



TAX EXEMPT AND
GOVERNMENT ENTITIES

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

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Contact Person:

ID Number:

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LEGEND

A =
B =
C =
D =
E =
F =
G =
H =
T =
W =
X =
Y =
Z =
AA =
BB =
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DD =
EE =
FF =
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Dear :

This is in response to your letter dated July 7, 2004 requesting rulings under section 4941 of the Internal Revenue Code.

FACTS

X is exempt from federal income tax under section 501(c)(3) of the Code and is classified as a private foundation under section 509(a) of the Code. X was founded in hh with significant, substantially equal contributions from A and his brother, B. A and B are now deceased.

C, who is now deceased, was the cousin of A and B. C created a testamentary trust, identified as AA, which provided for a present beneficial interest on behalf of two nieces, E and E. Upon the death of either niece, the trustee pays the principal and any undistributed income to the surviving niece's trust fund. Upon the death of both nieces, the balance of the trust estate will be distributed to X.

D, who is now deceased, was also a cousin of A and B. D created a testamentary trust known as BB, which is very similar to AA's dispositive provisions, except upon either niece's death, the remaining principal of the particular trust is transferred to the niece's living descendants. If E or E does not have living descendants, the balance of the trust is distributed to X.

A, the father of E and E, created a trust called CC. The dispositive terms of CC are similar to those of BB, except upon E or E's death, the remaining principal is distributed to such daughter's living issue , per stirpes. If such daughter has no issue , then to A's living issue , per stirpes. If A does not have any issue , then to X.

B created two trusts called DD and EE. Both trusts provide for E, E and their issues. Upon B, B's sisters (in the case of EE), A, E and E's death, the remaining principal of the trust is paid and distributed to A's issue , per stirpes, or if there are no issue , to X.

As stated above, A, B, C and D created five trusts, AA, BB, CC, DD, and EE (collectively known as FF) for the benefit of E, E, E's and E's descendants (except for AA), and then X. In each situation, the trustee(s) is given broad investment and discretionary power to distribute income and principal for the benefit of any beneficiary of the trust. Therefore, E and E have a present beneficial interest while X has a contingent remainder interest.

Certain disputes arose between the beneficiaries and trustees of two similar trusts, Y and Z. Believing the trustees were not distributing sufficient amounts pursuant to the terms of the two trusts, E requested the trustees to make larger distributions from the trusts. The trustees acceded to most of the requests. Not receiving similar requests from E, during the same period, the trustees began distributing larger sums to E, but not as much as was distributed to E. E continually demanded for greater periodic distributions that led to conflicts with the trustees.

The trustees of Y and Z, represented by separate counsel, petitioned the appropriate state court having jurisdiction over the two trusts. After protracted mediation of the disputes, the parties reached a settlement agreement. The terms of the settlement agreement included the following: cash distributions to E; distributions of I stock to E having a value that equalized the earlier larger distributions to E; periodic cash distributions to E and E until Y and Z terminated; payment of trustee and professional fees; fifty-five percent of the remaining trust assets of Y and Z to be distributed in equal shares to E and E; the remainder of the Y and Z assets to be distributed to X; and the child born to E and

adopted by third persons is neither a contingent future current beneficiary nor a contingent remainder beneficiary of Y or Z, and the child has no interest of any type in Y or Z.

E expressed similar concerns with respect to FE. In light of similar factual situations and under threat of additional protracted court proceedings, the trustees and beneficiaries entered into negotiations in an effort to resolve their differences. X states if substantial additional distributions are made to E and F during their lifetimes, the trusts will likely be exhausted prior to E and F's deaths and there may be no assets left for the benefit of the remainder beneficiaries. X states the grantors' intent in creating their respective trusts was (a) to support E and F during their lifetimes, (b) to provide funds for E and F's surviving children, or (c) in default of such children, to benefit X.

E and F have reached their middle years and do not have children who qualify as remainder beneficiaries of the trusts. Additionally, E and F have substantial personal estates by reason of the termination and distribution of Y and Z. In light of such changes, X states the intent of A, B, C and D will be served by terminating and distributing FE currently among E, F and X.

Accordingly, the parties reached a settlement agreement ("Settlement Agreement") in gg. The Settlement Agreement was approved by the court having jurisdiction over FE. The Settlement Agreement's provisions are similar to the earlier settlement agreement and include the following terms:

1. Payment of trustee and professional fees and unpaid administrative expenses.
2. Fifty-five percent of the remaining trusts' assets of each trust to be distributed in equal shares to E and F.
3. The remainder of the trusts' assets to be distributed to X.
4. E will provide in her estate plan for any child or children born to or adopted by her, and who survive her, at least twenty-five percent of the net estate.
5. F will provide in her estate plan for any child or children born to or adopted by her, and who survive her, at least fifty percent of the net estate.

RULING REQUESTED

G, as the trustee of AA, BB and CC; H as the trustee of BB and CC; and W as the trustee of DD and EE collectively request the following rulings:

1. With respect to G, in his capacity of foundation manager of X, the proposed termination of AA, BB and CC and distribution of AA, BB and CC assets, as provided in the Settlement Agreement, does not constitute an act of self-dealing described in section 4941(d) of the Code.
2. With respect to E and E, the proposed termination of EE and distribution of EEs' assets, as provided in the Settlement Agreement, does not constitute an act of self-dealing described in section 4941(d) of the Code.

LAW

Section 4941(a) of the Code imposes certain excise taxes on direct and indirect acts of self-dealing between a disqualified person and a private foundation, and also imposes a separate excise tax on the participation by any foundation manager in an act of self-dealing between a disqualified person and a private foundation, knowing it is such an act, unless such participation is not willful and is due to reasonable cause.

Section 4941(a)(1) of the Code imposes an initial tax of 5% of the amount involved with respect to the act of self-dealing for each year in the taxable period. If the act of self-dealing is not corrected within the taxable period, then section 4941(b)(1) imposes a "second tier" excise tax equal to 200% of the amount involved.

Sections 4941(a)(2) and 4941(b)(2) of the Code impose excise taxes on a foundation manager who participates in an act of self-dealing between the private foundation and a disqualified person where the foundation manager knows such act is an act of self-dealing under section 4941. The initial tax is 2.5% of the amount involved. The maximum amount of tax imposed by section 4941(a)(2) is capped at \$10,000 for each disqualified person. Section 4941(b)(2) provides that in any case in which a tax is imposed on a foundation manager under section 4941(a)(2), a "second tier" tax equal to 50% of the amount involved is imposed if a foundation manager refused to agree to part or all of the correction of the self-dealing transaction. The tax under section 4941(b)(2) is also capped at \$10,000 for each foundation manager.

Section 4941(d)(1)(E) of the Code defines the term self-dealing to include the 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)(B) of the Code defines a disqualified person to include a foundation manager.

Section 4946(a)(1)(D) of the Code defines a disqualified person to include a member of the family of a substantial contributor to the foundation.

Section 53.4941(d)-1(a) of the Foundation and Similar Excise Taxes Regulations provides that, for purposes of section 4941 of the Code, the term "self-dealing" includes any direct or indirect transaction described in section 53.4941(d)-1 of the regulations.

Section 53.4941(d)-1(b)(3) of the regulations provides that the term “indirect self-dealing” shall not include a transaction with respect to 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 or executor of an estate or trustee of a revocable trust either:
 - (a) Possesses a power of sale with respect to the property,
 - (b) Has the power to reallocate the property to another beneficiary, or
 - (c) Is required to sell the property under the terms of any option subject to which the property was acquired by the estate (or revocable trust);
- (ii) Such 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) Such transaction occurs before the estate is considered terminated for federal income tax purposes pursuant to paragraph (a) of section 1.641(b)-3 of this Chapter (or in the case of a revocable trust, before it is considered subject to Code section 4947);
- (iv) The estate (or trust) receives an amount which equals or exceeds the fair market value of the foundation’s interest or expectancy in such property at the time of the transaction, taking into account the terms of any option subject to which the property was acquired by the estate (or trust); and
- (v) With respect to transactions occurring after April 16, 1973, the transaction either:
 - (a) Results in the foundation receiving an interest or expectancy at least as liquid as the one it gave up,
 - (b) Results in the foundation receiving an asset related to the active carrying out of its exempt purposes, or
 - (c) Is required under the terms of any option which is binding on the estate (or trust).

ANALYSIS

Section 53.4946-1(h)(3) of the regulations defines member of the family for purposes of section 4946 of the Code to include a lineal descendant.

E and F, nieces of C and D, are disqualified persons with respect to X. They are the children of A, a substantial contributor to X. Since E and F are lineal descendants of A, under section 53.4946-1(h)(3) of the regulations, they would be included as members of the family under section 4946(a)(1)(D) of the Code.

G is a foundation manager of X and is therefore a disqualified person within the meaning of section 4946(a)(1)(B) of the Code.

Section 4941(d)(1) of the Code defines the term "self-dealing" to include any direct or indirect sale or exchange, or leasing, of property between a private foundation and a disqualified person; or 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. However, section 53.4941(d)-1(b)(3) of the regulations provides a transaction with respect to a private foundation's interest or expectancy in property held by an estate does not constitute indirect self-dealing if five specific conditions are met. Based on your representations, the Settlement Agreement satisfies each of the five conditions, as explained below. Accordingly, its implementation will not result in indirect self-dealing under section 4941 of the Code.

First, the trustees of FF have complete discretion in making distributions to E and/or F including the purpose of simply augmenting their estates. Therefore, X has a mere unvested contingent future interest in FF which could be defeated either by the trustees' complete distribution of all of FF's assets to E and/or F or the adoption of a child by E or F.

Second, the Settlement Agreement (which includes provisions regarding the distribution of the assets among the respective beneficiaries of FF) has been approved by the court having jurisdiction over FF.

Third, the Settlement Agreement has been executed before FF is subject to section 4947 of the Code, which requires all unexpired interests in a non-exempt trust to be devoted to one or more purposes described under section 170(c)(2)(B) of the Code. In this situation, section 4947 does not apply to any of the trusts because the unexpired interests in the trusts are not devoted to purposes described in section 170(c)(2)(B) of the Code.

Fourth, FF is receiving an amount that equals or exceeds the fair market value of X's interest or expectancy in FF. Because the trustees have complete discretion in making distributions to E, F and their descendants, X's contingent interest could be zero. Therefore, X has a mere unvested contingent future interest in FF which could be defeated. However, through arm's-length negotiations, all parties agreed X's distributions would equal _____ of FF's total assets. Therefore, FF will receive a distribution of equal or greater than X's expectancy which could have been zero.

Fifth, by executing the Settlement Agreement, X will receive an interest that is at least as liquid as the interest it is giving up. Prior to the Settlement Agreement, X would be receiving only a contingent remainder interest in the trusts. The amount X would receive is

uncertain. The Settlement Agreement eliminates the uncertainty, or illiquidity, and replaces it with cash and readily saleable, publicly traded securities.

Accordingly, there is no basis for finding any self-dealing under section 4941(d)(1)(E) of the Code.

CONCLUSION

Based on the facts and information submitted and the representations made, we conclude as follows:

1. With respect to G, in his capacity of foundation manager of X, the proposed termination of AA, BB and CC and distribution of AA, BB and CC assets, as provided in the Settlement Agreements, does not constitute an act of self-dealing described in section 4941(d) of the Code.
2. With respect to E and F, the proposed termination of FF and distribution of FFs' assets, as provided in the Settlement Agreements, does not constitute an act of self-dealing described in section 4941(d) of the Code.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. You should keep a copy of this letter in your permanent records.

This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

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.

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

Sincerely yours,

Debra J. Kaweck

Debra J. Kaweck
Manager, EO Technical
Technical Group 1