Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4 - PLR-118057-00
Date: March 20, 2002

Re:

Legend

Taxpayer	=
Foreign Country	=
Foundation	=
Corporation	=
X	=
Founder	=
Shareholder Agreement	=
Mother	=
Date 1	=
Date 2	=
Sister	=
Brother	=
Year 1	=
Y	=
Shareholder Stock Pool	=

Dear :

This is in response to a letter dated September 15, 2000, and subsequent correspondence submitted on behalf of the taxpayer, requesting a ruling that a proposed transfer to a foreign foundation of cash and an interest in property will qualify for the federal gift tax charitable deduction under § 2522 of the Internal Revenue Code.

Facts

The facts submitted and representations made are as follows:

Taxpayer is a citizen of Foreign Country and a permanent resident of the United States. Taxpayer will establish a private foundation ("Foundation") in Foreign Country to promote specified nonprofit and charitable purposes. Taxpayer will contribute to the Foundation cash and an undivided interest (about X percent) of a remainder interest Taxpayer owns in shares of Corporation.

Foundation will be organized as a "stiftung". It is represented that, for United States tax purposes, Foundation is in the nature of a trust rather than a business entity. Foundation will become a legal entity upon approval by the tax authorities of Foreign Country.

Foundation will not be described in § 4948(b). Foundation's charter contains language intended to meet the requirements of § 508(e) and §§ 4941-4945. However, the Foreign Country tax authorities have indicated that the charter should not expressly reference any Internal Revenue Code provisions. Foundation will not apply for § 501(c)(3) exemption. It is represented that there are no tax treaty provisions between the United States and Foreign Country that affect the federal tax laws pertinent to this ruling request.

Taxpayer will be the only person that makes contributions to Foundation. Foundation's charter contemplates an initial gift to Foundation of cash as well as possible additional gifts of common stock of Corporation and remainder interests in common stock of Corporation. The stock will be subject to an agreement among the holders of Corporation's common stock ("Shareholder Agreement").

The charter provides that, Foundation's voting rights and other rights under the Shareholder Agreement, will be exercised by a "special representative," named in the charter. It is represented that this is a fiduciary position. The special representative will not be Taxpayer or any person related or subordinate to Taxpayer within the meaning of § 672(c)(2). At her death, Taxpayer may designate a successor special representative in her will. The charter further provides that any common stock of Corporation held by Foundation may only be sold pursuant to a resolution of the Board of Trustees adopted by a three-fourths majority of the votes cast.

Under Foundation's charter, the Board of Trustees of Foundation will make all decisions regarding payments for its charitable purposes. Neither Taxpayer nor any individual or entity related or subordinate to her (within the meaning of § 672(c)(2)) can serve on the Board of Trustees. Taxpayer can appoint and replace any member of the Board of Trustees.

It is represented that essentially 100 percent of the voting common stock of Corporation is currently held by descendants of the founder and incorporator of Corporation ("Founder"). Common shareholders have consented to restrictions on the

transfer of their shares under Shareholder Agreement. Shareholder Agreement provides that all of the shareholders subject to its terms are divided among three "stirpes," one for each of Founder's three children. The restrictions under Shareholder Agreement are intended, to the extent practical, to ensure retention of the ownership of Corporation by shareholders who are Founder's descendants.

Shareholders whose shares are subject to the agreement ("restricted shareholders") have also agreed, under Shareholder Agreement, that their shares will be voted at general meetings of Corporation by their "stirpital representative." The stirpital representatives are obligated to vote on general meeting agenda items according to resolutions adopted beforehand by the restricted shareholders at a family meeting. Each of the three stirps holds a family meeting. At each family meeting, the stirpital representative votes on behalf of the restricted shareholders from that stirps, unless a "ballot per capita" is required by Shareholder Agreement. For example, a ballot per capita is required to pass a resolution at a family meeting regarding the exercise of a vote at a general meeting to amend the Corporation bylaws. A stirps meeting must be held to prepare for a family meeting. At a stirps meeting, the restricted shareholders vote to elect a stirpital representative and to pass resolutions that instruct the stirpital representative how to vote at the family meeting.

To enable Foundation to meet its distribution requirements under § 4942, if Foundation has insufficient liquid funds and is unable to sell its Corporation stock in accordance with the Shareholder's Agreement, a Shareholder Stock Pool has agreed to purchase from Foundation, for a price to be determined by independent appraisal, shares of Corporation stock necessary to generate sufficient funds. None of the members of the Shareholder Stock Pool (which is not a legal entity, but a group of individuals) are disqualified persons under § 4946 with respect to Foundation.

The remainder interest in shares of Corporation that Taxpayer will transfer to Foundation was created under a deed of gift executed on Date 1 and amended on Date 2 by Taxpayer's Mother, a resident of Foreign Country. The deed of gift is governed by the law of Foreign Country. Under the amended deed of gift, Mother transferred an interest in common stock of Corporation to Taxpayer's Sister as the "Recipient of the Donation" and named Taxpayer and her Brother as "Third Party Beneficiaries." Mother retained a lifetime interest in 25 percent of the shares, the voting rights in all of the donated shares, and the right to represent Sister in all matters relating to those shares. Mother also retained a right to revoke any part of the donation during her lifetime. At Sister's death, Sister has the power to bequeath the stock to her descendants under the terms of her will. It is represented that, under the deed of gift, adopted persons cannot qualify as Sister's descendants. If Sister does not exercise this power, then one-half of the donated shares will pass outright to Taxpayer and one-half to Brother. If either Taxpayer or Brother predeceases Sister, the deceased individual's shares will pass to that individual's estate. All of the shares transferred under the deed of gift became subject to the Shareholder Agreement which was executed after the deed of gift, during Mother's life.

Mother died in Year 1, survived by Taxpayer, Sister, and Brother. Sister is currently Y years of age and has no descendants.

A ruling has been requested that Taxpayer's proposed transfer to Foundation of cash and an undivided interest (about X percent) of her remainder interest in the Corporation stock held under the above-described deed of gift will qualify for the federal gift tax charitable deduction under § 2522.

Law

Section 501(c)(3) exempts from federal income tax organizations organized and operated exclusively for charitable purposes. Section 508(a) provides generally that organizations shall not be treated as described in § 501(c)(3) unless they apply for recognition of exemption in a timely manner.

Sections 508(d)(2) and 1.508-2(b)(1) of the Income Tax Regulations provide that no gift or bequest made to an organization shall be allowed as a deduction under § 2522 if such gift or bequest is made--

(A) to a private foundation or a trust described in § 4947 in a taxable year for which it fails to meet the requirements of § 508(e), or

(B) to any organization in a period for which it is not treated as an organization described in § 501(c)(3) by reason of § 508(a).

Section 1.508-2(b)(1)(viii) provides that since a charitable trust described in § 4947(a)(1) is not required to file a notice under § 508(a), § 508(d)(2)(B) and § 1.508-2(b)(1)(i)(b) are not applicable to such a trust.

Section 508(e)(1) provides that a private foundation shall not be exempt from taxation under § 501(a) unless its governing instrument includes provisions:

(A) requiring that income for each taxable year be distributed at such time and in such manner as not to subject the foundation to tax under § 4942, and

(B) prohibiting the foundation from engaging in any act of self-dealing (as defined in § 4941(d)), retaining any excess business holdings (as defined in § 4943(c)), making any investments in such manner as to subject the foundation to tax under § 4944, and making any taxable expenditures (as defined in § 4945(d)).

Section 1.508-3(b)(1) provides, with respect to § 508(e), that specific reference to §§ 4941, 4942, 4943, 4944, and 4945 will generally be required to be included in the governing instrument, unless equivalent language is used which is deemed by the Commissioner to have full force and effect.

Section 4941(d)(1)(E) defines "self-dealing" as including a 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)-2(f)(1) provides generally that the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation shall constitute an act of self-dealing. For purposes of the preceding sentence, the purchase or sale of stock or other securities by a private foundation shall be an act of self-dealing if such purchase or sale is made in an attempt to manipulate the price of the stock or other securities to the advantage of a disqualified person.

Section 53.4941(d)-2(f)(2) provides that the fact that a disqualified person receives an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing.

In section 53.4941(d)-2(f)(9), Example (3), private foundation Y owns voting stock in corporation Z, the management of which includes certain disqualified persons with respect to Y. Prior to Z's annual stockholder meeting, the management solicits and receives the foundation's proxies. The transfer of such proxies in and of itself shall not be an act of self-dealing.

Section 4942 generally requires a private foundation to make annual charitable distributions of at least five percent of the aggregate fair market value of its investment assets.

Section 4947(a)(1) provides that for purposes of §§ 507-509 (other than §§ 508(a), (b), and (c)) and for purposes of chapter 42, a trust which is not exempt from taxation under § 501(a), all of the unexpired interests in which are devoted to one or more of the purposes described in § 170(c)(2)(B), and for which a deduction was allowed under §§ 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522 (or the corresponding provisions of prior law), shall be treated as an organization described in § 501(c)(3). Section 53.4947-1(a) provides that the purpose of § 4947 is to prevent avoidance of the requirements and restrictions applicable to private foundations through the use of a trust arrangement.

Section 4948(b) provides that § 507 (relating to termination of private foundation status), § 508 (relating to special rules with respect to § 501(c)(3) organizations), and chapter 42 (other than § 4948) shall not apply to any foreign organization which has received substantially all of its support (other than gross investment income) from sources outside the United States. Section 53.4948-1(b) provides that § 507 (relating to termination of private foundation status), § 508 (relating to special rules with respect to § 501(c)(3) organizations), and chapter 42 (other than § 4948) shall not apply to any foreign organization which from the date of its creation has received at least 85 percent of its support (as defined in § 509(d), other than § 509(d)(4)) from sources outside the United States. For purposes of this paragraph, gifts, grants, contributions, or membership fees

directly or indirectly from a United States person (as defined in § 7701(a)(30)) are from sources within the United States.

Section 2501(a)(1) imposes a tax, for each calendar year, on the transfer of property by gift by any individual, resident or nonresident.

Section 2511 provides that the tax imposed by § 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Under § 25.2511-2(b) of the Gift Tax Regulations, a gift is complete as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another. But if upon transfer of property (in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or partially complete and partially incomplete, depending upon all the facts in the particular case.

Under § 2512(a), if a gift is made in property, the value of the property on the date of the gift is the amount of the gift. Section 2512(b) provides that where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration received shall be deemed a gift.

Section 2522(a) provides that in computing taxable gifts for the calendar year, there shall be allowed as a deduction the amount of all gifts made during such year to or for the use of a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 25.2522(a)-1(a) provides that, in the case of a donor who was a citizen or resident of the United States at the time the gifts were made, the § 2522 deduction is not limited to gifts for use within the United States, or to gifts to or for the use of domestic foundations.

Section 2522(c)(1) provides that no deduction is allowed under § 2522 for a gift to or for the use of an organization or trust described in § 508(d) or § 4948(c)(4), subject to conditions specified in such sections.

Section 2522(c)(2) disallows the gift tax charitable deduction where a donor transfers an interest in property (other than an interest described in § 170(f)(3)(B)) to a person, or for a use, described in § 2522(a), and an interest in the same property is retained by the donor, or is transferred or has been transferred (for less than an

adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in § 2522(a), unless--

(A) in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)), or

(B) in the case of any other interest, such interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly of the fair market value of the property (to be determined yearly) (a unitrust interest).

Under § 25.2522-3(b), if an interest has passed to, or is vested in, charity on the date of the gift and the interest would be defeated by the performance of some act or the happening of some event, the possibility of occurrence of which appeared on such date to be so remote as to be negligible, the deduction is allowable.

Under § 2522(c)(2)(B) and § 25.2522-3(c)(1)(i), if a donor transfers an interest in property for charitable purposes and retains an interest in the same property, no gift tax charitable deduction is allowed unless the interest in property is a deductible interest. Under § 25.2522-3(c)(2)(i), a deductible interest includes a charitable interest that is an undivided portion, not in trust, of the donor's entire interest in the property. An undivided portion of a donor's entire interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the donor. For example, if the donor had been given a life estate in Blackacre for the life of his wife and the donor had no other interest in Blackacre on or before the time of gift, the gift by the donor of one-half of that life estate to charity would be considered the transfer of a deductible interest. Because the life estate would be considered the donor's entire interest in the property, the gift would be of an undivided portion of such entire interest.

Estate of Swan v. Commissioner, 24 T.C. 829 (1955), acq., 1956-2 C.B. 8, aff'd in part and rev'd in part on other grounds, 247 F.2d 144 (2d Cir. 1957), considered the application of the federal estate tax to two stiftungs, one organized under the laws of the Principality of Liechtenstein and the other, under the laws of Switzerland. Although the laws of neither country recognized trusts, the stiftungs were found to be comparable to trusts under U.S. law rather than corporations, and were treated accordingly. Id. at 856-858.

Analysis

In determining whether Taxpayer's proposed transfer to Foundation will qualify for the federal gift tax charitable deduction under § 2522, we must first determine whether the transfer satisfies § 2522(c)(1). That section disallows a gift tax charitable deduction for a gift to an organization described in § 508(d) or 4948(c)(4), "subject to the conditions specified in such sections."

Because Foundation will not be described in § 4948(b), it will be subject to § 508(d) and not to § 4948(c)(4). Section 508(d)(2)(B) disallows a charitable deduction for a contribution to any organization during a period in which the organization is not treated as described in § 501(c)(3) by reason of § 508(a). Under § 1.508-2(b)(1)(viii), contributions to charitable trusts described in § 4947(a)(1) are not subject to this rule. Thus, the question is whether Foundation will be described in § 4947(a)(1). If so, then contributions to Foundation will be deductible regardless of when or whether Foundation applies for recognition of exemption under § 501(c)(3). Otherwise, Foundation would have to apply for and receive recognition of exemption for the period in which the gift is made in order for the gift to be deductible.

Foundation will be described in § 4947(a)(1) because: (1) Foundation will be a trust; (2) Foundation will not be exempt from tax under § 501(a); (3) all of Foundation's assets will be devoted to charitable purposes; and (4) as discussed below, a deduction will be allowable under § 2522 for Taxpayer's contribution to Foundation. We conclude that Foundation is in the nature of a trust because it lacks associates and will not engage in the conduct of business for profit. See also, Estate of Swan v. Commissioner, supra, regarding the characterization of stiftungs organized under the laws of the Principality of Liechtenstein and of Switzerland as trusts for federal tax purposes. Regarding § 501(a) status, the Foundation plans not to apply for recognition of exemption. We find that the Foundation's purposes and planned operations are charitable. As discussed below, a gift tax charitable deduction will be allowable under § 2522(a) for Taxpayer's proposed transfers to Foundation. Therefore, §§ 2522(c)(1) and 508(d) will not disallow the deduction (based in part on our finding below that Foundation will meet the § 508(e) requirements), because Foundation will be described in § 4947(a)(1).

Section 508(d)(2)(A) disallows a deduction for a gift to a private foundation or a § 4947 trust in a taxable year for which the foundation or trust fails to meet the requirements of § 508(e). Under § 1.508-3(b)(1), the governing instrument need not specifically cite §§ 4941, 4942, 4943, 4944, and 4945 if it is determined that the governing instrument includes equivalent language. We conclude that Foundation's charter includes reasonably equivalent language.

The fact that Foundation's charter specifically contemplates a gift of Corporation stock raises the issue of whether such gifts would necessarily result in chapter 42 violations, because the regulations under § 508(e) generally prohibit mandatory directions conflicting with chapter 42 requirements. In particular, this aspect of the charter raises the question of whether Foundation can properly be viewed as operated exclusively for charitable purposes, or as meeting the requirements of § 4942, if it holds stock subject to the Shareholder Agreement. However, in view of the agreement by the Shareholder Stock Pool to purchase shares of Corporation stock necessary to enable Foundation to meet its distribution requirements under § 4942, we conclude that Foundation's ownership of stock subject to the Shareholder Agreement will not cause

Foundation to be operated other than for exclusively charitable purposes and will not cause Foundation to fail to satisfy the requirements of § 4942.

Accordingly, for purposes of § 2522(c)(1), we conclude that §§ 508(d) and 4948(c)(4) will not bar the deduction, under § 2522(a), of Taxpayer's proposed gift.

Taxpayer will transfer to Foundation cash and an undivided interest (about X percent) of her remainder interest in one-half of the stock transferred by Mother under the deed of gift.

To qualify for the gift tax deduction under § 2522(a),Taxpayer's transfer must be a completed gift. Under Foundation's charter, Taxpayer will not retain any interest in, nor reserve any power over the disposition of, the cash, the remainder interest, or the stock subject to that remainder interest. Foundation's voting rights with respect to Corporation stock and other rights under the Shareholder Agreement, will be exercised by a "special representative," an individual named in the Charter. In her will, Taxpayer can designate a successor special representative. The special representative cannot be Taxpayer or any person related or subordinate to Taxpayer within the definition of § 672(c)(2). The members of the Board of Trustees will make decisions regarding the distribution of Foundation's funds and the disposition of Foundation's Corporation stock. Taxpayer cannot be a member of the board but will have the power to remove and replace members of the Board of Trustee. However, members of the board cannot be related or subordinate to Taxpayer under § 672(c)(2). Consequently, Taxpayer's transfer of her remainder interest in the stock will be a completed gift under § 25.2511-2.

Taxpayer's remainder interest is a vested future interest, except that Taxpayer's interest is subject to divestiture if Sister dies with surviving descendants (excluding adoptees) and Sister bequeaths the stock to her descendants under her will. Sister is currently age X and has no descendants. Therefore, for purposes of § 25.2522-3(b), the possibility that Sister will die with descendants is so remote as to be negligible.

When Mother transferred the shares of Corporation common stock under the deed of gift, she was the owner of those shares and held all of the voting rights in those shares. Under the terms of the deed of gift, Mother retained all of the voting rights in the donated shares until the Shareholder's Agreement was executed and the donated shares became subject to the restrictions on transferability and the voting requirements under the Shareholder's Agreement. Taxpayer never had any interest in the Corporation stock other than the remainder interest she acquired under the deed of gift. Further, as discussed above, when she transfers the remainder interest to Foundation, Taxpayer will not retain any interest in, nor reserve any power over the disposition of, the remainder interest or the stock subject to that interest. Consequently, for purposes of § 2522(c)(2)(B) and § 25.2522-3(c), Taxpayer will transfer an undivided portion of her entire remainder interest.

Accordingly, we rule that Taxpayer's proposed transfer to Foundation of cash and an undivided interest (about X percent) of her remainder interest in the Corporation stock transferred by Mother under the above-described deed of gift will qualify for the federal gift tax charitable deduction under § 2522.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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

Sincerely yours,
Associate Chief Counsel
(Passthroughs and Special Industries)
By George Masnik
Chief, Branch 4

Enclosure
Copy for section 6110 purposes

cc: