



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **201206019**
Release Date: 2/10/2012

Date: November 15, 2011

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

UIL: 4941.04-00

Legend:

Estate =
Date1 =
X =
B =
M =
P =
Brothers =
Companies =

Dear _____ :

We have considered your ruling request received October 21, 2010 requesting a ruling on certain transactions with regard to an estate in which you have an expectancy involving section 4941 of the Internal Revenue Code ("Code").

Facts:

You are a private foundation as defined in section 509(a) of the Code and described by section 501(c)(3). Spouses H and W were substantial contributors to you. H pre-deceased W. W died testate. You have an expectancy in W's Estate. You represent that the Estate remains open pending a final distribution to you. W's will specified that her Estate distribute to you an amount equal to \$5 million less your asset value on Date1. The current balance due to you is \$X. The remaining assets of the Estate consist of cash, promissory notes, a residence, and an office building ("Building"). Under the terms of W's will, the residence is to be distributed to a trust for the benefit of her descendants upon termination of the Estate. The amount of cash and promissory notes in the Estate is insufficient to fully fund the distribution to you. The office building is subject to a mortgage. You state that the Estate's equity in the Building is sufficient to fund the required distribution to you.

W has 3 children, B, M, and P, collectively, the Brothers. M is the personal representative of the Estate. The Brothers own a number of companies, collectively the Companies. The

Companies owe various promissory notes to the Estate, which are noted above as assets of the Estate. The Companies are tenants in the office building currently owned by the Estate, although not the sole tenants.

B, M, and P are disqualified persons with respect to you, both as the children of substantial contributors to you and as foundation managers. The Companies are disqualified persons with respect to you since they are wholly owned by the Brothers. Thus, transactions between you and the Brothers or the Companies are subject to the self-dealing prohibitions of section 4941 of the Code.

You, the Brothers, and the Estate propose that the Brothers or one of their Companies buy from the Estate an ownership interest in the Building equal in value to the amount owed to you by the Estate. The purchase price would be paid with a promissory note ("Note") issued to the Estate. The Estate would then distribute the Note to you. The Building itself would be distributed to the Brothers as remainder beneficiaries of the Estate. The terms of the Note would be as follows:

1. The principal amount of the Note will equal the amount owed by the Estate;
2. The Note will be secured by a second mortgage on the Building;
3. The Note will bear interest at the mid-term Applicable Federal Rate in effect on the date of the purchase;
4. The Note will have a term of nine years;
5. Payments will be interest only for years one through nine, with a balloon payment at maturity;
6. There is no penalty for pre-payment of principal;
7. A due on sale provision will require that the Note be paid in full if the Building is sold prior to expiration of the Note term; and
8. Each of the Brothers will personally guarantee the Note.

You represent that the Estate has not terminated for Federal income tax purposes. The parties to the transaction represent that they will obtain approval for the transaction from the probate court having jurisdiction over the Estate. Pursuant to W's will, M, as personal representative of the Estate, has the power "[t]o sell, assign, transfer, convey, lease, or mortgage any real or personal property belonging to [the] [E]state."

Requested Rulings:

1. The purchase of the Building from the Estate by the Brothers will not be an act of direct or indirect self-dealing because the transaction fits within the exception to self-dealing described in section 53.4941(d)-1(b)(3) of the Foundation and Similar Excise Tax Regulations ("foundation regulations").
2. The distribution of a promissory note from the Estate to you and the payment of the amounts owed on the promissory note to you by the Brothers will not be an act of self-dealing because it is allowed by section 53.4941(d)-2(c)(1) of the foundation regulations.

Law:

Section 501(c)(3) of the Code exempts from federal income tax organization organized and operated exclusively for charitable or educational purposes.

Section 507(d)(2)(A) of the Code defines a substantial contributor as any person who contributed or bequeathed an aggregated amount of more than \$5,000 to a 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.

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

Section 4941(d)(1) of the Code defines self-dealing, in part, as including any direct or indirect sale or exchange of property between a private foundation and a disqualified person; the extension of credit between a foundation and a disqualified person; and the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4941(d)(2)(B) of the Code states, in part, that the lending of money by a disqualified person to a private foundation shall not be an act of self-dealing if the loan is without interest or other charge and if the proceeds of the loan are used exclusively for purposes specified in section 501(c)(3).

Section 4946(a)(1) of the Code defines the term "disqualified persons" with respect to a private foundation as including a substantial contributor to the foundation, a foundation manager, and an owner of more than 20 percent of the total combined voting power of a corporation which is a substantial contributor to the foundation. It also includes a member of the family of any individual described above. The definition includes a corporation of which the persons described *ante* own more than 35 percent of the total combined voting power. In addition it includes a trust or estate in which persons described above hold more than 35 percent of the beneficial interest.

Section 4946(b) of the Code defines the term foundation manager as including 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.

Section 4946(d) of the Code states that the term "a member" of the family of a disqualified person includes the spouse, children of and grandchildren of a disqualified person.

Section 53.4941(d)-1(a) of the Foundations and Similar Excise Tax Regulations ("foundation regulations") provides, in general, that for the purposes of section 4941, the term "self-dealing" means any direct or indirect transaction described in section 53.4941(d)-2 of the foundation regulations.

Section 53.4941(d)-1(b) of the foundation regulations provides that certain transactions described in section 53.4941(d)-2 as indirect self-dealing are excepted from the definition of

“indirect self-dealing.”

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 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) Possess 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 transaction 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 foundation regulations provides, in part, that except in the case of the receipt and holding of a note pursuant to a transaction described in section 52.4941(d)-1(b)(3), an act of self-dealing occurs when 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:

Ruling Request No. 1:

Generally, transactions between a disqualified person and a foundation are subject to the self-dealing rules set forth in section 4941 of the Code. Section 4941(d)(1), in part, defines “self-dealing” to include any direct or indirect sale or exchange, or leasing, of property between a private foundation and a disqualified person or the lending of money or other extension of credit

between a private foundation and a disqualified person. The transaction described above involves the sale by an estate of property in which a private foundation has an expectancy. The sale by an estate of property in which a private foundation has an expectancy under a will can be an act of indirect self-dealing. If the transaction described above were determined to be an act of self-dealing, it would subject the self-dealing persons to an excise tax on "each act of self-dealing between a disqualified person and a private foundation" pursuant to section 4941(a)(1). However, in order to apply section 4941 we must first determine if there are disqualified persons in the transaction with the private foundation.

Here, W is a disqualified person with respect to you under section 4945(a)(1)(A) of the Code as a substantial contributor to you. B, M, and P are disqualified persons with respect to you, both as the children of substantial contributors to you under section 4946(a)(1)(D) and as foundation managers under section 4946(a)(1)(B). The Companies are disqualified persons with respect to you under section 4946(a)(1)(E) since they are wholly owned by the Brothers. Thus, transactions between you and the Brothers or the Companies are subject to the self-dealing prohibitions of section 4941 of the Code.

Section 53.4941(d)-1(a) of the foundation regulations states that the term "self-dealing" means any direct or indirect transaction described in section 53.4941(d)-(2). The sale transaction described above, to a disqualified person, will be an act of self-dealing under section 53.4941(d)-(1)(b) of the foundation regulations unless it qualifies as a transaction during the administration of an estate under section 53.4941(d)-1(b)(3). To qualify under this exception to the self-dealing rules, all five conditions of section 53.4941(d)-1(b)(3) must be met.

First, the administrator of an estate must possess a power of sale with respect to the property. Under the terms of W's will, M is the personal representative of the Estate and may sell or transfer any real or personal property of the Estate. Thus, the first condition is met.

Second, the probate court or other court having jurisdiction over the estate must approve the transaction. You represent that you will present the transaction to the court for its approval.

Third, the transaction must occur before the estate is considered terminated for federal income tax purposes. You represent that the Estate has not terminated for Federal income tax purposes.

Fourth, 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. You represent that the Estate will receive an amount that equals your expectancy in the Estate at the time of the transaction.

Fifth, the transaction results in the foundation receiving an interest or expectancy at least as liquid as the one it gave up. You represent the transaction will result in your receiving a Note which is more liquid than an interest in the Building.

Ruling Request No. 2:

Section 53.4941(d)-2(c) of the foundation regulations provides that the lending of money and other extension of credit between a private foundation and a disqualified person shall constitute an act of self-dealing. For example, 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. However, section 53.4941(d)-2(c) also provides that such a transfer of a note to a private foundation does not constitute self-dealing if the foundation receives and holds the note pursuant to a transaction described in section 53.4941(d)-1(b)(3).

The proposed transaction consists of the sale of the Building owned by the Estate to either Brothers or Companies, disqualified persons, in exchange for a promissory note. Estate will then distribute the Note to you. The disqualified person(s) will make payments on the Note to you. This results in an extension of credit between a disqualified person and a private foundation which constitutes self-dealing under section 53.4941(d)-2(c) of the foundation regulations. However, an exception under this section provides that such a transfer of a note to a private foundation does not constitute self-dealing if the foundation receives and hold the note pursuant to a transaction described in section 53.4941(d)-(1)(b)(3).

Where a note has been issued subject to all the safeguards enumerated in section 53.4941(d)-1(b)(3), receipt and continued holding of the promissory note will not be deemed an extension of credit between a foundation and a disqualified person.

Ruling:

1. So long as the sale of Building by Estate to disqualified persons qualifies as a transaction during the administration of an estate under section 53.4941(d)-1(b)(3) of the foundation regulations by meeting all five conditions required of the exception, the sale transaction will not be self-dealing.
2. The distribution of a promissory note from the Estate to you and the payment of the amounts owed on the promissory note to you by disqualified persons will not be deemed an extension of credit between a disqualified person and a foundation that is an act of self-dealing so long as you receive and hold the Note pursuant to a transaction described in section 53.4941(d)-(1)(b)(3) of the foundation regulations.

This private letter ruling request was submitted prior to the issuance of Revenue Procedure 2011-4, Section 6, in which a no-rule position was announced with regard to self-dealing issues involving the issuance of a promissory note by a disqualified person during the administration of an estate or trust.

This ruling will be made available for public inspection under section 6110 of the Code 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) of the Code 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 resolved 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,

Laurice A. Ghougasian
Acting Manager, Exempt Organizations
Technical Group 4

Enclosure
Notice 437