TAX EXEMPT AND
GOVERNMENT ENTITIES

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

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Contact Person:

ID Number:

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UIL: 4941.00-00
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LEGEND

K =
L =
M =

Dear :

K is requesting a ruling its membership interest in M does not constitute self-dealing under section 4941 of the Internal Revenue Code.

FACTS

K is exempt under section 501(c)(3) of the Internal Revenue Code and is classified as a private foundation within the meaning of section 509(a) of the Code. K's principal activity is to provide funding to other non-profit organizations described in section 501(c)(3) of the Code.

L, K's founder, along with related individuals and entities L controls directly or indirectly (hereinafter "Group"), established M, an investment fund treated and taxed as a partnership for federal income tax purposes. The Group will contribute cash or other assets to M. The Group's members are disqualified persons. K states M was created to coordinate certain investment resources of the Group and facilitate the co-investment of the Group's members with the expectation of (i) reducing administrative costs, (ii) obtaining access to investments and investment funds that might otherwise be unavailable to the individual members, (iii) facilitating diversification of the Group

members' assets in a manner that could not be achieved by acting individually, and (iv) obtaining economies of scale and cost savings as well as greater negotiating power through a co-investment model.

K states M invests in a variety of separately managed investment funds. M is managed by an independent unrelated manager. M's members are permitted to withdraw all or a part of their investment, and accrued earnings, provided the withdrawal: is effective on the first business day of a calendar quarter, exceeds $10,000 and is communicated to the Fund at least 30 days prior to a withdrawal. If a withdrawal request exceeds $2 million, M has the option to pay the amount in cash or portfolio securities or a combination of both. In the event the withdrawal relates to the entire investment of the withdrawing member, 90% of the value of the member's interest as of the previous quarter will be distributed on the scheduled date with the balance of the value, determined as of the date of withdrawal, payable approximately one month later with interest. K states the purpose of the delay is to allow M to precisely and accurately determine the value of the member's interest. Members may make additional investments on the first day of each calendar quarter provided they make a minimum additional contribution of $10,000.

K states it has many of the same investment objectives M currently pursues. Therefore, M has invited K to join in order to have access to the investment management services and diversified portfolio of investments M provides and maintains. K states it will be beneficial to invest through M because the investment will: (i) assist K in reducing the administrative cost associated with K's various brokerage and portfolio services; (ii) assist K in diversifying its investment portfolio; (iii) allow K to obtain access to investments with higher minimum investment requirements; (iv) permit K to benefit from the economies of scale and resulting costs savings and obtain greater negotiating power.

K states it does not know the aggregate amount of assets it will use to invest in M. However, K contemplates it will invest approximately 56 % of its assets in M. K may make contributions or withdrawals from time to time. In such instance, K's ownership interest in M will be correspondingly reduced or increased in connection with each contribution or withdrawal.

M's sole manager ("Manager") is an entity controlled by the Group and is therefore a disqualified person with respect to K. The Manager receives an annual base fee on the assets managed and a performance fee for achieving returns in excess of a certain threshold. But the operating agreement provides the Manager will waive, and K will not be obligated to pay, either fee. K will pay its proportionate share of the investment management fees paid to the independent third-party managers of the individual investment funds in which M invests; however, the Operating Agreement provides, to the extent any costs, fees, or expenses of these third parties are based on a percentage of assets managed and such assets varies depending upon the amount of such assets, K will pay the lowest possible percentage fees and the Group's members will pay the remaining fees.

K states M will not buy, lease, or sell property in a sale or lease transaction with any disqualified person with respect to any of M's members. K also states, in compliance with section 4941(d)(2)(A) of the Code, neither M nor any of its holdings are or will be subject to a mortgage or a similar lien. Finally, K states, in compliance with section 4941(d)(1)(B) of the Code, M will not receive credit from or extend credit to a disqualified person with respect to any of its members and in compliance with section 53.4941(d)-2(f)(1) of the Foundation and Similar Excise Taxes Regulations, M will not purchase or sell investments in an attempt to manipulate the price of investments to the advantage of a disqualified person.

RULINGS REQUESTED

K requests the following rulings:

1. K's participation in M, including contributions to and withdrawals from M, will not result in self-dealing within the meaning of section 4941(d)(1)(A) of the Code.

2. K's participation in M, including contributions to and withdrawals from M, will not result in self-dealing within the meaning of section 4941(d)(1)(B) of the Code.

3. K's participation in M, including contributions to and withdrawals from M, will not constitute a transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation within the meaning of the self-dealing rules of section 4941(d)(1)(E) of the Code.

4. K's sharing of third-party investment management fees and expenses incurred due to K's participation in investment funds held by M will not result in self-dealing because such payments will be for the performance of personal services which are reasonable and necessary, assuming such payment is not excessive.

5. Any contribution to or withdrawal from M by any investor other than K will not result in self-dealing within the meaning of section 4941(d)(1)(A) of the Code.

LAW

Section 4941(a) of the Internal Revenue Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(A) of the Code defines the term "self-dealing" to include any direct or indirect sale or exchange, or leasing, of property between a private foundation and a disqualified person.

Section 4941(d)(1)(B) of the Code defines the term "self-dealing" to include any direct or indirect lending of money or other extension of credit between a private foundation and a disqualified person.

Section 4941(d)(1)(E) of the Code defines the term "self-dealing" to include any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a)(1) of the Code provides the term "disqualified person" with respect to a private foundation means a person who is:

(A) a substantial contributor to the foundation,
(B) a foundation manager,
(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 that is a substantial contributor to the foundation,
(D) a member of the family of any individual described in subparagraphs (A), (B) or (C),
(E) a corporation of which persons described in subparagraphs (A), (B), (C) or (D) own more than 35 percent of the total combined voting power,
(F) a partnership in which persons described in subparagraphs (A), (B), (C) or (D) own more than 35 percent of the profits interest, or
(G) a trust or estate in which persons described in subparagraphs (A), (B), (C) or (D) hold more than 35 percent of the beneficial interest.

Section 4946(d) of the Code provides, for purposes of section 4946(a)(1), the family of an individual shall include only his spouse, ancestors, children, grandchildren, great-grandchildren, and the spouses of children, grandchildren, and great-grandchildren.

Section 53.4941(d)-1(a) of the regulations provides it is immaterial whether a self-dealing transaction results in a benefit or detriment to the private foundation. Self-dealing does not, however, include a transaction between a private foundation and a disqualified person where the disqualified person status arises only as a result of such transaction.

Section 53.4941(d)-2(f)(2) of the regulations provides 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 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 purpose of the private foundation shall not be an act of 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. The determination of whether compensation is reasonable and not excessive is made by looking at prevailing industry standards to determine whether the compensation or fees are similar in amount to those paid for comparable services by like enterprises under similar circumstances. See section 1.162-7 of the regulations.

In section 53.4941(d)-3(d)(2), Example 2 of the regulations, 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 does not constitute an act of self-dealing.

Section 4943 of the Code imposes an excise tax on any "excess business holdings" of a private foundation.

Section 4943(c) of the Code defines an "excess business holding" as any interest in a "business enterprise" held in excess of 20% of the business's voting stock or profits interest reduced by any such stock or interest held by disqualified persons.

Section 4943(d)(3)(B) of the Code provides that the term "business enterprise" does not include a trade or business at least 95% of the gross income of which is derived from passive sources.

ANALYSIS

K's membership interest in M is in substance a "co-investment arrangement" by K in M. Consequently, it is not a sale or exchange between K and M or between K and the other Group members, for purposes of section 4941(d)(1)(A) of the Code. Any benefits M and the other members may derive from K's participation in M will be incidental and tenuous as described in section 53.4941(d)-2(f)(2) of the regulations. K's participation in M is not a transfer to, or use by or for the benefit of, M of K's income or assets. In joint or co-investment situations, when a private foundation makes an initial investment, acquires an additional interest in the partnership entity after its formation and initial funding, or withdraws its interest, there is neither an economic benefit to the other investors nor does the ownership or holdings of the other investors change in any economic or other material respect. K's payment of interest upon the complete withdrawal of a member's investment is not the lending of money or other extension of credit between a private foundation and a disqualified person under section 4941(d)(1)(B) of the Code. Further, the payment of interest upon complete withdrawal of a member's investment is the result of M's 10% hold on the withdrawal from the members account, not evidence of a loan. The interest paid represents the equitable payment by M for its delay in making a full payment because of the time it needs to determine the member's exact interest in M.

Section 4943 of the Code expressly contemplates and permits joint or co-investments by disqualified persons and private foundations. Numerous joint or co-investment situations exist, as permitted by section 4943, where both the private foundations and the disqualified persons involved either buy or sell interests in the investment entity or make withdrawals from such entity after formation and initial funding. The passive investments contemplated by M are not considered a "business enterprise." See section 4943(d)(3)(B).

K's investment in M permits it to obtain "brokerage and portfolio services" as well as investment management services. K states M will: investigate, select investments, monitor the underlying investments and make changes when deemed appropriate or prudent; provide the necessary brokerage services which are required to invest in the underlying investments; and provide K with periodic reports describing the current status of their investments. These services and benefits which K will receive by investing in M are in the nature of "brokerage and portfolio services," and, as such, they are considered "personal services" within the meaning of section 53.4941(d)-3(c)(1) of the regulations. See also Example 2 in section 53.4941(d)-3(d)(2). Therefore, even though the Manager has waived the right to receive any fees for such services from K, the payment of compensation for such services nevertheless will not constitute an act of self-dealing.

CONCLUSION

Based on K's representations, and the applicable law, we conclude:

1. K's participation in M, including contributions to and withdrawals from M, will not result in self-dealing within the meaning of section 4941(d)(1)(A) of the Code.

2. K's participation in M, including contributions to and withdrawals from M, will not result in self-dealing within the meaning of section 4941(d)(1)(B) of the Code.

3. K's participation in M, including contributions to and withdrawals from M, will not constitute a transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation within the meaning of the self-dealing rules of section 4941(d)(1)(E) of the Code.

4. K's sharing of third-party investment management fees and expenses incurred due to K's participation in investment funds held by M will not result in self-dealing because such payments will be for the performance of personal services which are reasonable and necessary, assuming such payment is not excessive.

5. Any contribution to or withdrawal from M by any investor other than K will not result in self-dealing within the meaning of section 4941(d)(1)(A) of the Code.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative. This ruling 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 described.

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

Please keep a copy of this ruling letter in your permanent records.

If you have any questions about this ruling, please contact the persons whose name and telephone number are shown above in the heading of this letter.

Sincerely yours,

Debra J. Kawecki
Manager, EO Technical
Technical Group 1

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