DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224 200019044

Date: FEB 09 2000

Contact Person:

OP:E:EO:T 2

Uniform Issue List: 4941.04-00
4945.04-00
4945.04-06

Contact Number:

Legend:
D =
F =
T =
M =
x =

Dear Sir or Madam:

This is in reply to your letters of September 18, 1998, and December 10, 1999, for rulings that the transactions, described below, will not constitute any act of self-dealing under section 4941 of the Internal Revenue Code or any taxable expenditure under section 4945 of the Code.

F is exempt from federal income tax under section 501(c)(3) of the Code and is a private foundation under section 509(a) of the Code. F was created pursuant to the will of decedent D who died in 1993. T is a living trust created by D during D's lifetime that is not a part of D's probate estate. M is a trustee of F and of T.

T will wind up its affairs by distributing all of its remaining assets of about x dollars to F, pursuant to D's will. Under the state probate code, a distributee of amounts from trust T can be required to return amounts distributed to it to the extent that claims arise against the trust, including taxes, and other claims against the estate or the decedent from which the trust acquired its property. F and T will enter into an Agreement whereby F will indemnify T and its trustees, such as M, against such liabilities incurred by them in connection with such administration of T, excepting any claims resulting from gross negligence or intentional misconduct. No indemnity payment will be made unless and until a court with jurisdiction over T under the probate code, such as the California Probate Court, issues its order approving T's entering into this Agreement and the payments satisfy such Agreement and court order. F's taking of such assets will be subject to a statutory lien by operation of the state probate law, pursuant to which F may have to return some or all of the assets received from T to one or more not yet known possible claimants who might establish the right to such assets. Subsequent claims, including back taxes, could possibly be asserted against T or its transferee F, or fiduciaries such as M, following T's distribution of its assets to F. You represent that reasonable efforts have been made to determine any claimant(s) of T's assets, and there are no known substantial claims pending.

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F, T, and M request rulings that:

1. No act of self-dealing under section 4941 of the Code will arise on account of entering into the Agreement or the Foundation making payments required under California Probate Code Section 15685 under the Agreement or otherwise.

2. There will not be a taxable expenditure under section 4945 of the Code with respect to any payment made under California Probate Code Section 15685 under the Agreement or otherwise.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations organized and operated exclusively for charitable and/or the other exempt purposes stated in that section.

Section 509(a) of the Code describes organizations exempt from federal income tax under section 501(c)(3) of the Code that are private foundations subject to the private foundation provisions of Chapter 42 of the Code.

Section 4941(a)(1) of the Code imposes an excise tax to be paid by a disqualified person under section 4946 of the Code as to a private foundation who participates in an act of self-dealing with such private foundation.

Section 4941(a)(2) of the Code imposes an excise tax to be paid by a private foundation manager who participates in an act of self-dealing between a private foundation and a disqualified person where the foundation manager knows that such act is an act of self-dealing under section 4941 of the Code.

Section 4941(d)(1)(E) of the Code provides that an act of self-dealing includes a transfer to, or use by, a disqualified person of any assets of a private foundation.

Section 4941(d)(2)(A) of the Code and section 53.4941(d)-2(a)(2) of the Foundation and Similar Excise Taxes Regulations provide that the transfer of real or personal property by a disqualified person to a private foundation will be an act of self-dealing if the private foundation takes the property subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer to the private foundation. The term "similar lien" includes, but is not limited to, deeds of trust and vendors' liens, but does not include any other lien if such lien is insignificant in relation to the fair market value of the property transferred.

Section 53.4941(d)-2(f) of the regulations provide that the existence of an incidental or tenuous benefit to a disqualified person from the use of the assets of a private foundation does not constitute an act of self-dealing under section 4941 of the Code.

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In George M. Underwood, Jr. v. United States, 461 F. Supp. 1382 (N. D. Texas, November 14, 1978), an individual made a contribution to a private foundation, subject to the condition that he could deduct all of the contribution as a charitable donation. The Service determined that the individual's contribution to the foundation exceeded the maximum deductible amount and disallowed part of his claimed deduction. Under the donor's condition of the gift, the private foundation returned to the donor the amount of the contribution that was disallowed as a deduction, with the understanding that the individual would contribute the funds to a donee qualified for the further deductible amount. The court held that, because the individual's donation was conditioned on the deductibility of the contributions, the private foundation's refund of the nondeductible amount to the donor was a return of the amount which the foundation was not entitled to keep and, thus, such return of the donated pursuant to the conditional gift did not constitute any use of the assets by the foundation or the donor in any act of self-dealing under section 4941 of the Code.

Section 4945(a)(1) of the Code imposes excise tax to be paid by a private foundation that makes a taxable expenditure under section 4945(d) of the Code.

Section 4945(a)(2) of the Code imposes excise tax to be paid by a private foundation manager who knowingly agrees to make a private foundation's taxable expenditure under section 4945(d) of the Code, unless such agreement is not willful and is due to reasonable cause.

Section 4945(d)(5) of the Code provides that a taxable expenditure includes any amount expended by a private foundation for purposes other than purposes under section 170(c)(2)(B) of the Code, which includes charitable and other exempt purposes.

Section 53.4945-6(a) of the regulations provides that a taxable expenditure under section 4945(d)(5) of the Code is directed to the type of expenditure for a nonexempt purpose that would cause loss of the private foundation's tax exemption.

Section 53.4945-6(b)(i) of the regulations provides that a taxable expenditure under section 4945(d)(5) of the Code is not directed to a foundation's reasonable expenses with respect to obtaining funds for its exempt purposes.

Private foundation F will take the assets from decedent's living trust T, subject to the condition in the Agreement for indemnity that F will return any portion of the assets to any existing, but now unknown, valid claimant of T's assets, for whom there would be a statutory lien on the assets by operation of the state probate law. You represent that reasonable efforts over time have been made on behalf of F, T, and M to determine any claimant(s) of T's assets, and there are no known substantial claims pending. If a valid claimant arises, F's return of some or all of the assets to such valid claimant will be an action required by state law taken with approval by the state court.

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F's duty to refund and indemnify T and/or M under the Agreement does not constitute a "mortgage or similar lien" on the property transferred under the Agreement within the meaning of section 4941(d)(2)(A) of the Code. Although the Agreement constitutes a "lien" on the property in the ordinary sense of the term, the term "mortgage or similar lien" generally involves a volitional act by the disqualified person in placing the lien on the property, whereas the equitable lien arises by operation of law. Since the Agreement merely restates and clarifies the terms of the equitable lien, and since any refund will be made only upon a court determination before the refund is made that the Trustee has an enforceable lien (regardless of the Agreement) for these expenses against the Trust property transferred to F, the Agreement and any refund under it will not involve a "transfer to, or use by or for the benefit of, a disqualified person of the income or assets" of F. The benefit to T or M is incidental to their legal right to indemnification under State law.

Similarly, any refunded assets under the Agreement will not be expenditures for noncharitable purposes under section 4945 of the Code, but will be necessary administrative expenses. Any such refunds will not constitute "grants" and, thus, F need not exercise expenditure responsibility under section 4945(h) of the Code with respect to them.

Accordingly, we rule that, as to F, T, and M, the making of the Agreement and any refund by F to T or M of all or a portion of the distribution F receives in accordance with the Agreement will constitute neither an act of self-dealing under section 4941 of the Code nor a taxable expenditure under section 4945 of the Code, and F will not be required to exercise expenditure responsibility under section 4945 of the Code with respect to any refunded assets.

Except as we have ruled above, we express no opinion as to the tax consequences of these transactions under the cited provisions of the Code or under any other provisions of the Code.

Because this ruling letter could help to resolve any questions, please keep it in your permanent records.

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

Sincerely,

(signed) Garland A. Carter

Garland A. Carter
Manager, Exempt Organizations
Technical Group 2

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