TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Contact Person:

Number: **201430017**
Release Date: 7/25/2014

Identification Number:

Telephone Number:

Date: May 2, 2014

Employer Identification Number:

UIL: 512.00-00; 512.01-00; 514.00-00; 4943.00-00
4943.04-03; 4944.00-00

Legend:

Foreign Country =

Dear :

We have considered your ruling request dated October 7, 2013, requesting rulings under Internal Revenue Code (I.R.C.) §§ 512, 514, 4943, and 4944.

FACTS

You are a tax-exempt organization recognized under § 501(c)(3) and classified as a private, non-operating foundation under § 509(a). Your mission is to provide substantial, widespread, and lasting changes to society that will maximize opportunity and minimize injustice.

You intend to form a corporation in Foreign Country (Corporation) for the purpose of facilitating and managing your foreign investing, which will include distressed-debt investing. Working closely with your investment advisors, your managers determined that your foreign investments can be better managed, result in a more tax-efficient structure, and enhance your ability to fulfill your charitable mission by using the Corporation. Additionally, you desire to make your foreign investments through the Corporation for asset management and liability protection purposes.

You will capitalize the Corporation with cash and non-encumbered property; you state that you will not borrow funds or otherwise incur debt to finance the Corporation. In exchange, you will own 100 percent of the Corporation's stock. The Corporation will be treated as a corporation for U.S. income tax purposes.

You represent the following:

- At least 95 percent of the Corporation's income will be from passive investments, such as interest income from loans, within the meaning of § 4943(d)(3)(B) and within the

definition of foreign personal holding company income under § 954(c)(1)(A) from foreign sources.

- The Corporation will not receive income attributable to insurance income.
- As a general proposition, the Corporation will hold investments that, if you owned them, would be debt-financed and therefore would generate unrelated business taxable income.
- The Corporation's investments, when combined with your investments and the investments of your disqualified persons, will not exceed a 35 percent voting interest in a business enterprise where effective control can be demonstrated to be with non-disqualified persons and will not exceed a 20 percent voting interest in a business entity otherwise.

RULINGS REQUESTED

1. The Subpart F income includable in your income with respect to the Corporation will not be subject to the unrelated business income tax under §§ 512 and 514.

2. Your ownership of the Corporation does not result in an excess business holding under § 4943(c).

3. Your ownership of the Corporation is not a jeopardizing investment under § 4944.

LAW

I.R.C. § 511(a)(1) imposes a tax on the unrelated business taxable income (UBTI) (as defined by § 512) of certain exempt organizations, including § 501(c)(3) organizations.

I.R.C. § 512(b)(1) provides that there shall be excluded from the calculation of UBTI all dividends, interest, payments with respect to securities loans (as defined in subsection (a)(5)), amounts received or accrued as consideration for entering into agreements to make loans, and annuities, and all deductions directly connected with such income.

I.R.C. § 512(b)(4) provides that, notwithstanding the general exclusion of dividends from UBTI, dividends and other passive investment income derived from certain debt-financed property (and corresponding deductions) are included, as an item of gross income derived from an unrelated trade or business, in an amount ascertained under § 514.

I.R.C. § 512(b)(17), added by the Small Business Job Protection Act of 1996, provides that any amount included in gross income under § 951(a)(1)(A) shall be included as an item of gross income derived from an unrelated trade or business to the extent that the amount so included is attributable to insurance income as defined in § 953.

I.R.C. § 953 defines "insurance income," in part, as income which is attributable to the issuing of an insurance or annuity contract.

I.R.C. §§ 951 through 964 comprise Subpart F -- Controlled Foreign Corporations. Section

951(a)(1)(A) provides that a United States shareholder of a controlled foreign corporation must include in gross income his pro rata share of the controlled foreign corporation's Subpart F income for the year, even if not distributed. Section 954(c)(1) of the Code provides that Subpart F income includes investment income.

I.R.C. § 514 provides that the term "unrelated business income" includes "unrelated debt-financed income" from investment property. The investment income included is proportionate to the debt on the property.

I.R.C. § 4943(a) imposes a tax on the excess business holdings of any private foundation in a business enterprise during any taxable year in which ends during the taxable period.

I.R.C. § 4943(c)(1) provides that the term "excess business holdings" means, with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the enterprise which the foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

I.R.C. §4943(c)(2) provides that the permitted holdings of any private foundation in an incorporated business enterprise are—

(i) 20 percent of the voting stock, reduced by
(ii) The percentage of the voting stock owned by all disqualified persons.

In any case in which all disqualified persons together do not own more than 20 percent of the voting stock of an incorporated business enterprise, nonvoting stock held by the private foundation shall also be treated as permitted holdings.

I.R.C. § 4943(d)(3)(B) provides that the term "business enterprise" does not include a trade or business at least 95 percent of the gross income of which is derived from passive sources, which includes items excluded by § 512(b)(1), (2), (3), and (5).

Treas. Reg. § 53.4943-10(a)(1) provides that, except as provided in paragraph (b) or (c) of this section under § 4943(d)(4), the term "business enterprise" includes the active conduct of a trade or business, including any activity which is regularly carried on for the production of income from the sale of goods or the performance of services and which constitutes an unrelated trade or business under § 513. For purposes of the preceding sentence, where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from the classification of a business enterprise merely because it does not result in a profit.

Treas. Reg. § 53.4943-10(c)(1) provides that, for purposes of § 4943(d)(4), the term "business enterprise" does not include a trade or business at least 95 percent of the gross income of which is derived from passive sources; except that if in the taxable year in question less than 95 percent of the income of a trade or business is from passive sources, the foundation may, in applying this 95 percent test, substitute for the passive source gross income in such taxable

year the average gross income from passive sources for the 10 taxable years immediately preceding the taxable year in question (or for such shorter period as the entity has been in existence). Thus, stock in a passive holding company is not to be considered a holding in a business enterprise even if the company is controlled by the foundation. Instead, the foundation is treated as owning its proportionate share of any interests in a business enterprise held by such company under § 4943(d)(1).

Treas. Reg. § 53.4943-10(c)(2) provides that gross income from passive sources, for purposes of this paragraph, includes the items excluded by § 512(b)(1) (relating to dividends, interest, and annuities), 512(b)(2) (relating to royalties), 512(b)(3) (relating to rent) and 512(b)(5) (relating to gains or losses from the disposition of certain property). Any income classified as passive under this paragraph does not lose its character merely because § 512(b)(4) or 514 (relating to unrelated debt-financed income) applies to such income.

I.R.C. § 4944(a) imposes a tax if a private foundation invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes.

Treas. Reg. § 53.4944-1(a)(2)(i) provides that, except as provided in §§ 4944(c), § 53.4944-3, § 53.4944-6(a), and subdivision (ii) of this subparagraph, an investment shall be considered to jeopardize the carrying out of the exempt purposes of a private foundation if it is determined that 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. In the exercise of the requisite standard of care and prudence the foundation managers may take into account the expected return (including both income and appreciation of capital), the risks of rising and falling price levels, and the need for diversification within the investment portfolio (for example, with respect to type of security, type of industry, maturity of company, degree of risk and potential for return). The determination whether the investment of a particular amount jeopardizes the carrying out of the exempt purposes of a foundation shall be made on an investment by investment basis, in each case taking into account the foundation's portfolio as a whole. No category of investments shall be treated as a per se violation of § 4944. However, the following are examples of types or methods of investment which will be closely scrutinized to determine whether the foundation managers have met the requisite standard of care and prudence: Trading in securities on margin, trading in commodity futures, investments in working interests in oil and gas wells, the purchase of "puts," "calls," and "straddles," the purchase of warrants, and selling short. The determination whether the investment of any amount jeopardizes the carrying out of a foundation's exempt purposes is to be made as of the time that the foundation makes the investment and not subsequently on the basis of hindsight. Therefore, once it has been ascertained that an investment does not jeopardize the carrying out of a foundation's exempt purposes, the investment shall never be considered to jeopardize the carrying out of such purposes, even though, as a result of such investment, the foundation subsequently realizes a loss. The provisions of § 4944 and the regulations thereunder shall not exempt or relieve any person from compliance with any Federal or State law imposing any obligation, duty, responsibility, or other standard of conduct with respect to the operation or administration of an organization or trust to which § 4944 applies. Nor shall any State law exempt or relieve any person from any obligation,

duty, responsibility, or other standard of conduct provided in § 4944 and the regulations thereunder.

ANALYSIS

1. Unrelated Business Taxable Income

The Subpart F income includable in your income with respect to the Corporation will not be subject to the unrelated business income tax under §§ 512 and 514. Section 511(a)(1) imposes a tax on the unrelated business taxable income (UBTI) of certain exempt organizations. Section 512(b)(1) generally excludes from the calculation of UBTI income from dividends, interest, and annuities. Here, you characterize the income you will receive from the Corporation as "Subpart F income" from a controlled foreign corporation. Subpart F income generally includes "insurance income" defined in § 953. However, you state that none of the income you receive from the Corporation will be attributable to insurance income, which would be included in calculating UBTI under § 512(c)(17). Furthermore, you state that the Corporation will derive at least 95 percent of its income for passive investments within the meaning of § 954(c)(1)(A), which defines "personal holding company income" as the portion of gross income which consists of dividends, interest, royalties, rents, and annuities. Accordingly, income received from the Corporation will be dividend income and therefore will be excluded from the computation of UBTI under § 512(b)(1).

Nonetheless, §§ 512(b)(4) and 514 require, in the case of debt-financed property, the inclusion of an amount proportionate to the debt on the property in the calculation of UBTI. You state that the Corporation will hold investments that, if you owned them directly, would be debt-financed and therefore would generate UBTI. However, you state that you will receive this income indirectly from the Corporation in the form of dividends, which are not taxable under § 512(b)(1). Additionally, you state that you will not borrow funds or otherwise incur debt in financing your investment in the Corporation. Accordingly, the dividends received from the Corporation are not debt-financed income described in § 514.

2. Excess Business Holding

Your ownership of the Corporation's stock does not result in an excess business holding within the meaning § 4943. Section 4943(a) imposes a tax on the excess business holdings of any private foundation in a business enterprise. Section 4943(c)(2)(A) provides that a private foundation may hold 20 percent of the voting stock, reduced by the percentage of voting stock owned by all disqualified persons, of an incorporated business enterprise. Any amount of stock or other interest in the enterprise held in excess of this amount is an excess business holding under § 4943(c)(1).

You hold 100 percent of the Corporation's stock. Accordingly, your holding of the Corporation's stock is an excess benefit holding if the Corporation is a "business enterprise" within the meaning of Treas. Reg. § 53.4943-10(a), which defines "business enterprise" as including the active conduct of a trade or business, including any activity which is regularly carried on for the production of income from the sale of goods or the performance of services and which includes

an unrelated trade or business under § 513. Nonetheless, § 4943(d)(3)(B) provides that the term "business enterprise" does not include a trade or business at least 95 percent of the gross income of which is derived from passive sources, including items excluded by § 512(b)(1) (dividends, interest, and annuities), (2) (royalties), (3) (certain rents), and (5) (gains or losses from the disposition of certain property). Treas. Reg. § 53.4943-10(c)(1) & (2). Accordingly, the Corporation is not a "business enterprise" because you represent that at least 95 percent of the Corporation's gross income will be derived from passive sources within the meaning of § 4943(d)(3)(B). The passive character of the Corporation's investments is not changed even though some of those investments would result in debt-financed income if held by you. Treas. Reg. § 53.4943-10(c)(2). Nonetheless, this ruling does not address whether the Corporation's underlying investments may result in excess business holdings. See Treas. Reg. § 53.4943-10(c)(1) (regarding passive holding companies).

3. Jeopardizing Investment

Your ownership of the Corporation is not a jeopardizing investment under § 4944. Section 4944(a) imposes a tax if a private foundation invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes. An investment is a jeopardizing investment if the foundation managers, in making such investment, failed to exercise ordinary business care and prudence in providing for the long- and short-term financial needs of the foundation to carry out its exempt purposes. Treas. Reg. § 53.4944-1(a)(2)(i). No one category of investments is a per se jeopardizing investment. Id. However, certain investments will be scrutinized more closely, such as trading in securities on margin, trading in commodity futures, investments in working interests in oil and gas wells, the purchase of "puts," "calls," and "straddles," the purchase of warrants, and selling short. Id.

Your foundation managers exercised ordinary business care and prudence in deciding to make your foreign investments through the Corporation. First, you state that your managers determined that your foreign investments can be better managed, result in a more tax-efficient structure, and enhance your ability to fulfill its charitable mission by using the Corporation. Second, you state that you worked closely with your investment advisors in making this determination. Additionally, the Corporation's stock is not one of the scrutinized investments listed in Treas. Reg. § 53.4944-1(a)(2)(i).

CONCLUSION

Based on the foregoing, we rule as follows:

1. The Subpart F income includable in your income with respect to the Corporation will not be subject to the unrelated business income tax under §§ 512 and 514.

2. Your ownership of the Corporation does not result in an excess business holding under § 4943(c).

3. Your ownership of the Corporation is not a jeopardizing investment under § 4944.

This ruling is based on the representation that at least 95 percent of the Corporation's income will be from passive investments. See Treas. Reg. § 53.4943-10(c).

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