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## **Self-Dealing and Other Complex Compliance Issues**

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# Blazek & Vetterling

## COMPENSATION OF DISQUALIFIED PERSON CHECKLIST

*This checklist can serve as a guide to documenting the reasonableness of compensation a private foundation ("PF") pays to the persons that create, control, and manage it. The general rule prohibits such payments [§14.1]. A statutory exception permits the payment of reasonable compensation to such persons for personal services rendered in carrying out the tax-exempt purposes of the foundation*

**Name of Foundation** \_\_\_\_\_

**Self-dealing** occurs, and penalties can be imposed, when a disqualified person receives unreasonable compensation for services rendered.

**Unreasonable compensation** results when the total economic benefit provided directly or indirectly to a disqualified person (DP) exceeds value of personal services provided by the DP.

**Disqualified Person** is one with substantial influence over the PF's affairs, including a substantial contributor, officer, director, trustee, or one with similar responsibilities, owners of certain businesses that contribute to the PF, and their family members [§12.1(c)].

### Question 1. Is the compensation paid to a disqualified person reasonable?

- Is there a job description, employment contract, engagement letter, or other agreement that fully describes the duties, hours, responsibilities of the disqualified person? [§14.4(a)] \_\_\_\_\_
- Are all types of compensation, including benefits, fringes, and allowances, taken into account to determine total annual compensation? \_\_\_\_\_
- If commission or other type of revenue sharing (incentive pay) is paid, evidence that rate is in lien with industry standards are obtained? [§20.2(c)] \_\_\_\_\_

### Question 2. Is the reasonableness of compensation properly documented?

- Is comparable data –surveys, offers DP received from others, availability of others for job, opinion of consultants, and other evidence of value gathered? \_\_\_\_\_
- Is the compensation reported to the IRS on Forms W-2 or 1099? \_\_\_\_\_
- Is all compensation, including taxable and non-taxable fringe benefits reported on Part VIII of Form 990-PF? \_\_\_\_\_
- Is compensation approved (when possible) by non-disqualified persons? \_\_\_\_\_
- Are written record of meeting (minutes) when engagement was approved kept with notations of votes, abstentions (conflict), and any other discussions? \_\_\_\_\_

Prepared by \_\_\_\_\_ with (PF representative) \_\_\_\_\_ date \_\_\_\_\_

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Tax Research Memorandum

**Alternative Investment Valuation**

SLIDE 21

**Facts:** Private foundation (“PF”) has a limited partnership interest in general partnership that holds marketable securities and other investments. The partnership issues monthly valuation reports which reflect the fair market values of marketable securities and other investments it holds. The PF and its related foundations (if any) and disqualified persons do not have effective control of the partnership. Assume the limited partnership interest may meet the definition of a “security.” The term “securities” includes, but is not limited to, common and preferred stocks, bonds, and mutual fund shares.<sup>1</sup> In a private ruling, the IRS has said “a taxpayer’s profits interest in a partnership is analogous to the voting stock of an issuer of unlisted securities.”<sup>2</sup>

**Issues:**

1. Is the value of the PF’s limited partnership interest reported on the 990-PF in Part X, Minimum Investment Return, on:
  - A. Line 1a - Average monthly fair market value of securities, OR
  - B. Line 1c - Fair market value of all other assets
2. Should the Foundation value its limited partnership interest annually or on a monthly or quarterly basis? Though the general rule says “other assets are valued annually,”<sup>3</sup> could the interest in the partnership which holds marketable securities be valued based on periodic valuation reports to arrive at an annual value?
3. If the Foundation begins to value the partnership interest on an annual basis for 2008, is it making a change of accounting method? And if so, must the change be reflected retroactively to returns for which the statute of limitations has not closed?

**Analysis of Issue 1:**

Form 990-PF, Part X, line 1a is entitled “*Average monthly fair market value of **securities**.*” Is it reasonable to conclude an interest in a partnership holding marketable securities should be reported on this line and averaged using the monthly values? Line 1c is entitled “*Fair market value of all other assets*” and has no reference to **securities**.

The Form 990-PF instructions say “If market quotations are readily available, a foundation may use any reasonable method to determine the average monthly fair market value of **securities** such as common and preferred stock....” Is this sufficient directive to allow use of the periodic valuation

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<sup>1</sup> Reg. §53.4942(a)-2(c)(4)(v)

<sup>2</sup> PLR 200548026

<sup>3</sup> Reg. §53.4942(a)-2(c)(4)(iv)

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