Private foundation's self-dealing; insurance to indemnify disqualified person. The payment of premiums by a private foundation for insurance indemnifying a disqualified person against liability for claims, in connection with his assistance in preparing a registration statement and prospectus for the foundation's public offering of stock issued by a corporation of which he was a principal officer, are treated as part of his compensation for such services and do not constitute acts of self-dealing if the compensation is not excessive.

Advice has been requested whether indemnification of a disqualified person by a private foundation against liability for claims under the circumstances described below constitutes an act of self-dealing under section 4941(d)(1)(E) of the Internal Revenue Code of 1954.

A disqualified person with respect to a private foundation assisted in the preparation of a registration statement and prospectus to be filed with the Securities and Exchange Commission in connection with a public offering of particular stock owned by the foundation. The disqualified person who was one of the principal officers of the corporation which had issued the stock had so agreed to assist in preparing such documents only if the foundation would indemnify him against all liability for claims that the documents contain an untrue statement of a material fact or omit a material fact. The indemnification was accomplished through the purchase of Securities Act Liability Insurance.

The public offering enabled the foundation to sell a substantial block of the stock that would otherwise have given rise to liability for the taxes on excess business holdings which are imposed by section 4943 of the Code. If the insurance premiums paid by the foundation were to be treated as part of the total amount paid to the disqualified person for helping to prepare the prospectus and registration statement, such total payment would not be in excess of reasonable compensation for the services actually rendered.

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 (as defined in section 4946(a) of the income or assets of a private foundation.

Section 53.4941(d)-2(f)(1) of the Foundation Excise Tax Regulations provides that the payments by a private foundation of the premiums for an insurance policy providing liability insurance to a disqualified person for chapter 42 taxes shall be a act of self-dealing under the provisions of section 4941(d)(1)(E) of the Code unless such premiums are treated as part of the compensation paid to such disqualified person. The indemnification for liabilities arising under the securities laws would be a similar example of self-dealing unless considered compensation.
Section 4941(d)(1)(D) of the Code provides that any direct or indirect payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person also constitutes an act of self-dealing. This general provision is qualified, however, by section 4941(d)(2)(E) which provides that, with an exception not relevant here, 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.

The provision of indemnification for liabilities which may be incurred under the securities laws is a common practice, without which essential persons would often be unwilling to become involved in public offerings of stock. In view of the potential status as excess business holdings of some of the stock here cleared for public sale, it is also evident that the statement services of the disqualified person made an important contribution to the accomplishment of the foundation's exempt purpose.

Since the associated premiums to procure the indemnity insurance coverage did not cause the total compensation of the disqualified person to be excessive, it follows that their payment did not constitute an act of self-dealing under section 4941(d)(1)(E) of the Code.