



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **200846038**

Release Date: 11/14/08

Date: 8/21/08

UIL 4943.04-01

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

A =

B =

C =

D =

E =

F =

Dear :

This is in reply to your ruling request dated August 2, 2007, regarding application of the five-year period to dispose of certain assets acquired other than by purchase under section 4943(c)(6)(A) of the Internal Revenue Code (the Code).

FACTS:

A is a B nonstock corporation organized to benefit organizations described in section 501(c)(3) of the Code that are devoted exclusively to charitable, educational, religious, and scientific purposes. You further state that A was created by C. A is recognized as an organization that is exempt from federal income tax under section 501(c)(3) of the Code and is a private, non-operating foundation within the meaning of section 509(a).

You represent that C has at all time since the creation of A been a substantial contributor to A within the meaning of section 4946(a)(1) of the Code. C is Chairman of the Board, controlling shareholder and CEO of D, a B based for-profit holding company. You further represent that D made a subchapter S election for tax purposes.

D is directly or indirectly engaged in one or more operating business enterprises. One of D's holdings is a limited liability company engaged in an operating business enterprise. C serves as its executive chairman.

C created an irrevocable trust (hereafter E) to benefit lineal descendants and A. C will transfer D shares to E by means of the remainder interest in F, a trust also created and funded by C.

The beneficiaries of E will be A and C's lineal descendants. You state that each year, 10% of the trust's net cash flow from the prior year will be distributed to the A as a first priority distribution. You further state that as a second priority, the trustees of the trust (none of whom will be C) will have discretion to pay trust income or principal to C's lineal descendants if the descendants need additional amounts. To the extent there is excessive annual cash flow in the trust, such excessive annual cash flow will also be paid or distributed to A. Upon termination of the trust, all of the trust assets will be distributed only to A.

You state that E will be irrevocable and will be a grantor trust for federal income tax purposes. It will not be recognized as a separate entity for federal income tax purposes because C will retain grantor type powers over the trust. E will be a grantor trust (at least initially) so that the trust can qualify as a permitted subchapter S corporation shareholder during C's lifetime. You state that C's intention is to structure E so that the value of any assets held in the trust will be excluded from C's gross estate for estate tax purposes. It has been represented that at no time will C or his estate take, claim, or be eligible for an income, gift, or estate tax charitable deduction for contributions of any assets to the trust.

In response to our request for further information regarding the status of these proposed transactions, you submitted letters stating, among other things, that on January 1, , C created E, which will serve as the irrevocable Trust described above. E was funded with \$. Also, you stated in your updated information that on January 1, , C also created F, which was funded with shares of D.

RULING REQUESTED:

The five-year period to dispose of amounts acquired other than by purchase provided by section 4943(c)(6)(A) of the Code shall not commence until the date that E distributes its D shares to A.

LAW:

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, educational and other designated purposes.

Section 509(a) of the Code provides that, unless specifically excepted, a domestic or foreign organization described in section 501(c)(3) is a private foundation and hence subject to the excise taxes of Chapter 42.

Section 4943(a)(1) of the Code imposes a tax on the excess business holdings of any private foundation in a business enterprise during any taxable year that ends during the taxable period. The tax is equal to 10% of the value of the excess business holdings.

Section 4946(a) of the Code provides that the term disqualified person generally includes with respect to any foundation: a substantial contributor; a foundation manager; the more than 20% owners of any entity that is a substantial contributor; a family member of any of the above; and any entity itself if any of the above individuals own more than 35% of the entity.

Section 4943(d)(1) of the Code defines business holdings and provides, among other things, that any stock or other interest owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries. Other rules apply in the case of section 4947 trusts which are not applicable here.

Section 4943(c)(1) of the Code provides that with respect to the holdings of any private foundation in any business enterprise, excess business holdings means the amount of stock or other interest in a business enterprise which the foundation, or disqualified person, would have to dispose of, to a person other than a disqualified person, in order for its remaining holdings in such enterprise to be permitted holdings.

Section 4943(c)(2)(A) of the Code generally provides that the permitted holdings of any private foundation in an incorporated business enterprise are 20% of the voting stock, reduced by the percentage of the voting stock owned actually or constructively by all disqualified persons. Furthermore, if all disqualified persons do not own more than 20% of a corporation's voting stock, the nonvoting stock held by foundation is treated as permitted holdings and not subject to the excess business holdings rules.

Section 4943(c)(6)(A) of the Code provides that, with certain exceptions not applicable here, if after May 26, 1969, 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 in 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 53.4943-1 of the Foundation and Similar Excise Tax Regulations (the regulations) generally provides that a private foundation and all disqualified persons, as defined in section 4946(a) of the Code, together cannot hold more than 20% of the voting stock in any corporation conducting a business which is not substantially related to the exempt purposes of the foundation other than through the production of income.

Section 53.4943-8(b)(1) of the regulations generally provides that an interest actually or constructively owned by a trust is deemed constructively owned by the trust remainder beneficiary.

Section 53.4943-2(a)(vi) of the regulations provides that holdings acquired other than by purchase by the foundation or a disqualified person will fail under the rules of section 4943(c)(6) and section 53.4943-6(b) of the regulations.

Section 53.4943-6(a)(2) of the regulations provides that the rule imposed by section 4943(c)(6)(A) of the Code, regarding acquisitions that are not purchases, applies in the case of an acquisition by gift, devise, bequest or intestate succession.

Section 53.4943-6(b)(1) of the regulations provides 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.

Section 53.4943-10(a)(1) of the regulations defines a business enterprise as including: (1) the active conduct of a trade or business; or (2) any activity which is regularly carried on for the production of income from the sale of goods or the performance of services and which constitutes an unrelated trade or business under section 513 of the Code. Certain exceptions are provided for some income and functionally related businesses.

ANALYSIS:

The excise tax under section 4943(a)(1) of the Code is imposed on a private foundation's excess business holdings in a business enterprise. On the date the shares of D are acquired by A as a result of distributions from E, the shares will then be treated as holdings of a private foundation in a business enterprise. As described in section 4943(c)(2)(A) of the Code, a private foundation may not own more than 20% of the voting stock of a business enterprise reduced by the percentage of the voting stock owned by all disqualified persons. Therefore, at the time the D shares are distributed to A, it is likely that A will have excess business holdings under section 4943(c)(1) of the Code.

Section 53.4943-6(b)(1) of the regulations provides that the five-year grace period prescribed by section 4943(c)(6)(A) of the Code for disposition of the excess business holdings begins on the date that such holdings were acquired by the foundation or the disqualified person. Pursuant to that provision, A's interest in the D stock, a holding acquired by gift or bequest, will be treated as held by a disqualified person (rather than by A) during the period the D shares are held by E.

Under the regulations, the five-year grace period will not begin until E actually distributes the D shares to A.

CONCLUSION:

Accordingly, based on the above and other materials provided in support of your ruling request, we rule as follows:

The five-year period to dispose of amounts acquired other than by purchase shall not commence until the date that E distributes the D shares to the A, as provided by section 4943(c)(6)(A) of the Code and section 53.4943-6(b)(1) of the regulations.

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. In particular, this ruling does not address the applications of the income, estate or gift tax to the transaction or any of the trusts described in the transaction. Specifically, no rulings are made or implied concerning whether E or F are grantor trusts and thus eligible S corporation shareholders, whether D is an S corporation, or whether E meets the requirements of § 2702. Because it could help resolve 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,

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437