Rev. Rul. 81-125, 1981-1 C.B. 515

Private foundations; taxable expenditure; grant to instrumentality of political subdivision. A grant for exclusively charitable purposes made by a private foundation to a wholly owned instrumentality of a political subdivision of a state is not a taxable expenditure under section 4945(d)(4) of the Code even if the foundation does not exercise expenditure responsibility over the grant.

ISSUE

Does a grant, for exclusively charitable purposes, made by a private foundation to a wholly owned instrumentality of a political subdivision of a state constitute a taxable expenditure under section 4945(d)(4) of the Internal Revenue Code if the foundation does not exercise expenditure responsibility with respect to the grant in accordance with section 4945(h)?

FACTS

The foundation is exempt from federal income tax under section 501(c)(3) of the Code and is a private foundation under section 509(a). The foundation accomplishes its objectives through a program of making grants to other organizations for charitable purposes.

The foundation has made a grant, for exclusively charitable purposes as described in section 170(c)(2)(B) of the Code, to X, a wholly owned instrumentality of a political subdivision of the State of Y. X has not been recognized as exempt from federal income tax under section 501(c)(3), and is not itself a political subdivision described in section 170(c)(1). The grant was not earmarked for use by a secondary grantee in the manner described in section 53.4945-5(a)(6) of the Foundation Excise Tax Regulations. The foundation did not exercise expenditure responsibility with respect to the grant in accordance with section 4945(h).

LAW AND ANALYSIS

Section 170(c)(1) of the Code provides that the term "charitable contribution" means a contribution or gift to or for the use of a state, a possession of the United States, or any political subdivision of any of the foregoing or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

Section 4945 of the Code imposes a tax on each taxable expenditure of a private foundation.

Generally, pursuant to section 4945(d)(4) of the Code, a private foundation must exercise expenditure responsibility in connection with any grant to an organization, unless the grantee

organization is described in section 509(a)(1), (2), or (3). Failure to comply with this requirement will cause the grant to be a taxable expenditure within the meaning of section 4945(d)(4).

Section 4945(h) of the Code provides that expenditure responsibility referred to in section 4945(d)(4) means that a private foundation is responsible to exert all reasonable efforts, and to establish adequate procedures--

(1) to see that the grant is spent solely for the purpose for which made,

(2) to obtain full and complete reports from the grantee on how the funds are spent, and

(3) to make full and detailed reports with respect to such expenditures to the Secretary or the Secretary's delegate.

Section 53.4945-5(a)(4) of the regulations provides that, for purposes of section 4945(d)(4) of the Code, an organization will be treated as a section 509(a)(1) organization if it is an organization described in section 170(c)(1), even if it is not described in section 501(c)(3); or if it is a foreign government or any agency or instrumentality thereof, even if it is not described in section 501(c)(3). However, any grant to such organizations must be made exclusively for charitable purposes as described in section 170(c)(2)(B).

In this case, the private foundation has made a grant for exclusively charitable purposes to a wholly owned instrumentality of a political subdivision in the state of Y. Because a grant to an instrumentality of a foreign government is treated as a grant to a section 509(a)(1) organization, for purposes of section 4945(d)(4) of the Code, the grant made by X, an instrumentality of a domestic political subdivision, should also be treated as a grant made to a section 509(a)(1) organization. Accordingly, the foundation is not required to exercise expenditure responsibility over the grant made to X.

HOLDING

A grant, for exclusively charitable purposes, made by a private foundation to a wholly owned instrumentality of a political subdivision of a state does not constitute a taxable expenditure under section 4945(d)(4) of the Code even though the foundation does not exercise expenditure responsibility with respect to the grant in accordance with section 4945(h).