TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Contact Person:

Number: **201446024**
Release Date: 11/14/2014

Identification Number:

Telephone Number:

Date: August 21, 2014

Employer Identification Number:

U.I.L: 4941.00-00

Legend:
Decedent
Revocable Trust
Foundation
Company
Irrevocable Trust
Executor/Trustee
LLC

Dear :

We have considered your ruling request dated September 6, 2013, as amended on July 18, 2014, concerning the tax consequences under § 4941 of the Internal Revenue Code of 1986, as amended (hereafter "I.R.C.").

Facts:

During life, Decedent formed Company, and at its inception, received both voting and non-voting units in Company. Subsequently thereafter, Decedent formed Irrevocable Trust and sold approximately 85% of his interest in Company, and in exchange, received a promissory note ("Note"). Note evidenced Irrevocable Trust's obligation to pay Decedent, principal and interest at regularly prescribed intervals.

As part of Decedent's estate planning, Decedent executed a will and formed Revocable Trust. The terms of the will provided that upon Decedent's death, the residue of Decedent's estate, including Note, would pass to Revocable Trust and thereafter the assets would be distributed to several beneficiaries including Foundation. Accordingly, at Decedent's death, the Note became part of the residuary estate and the obligor of Note continued to be Irrevocable Trust.

The Executor/ Trustee has represented that the current beneficiaries of Irrevocable Trust are all family members of Decedent and thus their combined beneficial interest in Irrevocable Trust is

greater than 35%. Because Irrevocable Trust is the obligor of Note and Foundation will become the creditor of Note, the Executor/Trustee has represented that an act of self-dealing under I.R.C. § 4941 will result when Note is transferred to Foundation.

As such, the Executor/Trustee proposes to contribute Note to a new entity LLC for which the estate will receive 100 voting and 9,800 non-voting units in LLC. Simultaneously, Executor/Trustee, in his individual capacity, would contribute cash equal to 1% of the value of LLC in exchange for 100 non-voting units in LLC. Further, Executor/Trustee, in his individual capacity, would buy the 100 voting units in LLC from the Estate for cash equal to a purchase price determined by a qualified appraisal. In the end, Foundation would receive cash and 9,800 non-voting units of LLC instead of Note from the Revocable Trust. LLC's amended operating at Article 6, section 6.1, provides in essence, that upon any default on the Note, LLC "shall immediately take all necessary actions to foreclose on and collect payment of the Note from the Borrower and/or Guarantor." Executor/Trustee will seek court approval from the probate court regarding the sale of the Note to LLC and the sale of voting units to Executor/Trustee.

You have represented that LLC will engage in only passive investment activities, and not in the operation of any business enterprise, and at least 95% of its gross income will be from passive investments including interest and dividends. LLC's operating agreement allocates profits and losses in proportion to the number of units held by each member and all payments received on Note will be distributed annually to members. Any amendment to LLC's operating agreement would require consent of all members and an unqualified opinion of counsel that such an amendment would not jeopardize any member's tax status.

Ruling Requested:

1. The exercise of the Executor's power to contribute assets from the Estate, specifically the Note to LLC; the receipt of consideration by the Estate of voting and non-voting units in LLC; the subsequent sale of the voting units for cash equal to fair market value; and distribution of such non-voting units and cash from the Estate through the Revocable Trust to Foundation, will satisfy the requirements for the exception to self-dealing described in Treas. Reg. § 53.4941(d)-1(b)(3) and therefore will not constitute impermissible acts of self-dealing under § 4941.

2. LLC's retention of the Note, receipt of payments on the Note, and distributions of such payments will not constitute acts of self-dealing pursuant to Treas. Reg. § 53.4941(d)-1 and will not violate § 4941.

3. The Foundation's ownership of non-voting units in LLC will not constitute a violation of the prohibition against ownership of excess business holdings under § 4943.

Law:

I.R.C. § 170(f)(11)(E)(i) provides that the term "qualified appraisal" means, with respect to any property, an appraisal of such property which:

(I) is treated for purposes of this paragraph as a qualified appraisal under regulations or other guidance prescribed by the Secretary, and
(II) is conducted by a qualified appraiser in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed under subclause (I).

I.R.C. § 170(f)(11)(E)(ii) provides that the term "qualified appraiser" means an individual who:

(I) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Secretary,
(II) regularly performs appraisals for which the individual receives compensation, and
(III) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance.

I.R.C. § 507(d)(2) defines the term "substantial contributor" as any person who contributed or bequeathed an aggregate amount of more than $5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person. In the case of a trust, the term "substantial contributor" also means the creator of the trust. Subpart (b)(iv) of the same section also states that any person who is a substantial contributor on any date shall remain a substantial contributor for all subsequent periods.

I.R.C. § 4941(a) imposes a tax on each act of self-dealing between a disqualified person and a private foundation and imposes an additional tax if a foundation manager participates in the self-dealing.

I.R.C. § 4941(d)(1) defines the term "self-dealing" as 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; and (F) agreement by a private foundation to make any payment of money or other property to a government official (as defined in § 4946(c)), other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating his government service within a 90-day period.

I.R.C. § 4943(a)(1) imposes a tax on the excess business holdings of any private foundation in a business enterprise.

I.R.C. § 4943(c)(1) defines the term "excess business holdings" in reference to a private foundation, the amount of stock or other interest in any business enterprise which the foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

I.R.C. § 4943(d)(3)(B) provides that the term "business enterprise" does not include a trade or business at least 95 percent of the gross income of which is derived from passive sources.

I.R.C. § 4946(a)(1) defines the term "disqualified person", with respect to a private foundation, a person who is:

(A) a substantial contributor to the foundation,
(B) a foundation manager (within the meaning of subsection (b)(1)),
(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),
(E) a corporation of which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the total combined voting power,
(F) a partnership in which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the profits interest,
(G) a trust or estate in which persons described in subparagraph (A), (B), (C), or (D) hold more than 35 percent of the beneficial interest.

I.R.C. § 4946(b)(1) defines, the term "foundation manager" to mean, with respect to any private foundation, an officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation.

I.R.C. § 4946(d) for purposes of § 4946(a)(1), defines a family member as including only a person's spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren.

Treas. Reg. § 53.4941(d)-1(a) provides that the term "self-dealing" means any direct or indirect transaction described in § 53.4941(d)-2. 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.

Treas. Reg. § 53.4941(d)-1(b)(3) states 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 § 1.641(b)-3 of this chapter (or in the case of a revocable trust, before it is considered subject to § 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).

Treas. Reg. § 53.4941(d)-1(b)(4) provides that a transaction between a private foundation and an organization which is not controlled by the foundation (within the meaning of subparagraph (5) of this paragraph), and which is not described in § 4946(a)(1)(E), (F), or (G) because persons described in § 4946(a)(1)(A), (B), (C), or (D) own no more than 35 percent of the total combined voting power or profits or beneficial interest of such organization, shall not be treated as an indirect act of self-dealing between the foundation and such disqualified persons solely because of the ownership interest of such persons in such organization.

Treas. Reg. § 53.4941(d)-1(b)(5) states that 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.

Treas. Reg. § 53.4941(d)-2 list the following acts of self-dealing: (a) Sale or exchange of property...; (b) Leases...; (c) Loans...; (d) Furnishing goods, services, or facilities...; (e) Payment of compensation...; and, (f) Transfer or use of the income or assets of a private foundation.

Treas. Reg. § 53.4941(d)-2(c)(1) states that absent an exception, 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 § 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.

Treas. Reg. § 53.4946-1(a)(1) defines disqualified persons with respect to a private foundation as :

(i) All substantial contributors to the foundation, as defined in § 507(d)(2) and the regulations thereunder.
(ii) All foundation managers of the foundation as defined in § 4946(b)(1) and paragraph (f)(1)(i) of this section,
(iii) An owner of more than 20 percent of:
    (a) The total combined voting power of a corporation,
    (b) The profits interest of a partnership,
    (c) The beneficial interest of a trust or unincorporated enterprise,
    which is (during such ownership) a substantial contributor to the foundation, as defined in § 507(d)(2) and the regulations thereunder,
(iv) A member of the family, as defined in § 4946(d) and paragraph (h) of this section, of any of the individuals described in subdivision (i), (ii), or (iii) of this subparagraph,
(v) A corporation of which more than 35 percent of the total combined voting power is owned by persons described in subdivision (i), (ii), (iii), or (iv) of this subparagraph,
(vi) A partnership of which more than 35 percent of the profits interest is owned by persons described in subdivision (i), (ii), (iii), or (iv) of this subparagraph, and
(vii) A trust, estate, or unincorporated enterprise of which more than 35 percent of the beneficial interest is owned by persons described in subdivision (i), (ii), (iii), or (iv) of this subparagraph.

Treas. Reg. § 53.4946-1(a)(3) provides that for subparagraphs (1)(iii)(c) and (vii) of this paragraph, the beneficial interest in an unincorporated enterprise (other than a trust or estate) includes any right to receive a portion of distributions from profits of such enterprise, and, if the portion of distributions is not fixed by an agreement among the participants, any right to receive a portion of the assets (if any) upon liquidation of the enterprise, except as a creditor or employee. For purposes of this subparagraph, a right to receive distributions of profits includes a right to receive any amount from such profits other than as a creditor or employee, whether as a sum certain or as a portion of profits realized by the enterprise.

Revenue Ruling 76-158, 1976-1 C.B. 354, 1976 provides an example for the two control tests set forth in Treas. Reg. § 53.4149(d)-(1)(b)(5).

Rationale:

1. Sale of Estate Assets

Under the current structure of the Revocable Trust, when Note is distributed to the Foundation, any payment of principal and interest on Note, made from Irrevocable Trust to Foundation, will constitute an act of self-dealing pursuant to § 4941(a).

I.R.C. § 4946(a)(1) defines a disqualified person as an individual who is a substantial contributor to the foundation, a substantial contributor's family member, or an estate, trust or an unincorporated business enterprise in which a substantial contributor or family member owns at least a 35 percent beneficial interest. See also, Treas. Reg. § 53.4946-1(a)(1). Section 4946(d) defines a family member as a person's spouse, ancestors, children, grandchildren, great grandchildren and the spouses of children, grandchildren and great grandchildren. Section 507(d)(2) defines a substantial contributor as any person who contributes more than $ 5000 to

the private foundation, if such amount is more than 2 percent of the total contributions to the foundation for that taxable year. Here, Decedent is a disqualified person as a substantial contributor because Decedent originally created and funded Foundation. Executor/Trustee is also a disqualified person to Foundation as he is a family member and also Foundation manager. I.R.C § 4946(b)(1). Irrevocable Trust, the obligor of Note held by Decedent's estate, is a disqualified person because, as per the representations made by Executor/Trustee, the current beneficiaries of Irrevocable Trust are all family members of Decedent and their combined beneficial interest in Irrevocable Trust is greater than 35%.

Treas. Reg. § 53.4941(d)-(2)(c)(1) states that a note transferred by a third party to a private foundation in which the obligor is a disqualified person is an act of self-dealing unless the note was received as part of the "estate administration exception." Treas. Reg. § 53.4941(d)-(1)(b)(3). Here, Revocable Trust or Decedent's estate is the third party. Irrevocable Trust is the disqualified obligor of the Note. Note is part of Decedent's estate because of Decedent's sale of stock in exchange for Note from Irrevocable Trust and not as a result of the estate administration exception. Therefore, absent an exception, Foundation's receipt of Note and any subsequent receipt of payments of principal and interest from Irrevocable Trust to Foundation will constitute acts of self-dealing under I.R.C. § 4941.

To overcome this result, the Executor/Trustee proposes to exchange Note for cash and non-voting interest in LLC, and distribute the cash and non-voting interest to Foundation. The effect is that Foundation will receive regular payments of principal and interest from LLC on Note as those payments are made to LLC from Irrevocable Trust. The estate administration exception is available to exchange a self-dealing asset with a non-self-dealing asset provided all five prongs of the estate administration exception are satisfied. Treas. Reg. § 53.4941(d)-(1)(b)(3). The estate administration exception requires the following five prongs to be met: (i) The executor of an estate has the power to sell the self-dealing asset; (ii) the sale/exchange transaction is approved by the probate court; (iii) the sale/exchange transaction occurs before the estate is terminated; (iv) the estate receives an amount which equals or exceeds the fair market value of the foundation's interest or expectancy in such property; and, (v) the transaction results in the foundation receiving an interest or expectancy at least as liquid as the one it gave up.

The first prong of the estate administration exception is met because, under the terms of Decedent's will, the Executor/Trustee has the power to "sell, transfer, or convey, publicly or privately, for cash or credit, all or any part of any real or personal property." Treas. Reg. § 53.4941(d)-(1)(b)(3)(i)(a), Decedent's Will, page 5, paragraph B.

The second prong is met because Executor/Trustee will seek court approval from the probate court regarding the sale of Note to LLC and the sale of voting units to Executor/Trustee. Treas. Reg. § 53.4941(d)-(1)(b)(3)(ii).

The third prong is met because the sale of Note to LLC for all the voting and 9,800 non-voting units and subsequent sale of the voting units to Executor/Trustee will be completed during the normal time required for administration of the estate and trust and such administration will not be unduly delayed. Treas. Reg. § 53.4941(d)-(1)(b)(3)(iii)

The fourth prong is met because the Estate will receive property with a value equal to the fair market value of Foundation's interest in Note. Foundation will receive non-voting units in LLC

and cash equal to the value of the voting units of LLC instead of Note. The purchase price of the voting units will be determined by a qualified appraisal meeting the requirements of IRC § 170(f)(11)(E)(i), (ii) and Treas. Reg. § 53.4941(d)(-(1)(b)(3)(iv).

The fifth prong is met because the non-voting units in LLC and cash are at least as liquid as the interest Foundation would have received. The non-voting units are backed by Note, all interest payments made on Note will be distributed annually, there are no sale or transfer restrictions on the non-voting units, and the non-voting units cannot be changed or burdened because amendments to the operating agreement of LLC that require consent of all members and an opinion of counsel on the tax status of the proposed amendment. Furthermore, LLC's amended operating at Article 6, section 6.1, provides in essence, that upon any default on the Note, LLC "shall immediately take all necessary actions to foreclose on and collect payment of the Note from the Borrower and/or Guarantor," which places Foundation the same position as if it controlled the Note directly. Therefore, Foundation receives an interest at least as liquid as the interest Foundation would have received. See Treas. Reg. § 53.4941(d)(-(1)(b)(3)(v).

As such, the Executor/Trustee's power to sell Estate assets for cash and non-voting interest in LLC will satisfy the requirements of Treas. Reg. § 53.4941(d)(-(1)(b)(3). Therefore, the transaction will not constitute an impermissible act of self -dealing for purposes of IRC §§ 4941(a) and 4941(d)(1).

2. Retention of Note

The term "self-dealing", as defined in Treas. Reg. § 53.4941(d)-1(a), means any direct or indirect transaction as described in Treas. Reg. § 53.4941(d)-2. Under Treas. Reg. § 53.4941(d)-2, the following five specific acts of self-dealing are listed: (1) sale or exchange of property; (2) leases; (3) loans; (4) furnishing goods, services, or facilities; and (5) transfer, use or benefit of the income or assets of a private foundation. Executor/Trustee will transfer the Note from the Estate to LLC, pursuant to the estate administration exception under Treas. Reg. § 53.4941(d)-(1)(b)(3). In exchange, Foundation (which would have received the Note) will receive non-voting units and cash in LLC equal to the value of Note. Although the obligor on Note remains Irrevocable Trust, which is a disqualified party in relation to Foundation, Foundation's retention of non-voting units in LLC and its receipt of passive income from LLC is not an act of self-dealing described in Treas. Reg. § 53.4941(d)-2 because of the following reasons:

1. Foundation will acquire the non-voting units in LLC by testamentary gift rather than through a self-dealing transaction;
2. The arrangement between Foundation and LLC is neither a loan nor an extension of credit;
3. Foundation, as holder of the non-voting units, has a right to receive distributions from LLC, but not the right to compel distributions;
4. Foundation cannot be compelled to make any capital contributions to or transfer any property to LLC; and,
5. Any benefit or use of Foundation's income that could be attributed to Executor/Trustee's interest in LLC was purchased as part of the estate administration exception under Treas. Reg. § 53.4941(d)-(1)(b)(3).

Furthermore, under Treas. Reg. § 53.4941(d)(-1(b)(4), a transaction between a private foundation and an organization, in which the organization is neither controlled by the foundation nor does it have a disqualified person owning at least a 35% beneficial interest in the organization, would not be a transaction resulting in an act of self-dealing. Here, under the "control test" of Treas. Regs. § 53.4941(d)-1(b)(5), Foundation does not control LLC, because Foundation only holds non-voting interests, with the only voting interests in LLC are held by Executor/Trustee in his individual capacity and not as a foundation manager. See Rev. Rul. 76-158. Also, only Executor/Trustee, in his individual capacity, is a disqualified person who has a beneficial interest in LLC, as defined in Treas. Reg. § 53.4946-1(a)(3). However, Executor/Trustee's beneficial interest only amounts to 2%, far less than the 35% threshold.

As such, Foundation's retention of non-voting units in LLC and its receipt of passive income from LLC is not an act of either direct or indirect self-dealing. I.R.C. § 4941, Treas. Regs. §§ 53.4941(d)-1 and 53.4941(d)-2.

3. Excess Business Holdings

Under I.R.C. § 4943(a)(1), a private foundation with "excess business holdings," as defined in § 4943(c)(1), is subject to an excise tax. Only interests in a "business enterprise" may be excess business holdings and the term "business enterprise" under § 4943(d)(3)(B) does not include a business with at least 95% of its gross income derived from passive sources. You have represented that LLC will engage in only passive investment activities, and not in the operation of any business enterprise, and at least 95% of its gross income will be from passive investments including interest and dividends. Therefore, Foundation's holdings of non-voting units are not interests in a business enterprise and do not constitute "excess business holdings." This ruling does not address any underlying future investments by LLC that may result in excess business holdings.

Conclusion:

Based on the representations provided, we rule as follows:

1. The exercise of the Executor's power to contribute assets from the Estate, specifically the Note to LLC; the receipt of consideration by the Estate of voting and non-voting units in LLC; the subsequent sale of the voting units for cash equal to fair market value; and distribution of such non-voting units and cash from the Estate through the Revocable Trust to Foundation, will satisfy the requirements for the exception to self-dealing described in Treas. Reg. § 53.4941(d)-1(b)(3) and therefore will not constitute impermissible acts of self-dealing under § 4941.

2. LLC's retention of the Note, receipt of payments on the Note, and distributions of such payments will not constitute acts of self-dealing pursuant to Treas. Reg. § 53.4941(d)-1 and will not violate § 4941.

3. The Foundation's ownership of non-voting units in LLC will not constitute a violation of the prohibition against ownership of excess business holdings under § 4943.

This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept 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.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael Seto
Manager, EO Technical

Enclosure
Notice 437