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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Contact Person: NO THIRD PARTY CONTACTS

Telephone Number:

In Reference to:

Date: OCT 22 1998

Legend:

M =
N =
O =
A =
B =
C =
D =
E =
F =
a =
b =
c =
d =
e =
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Dear Ladies and Gentlemen:

This is in reply to your letter of May 1, 1998. You have asked us to rule on whether your proposed investment of funds will constitute a direct or indirect act of self-dealing under section 4941 of the Internal Revenue Code. In addition, you have asked us to rule on whether your payment of compensation for proposed investment advisory services will constitute self-dealing, and whether the payment of such compensation will constitute inurement of your net earnings to any private individual or entity.

You are a non-profit corporation and received a ruling that you are tax exempt under section 501(c)(3) of the Code on October 15, 1997. You have been classified as a private foundation within the meaning of section 509(a). Your primary source of financial support has been and will continue to be contributions from your founder, M. You state further, that you have also received a contribution from N and may receive donations from employees of M. These contributions, plus the revenues produced through investment of contributions, will be disbursed only to organizations which have qualified for exemption under section 501(c)(3).

You propose to invest a substantial portion of your assets by purchasing mutual fund shares in O. O is a family of retail mutual fund companies. Currently, O consists of eleven separate legal entities organized as either corporations or business trusts. You indicate that the number of separate funds under the umbrella of O may change periodically. Each separate entity may have several different series, with its own investment portfolio. Each series constitutes a fund, which may issue one or more classes of shares. You have submitted a prospectus and annual report for each Fund in which you propose to invest.

You also propose that A provide investment advisory services to manage your assets to the extent you invest in mutual funds. To the extent you place assets in investments other than mutual funds, B may provide investment advisory services. Both A and B would be paid compensation or advisory fees for services rendered based on the assets under management. You state that these fees and rates would be no more than the customary fees and rates charged on a regular basis to M's thousands of public customers.

You have supplied the following background information. C was created through the merger of M and D. C is a holding company that holds all of the stock of M. M is now a subsidiary holding company. Neither M nor C conducts business operations.

A is a wholly-owned subsidiary of M, your creator. A is a registered investment advisor which provides investment advisory services to O and receives an advisory fee from each separate Fund based on the assets under management. E is a wholly-owned subsidiary of A. E serves as underwriter to the Funds and receives a distribution fee from each Fund based on the assets under management. A and F, another wholly-owned subsidiary, also receive certain administrative fees from O. The advisory agreements between each Fund and A and the underwriting agreements between each Fund and E must be approved by the directors of each Fund and may be cancelled upon 60 days notice. Each advisory agreement and underwriting agreement will terminate automatically unless it is renewed annually by each Fund.

B provides advisory services to A and private accounts. B receives fees from A and each private account under separate service agreements based on assets under management.

M appoints your Board of Trustees. Currently, a, b, and c, serve as Trustees. You have indicated that d will be nominated for election as a Trustee at the next appropriate board meeting. Your day-to-day management is conducted by five officers appointed by the Board of Trustees. Your current officers are:

a, President, b, Vice President, c, Vice President, e, Secretary/Treasurer, and f, Executive Director.

As of December 31, 1997, b, with his spouse, owned 0.13% of C's common stock. In addition, two related partnerships owned by b and his spouse, owned an additional 5.23% of C's common stock. Overall, b and his spouse, together with the family owned partnerships, owned 5.36% of C's common stock.

a, with his spouse, owned 8.13% of C's common stock. In addition, several a family trusts owned .78% of C's common stock. Overall, a and his spouse, together with the family trusts, owned 8.91% of C's common stock.

c, with his spouse, owned 4.29% of C's common stock. A related partnership owned an additional 1.34% of the stock. Overall, c, his spouse, and related partnership, owned 5.63% of C's common stock.

d, with her spouse, owned .36% of C's common stock. In addition, a related d trust owned .05% of the stock. Overall, d, her spouse, and related entities, owned .41% of C's common stock.

Together, a, b, and c, collectively and together with their related parties, owned 19.90% of C's common stock. If d is included by virtue of her proposed election as a Trustee, individuals on your Board of Trustees will hold, collectively and together with their related parties, 20.31% of C's common stock.

a serves on C's Board of Directors. He is one of 15 members and is C's current Vice President. a is one of 4 members of the Board of Directors of M and is its current Chairman. a is also the Chairman and a Director of A, E, and F. He also serves as Chairman and a Director of each of the Funds. Each Fund is required by law to have a majority of directors that are unaffiliated with M or any of its subsidiaries.

c is a member of C's Board of Directors. He is one of the four members of the Board of M and is its current Senior Vice President. c is a director of E and F. He is Senior Vice President of each of the Funds and may become a director in the future.

b serves on C's Board of Directors and on M's Board. b is the current President and Chief Executive Officer of M, a senior managerial position. b is a director and President of A. In addition, b is a director and Senior Vice President of E and F. He is President and a director of each of the Funds.

d is the current Vice President of M.

You indicate further that after the initial offering, shares in each of M's Funds are owned by the investing public. M's continuing ownership interest in any given Fund constitutes less that .01% of the outstanding shares.

Your Trustees, a, b, c, and, potentially, d, own shares in some of the Funds. a, b and c's ownership interests, together with their spouses and related parties, constitute less than 2 percent of the outstanding shares of any Fund. d's ownership interest in any of the Funds is limited to less than 1%. You have stated that you will keep track of the ownership interests of your Trustees and in M's ownership of any of the Funds in O. You will not invest, or remain invested, in any Fund if the collective ownership interest of your Trustees and M equals or exceeds 5% of the outstanding shares of such Fund.

Based on the above information, you have requested the following rulings:

1. Your purchase of shares in existing Funds issued by O will not constitute a direct or indirect act of self-dealing between you and a disqualified person under section 4941 of the Code.

2. Your payment of compensation to A or B for investment advisory services will not constitute self-dealing under section 4941 of the Code, provided that the compensation is not excessive in relation to the services provided by each of them.

3. Your payment of compensation to A or B for investment advisory services will not constitute inurement of your net earnings to the benefit of either A or B, or any private individual, provided that the compensation paid is not excessive in relation to the services provided by them.

Section 4941(a) of the Code imposes a tax on each act of self-dealing between a private foundation and a disqualified person as defined in section 4946(a).

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

Section 4941(d)(1)(D) of the Code provides that the term "self-dealing" includes any direct or indirect payment of

compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person.

Section 53.4941(d)-1(a) of the Foundation and Similar Excise Tax Regulations provides that for purposes of section 4941, the term "self-dealing" means any direct or indirect transaction described in section 53.4941(d)-2 of the regulations. For purposes of this section it is immaterial whether the transaction results in a benefit or detriment to the private foundation.

The regulations under section 4941 restrict the application of the word "indirect" as found in section 4941(d) by describing certain safe harbor transactions that will not be treated as indirect self-dealing. Section 53.4941(d)-1(b)(4) of the regulations provides, in pertinent part, as follows:

> (4) Transactions with certain organizations. A transaction between a private foundation and an organization which is not controlled by the foundation (within the meaning of subparagraph (5) of this paragraph), and which is not described in section 4946(a)(1)(E) ..., because persons described in section 4946(a)(1)(A), (B), (C), or (D) own no more than 35 percent of the total combined voting power... of such organization, shall not be treated as an indirect act of self-dealing between the foundation and such disqualified persons solely because of the ownership interest of such persons in such organization.
>
> (5) Control. For purposes of this paragraph, an organization is controlled by a private foundation if the foundation or one or more of its foundation managers (acting only in such capacity) may, only by aggregating their votes or positions of authority, require the organization to engage in a transaction which if engaged in with the private foundation would constitute self-dealing....

Section 4941(d)(2)(E) of the Code provides, in part, that the payment of compensation by a private foundation to a disqualified person for personal services which are reasonable and necessary to carry out the exempt purpose of the foundation shall not be an act of self-dealing if the compensation is not excessive.

Section 53.4941(d)-3(c)(1) of the regulations provides that the payment of compensation (and the payment of 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 purposes 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 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. This paragraph applies without regard to whether the person who receives the compensation (or payment or reimbursement) is an individual.

Example 2 of section 53.4941(d)-3(c)(2) of the regulations provides as follows:

> C, a manager of private foundation X (and hence a disqualified person with respect to 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 not to be excessive. The payment of such compensation to C shall not constitute an act of self-dealing.

Section 4946(a)(1) of the Code states, in pertinent part, that the term "disqualified person" means with respect to a private foundation, 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 ... which is a substantial contributor to the foundation,
>
> (D) a member of the family (including a spouse, children, and grandchildren) of any individual described in subparagraph (A), (B), or (C).,
>
> (E) a corporation in which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the total combined voting power.

Section 4946(b) of the Code defines a foundation manager as: an officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of

officers, directors, or trustee...) and 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(e)(2) of the Code states that a "substantial contributor" is, generally, anyone (individual, corporate or entity) who contributes or bequeaths more than $5,000 to a private foundation if it amounts to more than two percent of the total contributions and bequests received by the foundation before the close of its tax year.

In determining a person's stock holdings under section 4946(a)(1)(E), section 4946(a)(3) and (4) indicate that the ownership of stock by an individual's family or by corporations, partnerships, or other entities in which the individual has an interest will be attributed to the stockholder.

Your first question, whether your purchase of shares in existing O Funds will constitute a direct or indirect act of self-dealing, falls within the purview of section 4941(d)(1)(A) which includes a "sale or exchange of property" as an act of self-dealing. No act of self-dealing will occur unless any of the Funds is determined to be a disqualified person.

The Funds may be classified as disqualified persons with respect to you if (i) they are substantial contributors [4946(a)(1)(A)] or (ii) if a substantial contributor and its trustees own more than 35 percent of the combined voting power [4946(a)(1)(E)]. Since none of the Funds has made any contributions to you, none of the Funds is a substantial contributor. As determined by the attribution rules of section 4946(a)(2) and (3), the combined holdings of M, a, b, c, and d in each of the Funds is below the 35 percent threshold. In addition, section 53.4941(d)-1(b)(4) of the regulations provides a safe harbor from any implication of indirect self-dealing between these parties. Because none of the Funds are disqualified persons, your purchase of any of the existing Funds in O will not constitute an act of direct or indirect self-dealing within the meaning of section 4941 of the Code.

Your second question is whether your payment of compensation to A or B for investment advisory services will constitute an act of self-dealing. A and B are disqualified persons under section 4946(E) because they are wholly owned subsidiaries of M, a substantial contributor. You have stated that the fees to be paid will be the same as those paid by numerous unrelated members of the investing public on a regular basis for similar investment services. Investment advisory services are one type of personal

services covered by section 4941(d)(2)(E) of the Code and section 53.4941(d)-3(c)(1) of the regulations. Similar services are described in Example 2 of section 53.4941(d)-3(c)(2). Because the compensation you are to pay A and B for personal investment services is the same as those fees paid by the general public we conclude that the compensation is not excessive within the meaning of section 53.4941(d)-3(c)(1). Such services also seem to be reasonable and necessary to carry out your exempt purpose of generating funds for charitable contributions through management of your investment portfolio. Accordingly, your payment of compensation to A and B will not constitute an act of self-dealing under section 4941.

Your third question is whether your payment of compensation to A or B for investment advisory services constitutes inurement of your net earnings to the benefit of either A or B, or any private individual, provided the compensation paid is not excessive in relation to the services provided. Section 501(c)(3) of the Code and the regulatory scheme thereunder provides that inurement and undue private benefit are inconsistent with exemption and are prohibited.

It is well established that an organization described in section 501(c)(3) of the Code is entitled to pay compensation for services rendered, provided the compensation is reasonable in amount and not excessive in relation to the services provided. See, Home Oil Mill v. Willingham, 68 F. Supp. 525 (N.D. Ala. 1945), aff'd, 181 F.2d 9 (5th Cir.), cert. denied, 340 U.S. 852 (1950); Mabee Petroleum Corp. v. U.S. 203 F.2d 872 (5th Cir. 1953); Rev. Rul. 69-383, 1969-2 C.B. 113.

As indicated above, the compensation you propose to pay A and B for investment advisory services is not excessive. You will be paying the same fees as members of the general public purchasing shares of the Funds. Because the compensation you will be paying is reasonable, it will not constitute inurement nor undue private benefit and will not jeopardize your continued exemption under section 501(c)(3) of the Code.

In conclusion, based on the facts you have described, we rule as follows:

1. Your purchase of shares issued by O will not constitute a direct or indirect act of self-dealing between you and a disqualified person under section 4941 of the Code.

2. Your payment of compensation to A or B for investment advisory services will not constitute self-dealing under section

4941 of the Code, provided that the compensation is not excessive in relation to the services provided by each of them.

3. Your payment of compensation to A or B for investment advisory services will not constitute inurement of your net earnings to the benefit of either A or B, or any private individual, provided that the compensation paid is not excessive in relation to the services provided by them.

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

We are informing the EP/EO key district office of this ruling. Because this letter could help resolve any questions about your exempt status and foundation status, you should keep it in your permanent records.

If you have any immediate questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter. For other matters, including questions concerning reporting requirements, please

Gerald V. Sack

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4