



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

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UIL No.  
4941.04-00

Contact Person:

Identification Number:

Telephone Number:

Taxpayer Identification Number:

Legend:

B =  
C =  
D =  
E =  
F =  
G =

Dear \_\_\_\_\_ :

This is in response to your request for a ruling regarding the proposed transaction described below:

B had three children: C, married to D, E, married to F, and G. C, E, D, and G are now deceased. D, F and G are each referred to as a "Taxpayer" and collectively as the "Taxpayers."

C, F and G entered into a business transaction with family members (including trusts or other entities controlled by, or created for the benefit of, family members). Pursuant to these transactions, C, F and G acquired a promissory note as consideration, each referred to as a "Note." Each Note provides for annual interest at the mid-term Applicable Federal Rate, with principal due at the end of the note term.

Each Taxpayer created a single member limited liability company of which the Taxpayer is the sole member. Each of these entities is referred to as a "Company" and collectively as the "Companies." Each Taxpayer contributed his or her Note to his or her Company, in exchange for which the Taxpayer received all of the voting units ("Voting Units") and nonvoting units ("Nonvoting Units") of his or her respective Company. Pursuant to C's and D's estate plans, D's estate currently owns the Voting and Nonvoting Units in C's Company. In addition, F (through her revocable trust) currently owns the Voting and Nonvoting Units in F's Company, and G's estate currently owns the Voting and Nonvoting Units in G's Company. Each taxpayer entered into a limited liability company agreement ("Company Agreement") to govern his or her respective Company.

Taxpayers state that each Company will be engaged solely in passive investment activities; will not engage in the operation of any business enterprise; and at least 95 percent of the gross

income of each Company will be derived from passive investments that will include, for example, interest and dividends.

Each Taxpayer created a charitable trust to be funded at his or her death. Each of these trusts is referred to as a "CT" and collectively as the "CTs." Each CT has a 20-year term commencing at the Taxpayer's death, during which term the CT will annually pay a guaranteed annuity to one or more charitable organizations.

Each Taxpayer has also created a revocable trust, separate and distinct from the Taxpayer's CT. Taxpayers state that each Taxpayer has provided in his or her revocable trust that at the Taxpayer's death, the Nonvoting Units owned by the Taxpayer will be allocated to the CT created by that Taxpayer. As a Nonvoting Unit holder, the CT cannot be required by the Company or its members, under the Company Agreement, to make any capital contributions or take any other actions. Nor does the CT have a right to force any distributions from the Company. Rather, under the Company Agreement the CT only has a right to receive distributions (in proportion to its ownership interest) when the Company dissolves or otherwise chooses to make distributions. The Taxpayer's Voting Units will be bequeathed to or in trust for the benefit of the Taxpayer's descendants.

Pursuant to an agreement (the "Option Agreement"), each Taxpayer (and his or her revocable trust) granted his or her children and a business entity controlled by the Taxpayers and their families (collectively, the "Option Holders") an option (the "Option") to purchase one or more specific assets (including the Note and any of the Nonvoting Units) (collectively, the "Option Assets") from the then current owner of the Option Assets, including the Company or the Taxpayer's estate or revocable trust. The Option Assets will not include any of the Voting Units. The Option Agreement provides that the Option Holders may purchase some or all of the Option Assets for a purchase price equal to the fair market value of such Option Assets as determined for federal estate tax purposes in the Taxpayer's estate at any time within nine months of the Taxpayer's death (the "Option Term"). The Option Holders will be required to pay the purchase price for the Option Assets in cash, marketable securities, or a combination of both.

With respect to any Option Assets to be purchased from the Taxpayer's estate or revocable trust, before the expiration of the Option Term, Taxpayers state that their estates or revocable trusts will petition a court of competent jurisdiction for approval of both the Option Holders' exercise of their options, as well as the tendering and receipt of consideration pursuant to each Option Agreement. Taxpayers state that the exercise of the Options by the Option Holders, the sale and purchase of Option Assets, and the tendering and receipt of consideration related thereto, will occur before the end of the period reasonably required by the executors or trustees to perform the ordinary duties of administration necessary for the settlement of the Taxpayers' estates and before the Taxpayers' revocable trusts are treated as trusts under section 4947 of the Code. Taxpayers state that the purchase of the Option Assets owned by the Taxpayers' estates or revocable trusts pursuant to each Option Agreement will be contingent upon receipt of approval from a court of competent jurisdiction.

## **Rulings Requested**

1. The exercise of the Option and the purchase of Option Assets from a Taxpayer's estate or revocable trust by the Option Holders, the tendering of consideration by the Option Holders to the Taxpayer's revocable trust or estate, the receipt of such consideration by the Taxpayer's

revocable trust or estate, and a distribution of such consideration from the Taxpayer's revocable trust or estate to the CT, will satisfy the requirements for the exception to self-dealing described in section 53.4941(d)-1(b)(3) of the Foundation and Similar Excise Taxes Regulations, and therefore will not constitute impermissible acts of self-dealing under section 4941 of the Code.

2. Neither (i) the exercise of an Option and related sale and purchase of the Option Assets between one or more disqualified persons as to a Taxpayer's CT and the Taxpayer's Company nor (ii) the retention by that Company of a Note following the Taxpayer's death, will constitute indirect acts of self-dealing pursuant to section 53.4941(d)-1 of the regulations, and will not violate section 4941 of the Code.

3. A CT's ownership of Nonvoting Units will not constitute a violation of the prohibition against ownership of excess business holdings under section 4943 of the Code because the Company is not a "business enterprise" within the meaning of section 4943(d)(3).

## Law

Section 4941(a) of the Code imposes certain excise taxes on direct and indirect acts of self-dealing between a disqualified person and a private foundation, and also imposes a separate excise tax on the participation by any foundation manager in an act of self-dealing between a disqualified person and a private foundation, knowing it is such an act, unless such participation is not willful and is due to reasonable cause.

Section 4941(d)(1) of the Code, in relevant part, provides that the term "self-dealing" includes 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; ...and,

(E) transfer to, or for the use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a)(1) of the Code provides, in relevant 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, ...or

(D) a member of the family of any individual described in subparagraphs (A), (B), or (C).

Section 53.4941(d)-1(a) of the regulations provides that, for purposes of section 4941 of the Code, the term "self-dealing" includes any direct or indirect transaction described in section 53.4941(d)-2 of the regulations.

Section 53.4941(d)-2 of the regulations describes six specific acts of self-dealing between a private foundation and a disqualified person: (1) sale or exchange of property; (2) leases; (3) loans; (4) furnishing goods, services, or facilities; (5) payment of compensation; and (6) transfer or use of the income or assets of a private foundation.

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) 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 section 1.641(b)-3 of the regulations (or in the case of a revocable trust, before it is considered subject to section 4947 of the Code);
  
- (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 \_\_\_\_\_, 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)-(1)(b)(5) of the regulations states 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.

Section 4943(a) of the Code prohibits a private foundation from owning any excess business holdings.

Section 4943(c) of the Code defines excess business holdings as: "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(d)(3)(B) of the Code excludes from the definition of "business enterprise," "a trade or business at least 95 percent of the gross income of which is derived from passive sources."

Section 53.4943-10(c)(1) of the regulations states 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.

Section 4947(a)(2) of the Code states, in relevant part, that sections 4941 and 4943 of the Code apply to tax exempt split-interest trusts.

### **Analysis for Ruling Request 1**

Section 4947(a)(2) of the Code states that in the case of a non-exempt trust, a portion of the interests of which are devoted to tax-exempt purposes and for which contribution deductions were allowed, sections 4941 and 4943, among others, apply as if the trust were a private foundation. Therefore, each CT is subject to sections 4941 and 4943 as if it were a private foundation.

Sections 4941(a) and 4941(d) of the Code imposes certain excise taxes on acts of self-dealing between a disqualified person and a private foundation. Section 4941(d) provides that the term "self-dealing" includes certain direct or indirect transactions. Section 53.4941-1(d)-1(b) of the regulations provides that the term "indirect self-dealing" does not include certain transactions. One such exclusion involves transactions during the administration of an estate or revocable trust, provided that all of the requirements in section 53.4941-(d)1(b)(3) are satisfied.

Upon each Taxpayer's death, their respective estates and revocable trusts, children, the Taxpayer's Company and the business entity controlled by the Taxpayers and their families will become disqualified persons as to the Taxpayer's CT under section 4946(a)(1) of the Code.

Each Taxpayer's estate or revocable trust will have the express authority (through the executor or trustee) to sell the Option Assets pursuant to the Option Agreement, and will be required to sell the Option Assets if the option is exercised. See section 53.4941(d)-1(b)(3)(i) of the regulations. Taxpayers state that the exercise of the Option and the underlying transfer and receipt of property will be approved by a court of competent jurisdiction as a condition of the transaction closing. See section 53.4941(d)-1(b)(3)(ii) of the regulations. Taxpayers state that the exercise of the Option, the sale of the Option Assets and the tendering and receipt of related consideration will occur before the Taxpayer's estate is considered terminated for federal income tax purposes, or in the case of the Taxpayer's revocable trust, before it is considered subject to section 4947 of the Code. See section 53.4941(d)-1(b)(3)(iii) of the regulations. The terms of the Option Agreement provide the Option must be exercised within nine months of the Taxpayer's death. The Option Agreement also provides that the Option Holders are required to pay consideration equal to the fair market value of the Option assets as determined for federal estate tax purposes. See section 53.4941(d)-1(b)(3)(iv) of the regulations. The transaction will be conducted pursuant to an option that is binding on the Taxpayer's estate. See section 53.4941(d)-1(b)(3)(v)(c) of the regulations.

Accordingly, the contemplated exercise of the Option by the Option Holders and subsequent purchase of the Option Assets by the Option Holders from each Taxpayer's estate or revocable trust within the period of the Option Term as described above will satisfy the requirements in section 53.4941(d)-1(b)(3) of the regulations. Therefore, these transactions will not constitute impermissible acts of self-dealing for purposes of sections 4941(a) and 4941(d)(1) of the Code.

### **Analysis for Ruling Request 2**

#### **(i) Exercise of Option**

If the Option Holders were to exercise the Option, the exercise of the Option and related sale

and purchase of the Option Assets between one or more disqualified persons and Taxpayer's Company would not constitute acts of indirect self-dealing under section 53.4941(d)-1 of the regulations or violate section 4941 of the Code, for the reasons set forth in the Analysis for Ruling Request 1, above. See section 53.4941(d)-1(b)(3) of the regulations.

(ii) Retention of Note

Section 53.4941(d)-1(a) of the regulations states that "the term 'self dealing' means any direct or indirect transaction described in §53.4941(d)-2. Section 53.4941(d)-2 describes five specific acts of self-dealing: (1) sale or exchange of property; (2) leases; (3) loans; (4) furnishing goods, services, or facilities; and (5) transfer or use of the income or assets of a private foundation.

If the Option Holders fail to exercise their option after a Taxpayer's death, the Taxpayer's Company would retain ownership of the Note, and the Taxpayer's CT would own Nonvoting Units in the Company. Both the Company and the Taxpayer's family members who are debtors to the Company under the Note would be disqualified persons as to the CT. However, the CT's retention of a nonvoting interest in the Company and its receipt of passive income from the Company would not constitute any of the acts of self-dealing described in section 4941(d)(1) of the Code or section 53.4941(d)-2 of the regulations. The arrangement between the Company and the CT would neither be a loan nor an extension of credit. The CT would acquire Nonvoting Units in the Company by gift, rather than through a self-dealing transaction. As a holder of Nonvoting Units, the CT would have a right to receive distributions only if the Company dissolves or chooses to make distributions, but the timing and amount of such distributions would be uncertain, and could not be compelled by the CT. Further, the CT could not be required by the Company or its members to make any capital contributions, transfer any other income or assets, or take any other actions that could result in a prohibited self-dealing transaction. See section 53.4941(d)-2(f) of the regulations.

The CTs would not have "control" over the Company (as defined in section 53.4941(d)-1(b)(5) of the regulations), only a passive, non-voting interest in the Company. Because of this lack of control, any transactions between the Company and a disqualified person or persons of the CT (e.g., interest paid by disqualified persons to the Company, in its capacity as holder of the Note) would not be attributable to the CT.

Therefore, the retention by the Company of a Note following the Taxpayer's death would not be an act of indirect self-dealing between the CT and one or more disqualified persons under section 53.4941(d)-1 of the regulations or section 4941 of the Code.

### **Analysis for Ruling Request 3**

The Taxpayers state that each Company will be engaged solely in passive investment activities; will not engage in the operation of any business enterprise; and that at least 95 percent of the gross income of each Company will be derived from passive investments that will include interest and dividends. Thus, each Company is excluded from the definition of "business enterprise" under section 4943(d)(3)(B) of the Code and section 53.4943-10(c)(1) of the regulations. Because the CT's Nonvoting Units do not constitute interests in a business enterprise, the CT's Nonvoting Units will not constitute "excess business holdings" under section 4943 of the Code.

## Rulings

1. The exercise of the Option and the purchase of Option Assets from a Taxpayer's estate or revocable trust by the Option Holders, the tendering of consideration by the Option Holders to the Taxpayer's revocable trust or estate, the receipt of such consideration by the Taxpayer's revocable trust or estate, and a distribution of such consideration from the Taxpayer's revocable trust or estate to the CT, will satisfy the requirements for the exception to indirect self dealing described in section 53.4941(d)-1(b)(3) of the regulations, and therefore will not constitute impermissible acts of self-dealing under section 4941 of the Code.

2. Neither (i) the exercise of an Option and related sale and purchase of the Option Assets between one or more disqualified persons as to a Taxpayer's CT and the Taxpayer's Company nor (ii) the retention by that Company of a Note following the Taxpayer's death, will constitute indirect acts of self-dealing pursuant to section 53.4941(d)-1 of the regulations, and will not violate section 4941 of the Code.

We are expressly not ruling as to whether any subsequent transactions between a CT and a Company would constitute an act of self-dealing under section 4941 of the Code.

3. A CT's ownership of Nonvoting Units will not constitute a violation of the prohibition against ownership of excess business holdings under section 4943 of the Code because the Company is not a "business enterprise" within the meaning of section 4943(d)(3).

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.

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,

Steven Godnitzky  
Manager, Exempt Organizations  
Technical Group 1

Enclosure: Notice 437