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

Date:

MAR 10 2000

Contact Person:

ID Number:

Contact Number:

OP:E:EO:T5

Employer Identification Number:

LEGEND: M =
N =
O =
P =

Dear Sir or Madam:

This is in reply to your letter of January 8, 1998, as amended by your letters of February 13, 1998 and July 9, 1998, regarding the proposed investment of the assets of certain charitable organizations and nonexempt charitable trusts in investment portfolios sponsored by M.

M and N are national banking associations. Each is a direct, wholly owned subsidiary of 0. M is a national bank offering a full range of banking, trust and investment services. M maintains certain funds exclusively for the collective investment of monies contributed thereto by M in its capacity as a trustee, executor, administrator, guardian, or custodian. Some of these common trust funds have been established primarily for the investment of the assets of private foundations. For the purposes of this letter, unless otherwise specified both private foundations and all of the various types of trusts described in section 4947(a)((l) and (a)(2) will be referred to as private foundations. It has been represented that these funds are common trust funds described in section 584(a). M wants to convert the two common trust funds maintained primarily for the investment of private foundation assets into mutual funds and terminate the common trust funds.

In the past, M has contributed assets of the private foundations to the common trust funds either in its capacity as trustee of a private foundations or in its capacity as trustee of a trust established by a private foundation for the investment of a portion of its assets. M charges fees to each private foundation for which it acts as trustee. The fees are generally based on a fixed percentage of the assets under management, with a sliding scale dependent upon the amount of the assets under management. Where assets are invested in a mutual fund advised by M the fee schedule is altered to exclude the costs of investment management or advisory services.

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M is the investment advisor to P, a family of open-end management investment companies. These funds are bank advised funds. Each corporate entity consists of a series of distinct portfolios of assets having different investment policies and objectives. Shareholders hold a series of
shares that represent an exclusive interest in one distinct portfolio of assets. It has been represented that each portfolio (or mutual fund) referred to herein as a Fund qualifies as a regulated investment company under Subchapter M sec 851 et. seq. of the Code.

Each Fund is subject to certain fees charged by its service providers. Certain of the service providers are not affiliated with M. M is currently prohibited by the Glass-Steagall Act from serving as principal underwriter of the shares of any of the Funds. M acts as investment advisor to all Funds under investment advisory contracts. M has also served as sub-administrator to the Funds and receives for its services a fee from the administrator. N serves as custodian for the Funds, for which it receives fees from the Funds.

Subject to the approval of the members of the Boards of Directors of P, M will be substituted for N as custodian of the Funds. If this occurs the custodial fees earned in the future by M will, like those currently earned by N, be reasonable and in accordance with industry practices and will be approved by the Boards of Directors of the Funds.

It has been represented that none of the Funds own any stock of O. M does not own shares of any of the Funds, except on behalf of other parties. These parties include three defined benefit pension plans organized for the exclusive benefit of O's employees and the employees of its subsidiaries.

From time to time M may purchase shares of those Funds that are money market mutual funds through what is referred to as a "late day program". It has been represented that such a program has been approved by the Office of the Comptroller of the Currency as a natural extension of established banking services.

M has determined, in its capacity as fiduciary of the private foundations participating in the common trust funds that investments be made directly in P. To effect this conversion substantially all of the assets of each common trust fund will be transferred to a Fund in exchange for shares equal in value to the transferred assets. Each common trust fund will then terminate. No fees will be charged to either the common trust funds or the private foundations that are participants in those Funds in connection with the conversion.

It is possible that, in the future, M in its capacity as trustee for a private foundation will have the private foundation sell the shares in the Fund in which it is invested and purchase the shares of another Fund.

It has been represented that::

(1) All of the fees charged by M to the private foundations for its services as trustee are reasonable for the services rendered, in accordance with industry practice, and consistent with local laws governing fiduciaries.

(2) All of the fees charged by M or N to the Funds for their representative services as investment advisor, sub-administrator and custodian of the Funds, and all of the fees that may be charged in the future by M and N to the Funds for other services they may provide to the Funds, are reasonable and in accordance with industry practice.

(3) In its capacity as trustee of the private foundations, M will not cause the private foundations to

purchase or sell shares of the Funds in an attempt to manipulate the price of the shares of the Funds for the benefit of M, any of its affiliates, or the defined benefit plans maintained for the benefit of the employees of O and its subsidiaries.

The following rulings have been requested:

1. The investment of the assets of the private foundations for which M serves as trustee, or of the assets of trusts established by private foundations for the investment of a portion of their assets and for which M serves as trustee, in the Funds sponsored by M will not constitute acts of self-dealing within the meaning of section 4941 of the Code.

2. The receipt by M or N of fees from the private foundations after the investment of their assets in the Funds or from the Funds in which the private foundation assets are invested will not constitute acts of self-dealing within the meaning of section 4941 of the Code.

Section 501(c)(3) of the Code provides, in part, for exemption from federal income tax for a corporation organized and operated exclusively for charitable, scientific or educational purposes provided no part of the corporation's net earnings inure to the benefit of any private shareholder or individual.

Section 509(a) of the Code provides that, unless specifically excepted, a domestic or foreign organization described in section 501(c)(3) is a private foundation and subject to the excise taxes of Chapter 42.

Section 4947(a) of the Code applies certain of the excise taxes imposed by Chapter 42 of the Code to certain nonexempt trusts. Such trusts include charitable remainder trusts, charitable lead trusts and nonexempt charitable trusts.

Section 4941(a) 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)(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 4941(d)(1)(E) of the Code provides that the term "self-dealing" includes 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 4941(d)(2)(D) of the Code provides that the furnishing of goods, services, or facilities by a private foundation to a disqualified person shall not be an act of self-dealing if such furnishing is made on a basis no more favorable than that on which such goods, services, or facilities are made available to the general public.

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 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)-l(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

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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.

Section 53.4941(d)-2(c)(4) of the regulations provides that the performance by a bank or trust company, which is a disqualified person, of trust functions and certain general banking services for a private foundation is not an act of self-dealing, where the banking services are reasonable and necessary to carrying out the exempt purposes of the private foundation, if the compensation paid to the bank or trust company, taking into account the fair interest rate for the use of the funds by the bank or trust company, for such services is not excessive. The general banking services allowed by this subparagraph are: (1) checking accounts, as long as the bank does not charge interest on any withdrawals; (2) savings accounts, as long as the foundation may withdraw its funds on no more than 30-days notice without subjecting itself to a loss of interest on its money for the time during which the money was on deposit; and (3) safekeeping activities.

Section 53.4941(d)-3(c)(1) of the regulations provides that the payment of compensation (and the payment or 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 resect 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 describes a disqualified person as including a foundation manager as that term is described in section 4946(b).

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 trustees of the foundation), 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 7701(a)(1) of the Code defines the term "person" as including an individual, a trust, estate, partnership, association, company or corporation.

Rev. Rul. 67-5, 1967-1 CB 123 holds that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities that were beneficial to them, but detrimental to the foundation. This resulted in the foundation's ownership of a non-income producing assets which prevented it carry on a charitable program commensurate in scope with its financial resources. The ruling concludes that the

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foundation was operated for a substantial nonexempt purpose and served the private interest of the creator and his family and therefore was not entitled to exemption under section 501(c)(3) of the Code.

Rev. Rul. 74-287, 1974-1 C.B. 327 provides that the employees of a bank designated as the trustee of a private foundation, who have been delegated the responsibility for the day-to-day administration and distribution of the trust funds, are foundation managers within the meaning of section 4946(b)(1) of the Code and are disqualified persons as defined in section 4946(a)(1)(B) even though they are ultimately responsible to the bank directors and officers for their actions with respect to the trust.

Rev. Rul. 77-259, 1977-2 C.B. 387, holds that the purchase by a private foundation of a mortgage from a bank which is a disqualified person engaged in the normal course of its business in acquiring and selling mortgages is not within the exception for general banking services under section 53.4941(d)-2(c)(4) of the regulations and constitutes an act of self-dealing.

Rev. Rul. 77-288, l977-2 C.B. 388, holds that the purchase by a private foundation from a banking institution, a disqualified person with respect to the foundation, of certificates of deposit with a maturity date one year from the date of issue and providing for a reduced rate of interest if they are not held to the maturity date is an act of self-dealing.

Generally, an act of self-dealing may be present where the assets of a private foundation are transferred to or used by or for a disqualified person. See Rev. Rul. 77-288, supra. It is not pertinent whether the transaction is beneficial or detrimental to the private foundation. Similarly, an abuse of the assets of a private foundation could lead to revocation of tax exempt status. See Rev. Rul. 67-5, supra.

It is also well established that a bank or any of its employees may be considered a disqualified party where it is responsible for the day-to-day administration of trust funds. See Rev. Rul. 74-287, supra and Rev. Rul. 77-259, supra. However, an exception is provided to the definition of self-dealing where the bank or individual only performs trust functions and certain limited general banking services, the services are reasonable and necessary to carrying out the exempt purposes of the private foundations and the compensation paid to the individual or the bank is not excessive. The Service has consistently strictly interpreted the term general banking services to include only checking accounts, saving accounts, and safekeeping activities. Trust functions historically include investment functions.

The information submitted establishes that M and N will be compensated for their services in managing the assets of certain private foundations. The Funds are not controlled by M or N or any of their affiliates and none of M or Ns assets or any of the assets of their affiliates will be invested in Funds. The services to be provided by M and N fall within the term "trust functions" as used in section 53.4941(d)-2(c)(4) of the regulations and within Example 2 of section 53.4941(d)-3(c). It is clear that the services provided are reasonable and necessary to obtain funds to carry out the exempt purposes of the private foundations. Furthermore, it has been represented that the amount of compensation to be paid M and N will be reasonable.

Therefore, based on the description of this program and the representations you have presented we rule that:

1. The investment of the assets of the private foundations for which M serves as trustee, or of the assets of trusts established by private foundations for the investment of a portion of their assets and for which M serves

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as trustee, in the Funds sponsored by M will not constitute acts of self-dealing within the meaning of section 4941 of the Code.

2. The receipt by M or N of fees from the private foundations after the investment of their assets in P or from P in which the private foundation assets are invested will not constitute acts of self-dealing within the meaning of section 4941 of the Code.

This ruling does not address any possible effect under the Chapter 42 Excise Tax Provisions which might occur if the Glass Steagall Act were repealed or amended in such a way as to permit the Bank to serve as a principal underwriter.

As requested, we are not considering the issue of whether investing in an equity index fund or any industry specialized fund which includes stock in a disqualified person is an act of either direct or indirect self-dealing within the meaning of section 4941 of the Code.

This ruling is directed solely to provisions of the Code which pertain to section 501(c)(3) tax exempt organizations or other organizations subject to the Foundation and Similar Excise Tax Provisions, for example organizations described in section 4947(a)(1) or (2). All representations or references to any other subsections of the Code have been accepted as presented and the Service has not ruled that these provisions are or are not applicable.

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

Sincerely yours,

(signed) Garland A. Carter

Garland A Carter
Manager, Exempt Organizations
Technical Group 2

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