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

UIL Numbers: 4941.00-00
4946.01-00

Date:
MAR 22 2001

Contact Person:
ID Number:
Telephone Number:

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Employer Identification Number:

Legend

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X =
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Dear Sir or Madam:

This letter responds to the request of counsel for X (the Estate), dated June 23, 2000, as supplemented, and amended, by letters dated October 25, November 6, November 13, and March 19, 2001, for rulings regarding the issue of self-dealing under section 4941 of the Internal Revenue Code.

Y died on February 3, 1999 and under the terms of his Last Will and Testament (Will) all of the decedent's assets passed to a marital trust for the benefit of his wife (Marital Trust). The co-executors split the Marital Trust into three trusts, each with identical terms. Under the terms of the Marital Trusts, the wife is entitled to all of the income paid at least quarterly. The Will provides that upon the wife's death, the remaining assets in the Marital Trusts are to be distributed as follows:

1. A will be paid to four continuing trusts for the benefit of decedent's descendants;

2. remainder distributed in equal shares to five charitable lead trusts (CLATs) described under section 4947(a)(2) of the Code.

The term of each CLAT is twenty-one years and the annuity amount is the smallest amount that could be provided under the terms of the charitable lead trusts to produce a Federal estate tax deduction equal to 100% of the Federal estate tax value of the assets of the CLAT.

The co-executors have proposed to sell interests in real estate and various real estate partnerships and corporations to a newly formed limited liability company (hereafter family LLC) which will be owned, partially or wholly, by or for the benefit of any or all of Y's four children and their issue, (Related Family Members), in exchange for a secured, interest-bearing promissory note (Note). The Note (i) will bear interest at the applicable federal rate in effect for the month in which the sale occurs; (ii) will have a term of not greater than thirty years; and (iii) will be secured by the real estate interests. The fair market value of the Note will be equal to the fair market value of the property as established by a qualified appraisal.

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The proposed transaction is required by State law to be structured so that the interests of the charitable beneficiaries under the Will are protected. The State Court must approve the proposed transaction and the Attorney General of State will represent the interests of the charitable beneficiaries in that proceeding. Thus, the real estate interests will be sold at their appraised fair market value, the Note will bear a market interest rate, and the Note will be secured by the property sold (i.e., the real estate interests.)

As represented by X, the effect of such arm's length terms and conditions is that the charitable beneficiaries will be in a position which is at least as favorable as their current position and is likely to be more favorable.

First, by entering into the transaction, the CLATs will be protected from fluctuations in the real estate market that may occur prior to the death of the decedent's wife. The Note will serve to fix the value of the CLATs assets at the current value of the real estate interest, thus protecting the CLATs from a downturn in the real estate market, and will fix the return of the CLATs through a fixed rate of interest, thus protecting the CLATs from fluctuations in the returns realized by the real estate itself.

Secondly, as a result of the proposed transaction, the cash flow of the CLATs will be improved and stabilized so that the CLATs will be better able to satisfy their annuity obligations. Without the sale, the CLATs would receive the real estate interests and would be required to engage in the real estate business. Rental income would be subject to market fluctuations and the CLATs would be required to incur debt in order to sustain and to grow the business. Mortgage indebtedness is generally considered to be an integral part of the real estate business without which growth is difficult. Thus, the net rental income of the CLATs will be subject to future interest rates that are unknown, and to interest rate fluctuations. With the proposed transaction, the CLATs and thus the charitable beneficiaries will be less concerned about fluctuations in the real estate market and in interest rates since the CLATs' income will be fixed in accordance with the terms of the Note.

Finally, the CLATs will receive property that is at least as liquid as the property sold for the following represented reasons:

1. The Note will be negotiable and thus can be sold to a third party for cash at any time by the CLATs. The real estate interests, by their nature, are less liquid because they constitute separate interests in numerous and diverse real estate properties. Finding a purchaser for all the real estate interests, the negotiation of the terms of sale such as the assumption of debts and contingent (e.g. environmental) liabilities, and the actual closing of the transaction would take many months.

2. The Note will be secured by the real estate interests. Thus, in addition to a sale of the Note, the CLATs will have an additional source of liquidity in the real estate itself.

3. The family LLC, which will purchase the real estate interests, will have substantial capital and this capital will be available to the CLATs to satisfy the Note payments. The family LLC will have capital equal to at least Z of the value of the real estate interest purchased. Thus, in the event of a default on the Note, the CLATs will not be limited to the real estate interests, but will have recourse against the capital of the LLC.

Without the proposed transaction, the CLATs would only have access to the real estate interests in order to satisfy annuity payments to the charitable beneficiaries. With the proposed transaction, the CLATs have access to (i) the Note, (ii) the real estate interests themselves, and (iii) the capital of the family LLC.

After the transaction, the Note will be included among the assets used to fund the Marital Trusts for the benefit of decedent's wife. Upon her death, the Note will be included among the assets used to fund the CLATs. As a result, the Related Family Members will be indebted to the CLATs under the terms of the Note.

You have requested the following rulings:

1. The sale of the property during the Estate administration to the Related Family Members will not constitute an act of self-dealing under section 4941 of the Code and will not give rise to tax under that section to the Estate, to the Marital Trusts, to the Related Family Members, or to the CLATs.

2. The receipt and holding of the Note by the CLATs, and the subsequent payment of principal and interest on the Notes by disqualified persons will not constitute acts of self-dealing under section 4941(d) of the Code, and will not give rise to tax liability under section 4941 to the Estate, to the Martial Trusts, to the Related Family Members, or to the CLATs.

3. Notwithstanding that the real estate interests that will be sold to the LLC, a disqualified person, will be pledged as collateral for the Note to the CLATs, the continued operation of the real estate business by the managers of the LLC or any other member of the Related Family Members, including, but not limited to, the leveraging and selling of secured assets, and the acquisition of new assets, will not constitute acts of self-dealing under section 4941(d) of the Code because the proposed transaction has met the requirements of section 53.4941(d)-1(b)(3) of the Foundation and Similar Excise Taxes Regulations, so long as the value of the collateral remains as required by the terms of the Note, and will not give rise to tax liability under section 4941 of the Code to the Estate, to the Marital Trusts, to the Related Family Members, or to the CLATs.

Chapter 42 of the Code subjects private foundations described in section 509(a) of the Code and disqualified persons described in section 4946 of the Code to certain excise tax provisions including section 4941 of the Code.

Section 4947(a)(2) of the Code provides that the self-dealing excise tax imposed by section 4941 of the Code applies equally with respect to a charitable lead trust as if such trust were a private foundation.

Section 4941(a) of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation [charitable lead annuity trust].

Section 4941(d)(1) of the Code provides, in part, that the term "self-dealing" means any direct or indirect (A) sale or exchange, or leasing, of property between a private foundation [charitable lead annuity trust] and a disqualified person; (B) lending of money or other extension of credit between a private

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foundation [charitable lead annuity trust] and a disqualified person;...(E) transfer to, or use by or for the benefit of, a disqualified person of the assets of a private foundation [charitable lead annuity trust].

Section 4946(a)(1) of the Code provides, in part, that the term "disqualified person" means, with respect to a private foundation [charitable lead annuity trust], a person who is – (A) a substantial contributor to the foundation [trust], (B), a foundation manager, ... or (D) a member of the family of any individual described in subparagraphs (A), (B), or (C).

Section 53.4941(d)-2(c)(1) of the Foundation and Similar Excise Taxes Regulations (hereafter regulations) provides that the lending of money or other extension of credit between a private foundation [charitable lead annuity trust] and a disqualified person shall constitute an act of self-dealing. Further, section 53.4941(d)-2(c)(1) of the regulations provides that except in the case of the receipt and holding of a note pursuant to a transaction described in section 53.4941(d)-1(b)(3) of the regulations, an act of self-dealing occurs where a note, the obligor of which is a disqualified person, is transferred by a third party to a private foundation [charitable lead annuity trust] which becomes the creditor of the note.

Section 53.4941(d)-1(b)(3) of the regulations excepts certain transactions carried out during the administration of an estate from the definition of self-dealing. Specifically, 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 [charitable lead annuity trust] 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 the regulations (or in the case of a revocable trust, before it is considered subject to section 4947 of the Code);

(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).

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You have represented that: (i) the co-executors of the estate possess a power of sale with respect to the interests at issue; (ii) the transaction will be consummated prior to the termination of the Estate's administration for Federal income tax purposes as provided by paragraph (a) of section 1.641(b)-(3) of the regulations; (iii) a petition seeking approval of the transaction by the probate court having jurisdiction over this transaction will be filed, and the transaction will not be consummated without prior approval of such Court; (iv) the Estate shall receive an amount which equals or exceeds the fair market value of the property to be sold [such fair market value to be determined pursuant to the provisions of section 53.4941(d) – 1(b)(3) of the regulations]; and (v) the proposed sale will be for a promissory note, to be secured by the real estate interests.

You have also represented that by entering into the transaction, the CLATs will be protected from fluctuations in the real estate market that may occur prior to the death of decedent's wife. The Note will serve to fix the value of the CLAT assets at the current value of the real estate interest (thus protecting the CLATs from a downturn in the real estate market) and will fix the return of the CLATs through a fixed rate of interest (thus protecting the CLATs from fluctuations in the returns realized by the real estate itself).

Also, as a result of the proposed transaction, the cash flow of the CLATs will be improved and stabilized so that the CLATs will be better able to satisfy their annuity obligations. Without the sale, the CLATs would receive the real estate interests and would be required to engage in the real estate business. Rental income would be subject to market fluctuation and the CLATs would be required to incur debt in order to sustain and to grow the business. Mortgage indebtedness is generally considered to be an integral part of the real estate business without which growth is difficult. Thus, the net rental income of the CLATs will be subject to future interest rates that are unknown, and to interest rate fluctuations. With the proposed transaction, the CLATs and thus the charitable beneficiaries will be less concerned about fluctuations in the real estate market and in interest rates since the CLATs' income will be fixed in accordance with the terms of the Note.

Finally, the CLATs will receive property, which is at least as liquid as the property sold for the reasons listed above.

Without the proposed transaction, the CLATs would only have access to the real estate interests in order to satisfy annuity payments to the charitable beneficiaries. With the proposed transaction, the CLATs have access to (i) the Note, (ii) the real estate interests themselves, and (iii) the capital of the family LLC.

Since the Note is represented to be more liquid than the real estate interests, the CLATs will receive through the Note an interest or expectancy at least as liquid as the interest that the CLATs give up. Additionally, the Note will be issued with all the safeguards enumerated in section 53.4941(d)-1(b)(3) of the regulations and continued holding of the Note by the CLATs will not be considered an extension of credit or other act of self-dealing between the CLATs and a disqualified person for the purposes of section 4941(d)(1)(B) of the Code. Finally, the continued operation of the real estate business by a disqualified person will not constitute acts of self-dealing under section 4941 of the Code because all of the requirements of section 53.4941(d)-1(b)(3) of the regulations will have been satisfied.

Accordingly, based on the information and representations submitted, we are ruling as follows:

1. The sale of the property by the Estate to the Related Family Members is not an act of self-dealing within the meaning of section 4941 of the Code, and will not give rise to tax under that section to the Estate, to the Marital Trusts, to the Related Family Members, or to the CLATs.

2. The receipt and holding of the Note by the CLATs, and the subsequent payment of principal and interest on the Notes by disqualified persons will not constitute acts of self-dealing under section 4941(d) of the Code, and will not give rise to tax liability under section 4941 to the Estate, to the Martial Trusts, to the Related Family Members, or to the CLATs.

3. Notwithstanding that the real estate interests that will be sold to the limited liability company, a disqualified person, will be pledged as collateral for the Note to the CLATs, the continued operation of the real estate business by the managers of the limited liability company or any other Related Family Members, including, but not limited to, the leveraging and selling of secured assets, and the acquisition of new assets, will not constitute acts of self-dealing under section 4941(d) of the Code because the proposed transaction has met the requirements of section 53.4941(d)-1(b)(3) of the regulations as represented, so long as the value of the collateral remains as required by the terms of the Note, and will not give rise to tax liability under section 4941 of the Code to the Estate, to the Marital Trusts, to the Related Family Members, or to the CLATs.

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

This ruling is limited to the applicability of the provisions of sections 4941(d) and 4946 of the Code and does not purport to rule on any facts that were not represented in the ruling request as supplemented or on any changes of those facts. Also, in this ruling, we have not determined whether the methodology you or your independent appraisers are using to determine fair market value is proper. We merely have accepted your representations that the Note will reflect fair market value. This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

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.

Sincerely,

/s/

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

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