



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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0512.01-01
4941.00-00
4943.03-01
4944.00-00

Dear

We are responding to a request for a ruling submitted by your authorized representative.

You have been recognized as an organization described in section 501(c)(3) of the Internal Revenue Code and classified as a private foundation described in section 509(a) of the Code.

You were formed to receive funds, administer your investments, and distribute earnings for charitable purposes. Your initial funding came from your founder and his family. You expect to receive additional gifts and bequests from your founder and his family. A substantial number of the gifts and bequests will be in the form of commercial and residential rental real estate currently owned by your founder and his family. There will be little or no debt against the properties you will receive.

Your real estate portfolio will consist of commercial and residential rental properties. The decision to retain or sell any property will be made by your Trustees based on the facts and circumstances at the time the property is received. Such decisions will be made on an investment-by-investment basis, taking into consideration your current investment portfolio.

You plan to form one or more limited liability companies ("LLCs") to own and manage your real property investment portfolio. With respect to each LLC, the activities will not exceed those that you could conduct relating to the management of the portfolio; you will be the sole member; and, you will have the authority to appoint the managers. Each of the LLCs will elect to be treated as a disregarded entity for federal income tax purposes.

You plan to appoint one or more of your Trustees to act as the

The Trustees appointed may be disqualified persons. That Trustee will be responsible for overseeing the day-to-day activities of the . He will receive reasonable compensation for the services provided. You plan to contract with the , to provide the following services with respect to management of your real property investment portfolio:

1. identification and analysis of potential real estate acquisitions;
2. contract negotiations;
3. cash management;
4. debt management including budgeting;
5. negotiation of financing;
6. review of loan agreements and expenditures;
7. accounting;
8. supervision of property operations and inspections;
9. advertising;
10. leasing and lease negotiations;
11. goodwill relations with tenants and communities;
12. interface with municipalities and compliance with new ordinances;
13. collection of rents;
14. supervision and administration of a risk management program;
15. supervision of personnel and human resources;
16. supervision and administration of legal and tax services and other incidental and ancillary activities associated with the ownership of passive rental real property; and,
17. services relating to the disposition of property.

The will not provide any maintenance, repair, janitorial, cleaning, landscaping or other operation or capital improvements but it may supervise third-party vendors who will conduct such activities.

Rulings Requested

1. The proposed activities do not jeopardize your exempt status under section 501(c)(3) of the Code.
2. Rental income received from the real property investments shall be excluded from unrelated business taxable income.
3. Income received as a result of the sale of your real property investments is excluded from unrelated business taxable income.
4. Contracting with a wholly-owned LLC, managed by one or more of your trustees who are disqualified persons, to provide certain real property investment management services will not constitute an act of self dealing.

Your role as the sole member of the , will not constitute excess business holdings under section 4943 of the code;

5. Your holdings of real property will not be considered jeopardizing investment as described in section 4944 of the Code.

Law:

Section 501(c)(3) of the Code provides, in part, that an organization is exempt from federal income tax if it is organized and operated exclusively for charitable purposes, and if no part of the net earnings of the organization inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes relieving the poor, distressed or underprivileged, lessening the burdens of government, and promotion of social welfare by organizations designed to lessen neighborhood tensions, eliminate prejudice and discrimination, defend human and civil rights secured by law, or combat community deterioration and juvenile delinquency.

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c), including those described in section 501(c)(3).

Section 512(a)(1) of the Code provides, in pertinent part, that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (defined in section 513) regularly carried on by it.

Section 512(b)(3)(A)(i) of the Code provides that there shall be excluded from the computation of unrelated business taxable income all rents from real property and all rents from personal property leases with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease. This section does not apply if more than fifty percent (50%) of the total rent is attributable to personal property or if the amount of rent paid depends in whole or in part on the income or profits derived.

Section 512(b)(5) of the Code provides, in part, that there shall be excluded from the computation of unrelated business taxable income all gains or losses from the sale, exchange, or other disposition of property.

Section 513(a) of the Code defines "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the organization's need for funds or the use it makes of the profits derived) to the organization's exercise or performance of the purpose or function constituting the basis for its exemption under section 501.

Section 4941(a) of the Code imposes a tax upon any act of self-dealing between a private foundation and any of its disqualified persons, as defined in section 4946 of the Code. The tax is imposed on the disqualified person and, in certain situations, a tax is also imposed on any foundation manager participating in such act or acts.

Section 4941(d)(1)(D) of the Code defines "self-dealing" as any direct or indirect payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person.

Section 4941(d)(2)(E) of the Code provides that the payment of compensation (and the payment or reimbursement of expenses) by a private foundation to a disqualified person for personal services which are reasonable and necessary to carrying out the exempt purpose of the private foundation shall not be an act of self-dealing if the compensation (or payment or reimbursement) is not excessive.

Section 4943 of the Code imposes a tax annually on the value of a private foundation's excess holdings in a business enterprise. Excess business holdings are generally determined with reference to a foundation's own holdings and the holdings of all of its disqualified persons, a term defined in section 4946.

Section 4943(d)(3)(A) of the Code states that the term "business enterprise" does not include a functionally related business or a trade or business at least 95 percent of the gross income of which is derived from passive sources. Section 4943(d)(3)(B) further provides that gross income from passive sources includes the items excluded by sections 512(b)(1), (2)(3), and (5), without regard to the debt-financing rules of section 514.

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

Section 53.4944(a)(2)(i) of the Foundation Excise Tax Regulations defines a jeopardizing investment, in part, as one in which the foundation managers, in making such investment, have failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the long and short term financial needs of the foundation to carry out its exempt purposes.

The "check the box" regulations at section 301.7701 of the Procedure and Administration Regulations allow certain organizations to choose treatment as either a partnership or a corporation, or to be treated as a disregarded entity for federal tax purposes. Announcement 99-102, 1999-43 I.R.B. 545, confirms that a single member limited liability company ("LLC") is presumed to be a disregarded entity. Where the sole member is a tax-exempt organization described in section 501(c)(3), the LLC is treated as an activity of the tax-exempt organization.

Rationale:

Your purpose is to receive funds, administer your investments and distribute earnings thereon for charitable purposes. In furtherance of your purposes, you have the power and authority to administer your investments, whether real or personal property, to further your exempt purposes.

You indicate that none of the single member you will create will elect to be treated as a corporation. Accordingly, the single member , will be treated as disregarded entities and their activities will be treated as your own pursuant to Announcement 99-102 and section 301.7701 of the regulations.

The will own and manage your rental real property, an investment activity that you can conduct on your own behalf without jeopardizing your tax exempt status. The fact that this activity will be carried out by the , will not change the character of these activities. The ' activities will be considered an extension of yours. Therefore, the formation of the to engage in these activities will not jeopardize your tax exempt status.

Section 512(b) of the Code provides that certain types of income will not be subject to unrelated business income tax ("UBIT") under section 511. Section 512(b)(3) provides that rental income from real property is not subject to UBIT. The leased property in your real estate portfolio will be limited to real property which is not debt-financed. Therefore, any income you receive from this source is not subject to UBIT.

Pursuant to section 512(b)(5) of the Code, any gains or losses from the sale, exchange, or other disposition of property other than inventory or property held primarily for sale to customers is not subject to UBIT. The real property in your real estate portfolio is held solely for investment purposes. Accordingly, any income from the sale, exchange, or other disposition of the property will not be subject to UBIT.

Because the will be treated as disregarded entities, they will not be considered disqualified persons with respect to you.

You plan to hire one or more of your Trustees to act as As a member of your governing board, the Trustee(s) will be a disqualified person. The Trustee(s) will receive reasonable compensation as Because the services provided will be personal services, will be reasonable and necessary to carrying out your exempt purpose, and the compensation will not be excessive, the payment of compensation to your Trustee(s) for managing the will not be act of self dealing.

Under section 4943 of the Code, the term “business enterprise” does not include a trade or business that derives at least 95% of its gross income from passive sources. Your main source of income, rents the , will collect from real property you own and manage, is considered to be passive income that is excluded from unrelated business taxable income by section 512(b)(3). You may also receive income from the gains or losses from the sale of your real property investments. Such income is considered to be passive income, income that is excluded from unrelated business taxable income by section 512(b)(5).

Conclusion:

1. The proposed activities described in this ruling will not jeopardize your status as an organization described in section 501(c)(3) of the Code.
2. Rental income received by you from the real property investments as described herein is excluded from unrelated business taxable income.
3. Income received as a result of the sale, exchange or other disposition of your real property investments as described herein is excluded from unrelated business taxable income.
4. Contracting with the , , which will be managed by one or more disqualified persons, to provide real property investment management services as described herein will not constitute an act of self dealing.
5. Your role as the sole member of the will not constitute excess business holdings under section 4943 of the Code.
6. Your holdings of real property will not be considered a jeopardizing investment as described in section 4944 of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. No opinion is expressed as to whether the compensation paid for real property investment management services is, in fact, reasonable.

This ruling letter 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 as precedent.

Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transactions described above under any other provision of the Code.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative. A copy of this letter should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone are shown in the heading of this letter.

Sincerely,

Debra J. Kawecki
Manager, Exempt Organizations
Technical Group 2

Enclosure
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