



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

Foundation =  
Bank =  
Public Charity =  
A =  
B =  
C =  
D =  
x date =  
y =

Dear \_\_\_\_\_ :

We have considered your ruling request dated November 9, 2004, regarding whether the engagement of Bank to perform investment management services for compensation that is not excessive constitutes an exception to self dealing as defined in section 4941(d) of the Internal Revenue Code of 1986, as amended.

FACTS

Foundation is a tax-exempt organization and private foundation as described in section 501(c)(3) and section 509(a) respectively of the Code. Foundation proposes to engage Bank to perform investment management services for compensation that is not excessive.

Foundation was founded by industrialist and philanthropist, A, in . The Board of Directors and officers are members of A's family. Foundation was established to assist organizations in the communities where A's company had manufacturing plants, to aid in the development of those communities.

A acquired 100% of the outstanding shares of Bank in . Bank had no trust department at the time of acquisition. A subsequently formed a bank holding company, B ( "Holding Company"), into which the Bank was merged, thereby becoming a wholly owned subsidiary of Holding Company. A directly owns 100% of the outstanding shares of the Holding Company and, by virtue of its status as a wholly owned subsidiary of the Holding Company, A indirectly owns 100% of the Bank's outstanding shares. The Bank and Holding Company are governed by the Federal Reserve, the Federal Deposit Insurance Corporation, and the D.

The company which A founded was sold. A instituted procedures to establish a trust department at Bank to manage his and his family's "new-found" assets. Trust powers for the Bank were approved on x date. The Trust Department currently has four employees, none of whom is related to the C family. The Trust Committee of the Board of Directors consists of five individuals, four of whom are unrelated to the C. The fifth member is A, who serves as Vice Chair. The Trust Department currently has approximately y in assets under management, consisting of some 23 accounts, all of which came from members of the C family or entities formed by A and/or members of his family.

The Board of Directors of the Bank consists of six unrelated individuals, one distant relative of A, and A who serves as chairman. None of the officers of the Bank is related to any member of the C family. The Holding Company Board consists of seven individuals, of whom four are members of the C family, including A, who serves as chairman. A is also President of the Holding Company, but the other officers are unrelated to the C family.

A has also established a Code Section 501(c)(3) community foundation operating as a public charity (Public Charity). All of Public Charity's assets, all funded by the Foundation, are currently managed by the Bank's Trust Department and are included in the \$y total assets being managed. None of the Foundation's funds, however, are currently in the Bank.

While the Bank anticipates it will have customers other than the C family as time goes on, one of its basic objectives for going into the trust business was to have a place where the assets of the entire C family could be managed efficiently in one central location. For that reason, the C Family would like for the assets of the Foundation--the private foundation--also to be managed by the Bank's Trust Department. The Trust Department can also assist both the Foundation and the Public Charity in the fulfillment of charitable purposes, and pass on the economies of scales to both entities.

The Trust Department of the Bank will participate with Foundation's directors in the determination of the allocation of assets for maximum investment performance in accordance with the rules governing private foundations on required charitable distributions and in accordance with the mission of the Foundation. In this connection, it may recommend buying and selling certain publicly-traced mutual funds, bond funds, or individual stocks and bonds. In

addition, the Bank's Trust Department will monitor investment performance and render reports to Foundation's management and directors. From time to time, money might be placed with an outside manager, in which case the Trust Department would perform due diligence on the manager and monitor performance. In all investment activity, the Trust Department will act in accordance with the prudent man investment rules and the regulatory rules applicable to bank trust departments.

The Foundation represents that it is familiar with fees charged by money managers and financial consultants and that the Bank's schedule is more than competitive. Other charges, if any, would be minimal. The Bank will survey other institutions at least annually to determine its fees are totally competitive.

#### RULING REQUESTED

The Foundation requests a ruling that the engagement of the Bank by the Foundation, a private foundation, to perform investment management services for compensation that is not excessive constitutes an exception to self-dealing as defined in Section 4941(d)(2)(E) of the Code.

#### LAW

Section 4941 of the Internal Revenue Code imposes an excise tax on any direct or indirect act of self-dealing between a private foundation and a disqualified person with respect to the foundation. The tax is imposed on the disqualified person and, in certain situations, a tax is also imposed on the foundation manager or managers participating in the self-dealing act or acts.

Section 4941(d)(1) of the Code provides, in part, that the term self-dealing includes a direct or indirect: (A) sale or exchange, or leasing, of property 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; or (E) 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) of the Code enumerates certain exceptions to the foregoing rules. As one exception, section 4941(d)(2)(E) provides that, except in the case of a government official as defined in section 4946(c), the payment of compensation (and the payment or reimbursement of expenses) by a private foundation to a disqualified person for personal services which are reasonable and necessary to carrying out the exempt purpose of the private foundation shall not be an act of self-dealing if the compensation (or payment or reimbursement) is not excessive.

Section 53.4991(d)-2(c)(4) of the Foundation and Similar Excise Tax 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 is not excessive. The general banking services allowed by this subparagraph are: (1) checking accounts so long as

the bank does not change interest on 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)-3(c)(1) of the regulations provides that the payment of compensation (and the payment or reimbursement of expenses) 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 self-dealing if such compensation (or payment or reimbursement) is not excessive. For purposes of this subparagraph the term "personal services" includes the services of a broker serving as agent for the private foundation, but not the services of a dealer who buys for the private foundation as principal and resells to third parties. For the determination whether compensation is excessive, see section 1.167-7 of the regulations. Section 1.162-7 of the regulations provides that the determination of whether compensation is reasonable and not excessive is made looking at prevailing industry standards, that is, whether the compensation or fees are similar in amount to those paid for comparable services by like enterprises under similar circumstances.

Section 53.4941(d)-3(c)(2) of the regulations, Example (2), states that C, a manager of a private foundation X (and hence a disqualified person with respect to X), owns an investment counseling business. Acting in his capacity as an investor counselor, C manages X's investment portfolio for which he receives an amount which is determined not to be excessive. The payment of such compensation to C shall not constitute an act of self-dealing.

Section 4946(a)(1)(B) of the Code defines the term "disqualified person" to include, among others, a foundation manager.

Section 4946(b)(1) 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).

## ANALYSIS

The term disqualified person is defined in section 4946 of the Code. Based on this definition, Bank is a disqualified person with respect to the Foundation.

However, even though Bank is a disqualified person, Bank's provision of certain investment management services will not involve an act of self-dealing by virtue of the self-dealing exception set forth in section 4941(d)(2)(E), *supra*. The provision of investment management services described above by the Bank involves "trust functions" and "general banking services" performed for reasonable compensation to carry out Foundation's exempt purpose as permitted by sections 53.4941(d)-2(c)(4) and 53.4941(d)-3(c)(1) and (2) of the regulations.

The performance by a bank or trust company that is a disqualified person of trust functions and certain general banking services for a private foundation is not self-dealing if the trust functions and banking services are reasonable and necessary to the foundation's exempt purpose, and the compensation, taking into account the fair interest rate for the use of funds by the bank or

trust company, is not excessive. Section 53.4941(d)-2(c)(4) of the regulations.

Section 53.4941(d)-3(c)(1) of the regulations provides an exception from self-dealing for payment of reasonable compensation for personal services rendered by a disqualified person in carrying out the exempt purpose of a private foundation. This provision is related to the trust functions/ banking services exception in section 53.4941(d)-2(c)(4), *supra*. In fact, banking services are referenced and described as personal services in section 53.4941(d)-3(c)(1) of the regulations and in Example (3) of section 53.4941(d)-3(c)(2) section of the regulations.

#### RULING

We rule that the engagement of the Bank by the Foundation, a private foundation, to perform investment management services for compensation that is not excessive constitutes an exception to self-dealing as defined in Section 4941(d)(2)(E) 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. Any changes that may have a bearing on your tax status should be reported to the Service. 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.

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 Internal Revenue Code provides that it may not be used or cited by others as precedent.

Because this letter could help to resolve future questions about your federal tax responsibility, please keep a copy of this ruling 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.

Sincerely,

Mary Jo Salins  
Acting Manager, Exempt Organizations  
Technical Group 2

Enclosure  
Notice 437