



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

200352021

4941.04-00

Date: OCT 1 2003

Contact Person:

Identification Number:

Telephone Number:

T:EO:BR4

Employer Identification Number:

Legend:

Foundation =

Bank =

Corporation =

B =

D =

E =

F =

G =

H =

J =

K =

z =

y =

x =

Dear Taxpayer:

We have considered Foundation's ruling request dated March 26, 2003, concerning the proper treatment of its proposed engagement of Bank to provide cash management, investment planning, legal, accounting and other comparable services, under Section 4941 of the Internal Revenue Code.

Facts

Foundation is exempt from federal income taxes under section 501(c)(3) of the Code and is a private foundation under Section 509(a). Foundation is managed and operated by its board of Trustees, made up of D, E, F, G, H, J and K. Foundation's activities include responsible philanthropy through active roles in organizations it supports by monitoring their operations, serving on governing boards, reviewing organizational materials and offering consultations.

Bank was organized as the first merchant bank with fiduciary powers to be chartered in the State of B. The voting interests in Bank are owned by F, G, and H and are subject to a voting

trust agreement, of which J is the Voting Trustee. The non-voting interests in Bank are owned by trusts created for the benefit of F, G, and H and for their children. Bank is a disqualified person with respect to the Foundation, as defined in Section 4946(a)(1).

Initially, Bank consisted of two separate departments, an Investment Banking Department and a Trust Department. The Investment Banking Department was intended to provide venture capital to various start-up corporations in the State of B and elsewhere. The department has made investments, with varying success; however, because of market conditions and changes in personnel, the department has been deemphasized, and Bank is no longer actively seeking new investments.

The Trust Department was organized principally to provide full service fiduciary and trust-related business and personal financial services inter-generationally among D and E and their issue (collectively, the "Family"). The Family assets are held by various trusts, foundations, corporations, limited liability companies and partnerships and are also held individually by various Family members. The Trust Department has developed extensive Policies and Procedures which are based upon the Statement of Principles of Trust Department Management promulgated by the FDIC and utilized by the B agency which direct how trust assets are to be managed, invested and distributed. Bank has created Trust and Investment Committees, including some of the officers and directors of Bank, to oversee Trust Department activities. The Committees meet quarterly to review all trust accounts, as well as the Trust Department's purchase and sale activity, balance sheet and financial condition.

Currently, the Trust Department maintains 16 trust accounts for the Family, and serves as Investment Manager for the Family's primary financial-holding partnership.

D owns all of the stock of Corporation, which provides personal and financial management services to the Family both directly and indirectly through Bank. Accordingly, Corporation is a disqualified person with respect to Foundation, as defined in Section 4946(a)(1). Bank and Corporation entered into a Service Agreement, in accordance with which Bank has outsourced certain functions to Corporation for a fixed fee. Corporation operates on a cost recovery basis, and earns little or no profit from its activities. It is anticipated that Corporation may eventually be merged into Bank, and Bank will thereafter perform all such services.

Among the many services that Bank and Corporation provide to the Family are: (i) cash management; (ii) investment counseling; (iii) household management; (iv) personal financial planning; (v) trust and estate administration; (vi) financial statement preparation; (vii) accounting services, including tax return preparation; (viii) legal services; and (ix) custody of assets (collectively, the "Services"). Bank also serves as liaison with and manager of outside advisors, such as legal counsel, financial planners, investment managers, tax and accounting advisors and banks.

Bank employs two individuals on a full-time basis, a Senior Trust Officer and her assistant. No member of the Family is active in the management of Bank, with the exception of D, who serves as Chairman and director, for which he receives no compensation. Corporation currently

employs seventeen people, seven of whom provide financial, accounting and legal services to the Family and to Bank on a full-time basis. The remaining employees provide other services for the Family, such as maintenance, transportation and household management services. D and E serve as uncompensated officers of Corporation. No other member of the Family is active in the management of Corporation.

A principal purpose for developing Bank was to be able to provide services efficiently under "one roof," inter-generationally, for the benefit of the Family, as a private trust company. Bank charges each of its accounts a fixed annual fee, which is based upon Bank's relative responsibility and effort provided to each account. All fees charged are in accordance with industry practice and are permitted under the applicable local laws governing fiduciary activities. Bank and Corporation provide Services for a lower cost than could be obtained by the Family elsewhere. In addition, Bank acts as a "buffer" to protect the individual Family members from investment, business, political and charitable solicitations. The use of Bank also ensures that confidentiality of Family information is preserved. Finally, aggregating Family assets into one entity provides the Family with consolidated financial analysis and reporting, as well as economies of scale, that cannot be realized when assets are held in various institutions. Currently, neither Bank nor Corporation provides Services for anyone outside the Family.

In order to carry out its exempt purposes, Foundation requires investment counseling, financial planning and legal and accounting services. Bank and Corporation employ accounting, legal, bookkeeping and other personnel and provides services which include the services required by the Foundation. Foundation would like to engage Bank and Corporation to perform such Services for Foundation.

Foundation represents that Bank is able to provide these services to Foundation at a discounted rate because it has a cost advantage over area trust departments. Because Bank has only one client, Family, it does not need to engage in any advertising for its services, nor does it need to offer discounts, special promotions or other incentives to attract investment. Additionally, Bank by law does not accept deposits and therefore has no interest obligations. These cost advantages are passed on to Family and would be passed on to Foundation as well.

Foundation represents that Bank trust departments that operate in Bank's area are currently charging an average fee of approximately z% of assets managed solely for portfolio management. These charges in general do not reflect accounting, tax, legal or other services that the Family requires and that Bank and the Corporation provide. The addition of such services could increase the management fee to as high as y% of assets managed. Foundation represents that charges by Bank and Corporation to Foundation for these services will be less than x%.

Ruling Requested

Foundation requests a ruling that the engagement of the Bank by Foundation to perform the professional services described herein, that are reasonable and necessary for compensation

that is not excessive, constitutes an exception from self-dealing defined in section 4941(d)(2)(E) of the Code.

Law

Section 4941(d)(1)(D) of the Code defines an act of "self-dealing" to include 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) of the Code provides that except in the case of a government official, 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 53.4941(d)-3(c)(1) of the Foundation and Similar Excise Taxes Regulations provides, in part, 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 purpose of the private foundation shall not be an act of self-dealing if such compensation (or payment or reimbursement) is not excessive.

Section 53.4941(d)-3(c)(2) of the regulations provides the following examples:

Example (1). M, a partnership, is a firm of 10 lawyers engaged in the practice of law. A and B, partners in M, serve as trustees to private foundation W and, therefore, are disqualified persons. In addition, A and B own more than 35 percent of the profits interest in M, thereby making M a disqualified person. M performs various legal services for W from time to time as such services are requested. The payment of compensation by W to M shall not constitute an act of self-dealing if the services performed are reasonable and necessary for the carrying out of W's exempt purposes and the amount paid by W for such services is not excessive.

Example (2). C, a manager of private foundation X, owns an investment counseling business. Acting in his capacity as an investment counselor, C manages X's investment portfolio for which he receives an amount which is determined to be not excessive. The payment of such compensation to C shall not constitute an act of self-dealing.

Section 4946(a)(1) of the Code defines the term "disqualified person" to include:

- (A) a substantial contributor to the foundation,
- (B) a foundation manager (within the meaning of section 4946(b)(1)),
- (C) an owner of more than 20 percent of –
 - (i) the total combined voting power of a corporation,
 - (ii) the profits interest of a partnership, or

- (iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation,
- (D) a member of the family (as defined in section 4946(d)) of any individual described in subparagraph (A), (B), or (C),
- (E) a corporation of which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the total combined voting power, or
- (F) a partnership in which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the profits interest.

Section 4946(b) of the Code defines the term "foundation manager" to mean, with respect to any private foundation –

- (1) 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
- (2) 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 4946(d) of the Code defines the family members of an individual as such individual's spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren.

Analysis

Bank and Corporation employ accounting, legal, bookkeeping and other personnel to provide investment counseling, financial planning and legal and accounting services to Family. In order to carry out its exempt purposes, Foundation requires such services. The services are comparable to those listed in section 53.4941(d)-3(c)(2) of the regulations.

Foundation represents that the services rendered by Bank and Corporation are necessary for the carrying out of Foundation's exempt purposes. Foundation takes an active role in the organizations it supports by monitoring their operations, serving on governing boards, reviewing organizational materials, and offering consultations. Accounting services assist the Taxpayer in monitoring the performance of its donee organizations, and legal services assist in preparing and reviewing pledge agreements and provide advices on administrative and operational issues. In addition, Foundation's contributions are derived from the earnings generated by its assets. The pooling of investment management under the direction of Bank will enable Foundation to maximize funds available for contributions, make projections regarding cash flow needs and fund availability, consolidate financial information, facilitate financial long-range planning and coordinate Foundation's accounting and bookkeeping requirements.

Foundation acknowledges that Bank and Corporation are disqualified persons with respect to Foundation because they are owned and controlled by persons who are themselves disqualified persons.

Foundation represents that the fees paid to Bank and Corporation are reasonable. Trust departments that operate in Bank's area are currently charging an average fee of approximately z% of assets managed solely for portfolio management. These charges in general do not reflect accounting, tax, legal or other services. When these additional services are taken into account, trust fees increase to as high as y% of assets managed. Foundation will be charged a flat fee which represents less than x% of assets managed.

Ruling

Based upon the information and representations that you have submitted, under the facts described above:

The engagement of Bank by Foundation to perform the professional services described herein, that are reasonable and necessary for compensation that is not excessive, constitutes an exception from self-dealing defined in section 4941(d)(2)(E) of the Code.

This ruling is limited to the applicability of the provisions of section 4941(d)(2)(E) of the Code to the issue raised and does not purport to rule on any facts that were not represented in the ruling request or on any changes of those facts. Also, in this ruling, we have not determined whether the fees paid to Bank are reasonable, but merely accepted your representations that they are in fact reasonable. This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transactions described above under any other provision of the Internal Revenue Code. Additionally, it does purport to rule on any investment activity of the Foundation. (See section 4941(d)(1)(E))

Because this ruling could help resolve future questions about your federal income tax liabilities, you should keep it in your permanent records.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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,

Debra J. Kaweck
Acting Manager
Exempt Organizations
Technical Group 4