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

200117042

Date: JAN 30 2001

Contact Person:

Identification Number:

Telephone Number:

T:EO:B2

Employer Identification Number:

LEGEND:	UIL Nos.
A =	501.03-02
B =	507.01-00
C =	507.05.00
D =	4940.00-00
E =	4941.04-00
t =	4943.03-00
u =	4944.03-00
V =	4945.04-00
W =	
X =	
Y =	
Z =	

Dear Applicant:

This letter responds to X's request dated August 8, 2000 for rulings pertaining to proposed transactions involving the administration of an estate, reorganization of a private foundation, and settlement payments to a disqualified person from a corporation in which a private foundation has an interest.

FACTS:

X, a private foundation ("X Foundation"), is described in sections 501(c)(3) and 509(a) of the Code. A, a substantial contributor to X Foundation, died several years ago. A's survivors include A's children, B and C. X Foundation's four trustees are B, C, a retired Vice President of W Corporation, and a first cousin of B and C.

B and C are the Executors of A's estate ("the Estate"). A's Will gives the executors power to sell any property on such terms as they deem proper, and to exchange any securities or property for other securities or property.

232

The Estate owns most of the stock of W Corporation. W Corporation has two classes of stock, identical in all respects except one class is voting and the other not. B and C equally own all of the voting stock, which comprises about a quarter of all stock. The Estate owns nearly all of the nonvoting stock--under A's Will, X Foundation has an expectancy interest in nearly all of such nonvoting stock held by the Estate, and B has an expectancy interest in the remainder of the stock held by the Estate. The remainder of the nonvoting stock is held by C and trusts for the benefit of B, C, and their children. The Estate has elected under section 6166 of the Code to pay estate tax for the next nine years on an installment basis.

W Corporation has a variety of holdings in other companies engaged in the D business. W Corporation also wholly owns a subsidiary corporation that wholly owns another subsidiary corporation (V corporation). V Corporation holds a majority interest in a partnership that owns and operates a E business.

Things have not gone smoothly between B and C, due largely to differing business philosophies and management styles, resulting in litigation between them. The litigation involves B's right to manage the E business, B's dealings with a potential developer of property near a proposed new facility for the E business, and debts owed between the parties.

In partial settlement of their differences, B and C have entered into an agreement to engage in a series of transactions, contingent on favorable IRS rulings, in order to (1) place control of the D business of W Corporation in the hands of B and B's family, (2) divest B and B's family of any interest in the E business, (3) place control of the E business in the hands of C and C's family, (4) divest C and C's family of any interest in the D business, and (5) leave undisturbed the economic interest of X Foundation in the D and E businesses of W Corporation and V Corporation. The transactions involve W Corporation's split-off of ownership of V Corporation ("the Split-off") to certain W Corporation shareholders, intended as a nontaxable distribution to the shareholders under section 355 of the Code. The Estate has obtained the probate court's approval of the Estate's participation in the proposed transaction.

To accomplish the objective, W Corporation will undertake a series of transactions to redistribute value, place ownership of its subsidiaries' active E businesses directly in its hands, and otherwise facilitate the Split-off. V Corporation will be recapitalized so that its outstanding stock is identical to the stock of W Corporation in classes, terms and provisions. The number of shares of each class of V Corporation stock will be equal to one-half the number of shares of each corresponding class of W Corporation stock. W Corporation will then distribute all of the voting and nonvoting stock of V Corporation to certain W Corporation shareholders in redemption of half of the W Corporation stock, as follows:

(1) C and the trusts for the benefit of C's children will exchange all of their shares in W Corporation for same number and types of shares in V Corporation;
(2) The Estate will exchange half of its shares in W Corporation for the same number and class of shares in V Corporation;
(3) Each of the trusts for the benefit of B's children will exchange a certain number of shares of nonvoting stock in W Corporation for an equal number of shares of nonvoting

stock in V Corporation.

Each of the trusts for the benefit of B's children will then immediately contribute the shares of nonvoting stock in V Corporation received to Z Foundation (discussed below). The trusts and B's children will execute enforceable pledge agreements obligating them to make these transfers before the Split-off occurs.

As part of the settlement of the litigation, the parties to the litigation (B, C, W Corporation, V Corporation, and several other related entities), through protracted negotiations, have also entered into an agreement that provides for certain payments between the parties in settlement of their claims. For B's release of claims and agreement to dismiss the litigation with prejudice, C will cause a portion of the interests of C and C's family under A's will to be paid, through V Corporation, to B or B's designee. Also, V Corporation will make a payment to B or B's designee of u dollars on a fixed date in a few years. If the E business is sold for more (or less) than t dollars before the fixed date, then the payment to B will be adjusted upward (or downward) by half of the difference between the sale price and t dollars. However, there are tax and economic disincentives that make the sale of E business before the fixed date quite unlikely. The payment to B is expected to be a substantial but minor portion of the estimated value of the E business. The parties secured an independent appraisal firm to evaluate the fairness of the payment to W Corporation and V Corporation--the firm concluded that the settlement is fair to the corporations (i.e., that they are not transferring value to B in excess of the value of B's claims against them).

After the Estate completes its asset transfer to X Foundation, X Foundation plans to transfer its assets to two new foundations recently recognized as exempt under section 501(c)(3) of the Code (Y Foundation and Z Foundation) and dissolve. The purpose of this transaction is to limit further discord between B and C and thus better achieve the Foundation's exempt goals. B appoints the board of Y Foundation, and C appoints the board of Z Foundation. X Foundation will evenly distribute 100% of the value of its assets to each foundation--the interest in W Corporation will go to Y Foundation, and the interest in V Corporation will go to Z Foundation. Thereafter, X Foundation will notify the Service that it is terminating its private foundation status under section 507(a)(1). The taxpayer represents that X Foundation has no grants outstanding that require the exercise of expenditure responsibility under section 4945(h); that X Foundation has not committed willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) giving rise to liability under chapter 42; and the proposed transfers will not involve excess business holdings under section 4943 or jeopardizing investments under section 4944.

RULINGS REQUESTED:

X requests the following rulings:

1. The Estate's participation in the Split-off will not constitute an indirect act of self-dealing and will not result in the imposition of tax under section 4941(a) of the Code on any disqualified person with respect to X Foundation or Foundation manager because the transaction satisfies the requirements of section 53.4941(d)-1(b)(3) of the regulations.

2(a). The proposed transfers by X Foundation to Y Foundation and Z Foundation will not result in a termination of X Foundation's private foundation status under section 507(a) of the Code and will not cause the imposition of the termination tax described in section 507(c).

2(b). If, after the transfer of all of its assets to the Y Foundation and Z Foundation, X Foundation properly notifies the Service of its intent to terminate private foundation status, then such notice will be effective to terminate the private foundation status of X Foundation under section 507(a)(1) of the Code.

2(c). If, after the transfer of all of its assets to Y Foundation and Z Foundation, X Foundation properly notifies the Service of its intent to terminate its private foundation status, and if the value of X Foundation's net assets at the time it gives the notice and terminates its private foundation status is zero, then X Foundation will not be liable for any termination tax under section 507(c) of the Code.

2(d). The proposed transfer from X Foundation to Y Foundation and Z Foundation will not adversely affect the tax exempt status of X Foundation, Y Foundation, or Z Foundation.

2(e). Y Foundation and Z Foundation will succeed to the aggregate tax benefit of X Foundation in proportion to the value of the assets transferred by X Foundation to Y Foundation and Z Foundation.

2(f). For purposes of the chapter 42 private foundation excise tax provisions and section 507 through 509 of the Code, Y Foundation will be treated as if it is X Foundation, but only in the proportion which the net fair market value of the assets it receives from X Foundation bears to the net fair market value of all X Foundation's assets immediately before the transfer. Since Y Foundation will receive 50% of all of X Foundation's assets, Y Foundation will succeed to 50% of X Foundation's tax attributes under chapter 42 and sections 507 through 509, including the following:

(1) For purposes of section 4940, 50% of the net investment income of X Foundation for the taxable year of the transfer to Y Foundation will be apportioned to Y Foundation and will be includible in the computation of the net investment income of Y Foundation in the taxable year of the transfer.

(2) The transfer to Y Foundation will not be an event giving rise to net investment income. Therefore, such transfer itself will not give rise to tax under section 4940.

(3) Y Foundation will be responsible for satisfying 50% of X Foundation's distribution requirement under section 4942 to the extent that such distribution requirements are not satisfied by X Foundation.

2(g). For purposes of the chapter 42 private foundation excise tax provisions and section 507 through 509 of the Code, Z Foundation will be treated as if it is X Foundation, but only in the proportion which the net fair market value of the assets it receives from X Foundation bears to the net fair market value of all X Foundation's assets immediately before the transfer. Since Z

Foundation will receive 50% of all of X Foundation's assets, Z Foundation will succeed to 50% of X Foundation's tax attributes under chapter 42 and sections 507 through 509, including the following:

(1) For purposes of section 4940, 50% of the net investment income of X Foundation for the taxable year of the transfer to Z Foundation will be apportioned to Z Foundation and will be includible in the computation of the net investment income of Z Foundation in the taxable year of the transfer.

(2) The transfer to Z Foundation will not be an event giving rise to net investment income. Therefore, such transfer itself will not give rise to tax under section 4940.

(3) Z Foundation will be responsible for satisfying 50% of X Foundation's distribution requirement under section 4942 to the extent that such distribution requirements are not satisfied by X Foundation.

2(h). The transfers by X Foundation to Y Foundation and Z Foundation will not result in any liability for tax under section 4940 of the Code since the transfers will not constitute a "sale or other disposition of property or other realizable event" within the meaning of section 4940.

2(i). The transfers by X Foundation to Y Foundation and Z Foundation will not constitute self-dealing under section 4941 of the Code because for purposes of section 4941 the term "disqualified person" does not include an organization described in section 501(c)(3) other than an organization described in section 509(a)(4). Consequently, such transfer will not subject X Foundation, Y Foundation, or Z Foundation to tax under section 4941.

2(j). Once shares of W Corporation are distributed outright by the Estate to Y Foundation, they will be treated as held by a disqualified person under section 4943(c)(6) of the Code for 5 years from the date of such distribution.

2(k). Once shares of V Corporation are distributed outright by the Estate to Z Foundation, they will be treated as held by a disqualified person under section 4943(c)(6) of the Code for 5 years from the date of such distribution.

2(l). Y Foundation will not be subject to tax under section 4943 of the Code on the shares distributed from X Foundation until 5 years from the date it receives such stock from the Estate.

2(m). Z Foundation will not be subject to tax under section 4943 of the Code on the shares distributed from X Foundation until 5 years from the date it receives such stock from the Estate.

2(n). The transfers by X Foundation to Y Foundation and Z Foundation will not constitute a jeopardizing investment within the meaning of section 4944 of the Code.

2(o). The transfers by X Foundation to Y Foundation and Z Foundation will not constitute a taxable expenditure within the meaning of section 4945 of the Code, and X Foundation will not

be required to exercise expenditure responsibility (as the term is defined in section 4945(h)) with respect to the transferred assets.

3. The payments made by V Corporation to B or B's designee will not constitute indirect acts of self-dealing because neither W Corporation nor V Corporation is controlled by a private foundation under section 53.4941(d)-1(b)(5) of the regulations. Therefore, the payments will not result in the imposition of tax under section 4941.

LAW:

Section 507(a) of the Code provides that except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if--

> (1) such organization notifies the Secretary of its intent to accomplish such termination (at such time and in such manner as the Secretary may by regulations prescribe), or
>
> (2) (A) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter 42, and
> (B) the Secretary notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c),

and either such organization pays the tax imposed by subsection (c) (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

Section 507(b)(2) of the Code provides that in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

Section 507(c) of the Code imposes a tax on each organization for which private foundation status is terminated under section 507(a), limited to the value of the net assets of such foundation.

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

Section 4941(d)(1) of the Code defines self-dealing as including any 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.

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

Section 4942 of the Code imposes an excise tax on a private foundation's undistributed income for any taxable year.

Section 4943(a)(1) of the Code imposes an excise tax on a private foundation's excess business holdings in a business enterprise during any tax year.

Section 4943(c)(6) of the Code 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--

(A) 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 5-year period beginning on the date of such change in holdings; or

(B) an increase in excess business holdings in such enterprise (determined without regard to subparagraph (A)), subparagraph (A) shall apply, except that the excess holdings immediately preceding the increase therein shall not be treated, solely because of such increase, as held by a disqualified person (rather than by the foundation).

Section 4944(a)(1) of the Code imposes an excise tax on a private foundation's making of an investment in such a manner as to jeopardize the carrying out of any of its exempt purposes.

Section 4944(c) of the Code provides that investments, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes.

Section 4945 of the Code imposes an excise tax on each taxable expenditure by a

private foundation.

Section 4945(d) of the Code defines a "taxable expenditure" as including an amount paid or incurred by a private foundation--

(4) as a grant to an organization unless--

(A) such organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation (as defined in section 4940(d)(2)), or

(B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h), or

(5) for any purpose other than one specified in section 170(c)(2)(B).

Section 4946(a)(1) of the Code provides that a "disqualified person," with respect to a private foundation, includes

(A) a substantial contributor (including a creator of a trust)
(B) a foundation manager
(C) an owner of more than 20% of a corporate, partnership, or trust substantial contributor
(D) a family member (including a child or grandchild) of an individual described above
(E) a corporation of which persons described above own more than 35% of the total combined voting power
(F) a partnership in which persons described in (A)-(D) own more than 35% of the profits interest
(G) a trust or estate in which persons described in (A)-(D) hold more than 35% of the beneficial interest
(H) only for purposes of section 4943, a private foundation—
(i) which is effectively controlled (directly or indirectly) by the same person or persons who control the private foundation in question, or
(ii) substantially all of the contributions to which were made (directly or indirectly) by the same person or persons described in section 4946(a)(1)(A), (B), or (C), or members of their families (within the meaning of section 4946(d)), who made (directly or indirectly) substantially all of the contributions to the private foundation in question

Section 1.507-1(b)(6) of the Income Tax Regulations provides that if a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in section 507(b)(2) of the Code and section 1.507-3(c) of the regulations, such transferor foundation will not have terminated its private foundation status under section 507(a)(1) of the Code.

Section 1.507-1(b)(7) of the regulations provides that neither a transfer of all of the assets of a private foundation nor a significant disposition of assets by a private foundation shall

be deemed to result in a termination of the transferor private foundation under section 507(a) unless the transferor private foundation elects to terminate pursuant to section 507(a)(1) or section 507(a)(2) is applicable.

Section 1.507-1(b)(9) of the regulations provides that a private foundation which transfers all of its net assets is required to file the annual information return required by section 6033 of the Code, and the foundation managers are required to file the annual report of a private foundation required by section 6056, for the taxable year in which such transfer occurs. However, neither such foundation nor its foundation managers will be required to file such returns for any taxable year following the taxable year in which the last of any such transfers occurred, if at no time during the subsequent taxable years in question the foundation has either legal or equitable title to any assets or engages in any activity.

Section 1.507-3(a)(1) of the regulations provides that in the case of a significant disposition of assets to one or more private foundations within the meaning of section 1.507-3(c), the transferee organization shall not be treated as a newly created organization, but as possessing those attributes and characteristics of the transferor organization which are described in section 1.507-3(a)(2), (3), and (4).

Section 1.507-3(a)(2)(i) of the regulations provides that a transferee organization shall succeed to the aggregate tax benefit of the transferor organization in an amount determined as follows: Such amount shall be an amount equal to the amount of such aggregate tax benefit multiplied by a fraction the numerator of which is the fair market value of the assets (less encumbrances) transferred to such transferee and the denominator of which is the fair market value of the assets of the transferor (less encumbrances) immediately before the transfer. Fair market value shall be determined as of the time of the transfer.

Section 1.507-3(a)(7) of the regulations provides that where the transferor has disposed of all of its assets, during any period in which the transferor has no assets, section 4945(d)(4) and (h) of the Code shall not apply to the transferee or the transferor with respect to any "expenditure responsibility" grants made by the transferor, except for information reporting requirements for the year in which made.

Section 1.507-3(a)(9)(i) of the regulations provides that if a private foundation transfers all of its assets to one or more private foundations which are effectively controlled (within the meaning of section 1.482-1(a)(3) of the regulations), directly or indirectly, by the same person or persons which effectively controlled the transferor private foundation, then for purposes of chapter 42 (section 4940 et seq.) and part II of subchapter F of chapter 1 of the Code (sections 507 through 509) such a transferee private foundation shall be treated as if it were the transferor (with certain exceptions in section 1.507-3(a)(9)(ii) of the regulations). However, where proportionality is appropriate, such a transferee private foundation shall be treated as if it were the transferor in the proportion which the fair market value of the assets (less encumbrances) transferred to such transferee bears to the fair market value of the assets (less encumbrances) of the transferor immediately before the transfer.

In Example (2) of section 1.507-3(a)(9)(iii) of the regulations, A and B are the trustees of

the P charitable trust, a private foundation, and are the only substantial contributors to P. On July 1, 1973, in order to facilitate accomplishment of diverse charitable purposes, A and B create and control the R Foundation, the S Foundation and the T Foundation and transfer the net assets of P to R, S, and T. As of the end of 1973, P has an outstanding grant to Foundation W and has been required to exercise expenditure responsibility with respect to this grant under sections 4945(d)(4) and (h). Under these circumstances, R, S, and T shall each be treated as if they are P in the proportion the fair market value of the assets transferred to each bears to the fair market value of the assets of P immediately before the transfer. Since R, S, and T are treated as P, absent a specific provision for exercising expenditure responsibility with respect to the grant to W, each of them is required to exercise expenditure responsibility with respect to such grant. If, as a part of the transfer to R, P assigned, and R assumed, P's duties with respect to the expenditure responsibility grant to W, only R would be required to exercise expenditure responsibility with respect to the grant to W. Since R, S, and T are treated as P rather than as recipients of "expenditure responsibility" grants, there are no expenditure responsibility requirements which must be exercised under sections 4945(d)(4) and (h) with respect to the transfers of assets to R, S, and T.

Section 1.507-3(c)(1) of the regulations provides that for purposes of section 507(b)(2) of the Code, the terms "other adjustment, organization, or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Section 1.507-3(d) of the regulations provides that unless a private foundation voluntarily gives notice pursuant to section 507(a)(1) of the Code, a transfer of assets described in section 507(b)(2) of the Code will not constitute a termination of the transferor's private foundation status under section 507(a)(1) of the Code. Such transfer must, nevertheless, satisfy the requirements of any pertinent provisions of chapter 42.

Section 1.641(b)-3(a) of the Income Tax Regulations provides that the period of administration of an estate is the period actually required to perform the ordinary duties of administration, and that this period cannot be unduly prolonged.

Section 53.4941(d)-1(b)(3) of the regulations provides that "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 an estate (or 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 administrator or executor of an estate or trustee of a 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 estate (or revocable trust);

(ii) Such transaction is approved by the probate court having jurisdiction over the estate (or by another court having jurisdiction over the estate (or trust) or over the private foundation);

(iii) Such transaction occurs before the estate is considered terminated for federal income tax purposes pursuant to section 1.641(b)-3(a) (or in the case of a revocable trust, before it is considered subject to section 4947 of the Code);

(iv) The estate (or 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 estate (or 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 estate (or trust).

Section 53.4941(d)-1(b)(5) of the regulations provides that, for purposes of indirect self-dealing, an organization is controlled by a private foundation if the foundation or one or more of its foundation managers (acting only in such capacity) may, only by aggregating their votes or positions of authority, require the organization to engage in a transaction which if engaged in with the private foundation would constitute self-dealing. Similarly, an organization is controlled by a private foundation in the case of such a transaction between the organization and a disqualified person, if such disqualified person, together with one or more persons who are disqualified persons by reason of such a person's relationship (within the meaning of section 4946(a)(1)(C) through (G)) to such disqualified person, may, only by aggregating their votes or positions of authority with that of the foundation, require the organization to engage in such a transaction. An organization will be considered to be controlled by a private foundation or by a private foundation and disqualified persons referred to in the second sentence of this subparagraph if such persons are able, in fact, to control the organization (even if their aggregate voting power is less than 50% of the total voting power of the organization's governing body) or if one or more of such persons has the right to exercise veto power over the actions of such organization relevant to any potential acts of self-dealing.

200117042

Section 53.4941(d)-1(b)(6) of the regulations provides that the term "indirect self-dealing" shall not include certain retail business transactions involving limited amounts between a disqualified person and an organization controlled by a private foundation (within the meaning of subparagraph (5) of this paragraph) or between two disqualified persons where the foundation's assets may be affected.

In section 53.4941(d)-1(b)(8), Example (6) of the regulations, private foundation P owns 20% of the voting stock of corporation W. A, a substantial contributor with respect to P, owns 16% of the voting stock of corporation W. B, A's son, owns 15% of the voting stock of corporation W. The terms of the voting stock are such that P, A, and B could vote their stock in a block to elect a majority of the board of directors of W. W is treated as controlled by P (within the meaning of subparagraph (5) of this paragraph) for purposes of this example A and B also own 50% of the stock of corporation Y, making Y a disqualified person with respect to P under section 4946(a)(1)(E) of the Code. W makes a loan to Y of $1 million. The making of this loan by W to Y shall constitute an indirect act of self-dealing between P and Y.

Section 53.4941(d)-2(f)(2) of the regulations provides that the fact that a disqualified person receives an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing. For example, a grant by a private foundation to a section 509(a)(1), (2), or (3) organization will not be an act of self-dealing merely because one of the section 509(a)(1), (2), or (3) organization's officers, directors, or trustees is also a manager of the foundation.

Section 53.4943-5(b)(1) of the regulations provides that the date of distribution shall be deemed to occur no later than the date on which the trust or estate is considered to be terminated under section 1.641(b)-3.

In Example (1) of section 53.4943-6(a)(3) of the regulations, on January 4, 1985, A, an individual, makes a contribution to F, a private foundation, of 200 shares of X Corporation common stock. Assume that F had no X stock before January 4, 1985, and under section 4943(c)(1) the receipt of the X stock by F would cause some or all of the 200 shares of the X stock to be classified as excess business holdings. Under the provisions of section 4943(c)(6)(A) and this paragraph (a), since the contribution of the X stock to F is a gift and not a purchase, the X stock in F's hands is treated as held by disqualified persons and not by F through January 3, 1990.

Example (2) of section 53.4943-6(a)(3) of the regulations assumes the facts as stated in Example (1) except that F receives the X stock as a bequest pursuant to the terms of A's will executed on April 1, 1980. A dies on June 3, 1984, and the stock is distributed to F on February 16, 1985. As in Example (1), the bequest of X to F is not a purchase under this paragraph (a). Consequently, the X stock in F's hands is treated as held by disqualified persons and not by F through February 15, 1990.

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) of the Code and section 53.4943-6 of the

regulations shall not commence until the date on which the distribution of such holdings from the estate or trust to the foundation occurs. See section 53.4943-5(b)(1) for rules relating to the determination of the date of distribution under the terms of a will or trust. For purposes of this subparagraph, holdings in a business enterprise will not be treated as acquired by a private foundation pursuant to the terms of a will where the holdings in the business enterprise were not held by the decedent. Thus, in the case of after-acquired property, section 53.4943-6(b)(1) shall not apply, the five-year period described in section 4943(c)(6) of the Code and section 53.4943-6 of the regulations shall commence on the date of acquisition of such holdings by the estate, and such five-year period may expire prior to the date of distribution of such holdings from the estate. To the extent that an interest to which section 4943(c)(6) of the Code and section 53.4943-6(b)(1) of the regulations apply is constructively held by a private foundation under section 4943(d)(1) of the Code and section 53.4943-8 of the regulations prior to the date of distribution, it shall be treated as held by a disqualified person prior to such date by reason of section 4943(c)(6) of the Code. See section 53.4943-8 of the regulations for rules relating to constructive holdings held in an estate or trust for the benefit of the foundation.

Section 53.4943-6(c)(1) of the regulations provides that section 4943(c)(6) of the Code shall not apply to any transfer of holdings in a business enterprise by one private foundation to a related private foundation under section 4946(a)(1)(H).

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

Section 53.4944-3(a)(1) of the regulations defines a "program-related investment" as an investment which possesses the following characteristics:

(i) The primary purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(B) of the Code;

(ii) No significant purpose of the investment is the production of income or the appreciation of property; and

(iii) No purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(D).

Section 53.4945-6(c)(1)(i) of the regulations provides that since a private foundation cannot make an expenditure for a purpose other than a purpose described in section 170(c)(2)(B) of the Code, a private foundation may not make a grant to an organization other than an organization described in section 501(c)(3) unless

(i) The making of the grant itself constitutes a direct charitable act or the making of a program-related investment, or

(ii) Through compliance with the requirements of section 53.4945-6(c)(2) of the regulations, the grantor is reasonably assured that the grant will be used exclusively for purposes described in section 170(c)(2)(B) of the Code.

Section 53.4945-6(c)(3) of the regulations generally provides that if a private foundation makes a section 507(b)(2) transfer of assets to any person, the transferred assets will not be considered used exclusively for purposes described in section 170(c)(2)(B) of the Code unless the assets are transferred to a fund or organization described in section 501(c)(3).

Section 53.4946-1(a)(8) of the regulations provides that, for purposes of section 4941 of the Code only, the term "disqualified person" shall not include an organization which is described in section 501(c)(3) (other than an organization described in section 509(a)(4)).

Rev. Rul. 76-23, 1976-1 C.B. 264, reasoned that where the sole purpose for retaining stock in a closely held business is to facilitate the payment of estate tax under section 6166 of the Code, the administration of the estate will not be considered unreasonably prolonged.

Rev. Rul. 76-158, 1976-1 C.B. 354, held that a private foundation that owns 35% of the voting stock of a corporation, and whose foundation manager personally owns the remaining 65% but does not hold a position of authority in the corporation by virtue of being foundation manager, does not control the corporation for purposes of the self-dealing provisions of section 4941 of the Code. The Service noted that an example of an act of indirect self-dealing would be a transaction of the type described in section 4941(d)(1) between a disqualified person with respect to a private foundation and a corporation controlled by the private foundation within the meaning of section 53.4941(d)-1(b)(5) of the regulations.

Rev. Proc. 2000-3, 2000-1 I.R.B. 103, section 3.01(32) provides that the Service will not rule whether the period of administration or settlement of a trust (other than a trust described in section 664) is reasonable or unduly prolonged. Section 4.02(1) provides that the Service ordinarily will not rule on matters in which the determination requested is primarily one of fact, e.g., whether an interest in a corporation is to be treated as stock or indebtedness.

RATIONALE:

Each of the requested rulings is discussed in turn below.

1. The Estate's participation in the Split-off will not constitute an indirect act of self-dealing and will not result in the imposition of tax under section 4941(a) of the Code on any disqualified person with respect to X Foundation or Foundation manager because the transaction satisfies the requirements of section 53.4941(d)-1(b)(3) of the regulations.

W Corporation is a disqualified person with respect to X Foundation because disqualified persons, B and C, own more than 35% of its voting stock. Without an exception to the self-dealing rules, the exchange of shares between the Estate and W Corporation would be an indirect exchange of property between X Foundation (which has an expectancy interest in the Estate's assets) and a disqualified person.

Under the facts presented, the proposed transaction will satisfy the "estate administration" exception to self-dealing under section 53.4941(d)-1(b)(3) of the regulations. The executor possesses a power of sale or exchange with respect to the property. The Estate

has obtained approval by the probate court of jurisdiction before entering into the transaction. The taxpayer represents that the transaction will occur before the Estate is considered terminated for federal income tax purposes (the Service does not rule whether the period of administration is reasonable). The taxpayer represents that the Estate will receive an amount which equals the fair market value of X foundation's interest or expectancy in such property at the time of the transaction. In this regard, the Estate (and therefore X Foundation) will receive the same percentage and class of stockholdings in W Corporation and V Corporation as it held before the transaction, the only difference being that its holdings in V Corporation will be direct rather than indirect through W Corporation. Also, the taxpayer represents that the transaction will result in X foundation receiving an interest or expectancy at least as liquid as the one it gave up, and perhaps more liquid, since its interest in V Corporation will be directly held rather than indirectly held.

2(a). The proposed transfers by X Foundation of half of its assets each to Y Foundation and Z Foundation are a transfer pursuant to a liquidation or reorganization as described in section 507(b)(2) of the Code and the regulations thereunder. Under section 1.507-1(b)(6) of the regulations, a 507(b)(2) transfer does not terminate the transferor foundation's private foundation status or result in termination tax.

2(b). Under section 507(a)(1) of the Code and the regulations thereunder, X Foundation will terminate its private foundation status if it properly notifies the Service of its intent and pays any termination tax due under section 507(c).

2(c). A section 507(b)(2) transfer of assets will not constitute a section 507(a)(1) voluntary termination unless the private foundation voluntarily gives notice of termination. The termination tax under section 507(c) of the Code is the lesser of the foundation's aggregate tax benefit or the value of its net assets. If X Foundation gives proper notice at least one day after all of its net assets are transferred to Y Foundation and Z Foundation, a section 507(a) termination will occur, and the value of its net assets will be zero, resulting in no termination tax.

2(d). The proposed 507(b)(2) transfer will be made in order to better accomplish the charitable purposes of X Foundation and therefore will not adversely affect the exemption of the transferor and transferee foundations.

2(e). Under sections 1.507-3(a)(2)(i) and 1.507-3(a)(9)(i) of the regulations, Y Foundation and Z Foundation will succeed to the aggregate tax benefit of X Foundation in proportion to the value of the assets transferred by X Foundation to each of them.

2(f and g). The taxpayer represents that Y Foundation and Z Foundation will be effectively controlled by the same persons that effectively control X Foundation. Therefore, under section 1.507-3(a)(9)(i) of the regulations, each transferee foundation will, for purposes of sections 507-509 of the Code and chapter 42, be treated as X Foundation in proportion to the net fair market value received from X Foundation (50% each). Each transferee foundation will be apportioned half of X Foundation's net investment income in the year of the transfer for 4940 purposes. Since the transferees are treated as the transferor, the transfer itself is not regarded as a taxable event. Each transferee foundation also will be responsible for satisfying 50% of X

Foundation's distribution requirement under section 4942 to the extent that such distribution requirements are not satisfied by X Foundation.

2(h). Under section 1.507-3(a)(9)(i) of the regulations, the transfer from X Foundation to the transferee foundations is disregarded for purposes of section 4940 of the Code.

2(i). Under sections 53.4946-1(a)(8) and 53.4941(d)-2(f)(2) of the regulations, the 507(b)(2) transfers will not constitute self-dealing, because the transferee foundations are not disqualified persons for purposes of section 4941 of the Code, and any benefit to B and C is incidental and tenuous.

2(j-m). On the date that the Estate distributes shares in W Corporation or V Corporation constituting excess business holdings to X Foundation, actually or constructively under section 53.4943-5(b)(1) of the regulations, the excess holdings will be treated as held by a disqualified person for a period of 5 years. See section 4943(c)(6) of the Code and the regulations thereunder. Prior to the distribution by the Estate, X Foundation's constructive holdings in the Estate assets will be treated as held by a disqualified person. Since the 507(b)(2) transferees will be treated as X Foundation, X Foundation's period to dispose of the excess will carry over to the 507(b)(2) transferees.

2(n). The transfers by X Foundation to Y Foundation and Z Foundation are program-related investments since they will be made for a section 170(c)(2)(B) purpose, not for the production of income, and not for a legislative or political purpose, and therefore will not be jeopardizing investments. Moreover, since Y Foundation and Z Foundation are treated (proportionally) as X Foundation under section 1.507-3(a)(9)(i) of the regulations, X is not treated as having made a transfer to them for purposes of section 4944 of the Code.

2(o). Under section 53.4945-6(c)(1)(i) of the regulations, the unrestricted transfers by X Foundation to Y Foundation and Z Foundation (organizations described in section 501(c)(3) of the Code) are not expenditures for non-charitable purposes under section 4945(d)(5). The transfers are program-related investments to private foundations under section 4945(d)(4) and section 53.4945-5(d)(4) over which X Foundation would ordinarily have to exercise expenditure responsibility, absent an exception. There are two exceptions here. One is that, since Y Foundation and Z Foundation are treated (proportionally) as X Foundation, X Foundation is not treated as having made a transfer to them for purposes of section 4945. See Example (2) of section 1.507-3(a)(9)(iii) of the regulations. Even without that exception, expenditure responsibility need not be exercised when a private foundation has no assets, except for information reporting requirements in the year in which made, under section 1.507-3(a)(7). Neither X Foundation nor its foundation managers will be required to file section 6033 returns for any taxable year following the taxable year in which it completes the transfer of all of its net assets, if at no time during the subsequent taxable years in question X Foundation has either legal or equitable title to any assets or engages in any activity.

3. The payments made by V Corporation to B or B's designee are not a direct act of self-dealing between a private foundation and a disqualified person. However, a foundation has an expectancy interest in the primary ownership (without voting power) of V Corporation. The

question arises whether the payments constitute an indirect act of self-dealing, particularly an indirect transfer to a disqualified person (B) of the assets of X Foundation.

Because of the great variety of possible situations that could be considered "indirect self-dealing," the regulations do not contain a comprehensive definition. Instead, they address some "safe harbor" situations that are not self-dealing. A limited safe harbor provision is found in section 53.4941(d)-1(b)(4)--a transaction between a foundation and an organization that is not controlled by the foundation and not a disqualified person (as more than 35% owned by disqualified persons) shall not be treated as an indirect act of self-dealing solely because disqualified persons own some of the organization.

Rev. Rul. 76-158 indicated that an example of an act of indirect self-dealing would be a transaction of the type described in section 4941(d)(1) of the Code between a disqualified person (with respect to a foundation) and a corporation controlled by the foundation within the meaning of section 53.4941(d)-1(b)(5) of the regulations. The ruling held that the corporation at issue was not controlled by the foundation under the facts presented. The ruling did not purport to hold that a transaction between a disqualified person and a disqualified person corporation not controlled by a foundation can never result in an indirect act of self-dealing. Section 53.4941(d)-1(b)(6) suggests that transactions between two disqualified persons that affect a foundation's assets may be indirect self-dealing, at least under some circumstances.

Like the corporation in Rev. Rul. 76-158, neither W Corporation nor V Corporation is directly or indirectly controlled by a foundation. Although B and C control those corporations, they do so not in their capacity as foundation managers of X Foundation but solely in their capacity as shareholders, as in Rev. Rul. 76-158. The same will be true after the Split-off.

We have considered whether the payments to B under the settlement agreement would be an indirect transfer to B of the assets of X Foundation (which would be an indirect act of self-dealing) regardless of whether X Foundation controls the corporations. Given the litigation between B and C, the common interests of C and X Foundation as owners of V Corporation, the independent appraisal, and the expectation that the settlement leaves V Corporation with substantial assets after the payment, the negotiated settlement may be regarded as appropriate for the shareholders of W Corporation and V Corporation and, under these particular facts and circumstances, the payments would not constitute indirect self-dealing.

RULINGS:

Accordingly, we rule as follows:

1. The Estate's participation in the Split-off will not constitute an indirect act of self-dealing and will not result in the imposition of tax under section 4941(a) of the Code on any disqualified person with respect to X Foundation or Foundation manager because the transaction satisfies the requirements of section 53.4941(d)-1(b)(3) of the regulations.

2(a). The proposed transfers by X Foundation to Y Foundation and Z Foundation will not result in a termination of X Foundation's private foundation status under section 507(a) of the Code and will not cause the imposition of the termination tax described in section 507(c).

2(b). If, after the transfer of all of its assets to the Y Foundation and Z Foundation, X Foundation properly notifies the Service of its intent to terminate private foundation status, then such notice will be effective to terminate the private foundation status of X Foundation under section 507(a)(1) of the Code.

2(c). If, after the transfer of all of its assets to Y Foundation and Z Foundation, X Foundation properly notifies the Service of its intent to terminate its private foundation status, and if the value of X Foundation's net assets at the time it gives the notice and terminates its private foundation status is zero, then X Foundation will not be liable for any termination tax under section 507(c) of the Code.

2(d). The proposed transfer from X Foundation to Y Foundation and Z Foundation will not adversely affect the tax exempt status of X Foundation, Y Foundation, or Z Foundation under section 501(c)(3) of the Code.

2(e). Y Foundation and Z Foundation will succeed to the aggregate tax benefit of X Foundation in proportion to the value of the assets transferred by X Foundation to Y Foundation and Z Foundation.

2(f). For purposes of the chapter 42 private foundation excise tax provisions and section 507 through 509 of the Code, Y Foundation will be treated as if it is X Foundation, but only in the proportion which the net fair market value of the assets it receives from X Foundation bears to the net fair market value of all X Foundation's assets immediately before the transfer. Since Y Foundation will receive 50% of all of X Foundation's assets, Y Foundation will succeed to 50% of X Foundation's tax attributes under chapter 42 and sections 507 through 509, including the following:

(1) For purposes of section 4940, 50% of the net investment income of X Foundation for the taxable year of the transfer to Y Foundation will be apportioned to Y Foundation and will be includible in the computation of the net investment income of Y Foundation in the taxable year of the transfer.

(2) The transfer to Y Foundation will not be an event giving rise to net investment income. Therefore, such transfer itself will not give rise to tax under section 4940.

(3) Y Foundation will be responsible for satisfying 50% of X Foundation's distribution requirement under section 4942 to the extent that such distribution requirements are not satisfied by X Foundation.

2(g). For purposes of the chapter 42 private foundation excise tax provisions and section 507 through 509 of the Code, Z Foundation will be treated as if it is X Foundation, but only in the proportion which the net fair market value of the assets it receives from X Foundation bears to the net fair market value of all X Foundation's assets immediately before the transfer. Since Z Foundation will receive 50% of all of X Foundation's assets, Z Foundation will succeed to 50%

of X Foundation's tax attributes under chapter 42 and sections 507 through 509, including the following:

(1) For purposes of section 4940, 50% of the net investment income of X Foundation for the taxable year of the transfer to Z Foundation will be apportioned to Z Foundation and will be includible in the computation of the net investment income of Z Foundation in the taxable year of the transfer.

(2) The transfer to Z Foundation will not be an event giving rise to net investment income. Therefore, such transfer itself will not give rise to tax under section 4940.

(3) Z Foundation will be responsible for satisfying 50% of X Foundation's distribution requirement under section 4942 to the extent that such distribution requirements are not satisfied by X Foundation.

2(h). The transfers by X Foundation to Y Foundation and Z Foundation will not result in any liability for tax under section 4940 of the Code since the transfers will not constitute a "sale or other disposition of property or other realizable event" within the meaning of section 4940.

2(i). The transfers by X Foundation to Y Foundation and Z Foundation will not constitute self-dealing under section 4941 of the Code because for purposes of section 4941 the term "disqualified person" does not include an organization described in section 501(c)(3) other than an organization described in section 509(a)(4). Consequently, such transfer will not subject X Foundation, Y Foundation, or Z Foundation to tax under section 4941.

2(j). Once shares of W Corporation are distributed outright by the Estate to Y Foundation, they will be treated as held by a disqualified person under section 4943(c)(6) of the Code for 5 years from the date of such distribution.

2(k). Once shares of V Corporation are distributed outright by the Estate to Z Foundation, they will be treated as held by a disqualified person under section 4943(c)(6) of the Code for 5 years from the date of such distribution.

2(l). Y Foundation will not be subject to tax under section 4943 of the Code on the shares distributed from X Foundation until 5 years from the date X Foundation receives such stock from the Estate.

2(m). Z Foundation will not be subject to tax under section 4943 of the Code on the shares distributed from X Foundation until 5 years from the date X Foundation receives such stock from the Estate.

2(n). The transfers by X Foundation to Y Foundation and Z Foundation will not constitute a jeopardizing investment within the meaning of section 4944 of the Code.

2(o). The transfers by X Foundation to Y Foundation and Z Foundation will not constitute a taxable expenditure within the meaning of section 4945 of the Code, and X Foundation will not

be required to exercise expenditure responsibility (as the term is defined in section 4945(h)) with respect to the transferred assets.

3. The payments made by V Corporation to B or B's designee will not constitute indirect acts of self-dealing under section 4941 of the Code.

Except as we have ruled above, we express no opinion as to the tax consequences of the transaction 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 questions about the application of the Code to X's activities, X should keep a copy of this ruling in its permanent records.

Sincerely yours,

/S/

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2