Internal Revenue Service

Department of the Treasury

200032043

Washington, DC 20224

Contact Person:

Telephone Number:

In Reference to:

Date: MAY 15 2000

Significant Index No.
4941.00-00

cP:E:EO:T 3

Legend:

M=
N=
O=
P=
Q=
R=
S=
T=
U=
V=
W=
X=
Y=
Z=
A=
B=
C=
D=
E=
F=
G=

Dear Sir or Madam:

This is in response to M's request for a ruling under section 4941 of the Internal Revenue Code submitted by M's legal representative. M has requested a ruling that the terms of a compromise agreement between parties named in decedent's will, and the codicil thereto, will not constitute an act of self-dealing as described in section 4941 of the Code.

A was a prominent scientist who died on C. M states that A's estate plan documents consist of A's will, the first codicil to the will, the seventh amendment to Z, and the eighth amendment to Z.

29

P is the brother of A. P serves as the executor of A's estate.

Z is a revocable trust created by A. Z became irrevocable upon A's death.

N and O have been recognized as exempt under section 501(c)(3) of the Code and classified as private foundations described in section 509(a). N and O are organized to accomplish charitable purposes described in section 501(c)(3) of the Code.

P and B serve as trustees for N and O. B is the son P.

Article Fifth of A's original will bequeathed property F to Q. Article Eighth of A's will provides that the residue of A's estate passes to Z, to be distributed in accordance with terms of the Z agreement. Article second of the Z agreement directs the trustees to distribute portions of the trust property to various beneficiaries upon A's death. After the satisfaction of these specific bequests the balance of Z's assets is to be divided among N, O, Q, R, S, T, U, V, W, X, and Y, including E percent of the Z residue to Q.

After executing his will and the Z agreement, A made various changes. Article fifth, section A of the codicil eliminated the gift of the F property to Q. The F property was devised, instead, to A's brother, P. The codicil provided no direction regarding the disposition of the F property in the event that P predeceased A. Article fifth, section C of the codicil devised property G to P. Under the terms of the original will, property G was not bequeathed to any particular beneficiary and would have passed as part of the residuary to Z, to be divided among the charitable beneficiaries as described in the Z agreement. An amendment to the Z agreement made one significant change. Article eighth, section E of the Z agreement eliminated Q's E percent interest in the Z residue.

Various legal claims have been filed with the probate court with jurisdiction over A's estate challenging the validity of the codicil and amendments to Z by parties named in the documents. In order to resolve these claims and to effectuate continued administration of A's estate the parties have entered into a compromise agreement.

Under the terms of the compromise agreement, the G property that was previously part of the residual assets, will instead be distributed to P. In addition, the F property previously bequeathed to Q, to be used as part of Q's educational and environmental conservation programs, will instead be interpreted to give P, as executor of M, the right to select the charitable

organization as the recipient. The terms of the agreement require that the property be dedicated to charitable purposes. N and O are charitable beneficiaries named in A's will and have an expectancy of D percent of the residual assets of A's estate, including the Z assets.

In addition to N and O, Q, R, S, T, U, V, W, and X have been named as charitable beneficiaries in A's will, and therefore, have an expectancy in A's estate. All of the parties have approved the compromise agreement. M represents that the parties have executed the compromise agreement in order to avoid expensive and unpleasant litigation. The agreement has also been approved by a court with competent jurisdiction over A's estate.

M represents that after the execution of the compromise agreement the fair market value of N and O's D percent interest in the residual assets of A's estate will be more than the property interests held by M, on behalf of N and O, before the agreement was executed.

Section 4941(a)(1) of the Code provides for the imposition of tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(A) of the Code provides that the term "self-dealing" means any direct or indirect sale or exchange, or leasing of property between a private foundation and disqualified person.

Section 4941(d)(1)(E) of the Code states that the term "self dealing" means 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 4941(d)(2)(A) of the Code provides that the transfer of real or personal property by a disqualified person to a private foundation shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the foundation assumes or if it is 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.

Section 4946(a)(1)(B) provides that the term "disqualified person" means, with respect to a private foundation, a person who is a foundation manager to the foundation.

Section 53.4941(d)-1(a) of the Foundation and Similar Excise Tax Regulations provides that the term "self-dealing" does not, however, include a transaction between a private foundation and a disqualified person where the disqualified person status arises only as a result of such transaction. For example, the bargain

sale of property to a private foundation is not a direct act of self-dealing if the seller becomes a disqualified person only by reason of his becoming a substantial contributor as a result of the bargain element of the sale. For the effect of sections 4942, 4943, 4944, and 4945 upon an act of self-dealing which also results in the imposition of tax under one or more of such sections, see the regulations under those sections.

Section 53.4941(d)-1(b)(5) of the regulations provides that for purposes of this paragraph, an organization is controlled by a private foundation if the foundation or one or more of its foundation managers (acting only in such capacity) may, only by aggregating their votes or positions of authority, require the organization to engage in a transaction which if engaged in with the private foundation would constitute self-dealing. Similarly, for purposes of this paragraph, an organization is controlled by a private foundation in the case of such a transaction between the organization and a disqualified person, if such disqualified person, together with one or more persons who are disqualified persons by reason of such a person's relationship (within the meaning of section 4946(a)(1)(C) through (G)) to such disqualified person, may, only by aggregating their votes or positions of authority with that of the foundation, require the organization to engage in such a transaction. The 'controlled' organization need not be a private foundation; for example, it may be any type of exempt or nonexempt organization including a school, hospital, operating foundation, or social welfare organization. For purposes of this paragraph, an organization will be considered to be controlled by a private foundation or by a private foundation and disqualified persons referred to in the second sentence of this subparagraph if such persons are able, in fact, to control the organization (even if their aggregate voting power is less than 50 percent of the total voting power of the organization's governing body) or if one or more of such persons has the right to exercise veto power over the actions of such organization relevant to any potential acts of self-dealing. A private foundation shall not be regarded as having control over an organization merely because it exercises expenditure responsibility (as defined in section 4945 (d)(4) and (h)) with respect to contributions to such organization. See example (6) of subparagraph (8) of this paragraph.

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 Sec. 1.641(b)-3 of this chapter (or in the case of a revocable trust, before it is considered subject to 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).

N and O are charitable beneficiaries named in A's will. Prior to the execution of the compromise agreement N and O had a D percent interest in the residual assets of A's estate. M represents that the fair market value of N and O's expectancy in A's estate equals or exceeds the fair market value of N and O's interest before the compromise agreement was executed to avoid expensive and unpleasant litigation.

The compromise agreement, involving property allocation changes amongst the estate beneficiaries, including P, a disqualified person within the meaning of section 4946 of the

205

Code, has been approved by a court with competent jurisdiction over the administration A's will and estate. Under the terms of A's will N and O are entitled to receive a D percent interest in the residual assets of A's estate. The probate court with jurisdiction over the administration of A's will has approved a compromise agreement between the parties, including Foundation N and O, who have a D percent interest in the residual assets in A's estate held by M, on N and O's behalf, pursuant to section 53.4941(d)-1(b)(3)(ii) of the regulations. P as executor of M and trustee of N and O, has the power to reallocate the property, held by M on behalf of N and O, to another beneficiary pursuant to section 53.4941(d)-1(b)(3)(i) of the regulations. The transaction is occurring as part of the estate administration and M has not been terminated for federal income tax purposes pursuant to section 53.4941(d)-1(b)(3)(iii). Under the facts presented the fair market value and liquidity requirements will be satisfied pursuant to sections 53.4941(d)-1(b)(3)(iv) and (v).

Based on the above we rule that the terms of the compromise agreement between the parties named in A's will and the codicil thereto, will not constitute an act of self-dealing as described in section 4941 of the Code.

This ruling does not purport to rule on transactions that occur after the distributions from M to N and O. Further, this ruling does not purport to rule on any other provisions of the Code. However, we understand that the Assistant Chief Counsel, Passthroughs & Special Industries has recently issued a ruling to M that the transfers of property to the charitable organizations involved herein pursuant to the compromise agreement qualify for the estate tax deduction under section 2055 of the Code.

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 as precedent.

Sincerely yours,

(signed) Robert C. Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3

206