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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: FEB 25 2003

Contact Person:

4941.00-00
4941.04-00
4945.00-00
4945.05-00
4946.01-00

Identification Number:

Telephone Number:

Fax Number:

T:EO:B1

Employer Identification Number:

Legend

A =
B =
C =
D =

Dear Sir or Madam:

We have considered your ruling request concerning the effect on your status under section 501(c)(3) of the Internal Revenue Code of a grant you are considering making to A, as well as the application of sections 4941 and 4945 of the Code to this proposed transaction.

You are a private foundation formed exclusively to make cash grants to qualified organizations described in section 501(c)(3) of the Code that provide community services in the areas of health, children and families, and education within thirteen (13) counties in D. You received all your contributions from B.

B is a corporation that provides indemnity type health care insurance coverage to individuals and groups of persons. It also provides managed care types of health coverage through C, its wholly-owned subsidiary. It operates in the same counties as you. B is the dominant health insurer in its service area. In the course of its business B contracts with health care providers to provide medical services to its subscribers.

A is an organization described in section 501(c)(3) of the Code and is classified as other than a private foundation under section under section 509(a)(3) of the Code. A and its affiliates provide acute, rehabilitation, and outpatient medical services through a network that includes a hospital and a variety of adjunctive facilities. As a health care provider, A has various contracts with B and C that basically set out the fee structures and other terms and conditions under which A will provide health care services to their subscribers.

A applied to you for a grant to fund an outpatient program in diabetes management. This will consists of outreach programs to undiagnosed diabetes cases and education and disease management services to persons with a diabetes diagnosis that would typically be referred to the program by a primary care physician. Patients will receive nutrition therapy, disease management education, follow-up care, and some laboratory testing. A had previously operated a similar program but discontinued it due to financial concerns. A believes the need for such a program persists and proposes to reestablish it. However, A believes that the payments from Medicare and other reimbursements will cover only approximately fifty percent (50%) of the costs of providing this service, including depreciation. A's grant request seeks funding from you to cover this shortfall in operating expenses, other than depreciation, over reimbursements for three years. You presume that once established, the diabetes management program should meet the criteria to constitute a covered service under B's and C's subscriber contracts. If so, A would be reimbursed for such services under the typical outpatient terms of the hospital service agreements.

RULINGS REQUESTED

1. That your grant to A will not jeopardize your status as an organization exempt from federal income tax under section 501(c)(3) of the Code.

2. That your grant will not result in any act of self-dealing under section 4941 of the Code. In particular, that the grant will not constitute an act of self-dealing with respect to the fact that you, as a disqualified person, and your affiliates may benefit from lowered health care claims costs from subscribers who receive services under A's diabetes program.

3. That your grant will not constitute a taxable expenditure under section 4945 of the Code.

LAW

Section 501(a) of the Internal Revenue Code exempts from taxation organizations described in subsection (c)(3), which includes corporations organized and operated exclusively for charitable, scientific, and educational purposes. Furthermore, the aforementioned subsection requires that no part of the organization's net earnings inure to the benefit of any private shareholder or individual, that no substantial part of its activities is to influence legislation, and that it does not participate in any political campaign on behalf of or in opposition to any candidate for public office.

Section 1.501 (c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages

primarily in activities that accomplish one or more of such purposes described in section 501(c)(3) of the Code, but will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 509(a) of the Code provides that, unless specifically excepted, a domestic or foreign organization described in section 501(c)(3) is a private foundation and subject to the excise taxes of Chapter 42.

Section 4941(a)(1) of the Code imposes a tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d) of the Code defines the term self-dealing as any direct or indirect--

(A) sale or exchange, or leasing, of property between a private foundation and a disqualified person;

(B) lending of money or other extension of credit between a private foundation and a disqualified person;

(C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;

(D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;

(E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation; and

(F) agreement by a private foundation to make any payment of money or other property to a government official (as defined in section 4946(c)), other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating his government service within a 90-day period.

Section 4941(a) of the Code imposes an excise tax on each act of self-dealing between a private foundation and a disqualified person.

Section 4941(d)(1)(E) of the Code defines the term 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.

Section 53.4941(d)-2(f)(2) of the Foundation and Similar Excise Taxes Regulations provides that the fact that a disqualified person receives an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing.

In Example (1) of section 53.5941(d)-2(f)(4) of the regulations, M, a private foundation, makes a grant of $50,000 to the governing body of N City for the purpose of alleviating the slum conditions that exist in a particular neighborhood of N. Corporation P, a substantial contributor to M, is located in the same area in which the grant is to be used. Although the general improvement of the area may constitute an incidental and tenuous benefit to P, such benefit by itself will not constitute an act of self-dealing.

Section 4945(a) of the Code imposes an excise tax upon a private foundation's making any taxable expenditure.

Section 4945(d)(5) of the Code provides that the term taxable expenditure means any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B), which defines charitable contributions.

Section 53.4945-6(a) of the regulations provides that ordinarily only an expenditure for an activity which, if it were a substantial part of an organization's total activities, would cause loss of tax exemption is a taxable expenditure.

Section 4946(a)(1)(A) of the Code defines a disqualified person with respect to a private foundation to include a substantial contributor to the foundation as defined in section 507(d)(2).

Section 4946(a)(1)(E) of the Code provides that a corporation in which more than 35% of the voting power is owned by a disqualified person is also a disqualified person

Section 507(d)(2) of the Code defines substantial contributor as any person who contributed an aggregate amount of more than $5,000 to a private foundation, if such amount is more than 2 percent of the total contributions received by the foundation before the close of the taxable year of the foundation in which the contribution is received by the foundation from such person.

Rev. Rul. 67-5, 1967-1 CB 123, holds that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities that were beneficial to them, but detrimental to the foundation. This resulted in the foundation's ownership of common stock that paid no dividends of a corporation controlled by the foundation's creator and his family, which prevented it from carrying on a charitable program commensurate in scope with its financial resources. This ruling concluded that the foundation was operated for a substantial non-exempt purpose and served the private interest of the creator and therefore, was not entitled to exemption under section 501(c)(3) of the Code.

Rev. Rul. 77-160, 1977-1 CB 351, holds that the payment of church dues by a private foundation on behalf of a disqualified person, although they might constitute a charitable contribution if paid by the disqualified person directly, constitutes an act of self-dealing because the foundation's payment results in a direct economic benefit to the disqualified person who would have been expected to pay the dues had they not been paid by the foundation.

Rev. Rul. 80-310, 1980-2 CB 319, holds that the grants of a private foundation to an educational institution for engineering instruction will not be an act of self- dealing for a corporation that is a disqualified person and that intends to hire graduates of the engineering program and encourage its employees to participate in the program. The ruling states that because the corporation will compete on an equal basis for program graduates and admission of its own employees to the program, the corporation will receive only an incidental or tenuous benefit under section 53.4941(d)-2(f) of the regulations.

Rev. Rul. 85-162, 1985-2 C.B. 275, holds that there is no act of self-dealing if a private foundation, whose disqualified person is a bank, makes loans to publicly supported organizations for the charitable purpose of construction projects in disadvantaged areas where the contractors doing the construction may be ordinary customers of the bank. Any benefit to the bank from the fact that the loan proceeds are paid by the public charities to the contractors who are ordinary customers of the bank is incidental or tenuous under section 53.5941(d)-(f)(2) of the regulations.

ANALYSIS

B, as the only contributor, is a substantial contributor to the Foundation. Therefore, B and C the HMO are disqualified persons with respect to the Foundation under section 4946(a)(1) of the Code. Because they are disqualified persons, section 4941 of the Code would in general impose an excise tax on self-dealing for any direct or indirect transfer, such as a grant to a third party, of your assets for the benefit of B and the C. Grant expenditures by you that benefit B will also be subject to excise tax under section 4945 of the Code as taxable expenditures if they are for a non-charitable purpose under section 4945(d)(5) of the Code. If the your assets are used to benefit B and its affiliates, your tax exemption could also be called into question as it was in Rev. Rul. 67-5, supra

B and C are in the business of underwriting health care coverage and otherwise serving as the financial intermediary between persons requiring health care and health care providers such as A. In the ordinary course of business, persons subscribing to health care insurance coverage from B and C will regularly seek health care services from A. Given A's leading market position in the D, any program that has a positive outcome in terms of the population's health and related care costs is going to inure to B's benefit by reducing health care claims costs. Beyond that, it is expectable that B and C's subscribers will directly participate in and benefit from A's diabetes management program, their charges for such participation may be covered in whole or part by B and C, and that the overall level of claims costs related to these subscribers will be reduced if the program is successful.

However, not every benefit realized by a disqualified person from the actions of a private foundation is subject to excise tax or potentially disqualifying to the foundation as a tax-exempt organization. The purpose of the your grant to A will be to fund health care that may not

otherwise be available or affordable to the population that needs it. This is a charitable activity that is of general interest to the community and consistent with your charitable purpose. The grant is not conditioned on or limited to the provision of care by A to B's and C's subscribers. The subscribers will not receive preferential access or treatment under the WV program.

Under section 53.4941(d)-2(f)(2) of the regulations, self-dealing does not include an incidental or tenuous benefit to a disqualified person from the indirect use of a private foundation's assets. In the present case, as with the educational program in Rev. Rul. 80-310, supra, B and its affiliates will only benefit in an incidental manner, and without preferential treatment, from the availability of the diabetes management service to the general public. As in Example 1 of section 53.4941(d)(2)-2(f)(4) of the regulations and Rev. Rul. 85-162, supra, B and its affiliates will not be held to engage in self-dealing because a charitable effort of broad public interest may incidentally benefit them by improving the environment in which they operate.

RULINGS

Therefore, we rule as follows:

1. The grant by you to A will not jeopardize your status as an organization that is exempt under section 501(c)(3) of the Code because the benefits accruing to private interests are only incidental to the charitable purpose of the grant.

2. Your grant will not result in any act of self-dealing under section 4941 of the Code. In particular, the grant will not constitute an act of self-dealing with respect to the fact that you, as a disqualified person, and your affiliates may benefit from lowered health care claims costs from subscribers who receive services under A's diabetes program.

3. The grant will not be a taxable expenditure under section 4945 of the Code .

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 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 yours,

(signed) Marvin Friedlander

Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1