

Internal Revenue Service

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March 25, 2024

Legend

- Trust =
- Trustor =
- Company =
- X =
- Y =
- Z =
- Foundation =
- Date 1 =
- Date 2 =
- Date 3 =
- City =
- Regulatory Agency =
- State =

Dear :

This letter ruling responds to a request dated October 4, 2023, and subsequent correspondence submitted on behalf of Trust, requesting an extension of an additional five years under section 4943(c)(7) of the Internal Revenue Code (Code)¹ for disposing of certain excess business holdings.

FACTS

Trust was established by Trustor and became irrevocable on his death. Company was a closely held corporation acquired by Trustor. Until Trustor’s death, Trustor was the sole director and owner of all of the issued and outstanding shares of Company, which was

¹ All references in this letter ruling to “section” refer to the Internal Revenue Code of 1986, as amended.

taxed as an S corporation. After Trustor's death, 100 percent of Company was held by Trust and the trustees converted Company to a limited liability company. The trustees sold a combined X% interest in Company to two key employees of Company. Y% of Company was distributed to a trustee of Trust pursuant to the terms of the trust instrument, leaving Trust with a Z% interest in Company which is treated as a partnership for federal income tax purposes. The trustee who received a Y% interest in Company is a disqualified person with respect to Trust as a foundation manager under section 4946(a)(1)(B).

Trust represents that following the distribution of certain assets in accordance with the terms of the trust instrument, the remaining assets held by Trust include a Z% interest in Company and a 100% ownership interest in two other companies that are excepted from the definition of a "business enterprise" under section 4943(d)(3) because 100 percent of the gross income they derive is from passive sources. Trust's sole remaining beneficiary is Foundation, which is an organization that is exempt from income tax under section 501(c)(3) and classified as a private foundation under section 509(a).

Trust represents that Trustor's estate claimed and was allowed a charitable deduction under section 2055 on its Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*, and that Trust has claimed and been allowed deductions under section 642(c) on its Forms 1041, *U.S. Income Tax Return for Estates and Trusts*.

Prior to Date 1, which Trust represents is the "applicable date" under section 645(b)(2) and regulations thereunder, Trust was treated as part of Trustor's estate per an election made under section 645. This election terminated one day before Date 1, at which time Trust represents that because there were no noncharitable interests remaining, Trust became a nonexempt charitable trust described in section 4947(a)(1) and treated as an organization described in section 501(c)(3) which is classified as a private foundation under section 509. Trust further represents that due to its Z% interest in Company, Trust owned excess business holdings that required disposition.

Beginning around Date 1, the trustees of Trust began attempting to dispose of Trust's interest in Company. Company operates in a highly specialized niche market based primarily out of City due to necessary proximity to Regulatory Agency, and all companies that provide a significant volume of services similar to Company are also located in the City metropolitan area.

The trustees of Trust initially offered to transfer Trust's interest in Company to Trust's residuary beneficiary, Foundation. Foundation declined to accept the membership interests in Company. The trustees next attempted to market and sell Trust's interest in Company by approaching investment bankers and business opportunity brokers. Trust represents that very few had interest in handling the sale, as they lacked the requisite expertise with respect to Company's unique business, including its particular operations and risks. After evaluating numerous potential entities, the trustees selected an entity to handle the sale and entered into a formal written agreement. However, that written

agreement was executed at the same time that the COVID-19 pandemic began, which led to a high degree of uncertainty in the commercial environment, particularly for this type of niche transaction. Consequently, the trustees and the entity hired to sell Company concluded that it would not be fruitful to attempt to secure a buyer from among an already depleted and limited group of potential purchasers due to the unique nature of Company's business.

Notwithstanding this setback, the trustees continued searching for purchasers, contacting major firms in adjacent industries to gauge their interest in expanding into Company's business, but none were receptive. The trustees also contacted entities, private equity investors, and entrepreneurs the trustees believed might be interested in expanding their businesses, but none of them wanted to venture into an area where neither they nor their business associates had prior experience. Trust also considered selling its interest in Company to the two key employees who own a combined X% interest in Company. However, the key employees did not then have the financial resources to purchase the interest.

Trust represents that multiple factors have complicated efforts to sell its interest in Company, including the need to protect confidential information, business uncertainty resulting from and interest rate increases during the COVID-19 pandemic, and the fact that many buyers are not interested in purchasing less than a majority interest in Company. Trust also represents that the successor company would have to either operate in City or establish an office there because a physical presence is necessary for certain administrative reasons and in order to avoid certain risks. Because of the size, value, nature, and complexity of Company as well as the unpredictable and unstable economic conditions for the past three years, Trust has been unable to complete the sale within the prescribed five-year period despite its diligent efforts to do so.

Trust submitted a plan for disposing of its excess business holdings to the State Attorney General. The plan includes selecting a qualified independent appraiser to value Company and entering into an agreement to market Company to prospective purchasers. Trust will retain an investment banker to find a qualified buyer to purchase the business of Company. Trust will request that the firm approach selected business entities in the United States and elsewhere, which may have an interest in establishing a new business in the United States, and approach selected individuals who are known to invest in or acquire unusual business opportunities. If Trust is unable to sell after its efforts have been exhausted during the next two years, Trust will attempt to reach an agreement with the two key employees of Company who Trust expects to have sufficient cash and financing to purchase the remaining interest in Company as a result of receiving income distributions from Company over the next year or two. There are no restrictions on Trust's ability to sell Company that would prevent a sale.

Trust's initial five-year period for disposing of excess business holdings under section 4943(c)(6) ends on Date 2. Trust submitted its request for an extension of time prior to the end of the five-year period.

RULING REQUEST

Trust requests an extension for an additional five years of the period of time for disposing of its excess business holdings under section 4943(c)(7) such that, during the extension period, Trust's interest in Company will not be subject to the tax on excess business holdings under section 4943(a)(1).

LAW

Section 170(c)(2)(B) provides in part that a charitable contribution is a contribution or gift to or for the use of an organization organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Section 4943(a)(1) imposes a tax on the value of excess business holdings of a private foundation in a business enterprise.

Section 4943(c)(1) provides that the term "excess business holdings" means, with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the 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.

Section 4943(c)(2) generally provides that the permitted holdings of any private foundation in an incorporated business enterprise are 20 percent of the voting stock, reduced by the percentage of the voting stock owned by all disqualified persons.

Section 4943(c)(3)(A) provides, in part, that to determine the permitted holdings of a private foundation in the case of a partnership or joint venture, "profits interest" shall be substituted for "voting stock."

Section 4943(c)(6) generally provides that if there is a change in the holdings in a business enterprise (other than by purchase by the private foundation or by a disqualified person) which causes the private foundation to have excess business holdings in such enterprise, the interest of the foundation in such enterprise (immediately after such change) shall (while held by the foundation) be treated as held by a disqualified person (rather than by the foundation) during the five-year period beginning on the date of such change in holdings.

Section 4943(c)(7) provides that the Secretary may extend the section 4943(c)(6) period to dispose of excess business holdings for an additional five years in the case of an unusually large gift or bequest of diverse business holdings or holdings with complex corporate structures if:

- (A) the foundation establishes that:

- (i) diligent efforts to dispose of such holdings have been made within the initial five-year period, and
 - (ii) disposition within the initial five-year period has not been possible (except at a price substantially below fair market value) by reason of such size and complexity or diversity of such holdings;
- (B) before the close of the initial five-year period:
- (i) the private foundation submits to the Secretary a plan for disposing of all of the excess business holdings involved in the extension, and
 - (ii) the private foundation submits the plan described in clause (i) to the Attorney General (or other appropriate State official) having administrative or supervisory authority or responsibility with respect to the foundation's disposition of the excess business holdings involved and submits to the Secretary any response received by the private foundation during the five-year period, and
 - (iii) the Secretary determines that such plan can reasonably be expected to be carried out before the close of the extension period.

Section 4943(d)(3) provides that a "business enterprise" does not include a trade or business that derives at least 95 percent of its gross income from passive sources.

Section 4946(a)(1) provides in part that the term "disqualified person" with respect to a private foundation includes:

- (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, or
- (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 4947(a)(1) provides that a trust which is not tax exempt under section 501(a), all of the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2)(B), and for which a deduction was allowed under section 170, 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522, shall be treated as an organization described in section 501(c)(3) for purposes of chapter 42 and certain other purposes.

Treas. Reg. § 53.4943-6(b)(1) provides generally that in the case of an acquisition of holdings in a business enterprise by a private foundation pursuant to the terms of a will or trust, the five-year period described in section 4943(c)(6) and in this section shall not commence until the date on which the distribution of such holdings from the estate or trust to the foundation occurs.

Treas. Reg. § 53.4947-1(a) provides that section 4947 subjects trusts which are not exempt from taxation under section 501(a), all or part of the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2)(B), and which have amounts in trust for which a deduction was allowed under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522 to the same requirements and restrictions that are imposed on private foundations. The basic purpose of section 4947 is to prevent these trusts from being used to avoid the requirements and restrictions applicable to private foundations.

Treas. Reg. § 53.4947-1(b)(2)(iv) defines a reasonable period of settlement as that period reasonably required (or if shorter, actually required) by the trustee to perform the ordinary duties of administration necessary for the settlement of the trust.

Treas. Reg. § 53.4947-1(b)(2)(v) provides that a revocable trust that becomes irrevocable upon the death of the decedent-grantor from which the trustee is required to distribute all of the net assets in trust for or free of trust to charitable beneficiaries is not considered a charitable trust under section 4947(a)(1) for a reasonable period of settlement (within the meaning of Treas. Reg. § 53.4947-1(b)(2)(iv)) after becoming irrevocable. After that period the trust is considered a charitable trust under section 4947(a)(1).

ANALYSIS

Trust is not recognized as exempt from federal income tax under section 501(a). During the administration of Trustor's estate, Trust distributed specific bequests to noncharitable beneficiaries. Since Date 1, the sole remaining beneficiary of Trust is Foundation, which is an organization that is tax exempt as described in section 501(c)(3) and further classified as a private foundation under section 509(a). Accordingly, the remaining unexpired interests in Trust are devoted to one or more of the purposes described in section 170(c)(2)(B). Trust represents that it has amounts in trust for which deductions have been allowed under section 2055 and section 642(c). Therefore, Trust meets the requirements of section 4947(a)(1) to be treated as a charitable trust described in section 501(c)(3) and is subject to the same requirements and restrictions that are imposed on private foundations. See Treas. Reg. § 53.4947-1.

As of Date 1, Trust has held a Z% interest in Company. In addition, one of the trustees of Trust, who is a disqualified person with respect to Trust under section 4946(a)(1), has a Y% interest in Company. As a charitable trust subject to the requirements and restrictions imposed on private foundations, Trust's permitted holdings in Company are

20% of the profits interest, reduced by the amount held by disqualified persons. See section 4943(c)(2) and section 4943(c)(3)(a). Accordingly, Trust's Z% interest in Company exceeds its permitted holdings and constitutes excess business holdings. See section 4943(c)(1).

Trust represents that it became a section 4947(a)(1) nonexempt charitable trust (and thus treated as a private foundation for purposes of section 4943) on Date 1, the date Trust was no longer treated and taxed as part of Trustor's estate. We accept this representation and find it generally consistent with the end of a reasonable period of settlement as set forth in Treas. Reg. § 53.4947-1(b)(2)(v). Consequently, we find that on Date 1 there was a change in Trust's holdings in a business enterprise (other than by purchase), for purposes of section 4943(c)(6)(A) and that the five-year period described in section 4943(c)(6)(A) commenced on Date 1. See Treas. Reg. § 53.4943-6(b)(1).

Trust held a Z% interest in Company, which represented substantially all of the fair market value of all assets held by Trust. Company is a closely held company, with only four holders of membership interests: Trust, two key employees of Company, and one of the trustees of Trust. Company operates in an industry which is complex and highly regulated. Therefore, the distribution from Trustor's estate to Trust of the business holdings of Company represents an unusually large gift or bequest of holdings with a complex corporate structure within the meaning of section 4943(c)(7).

Trust engaged in numerous efforts to sell its interest in Company within the five-year period described in section 4943(c)(6). However, various factors complicated efforts to sell Trust's interest in Company, including business uncertainty as a result of the COVID-19 pandemic, the need for any successor company to operate in the City metropolitan area, and the fact that many buyers are only interested in purchasing 100% of Company or at least a majority interest in Company.

Despite diligent efforts during the initial five-year period to dispose of Trust's excess business holdings, disposition of those excess business holdings was not possible during the initial five-year period, except at a price substantially below fair market value, by reason of the size and diversity of such holdings. See section 4943(c)(7)(A)(ii).

Before the end of the initial five-year period, Trust submitted its request seeking an additional five-year period within which to dispose of its excess business holdings in Company. Trust's request includes its plan for disposing of the excess business holdings during the requested extension period. Trust also submitted its plan to the State Attorney General. See section 4943(c)(7)(B). Trust plans to enter into an agreement to market Company to prospective purchasers in the United States and internationally. In the event Trust is unable to sell Company through these marketing efforts, Trust expects to be able to reach an agreement to sell its remaining interest in Company to the two key employees of Company who currently own a combined X% interest.

We have determined that Trust's plan to dispose of its excess business holdings in Company received on Date 1 can reasonably be expected to be carried out before the close of the extension period on Date 3.

RULING

Based on the facts and representations made by Trust, we have determined that Trust meets the requirements under section 4943(c)(7) for an extension of an additional five years to dispose of excess business holdings in Company. Consequently, Trust's excess business holdings in Company will not be subject to tax under section 4943(a)(1) if Trust disposes of such excess business holdings before the close of the five-year extension period on Date 3.

The ruling contained in this letter is based upon information and representations submitted by or on behalf of Trust and accompanied by penalties of perjury statements executed by individuals with authority to bind Trust and upon the understanding that there will be no material changes in the facts. While this office has not verified any of the material submitted in support of the request for these rulings, it is subject to verification on examination. The Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes) will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2024-1, 2024-1 I.R.B. 1, section 11.05.

This letter does not address the applicability of any section of the Code or Regulations to the facts submitted, other than those sections specifically described. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed as to whether the period of administration or settlement of the estate is reasonable or unduly prolonged within the meaning of Treas. Reg. § 53.4947-1(b)(2)(iv). In addition, no opinion is expressed as to whether Trust's assets other than Company are excepted from being a "business enterprise" under section 4943(d)(3), nor is any opinion expressed regarding Trust's plan of disposition beyond the ruling provided herein.

This 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 Trust's authorized representatives.

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,

Matthew Giuliano
Branch Chief
(Exempt Organizations Branch 1
Employee Benefits, Exempt Organizations, and
Employment Taxes)

cc: