Section 4942(a) of the Internal Revenue Code imposes an excise tax on the undistributed income of a private income. Undistributed income is defined, in part, as the amount by which qualifying distributions are less than the foundation's minimum investment return.

Section 4942(g)(1)(A) of the Code defines a qualifying distribution to mean any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B) of the Code (other than contributions to controlled organizations or to non-operating foundations).

Section 53.4942(a)-3(a)(3) of the Foundation and Other Excise Tax Regulations provides in part that 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 positions of authority, require the donee organization to make an expenditure, or prevent the donee organization from making an expenditure.

Section 53.4942(a)-3(a)(8) of the regulations includes the following example with respect to qualifying distributions. M, a private foundation makes the following payments in a calendar year: (i) a payment of $44,000 to five employees for conducting a foundation program of educational

grants for research and study; (ii)$20,000 for various items of overhead, 10% of which is attributable to

Section 4945 of the Code imposes an excise tax on each taxable expenditure made by a private foundation.

Section 4945(d) of the Code provides in part that a taxable expenditure is any amount paid or incurred by a private foundation (i) to carry on propaganda, or otherwise attempt to influence legislation, (ii) to influence the outcome of any specific public election, or to carry on directly or indirectly, any voter registration drive, (iii) as a grant to an individual for travel, study, or other similar purposes by such individual; (iv) as a grant to an organization unless such organization is a public charity, an exempt operating foundation, or the private foundation exercises expenditure responsibility with respect to such grant; or (v) for any purpose other than one described in section 170(c)(2)(B) of the Code.

Section 53.4945-4(a)(4)(i) of the regulations provides in part that a grant by a private foundation to another organization, which the grantee organization uses to make payments to an individual for purposes described in section 4945(d)(3), shall not be regarded as a grant by the private foundation to the individual grantee if the foundation does not earmark the use of the grant for any named individual and there does not exist an agreement, oral or written, whereby such grantor foundation may cause the selection of the individual grantee by the grantee organization. For purposes of this subparagraph, a grant described herein shall not be regarded as a grant by the foundation to an individual grantee even though such foundation has reason to believe that certain individuals would derive benefits from such grant so long as the grantee organization exercises control, in fact, over the selection process and actually makes the selection completely independently of the private foundation.

Section 53.4945-4(a)(4)(ii) of the regulations provides that a grant by a private foundation to an organization described in section 509(a)(1), (2) or (3), which the grantee organization uses to make payments to an individual for purposes described in section 4945(d)(3), shall not be regarded as a grant by the private foundation to the individual grantee (regardless of the application of subdivision (i) of this subparagraph) if the grant is made for a project which is to be undertaken under the supervision of the section 509(a)(1),(2) or (3) organization and such grantee organization controls the selection of the individual grantee. This subdivision shall apply regardless of whether the name of the individual grantee was first proposed by the private foundation, but only if there is an objective manifestation of the section 509(a)(1), (2), or (3) organization=s control over the selection process, although the selection need not be make completely independently of the private foundation.

The preliminary expenditures incurred to research and develop the program represent direct expenditures by Y to investigate and design a program in furtherance of its educational purposes similar to those specified in example (1) under section 53.4942(a)-3(a)(8) of the regulations. Likewise, the anticipated expenses Y will incur in furtherance of the program's supporting activities, including the reasonable overhead associated with these activities all come within the definition of qualifying distributions set out in section 4942(g) of the Code. In addition, the grants to X will constitute direct payments to a public charity that is not controlled by Y. Because X is a public charity, amounts donated to X by Y will be viewed as amounts expended to accomplish one or

more of the purposes described in section 170(c)(2)(B) of the Code. Thus, the preliminary expenditures, the grants and the supporting expenditures constitute qualifying distributions under section 4942(g) of the Code and applicable regulations.

Section 4945 of the Code imposes an excise tax on each taxable expenditure made by a private foundation. Neither the preliminary expenditures nor the supporting expenditures constitute taxable expenditures for purposes of section 4945(d) of the Code because Y expended or will expend these amounts in furtherance of an educational purpose, one of the purposes specified in section 170(c)(2)(B). Amounts incurred in support of the scholarship program are in support of an educational purpose because the program provides scholarships and fellowship for higher education.

The definition of taxable expenditure under section 4945(d)(4) of the Code specifically excludes grants to an organization that is a public charity described in section 509(a)(1) of the Code. In the present case the grants are made to X, a public charity. While the definition of taxable expenditure does include amounts paid or incurred by a private foundation as a grant to an individual for travel, study or similar purposes by such individual unless the grant satisfies the requirements of section 4945(g) of the Code, this provision does not apply in this situation because the grants here are grants to X and not to individuals per se. Rather, the program comes within the purview of section 53.4945-4(a)(4)(ii) of the Regulations, which provides that a grant by a private foundation to a public charity which the grantee organization uses to make payments to an individual for purposes described in section 4945(d)(3) of the Code, shall not be regard as a grant by the private foundation to the individual grantee if the grant is made for a project to be undertaken under the supervision of the public charity and such grantee organization controls the selection of the individual grantee. Under the program described herein, X will supervise the scholarships and fellowships and will control the selection of the individual grantees. Therefore, the grants will not constitute taxable expenditures under section 4945(d)(3) of the Code.

Accordingly, we conclude that:

A. The preliminary expenditures, the grants and the supporting expenditures all constitute "qualifying distributions" under section 4942(g) of the Code.

B. The preliminary expenditures and the supporting expenditures comply with the requirements of section 4945(d)(5) of the Code and therefore do not constitute "taxable expenditures" under section 4945(d) of the Code. The grants comply with the requirements of section 4945(d)(4) of the code and therefore will not constitute Ataxable expenditures@ under Section 4945(d) of the Code.

Because this letter could help to resolve any questions, please keep a copy of it in your permanent records.

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

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,

(signed) Robert C Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3