Q. IRC 4941 - THE NATURE OF SELF-DEALING

1. Introduction

When are transactions between private foundations and disqualified persons acts of self-dealing? Can an act of self-dealing benefit a private foundation? Will the deposit of foundation funds in a checking account with a disqualified person be an act of self-dealing? The purpose of this topic is to discuss the nature of self-dealing acts and to enable you to determine whether particular transactions involve self-dealing.

2. History

Since enactment in 1913, IRC 501(c)(3) and its predecessors have contained restrictions on dealings between exempt organizations and related persons. In order to qualify for exemption an organization has had to demonstrate that it is organized and operated exclusively for exempt purposes and that no part of its net earnings inure to the benefit of any private shareholder or individual.

In 1950 Congress further restricted transactions between exempt organizations and related persons by enacting what is now IRC 503. Generally, IRC 503 provided that if certain IRC 501(c)(3) organizations and related persons engaged in "prohibited transactions", the organization would lose its tax exempt status for at least one year. The organizations subject to IRC 503 were similar to those that we would now characterize as private foundations. The definition of related persons for IRC 503 was roughly equivalent to the definition of a disqualified person under IRC 4946. Not surprisingly, the list of prohibited transactions resembled in many ways the current statutory list of acts of self-dealing. The most significant difference between IRC 503 and the current self-dealing provisions was that in order for a transaction to be a prohibited transaction the organization would have to suffer a detriment. Disqualified persons are absolutely prohibited from engaging in acts of self-dealing. In effect, IRC 503 imposed arm's length standards on prohibited transactions.

After the passage of IRC 503 the Service found the new law difficult to administer. As the Joint Committee on Taxation found in 1969, the arm's-length standards proved to require disproportionately great enforcement efforts, resulting in sporadic and uncertain effectiveness of the provisions. On occasion the sanctions were ineffective and discouraged the expenditure of enforcement effort.

On the other hand, in many cases the sanction (loss of exemption) was so great in comparison to the offense involved, it caused reluctance in enforcement, especially in view of the element of subjectivity in applying arm's-length standards. Consequently, as a practical matter, prior law did not preserve the integrity of private foundations.

In the Tax Reform Act of 1969, the prohibited transactions rules of IRC 503 were amended to exclude IRC 501(c)(3) organizations from their coverage after December 31, 1969. In IRC 4941, the act set fixed standards that are not dependent in their application on arm's length standards. The Congress listed a series of transactions between foundation (defined in IRC 509(a)) and disqualified persons (defined in IRC 4946) that would give rise to excise tax. Generally, the rules are applied without regard to whether the foundation has suffered a detriment. This was intended to eliminate the enforcement problems created by arm's length standards. Self-dealing transactions may, in fact, in some situations benefit a foundation. None the less they are subject to tax under IRC 4941.

3. General Explanation of IRC 4941

The self-dealing taxes of IRC 4941 apply to private foundations, nonexempt trusts described in IRC 4947(a)(1) that are private foundations, and to certain split-interest trusts described in IRC 4947(a)(2). Self-dealing issues are discussed in the 1981 and 1982 CPE texts.

IRC 4941(d) provides that the following transactions are generally considered acts of self-dealing between a private foundation and a disqualified person:

A. Sale, exchange, or leasing of property,
B. Lending money or other extension of credit,
C. Furnishing of goods, services, or facilities,
D. Paying compensation or paying or reimbursing expenses to a disqualified person,
E. Transferring foundation income or assets to, or for the use by or benefit of, a disqualified person,
F. Certain agreements to make payments of money or property to government officials.

For purposes of IRC 4941, it is immaterial whether the transaction results in a benefit or a detriment to the private foundation. A self-dealing transaction does

not include a transaction between a private foundation and a disqualified person where the disqualified person status arises only as a result of the transaction.

The general counsel memorandum and private letter rulings cited in this article are not to be used as authority. They are included for illustrative purposes only.

IRC 4941 prohibits indirect as well as direct self-dealing. The purpose of the indirect self-dealing rules is to prevent transactions from taking place indirectly that could not be accomplished directly between the private foundation and a disqualified person. Indirect self-dealing involves transactions between a disqualified person and an organization controlled by a private foundation. Reg. 53.4941(d)-1(b)(5) defines "control" for purposes relative to acts of indirect self-dealing.

Reg. 53.4941(d)-1(b)(1) contains the following exception to the indirect self-dealing rules:

(i) If a transaction results from a business relationship established before the transaction otherwise constituting an act of self-dealing; and

(ii) the transaction is at least as favorable to the organization controlled by the foundation as an arm's-length transaction with an unrelated person; and

(iii) either the (a) organization controlled by the foundation could have engaged in the transaction with someone other than a disqualified person only at a severe economic hardship, or (b) because of the unique nature of the product or services provided by the organization controlled by the foundation, the disqualified person could not have engaged in the transaction with anyone else, or could have done so only at severe economic hardship, the transaction is not an act of indirect self-dealing.

Reg. 53.4941(d)-1(b) contains several other exceptions to the self-dealing rules. These include the following:

Reg. 53.4941(d)-1(b)(3) provides that indirect self-dealing does not include a transaction involving a private foundation's interest or expectancy in property (whether or not encumbered) held by an estate (or revocable trust, including a trust which has become irrevocable on a grantor's death), regardless of when title to the property vests under local law, if:

(i) the administrator, executor or trustee can sell, is required to sell, or can distribute the property to another beneficiary;

(ii) the transaction is approved by the probate court having jurisdiction over the estate (or by another court having jurisdiction over the estate (or trust) or over the private foundation);

(iii) the transaction occurs before the estate is terminated for federal income tax purposes (or, in the case of a revocable trust, before it is considered subject to IRC 4947);

(iv) the estate (or trust) receives an amount at least equal to the foundation's interest or expectancy in the property at the time of the transaction; and

(v) with respect to transactions occurring after April 16, 1973, the transaction (1) results in the foundation receiving an interest or expectancy at least as liquid as the one it gave up; (2) results in the foundation receiving an asset related to the active carrying out of its exempt purposes; or (3) is required under the terms of any option which is binding on the estate (or trust).

Reg. 53.4941(d)-1(b)(4) provides that transactions between a private foundation and an organization that is not controlled by the foundation and is not a disqualified person with respect to the foundation are not to be considered indirect self-dealing acts between the private foundation and the stockholders or holders of beneficial interest in the organization, even though the stockholders of beneficial interest are disqualified persons with respect to the foundation, solely because of the ownership interests of such persons.

Reg. 53.4941(d)-1(b)(6) provides that indirect self-dealing does not include any transaction between a disqualified person and an organization controlled by a private foundation or between two disqualified persons where the foundation's assets may be affected by the transaction if:

(i) the transaction arises in the normal and customary course of a retail business engaged in with the general public.

(ii) in the case of a transaction between a disqualified person and a controlled organization, the transaction is at least as favorable to the controlled organization as an arm's-length transaction with an unrelated person, and

(iii) the total of the amount involved in transactions with any one disqualified person does not exceed $5000 in any one taxable year.

A. Sale, Exchange or Leasing of Property

(1) Sale or Exchange of Property in General

Generally, under IRC 4941(d)(1)(A) any direct or indirect sale or exchange of property between a private foundation and a disqualified person is an act of self-dealing. For example, the sale of incidental supplies by a disqualified person to a private foundation is an act of self-dealing regardless of the amount paid to the disqualified person. A special rule in IRC 4941(d)(2)(A) provides that the transfer of real or personal property by a disqualified person to a private foundation is treated as a sale or exchange if the foundation:

(a) assumes a mortgage or similar lien which was placed on the property prior to the transfer, or

(b) takes the property subject to a mortgage or similar lien placed on it by the disqualified person within the 10-year period ending on the date of transfer. The term "similar lien" includes, but is not limited to, deeds of trust and vendors'

liens. It does not include any lien which is insignificant in relation to the fair market value of the property transferred.

Published examples of the application of IRC 4941(d)(1)(A) include:

a. Rev. Rul. 76-18, 1976-1 C.B. 355, holding that the sale of a private foundation's art objects to a disqualified person at a public auction conducted by an auction gallery to which the items were consigned for sale constitutes an act of self-dealing. The auctioneer is the agent of the seller and, under such circumstances, the seller and highest bidder for the property (the disqualified person) are principals to the transaction.

b. Rev. Rul. 77-259, 1977-2 C.B. 387, holds that the purchase by a private foundation of a mortgage from a bank, a disqualified person that in the normal course of its business acquires and sells mortgages, was not within the exception for general banking services and was an act of self-dealing under IRC 4941(d)(1)(A).

c. Rev. Rul. 77-379, 1977-2 C.B. 387, holds that a private foundation's transfer of stock in repayment of an interest-free loan, made by a disqualified person and used exclusively for exempt purposes, is tantamount to a sale or exchange between the private foundation and the disqualified person and is an act of self-dealing under IRC 4941(d)(1)(A).

d. Rev. Rul. 78-76, 1978-1 C.B. 377, holds that the trustee of a foundation who, while representing both himself and the foundation, willfully and without reasonable cause sells property he owns to the foundation knowing that the sale is an act of self-dealing is liable for both the tax imposed on an act of self-dealing by IRC 4941(a)(1) and the tax imposed on the participation of foundation managers by IRC 4941(a)(2).

e. Rev. Rul. 78-77, 1978-1 C.B. 378, holds that the purchase of property by a private foundation from a testamentary trust is

not an act of self-dealing under IRC 4941(d)(1)(A) merely because a banking institution is the trustee of both the purchasing private foundation and the selling trust. The trust is not a disqualified person under IRC 4946 with respect to the foundation.

The following court cases also illustrate the application of IRC 4941(d)(1)(A).

f. George M. Underwood, Jr. and The Underwood Foundation v. U.S., 461 F. Supp. 1382 (N.D. TX 1978). The Court held that there was no act of self-dealing where the foundation manager donated a large sum of money to the foundation on the condition and to the extent that the donation would be tax-deductible, and later received a refund of the donation to the extent that the IRS disallowed the charitable deduction. The return by the foundation of a portion of the contribution was not an act of self-dealing because the commitment to the foundation was conditioned upon the contributor being able to deduct all of his contributions to the foundation.

   Additionally, it was held that the foundation manager conveyed only his equitable interest in real estate, and not legal title to a parcel of property where he sent a letter to the foundation stating his intention to sell the property and donate his net proceeds to the foundation, which in fact, he did. Consequently, the transaction did not constitute a sale to the foundation (an act of self-dealing.)

g. Rockefeller v. U.S., 718 F. 2d 290 (8th Cir. 1983), cert. denied, 104 S. Ct. 2180 (1984), aff'g 572 F. Supp. 9 (E.D. AR 1982). The Supreme Court denied certiorari in Rockefeller v. U.S. The Eighth Circuit Court affirmed the District Court decision upholding the Service's ruling that an IRC 4941 indirect act of self-dealing between a disqualified person and a private foundation that was established by a decedent's bequest resulted from the purchase of stock from the estate by the son of the decedent. The Court also upheld the validity of IRC 4941 and the regulations thereunder.

(2) Sales or Exchanges of Property That are Not Self-Dealing and Transitional Rules

Reg. 53.4941(d)-2(d)(3) provides that the furnishing of goods, services, or facilities by a disqualified person to a private foundation is not an act of self-dealing if they are furnished without charge. A furnishing is without charge even though the private foundation pays for transportation, insurance, or maintenance costs it incurs in obtaining or using the property, so long as the payment is not made directly or indirectly to the disqualified person.

Reg. 53.4941(d)-3(b) provides that the furnishing of functionally related (as defined in IRC 4942(j)(4)) goods, services, or facilities by a private foundation to a disqualified person is not an act of self-dealing if the same goods, etc. are made available to the general public on at least as favorable a basis. For purposes of this provision, there must be a substantial number of persons, other than disqualified persons, who could reasonably be expected to utilize the foundation's goods, services, or facilities.

Reg. 53.4941(d)-3(d) provides that under certain conditions, a transaction between a private foundation and a corporation which is a disqualified party is not considered self-dealing if the transaction takes place pursuant to a liquidation, merger, redemption, recapitalization, or other corporate adjustment, organization, or reorganization. The foundation must be afforded at least as favorable treatment as other holders of securities in the corporation in order for the transaction not to be considered self-dealing. Compensating the foundation with property, such as debentures, for its stock when other holders of identical stock receive cash would not be considered treating the foundation on a uniform basis. See Reg. 53.4941(d)-3(d)(2) for examples of this provision.

The self-dealing provisions became effective on January 1, 1970. However, certain transitional rules were adopted to permit the orderly elimination of existing arrangements. The transitional rules are described at Reg. 53.4941(d)-4.

(a) Section 101(l)(2)(A) of the Tax Reform Act of 1969 provides that transactions between a foundation and a corporation which is a disqualified person pursuant to terms of securities acquired by the foundation prior to May 27, 1969, are not acts of self-dealing provided such terms were in existence at the time the foundation

acquired the securities. An example is the sale of callable preferred stock acquired prior to the above date.

(b) Section 101(l)(2)(B) of the Tax Reform Act of 1969 permits a private foundation to sell certain excess business holdings to a disqualified person. See the 1979 EO ATRI Text for a discussion of section 101(l)(2)(B) and the 1981 EO CPE Text for an update on section 101(l)(2)(B).

(3) Transfer of Property Subject to a Mortgage or Similar Lien

One of the more significant problems in determining whether property is transferred subject to a mortgage or similar lien is whether the lien is "similar" within the meaning in the statute. Reg. 53.4941(d)-2(a)(2) provides that the term similar lien includes, but is not limited to, deeds of trust and vendor's liens, but does not include any other lien if the lien is insignificant in relation to the fair market value of the property transferred.

Rev. Rul. 78-395 and Rev. Rul. 80-132 provide guidance in determining what is a "mortgage or similar lien" within the meaning of Reg. 53.4941(d)-2(a)(2).

Rev. Rul. 78-395, 1978-2 C.B. 270, concerns a disqualified person who contributed his entire interest in certain land and improvements to a private foundation. The foundation did not assume the existing liens on the property and improvements but accepted the gift subject to them. One of the liens, a deed of trust, was placed on property by the disqualified person within the 10-year period described in IRC 4941(d)(2)(A). Accordingly, the transfer is treated as an act of self-dealing.

In the case described in Rev. Rul. 80-132, 1980-1 C.B. 255, a life insurance policy, donated to a private foundation, was subject to an outstanding loan made to the donor within the 10-year period described in IRC 4941(d)(2)(A). The amount of the loan was not insignificant in relation to the value of the policy. Under the terms of the policy, failure to repay the principal or interest on the policy loan reduces the proceeds that are payable to the beneficiary upon voluntary surrender of the policy or upon the death of the insured. The fact that the insurer will not demand repayment of the loan or payment of interest as it accrues does not mean that the loan is not a "mortgage or other lien" within the meaning of Reg.

53.4941(d)-2(a)(2). Accordingly, the donation of the life insurance policy subject to an outstanding policy loan is an act of self-dealing within the meaning of IRC 4941(d)(1)(A).

A second significant issue under IRC 4941(d)(2)(A) is whether the disqualified person referred to in the statute is the mortgagor or the mortgagee. The mortgagor is the debtor who placed the mortgage on the property while the mortgagee is the lender who holds the mortgage. A case involving this question is discussed in G.C.M. 39033, dated September 20, 1983.

The purpose of IRC 4941(d)(2)(A) is to prevent the disqualified person-debtor from shifting his liability as mortgagor by contributing the underlying property to the foundation. This is an indirect use of the foundation's assets for the benefit of the disqualified person.

No such language or policy, however, supports the interpretation that the disqualified person referred to in IRC 4941(d)(2)(A) is the creditor-mortgagee. There is no reason why a disqualified person may not freely contribute, as opposed to sell, a debt it owns to the foundation. As the new owner, the foundation would have the right to receive the payments under the note, and, if the debtor defaults, foreclose on the collateral.

(4) Leasing of Property

Under IRC 4941(d)(1)(A) the leasing of property between a private foundation and a disqualified person generally constitutes self-dealing. However, the leasing of property by a disqualified person to a private foundation without charge is not an act of self-dealing. Reg. 53.4941(d)-2(b)(2) provides that a lease is considered to be without charge even though the foundation pays for janitorial services, utilities, or other maintenance costs, as long as the payment is not made directly or indirectly to a disqualified person.

Section 101(l)(2)(C) of the Tax Reform Act of 1969 provides that the continuation of certain existing leases between a foundation and a disqualified person are not self-dealing until taxable years beginning after December 31, 1979.

Public Law 96-608, effective December 28, 1980, amended IRC 4941(d)(2) to provide a permanent exception to IRC 4941(d)(1)(A) in certain circumstances where a private foundation leases office space from a disqualified person. The exception, described in IRC 4941(d)(2)(H), provides that the leasing by a

disqualified person to a private foundation of office space for use by the foundation in a building with other tenants who are not disqualified persons shall not be treated as an act of self-dealing if: (i) the leasing of office space is pursuant to a binding lease which was in effect on October 9, 1969, or pursuant to renewals of such a lease; (ii) the execution of the lease was not a prohibited transaction (within the meaning of IRC 503(b) or any corresponding provision of prior law) at the time of the execution; and (iii) the terms of the lease (or any renewal) reflect an arm's-length transaction.

Reg. 53.4941(d)-4(f) provides that under section 101(l)(2)(F) of the Tax Reform Act of 1969, as amended by the Tax Reform Act of 1976, the sale, exchange, or other disposition (other than by lease) to a disqualified person of property being leased to the disqualified person by a private foundation is not an act of self-dealing if:

(i) the private foundation is leasing substantially all of the property to the disqualified person under a lease to which Reg. 53.4941(d)-4(c) applies;

(ii) the disposition occurs after October 4, 1976, and before January 1, 1978; and

(iii) the disposition satisfies the requirements of Reg. 53.4941(d)-4(f)(2).

B. Lending Money or Other Extension of Credit

IRC 4941(d)(1)(B) provides that the term "self-dealing" means any direct or indirect lending of money or other extension of credit between a private foundation and a disqualified person. The rule is equally applicable where the disqualified person is a successor in interest rather than an original party to the loan or extension of credit. Reg. 53.4941(d)-2(c)(1) provides, for example, an act of self-dealing occurs where a third party purchases property and assumes a mortgage, the mortgagee (creditor) of which is a private foundation, and subsequently the third party transfers the property to a disqualified person who either assumes liability under the mortgage or takes the property subject to the mortgage. Reg. 53.4941(d)-2(c) provides three exceptions to IRC 4941(d)(1)(B):

(a) The lending of money or other extension of credit by a disqualified person to a private foundation is not an act

of self-dealing if the loan or other extension of credit is without interest or other charge. See IRC 4941(d)(2)(B) and Reg. 53.4941(d)-2(c)(2).

(b) The making of a promise, pledge, or similar arrangement to a private foundation by a disqualified person, whether evidenced by an oral or written agreement, a promissory note, or other instrument of indebtedness, to the extent motivated by charitable intent and unsupported by consideration, is not an extension of credit within the meaning of Reg. 53.4941(d)-2(c), before the date of maturity.

The effect of Reg. 53.4941(d)-2(c)(3) is to put donative pledges outside the ambit of IRC 4941(d)(1)(B) until the obligation reaches maturity. Accordingly, an extension of time beyond the due date by the private foundation to the disqualified person is an extension of credit within the meaning of IRC 4941(d)(1)(B) and is an act of self-dealing.

(c) Under IRC 4941(d)(2)(E), 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 the trust company, for such services is not excessive.

Reg. 53.4941(d)-2(c)(4) lists the general banking services allowed:

(i) checking accounts, as long as the bank does not charge interest on any overwithdrawals,

(ii) 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

(iii) safekeeping activities such as the rental of a safety deposit box.

Rev. Rul. 73-595, 1973-2 C.B. 384, holds that a private foundation's deposit of funds with a disqualified person in a savings account does not fall within the scope of the general banking functions permitted by Reg. 53.4941(d)-2(c)(4) under the following circumstances.

X, a private foundation maintains a savings account with Y, a banking institution which is a disqualified person with respect to X. In the normal course of banking operations, Y pays interest on the last day of the quarter on funds that have been on deposit for the entire quarter. Accordingly, deposits are subject to a loss of interest if funds are withdrawn before the last day of a quarter. Because X could lose the interest if the funds are withdrawn early, the deposit of X's funds with Y is an act of self-dealing regardless of whether the funds are, in fact, withdrawn prior to the last day of the quarter.

X, a private foundation, purchased from Y, a disqualified person with respect to X, a certificate of deposit with a maturity date one year from the date of issue and providing for a reduced rate of interest if not held to the maturity date. Is the purchase of this certificate of deposit an act of self-dealing under IRC 4941(d)(1)(B) or does it fall within the exception for general banking services described in Reg. 53.4941(d)-2(c)(4)?

Rev. Rul. 77-288, 1977-2 C.B. 388, holds that the sale of a certificate of deposit, as described above, is not one of the general banking functions permitted by section 53.4941(d)-2(c)(4) of the regulations because the foundation will suffer a loss if it withdraws the funds prior to the maturity date.

C. Furnishing of Goods, Services, or Facilities

IRC 4941(d)(1)(C) provides that the term "self-dealing" means any direct or indirect furnishing of goods, services, or facilities between a private foundation and a disqualified person. This type of self-dealing generally includes the furnishing of goods, services, or facilities such as office space, automobiles, auditoriums, secretarial help, meals, libraries, publications, laboratories, or parking lots. See Reg. 53.4941(d)-2(d)(1).

IRC 4941(d)(2)(C) provides that the furnishing of goods, services, or facilities by a disqualified person to a private foundation is not an act of self-dealing if they are furnished without charge and if the goods, services, or facilities are used exclusively for purposes specified in IRC 501(c)(3). For example, the furnishing of goods, such as pencils, stationery, or other incidental supplies, or the furnishing of facilities such as a building, by a disqualified person to a private foundation is allowed if such supplies or facilities are furnished without charge. A furnishing of goods is considered to be without charge even though the private foundation pays for the transportation, insurance, or maintenance costs it incurs in obtaining or using the property, so long as the payment is not made directly or indirectly to the disqualified person. See Reg. 53.4941(d)-2(d)(3).

IRC 4941(d)(2)(D) provides that the furnishing of goods, services, or facilities by a private foundation to a disqualified person is not 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. This exception shall not apply, however, unless there are a substantial number of persons other than disqualified persons who are actually utilizing such goods, services, or facilities. See Reg. 53.4941(d)-3(b)(2).

Reg. 53.4941(d)-3(b)(1) provides that in the case of goods, services, or facilities furnished after May 16, 1973, the exception provided in IRC 4941(d)(2)(D) shall not apply unless such goods, services, or facilities are functionally related, within the meaning of IRC 4942(j)(5) (now IRC 4942(j)(4)), to the exercise or performance by a private foundation of its charitable, educational, or other purpose or function constituting the basis for its exemption under IRC 501(c)(3).

The furnishing of goods, services, or facilities to a foundation manager, to an employee, or to an unpaid worker in recognition of his or her services is not self-dealing if the value of whatever is furnished is reasonable and necessary to the performance of his or her tasks in carrying out the tax exempt purposes of the foundation and is not excessive. See Reg. 53.4941(d)-2(d)(2).

Reg. 53.4941(d)-4(d) provides that, under section 101(l)(2)(D) of the Tax Reform Act of 1969, the sharing of goods, services, or facilities by a private foundation and a disqualified person is not self-dealing until taxable years beginning after December 31, 1979, if the sharing is conducted pursuant to an

arrangement in force and effect before October 9, 1969, and the arrangement was not a prohibited transaction under IRC 503(b).

Reg. 53.4941(d)-4(e) provides that, under section 101(l)(2)(E) of the Tax Reform Act of 1969, the use of property in which a private foundation and a disqualified person have a joint or common interest is not self-dealing if the interests of both parties were acquired before October 9, 1969.

Published examples of the application of IRC 4941(d)(1)(C) governing the furnishing of goods, services or facilities between a private foundation and a disqualified person include the following:

a. Rev. Rul. 73-363, 1973-2 C.B. 383, holds that the rental of a charter aircraft by a disqualified person, a charter aircraft company, to a private foundation constitutes an act of self-dealing. Two exceptions to IRC 4941(d)(1)(C) were considered. The exception described in IRC 4941(d)(2)(C) for furnishing of goods, services or facilities without charge is not applicable. The revenue ruling also discussed the applicability of IRC 4941(d)(2)(E), which will be discussed in the next section.

b. Rev. Rul. 76-10, 1976-1 C.B. 355, holds that the use of a private foundation's meeting room by a disqualified person was not an act of self-dealing because the room was made available to the disqualified person on the same basis that it was made available to other community and civic groups and was functionally related to the foundation's exempt purpose. The exception described at IRC 4941(d)(2)(D) was applicable in this case.

c. Similarly, Rev. Rul. 76-459, 1976-2 C.B. 369, holds, that the use of a private foundation museum's private road for access to the adjacent headquarters and manufacturing plant of a corporation (a disqualified person) during the same hours the road is used by the general public as a thoroughfare connecting two public streets is not an act of self-dealing under IRC 4941(d)(1)(C).

Generally, by permitting a disqualified person to use its private road, a private foundation would be engaging in an act of self-dealing. However, in the situation described above, the road is made available to the disqualified person on a basis that is no more favorable than the basis on which it is made available to the general public. In addition, a substantial number of persons other than the disqualified persons actually use the road. Further, the use of the road as an entrance to the foundation's museum is functionally related within the meaning of IRC 4942(j)(4) to the foundation's exempt purpose of operating a museum for the benefit of the general public.

d. Compare Rev. Ruls. 76-10 and 76-459 with Rev. Rul. 79-374. Rev. Rul. 79-374, 1979-2 C.B. 387, concerns a private foundation which conducts agricultural economics research and experimentation in part of an office building it owns. The private foundation rents the remaining space to disqualified persons who engage in agricultural business activities. The foundation does not utilize these businesses in its research. Because the rental of the office space is not functionally related to the foundation's exempt purpose, it constitutes an act of self-dealing under IRC 4941(d)(1)(C).

D. Payment of Compensation

IRC 4941(d)(1)(D) provides that the payment of compensation or the reimbursement of expenses by a private foundation to a disqualified person constitutes an act of self-dealing. However, IRC 4941(d)(2)(E) provides that the payment of compensation (and payment or reimbursement of expenses) by a private foundation to a disqualified person (other than a government official) for the performance of personal services reasonable and necessary to carrying out the exempt purpose of the foundation, is not an act of self-dealing, if the payment is not excessive (as defined in Reg. 1.162-7).

Reg. 53.4941(d)-3(c) provides that: (1) 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; (2) the portion of any payment which represents payment of compensation (or payment or reimbursement of expenses) for the performance of

personal services; and 3) the making of a cash advance (usually not more than $500) to a foundation manager or employee is not an act of self-dealing, so long as the amount is reasonable in relation to the duties and expense requirements of the foundation manager.

The following revenue rulings discuss the payment of compensation:

a. Rev. Rul. 73-363, 1973-2 C.B. 383, holds that the rental of charter aircraft does not constitute the performance of personal services within the meaning of Reg. 53.4941(d)-3(c). Accordingly, the revenue ruling held that the rental of charter aircraft by a disqualified person to private foundation is an act of self-dealing under IRC 4941(d)(1)(C).

b. Rev. Rul. 73-546, 1973-2 C.B. 384, holds that the payment by a private foundation to a bank, a disqualified person, of a service fee for an overdrawn checking account in an amount equal to the actual cost of processing the overdraft does not constitute an act of self-dealing. The service fee is part of the compensation paid by the foundation to the bank for the maintenance of its checking account. As the service fee equals the actual expense of processing the amount overdrawn, it is not excessive and falls within the exception provided in IRC 4941(d)(2)(E).

c. Rev. Rul. 74-591, 1974-2 C.B. 385, holds that a pension for past personal services paid by a private foundation to one of its directors, a disqualified person whose total compensation including the pension is not excessive, does not constitute an act of self-dealing under IRC 4941(d)(1)(D). The payment of the pension falls within the exception provided at IRC 4941(d)(2)(E).

Rev. Rul. 73-613, 1973-2 C.B. 385, concerns the payment by a private foundation of court awarded legal fees to director-manager who was a disqualified person. By filing a suit against the remaining directors to require them to carry on the foundation's charitable program, the director-manager was carrying out his responsibilities. Under the circumstances the payment of legal fees did not constitute an act of self-dealing.

E. Transfer of Income or Assets

IRC 4941(d)(1)(E) provides that the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation is an act of self-dealing. Examples of self-dealing under IRC 4941(d)(1)(E) listed at Reg. 53.4941(d)-2(f)(1) include:

(a) The payment by a private foundation of any tax imposed on a disqualified person by chapter 42;

(b) The payment by a private foundation of the premiums for an insurance policy providing liability insurance to a foundation manager for Chapter 42 taxes unless the premiums are treated as part of the compensation paid to the manager for purposes of determining whether the compensation is reasonable under IRC 4941(d)(1)(D).

(c) The purchase or sale of stock or other securities by a private foundation if such purchase or sale is made in an attempt to manipulate the price of the stock or other securities to the advantage of a disqualified person;

(d) The indemnification (of a lender) or guarantee (of repayment) by a private foundation with respect to a loan to a disqualified person; and

(e) A grant or other payment made by a private foundation which satisfies the legal obligation of a disqualified person. However, if the grant or payment satisfies a pledge, enforceable under local law, to an IRC 501(c)(3) organization, such pledge is made on or before April 16, 1973, the grant or payment will not constitute an act of self-dealing so long as the disqualified person obtains no substantial benefit, other than the satisfaction of his obligation, from such grant or payment.

Reg. 53.4941(d)-2(f)(2) 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.

An incidental or tenuous benefit occurs when the general reputation or prestige of a disqualified person is enhanced by public acknowledgement of some specific donation by such person, when a disqualified person receives some other

relatively minor benefit of an indirect nature, or when such a person merely participates to a wholly incidental degree in the fruits of some charitable program that is of broad public interest to the community. This rule is discussed in the following:

a. Rev. Rul. 73-407, 1973-2 C.B. 383, holds that a contribution by a private foundation to a public charity made on the condition that the public charity change its name to that of a substantial contributor to the foundation and agree not to change the name again for 100 years does not constitute an act of self-dealing under IRC 4941(d)(1)(E).

   The public recognition a person may receive, arising from the charitable activities of a private foundation to which such person is a substantial contributor, does not in itself result in an act of self-dealing since generally the benefit is incidental and tenuous. See example (4) of Regs. 53.4941(d)-2(f)(4).

b. B, a private foundation, placed three of its paintings in the residence of P, a substantial contributor. The three paintings had been on exhibit in various museums for a number of years prior to placement in P's home. The paintings are displayed together with P's large private art collection.

   P exercises sole control over the public's access to his residence. On organized semiannual tours, an estimated 2,000 visitors are admitted to view P's private collection and B's paintings. In addition, special tours are arranged on occasion for small groups of persons associated with the arts.

   Is the placing of the paintings by B in P's home an act of self-dealing under IRC 4941(d)(1)(E) or is the benefit to P incidental and tenuous? Rev. Rul. 74-600, 1974-2 C.B. 385, held that although the foundation's paintings are sometimes made available for public viewing, the placement in the residence of P results in a direct use of the foundation's assets by or for the benefit of P and constitutes an act of self-dealing.

c. Rev. Rul. 75-42, 1975-1 C.B. 359, considers whether a grant authorized by an private foundation to an exempt hospital for

modernization, replacement, and expansion constitutes an act of self-dealing where two individuals serve as trustees of both organizations.

Reg. 53.4941(d)-2(f)(2) 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. As an example, a grant by a private foundation to an IRC 509(a)(1), (2) or (3) organization will not be an act of self-dealing merely because one of the IRC 509(a)(1), (2) or (3) organization's officers, directors, or trustees is also a manager of or a substantial contributor to the foundation.

Since any benefit to disqualified persons (the two trustees) is incidental, the grant described in Rev. Rul. 75-42 is not an act of self-dealing. See also Rev. Rul. 82-136, 1982-2 C.B. 300.

d. H, an exempt hospital, financed an expansion program by arranging for the local hospital authority to issue revenue bonds for the benefit of the hospital. H was responsible for repayment of both the principal and interest. The bonds were secured by the net operating revenues of H.

In order to reduce the cost of the bonds to the hospital, P, a private foundation, agreed to guarantee the payment of both the principal and the interest on the bonds if H was unable to make such payments.

D, a disqualified person with respect to P and an officer of H, purchased a portion of the bond issue. The guarantee did not apply to any of the bonds purchased by D and was not applicable to those bonds even if they were subsequently sold to other than a disqualified person.

Was the purchase of the bonds by D an act of self-dealing within the meaning of IRC 4941(d)(1)(E)?

Rev. Rul. 77-6, 1977-1 C.B. 350, holds that the purchase of the bonds by a disqualified person under the circumstances described above was not an act of self-dealing. Because the guarantee did

not apply to bonds purchased by a disqualified person, the arrangement did not result in any use of the foundation's assets for the economic benefit of a disqualified person. Moreover, any benefit derived by the disqualified person by virtue of that person's position as an officer of the hospital is incidental or tenuous.

e. Is the payment by P, a private foundation, of church membership dues of D, a disqualified person, in order to maintain D's church membership an act of self-dealing under IRC 4941(d)(1)(E)?

   As a result of the payment of the dues, D is entitled to hold office, vote in congregational meetings to elect officers and conduct other business, and otherwise participate in the religious activities of the congregation.

   Although any rights or benefits that D receives from the church by reason of his membership status might be described as incidental or tenuous, it cannot be said that the benefit to D by reason of P's payment of D's membership dues is incidental or tenuous.

   Membership dues and fees, by their very nature, are usually paid by individuals on a continuing basis. When dues are paid by a private foundation on behalf of a disqualified person, it may be presumed that the disqualified person is being relieved of the obligation, whether or not legally enforceable, to make such payment. The benefit conferred on the individual is not incidental or tenuous, but is direct and economic in nature.

   Accordingly, Rev. Rul. 77-160, 1977-1 C.B. 351, holds that the payment of membership dues by a private foundation on behalf of a disqualified person is an act of self-dealing under IRC 4941(d)(1)(E).

f. C, a private foundation, established a student loan guarantee program by a grant to X. X, an organization described in IRC 501(c)(3) and 509(a)(1), guarantees student loans made by various cooperating financial institutions. X agreed to guarantee $100,000 in loans to children of employees of C. Under the program, the children of all C's employees, including a few disqualified

persons, are eligible to apply for loan guarantees. The facts and circumstances indicate that the program is not compensatory to the employees.

Is the guarantee of loans made to disqualified persons under the student loan guarantee program established by C for the children of its employees an indirect act of self-dealing by C?

Rev. Rul. 77-331, 1977-2 C.B. 388, held that although the grant made by C to X is not used to provide loans to disqualified persons, the grant can be used by X to guarantee loans made to disqualified persons and, in the event a disqualified person defaults, in repaying the loan. This use of C's assets confers more than an incidental or tenuous benefit upon the disqualified persons involved. Accordingly, the guarantee of loans made to disqualified persons under the program will constitute acts of self-dealing.

g. P, a private foundation, made a grant to U, an exempt university, to establish an educational program providing instruction in manufacturing engineering. W, a corporation that is a disqualified person with respect to P, intends to hire graduates of the new program and encourage its employees to enroll in the program. W will not receive preferential treatment in recruiting graduates or enrolling its employees. Is the grant by P to U an act of self-dealing?

Example (1) of Reg. 53.4941(d)-2(f)(4) considers a grant by a private foundation to the governing body of a city for the purpose of alleviating the slum conditions that exist in a particular neighborhood of the city. A corporation that is a disqualified person with respect to the foundation is located in the same area in which the grant is to be used. Although the general improvement of the area may constitute an incidental and tenuous benefit to the corporation, such benefit by itself will not constitute an act of self-dealing.

In this case, as in the program described in Example (1) of the regulations, the educational program is of broad public interest to the community. The corporation will benefit from the program only in an incidental manner as one of many manufacturing

businesses that can benefit from the skills acquired by the students in the program.

Since any benefit to the corporation, a disqualified person, is incidental, Rev. Rul. 80-310, 1980-2 C.B. 319, holds that the grant by the private foundation to the university to establish an educational program in manufacturing engineering does not constitute an act of self-dealing.

h. B, a banking institution, is the sole trustee of both P and Q. P and Q are both private foundations exempt under IRC 501(c)(3). P's board of trustees authorized a large grant to Q for the purpose of providing funding for the expansion of Q's scholarship grant program.

   Does the grant by one private foundation to a second private foundation constitute an act of self-dealing where a banking institution is trustee, and thus a disqualified person, for both private foundations?

   Reg. 53.4941(d)-2(f)(2) contains an example that describes a grant from a public charity and concludes that the grant will not be an act of self-dealing merely because one of the public charity's officers, directors or trustees is also a disqualified person with respect to the foundation.

   Rev. Rul. 82-136, 1982-2 C.B. 300, holds that in this case the grant from private foundation P to private foundation Q does not constitute an act of self-dealing for this reason.

i. The National Office recently held that IRC 4941(d)(1)(E) does not prevent a bank acting as trustee of a charitable trust, or as a trustee or manager of a private foundation, from maintaining a custodial account with its investment branch. The fees paid for maintenance of such a custodial account fall within the exception provided in IRC 4941(d)(2)(E) for reasonable compensation paid for personal services.

   For administrative ease, many banks employ a common trust fund. The common trust fund enables the bank to collectively invest

trust assets in order to achieve economy of scale in its investment operations. The trustee-bank's fiduciary relationship and trust responsibilities continue unchanged. A bank may not invest in or borrow from these common trust funds and may not use them in any way inconsistent with its trust function.

B, a bank acts as trustee for 100 charitable trusts which are also private foundations. It charges each of the trusts its normal maintenance fee.

Each of the trusts purchases units of participation in B's common trust. B is not a principal when any of its various trusts acquire holdings in the common trust fund. B never acts as a principal any time with respect to such acquisitions. B administers its common funds as assets in trust. It earns money on them collectively and returns such earnings, less expenses, to the various trusts having rights to the common trust fund on a pro rata basis. The expenses deducted include a management fee paid to the bank.

The operation of a common trust fund is not a general banking service and does not fall within the exception described at Reg. 53.4941(d)-2(c)(4). However, Reg. 53.4941(d)-3(c) describes another exception to self-dealing which must be considered. That section provides that under IRC 4941(d)(2)(E), except in the case of a government official, 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 will not be an act of self-dealing if the compensation is reasonable.

Example (1) of Reg. 53.4941(d)-3(c) describes a situation similar to the one described above. It concerns the payment of compensation for legal services by a private foundation to a disqualified person, a law firm which was owned, in part, by two disqualified persons with respect to the foundation.

It was determined that the payment was not an act of self-dealing because the services were reasonable and necessary and the amount paid for the services was not excessive.

F. Payments to Government Officials

Private foundations are discouraged from practically all dealings with government officials. IRC 4941(d)(1)(F) provides that the term "self-dealing" includes any direct or indirect agreement by a private foundation to make any payment of money or other property to a government official, other than an agreement to employ such an individual for a period after the termination of his government service if such individual is terminating his government service within a 90-day period.

Reg. 53.4941(d)-3(e) provides that under IRC 4941(d)(2)(C) the term self-dealing does not apply to certain situations. Those situations include: reimbursement for domestic travel; employment after termination of government service, certain prizes, awards, scholarships, and fellowships; certain annuities or other payment forming part of a stock-bonus, pension or profit sharing plan; certain contributions, gifts, services, or facilities furnished to a government official; and certain payments under 5 U.S.C. Chapter 41 (relating to government employees' training programs).

The following revenue rulings discuss the exceptions contained in Reg. 53.4941(d)-3(e):

a. Rev. Rul. 74-601, 1974-2 C.B. 385, holds that reimbursement by a private foundation for travel, meals, and lodging expenses incurred by U.S. Congressmen the private foundation chooses to participate in a conference it cosponsors in a foreign country does not come within the exception to self-dealing set forth at IRC 4941(d)(2)(G)(vii). The exception applies to payment for travel solely from one point in the United States to another point in the United States.

b. Is the payment or reimbursement by a private foundation of expenses incurred by one of its trustees, a government official of the Commonwealth of Puerto Rico, for roundtrip travel from Puerto Rico to the United States to attend the foundation's trustee meetings an act of self-dealing?

   Rev. Rul. 76-159, 1976-1 C.B. 356, holds that the payment does constitute an act of self-dealing under IRC 4941(d)(1)(D). The payment does not fall within the exception provided at IRC

4941(d)(2)(G)(viii) because IRC 7701(a)(9) provides that the term "United States" when used in the geographical sense includes only the States and the District of Columbia.