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

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Contact Person:
Mr. John Patton
ID Number: 50-05569

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Contact Number:
(202) 622-8105

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Legend:
F =
M =

Dear Sir or Madam:

This is in reply to your ruling request of May 21, 1999, requesting a ruling that private foundation F's hiring of corporation M as an investment manager will not be an act of self-dealing pursuant to section 4941(d)(2)(E) of the Internal Revenue Code and section 53.4941(d)-3(c) of the Foundation and Similar Excise Taxes Regulations.

You, F, are recognized as exempt from federal income tax under section 501(c)(3) of the Code and as a private foundation under section 509(a) of the Code. M is a for-profit corporation that is a disqualified person under section 4946(a)(1)(E) of the Code with respect to private foundation F. M will provide portfolio investment management services to F. It is represented that M will receive no more than reasonable compensation for its services.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations organized and operated exclusively for charitable and/or the other exempt purposes stated in that section.

Section 509(a) of the Code describes organizations exempt from federal income tax under section 501(c)(3) of the Code that are private foundations subject to the private foundation provisions of Chapter 42 of the Code.

Section 4941 of the Code imposes excise tax on any act of self-dealing between a private foundation and any "disqualified person" with respect to it as defined in section 4946 of the Code.

Section 4941(d)(2)(E) of the Code provides, in pertinent part, that the payment of compensation by a private foundation to a disqualified person for personal services that 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 is not excessive.

Section 53.4941(d)-3(c)(1) of the Foundation and Similar Excise Taxes Regulations provides that, under section 4941(d)(2)(E) of the Code, except in the case of a government official as defined in section 4946(c) of the Code, the payment of compensation 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 is not excessive. 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 from the private foundation as principal and resells to third parties. For the determination whether compensation is excessive, see section 1.162-7 of the Income Tax Regulations. This paragraph applies without regard to whether the person who receives the compensation is an individual. The portion of any payment which represents payment for property shall not be treated as payment of compensation for the performance of personal services.

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Section 53.4941(d)-3(c)(2) of the regulations, Example 2, describes the exception to self-dealing under section 4941(d)(2)(E) of the Code: Foundation manager and disqualified person C of private foundation X owns an investment counseling business, and, acting in his capacity as an investment counselor, C manages foundation X's investment portfolio for which C receives an amount which is not excessive. The payment of such reasonable compensation by F to its disqualified person C shall not constitute an act of self-dealing under section 4941 of the Code.

Section 4946 of the Code defines the disqualified persons subject to section 4941 of the Code.

Section 4946(a)(1)(A) of the Code provides that a disqualified person includes a person who is a substantial contributor, as defined in section 507(d)(2) of the Code, to the private foundation.

Section 507(d)(2) of the Code provides that a substantial contributor is a person who contributed or bequeathed an aggregate amount of more than $5,000 to the private foundation, if such amount is more than 2 percent of the total contributions received by the foundation before the close of the tax year of the foundation in which the contribution is received by the foundation from such person.

Section 4946(a)(1)(B) of the Code provides that a disqualified person includes a foundation manager under section 4946(b)(1) of the Code.

Section 4946(b)(1) of the Code provides that a foundation manager is an officer, director, or trustee of the private foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation).

Section 4946(a)(1)(C) of the Code provides that a disqualified person includes a person who is 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.

Section 4946(a)(1)(D) of the Code provides that a disqualified person includes a member of the family, as defined in section 4946(d) of the Code, of any individual described in section 4941(a)(1)(A), 4941(a)(1)(B), or 4941(a)(1)(C) of the Code, cited above.

Section 4946(d) of the Code provides that the family of any individual shall include only his or her spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren.

Section 4946(a)(1)(E) of the Code provides that a disqualified person includes a corporation in which persons described in 4946(a)(1)(A), 4946(a)(1)(B), 4946(a)(1)(C), or 4946(a)(1)(D) of the Code own more than 35 percent of the profits interest.

In this case, M's providing of portfolio investment management services to F is a type of personal service that is allowed under section 4941(d)(2)(E) of the Code as shown by the above cited Example 2 of section 53.4941(d)-3(c)(2) of the regulations describing the exception to self-dealing for an investment manager's services provided at reasonable compensation to a private foundation. Similarly, the agreement between F and M for such services is not an act of self-dealing.

Accordingly, we rule that F's payments to M, for M's services as investment manager, advisor, and/or custodian for F, will not be an act of self-dealing under section 4941 of the Code, provided that the compensation paid by F to M is reasonable in amount for services actually provided.

Because this ruling letter could help to resolve any questions, please keep it in your permanent records.

This ruling letter 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.

Sincerely,

Joseph Chasin

Joseph Chasin
Acting Manager, Exempt Organizations
Technical Group 2