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

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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Index Numbers: 501.03-02; 4941.04-00

Date: SEP - 5 2001

T:EO:B4

Employer Identification Number:

LEGEND:
L =
M =
N =
O =
P =
Q =
R =

Ladies and Gentleman:

This is in response to L's letter requesting a ruling regarding a proposed exchange of assets in satisfaction of a bequest to L. L maintains that the transaction will not result in the loss of L's tax-exempt status under section 501(c)(3) of the Internal Revenue Code (the Code) or constitute "self-dealing" under section 4941.

FACTS

L is a private foundation exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). M initially funded L. L's charitable purpose is to conduct, support, encourage, and assist religious, charitable, scientific, literary, educational, and other projects and programs. L represents that it is required to distribute at least five percent of its assets to such programs each year.

A five member Board of Directors currently governs L. The board includes three original members, N, O, and P, who are children of M and disqualified persons to L within the meaning of section 4946 of the Code. Two independent members were appointed to the Board upon the death of M.

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M died testate in 1997. The Last Will and Testament (the Will) executed by M was duly admitted to probate in court. N was appointed and duly qualified as the personal representative of the Estate of M. According to M's Will, N has the power to sell, at public or private sale, with or without court order, all or any part of the property in M's Estate. Furthermore, under the Will, N has full power to exercise all powers granted by and under state law, which includes the power to exchange assets. The M Estate remains open and has not terminated for local law or for federal income tax purposes.

Under the terms of M's Will, M bequeathed her ownership interests in Q, as determined on the date of her death, to N, O, and P. Each child who survived M was to receive one-third of M's interest in Q. M's Will further stipulated that, if any legatee disclaimed all or any portion of this bequest, the disclaimed portion shall be distributed to L.

Q is a limited partnership comprising M, N, O, and P as limited partners, and R as general partner. At her death, M owned a 54.152 percent limited partnership interest in Q, resulting in a specific bequest of an 18.0507 percent limited partnership interest to each of N, O, and P. The sole members of R at M's date of death and currently are N, O, and P. L has represented that an independent appraisal of Q, accepted upon audit by the Internal Revenue Service (the Service) for federal estate tax purposes, valued M's interest in Q as of M's date of death.

N, O, and P each executed a disclaimer as to some portion or all of her or his said bequest. P disclaimed all of his interest in his specific bequest; N disclaimed 5.5843 percent of her specific bequest as finally determined for federal estate tax purposes, equivalent to a 1.0080 percent limited partnership interest in Q; and O disclaimed 5.5843 percent of his specific bequest as finally determined for federal estate tax purposes, equivalent to a 1.0080 percent limited partnership interest in Q. Each individual disclaimed all rights and powers as a director or officer of L with respect to any portion or amount of her or his disclaimed bequest. The disclaimers result in L being entitled to receive a 20.0667 percent limited partnership interest in Q (collectively, the Disclaimer Bequest). The Disclaimer Bequest has not yet been distributed to L.

L has represented that the satisfaction of its interest or expectancy in M's Estate with the limited partnership interests that comprise the Disclaimer Bequest (Disclaimed Q Interests) would result in L's receiving an illiquid asset. Under the Q Partnership Agreement, L would be an assignee and not a substituted limited partner absent action taken by N, O, and P (as members of R). As assignee, L would have limited rights. L would have no right to status as a substituted limited partner. However, even if admitted as a substituted limited partner, L would have no right to participate in the management of Q, no right to withdraw from Q, no right to force dissolution or termination of Q, no right to force distributions from Q, no right to partition of L's Q interest, and restricted transfer rights of L's Q interest.

Accordingly, L's two independent Board directors have determined that it is in L's best interest to accept cash or readily marketable publicly traded securities from M's Estate in substitution for the Disclaimed Q Interests, in satisfaction of the Disclaimer Bequest (the Distribution Plan). This transaction is subject to the approval of the probate court and the issuance by the Service of a private letter ruling finding that L's acceptance of cash or readily

marketable publicly traded securities under the Distribution Plan in satisfaction of the Disclaimer Bequest will not (i) result in the loss of L's exempt status under section 501(c)(3) of the Code, or (ii) constitute "self-dealing" under section 4941 of the Code.

The two independent directors, together with M's Estate, filed a joint petition with the probate court requesting it approve the Distribution Plan contingent upon the issuance by the Service of a private letter ruling finding that L's acceptance of cash or readily marketable publicly traded securities under the Distribution Plan in satisfaction of the Disclaimer Bequest will not (i) result in the loss of L's exempt status under section 501(c)(3) of the Code, or (ii) constitute "self-dealing" under section 4941 of the Code. Following a hearing, the probate court approved the petition by order. As set forth in the order, the terms of the Distribution Plan are to be as follows:

(a) L and M's Estate will obtain an independent, third-party appraisal (the Appraisal) of the fair market value (the Distribution Value) of the 20.0667 percent limited partnership interest in Q that comprises the Disclaimer Bequest, valued as of the date (the Valuation Date) of the issuance by the Service of a private letter ruling finding that the Distribution Plan will not (i) result in the loss of L's exempt status under section 501(c)(3) of the Code, or (ii) constitute "self-dealing" under section 4941 of the Code. L and M's Estate will also obtain an independent, third-party appraisal of the fair market value as of the Valuation Date of the cash and readily marketable publicly traded securities selected by the personal representative (the Substitute Assets) to substitute for the limited partnership interest in Q in satisfaction of the Disclaimer Bequest.

(i) In determining the Distribution Value of the Q interest that comprise the Disclaimer Bequest, the independent appraiser will apply the same conditions, terms, and valuation methodology as were used and accepted by the Service in determining the fair market value of such limited partnership interest in Q for federal estate tax purposes for M's Estate.

(ii) The independent appraiser will certify its opinion that the Substitute Assets are at least as liquid and readily marketable as the 20.0667 percent limited partnership interest in Q that comprises the Disclaimer Bequest.

(b) Within ten days of the Valuation Date, M's Estate will distribute to L the Substitute Assets having a value as of the Valuation Date equal to the Distribution Value.

LAW

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 509(a) of the Code provides that, unless specifically excepted, a domestic or foreign organization described in section 501(c)(3) is a private foundation and subject to the excise taxes of Chapter 42.

Section 4941(a) of the Code imposes a five percent 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 a disqualified person.

Section 4946(a)(1) of the Code provides, in part, that the term "disqualified person" means with respect to a private foundation, a person who is –

(A) a substantial contributor to the foundation;
(B) a foundation manager;
(C) an owner of more than 20 percent of –
  (i) the total combined voting power of a corporation,
  (ii) the profits interest of a partnership, or
  (iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation;
(D) a member of the family (as defined in subsection (d)) of any individual described in subparagraph (A), (B), or (C).....

Section 4946(d) of the Code provides that, for purposes of section 4946(a)(1), the family of any individual shall include only his spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren.

Section 1.501(a)-1(c) of the Income Tax Regulations (the regulations) provides that the words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in section 501(c)(3) of the Code unless it serves a public rather than a private interest. Thus, to qualify under section 501(c)(3), an organization must establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 53.4941(d)-1(a) of the Foundation and Similar Excise Taxes Regulations (the regulations) provides that, for purposes of section 4941, the term "self-dealing" means any direct or indirect transaction described in section 53.4941(d)-2 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 that 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 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 that 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 that is binding on the estate (or trust).

ANALYSIS

Based upon L's representations, L will not jeopardize its tax-exempt status under section 501(c)(3) of the Code by accepting cash or readily marketable publicly traded securities in exchange for the Disclaimed Q Interests. As represented, the cash or securities may be used directly in meeting L's obligation of distributing at least five percent of the value of L's assets each year for charitable purposes. As represented, there are no restrictions on using these assets. Thus, this transaction would not preclude L from furthering its exempt purposes under section 501(c)(3) and section 1.501(c)(3)-1(c)(1) of the regulations. Furthermore, there is no evidence that, by accepting the cash or securities, L operates to benefit the private interests of the disqualified persons who [individually] are limited partners of Q as well as the sole members of R.

L's acceptance of the Distribution Plan of exchanging cash or readily marketable publicly traded securities for the Disclaimed Q Interests would ordinarily constitute indirect "self dealing"

under section 4941(d)(1)(A) of the Code. N, O, and P are disqualified persons with respect to L. Therefore, because there is an exchange of property between L, a private foundation, and N, O, and P, through the Estate, the transaction would be considered indirect "self-dealing" for purposes of section 53.4941(d)-1(a) of the regulations.

However, based on L's representations, the proposed exchange and distribution of assets in which L has an expectancy will meet the estate administration exception to self-dealing contained in section 53.4941(d)-1(b)(3) of the regulations. Therefore, the transaction will not constitute an act of self-dealing under section 4941(d)(1)(A) of the Code.

Based on L's representations, N possesses a power of sale with respect to the property in question. According to M's Will, N has the power to sell, at public or private sale, with or without court order, all or any part of the property in M's Estate. N also has the power to exchange assets under M's Will. Second, the probate court will approve a petition requesting that it approve the Distribution Plan contingent upon a favorable ruling by the Service. The petition was approved by order. Third, the Estate remains open and has not terminated for local law or for federal income tax purposes. Fourth, according to the probate court order, L and M's Estate will obtain an independent appraisal of the Distribution Value of the 20.0667 percent limited partnership interest in Q that comprises the Disclaimer Bequest. L and M's Estate will also obtain an independent appraisal of the fair market value of the Substituted Assets. Within ten days of the Valuation Date, M's Estate will distribute to L the Substitute Assets having a value as of the Valuation Date equal to the Distribution Value. M's Estate receives an amount that is represented to equal the fair market value of L's interest or expectancy in such property at the time of the transaction. Fifth, as you represent, according to the probate court order, the Substitute Assets are at least as liquid and readily marketable as the 20.0667 percent limited partnership interest in Q that comprises the Disclaimer Bequest. Therefore, based on L's representations, the transaction results in L receiving an interest or expectancy at least as liquid as the one L gave up.

Based on the above facts, we rule as follows:

Based on L's representations, L's acceptance of the Distribution Plan of exchanging cash or readily marketable publicly traded securities for the Disclaimed Q Interests does not (a) result in the loss of L's exempt status under section 501(c)(3) of the Code, or (b) constitute "self-dealing" under section 4941of the Code.

This ruling is limited to the applicability of sections 501(c)(3) and 4941 of the Code and does not purport to rule on any facts that were not represented in the ruling request as supplemented. Also, in this ruling, we are not determining whether the methodology L is using to determine fair market value interest values is proper. We merely have accepted L's representations that the proposed transactions will reflect fair market value.

Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transactions described above under any other provision of the Code.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representatives. A copy of this letter should also be kept in your permanent records.

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

If there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4