

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201907004**
Release Date: 2/15/2019

Third Party Communication: None
Date of Communication: Not Applicable

Index Number: 4941.00-00, 4941.04-00,
4946.00-00, 4946.01-00,
4947.00-00

Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:EO1
PLR-117315-18

Date:
November 08, 2018

Trustor =
Trust =
LLC =
State =
LLC 2 =
Daughter =

Dear :

This letter responds to a letter from Trustor's authorized representative dated May 15, 2018, and subsequent correspondence requesting a ruling that Trustor's proposed lifetime irrevocable transfer to Trust of the nonvoting interests in LLC, the only assets of which are promissory notes from disqualified persons described in section 4946(a)(1)(G) of the Internal Revenue Code,¹ will not violate the prohibition against self-dealing under section 4941.

Trust represents the facts as follows:

¹ Section 4946(a)(1)(G) of the Internal Revenue Code of 1986, as amended, to which all subsequent section references are made unless otherwise stated.

FACTS

Trustor transferred certain business interests to trusts established for the benefit of Trustor's descendants (Beneficiary Trusts) in exchange for promissory notes that pay interest only for a term of 30 years, with the total principal amount due at the end of the term. The sole beneficiary or all of the beneficiaries of each Beneficiary Trust are Trustor's descendants.

Trustor assigned the promissory notes to LLC, a State limited liability company. The members of LLC are Trustor, who holds all of the nonvoting interests in LLC, and LLC 2, which holds all of the voting interests in LLC. The members of LLC 2 are Trustor's descendants and each holds interests as individuals.

LLC will hold and administer the promissory notes and receive payments of interest and principal on the promissory notes. Aside from the cash initially contributed by LLC 2 for the voting interests in LLC (which will fund LLC expenses), LLC's sole assets and source of income will be the promissory notes.

Power to manage the affairs of LLC is vested in the manager, who is selected and may be removed by a vote of the members holding at least a majority of the voting interests in LLC (currently LLC 2, which holds 100 percent of such voting interests). Daughter, who is also the trustee of Trust, is the initial manager of LLC. Daughter holds interests in LLC only in an individual capacity indirectly through her interests in LLC 2, not in her capacity as trustee of Trust.

The members holding nonvoting interests (currently Trustor, who holds 100 percent of such nonvoting interests) possess no management rights or rights to vote on who will be the manager of LLC. LLC may be dissolved only with written approval of all members, whether holding voting or nonvoting interests.

Trust is a charitable lead annuity trust (CLAT) within the meaning of Rev. Proc. 2007-45, the charitable interest in which is a right to a guaranteed annuity, distributed annually to a public charity that is described in section 501(c)(3). The remainder interests benefit Trustor's descendants. Trustor proposes to fund Trust by transferring Trustor's nonvoting interests in LLC to Trust. The annuity amount shall be paid from Trust's income, including distributions from LLC, and, to the extent income is insufficient, from Trust's principal. Trustor represents that Trust is subject to section 4941 under section 4947(a)(2).

LAW

Section 4941(a) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation and on the participation of any foundation manager, knowing that it is such an act.

Section 4941(d)(1)(B) defines self-dealing, in part, as including any direct or indirect lending of money or other extension of credit between a private foundation and a disqualified person.

Section 4946(a)(1) provides, in part, that the term “disqualified person” means, 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 section 4946(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 section 4946(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, and
- (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.

Section 4946(a)(2) provides that the term “substantial contributor” means a person who is described in section 507(d)(2) (i.e., a 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; and, in the case of a trust, the creator of the trust).

Section 4946(b)(1) defines the term “foundation manager” to include an officer, director, or trustee of a private foundation.

Section 4947(a)(2) provides in part that, in the case of a trust which is not exempt from tax under section 501(a), not all of the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2)(B), and which has amounts in trust for which a deduction was allowed under section 170, 545(b)(2), 652(c), 2055, 2106(a)(2), or 2522, certain Code provisions, including section 4941, shall apply as if such trust were a private foundation.

Treas. Reg. §53.4941(d)-1(b)(5) provides, in part, 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. For these purposes, an organization will be considered to be controlled by a private foundation if the private foundation has the right to exercise veto power over the actions of such organization relevant to any potential acts of self-dealing.

In Treas. Reg. §53.4941(d)-1(b)(8), Example (1), Private foundation P owns the controlling interest of the voting stock of corporation X, and as a result of such interest, elects a majority of the board of directors of X. Two of P's foundation managers, A and B, who are also directors of corporation X, form corporation Y for the purpose of building and managing a country club. A and B receive a total of 40 percent of Y's stock, making Y a disqualified person with respect to P under section 4946(a)(1)(E). In order to finance the construction and operation of the country club, Y requested and received a loan in the amount of \$4 million from X. The example concludes that the making of the loan by X to Y shall constitute an indirect act of self-dealing between P and Y.

Treas. Reg. §53.4941(d)-2(c)(1) restates the general rule under section 4941(d)(1)(B) that, generally, the lending of money or other extension of credit between a private foundation and a disqualified person shall constitute an act of self-dealing. It further states that, generally, 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

As a split-interest trust described in section 4947(a)(2), Trust is subject to the requirements of section 4941 as if it were a private foundation. Trustor is a disqualified person under section 4946(a)(1)(A) with respect to Trust as a "substantial contributor" because Trustor is the creator of Trust. Daughter is a disqualified person under section 4946(a)(1)(B) with respect to Trust as a "foundation manager."

Beneficiary Trusts are disqualified persons under section 4946(a)(1)(G) with respect to Trust because they are trusts in which Trustor's descendants, who are disqualified persons under section 4946(a)(1)(D) with respect to Trust, hold more than a 35-percent beneficial interest. Beneficiary Trusts are the obligors of promissory notes given to Trustor in exchange for certain business interests. An act of self-dealing would occur if Trustor transferred the promissory notes to Trust, which would become creditor under the notes. See Treas. Reg. §53.4941(d)-2(c)(1).

Instead, Trustor assigned the promissory notes to LLC and proposes to transfer nonvoting interests in LLC to Trust. Trust will acquire the nonvoting interests in LLC by gift rather than through a self-dealing transaction. However, if Trust would be considered to "control" LLC within the meaning of Treas. Reg. §53.4941(d)-1(b)(5), then

Trust would be considered to be the creditor, indirectly, under the note by reason of its ownership interest in LLC. See Treas. Reg. §53.4941(d)-1(b)(8), Example (1).

As holder of the nonvoting interests, Trust will have no management rights or right to vote on the manager of LLC. LLC 2 will own all of the voting interests, giving LLC 2 the right to select and remove the manager LLC. As a holder of nonvoting interests, Trust will have a right to receive distributions only if LLC dissolves or chooses to make current distributions, but the timing and amount of such distributions will be uncertain and could not be compelled by Trust. Only LLC 2, as the holder of the voting interests, may elect or remove the manager of LLC, and such manager will have the sole power to manage the affairs of LLC and determine the timing and amount of distributions. Thus, Trust and Trust's trustees (acting only in such capacity) will not have sufficient votes or positions of authority to cause LLC to engage in a transaction.

Additionally, Trust will not have the power to compel dissolution of LLC since LLC may only be dissolved with written approval of all members, including LLC 2. The power associated with the nonvoting interests of LLC as a necessary party to vote on the liquidation of LLC is not considered equivalent to a "veto power" within the meaning of Treas. Reg. §53.4941(d)-1(b)(5) because the power cannot be exercised over an action relevant to any potential act of self-dealing. Consequently, Trust will not "control" LLC within the meaning of Treas. Reg. §53.4941(d)-1(b)(5)

Accordingly, Trust's receipt of nonvoting interests in LLC from Trustor will not constitute a loan or extension of credit between a "private foundation" and a "disqualified person" within the meaning of section 4941(d)(1)(B) and Treas. Reg. §53.4941(d)-2(c) because Trust will not acquire an interest in the promissory note; instead, Trust will acquire nonvoting interests in LLC, with respect to which it will not have any management rights or control over distributions.

Thus, Trustor's proposed transfer of nonvoting interests in LLC to Trust will not constitute an act of self-dealing described in section 4941.

CONCLUSION

Based solely on the facts and representations submitted, we rule that Trustor's proposed irrevocable transfer to Trust of the nonvoting interests in LLC, the only assets of which are promissory notes from disqualified persons described in section 4946(a)(1)(G), will not constitute an act of direct or indirect self-dealing under section 4941.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party, as specified in Rev. Proc. 2018-1, 2018-1 I.R.B. 1, §7.01(16)(b). We have not verified any of the material submitted in support of the

request for a ruling and such material is subject to verification on examination. The Associate Office will revoke or modify a letter ruling and apply the revocation retroactively if: (1) there has been a misstatement or omission of controlling facts; (2) the facts at the time of the transaction are materially different from the controlling facts on which the ruling is based; or (3) the transaction involves a continuing action or series of actions and the controlling facts change during the course of the transaction. See Rev. Proc. 2018-1, §11.05.

No ruling is granted as to whether Trust qualifies as an organization described in Rev. Rul. 2007-45. No opinion is expressed regarding the valuation of any assets described in this ruling request for estate or gift tax purposes. Except as expressly provided above, no opinion is expressed or implied concerning the federal income, estate, gift, or foundation excise tax consequences of any other aspects of any transaction or item of income described in this letter ruling.

This ruling will be made available for public inspection under section 6110 after certain deletions of identifying information are made.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Theodore Lieber
Senior Tax Law Specialist
Exempt Organizations Branch 1
Associate Chief Counsel
(Tax Exempt and Government Entities)

cc: