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

200227044

Date: APR 12 2002

Contact Person:

Identification Number:

Telephone Number:

T:EO:B2

Employer Identification Number:

LEGEND:

A =
B =
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D =
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X =
Y =

U.I.L. Nos.
4941.04-00
4945.04-00

Dear Sir or Madam:

We have considered your ruling request dated May 14, 2001 on the proper treatment of a proposed settlement agreement under sections 4941 and 4945 of the Internal Revenue Code.

FACTS:

X is a private foundation described in sections 501(c)(3) and 509(a) of the Code. X has been recognized as exempt since 1974. X is named after A and B (A's spouse). A's and B's children include D and E. X's current trustees are B, C, and D.

In 1984, A, B, E, F (E's spouse), and several other parties entered into a written agreement regarding certain real property, in connection with A's sale of certain bank stock. Under the agreement, A and B agreed that they would cause A's interest in the property to pass to E at or prior to the death of the last of A and B to survive, either in trust or directly. The agreement recited that A's and B's intent was to bequeath A's interest to E upon the last of A and B to die.

A died in 2000. A created a will and revocable trust after 1984 that failed to acknowledge the 1984 Agreement. The estate plan called for A's interest in the real property to be held in trust for B's benefit during B's life, and the remainder to pass to X. The interested parties (comprising the personal representatives of A's estate, the trustees of A's Revocable

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Trust, B, D, E, and X) acknowledge that the 1984 Agreement is a legal, valid, binding contract enforceable against A's estate. The Interested Parties propose to enter into a Settlement Agreement under which A's interest in the real property would be transferred to a Settlement Trust for the benefit of B as income beneficiary, and upon B's death to E. The probate court of jurisdiction, Y, has indicated that it is willing to enter an order approving the Settlement Agreement.

RULINGS REQUESTED:

X requests the following rulings:

1. The execution, delivery, and performance of the Settlement Agreement by X will not constitute an act of self-dealing, and the trustees and directors of X (B, C, and D) will not be liable under section 4941 of the Code for such actions.

2. The execution, delivery, and performance of the Settlement Agreement by X will not constitute a taxable expenditure, and the trustees and directors of X (B, C, and D) will not be liable under section 4945 of the Code for such actions.

LAW:

Section 4941(a) of the Code imposes an excise tax on disqualified persons for each act of self-dealing between a disqualified person and a private foundation, and on foundation managers for agreeing to an act of self-dealing.

Section 4941(d)(1) of the Code defines self-dealing as including 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;

(C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;

(D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;

(E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

(F) agreement by a private foundation to make any payment of money or other property to a government official, other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating within a 90-day period.

Section 4945 of the Code imposes an excise tax on each taxable expenditure by a

private foundation, and on foundation managers for agreeing to make a taxable expenditure.

Section 4945(d)(5) of the Code defines a "taxable expenditure" as including an amount paid or incurred by a private foundation:

(1) to carry on propaganda, or otherwise to attempt, to influence legislation, within the meaning of section 4945(e),

(2) except as provided in section 4945(f), to influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive,

(3) as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirements of section 4945(g),

(4) as a grant to an organization unless--

(A) such organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation (as defined in section 4940(d)(2)), or

(B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h), or

(5) for any purpose other than one specified in section 170(c)(2)(B).

Section 4946(a)(1) of the Code provides that a "disqualified person," with respect to a private foundation, includes a substantial contributor, a foundation manager, a family member of an individual described above, and a trust or estate in which persons described above hold more than 35% of the beneficial interest.

Section 53.4941(d)-1(b)(3) of the regulations provides that "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 section 1.641(b)-3(a) (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).

In Underwood v. United States, 461 F.Supp. 1382 (N.D.Tex. 1978), an individual agreed to contribute $100,000 per year to a law school for ten years, conditioned on his being able to deduct all of the contributions. The individual set up a private foundation for this purpose and made his contributions to the foundation (for ultimate distribution to the school) instead of directly to the school. Upon audit, the IRS determined that the individual's contributions to the foundation exceeded the maximum permissible percentages and disallowed part of his claimed deductions. Thereafter, the foundation returned to the individual the amount of the contributions disallowed as a deduction, with the understanding that the individual would contribute the funds directly to the school upon receipt and obtain the benefit of the deduction, which he did. The IRS claimed that the refund to the individual was an act of self-dealing under section 4941(d)(1)(E) of the Code and a taxable expenditure under section 4945. The court held otherwise, reasoning that because the individual's commitment to the school was conditioned on the deductibility of the contributions, the foundation's refund was of amounts which the foundation should not have received and was not entitled to keep, and that the condition placed on the contribution was not void as against public policy.

RATIONALE:

The facts indicate that X's expectancy in the real property interest held by A's estate is subject to the 1984 Agreement, which entitles E to the interest. Because A had no right to subsequently transfer the property interest to X, X has no valid expectancy in

the property interest (assuming that the probate court approves the Settlement Agreement). Thus, X's participation in the Settlement Agreement is not a transfer of its assets to a disqualified person (or otherwise an act of self-dealing). The situation is analogous to the estate administration exception to self-dealing set forth in section 53.4941(d)-1(b)(3) of the regulations involving a binding option sale for nominal consideration. Similarly, X's participation in the Settlement Agreement does not involve an expenditure for non-charitable purposes or otherwise a taxable expenditure.

RULINGS:

Accordingly, we rule as follows:

1. The execution, delivery, and performance of the Settlement Agreement by X will not constitute an act of self-dealing, and the trustees and directors of X (B, C, and D) will not be liable under section 4941 of the Code for such actions, if the probate court (Y) subsequently approves the Settlement Agreement.

2. The execution, delivery, and performance of the Settlement Agreement by X will not constitute a taxable expenditure, and the trustees and directors of X (B, C, and D) will not be liable under section 4945 of the Code for such actions, if the probate court (Y) subsequently approves the Settlement Agreement.

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

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

Because this letter could help resolve any future questions about the application of the Code to your activities, you should keep a copy of this ruling in your permanent records.

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 yours,

(signed) Terrell M. Berkovsky

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2