DEPARTMENT OF THE TREASURY 200027055
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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No Third Party Contacts
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Dear Sir or Madam:

This is in response to your ruling request that certain proposed transactions will not have adverse consequences under sections 501(c)(3), 4941, 4942, or 4945 of the Internal Revenue Code.

The submitted information indicates that W consists of three siblings, X, Y, and Z, and their families. In furtherance of their strong commitment to philanthropy, X, Y, and Z have each established a private foundation (the "Private Foundations"). The Private Foundations are A, B, and C. X, Y, and Z are the presidents of A, B, and C, respectively. The Private Foundations currently hold significant assets and it is anticipated that one or more of these entities will be among the beneficiaries of the estates of members of W.

286

X, Y, and Z are interested in ensuring that their philantrophic philosophies and goals are carried out in a centralized and efficient manner, both currently and in the future. Accordingly, a reorganization of their philantrophic program was made centered around a new organization, L. L was established with a primary goal of providing planning and management with respect to W's charitable activities, as well as administrative and charitable services to other charitable organizations that are supported by W. L has filed for, and was granted recognition of exempt status under section 501(c)(3) of the Code and is classified as a private foundation. L's members and trustees are X, Y, and Z.

E is a for-profit corporation whose shares of stock are owned equally by X, Y and Z. E was organized to service the business, financial and philanthropic endeavors of W. K is a for-profit corporation and is a wholly-owned subsidiary of E.

E and K currently provide services to members of W and to the various entities (charitable and non-charitable) created or funded by it, including the Private Foundations. These services include:

1. asset management (e.g., review of and advice regarding asset allocation, including the selection and monitoring of investment managers);

2. coordination of tax matters (e.g., recordkeeping, preparation of returns, and tax planning);

3. other financial services (e.g., cash management, accounting, accounts payable, financial analysis and investment appraisals); and

4. administrative assistance in charitable programs (e.g., fundraising, development and administration of programs, processing and monitoring of grants, and recordkeeping).

In providing these services, E and K also coordinate the services of some outside consultants and service providers, including legal counsel, estate and financial planners, investment managers and brokerage firms, tax and accounting advisors and custodial institutions.

K charges for services based on the fair market value of the recipient's assets. K has designed its charges so as not to earn a profit, charging the Private Foundations a below market rate. The rates may increase in the future; however, they will never exceed market rates charged by others for similar services.

In evaluating the most efficient and cost-effective manner of accomplishing the W 's charitable goals, it has been concluded that it would be preferable if services related to philanthropic planning and programming were centralized within a charitable entity rather than a for profit entity such as E. These philanthropic-related services include: (1) services (referred to as charitable services) such as assisting with the development and implementation of charitable programs as well as strategic charitable planning (e.g., developing and documenting strategies for improving education in North America) and (2) services (referred to as administrative services) such as administrative assistance with charitable grants and programs as well as record keeping, preparation of tax returns and accounting services. L will now provide these services, currently provided by E. W has continued to subsidize these services and neither E nor L has charged the Private Foundations for them.

Pursuant to the reorganization of the operation of W's philanthropic program, L will operate charitable programs and, among other things, provide charitable and administrative services to charitable entities affiliated with W. The governing documents of A, B and C will be amended to provide that L has the authority to appoint a majority of the Trustees of each of them with the remaining Trustees appointed by members of W.

As a result of this reorganization, L will become the parent of the Private Foundations and there will be an overlap of persons serving as foundation managers of the Private Foundations and L. For example, initially, X, Y and Z, who are the members and trustees of L, will be half of the trustees of the Private Foundations. Pursuant to L's governing documents, when X, Y and Z are no longer members of L, L will remain as the Private Foundations' parent with the right to appoint a majority of the Private Foundations' trustees; however, L will no longer have members and no member of W will be permitted to serve as a trustee of L. In addition, it is intended that no member of W will be an employee of L. Thereafter, it is intended that the broad-based public nature of L's Board of Trustees will be reflected in the trustees of the Private Foundations who are appointed by L. In addition, since the Private Foundations will have no employees and L will provide services to the Private Foundations, the same persons will be responsible for the day-to-day operation of both the Private Foundations and L. For example, certain employees of L may be foundation managers of the Private Foundations.

The expenses in L's operating budget will be comprised of the direct and indirect cost of carrying out its charitable activities. These charitable activities include the following: (1) the operation of charitable programs (e.g., conducting educational conferences, disseminating related reports, and operating programs previously carried out by other charitable organizations); (2) making grants to other exempt organizations; and (3) providing charitable and administrative services to charitable entities affiliated

with W, such as the Private Foundations.

The Private Foundations will primarily fund the cost of L's operations. The Private Foundations will pay L an amount sufficient to cover the services that L provides directly to them, and provide funds for L's other charitable activities.

Since all payments from the Private Foundations to L constitute qualifying distributions, as explained below, regardless of which of L's activities they pay for, so long as L properly makes qualifying distributions out of corpus equal to the amount of such payments within the requisite time period, in accordance with section 4942(g)(3) of the Code, it is proposed that all amounts received by L from the Private Foundations be aggregated and treated as if they were grants. L would agree to make qualifying distributions equal to all funds that it received from the Private Foundations within the requisite time period under section 4942(g)(3), and to treat the entire amount as a distribution out of corpus under section 4942(h). The Private Foundations would also exercise expenditure responsibility with respect to such grant, in accordance with section 4945(h).

The changes in the proposed structure of W's philanthropic program and the responsibilities of E are as follows:

a. Most administrative and charitable services provided in connection with charitable activities of the Private Foundations would be shifted from E to L. Investment-related services would continue to be provided by K, which may also provide certain administrative services to the Private Foundations. Instead of basing its charges for services on its costs, K will calculate its charges based on the assets of the Private Foundations. K will charge no more than market rates for such services.

b. The Private Foundations, which will be reorganized so that L controls them, will primarily be responsible for funding L's activities. Since L is also a private foundation, it will agree to treat all amounts that it receives from the Private Foundations as grants and to make qualifying distributions equal to such amounts in accordance with sections 4942(g)(3) and 4942(h) of the Code. In addition, the Private Foundations will exercise expenditure responsibility with respect to all grants to L.

c. Any services provided by L to other unrelated charitable organization will be provided at no cost (or at substantially below cost).

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations which are organized and operated exclusively for charitable and

other exempt purposes.

Section 1.501(c)(3)-1(c)(2) of the Income Tax Regulations provides that an organization will not be considered as operating exclusively for charitable purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(a)-1(c) of the regulations defines "private shareholder or individual" as persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized exclusively for any of the purposes specified in section 501(c)(3) unless it serves public rather than private interests.

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

Section 4941(d)(1) of the Code provides that the term self-dealing means any direct or indirect --

(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;

Section 4941(d)(2)(C) of the Code provides that the furnishing of goods, services, or facilities by a disqualified person to a private foundation shall not be an act of self-dealing if the furnishing is without charge and if the goods, services, or facilities so furnished are used exclusively for purposes described in section 501(c)(3).

Section 4941(d)(2)(E) of the Code provides that 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 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 Tax 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 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 paragraph 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 regulations.

The following examples are set forth in section 53.4941(d)-3(c)(2) of the regulations:

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 4942(a) of the Code imposes a tax on the "undistributed income" of a private foundation.

Section 4942(c) of the Code defines "undistributed income" for a taxable year as the amount by which the foundation's distributable amount for the year exceeds the foundation's qualifying distributions attributable to such year.

Section 4942(g)(1)(A) of the Code provides that the term "qualifying distributions" means any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons (as defined in section 4946) with respect to the foundation, except as provided in paragraph (3), or (ii) a private foundation which is not an operating foundation (as defined in subsection (j)(3)), except as provided in paragraph (3).

Section 4942(g)(3) of the Code provides that the term "qualifying distributions" includes a contribution to a section 501(c)(3) organization described in 4942(g)(1)(A)(i)

or (ii) if --

(A) no later than the close of the first taxable year after its taxable year in which such contribution is received, such organization makes a distribution equal to the amount of such contribution and such distribution is a qualifying distribution which is treated as a distribution out of corpus, and

(B) the private foundation making the contribution obtains adequate records or other sufficient evidence from such organization showing that the qualifying distribution has been made by such organization.

Section 53.4942(a)-3(a)(8) Example (1) of the regulations clarifies that overhead expenses attributable to administrative activities which accomplish any section 170(c)(2)(B) purpose are also qualifying distributions.

Section 53.4942(a)-3(c)(1) of the regulations, which elaborates on the requirements that a contribution from one private foundation to another private foundation must satisfy in order to constitute a qualifying distribution, specifies that the requisite records from the donee foundation can consist of a statement by an appropriate officer or trustee of the donee foundation showing (a) that the qualifying distribution that the donee foundation is required to make has been timely made, (b) the name and address of the recipients of such distribution and the amount received by each, and (c) that the distribution is treated as a distribution out of corpus. This section of the regulation also provides that where a distribution is for an administrative expense which is part of a charitable expenditure that cannot reasonably be separately accounted for, the donee foundation merely needs to submit a statement setting forth the general purpose for which such expenditure was made and that the amount was distributed as a qualifying distribution.

Section 4945(d)(4) of the Code provides that the term "taxable expenditure" includes any amount paid or incurred by a private foundation as a grant to another private foundation that is not an exempt operating foundation under section 4940(d)(2) unless the grantor exercises expenditure responsibility with respect to such grant in accordance with section 4945(h) of the Code.

Section 4945(h) of the Code requires that the grantor private foundation exert all reasonable efforts and establish adequate procedures (1) to see that the grant is spent solely for the purpose for which it was made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and (3) to make full and detailed reports with respect to such expenditures to the Secretary.

Section 53.4945-5(a)(6) of the regulations specifies that a grant by a private foundation to a grantee organization which the grantee organization uses to make payments to another organization (the "secondary grantee") will not be regarded as a grant by the private foundation to the secondary grantee if the foundation does not earmark the use of the grant for any named secondary grantee and there is no agreement whereby the grantor foundation may cause the selection of the secondary grantee. So long as the original grantee exercises control over the selection independently of the grantor foundation, this will be the case even if the grantor foundation has reason to believe that certain organizations will derive benefits from its grant.

Section 53.4945-5(c) of the regulations provides that in the case of grants described in section 4945(d)(4), except as provided in subparagraph (2) of this paragraph, the granting private foundation shall require reports on the use of the funds, compliance with the terms of the grant, and the progress made by the grantee toward achieving the purposes for which the grant was made.

Section 53.4945-5(d) of the regulations provides that to satisfy the report-making requirements of section 4945(h)(3), a granting foundation must provide the required information on its annual information return, required to be filed by section 6033, for each taxable year with respect to each grant made during the taxable year which is subject to the expenditure responsibility requirements of section 4945(h).

Section 4946(a)(1) of the Code provides that the term "disqualified person" 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,
which is a substantial contributor to the foundation,
(D) a member of the family 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.

Section 53.4946-1(a)(8) of the regulations provides that for purposes of section 4941 only, the term "disqualified person" shall not include any organization which is described in section 501(c)(3) (other than an organization described in section

509(a)(4) (which refers to an organization organized and operated exclusively for testing public safety).

The foregoing information indicates that each of the Private Foundations' creating and governing instruments will be amended to implement the proposed reorganization. The amendments merely reflect each Private Foundation's parental relationship with L together with the authority granted to it as a parent. Since the amendments did not change any of the Private Foundation's charitable purposes nor indicate serving of private benefits, they will not have an adverse on the exempt status of any of the Private Foundations.

Since L has been determined to be exempt under section 501(c)(3) of the Code, L is not a disqualified person with respect to the Private Foundations for purposes of section 4941 pursuant to section 53.4946-1(a)(8) of the regulations. As such, the proposed provision of services for a fee by L to the Private Foundations and their payments to L should not treated as acts of self-dealing under section 4941(d)(1)(C) and (D) of the Code. In addition, the services are necessary in the performance of the Private Foundations' exempt purposes.

On the other hand, K is a disqualified person described in section 53.4946(a)(1)(E) of the regulations with respect to the Private Foundations. As such, the payment of compensation by the Private Foundations to K would have been an act of self-dealing under section 4941 of the Code. However, the compensation is for personal services necessary in the performance of the Private Foundations' exempt purposes. Also, it was represented that the compensation is not excessive but will be reasonable utilizing a method of calculation for simplification of administration. Under those facts and representations, the Private Foundations' compensation to K will not be an act of self-dealing pursuant to section 4941(d)(2)(E) of the Code and section 53.4941(d)-3(c)(1) of the regulations.

Based on representations on their use to accomplish exempt purposes accompanied with the exercise expenditure responsibility, payments or distribution by the Private Foundations to L will constitute qualifying distributions under section 4942 and will not be subject to tax under section 4945. Such payment by the Private Foundations to L of reasonable compensation for services is not prohibited inurement and not an activity serving the private interests of private individuals precluding exemption under section 501(c)(3).

Based on the foregoing, we rule as follows:

I. Amendments to the Private Foundations' Articles of Incorporation and Regulations to reflect L's authority to appoint a majority of the Private

Foundations' Trustees, as described above, will not adversely affect any of the Private Foundations' exempt status under Section 501(c)(3) of Code.

2. Payments by the Private Foundations to L for the rendering by L (or by outside consultants or service providers) of services on behalf of the Private Foundations will not be direct or indirect acts of self-dealing under section 4941 of the Code.

3. Payments by the Private Foundations to L for the rendering by L (or by outside consultants or service providers) of services on behalf of the Private Foundations and to further L's charitable purposes will constitute qualifying distributions for purposes of section 4942 of the Code.

4. The Private Foundations' obligation to exercise expenditure responsibility pursuant to section 4945 of the Code with respect to payments to L will be satisfied by the organizational and operational relationship between the Private Foundations and L, by L's agreement to redistribute all amounts received from the Private Foundations in qualifying distributions which are treated as distributions out of corpus and by the Private Foundations' reports on its Form 990-PF.

5. Payments by the Private Foundations to K for the rendering by K (or outside consultants or service providers) of services on behalf of the Private Foundations, calculated based on a percentage of the fair market value of the Private Foundations' assets rather than on a fully absorbed cost recovery basis and limited to the market rate for comparable services, will not be direct or indirect acts of self-dealing under section 4941 of the Code.

6. The payments by the Private Foundations described in 2 and 5 above will not constitute impermissible private inurement or private benefit or otherwise adversely affect any of the Private Foundations' exempt status under section 501(c)(3) of the Code, assuming that the amounts paid do not exceed fair market value for the services rendered.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. This ruling is directed only to the organizations 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,

(signed) Robert C Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3