Internal Revenue Service

Number: **202328018**
Release Date: 7/14/2023

Index Number: 4943.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:EEE:EOET:EO1
PLR-121248-22

Date:
April 13, 2023

Legend:

Foundation =
State =
Settlor =
Corporation =
Living Trust =

Bank =
Date 1 =
Date 2 =
Date 3 =
Foundation Gift Amount =
X =
Y =
Appraiser =

Dear :

This letter ruling responds to a request dated October 7, 2022, and subsequent correspondence submitted on behalf of Foundation, 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

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

Foundation is a State trust established by Settlor. Foundation is recognized as exempt from federal income tax under section 501(a) as an organization described in section 501(c)(3) and is classified as a private foundation under section 509(a).

Corporation is a privately held corporation founded by Settlor. Until Settlor's death, 100 percent of Corporation's stock was held by Settlor as trustee of Living Trust. Foundation represents that Corporation and Living Trust are disqualified persons with respect to Foundation under section 4946(a)(1). Corporation is a holding company that has a 100 percent interest in four subsidiary companies operating in disparate industries, such as hospitality, real estate development, manufacturing, and advanced military and security technology. Corporation has three directors, two of whom are also officers of Corporation and trustees of Foundation. Foundation represents that each of Corporation's wholly owned subsidiaries is a business enterprise within the meaning of section 4943(d)(3).

Settlor made two gifts of cash to Foundation prior to his death, at which time Living Trust became irrevocable and Bank succeeded Settlor as Trustee. The terms of Living Trust provide for a gift to Foundation, upon Settlor's death, equal to one-third of Settlor's gross estate, reduced by enforceable debts, funeral expenses, and administration expenses, as finally determined for federal estate tax purposes (Foundation Gift Amount). The trustee is further directed to satisfy the Foundation Gift Amount with up to one-third of Corporation stock.

Notwithstanding that the terms of Living Trust require or at least permit that up to one-third of the Foundation Gift Amount be paid in Corporation stock, Foundation's trustees met and had calls with Bank on many occasions during which the trustees expressed their preference for receiving assets other than Corporation stock due to potential complications resulting from Foundation having excess business holdings. Living Trust did not have sufficient cash or cash equivalents to fully satisfy the Foundation Gift Amount, as its assets consisted primarily of Corporation stock. Foundation's trustees, together with Bank, also met with the directors of Corporation to review Corporation's earning history, projected cash flow, and sources of liquidity, including asset sales and financing opportunities, in connection with a future redemption of shares by Corporation from all shareholders to reduce Foundation's business holdings in Corporation to permitted holdings, that is, no more than two percent of Corporation stock.

Foundation represents that during these meetings, Bank expressed its desire to make as large a distribution as possible from Living Trust, while Corporation was concerned with overextending itself in terms of the amount of stock it would be required to redeem. Foundation's trustees offered to memorialize in writing their willingness to wait for a distribution that could be funded with assets other than Corporation stock. Bank, however, insisted that a significant distribution to Foundation was needed to substantiate a charitable deduction claimed on Settlor's federal estate tax return, Form 706, and Bank was also concerned statutory interest would continue to accrue on the Foundation Gift Amount, which might implicate its fiduciary duty to Living Trust's remainder beneficiaries. Although Bank made several significant distributions of cash from Living Trust to Foundation, which Foundation used to partially satisfy certain gifts to public charities required by its trust instrument upon Settlor's death, Bank and Corporation agreed for Living Trust to distribute 12 percent of Corporation's outstanding shares to Foundation in partial satisfaction of the Foundation Gift Amount. This distribution, valued at $X by Appraiser and reflecting discounts for both lack of control and lack of marketability, was made on Date 1.

Living Trust's $X distribution of Corporation stock to Foundation was limited to the number of shares reasonably calculated—based on Corporation's financial projections at the time—to be redeemable by Corporation within five years of the distribution. Based on its long operating history, Corporation expected to be able to begin redeeming shares by generating sufficient cash from its operations and by expected sales, financing, and refinancing of real property owned by Corporation's hospitality and real estate investment subsidiaries. Due to Foundation's prior distributions to public charities required by the trust instrument upon Settlor's death, the Corporation stock received on Date 1 represented almost 100% of the fair market value of Foundation's assets. Although Living Trust currently owns the remaining 88% of outstanding shares of Corporation, Bank has limited power as trustee to affect the operations or cash flow of Corporation without the written consent of a committee established under Living Trust.

Significant unforeseeable events have rendered Corporation unable to redeem shares within five years of the distribution to Foundation on Date 1. In 2018, Corporation's manufacturing division began to suffer unexpected losses due to tariffs imposed by the United States against Chinese goods and subsequent retaliatory tariffs imposed by China on U.S. goods. Consequently, cash flow from the manufacturing division of Corporation was significantly reduced. Subsequently, the COVID-19 pandemic and economic downturn negatively impacted all of Corporation's subsidiaries and had a particularly severe economic impact on Corporation's hospitality division, which operates hotels in major tourist destinations as well as nightlife assets. Unprecedented cancellations and vacancies constricted Corporation's cash flow. Due to the effects of these economic conditions, Corporation did not have sufficient cash reserves to make significant or consistent distributions to Living Trust and Foundation from 2018 through 2022.

Foundation represents that its best option for disposing of its excess business holdings has always been a redemption of shares by Corporation. Foundation's trustees have determined that finding a third-party buyer to purchase Foundation's Corporation stock would be difficult and that any sale would be at a price substantially below its fair market value because: (1) Foundation has a non-controlling interest in Corporation;
(2) Corporation is a holding company for subsidiaries with disparate operations;
(3) Living Trust, as Corporation's majority shareholder, cannot materially impact Corporation's financial structure without consent of a committee established under Living Trust; (4) Foundation has not received consistent or significant distributions with

respect to its interest in Corporation; and (5) the unpredictable state of the economy and Corporation's financial projections would discourage a third-party sale.

Corporation has taken steps to raise capital for a redemption of shares from all shareholders. These steps include entering into contracts to sell real estate holdings and a plan to refinance an apartment building. Corporation hopes to generate additional cash over the next several years as COVID-19 travel restrictions abate, international travel increases, and Corporation's hospitality operations improve. Corporation also anticipates the sale of a large real estate parcel to close in 2023 and is applying to refinance another property which would increase Corporation's liquidity.

Living Trust has yet to distribute the remaining $Y of the Foundation Gift Amount, and Bank intends to satisfy that outstanding balance by distributing to Foundation additional shares of Corporation, despite Foundation's repeated requests that additional shares of Corporation not be distributed and Foundation's offer to formally document its willingness to wait to receive additional distributions until other assets are available to satisfy the remaining balance of $Y. Living Trust plans to engage Appraiser to value the additional Corporation stock it anticipates distributing to Foundation in 2023.

Foundation expects to reduce its holdings in Corporation to no more than two percent of the outstanding shares of Corporation by accepting a redemption offer. Corporation is working with counsel on structuring a redemption that would meet the requirements of section 4941(d)(2)(F). Foundation anticipates that Corporation would rely on Appraiser's valuation report for any redemption that occurs in 2023. Foundation represents that new appraisals would be prepared for additional redemption offers in subsequent years to ensure that Foundation receives fair market value for those shares. Additionally, because Corporation will make each redemption offer to all shareholders (i.e., Living Trust and Foundation), it will calibrate the offers to ensure that Corporation has sufficient assets to perform if all shareholders accept the redemption offers.

Corporation plans to redeem a sufficient number of Foundation's shares between 2023 and 2027 such that Foundation will have only permitted holdings in Corporation. If Corporation is unable to purchase Foundation's excess business holdings in a manner that satisfies section 4941(d)(2)(F) before Date 3, Foundation will distribute its excess business holdings in Corporation to public charities so as not to exceed the two percent de minimis level after Date 3. Foundation represents that three public charities named as beneficiaries under Foundation's trust instrument have agreed to accept shares of Corporation in partial or complete satisfaction of amounts to which they are entitled under the trust instrument. Foundation would engage Appraiser to value the shares. There are no transfer restrictions that would prevent these distributions.

Foundation's initial five-year period for disposing of excess business holdings under section 4943(c)(6) ends on Date 2. Foundation submitted the plan for disposing of Foundation's excess business holdings to the State Attorney General.

RULING REQUEST

Foundation 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, Foundation's interest in Corporation will not be subject to the tax on excess business holdings under section 4943(a)(1).

LAW

Section 4941(d)(2)(F) provides that any transaction between a private foundation and a corporation which is a disqualified person (as defined in section 4946(a)), pursuant to any liquidation, merger, redemption, recapitalization, or other corporate adjustment, organization, or reorganization, shall not be an act of self-dealing if all of the securities of the same class as that held by the foundation are subject to the same terms and such terms provide for receipt by the foundation of no less than fair market value.

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. A private foundation shall not be treated as having excess business holdings in any corporation in which it (together with all other private foundations which are described in section 4946(a)(1)(H)) owns not more than two percent of the voting stock and not more than two percent in value of all outstanding shares of all classes of 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.

Treas. Reg. § 53.4943-10(c)(1) provides that for purposes of section 4943(d)(1), a private foundation is treated as owning a proportionate share of any interest in a business enterprise that is held by a passive holding company.

ANALYSIS

On Date 1, Foundation received a distribution of 12 percent of Corporation stock in partial satisfaction of a bequest from Living Trust. Living Trust is Corporation's only other shareholder, holding the remaining 88 percent of Corporation stock, subject to an anticipated distribution of more shares in satisfaction of the remaining $Y of Foundation Gift Amount. Corporation and Living Trust are disqualified persons with respect to Foundation under section 4946(a)(1). Foundation represents that each of Corporation's wholly owned subsidiaries is a business enterprise within the meaning of section 4943(d)(3). Accordingly, Foundation's holdings in Corporation received from Living Trust on Date 1 constitute excess business holdings in a business enterprise by reason of Corporation's holdings in each of its subsidiaries. *See* section 4943(a)(1) and Treas. Reg. § 53.4943-10(c)(1). The receipt of stock by Foundation on Date 1 was a change in the holdings in a business enterprise (other than by purchase by Foundation or by a disqualified person) and, therefore, section 4943(c)(6) provides that Foundation's interest in the business enterprise will be treated as held by a disqualified person until Date 2.

The $X distribution on Date 1 was the largest distribution Foundation ever received and, due to required distributions Foundation made to public charities, the Corporation stock held by Foundation represented nearly 100 percent of the fair market value of Foundation's assets. Corporation is a closely held business and a holding company for four subsidiary companies operating in disparate industries. Therefore, the distribution to Foundation represents an unusually large gift or bequest of diverse business holdings within the meaning of section 4943(c)(7).

Foundation's trustees met with Bank and Corporation on many occasions to ensure that Corporation would be able to redeem a sufficient amount of any stock distributed by Living Trust to Foundation such that Foundation would have permitted holdings within five years of a distribution. *See* section 4943(c)(2). Foundation's trustees also offered to memorialize in writing their willingness to wait for a distribution that could be funded with assets other than Corporation stock. However, the unforeseeable impact of the COVID-19 pandemic and other economic conditions have prevented Corporation from being able to redeem stock prior to Date 2. Because of Corporation's diverse business holdings, with four distinct subsidiaries operating in entirely different sectors and in different countries, the lack of consistent dividends it paid to shareholders, and the economic conditions during the five-year period, Foundation determined that selling its shares of Corporation, the value of which constitutes nearly all of Foundation's total assets, to a third-party buyer was not possible except at a price substantially below its fair market value. Despite diligent efforts during the initial five-year period to dispose of Foundation's excess business holdings, disposition of those excess business holdings was not possible within 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, Foundation submitted its request seeking an additional five-year period within which to dispose of its excess business holdings in Corporation. Foundation also submitted its plan for disposing of the excess business holdings during the requested extension period. Foundation expects to receive and intends to accept an offer of share redemption by Corporation that satisfies the requirements of section 4941(d)(2)(F) so that the transaction is not an act of self-dealing. If such a redemption of Foundation's shares is not possible within the extension period, Foundation will distribute its excess business holdings in Corporation to public charities that are named beneficiaries under Living Trust. Foundation has confirmed those organizations are willing to accept Corporation stock in partial or complete satisfaction of amounts owed to them under Foundation's trust instrument. Foundation also represents that there are no transfer or other restrictions that would prevent these distributions. Foundation submitted its plan to the State Attorney General. *See* section 4943(c)(7)(B).

We have determined that Foundation's plan to dispose of its excess business holdings in Corporation 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 submitted by Foundation, we have determined that Foundation meets the requirements under section 4943(c)(7) for an extension of an additional five years to dispose of excess business holdings in Corporation received on Date 1. Consequently, Foundation's excess business holdings in Corporation will not be subject to tax under section 4943(a)(1) if Foundation 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 Foundation and accompanied by penalty of perjury statements executed by individuals with authority to bind Foundation 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. 2023-1, 2023-1 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 the existence or acts of self-dealing by disqualified persons with respect to Foundation, nor is any opinion expressed regarding Foundation'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 Foundation'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: