

Private foundation; self-dealing; office space rented to disqualified persons. An exempt private foundation conducts agricultural economics research and experimentation in part of an office building it owns and rents the remaining spaces to disqualified persons who are engaged in agricultural business activities. The foundation does not utilize these businesses in its research. The rental of the office space is not functionally related to the foundation's exempt purpose and constitutes an act of self-dealing under section 4941(d)(1)(C) of the Code.

ISSUE

Does the rental of office space by a private foundation to disqualified persons engaged in business activities in the same general subject area as the foundation's research, under the circumstances described below, constitute self-dealing under section 4941(d)(1)(C) of the Internal Revenue Code?

FACTS

The foundation, which was formed in 1974, is exempt from federal income tax under section 501(c)(3) of the Code, and is a private foundation under section 509(a). Its primary activity is agricultural economics research and experimentation.

The foundation owns a small office building in which it occupies approximately half the available space. It rents the remaining half to several persons who are disqualified persons within the meaning of section 4946(a)(1) of the Code. The disqualified persons are business corporations engaged in agricultural activities. The foundation does not utilize these agricultural businesses in its research.

LAW

Section 4941(d)(1)(C) of the Code provides that the term 'self-dealing' means any direct or indirect furnishing of goods, services, or facilities between a private foundation and a disqualified person.

Section 4941(d)(2)(D) of the Code provides that the furnishing of goods, services, or facilities by a private foundation to a disqualified person is not an act of self-dealing if made on a basis no more favorable than that on which such goods, services, or facilities are made available to the general public.

Section 53.4941(d)-3(b)(1) of the Foundation Excise Tax Regulations provides that section 4941(d)(2)(D) of the Code does not apply in the case of goods, services, or facilities furnished later than May 16, 1973, unless such goods, services, or facilities are functionally related, within the meaning of section

4942(j)(5), to the exercise or performance by a private foundation of its charitable, educational, or other purposes or function constituting the basis for its exemption under section 501(c)(3).

Section 4942(j)(5) of the Code provides that the term 'functionally related business' means a trade or business which is not an unrelated trade or business, or an activity which is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which is related (aside from the need of the organization for income or funds or the use it makes of the profit derived) to the exempt purposes of the organization.

ANALYSIS

Generally, the renting of office space by a foundation to a disqualified person is an act of self-dealing. An exception to this rule is provided where rental of office space is functionally related to a foundation's exempt purpose. In this case, although the disqualified persons conduct business activities in the same general subject area of the foundation's research, the rental of office space to the disqualified persons does not contribute importantly to the foundation's exempt purpose of conducting agricultural research and experimentation. Therefore, the rental of office space to the disqualified persons is not functionally related to the organization's exempt purpose. Since the rental of office space is not functionally related to the foundation's exempt purpose, within the meaning of section 4942(j)(5) of the Code, the exception to the self-dealing rules provided in section 4941(d)(2)(D) does not apply.

HOLDING

The rental of office space by a private foundation to disqualified persons engaged in business activities in the same general subject area as the foundation's research constitutes, under the circumstances described above, self-dealing under section 4941(d)(1)(C) of the Code.