SIN: 4941.00-00

200050047

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

Date: SEP 20 2000

Contact Person:

ID Number:

Telephone Number:

T:EO:4

LEDGEND:
"A" -
"B" -
"C" -
"D" -
"E" -
"F" -
"G"-
"x" -
"y" -
"z" -

Dear Sir or Madam:

This is in response to your request for rulings on whether management of "A" and "B's" assets by "D" would constitute an act of self dealing under section 4941 of the Internal Revenue Code. "A" and "B" are exempt from federal income tax under section 501(c)(3) of the Code and have been classified as private foundations within the meaning of section 509(a). This letter modifies our letter of September 20, 2000.

"C" was organized as a "x" and has two wholly owned subsidiaries. In connection with the conversion from mutual to stock form of organization, "E" was organized as a "y." "E" owns all of "C's" outstanding stock. "D" is the trust department of "C."

"C" formed "B" in 1995 and funded it with a contribution. "C" has made subsequent contributions. "B" is governed by a Board of Directors, which consists of directors, officers, and employees of "C." "B's" Board establishes the policies with respect to grants and donations consistent with the purposes for which "B" was established. Pursuant to the bylaws, only current or former officers and directors of "E" or its affiliates or subsidiaries, but not limited to "C" may comprise the Board of "B." "B" also employees three individuals who are also employees of "A."

"A" was formed in connection with the mutual to stock conversion of "C." "A" was funded at that time with shares of common stock of "E." "A" continues to hold shares of common stock that was contributed to it upon its formation. None of the other investments or financial products of "A" are related to "C" or its subsidiary organizations. "A's" cash management account is held by a nonaffiliated third party.

In connection with the conversion, "E" funded "A" with shares of "E's" common stock. "A's" Board establishes policies with respect to grants or donations consistent with the purposes for which

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it was established. The Directors are responsible for directing the activities including the management of the common stock held by "A." Pursuant to the bylaws, only current and former officers and directors of "E" or its affiliates or subsidiaries, including but not limited to "C" may comprise the Board of Directors. "A" currently has three employees who are also employees of "B."

"C" established "D" as a department within "C" to provide trust and investment services to individuals, trusts, fiduciary accounts and institutional investors. "D" proposed to provide custody and management services for the assets of "A" and "B," including: (i) safekeeping the securities; (ii) selling securities, including the common stock, when appropriate, to obtain working capital and funds with which to make donations; and (iii) investing any income received through the distributions of dividends by "E," dividends or interest earning on investments of "A" and/or "B" or through the sale of securities. As of December 1999, "D" manages "z" accounts. Of the "z" accounts, four of the accounts are related to "C" and its subsidiary organization. The accounts include: "F"- invested in U.S. Treasuries; "G" - required by government regulation; "A" - consists solely of cash and securities and is a custody account; and "B" - a custodial account. "D" does not make investments on behalf of "A."

You represent that the fees charged in connection with the services will be in accordance with the published rates charged by "D" with respect to its other clients and will be reasonable for the services rendered. Such fees will be in accordance with industry practice and will be permissible under the applicable local laws governing fiduciary activities. A standard courtesy discount of 10 percent is offered to all not-for-profit organizations and is being extended to "A" and "B."

"A" and "B" propose to use "D" in lieu of the trust department of a third party because (i) using a related party will add administrative convenience thus saving them time and money, allowing them to focus their efforts on reviewing grant applications and making donations; and (ii) this will ensure compliance with the "E" common stock restriction requiring all shares of "E" common stock be voted in the same ratio on each and every proposal considered by "E" stockholders.

"B" stated that its Finance Committee of the Board of Directors dictates its investments based on its investment policy. Investments are selected in consultation with the "C's" Finance Department. "D" follows the instructions provided to it by the Finance Committee and executes the investments. "D" invests the assets, using mutual funds or individual securities, in high-quality, fixed income investments and/or equities. None of "B's" investments or financial products are related to "C" or its subsidiary organizations. "B" case management account is held by a nonaffiliated third party.

None of "A" or "B's" investments will represent more than 10 percent of any single investment vehicle.

Section 501(c)(3) of the Code provides, in part, for exemption from federal income tax for a corporation organized and operated exclusively for charitable, scientific or educational purposes provided no part of the corporation's net earnings inure to the benefit of any private shareholder or individual.

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

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Section 4941(d)(1) of the Code provides, in part, that the term "self-dealing" means any direct or indirect - -

A. furnishing of goods, services or facilities between a private foundation and a disqualified person;

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

C. transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4941(d)(2)(E) of the Code provides that the payment of compensation by a private foundation to a disqualified person for personal services which are reasonable and necessary to carry out the exempt purpose of the foundation shall not be an act of self-dealing if the compensation is not excessive.

Section 53.4941(d)-1(a) of the Foundation and Similar Excise Taxes Regulations provides that for purposes of section 4941, the term "self-dealing" means any direct or indirect transaction described in section 53.4941(d)(2). For purposes of this section it is immaterial whether the transaction results in a benefit or detriment to the private foundation.

Section 53.4941(d)-2(c)(4) of the regulations provides that the performance by a bank or trust company, which is a disqualified person, of trust functions and certain general banking services for a private foundation is not an act of self-dealing, where the banking services are reasonable and necessary to carrying out the exempt purposes of the private foundation, if the compensation paid to the bank or trust company, taking into account the fair interest rate for the use of the funds by the bank or trust company, for such services is not excessive. The general banking services allowed by this subparagraph are: checking accounts, as long as the bank does not charge interest on any withdrawals; (2) savings accounts, as long as the foundation may withdraw its funds on no more than 30-days notice without subjecting itself to a loss of interest on its money for the time during which the money was on deposit; and (3) safekeeping activities.

Section 53.4941(d)-2(f)(2) of the regulations provides, in part, 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.

Section 53.4941(d)-3(c)(1) of the regulations provides that the payment of compensation (and the payment or reimbursement of expenses, including reasonable advances for expenses anticipated in the immediate future) by a private foundation to a disqualified person for the performance of personal services which are reasonable and necessary to carry out the exempt purposes of the private foundation shall not be an act f self-dealing if such compensation (or repayment or reimbursement) is not excessive. For purposes of this subparagraph the term "personal services" include the services of a broker serving as agent for the private foundation, but not the services of a dealer who buys from the private foundation as principal and resells to the third party.

Example 2 of section 53.4941(d)-3(c)(2) of the regulations provides:

> C, a manager of private foundation X (and hence a disqualified person with respect to X), owns an investment counseling business. Acting in his capacity as an investment counselor, C manages X's investment

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portfolio for which he receives an amount which is determined not to be excessive. The payment of compensation to C shall not constitute an act of self-dealing.

Section 4946(a)(1) of the Code defines the term "disqualified person" to mean, in relevant part, a person who is a substantial contributor to the foundation, a foundation manager, an owner of more than 20 percent of an entity which is a substantial contributor of the foundation, a member of the family of an individual previously

described, or an entity in which persons previously described own more than 35 percent.

Section 4946(b) of the Code defines a foundation manager as an officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation), and with respect to any act (or failure to act), the employees of the foundation having authority or responsibility with respect to such act (or failure to act).

Section 7701(a)(1) of the Code defines the term "person" as including an individual, a trust, estate, partnership.

Rev. Rul. 74-287, 1974-1 C.B. 327, provides that the employees of a bank designated as the trustees of a private foundation who have been delegated the responsibility for the day-to-day administration and distribution of the trust funds, are foundation managers within the meaning of section 4946(b)(1) of the Code and are disqualified persons as defined in section 4946(a)(1)(B) even though they are ultimately responsible to the bank directors and officers for their actions with respect to the trust.

Generally, an act of self-dealing may be present where the assets of a private foundation are transferred to or used by or for a disqualified person. It is not pertinent whether the transaction is beneficial or detrimental to the private foundation.

However, a private foundation may pay reasonable compensation to a disqualified person for personal services pursuant to section 4941(d)(2)(E) of the Code. An exception is provided where a bank only performs trust functions and certain limited general banking services. The services must be reasonable and necessary to carry out the exempt purposes of the private foundations. The compensation must not be unreasonable. The Service has consistently strictly interpreted the term general banking services to include only checking accounts, saving accounts, and safekeeping activities. Trust functions historically include investment functions. Another exception to the rules prohibiting self-dealing is where the disqualified person only receives an incidental or tenuous benefit from the use by the foundation of its assets.

The information submitted established that "A" and "B" were created by "C." "E" owns all of "C's" outstanding stock. "B" is governed by a Board of Directors, which consists of directors, officers, and employees of "C." "E" funded "A" with shares of "E's" common stock. "C" funded "B." "C," "D," and "E," as well as the officers and directors who are their employees are disqualified persons as to "A" and "B." Their relationship is similar to the one described in Rev. Rul. 74-287, supra. Thus payment of compensation by "A" and "B" would be considered self-dealing under section 4941(a) of the Code unless the compensation meets an exception.

Based upon the information submitted, the management and investing of "A" and "B's" funds by "C" is similar to trust and certain general banking services. Investment activity is a permissible use of foundation assets entered into for the purpose of obtaining funds to be used to further

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exempt purposes. Such services are excluded from the definition of self-dealing by reason of the provision of sections 53.4941(d)-2(c)(4) and 53/4941(d)(3)(C) of the regulations.

"D" follows the instructions provided to it by the Finance Committee and executes the investments. "D" invests the assets, using mutual funds or individual securities. The services provided by "D," which is a department of "C," will also fall within the term "trust functions" as used in section 53.4941(d)-2(c)(4) of the regulations and within Example 2 of section 53.4941(d)-3(c) of the regulations. "A" and "B" represent that the amount of compensation paid to "D" is reasonable and will be similar to those charged to other clients. They will be given a standard 10 percent discount given to not-for-profit organizations. Based on these representations, we conclude that the services provided by "D" are reasonable and necessary to obtain funds to carry out the exempt purposes of "A" and "B."

Based on the foregoing, we rule that:

The payment of fees by "A" and "B" to "D" for the services described above will not constitute an act of self-dealing under section 4941 of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

This ruling is directed only to "A," "B," "C," and "D." Section 6110(k)(3) of the Code states that it may not be used or cited as precedent. This ruling does not purport to rule under any other section of the Code.

A copy of this ruling is being sent to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service office. Please notify the Customer Service office if there is any change in your name, address, purposes or method of operation. The mailing address is: Internal Revenue Service, TE/GE Customer Service, P. O. Box 2508, Cincinnati, OH 45201. If you have any questions about filing requirements, excise, employment, or other federal taxes, please contact the Ohio TE/GE Customer Service office at 877-829-5500 (a toll free number).

Because this letter could help resolve questions you should keep this copy in your permanent records.

Sincerely yours,

Gerald V. Sack

Gerald V. Sack
Chief, Exempt Organizations
Rulings Branch 4

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