



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

UIL: 4941.00-00

Legend:

Foundation =  
Bank =  
A =  
B =  
C =  
D =

Dear :

We have considered your request, dated August 17, 2005, for a ruling concerning whether a private foundation's indemnification or maintenance of insurance for its director/co-trustees, as described below, constitutes an act of self-dealing between the Foundation and the managers or the Foundation and the related charitable trusts.

Facts:

The Service has recognized the Foundation as an organization that is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code and classified as a private foundation under section 509(a) of the Code. When A, the founder, died in 1997, his will appointed seven individuals, including B, C, and D, as Foundation directors and created several charitable remainder unitrusts and annuity trusts. A's family and selected business associates are the trusts' lifetime beneficiaries and the Foundation is the trusts' remainder beneficiary. Each trust has three co-trustees and the foundation directors initially filled those positions. Although many of the original director/co-trustees resigned in 1999 and 2000, B, C, and D remain. The Foundation and/or the Bank filled the vacant director/co-trustee positions.

The Foundation believes that there is a risk that the lifetime beneficiaries or the co-trustees

might sue the managers in their capacity as trustees for prior acts or future acts or omissions. It wants to provide them with indemnification and/or insurance coverage for any legal expenses associated with any suit related to their service as trustees. The Foundation will try to obtain a Trustee Errors & Omissions insurance policy. If it cannot obtain the coverage or if the policy does not cover all of the litigation claims and expenses, the Foundation plans to underwrite them.

Rulings requested by the Foundation, B, C, and D:

1. The Foundation's indemnification of the director/co-trustees for their defense in civil suits and/or administrative proceedings arising from their service as trustees will not constitute an act of self-dealing between the director/trustee and the Foundation or between the trust and the Foundation.
2. The Foundation's maintenance of a Trustee Errors & Omissions insurance policy to pay for or reimburse the director/trustees for the cost of their defense in civil suits and/or administrative proceedings with regard to their service as trustees will not constitute an act of self-dealing between the director/trustee and the Foundation or between the trust and the Foundation.

Law:

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

Section 4941(d)(1)(E) of the Code includes, in the term "self-dealing", 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 4946(a)(1) of the Code defines a disqualified person as a person who is a substantial contributor to a foundation, a foundation manager, a member of the family of a substantial contributor or a foundation manager, or a trust in which the substantial contributor or foundation manager own more than 35 percent of the beneficial interest.

Section 53.4941(d)-2(f)(3)(i) of the Foundation and Similar Excise Taxes Regulations states that section 4941(d)(1) of the Code shall not apply to the indemnification by a private foundation of a foundation manager, with respect to the manager's defense in any civil judicial or civil administrative proceeding arising out of the manager's performance of services (or failure to perform services) on behalf of the foundation, against all expenses (other than taxes, including taxes imposed by Chapter 42, penalties, or expenses of correction) including attorneys fees, judgments and settlement procedures if:

(A) the expenses are reasonably incurred by the manager in connection with the proceeding, and

(B) the manager has not acted willfully and without reasonable cause with respect to the act or failure to act which led to the proceeding or a liability for tax under Chapter 42.

Section 53.4941(d)-2(f)(6) of the regulations states that for purposes of this paragraph, the term indemnification shall include not only reimbursement by the foundation for expenses that the foundation manager has already incurred or anticipates incurring but also direct payment by the foundation of such expenses as the expenses arise.

Analysis:

The Foundation proposes to indemnify and/or insure its managers against any legal expenses associated with any suit related to their service as trustees of the charitable trusts. Section 4941 of the Code imposes an excise tax on acts of self-dealing between a private foundation and its foundation managers, which includes a 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. However, section 53.4941(d)-2(f)(3) of the regulations removes from the definition of self-dealing, a private foundation's indemnification or payment of insurance premiums for a foundation manager for expenses incurred with respect to the manager's defense in a civil judicial or administrative proceeding related to the manager's services (or failure to perform services) on behalf of the foundation. This exclusion only applies if the expenses are reasonable and the manager did not act willfully and without reasonable cause.

The managers are acting on behalf of the Foundation by protecting its remainder beneficiary interests when they serve as co-trustees. The provision of indemnification and/or insurance coverage for legal expenses would help the Foundation retain qualified co-trustees. The indemnification and insurance premium payments will not constitute an act of self-dealing under section 4941 of the Code as long as the expenses are reasonable and the manager has not acted willfully and without reasonable cause within the meaning of section 53.4941(d)-2(f)(3) of the regulations.

Conclusion:

Accordingly, based on the foregoing, we rule as follows:

1. The Foundation's proposal to indemnify its director/co-trustees for the cost of any legal expenses associated any suit related to their service as trustees of the charitable trusts would not constitute acts of self-dealing between the director/trustees and the Foundation or the trusts as long as the expenses are reasonable and the manager has not acted willfully and without reasonable cause.
2. The Foundation's proposal to pay insurance policy premiums to cover the cost of any legal expenses associated any suit related to their service as trustees of the charitable trusts would not constitute acts of self-dealing between the director/trustees and the Foundation or the trusts as long as the expenses are reasonable and the manager has not acted willfully and without reasonable cause.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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

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

Sincerely,

/s/

Debra J. Kawecki  
Manager, Exempt Organizations  
Technical Group 2

Enclosure  
Notice 437