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

200207028

Date: NOV 21 2001

Contact Person:

Identification Number:

UIL: 4941.00-00

Telephone Number:

T:EO:B4

Employer Identification Number:

Legend:

B:
C:
D:
E:
F:
G:
H:
J:
Decedent's Trust:
Survivor's Trust:

K:
L:
M:
N:
O:
aa:

Dear Taxpayer:

We have considered your ruling request, along with supplemental correspondence, concerning the application of section 4941 of the Internal Revenue Code, specifically the estate or trust administration exception from self-dealing under section 53.4941(d)-1(b)(3) of the Foundation and Similar Excise Tax Regulations. You are the Survivor's Trust as described in the following facts.

Facts

B and C created D. Upon C's death, D divided into two parts, each part administered as a separate trust. One trust became known as Survivor's Trust and the other trust became known as Decedent's Trust. B exercised limited power of appointment over Decedent's Trust and amended and restated Survivor's Trust in its entirety. F and H were appointed trustees of both Survivor's Trust ("ST") and Decedent's Trust ("DT").

DT was set up to benefit several of B's children and grandchildren including F. ST was set up to distribute assets to private individuals including H with the residual used to set up a charitable lead unitrust ("CLUT") and a charitable lead annuity trust ("CLAT"). These are nonexempt charitable trusts described in section 4947(a)(2) of the Code and are subject to some of the excise taxes imposed on private foundations under Chapter 42, including section 4941 of the Code.

Upon B's death and after several specific gifts to private individuals, the residue of the ST has been divided between the CLUT and the CLAT. The charitable beneficiary of both the CLUT and the CLAT is G with F and H serving as trustees. B is a substantial contributor of G through CLUT and CLAT. The remainder beneficiaries of the CLUT and CLAT are B's then living descendants.

G was exempt from tax under section 501(c)(3) of the Code and classified as a private foundation under section 509(a). G has split into two separate foundations: J and K. Both new foundations are exempt from taxes under section 501(c)(3). Pursuant to an agreement by the trustees, distributions from CLUT and CLAT will be made 1/3 to J and 2/3 to K.

L, a limited liability company (LLC), was created after B's death. At the time of B's death, all of L's property was held in M. At that time, M was owned fifty percent ST and fifty percent by DT. Because L was funded exclusively with the property from M, the ownership interests of ST and DT were the same. After B's death, another property was acquired by a new LLC, N. This was funded with assets from L and is owned by ST and DT and in the same proportion as L. The managing member of L and N is currently F.

Small interests in L and N were distributed to a marital trust that was created under ST. Under the terms of ST, the remaining interests in L and N owned by ST will have to be distributed either to the CLUT or the CLAT.

L currently owns many properties, some of which are subject to various mortgages. N currently owns one property that is also subject to a mortgage. In addition, it is contemplated that new properties may be acquired to enhance or improve the overall economic return of L and N. Alternatively, properties may be disposed of that are not performing at acceptable levels of economic return. The acquisition of such new properties may require that debt be used as part of the purchase consideration. L and N are flow through entities that are taxed as partnerships. Thus, the unrelated debt-financed income will flow through to ST and DT. If L and N interests were distributed to the CLUT or CLAT, income generated by the mortgaged property would likely be characterized as unrelated business taxable income within the meaning of sections 512 and 514 of the Code.

In summary, F is a trustee of ST, trustee and beneficiary of DT, a trustee of G, the beneficiary foundation of the CLUT and CLAT, and is the managing member of L and N. H is a trustee and beneficiary of ST, a trustee of DT and a trustee of G, the beneficiary foundation of CLUT and CLAT.

Split-interest trusts, such as CLUT and CLAT, may be subject to various excise taxes such as those imposed by section 4941 (taxes on self-dealing) and section 4943 (taxes on excess business holdings). It is foreseeable in the near future that there could be a need to redeem or have the other members of L and N purchase the interest, that could be distributed

to CLUT or CLAT. At such time as redemptions or purchases are necessary or appropriate, such a transaction may constitute acts of self-dealing.

The trustees of ST propose to sell its remaining interests in L and N to the trustees of DT under the following terms: (1) the sale price will be at the appraised fair market value, (2) the trustees of DT will issue a promissory note to the trustees of ST for the sales price, and (3) annual interest-only interest payments will be paid by DT to ST at the rate of aa percent. The principal sum shall be due on the day after distribution to the remainder beneficiaries.

The trustees have made the following representations:

First, ST's instrument gives the trustees of ST the power to sell its interest in L and N, and DT's instrument gives the trustees of DT the power to buy ST's interest in L and N;

Second, O (hereinafter "Court") has approved this transaction between DT and ST subject to a favorable response to this ruling request;

Third, the sale of ST's interest in L and N will occur during the administration period, before the trust is considered terminated for federal income tax purposes;

Fourth, the trustees have obtained appraisals for the fair market value of ST's interest in L and N, and an appraisal of the promissory note to be used as consideration in this transaction. The appraised fair market value of the promissory note is equal or slightly higher than the appraised fair market value of ST's interests in L and N; and,

Fifth, ST will constructively receive an amount, which equals or exceeds the fair market value of ST's interest in L and N; and the promissory note constructively received by ST will be at least as liquid as ST's current interests in L and N. The promissory note will be negotiable, transferable, and secured through a pledge of the L and N interests. If the seller desires to transfer the promissory note, no other party's consent is needed for such transfer.

Additionally, the trustees of ST represent that L and N's operating agreements impose limitations on the transferability of a member's interest. As a member of L and N, ST has no right to demand distributions or to withdraw from L and N. Furthermore, there is no ready market in which to sell ST's interests in L and N. Even if ST could find a potential purchaser, F, as manager of L and N has sole discretion as to whether to admit the purchaser as a new member. Without approval from the manager, the purchaser would merely receive an assignee interest (which would greatly lower the value of the interest sold and the likelihood of finding a potential purchaser).

Law

Section 4947(a) of the Code provides that section 4941 shall apply to charitable lead trusts as if such trusts were private foundations.

Section 4941(a)(1) of the Code imposes an excise tax on each act of self-dealing between a "disqualified person" and a private foundation.

Section 4941(a)(2) of the Code imposes an additional tax payable by a foundation manager who knowingly participated in an act of self-dealing between a disqualified person and a private foundation.

Section 4946(a)(1) of the Code defines a "disqualified person" as including:

(A) a substantial contributor to the foundation [i.e., a person who contributes or bequeaths more than $5,000 to such foundation if such amount is greater than 2% of the total contributions or bequests received by the foundation in the taxable year such bequest is received (see Code sections 507(d)(2)(A), 4946(a)(2), and 4946(a)(1)(A))];
(D) a family member of any substantial contributor, including such contributor's spouse, children, etc. [see Code sections 4946(a)(1)(D) and 4946(d)];
(E) a corporation of which persons who are substantial contributors or family members of such contributors own more than 35% of the total combined voting power [see Code section 4946(a)(l)(E)]; or
(G) a trust or estate of which persons who are substantial contributors or family members of such contributors hold more than 35% of the beneficial interests [see Code section 4946(a)(1)(G)].

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 and a disqualified person; (B) lending of money or other extension of credit between a private foundation and a disqualified person; and (E) transfer to, or use by or for the benefit of a disqualified person of the income or assets of a private foundation.

Section 53.4941(d)-1(b)(3) of the Foundation and Similar Excise Taxes 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 held by and estate (or a revocable trust), 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 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).

Section 53.4941(d)-2(c)(1) of the regulations states, generally, that the lending of money or other extension of credit between a private foundation and a disqualified person shall constitute an act of self-dealing. Thus, for example, an act of self-dealing occurs where a third party purchases property and assumes a mortgage, the mortgagee of which is a private foundation, and subsequently the third party transfers the property to a disqualified person who either assumes liability under the mortgage or takes the property subject to the mortgage. Similarly, 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), 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 which becomes the creditor under the note.

Analysis

A sale of L and N interests between the CLUT and CLAT and decedent's trust is restricted by the prohibitions against acts of self-dealing between a private foundation and a disqualified person.

With respect to the CLUT and the CLAT, DT and ST would qualify as disqualified persons under section 4946(a)(1)(G) of the Code. The decedent in this case, B, would be considered a substantial contributor to G, and its successors, J and K. ST and DT would also be considered disqualified persons because the remainder beneficial interests are for the benefit of children of the substantial contributor. Furthermore, since L and N were funded by M, owned by DT and ST, they are also disqualified persons.

Following the requirements of section 53.4941(d)-1(b)(3) of the regulations, you have represented that the trustees involved in the transaction possess a power of sale and purchase with respect to the property. The transaction has been approved by an appropriate court having jurisdiction over the trust. The sale of the interests in L and N will occur during the administration period, before the trust is considered terminated for federal income tax purposes.

You have represented that the trustees have obtained fair market value appraisals for both the L and N interests and the promissory note to be used as consideration in this transaction. You have represented that the note will be negotiable, transferable, and secured through a pledge of L and N interests. You have represented that the note will be an interest as liquid as the interests in L and N exchanged.

Rulings

Based on your representations, we rule as follows:

1. The purchase by DT of L and N interests to be distributed to the CLUT and the CLAT will not constitute an act of indirect self-dealing under section 4941(d) by the trustees of DT and ST.
2. The CLUT and CLAT will be not subject to excise taxes under section 4941 with respect to the proposed transaction.
3. The holding of DT note by the CLUT and CLAT pursuant to the proposed purchase agreement will not constitute an act of indirect self-dealing under section 4941(d) by the trustees of DT and ST.

Because this ruling could help resolve future questions about your federal income tax status, you should keep it in your permanent records.

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

This ruling is limited to the applicability of the provisions of sections 4941 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.

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,

(signed) Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4