



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **200651038**
Release Date: 12/22/06
Date: September 27, 2006

UIL 4941.04-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

A =

B =

C =

D =

E =

G =

H =

I =

J =

K =

XX =

M =

X =

Dear _____ :

We have considered your ruling request dated January 31, 2006, submitted by your legal representatives, requesting rulings regarding the proposed sale of certain property by F to C and D.

Facts:

The A was established by B under a trust agreement dated August 26, 1989. B amended and last restated the A by the Second Restatement dated January 6, 1999 (the "Second Restatement"). B subsequently amended the Second Restatement of the A by a First Amendment to the Second Restatement dated July 30, 2001 (the "First Amendment"). You represent that the Second Restatement, as amended by the First Amendment, constitutes the governing document of the A.

As a result of the First Amendment, B resigned as Trustee of the A and C became the successor Trustee. B died on October 5, 2002. As a result of B's death, A became irrevocable and hence, became an Administration Trust.

You state that C, as Trustee of the A and as required by applicable Treasury Regulations, obtained a taxpayer identification number for the Administration Trust.

The purpose and function of the Administration Trust is to do all things necessary to prepare the Administration Trust for distribution to its beneficiaries. Such activities include marshalling all assets, paying all creditors, filing all tax returns, liquidating assets as necessary or appropriate, and making distribution of remaining assets to the beneficiaries of the Administration Trust.

You state that after obtaining a taxpayer identification number for the Administration Trust, C then commenced performing her duties as Trustee and prepare the Administration Trust for eventual distribution and termination. In this regard, you state that C filed an estate tax return, Form 706, which showed no tax due. You state that C received an Estate Tax Closing Document dated June 30, 2004. The A provided for certain pecuniary bequests from the Administration Trust to certain noncharitable beneficiaries. C has distributed all such bequests.

The A provides that the entire residue of the Administration Trust is to be distributed to the E, a Charitable Trust (the "Charitable Trust"). C, as Trustee of the Charitable Trust, filed Form 1023, Application for Recognition of Exemption From Federal Income Tax under section 501(c)(3) of the Internal Revenue Code ("the Code"). You state that you received a favorable determination letter dated March 15, 2005, recognizing the Charitable Trust as exempt under section 501(c)(3) of the Internal Revenue Code and classifying the Charitable Trust as a private foundation under section 509(a) of the Code. The Charitable Trust also received a letter from the I Franchise Tax Board acknowledging that the Charitable Trust is exempt from I franchise and income tax under I Revenue and Taxation Code section 23701d. In addition, the Charitable Trust has registered with the Registry of Charitable Trusts of the Office of the Attorney General of the State of I. The purpose of the Charitable Trust is to make grants to public charities described in sections 170(b)(1)(A), 170(c), 2055(a), and 2522(a) of the Code.

You state that the Trustee has made a preliminary and partial distribution of residue of the Administration Trust to the Charitable Trust. The Administration Trust is not in a condition to be fully distributed because of two pieces of ongoing litigation which are not related to this ruling request. The Trustee believes that the litigation will not be resolved in the near future, and the Administration Trust will necessarily continue until all such litigation has been resolved.

The Administration Trustee holds a 33.40% interest in the profits and capital of G, a H limited liability company. G has elected to be treated as a partnership for tax purposes. C and her husband D, individually, own the remaining interests in the profits and capital of G. (The interest of the Administration Trust in G is hereafter referred to as the "Subject Interest").

G owns various interests in four other partnerships (including limited liability companies taxed as partnerships) (each a "Subsidiary Entity" and collectively the "Subsidiary Entities"). Each Subsidiary Entity owns real property in I. Three of the Subsidiary Entities own multi-tenant apartment projects and one Subsidiary Entity owns an industrial project rented to four tenants. Each project is subject to a mortgage.

Paragraph B. (1) of Article V of the Second Restatement provides that the Trustee has the power to “sell (for cash or on credit), exchange, purchase and retain assets...” The Trustee has the power to sell the Subject Interest without prior consent or approval from any beneficiary or any other person; subject, however, to the limitations of the transfer of the Subject Interest set forth in the Operating Agreement for G (the “Operating Agreement”).

The Trustee proposes to sell the Subject Interest to herself, C, individually, and her husband, D, individually. The Subject Interest is not a registered security and cannot be advertised for sale. The Trustee will be required to liquidate the Subject Interest in due course in any event. The Trustee would be required to expend time, effort, and expense in locating a qualified investor willing to invest a substantial sum to purchase an illiquid interest in an entity in which the investor would have no control. C and D are the only other members of G, and therefore, the most likely, logical, and available prospective purchasers.

The limitations on transfer of an interest in G make it unlikely that the Trustee could find a buyer to whom to sell the Subject Interest. Such a buyer could not be assured that he or she would become a Substitute Member and therefore be entitled to all the privileges of a Member. The limitations on transfer are set forth in Articles VI of the Operating Agreement.

Section 3.1 of Article III of the Operating Agreement provides in part that “Additional Members may be admitted with the approval of all Members.” [Emphasis added.]

Article VI of the Operating Agreement governs the transfer of interests and reads in part as follows:

6.1 Transfer and Assignment of Interests. No Member shall be entitled to transfer, assign, convey, sell, encumber or in any way alienate all or any part of his or her Membership Interest (collectively, “transfer”) except with the prior approval of all Members, which approval may be given or withheld in the sole discretion of the Members. [Emphasis added.]

6.2 Substitution of Members A transferee of a Membership Interest shall have the right to become a substitute Member only if (i) consent of the Members is given in accordance with Section 6.1., (ii) such person executes an instrument satisfactory to the Members accepting and adopting the terms and provisions of this Agreement, and (iii) such person pays any reasonable expenses in connection with his or her admission as a Member. The admission of a substitute Member shall not release the Member who assigned the Membership Interest from any liability that such Member may have to the Company.

6.3 Transfers in Violation of this Agreement and Transfers of Partial Membership . Upon a transfer in violation of this Article VI, the transferee shall have no right to vote or participate in the management of the Company or to exercise any rights of a Member. Such transferee shall only be entitled to receive the share of the Company’s Net Profits, Net Losses and distributions from the Company’s assets to which the transferor would otherwise be entitled. [Additional text omitted.]

Article VI goes on to provide that if a member transfers his or her interest in such a manner that the transferee does not receive the rights of the member to vote and participate in the

management of the Company, the Company has a right to purchase for \$100 of the rights of membership which remain with the selling member and which were associated with the transferred interest immediately before the transfer. If the Trustee were to sell the Subject Interest in a manner such that the buyer did not become a substitute member, the buyer would be buying only the rights as an assignee. G could then buy for \$100 all of the rights to vote and participate in the business of G which the Administration Trust owned as part of its ownership of the Subject Interest, and which remained with the Administration Trust, despite the purported sale.

C, the Trustee, individually, is a member of G. The Trustee may be obligated by some fiduciary duty to consent to the sale by the Administration Trust and to the admission of the buyer of the Subject Interest as a substitute member of G. Even so, D is not subject to any such fiduciary duty and may, in his "sole discretion," decline to admit the buyer as a substitute member and thereby limit the buyer's rights to those of an assignee.

Article VII of the Operating Agreement provides that upon the death of a member, the entity is dissolved unless the remaining members consent to the continuation of the entity. If the remaining members do consent to such continuation, the entity or the remaining members have a right to purchase the interest of the deceased member. Section 7.2 of the Operating Agreement provides that the "purchase price for the Former Member's Interest shall be the fair market value of the Former Member's Interest as determined by an independent appraiser jointly selected by the Former Member and by Remaining Members holding a majority of the remaining Membership Interests." C, and D, individually, being all the remaining members of G, have not yet exercised this right to purchase and may still be entitled to exercise such right. However, the exercise of the right would be subject to a determination of the "fair market value" of the Subject Interest, which would be determined through an appraisal process which is the same process which the Trustee used and which would presumably determine the very price at which the Trustee proposes to sell the Subject Interest to herself, individually, and to D.

You represent that as purchasers, C and D will pay the purchase price in cash.

The Trustee has caused the value of the Subject Interest to be determined by professional appraisers and valuation experts. The report of J was lodged with the court under notice of lodging dated May 25, 2006. The report of J shows that the value of the Subject Interest, as of May 11, 2006, was xx. You state that the report of J was based in part on appraisals of the four parcels of real property held in the four Subsidiary Entities. The real property appraisals were prepared by K, licensed real estate appraisers who are unrelated to the Trustee and who were recommended to the Trustee by her attorneys. The appraisals show valuation dates of December 8, 2005, December 13, 2005, and December 14, 2005, those dates being the dates the appraisers physically inspected the subject property. The Trustee received the last completed appraisal report on January 24, 2006.

The report of J shows that J first determined the fair market value of all of the assets of each Subsidiary Entity (other than the real property already appraised by K). J then determined the net fair market value of the assets of each of the Subsidiary Entities, which constituted the fair market value of each such entity. J then determined the fair market value of the interests of G

in the Subsidiary Entities and brought the resulting values up to G. J then used those values to determine the net fair market value of G and then determined the fair market value of the Subject Interest. You state that in the application of this process, J applied proper discounts or premiums as appropriate to determine the fair market value of the interests of G in the Subsidiary Entities and the fair market value of the Subject Interests.

You state that the Trustee believes the value so determined for the Subject Interest is the fair market value of the Subject Interest within the meaning of Treasury Regulations section 20.2031-1(b), which is "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts."

The Trustee proposes that the sale price shall be the fair market value, determined as described in the report of J, plus xx. Accordingly, the sale price will be an amount in excess of the fair market Value of the Subject Interest. The Cash which the Administration Trust will receive as a result of the sale to C and D will be much more liquid than the Subject Interest which the Administration Trust will give up in the transaction.

You represent that proceedings concerning the administration of the Administration Trust fall under the jurisdiction of the M Probate Court (the Probate Court). Contemporaneously with the filing of this ruling request, the Trustee filed a petition (the Petition) with the Probate Court requesting approval of the sale of the Subject Interest to C and D. Notice of the hearing of the Petition and a copy of the Petition has been served on the Attorney General for the State of I.

Recently, you have provided a copy of a letter dated May 23, 2006, from the Office of the Attorney General for the State of I expressing no objection to the proposed sale and consenting to the petition filed. In addition, you have recently provided a copy of an Order dated June 29, 2006, from the Probate Court approving the sale of the Subject Interest to C and D expressly conditioned on the issuance of a favorable ruling from the Internal Revenue Service.

You state that because of the litigation mentioned above, the administration of the Administration Trust is not complete and has not been unduly prolonged. You further state that the Administration Trust has not been terminated within the meaning of section 1.641(b)-3(b) of the Regulations and pursuant to sections 53.4947-1(b)(2)(i) and 53.4947-1(b)(2)(v) of the Regulations, the Administration Trust is not yet subject to section 4947 of the Code.

Based on the foregoing and other information submitted you have requested the following rulings:

1. The proposed sale of the Subject Interest for cash at the price of fair market value plus x to C and D will not constitute an act of self-dealing as to the Administration Trust and C as Trustee under section 4941(d) of the Code; and
2. Neither the Administration Trust nor C as Trustee will be subject to taxes under section 4941 of the Code with respect to the proposed sale of the Subject Interest in the manner and on the terms described above.

Law:

Section 4941(a)(1) of the Code imposes a tax on acts of self-dealing between a disqualified person as defined in section 4941 and a private foundation.

Section 4941(d)(1) of the Code provides, in part, that the term “self-dealing” means any direct or indirect- (A) sale or exchange, or leasing, of property between a private foundation and a disqualified person; and (e) transfers to, or 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 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, (D) a member of the family of any individual described in subparagraph (A) or (B), or (G) a trust or estate in which persons described in subparagraph (A), (B), or (D) holds more than 35% of the beneficial interest.

Section 4946(b) of the Code provides that a “foundation manager” is an officer, director, or trustee of a foundation.

Section 4946(d) of the Code provides that for purposes of section 4946(a)(1), the family of any individual shall include only his spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren.

Section 507(d)(2) of the Code provides that the term “substantial contributor” includes the creator of the trust.

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 held by a revocable trust which has become irrevocable on the grantor’s death, if the following conditions are met:

- a. The executors of an estate or trustee of a revocable trust possesses a power of sale with respect to the property or has the power to reallocate the property to another beneficiary;
- b. Such transaction is approved by the probate court having jurisdiction over the estate or by another court having jurisdiction over the estate, trust, or private foundation;
- c. The transaction occurs before the estate is considered terminated for Federal income tax purposes pursuant to section 1.614(b)-3(a) of the Regulations, or in the case of a revocable trust before it is considered subject to section 4947;
- d. The estate or revocable trust receives an amount that equals

or exceeds the fair market value of the private foundation's interest or expectancy in the property at the time of the transaction; and

e. The estate or revocable trust receives an asset that is at least as liquid as the property it sells, or receives an asset related to the active conduct of the private foundation's tax-exempt purposes.

Examples (4) and (5) of section 53.4941(d)-1(b)(8) of the Regulations provides examples employing the estate administration exception.

In *Rockefeller v. U.S.*, 718 F.2d 290 (8th Cir. 1983), cert. den., 104 S.Ct. 2180 (1984), the Court of Appeals affirmed a lower court decision holding that the purchase of stock from an estate by a son of the decedent constituted an indirect act of self-dealing between a disqualified person and a private foundation that was established by a decedent's bequest.

Analysis:

C, as the Trustee of the Administration Trust and as the Trustee of the Charitable Trust, is a disqualified person with respect to the Charitable Trust because she is a foundation manager within the meaning of section 4946(a)(1)(B) of the Code. D is a disqualified person with respect to the Charitable Trust within the meaning of section 4946(a)(1)(D) because he is the husband of C.

The prohibition against indirect self-dealing applies here to the proposed sale of the Subject Interest by the Administration Trust to C, individually, and to D, individually. See *Rockefeller v. U.S.*, supra. However, the proposed sale of the Subject Interest does not constitute a prohibited act of self-dealing under section 4941 of the Code because it meets all of the requirements of section 53.4941(d)-1(b)(3) of the Regulations, as follows:

1. C, as the Trustee of the Administration Trust possesses the power of sale over the Subject Interest pursuant to paragraph B.(1) of Article V of the Second Restatement of the A;
2. The proposed sale of the Subject Interest will not take place without the approval of the Probate Court which has jurisdiction over the Administration Trust;
3. The proposed sale of the Subject Interest will occur before the Administration Trust is subject to section 4947 of the Code;
4. The Administration Trust will receive an amount equal to or greater than the fair market value of the Subject Interest; and
5. The Administration Trust will receive interests or expectancies at least

as liquid as the one it gives up.
See also examples (4) and (5) of section 53.4941(d)-1(b)(8) of the Regulations.

Therefore, neither the Administration Trust nor C, as Trustee of the Administration Trust, will be subject to excise taxes under section 4941 of the Code with respect to the proposed sale of the Subject Interest.

Conclusion:

Accordingly, we rule that:

1. The proposed sale of the Subject Interest for cash at the price of fair market value plus x to C and D will not constitute an act of self-dealing as to the Administration Trust and C as Trustee under section 4941(d) of the Code; and
2. Neither the Administration Trust nor C as Trustee will be subject to taxes under section 4941 of the Code with respect to the proposed sale of the Subject Interest in the manner and on the terms described above.

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,

Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437