

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
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Date:
September 11, 2018

Legend

Taxpayer	=
H	=
W	=
D	=
Corporation	=
State	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
a%	=
b%	=
c%	=

Dear _____ :

This letter responds to Taxpayer’s request dated March 21, 2018, seeking a ruling on whether the proposed transaction described below will satisfy the self-dealing exception of Treas. Reg. § 53.4941(d)-1(b)(3).

FACTS

Taxpayer is a non-profit organization recognized as described in § 501(c)(3) of the Internal Revenue Code and exempt from federal income tax under § 501(a).¹ Taxpayer is a private foundation described in § 509(a).

¹ All section references are to the Internal Revenue Code of 1986, as amended, unless otherwise stated.

H and W, husband and wife, respectively, created Taxpayer, whose mission includes educational, religious, scientific, and charitable purposes. H and W have been the only contributors to Taxpayer.

H's revocable trust (Trust) provides that upon H's death, Taxpayer shall receive H's Shares in Corporation (H's Shares). H's total contributions and bequests to Taxpayer exceed \$5,000 and 2% of the total contributions and bequests that Taxpayer has received.

Corporation was incorporated by H under State's laws and is an S corporation for federal tax purposes. H owned a% of Corporation's non-voting shares (which constitutes a majority of Corporation's non-voting shares) and b% of its voting shares (which constitutes less than a majority of Corporation's voting shares). W owned voting and non-voting shares of Corporation. Prior to W's death, H and W's daughter, D, owned b% of Corporation's voting shares, as well as c% of Corporation's non-voting shares. Following W's death, D received all of W's voting shares, resulting in D's owning a majority of Corporation's voting shares. D also is the CEO of Corporation.

After W's death, D terminated H's employment with Corporation. H, after his termination, together with Trust and Trust's trustee, filed a lawsuit against Corporation and D under State's laws (the Litigation) on Date 1. H alleged shareholder oppression and breach of fiduciary duties. H asked the Litigation court to enter an order requiring D and/or Corporation to buy H's Shares, or an order requiring H to purchase D's shares, among other relief possibilities.

Within three months after H initiated the Litigation, Corporation and D, pursuant to State's laws, filed a notice (the Election) under the Litigation to purchase H's Shares. H filed a motion to nullify the Election. The court denied H's nullification motion, granted Corporation's motion for summary judgment, and ruled that the Election was valid.

H died on Date 2, and Trust became irrevocable. Trust's administration is ongoing. Pursuant to Trust's terms, the trustee under pertinent laws and authority shall have the power and authority to enter into a sale or exercise of any stock rights. Because of the Litigation, Taxpayer has not received H's Shares from Trust, and during the Litigation, Trust cannot sell H's Shares to anyone other than Corporation.

The court in the Litigation, which is set for trial on Date 4, is required by state law to determine the "fair value" of H's Shares as of Date 1 or such other date the Litigation court deems appropriate. The court may determine the fair value of H's Shares to be less than the fair market value of H's Shares after marketability and control discounts are applied.

A State district court (the Probate Court), not the Litigation court, is overseeing administration of Trust. The Probate Court has the responsibility to ensure that

Taxpayer receives the full value of H's Shares and is required to approve H's Shares valuation and their sale to Corporation (the Proposed Transaction). If the Probate Court approves the Proposed Transaction, the Litigation court will honor the Probate Court's approval.

Trust is required to file on H's behalf a Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, which is due on Date 3. To enable the Litigation court to resolve the Litigation before the Form 706 is filed, Trust expects to request an extension of time within which to file the Form 706.

Taxpayer represents that before the sale of H's Shares by Trust takes place, distributions required to be made from the Trust to any beneficiary other than the Taxpayer will have been made, and Taxpayer will be the sole remaining beneficiary of the Trust.

Taxpayer represents that because of the active and on-going status of the Litigation, Trust's trustees are, and will be, unable to complete the ordinary duties of administration necessary for the settlement of the Trust prior to the date of the sale of H's Shares, and Trust should not be considered terminated for Federal income tax purposes pursuant to § 4947 and Treas. Reg. §§ 53.4947-1(b)(2)(v) prior to the date of the sale of H's Shares.

Taxpayer represents that it understands and acknowledges that the Treas. Reg. § 53.4941(d)-1(b)(3) exception to indirect self-dealing is inapplicable to the Proposed Transaction if the Probate Court (or another court having jurisdiction over Trust or over Taxpayer) does not approve the Proposed Transaction.

Taxpayer represents that it understands and acknowledges that the Treas. Reg. § 53.4941(d)-1(b)(3) exception to indirect self-dealing is inapplicable to the Proposed Transaction if the Trust does not receive an amount that equals or exceeds the fair market value of H's Shares at the time of the Proposed Transaction.

Taxpayer represents that it understands and acknowledges that regarding the Proposed Transaction, this ruling does not address what the fair market value of H's Shares is, and does not address whether any amount set by any court or paid for H's Shares will constitute at least fair market value of H's Shares at the time of transaction.

RULING REQUESTED

Taxpayer requests a ruling that Corporation's purchase of H's Shares of Corporation held by the Trust will satisfy the indirect self-dealing exception under Treas. Reg. § 53-4941(d)-1(b)(3).

LAW

Section 4941(a)(1) imposes a tax on acts of self-dealing between a disqualified person as defined in § 4946(a)(1) and a private foundation.

Section 4941(d)(1)(A) provides, in part, that the term "self-dealing" includes any direct or indirect sale or exchange, or leasing, of property between a private foundation and a disqualified person.

Treas. Reg. § 53.4941(d)-1(a) provides that for purposes of § 4941, the term "self-dealing" means any direct or indirect transaction described in Treas. Reg. § 53.4941(d)-2. For purposes of this section, it is immaterial whether the transaction results in a benefit or a detriment to the private foundation.

Treas. Reg. § 53.4941(d)-1(b)(3) provides, in part, 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 a 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 trustee of the 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 revocable trust;
- (ii) Such transaction is approved by a court having jurisdiction over the trust or over the private foundation;
- (iii) Such transaction occurs, in the case of a revocable trust, before it is considered subject to § 4947;
- (iv) The 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 trust; and
- (v) With respect to transactions occurring after April 16, 1973, 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 trust.

Section 4946(a)(1) provides that the term "disqualified person" means, in part, 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 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 § 4946(d)) of any individual described in subparagraph (A), (B), or (C), or
- (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.

Section 4946(d) provides that the term "members of family" with respect to any person who is a disqualified person includes the individual's spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren.

Treas. Reg. § 53.4947-1(b)(2)(v) provides, in part, that as to certain revocable trusts that wind up, 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). Treas. Reg. § 53.4947-1(b)(2)(iv) provides, in part, that the term "reasonable period of settlement" means 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. These duties include, for example, the collection of assets, the payment of debts, taxes, and distributions, and the determination of the rights of the subsequent beneficiaries.

Rev. Proc. 2018-3, section 3.01(80) provides that rulings will not be issued as to whether the period of administration or settlement of a trust is reasonable or unduly prolonged.

ANALYSIS

H's contributions and bequests to Taxpayer totaled more than \$5,000 and were more than 2% of Taxpayer's total bequests and contributions at close of the taxable years in which Taxpayer received the bequests and contributions from H. Therefore, H was a disqualified person as described under § 4946(a)(1)(A).

H's children are disqualified persons as to Taxpayer because their father, H, is a substantial contributor to Taxpayer. See § 4946(a)(1)(D). Corporation also is a disqualified person as to Taxpayer because H's daughter, D, owns more than 35% of Corporation's voting shares. See § 4946(a)(1)(E).

Since Corporation is a disqualified person as to Taxpayer, because of Taxpayer's expectancy of H's Shares from Trust, the proposed sale of H's Shares by Trust to Corporation pursuant to the Litigation Court's order (Proposed Transaction) could be indirect self-dealing under § 4941. See § 4941(d)(1) and Treas. Reg. § 53.4941(d)-1(a).

However, Treas. Reg. § 53.4941(d)-1(b)(3) 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 a trust that has become irrevocable on a grantor's death, regardless of when title to the property vests under local law, if specific requirements are satisfied.

First, under Treas. Reg. § 53.4941(d)-1(b)(3), a trust administrator must have the power to sell the trust's property. See Treas. Reg. § 53.4941(d)-1(b)(3)(i). Pursuant to the trust agreement that created Trust, Trust's administrator or trustee has the power to sell any Trust assets, which includes H's Shares. Thus, the Proposed Transaction will meet the first requirement of Treas. Reg. § 53.4941(d)-1(b)(3).

Second, a court with jurisdiction over the trust must approve the transaction. See Treas. Reg. § 53.4941(d)-1(b)(3)(ii). Taxpayer will seek and obtain the approval of the Proposed Transaction from the Probate Court that has jurisdiction and is overseeing administration of Trust. Thus, the Proposed Transaction will meet the second requirement of Treas. Reg. § 53.4941(d)-1(b)(3) upon the Trust's receipt of the Probate Court's approval of the proposed sale.

Third, the Proposed Transaction must occur before the trust is considered subject to section 4947. Taxpayer represents that because of the active and on-going status of the Litigation, Trust's trustees are, and will be, unable to complete the ordinary duties of administration necessary for the settlement of Trust prior to the date of the sale of H's

Shares, and Trust should not be considered subject to section 4947 pursuant to Treas. Reg. § 53.4947-1(b)(2)(iv) and (v) prior to the date of the sale of H's Shares. Before the sale of H's Shares by Trust takes place, Trust will have made distributions required to be made from the Trust to any beneficiary other than Taxpayer, and Taxpayer will be the sole remaining beneficiary of the Trust. Under Rev. Proc. 2018-3, section 3.01(80) provides that rulings will not be issued as to whether the period of administration or settlement of a trust is reasonable or unduly prolonged. Thus, if Trust is not considered terminated for Federal income tax purposes prior to the Proposed Transaction, the Proposed Transaction will meet the third requirement of Treas. Reg. § 53.4941(d)-1(b)(3).

Fourth, the trust must receive an amount that equals or exceeds the fair market value of the private foundation's interest or expectancy in such property at the time of the transaction. See Treas. Reg. § 53.4941(d)-1(b)(3)(iv). The Litigation court is tasked with valuing H's Shares. Taxpayer will endeavor to ensure that the Litigation court orders sale of H's Shares to Corporation at a price that is not less than the fair market value at the time of the Proposed Transaction. Thus, the Proposed Transaction will meet the fourth requirement of Treas. Reg. § 53.4941(d)-1(b)(3) if H's Shares are sold to Corporation at no less than their fair market value at the time of the transaction.

Fifth, the sale of the private foundation's interest or expectancy must result in the private foundation's receiving an interest as liquid as the one that was given up. See Treas. Reg. § 53.4941(d)-1(b)(3)(v). Pursuant to the trust agreement, Taxpayer currently has the expectancy of receiving H's Shares, which are illiquid. Upon the completion of the Proposed Transaction, Taxpayer will receive the money that Corporation pays Trust for H's Shares. Thus, the Proposed Transaction will meet the fifth requirement of Treas. Reg. § 53.4941(d)-1(b)(3) if Taxpayer receives the money proceeds from the Proposed Transaction.

RULING

Based solely on the facts and representations submitted by Taxpayer, as described above, we rule that Corporation's purchase of the shares of Corporation held by Trust, as described in the request for ruling, exhibits, and subsequent submissions, will satisfy the exception from indirect self-dealing under Treas. Reg. § 53-4941(d)-1(b)(3), contingent on the following:

1. The Probate Court (or another court having jurisdiction over Trust or over Taxpayer) approves the Proposed Transaction);
2. Trust is not considered subject to section 4947 pursuant Treas. Reg. § 53.4947-1(b)(2)(v) prior to the date of the sale of H's Shares by Trust;

3. Trust receives from the sale of H's Shares to Corporation an amount of cash or its equivalent that equals or exceeds the fair market value of H's Shares at the time of the transaction.

This ruling does not address what the fair market value of H's Shares is and does not address whether any amount paid for H's Shares will constitute at least fair market value.

The ruling contained in this letter is based upon information and representations submitted by or on behalf of Taxpayer and accompanied by a penalties-of-perjury statement executed by an individual with authority to bind Taxpayer 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 this ruling, it is subject to verification on examination. The Associate office 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. 2018-1, § 11.05.

No opinion is expressed concerning the federal tax consequences under any Code provision other than the provisions specifically cited above. 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. No ruling is granted as to whether Taxpayer qualifies as an organization described in section 501(c) or section 509(a). This ruling concerns only the federal private foundation excise tax treatment of the Proposed Transaction and may not be cited or relied upon by any other taxpayer.

This ruling is directed only to Taxpayer. Code § 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 Taxpayer's authorized representative.

Sincerely,

Mike Repass
Senior Technician Reviewer
Exempt Organizations Branch 3
(TEGE Associate Chief Counsel)

CC: