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MEMORANDUM LESS-THAN-ARMS-LENGTH TRANSACTIONS

TO: 2016- 2017 CACFP INSTITUTIONS
FROM: HEALTH AND NUTRITION UNIT
SUBJECT: LESS-THAN-ARMS-LENGTH TRANSACTIONS
DATE: JULY 5, 2016

This Memorandum provides information regarding less-than-arms-length transactions and includes the definition of less-than-arms-length transactions, disclosure and supporting documentation requirements for less-than-arms-length transactions, and treatment of costs associated with less-than-arms-length transactions.

All less-than-arms-length transactions must be disclosed to DHS. Rental costs under less-than-arms-length transactions for real property (facilities), equipment, vehicles, or durable supplies requires specific prior written approval of DHS and the FNS Regional Office. In order to determine if the cost related to a less-than-arms-length transaction is allowable, DHS requires supporting documentation including but not limited to the following: (1) copy of the lease agreement, (2) source documents related to the cost of ownership including tax returns, property tax records, insurance information, depreciation schedules, and maintenance costs. Additional information may be requested to verify the cost of ownership. DHS requires this information in order to assess whether the cost is reasonable and allowable. If supporting documentation is not provided, the cost will be disallowed as an unallowable expense. This means that child nutrition funds may not be used for payment of the unallowable expense.

The failure of the institution to identify and disclose to DHS related party transactions, less-than-arms-length transactions, ownership interests in equipment, supplies, vehicles and facilities inhibits DHS's ability to make an informed assessment regarding the allowability of a particular cost which will result in the disallowance of the cost and may subject the institution, its principals, employees, consultants or others to the administrative and legal remedies available to the State agency and FNS.

DEFINITIONS

A **Less-than-arms-length transaction** is one under which one party to the transaction is able to control or substantially influence the actions of the other(s). Such transactions include, but are not limited to, those between (i) divisions of an institution; (ii) institutions under common control through common officers, directors or members; and (iii) an institution and a director, trustee, officer, key employee of the

institution or such a person's immediate family, either directly or through corporations, trusts or similar arrangements in which a controlling interest is held. For example, the institution may establish a separate corporation for the sole purpose of owning property and leasing it back to the institution. Such transactions may also be referred to as related party transactions.

Family members include one party with any of the following relationships to another party: (i) Spouse, and parents thereof; (ii) children, and spouses thereof; (iii) parents, and spouses thereof; (iv) siblings, and spouses thereof; (v) Grandparents and grandchildren, and spouses thereof; (vi) Domestic partner and parents thereof, including domestic partners of any individual in (ii) through (v) of this definition; and (vii) any individual related by blood or affinity whose close association with the employee is equivalent of a family relationship.

Related party transaction is a transaction between the institution and its parent corporation, corporate divisions, subsidiaries, an employee(s), officer(s), agent(s) of the institution or members of their immediate family either directly or indirectly through corporations, trusts or similar arrangements in which they hold a controlling interest, no matter how represented. All related party transactions are less-than-arms-length transactions. See also **Less-than-arms-length transaction**.

Arms-length bargaining means that buyers and sellers act independently from each other when negotiating a price, and they have no relationship to each other that might result in a price that does not reflect the actual fair market value of the good or service.

ALLOWABLE COSTS FOR LESS-THAN-ARMS-LENGTH TRANSACTIONS

Rental costs under all less-than-arms-length transactions are allowable only up to the amount that would be allowed if the institution owned the property. This amount includes expenses such as depreciation, maintenance, taxes, and insurance. All less-than-arms-length transactions by institutions require specific prior written approval and must be supported by source documentation supporting the individual or entity's ownership costs. (See 2 CFR §200.465 Rental Costs of Real Property and Equipment.)

Furthermore, the rental of any property owned by any individuals or entities affiliated with the non-Federal entity, to include commercial or residential real estate, for purposes such as the home office workspace are unallowable. (See 2 CFR §200.465 Rental Costs of Real Property and Equipment.)

Uniform Guidance (2 CFR Part 200) – specific sections

2 CFR §200.112 Conflicts of Interest states in part that institutions are required to disclose in writing any potential conflicts of interest (in accordance with applicable policies) to the Federal awarding agency or pass-through entity.

2 CFR §200.404 Reasonable Costs states in part that in determining reasonableness of a given cost, consideration must be given to the restraints or requirements imposed by such factor as: sound business

practices; arm's length bargaining; Federal, state and other laws and regulations; and terms and conditions of the federal award.

2 CFR §200.465 Rental costs of Real Property and Equipment states that Rental costs under "sale and lease back" arrangements are allowable only up to the amount that would be allowed had the non-Federal entity continued to own the property. This amount would include expenses such as depreciation, maintenance, taxes, and insurance.

2 CFR §200.465 also states that Rental costs under "less-than-arm's-length" leases are allowable only up to the amount for a sale and lease back arrangement. For this purpose, a less-than-arm's-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to those between:

- (1) Divisions of the non-Federal entity;
- (2) The non-Federal entity under common control through common officers, directors, or members; and
- (3) The non-Federal entity and a director, trustee, officer, or key employee of the non-Federal entity or an immediate family member, either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest. For example, the non-Federal entity may establish a separate corporation for the sole purpose of owning property and leasing it back to the non-Federal entity.
- (4) Family members include one party with any of the following relationships to another party:
 - (i) Spouse, and parents thereof;
 - (ii) Children, and spouses thereof;
 - (iii) Parents, and spouses thereof;
 - (iv) Siblings, and spouses thereof;
 - (v) Grandparents and grandchildren, and spouses thereof;
 - (vi) Domestic partner and parents thereof, including domestic partners of any individual in (i) through (v) of this definition; and
 - (vii) Any individual related by blood or affinity whose close association with the employee is the equivalent of a family relationship.
- (5) Rental costs under leases which are required to be treated as capital leases under GAAP are allowable only up to the amount (as explained in paragraph on "sale and lease back" arrangements) that would be allowed had the non-Federal entity purchased the property on the date the lease agreement was executed. The provisions of GAAP must be used to determine whether a lease is a capital lease. Interest costs related to capital leases are allowable to the extent they meet the criteria in § 200.449 Interest. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the non-Federal entity purchased the property.
- (6) The rental of any property owned by any individuals or entities affiliated with the non-Federal entity, to include commercial or residential real estate, for purposes such as the home office workspace is unallowable.

Information on less than arm's length transactions may also be found in the FNS Instruction 796-2, Rev. 4, Financial Management – Child and Adult Care Food Program.