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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: MAR 11 2004

UIL No:  
4941.00-00  
4946.01-00

T. ED. B2

Employer Identification Number:

LEGEND:

A =  
B =  
C =  
D =  
L =  
M =  
N =  
O =  
P =  
Q =  
R =  
S =  
T =  
U =  
X =  
Y =

Dear

This is in response to X's letter dated October 23, 2001, as supplemented by subsequent submissions, in which X requested a ruling on the proper treatment of the proposed formation and operation of a limited liability company, taxed as a partnership, under section 4941 and section 4946 of the Internal Revenue Code.

X is an organization recognized as exempt from federal income tax under section 501(c)(3) of the Code, and is a private foundation within the meaning of section 509(a). Family members A, B, C, and D, along with Y, their closely held corporation, have been the substantial contributors to X.

L, M, N, O, P, Q, R, S, T and U are ten charitable remainder unitrusts ("CRUTs") created by A, B, C and D. The CRUTs have family members of A as the unitrust beneficiary, X as a charitable beneficiary, and X as the Trustee. The unitrust payout percentage for three of these is % % for three others, with the remaining payout percentages being %, %, % and %, respectively. Each CRUT is represented to be described in sections 4947(a)(2) of the Code and thus subject to sections 4941 and 4945.

As Trustee of each CRUT, X desires to form a limited liability company ("the LLC") to coordinate the investments of all of the CRUTs. Some of the CRUTs were single life unitrusts at 5% for family members in their teens. Due to a change in the tax law, such CRUTs were unable to be further funded. The previously funded amounts made investment and administration of the trusts less than economical. The formation of the LLC will allow the CRUTs 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 CRUT could satisfy using its assets alone.

The LLC is represented to invest only in money markets, bonds, and other marketable securities, and, as a result, will have more than 95% of the gross income derived from passive sources. Thus, X represents that the CRUTs' investment in the LLC is not subject to the excise tax provided in section 4943 of the Code based upon the exclusion provided by section 4943(d)(3)(B).

The structure of the LLC is represented as follows:

1. The only permissible members of the LLC will be the individual charitable remainder unitrusts (CRUTs) which name X as the charitable remainder beneficiary.
2. The trustee or trustees of the LLC members shall appoint a manager or managers other than X.
3. The LLC shall elect partnership treatment for federal tax purposes.
4. The majority of each CRUT's assets shall be sold and reduced to cash, and only cash will be transferred to the LLC in exchange for an interest in the LLC.
5. The initial capital contribution shall be made only in cash.
6. Each LLC interest shall be based upon the fair market value of marketable securities plus any cash or cash equivalents less any debts.
7. All earnings and distributions shall be in proportion to each member's interest in the LLC.
8. All future capital contributions shall be cash and shall not be marketable securities.
9. Upon any future capital contributions or withdrawals, the capital accounts of all members shall be adjusted to reflect all of the marketable securities at market, plus cash and cash equivalents, less any operating obligations or debts (net asset valuation marked to market currently). The value assigned by the LLC to each capital withdrawal shall be the fair market value of the securities distributed, if any, plus the amount of cash.
10. Each CRUT shall retain a separate investment account for purposes of addressing the differing CRUT distribution percentages.
11. X will not be a manager of the LLC, and shall not collect any management fee, nor provide any services to the LLC. X shall use its limited power of amendment to change

the trustee provision of each CRUT as follows: X shall have the ability to appoint a successor trustee and withdraw as trustee. X shall retain the right to remove such successor trustee and appoint a replacement trustee. X shall not collect any fees from the individual CRUTs.

12. The successor trustees of the individual CRUTs may receive a trustee's fee not in excess of the usual and customary trustee fees assessed by professional fiduciaries in the community.
13. The manager or managers of the LLC may receive a manager's fee not in excess of the usual and customary money management fees assessed by professional fiduciaries in the community.

X requests the following rulings:

1. That the formation, cash capital contributions and withdrawals from the LLC will not constitute a "sale or exchange" between the CRUTs and the LLC within the meaning of the self-dealing rules of section 4941(d)(1)(A) of the Code.
2. That the formation, cash capital contributions and withdrawals from the LLC 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) of the Code.
3. That the CRUTs' sharing of the LLC investment expenses, payment of management fees to managers, and payment of trustee's fees to Trustees will not constitute self-dealing within the meaning of the self-dealing rules of section 4941(d)(1)(C), (D), or (E) of the Code.
4. That the LLC is not a disqualified person as described by section 4946(a)(1) of the Code with regard to any of the CRUTs.
5. That the LLC is not a disqualified person as described by section 4946(a)(1) of the Code with regard to X.

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 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 the term 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 except in the case of a government official, 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 4946(a)(1) of the Code provides that a disqualified person, with respect to a private foundation, includes a person who is

- (A) a substantial contributor (including the creator of the trust) to the foundation,
- (B) a foundation manager,
- (C) an owner of more than 20% of a corporation, partnership, or beneficial interest of a trust which is a substantial contributor to the foundation,
- (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), above, own more than 35% of the profits interest, and,
- (G) a trust or estate in which persons described in (A)-(D), above, 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 7701(a)(1) of the Code defines the term "person" as including an individual, a trust, estate, partnership, association, company or corporation.

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)-1(b)(1) of the regulations provides that the term indirect self-dealing shall not include any transactions described in section 53.4941(d)-2 between a disqualified person and an organization controlled by a private foundation.

Section 53.4941(d)-1(b)(4) of the regulations provides that a transaction between a private foundation and an organization which is not controlled by the foundation (within the meaning of section 53.4941(d)-1(b)(5)), and which is not described in section 4946(a)(1)(E), (F), or (G) of the Code 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 or profits or beneficial interest 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.

Section 53.4941(d)-1(b)(5) of the regulations provides that 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. The controlled organization need not be a 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.

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. This paragraph applies without regard to whether the person who receives the compensation (or payment or reimbursement) is an individual.

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.

Section 53.4946-1(a)(8) of the regulations provides that for purposes of section 4941 of the Code only, the term "disqualified person" shall not include any organization which is described in section 501(c)(3) (other than an organization described in section 509(a)(4)).

Section 301.7701-3(a) of the Procedure and Administration Regulations provides that a business entity that is not classified as a corporation under section 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an "eligible entity") can elect its classification for federal tax purposes. A "business entity" is any entity recognized for federal tax purposes that is not properly classified as a trust under section 301.7701-4 or otherwise subject to special treatment under the Code. Section 301.7701-2(a). An eligible entity with at least two members can elect either to be classified as a corporation or a partnership.

Section 301.7701-3(b)(1) of the regulations provides that an eligible entity with at least two owners will be classified as a partnership unless it elects otherwise.

We have considered the issue of whether the formation, cash capital contributions and withdrawals from the LLC will constitute a "sale or exchange" between the CRUTs and the LLC within the meaning of the self-dealing rules of section 4941(d)(1)(A) of the Code. Given the taxpayer's representations regarding the applicable State law principles, we find no sale or exchange of property under the circumstances.

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.

Under the facts presented and represented, we find the reimbursement of investment expenses incurred by the LLC and management fees 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.

You state that the LLC has chosen to be treated as a partnership. You further represent that the only permissible members of the LLC will be individual charitable remainder unitrusts (CRUTs) that name X as the charitable remainder beneficiary. Based upon the facts represented, we find that the LLC is not a disqualified person as described by section 4946(a)(1) of the Code with regard to the CRUTs and to X.

Accordingly, we rule as follows:

1. That the formation, cash capital contributions and withdrawals from the LLC will not constitute a "sale or exchange" between the CRUTs and the LLC within the meaning of the self-dealing rules of section 4941(d)(1)(A) of the Code.
2. That the formation, cash capital contributions and withdrawals from the LLC 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) of the Code.

3. That the CRUTs' sharing of the LLC investment expenses, payment of management fees to managers, and payment of trustee's fees to Trustees will not constitute self-dealing within the meaning of the self-dealing rules of section 4941(d)(1)(C), (D), or (E) of the Code.
4. That the LLC is not a disqualified person as described by section 4946(a)(1) of the Code with regard to any of the CRUTs.
5. That the LLC is not a disqualified person as described by section 4946(a)(1) of the Code with regard to X.

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.

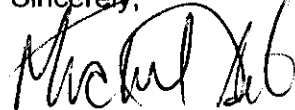
This ruling is directed only to X. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Because this letter could help resolve any future questions about the application of Chapter 42 of the Code to its activities, X 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.

If X has any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,



Michael C. Seto  
Acting Manager, Exempt  
Organizations  
Technical Group 2