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

Date: AUG 6 - 1999

Contact Person:

OP: E: ED: T: 2

ID Number:

Telephone Number:

Employer Identification Number:

ULL Nos.
4941.04-00
4942.03-003
4942.03-04
4943.03-03
4947.02-00

LEGEND

- A =
- M =
- X =
- Y =

Dear Applicant:

This letter responds to X's request dated July 14, 1999 for rulings regarding the consequences under sections 4941 and 4942 of the Internal Revenue Code of X's release of assets from a segregated account into its general funds.

X is a private foundation described in sections 501(c)(3) and 509(a) of the Code. Several decades ago, A, an individual, transferred to X a number of shares of stock in Y, a business corporation. A reserved certain rights to receive income from the shares for certain periods. The enactment of section 4943 in 1969 required X to dispose of its holdings in Y. To facilitate the disposal, X and A made an Agreement to exchange certain interests in the shares so that each would have fee interests in whole shares. About the same time, some of the Y shares in which both X and A held an interest were sold to the public, and the proceeds were placed in escrow. The Agreement was cleared by the Service, but the State Attorney General objected on the ground that X's interests were undervalued in the Agreement. A Settlement Agreement was reached with the Attorney General which called for a certain division of the escrowed funds and shares between X and A, with all funds and assets subject to satisfaction of certain tax liabilities of A.

X received a letter ruling in 1977 (clarified by two subsequent rulings the same year) from the Service which reasoned that the original transfers of shares from A to X created a trust of which X was trustee and X and A the beneficiaries, and that the Settlement Agreement changed the trustee's duties but did not terminate the trust. The rulings held that the trust was a split-interest trust described in section 4947(a)(2)(C) of the Code, and therefore no chapter 42 provisions applied to the trust; that to the extent that X acted as trustee in accepting the distribution under the Settlement Agreement, the amounts received by X would not need to be taken into account in computing X's adjusted net income under section 4942; that so long as the escrowed funds received by X under the Settlement Agreement remained segregated and held in trust, use of such funds for the litigation, settlement, or payment of A's tax liabilities would not constitute self-dealing under section 4941; that the stock received by X as trustee would not be considered as owned by

309

X until actually received by X for its own account and benefit or until the trust ceased to be described in section 4947(a)(2) (without regard to section 4947(a)(2)(C)); and that upon satisfaction of the trust's obligations under the Settlement Agreement, the release of remaining assets to X for X's own account and benefit would not constitute a "purchase" under section 4943(c)(6) of the assets by X or otherwise alter the rulings.

Under the Settlement Agreement, X has maintained a separate account, referred to as the "Safekeeping Account," which could be invaded for the payment of additional tax liabilities, if any, imposed on A and arising out of the Settlement Agreement. X has complied with the Settlement Agreement. X has taken into account the value of the Safekeeping Account in its calculation of its annual distributable amount under section 4942 of the Code.

After A's death in 1979, a State inheritance tax controversy developed, which was fully resolved in 1997. The statute of limitations has expired with respect to any income tax liability arising out of the Settlement Agreement and associated transactions, and there are no claims against the Safekeeping Account other than X's. X proposes to terminate the Safekeeping Account, which has outlived its purpose, and deposit the assets in the funds of X for X's own account and benefit. A's representative has confirmed facts warranting the transaction, and the M Attorney General consents to it.

X requests the following rulings:

1. Merger of the assets from the Safekeeping Account with the general assets of X will not alter the Service's prior rulings issued to X referenced above.
2. Merger of the assets from the Safekeeping Account with the general assets of X will not constitute an act of self-dealing within the meaning of section 4941, and will not subject X or its officers or trustees to section 4941 taxes.
3. The release of assets from the Safekeeping Account into the general assets of X, for X's own account and benefit, will not affect X's calculation of its distributable amount under section 4942, and therefore will not subject X to an increase in its distributable amount, or otherwise to an excise tax for failure to distribute income.

Section 4941(a) of the Code imposes an excise tax on each act of self-dealing-between a private foundation and a disqualified person.

Section 4941(d) of the Code defines "self-dealing" as a 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;
- (C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;

(D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;

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

(F) agreement by a private foundation to make any payment of money or other property to a government official (as defined in section 4946(c)), other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating his government service within a 90-day period.

Section 4942(a) of the Code imposes an excise tax on a private foundation's undistributed income which has not been timely distributed.

Section 4942(c) of the Code defines a foundation's undistributed income as its distributable amount less qualifying distributions.

Section 4942(d) of the Code defines a foundation's distributable amount as its minimum investment return, plus amounts described in section 4942(f)(2)(C) (representing recapture of amounts previously claimed as qualifying distributions), less certain taxes.

Section 4942(f) of the Code defines adjusted net income, for purposes of section 4942(j).

Section 4943 of the Code imposes an excise tax on the excess business holdings of a private foundation.

Each of the requested rulings is discussed in turn below.

1. The Service's rulings in 1977 contemplated that the split-interest trust would eventually be terminated, and that the proceeds of the trust would be transferred to X for X's own account and benefit. X may continue to rely on these rulings as having full force and effect. Of course, once the proposed transfer takes place, the proceeds will be treated like any other assets of X, subject to the usual rules under chapter 42 of the Code.

2. The liquidating transfer of the trust assets into the general assets of X is a mere contribution to X of funds and investment assets not subject to any mortgage or similar lien. The transaction is undertaken pursuant to the terms of the trust and not for the benefit of any disqualified person.

3. Because X is not an operating foundation under section 4942(j)(3) of the Code, X's adjusted net income under section 4942(f) is not relevant to determining its distributable amount or its liability under section 4942. Since X already takes into account the value of the Safekeeping Account in calculating X's annual distributable amount, the transfer of assets from the Safekeeping Account to X's general account will not affect the calculations.

Accordingly, we rule as follows:

1. Merger of the assets from the Safekeeping Account with the general assets of X will not alter the Service's prior rulings to X referenced above.
2. Merger of the assets from the Safekeeping Account with the general assets of X will not constitute an act of self-dealing within the meaning of section 4941, and will not subject X or its officers or trustees to section 4941 taxes.
3. The release of assets from the Safekeeping Account into the general assets of X, for X's own account and benefit, will not affect X's calculation of its distributable amount under section 4942, and therefore will not subject X to an increase in its distributable amount, or otherwise to an excise tax for failure to distribute income.

Except as we have ruled above, we express no opinion as to the tax consequences of the grant under the cited provisions of the Code or under any other provisions of the Code.

This ruling is directed only to X. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Because this letter could help resolve any future tax questions relating to X's activities, X should a copy of this ruling in its permanent records.

We are providing the [redacted] Key District Director a copy of this ruling.

Sincerely yours,

(signed) ~~Garland A. Carter~~

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2