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

200043047

Date: JUL 18 2000

Contact Person:

ID Number:

Telephone Number:

U.I.L. Nos.
4941.04-00
T:EO:RA:T2

Employer Identification Number:

LEGEND

A =
B =
K =
L =
M =
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Dear Applicant:

This letter responds to L's request dated June 25, 1999, as supplemented by subsequent submissions, for a ruling whether its participation in an investment partnership will result in excise tax under section 4941 of the Internal Revenue Code.

Facts:

L, M, N, O, P, Q, R, S, T, U, V, W, X, Y, and Z are 15 charitable remainder unitrusts ("CRUTs") benefitting the three children of A and B, and the children of the three children. Each CRUT benefits a particular child or grandchild of A and B. Each CRUT is represented to be described in sections 4947(a)(2) and 4947(b)(3) of the Code and thus subject to sections 4941 and 4945 but not 4943 or 4944. Each CRUT benefitting a member of one of the three family lines is a disqualified person with respect to the CRUTs benefitting other members of that family line under section 4946(a)(1)(G), but is not a disqualified person with respect to the CRUTs benefitting members of the other two family lines.

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In recent years, the family of A and B established K, a limited liability company ("the LLC"), to coordinate the investment of the family's assets. The LLC is managed by its Voting Members, who consist of the children of A and B (and any descendants to whom the children may transfer all or part of their Voting Membership Interest). The 15 CRUTs propose to invest in the LLC, in order to (1) diversify their portfolios, (2) pool their assets to obtain economies of scale and more negotiating power, and (3) obtain access to investments with higher minimums than each could satisfy using its assets alone.

The LLC is expected to be a disqualified person with respect to each of the CRUTs from time to time, as disqualified persons with respect to each CRUT will be deemed to own more than 35% of the profits interest in the LLC from time to time, either directly or under the attribution rules of section 267(c).

The LLC currently maintains multiple investment funds. Each fund has its own rules of governance ("Fund Rules"), including investment and redemption rules. Some funds that invest in nonmarketable, illiquid-type investments impose significant restrictions on the right of a fund participant or investor to withdraw. In contrast, those funds that invest solely in marketable securities grant each fund participant the right as of the end of each month upon reasonable advance notice (typically seven days) to withdraw from the fund in whole or part upon written request to the fund manager, and to receive fair market value in return for such withdrawal based on the participant's allocable share of the value of the securities held by the fund. The CRUTs will participate only in funds that invest solely in marketable securities and which, therefore, have liberal withdrawal rights.

L represents that its contribution to an LLC fund in exchange for a membership interest does not constitute a sale or exchange of property under the applicable State law. The LLC has elected partnership treatment for federal tax purposes.

The combined assets of the CRUTs to be contributed equal about 80% of the LLC's current assets. The percentage is expected to decline over time as individual family members contribute more assets to the LLC.

The LLC does not charge a member any fee for investing in its funds other than the member's pro rata share of expenses (investment, legal, accounting, administrative). However, each CRUT will not be charged for any expenses other than the marginal increase in investment expenses attributable to the CRUT's participation in the fund. Thus, no disqualified person will have fees reduced as a result of a CRUT's participation. Neither the LLC nor any disqualified person with respect to any of the CRUTs will, as a result of the participation in a fund by the CRUTs, receive compensation or any benefit other than some benefits also accruing to the CRUTs from the arrangement (i.e., increased negotiating power and access to investments with higher minimums). The CRUTs will incur substantially lower investment expenses in the LLC than they currently incur for essentially equivalent investments, which will increase the value of the charitable remainder interest of the CRUTs.

Under the representations made, there is no participation in the investment activities of the LLC by an organization described in section 501(c)(3) and classified as a private foundation.

In compliance with section 4941(d)(1)(A) of the Code, it is represented that the LLC will not buy, sell, or lease property in a sales or lease transaction with any disqualified person with respect to any of its members. In compliance with section 4941(d)(2)(A), neither the LLC nor its holdings are or will be subject to a mortgage or similar lien. In compliance with section 4941(d)(1)(B) of the Code, the LLC will not receive credit from, or extend credit to, a disqualified person with respect to any of its members. In compliance with section 53.4941(d)-2(f)(1) of the regulations, the LLC will not purchase or sell investments in an attempt to manipulate the price of the investments to the advantage of a disqualified

person.

Rulings Requested:

1. L's participation in a fund of the LLC, including deposits in and withdrawals from a fund by L, will not constitute a "sale or exchange" between L and the LLC within the meaning of the self-dealing rules of section 4941(d)(1)(A) of the Code.

2. L's participation in a fund of the LLC, including deposits in and withdrawals from a fund by L, 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).

3. L's sharing of LLC investment expenses incurred due to L's participation in a fund will not constitute self-dealing because such payment will be for the performance of personal services which are reasonable and necessary to carry out the exempt purpose of L, assuming such payment and reimbursement is not excessive.

Law:

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

Section 4941(d)(1) of the Code defines self-dealing as including any direct or indirect--

(A) sale or exchange, or leasing, of property between a private foundation and a disqualified person;

(B) lending of money or other extension of credit between a private foundation and a disqualified person;

(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;

(E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4941(d)(2)(E) of the Code provides generally that 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 4943 of the Code imposes a tax on the excess business holdings of a private foundation (combined with the holdings of disqualified persons) in a business enterprise.

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.

Section 4946(a)(1) of the Code provides that a "disqualified person," with respect to a private foundation, includes

(A) a substantial contributor (including a creator of a trust)
(B) a foundation manager
(C) an owner of more than 20% of a corporate, partnership, or trust substantial contributor
(D) a family member (including a child or grandchild) of an individual described above
(E) a corporation of which persons described above own more than 35% of the total combined voting power
(F) a partnership in which persons described in (A)-(D) own more than 35% of the profits interest
(G) a trust or estate in which persons described in (A)-(D) hold more than 35% of the beneficial interest

Section 4947(a)(2) of the Code provides that section 4941 applies to a split-interest trust for which a charitable deduction was allowed as if such trust were a private foundation.

Section 53.4941(d)-1(a) of the Foundation and Similar Excise Taxes Regulations provides that 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(d)(2) of the regulations provides that the furnishing of goods, services, or facilities without charge by a disqualified person to a private foundation shall not be an act of self-dealing.

Section 53.4941(d)-2(f)(2) of the regulations provides that 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 that "personal services" include 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. This paragraph applies without regard to whether the person who receives the compensation (or payment or reimbursement) is an individual. The portion of any payment which represents payment for property shall not be treated as payment of compensation (or payment or reimbursement of expenses) for the performance of personal services for purposes of this paragraph.

In section 53.4941(d)-3(c)(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 shall not constitute an act of self-dealing.

Rationale:

Each of the requested rulings is discussed in turn below.

1. We have considered the issue whether a contribution by a CRUT to the LLC in exchange for a membership interest constitutes a sale or exchange of property for purposes of section 4941(d)(1)(A) of the Code. If so, there would be an act of self-dealing where the ownership interests in the LLC were such as to constitute the LLC a disqualified person with respect to the CRUT immediately before the contribution. However, given the taxpayer's representations regarding the applicable State law principles, we find no sale or exchange of property under the circumstances.

2. We find that any benefits that the LLC and its disqualified person members may derive from a CRUT's participation in the LLC funds will be incidental and tenuous as described in section 53.4941(d)-2(f)(2) of the regulations. We note that section 4943 of the Code contemplates co-investment arrangements between foundations and disqualified persons under specified circumstances, and in the case of section 4943(d)(3)(B), without ownership limitations. We also note that, under the facts presented, participation by the CRUTs will not benefit the disqualified person investors by reducing their allocable administrative expenses.

3. Under the facts presented and represented, we find the reimbursement of investment expenses incurred by the LLC to be payment for personal services reasonable and necessary to carry out exempt purposes (assuming that the charges are not excessive). The situation is similar to that described in section 53.4941(d)-3(c)(2), Example (2) of the regulations.

Rulings:

Accordingly, we rule as follows:

1. L's participation in a fund of the LLC, including deposits in and withdrawals from a fund by L, will not constitute a "sale or exchange" between L and the LLC within the meaning of the self-dealing rules of section 4941(d)(1)(A) of the Code.

2. L's participation in a fund of the LLC, including deposits in and withdrawals from a fund by L, 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).

3. L's reimbursement to the LLC of investment expenses incurred due to L's participation in a fund will not constitute self-dealing because such payment will be for the performance of personal services which are reasonable and necessary to carry out the exempt purpose of L, assuming such payment and reimbursement is not excessive.

Except as we have ruled above, we express no opinion as to the tax consequences of the transaction under the cited provisions of the Code or under any other provisions of the Code.

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

Because this letter could help resolve any future questions about the application of Chapter 42 of the Code to its activities, L should keep a copy of this ruling in its permanent records.

We are providing the Ohio Tax Exempt and Government Entities office a copy of this ruling.

Sincerely yours,

(signed) Garland A. Carter

Garland A. Carter
Manager, Exempt Organizations
Technical Group 2