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Department of the Treasury  
Washington, DC 20224

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CC:EEE:EOET:EO3  
PLR-119677-18

Date:  
March 13, 2019

Founder =  
Foundation =  
A =  
B =

Dear :

This is in response to your request for rulings dated June 19, 2018, as supplemented by information submitted in letters dated October 15, 2018 and January 29, 2019. The request involves rulings under §§ 4941, 4942, and 4945<sup>1</sup> with respect to the payment of compensation for services provided by a disqualified person to a private foundation, as more fully set forth below.

### FACTS

Foundation is a nonprofit corporation organized to conduct activities that are exclusively religious, charitable, scientific, literary, or educational under §§ 170(c)(2)(B) and 501(c)(3), including, but not limited to, making contributions and grants to organizations recognized as tax exempt under § 501(a) as organizations described in § 501(c)(3). Foundation is recognized as an

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<sup>1</sup> Sections 4941, 4942, and 4945 of the Internal Revenue Code of 1986, as amended, to which all subsequent "section" or "§" references are made unless otherwise indicated.

organization described in § 501(c)(3) and is classified under § 509 as a private foundation. Foundation engages primarily in both grant-making and providing consulting services to other charitable entities. Founder created Foundation and is its primary donor. Founder also is a “substantial contributor,” as defined in § 507(d)(2), to Foundation.

Foundation is governed by a board of directors consisting of individuals, of whom are “independent”—i.e., disqualified persons, as defined in § 4946(a), only because they are foundation managers described in § 4946(a)(1)(B) and (b).

Founder has donated services, through Founder’s wholly-owned disregarded entities, A and B, to Foundation to enable Foundation to carry out its activities.

The personnel providing services directly to Foundation are employees of A, which is wholly owned by Founder and is disregarded as an entity separate from its owner within the meaning of Treas. Reg. § 301.7701-3. Currently, A provides various services described below to Foundation free of charge.

Founder also is the sole owner of B, which is disregarded as an entity separate from its owner within the meaning of Treas. Reg. § 301.7701-3. B’s employees provide certain investment advisory services to Foundation and others, as described more fully below. Founder also pays all of B’s operating costs.

In addition to Foundation, A and B provide services to Founder and to other tax-exempt organizations. A and B also provide services to Founder’s family members, and their separate donees/grantees. About one-third of A’s time is spent on non-Foundation work.

A provides philanthropic program and grant-making services to Foundation. These services include developing initiatives, conducting due diligence on potential grantees, developing partnerships with other organizations, reviewing grant proposals, selecting grantees, working with grantees on initiatives, drafting grant recommendations, drafting grant agreements and monitoring grant performance. A’s employees facilitate and shepherd Foundation’s grant process; maintain and update all documentation relating to grants, grantees, and a grant database; ensure that due diligence files are complete; and monitor and document grantee compliance with the terms of the grant agreements.

Foundation's charitable consulting activities include organizing meetings of experts and grant recipients and providing at no charge to other charities consulting services related to their philanthropic programs, which coordinate with Foundation's programs, as well as to their investment activities.

Foundation, utilizing the services of B's employees, provides advice to a number of public charities regarding investment strategies, asset allocation, and liquidity needs for making grants.

All entities that receive program-related, , or investment consulting services from Foundation are either public charities, foreign organizations that would be classified as non-private foundation tax-exempt charitable organizations if they were located in the United States, or entities with respect to which Foundation exercises expenditure responsibility, as defined by § 4945(h) and the regulations thereunder. None of them is controlled by Foundation or is a disqualified person with respect to Foundation.

A has program teams that provide various services to Foundation, Founder, and others. Each of the teams that is dedicated to Foundation's focus areas employs leaders with significant experience in each of those fields (each, a "Program Lead"). Program Leads are hired because they are considered leaders in their fields, each is highly credentialed, and many hold advanced degrees. Many of the team members also are highly credentialed, and hired with specific background and skills necessary to provide grant-making services. Some of A's employees are not assigned to a specific focus area but, rather, provide other support services to the program teams.

A also employs office and grants management staff necessary to permit the program teams to provide charitable services to Foundation in an efficient manner. A outsources such services as janitorial and maintenance services to unrelated parties.

To date, Founder has paid the operating costs of A and B and allowed Foundation to use A's and B's services for free. To help Foundation better understand its operating expenses and plan for its future self-sufficiency, Foundation will enter into a services agreement with A and begin paying A for the (i) programmatic and grant-making services, (ii) services that allow Foundation to engage in charitable consulting activities, and (iii) investment management and

advisory services to Foundation and to other entities at Foundation's direction.

Foundation's independent directors will review and approve the services agreement and the fee to be paid to A for the services. The non-independent directors will not participate in the consideration of or the voting on adoption of the agreement. A will contract with B to assist A in delivering the investment management and advisory services to Foundation and to other entities at Foundation's direction pursuant to the services agreement between Foundation and A.

The fees to be paid by Foundation to A will be expected to cover all costs of providing to Foundation grant-making, consulting, and investment advisory services, including salaries, benefits, supplies and office equipment. Foundation will employ third-party compensation experts to ensure that the fees to be paid by Foundation will fall within the range of reasonableness for similar services provided by similar service providers to similar foundations and will not be excessive in amount, taking into account (a) the size of Foundation; (b) the amount and complexity of the grants made by Foundation and (c) the types of consulting services provided by Foundation to others.

Foundation will maintain documentation of (i) the terms of the services agreement and the date approved, (ii) the independent directors who are present during debate on the services agreement and those who vote on it, (iii) data supporting the reasonableness of the fees that is obtained and relied upon by the independent directors and how the data is obtained and (iv) any actions taken with respect to consideration of a services agreement by anyone who is a director but who may have had an apparent conflict of interest with respect to the services agreement.

Foundation will only pay for services provided to it and not for any services provided to Founder, Founder's family members, or their donees/grantees. Founder will separately pay for all the services that A and B provide to Founder, Founder's family members, and their donees/grantees.

#### RULINGS REQUESTED

Based on the statement of facts and representations submitted by Foundation and summarized above, the following rulings are requested:

1. Payment by Foundation of a fee to Founder through A, a disregarded entity,

for programmatic and grant-making services shall not be an act of self-dealing between Foundation and Founder, a disqualified person, because it is the type of payment described in § 4941(d)(2)(E) and Treas. Reg. § 53.4941(d)-3(c)(1) for services which are reasonable and necessary to carrying out the exempt purposes of Foundation.

2. Payment by Foundation of a fee to Founder through A, a disregarded entity, for services to enable Foundation to engage in charitable consulting activities, including (i) program-related consulting provided to other charities, (ii) and (iii) investment consulting provided to other charities, shall not be an act of self-dealing between Foundation and Founder, a disqualified person, because it is the type of payment described in § 4941(d)(2)(E) and Treas. Reg. § 53.4941(d)-3(c)(1) for services which are reasonable and necessary to carrying out the exempt purposes of Foundation.
3. Foundation's expenditures for the programmatic, grant-making and consulting services listed above will be considered qualifying distributions under § 4942.
4. Foundation's expenditures for the programmatic, grant-making and consulting services listed above will not constitute taxable expenditures under § 4945.

### LAW AND ANALYSIS

Issues 1 and 2 – Whether payment by Foundation of a fee to A for programmatic grant-making services and its charitable consulting activities are excepted from self-dealing under § 4941(d)(2)(E) and the regulations.

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

Section 4941(d)(1)(D) defines “self-dealing” as including any direct or indirect payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person.

Section 4941(d)(2)(E) provides that, except in the case of a government official (as defined in § 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 4946(a)(1) defines the term “disqualified person” to include, with respect to a private foundation, a person who is a substantial contributor to the foundation, as defined in § 507(d)(2).

Treas. Reg. § 53.4941(d)-3(c)(1) provides, in part, that under § 4941(d)(2)(E), 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 private foundation shall not be an act of self-dealing if the compensation is not excessive. This rule applies without regard to whether the person who receives the compensation is an individual.

Treas. Reg. § 53.4941(d)-3(c)(2) provides examples of “personal services” for purposes of Treas. Reg. § 53.4941(d)-3(c)(1). These include legal services, investment counseling services, and general banking services.

In Madden v. Commissioner, 74 T.C. Memo 1997-395, the Tax Court ruled that maintenance, janitorial, and security services provided by a disqualified person to a private foundation are not “personal services” that are necessary to carrying out the exempt purposes of a private foundation for purposes of the exception to self-dealing. Citing the legislative history of § 4941, the Court noted that one of Congress’s stated goals in enacting § 4941 was to minimize the need for an arm’s-length standard by generally prohibiting self-dealing transactions between private foundations and disqualified persons and that any exceptions to the self-dealing transaction rules should be construed narrowly. The Court characterized the services described in the regulations under § 4941 as essentially professional and managerial in nature, and concluded that maintenance, janitorial, and custodial services do not meet the definition of “personal services” allowed under § 4941.

Founder is a substantial contributor, as defined in § 507(d)(2), and therefore, is a disqualified person with respect to Foundation as described in section 4946(a)(1)(A). Thus, any direct or indirect payment of compensation to Founder by Foundation will constitute an act of self-dealing unless an exception applies. Because A and B are disregarded as entities separate from their owners within

the meaning of Treas. Reg. § 301.7701-3, any payments of compensation by Foundation to either of them are considered to be payments to Founder.

. Founder, through A, which is a disregarded entity, employs individuals who provide a variety of services to Foundation. In order to carry out its exempt purposes, Foundation requires the services of individuals such as those employed by Founder through A, who provide the services described above to Foundation.

Payment of compensation by a private foundation to a disqualified person generally is an act of self-dealing under § 4941(d)(1)(D). However, § 4941(d)(2)(E) provides an exception to self-dealing for the payment of compensation by a private foundation to a disqualified person for personal services which are reasonable and necessary to carrying out the exempt purposes of the private foundation if the compensation is not excessive.

Treas. Reg. § 53.4941(d)-3(c)(2) provides examples of allowable personal services that consist of legal services, investment counseling services, and general banking services. Additionally, Madden v. Commissioner, supra, indicates that services that are professional and managerial in nature are types of personal services that are permitted under § 4941.

Foundation will enter into a services agreement to hire A to perform certain charitable program, grant-making and consulting services. Unlike the maintenance, janitorial, and custodial services described in Madden v. Commissioner, supra, the grant-making, consulting, investment, and management services that directly further charitable purposes are provided to Foundation by Founder through A (a disregarded entity) and are professional and managerial services. The programmatic, grant-making and consulting services are reasonable and necessary services that enable Foundation to carry out its charitable purposes. As such, they fall within the exception to the self-dealing rules for “personal services” described in § 4941(d)(2)(E) as long as the compensation is not excessive in relation to the services provided.

The services agreement also will include a provision that permits A to hire B to provide investment services. This situation is similar to the example in Treas. Reg. § 53.4941(d)-3(c)(2), Example (2), in which a manager of a private foundation who owned an investment counseling business provided investment services directly to the private foundation and was paid compensation for those

services. Consequently, payments by Foundation to A for B's investment services provided to Foundation will be payment for reasonable expenses necessary to carry out the exempt purposes of Foundation as long as the compensation is necessary and reasonable to carrying out Foundation's investment program and not excessive under § 4941(d)(2)(E).

Accordingly, payment to A by Foundation of a reasonable fee for the described services will not constitute a prohibited act of self-dealing within the meaning of § 4941 as long as the amount of the payment is not excessive.

Issue 3 – Whether payment by Foundation of a fee to A for programmatic, grant-making, and charitable consulting services will be considered a qualifying distribution under § 4942.

Section 4942(a) imposes a tax on the undistributed income of a private foundation for any taxable year.

Section 4942(g)(1)(A) defines "qualifying distribution" to mean, in part, any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in § 170(c)(2)(B). Section 170(c)(2)(B) lists the following purposes: "religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition . . . , or for the prevention of cruelty to children or animals." These purposes are the same purposes listed in § 501(c)(3).

Assuming that Foundation's payment to A for programmatic, grant-making, consulting, and other expenses listed above will be paid to accomplish one or more purposes described in § 170(c)(2)(B), such expenses will be considered qualifying distributions under § 4942.

Issue 4 – Whether expenditures by Foundation for the programmatic, grant-making and charitable consulting services listed above will constitute taxable expenditures under § 4945.

Section 4945 generally imposes a tax on taxable expenditures made by a private foundation.

Section 4945(d)(5) provides that a "taxable expenditure" includes any amount



paid or incurred by a private foundation for any purpose other than one specified in § 170(c)(2)(B).

Treas. Reg. § 53.4945-6(b)(1)(v) provides, in part, that any payment that constitutes a qualifying distribution under § 4942(g) ordinarily will not be treated as a taxable expenditure under § 4945(d)(5).

As determined above (see Issue 3), funds expended by Foundation for programmatic, grant-making, and charitable consulting services will be qualifying distributions under § 4942. As qualifying distributions, these expenditures will not be treated as taxable expenditures under § 4945(d)(5), and will not subject Foundation to excise tax under § 4945.

### RULINGS

Based on the information submitted and the representations contained in the request for rulings and supplemental submissions, we rule that:

1. Payment by Foundation of a fee to Founder through A, a disregarded entity, for programmatic and grant-making services will not be an act of self-dealing between Foundation and Founder, a disqualified person, because it is the type of payment described in § 4941(d)(2)(E) and Treas. Reg. § 53.4941(d)-3(c)(1) for services that are reasonable and necessary to carrying out the exempt purposes of Foundation if the amount of each such payment is not excessive.
2. Payment by Foundation of a fee to Founder through A, a disregarded entity, for services to enable Foundation to engage in charitable consulting activities, including (i) program-related consulting provided to other charities, (ii) , and (iii) investment consulting provided to other charities will not be an act of self-dealing between Foundation and Founder, a disqualified person, because it is the type of payment described in § 4941(d)(2)(E) and Treas. Reg. § 53.4941(d)-3(c)(1) for services that are reasonable and necessary to carrying out the exempt purposes of Foundation if the amount of each such payment is not excessive.
3. Foundation's expenditures for the programmatic, grant-making, and

consulting services listed above will be considered qualifying distributions under §4942(g).

4. Foundation's expenditures for the programmatic, grant-making, and consulting services listed above will not constitute taxable expenditures described in § 4945.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by penalty of perjury statements executed by an individual with authority to bind the taxpayer, and upon the understanding that there will be no material changes in the facts.

No opinion is expressed or implied concerning whether the proposed payments for services will be excessive.

This office has not verified any of the material submitted in support of the request for rulings, and such material is subject to verification on examination. The Associate office will revoke or modify a ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; if the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, if the controlling facts change during the course of the transaction. See Rev. Proc. 2019-1, § 11.05.

No ruling is granted as to whether Foundation qualifies as an organization described in § 501(c) or § 509(a).

This letter does not address the applicability of any section of the Code or Regulations to the facts submitted other than with respect to the sections specifically described, and, except as expressly provided above, no opinion is expressed or implied concerning the federal income or excise tax consequences of any other aspects of any transaction or item of income set forth in this letter. Because it could help resolve questions concerning federal income tax status, this letter should be kept in Foundation's permanent records.

A copy of this letter must be attached to any tax or information return to which it is relevant. Alternatively, if Foundation files its return electronically, this requirement may be satisfied by attaching a statement to the return that provides the date and

control number of this letter.

This letter is directed only to Foundation. Section 6110(k)(3) provides that it may not be used or cited by others as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Foundation's authorized representatives.

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,

Mike Repass  
Senior Technician Reviewer  
Exempt Organizations Branch 3  
(Employee Benefits, Exempt Organizations, and Employment Taxes)