TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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UIL 4941.04-00

Date: JUL 2 0 2001

Contact Person:

identification Number:

Telephone Number:

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LEGEND

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Dear Sir or Madam:

This is in response to your letter dated May 17. 2001, and June1 1, 2001, requesting rulings under section 4941 of the Internal Revenue Code on behalf of the interests identified hereafter.

X is a non-profit corporation , recognized as exempt from federal income tax under section 501(c)(3) of the Code. X is dassified as a private foundation. X was founded in hh with significant, substantially equal contributions from A and his brother, B.

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C was the sister of A. C died in ii. By her Will and pursuant to court order, C created a testamentary trust, identified as Y. The dispositive terms of Y provided for a present beneficial interest on behalf of two nieces (E and F) who were both children of A, plus a non vested contingent remainder interest in favor of X. The relevant provisions of Y for purposes of this ruling are as follows:

> During the lifetime of decedents nieces, E and F (herein sometimes called "decedent's nieces"), or either of them, the Trustees shall from time to time pay to or apply for the benefit of either or both of them so much, if any, of the net income and principal of the trust estate, as the Trustees in their sole discretion deem appropriate, whether for their support and maintenance, or otherwise, and with or without taking into consideration any other income or resources which either of them may have, but taking into consideration their best interests and welfare, including the desirability of augmenting their respective estates and other circumstances and factors which the Trustees deem pertinent. Notwithstanding the foregoing, the Trustees shall in no event pay any income or principal to or for the benefit of either of decedents nieces prior to the time when she attains the age of thirty-five years. Upon the death of either of decedents nieces, her child or children, if any, shall be substituted as the beneficiary or beneficiaries in her place and stead, and the Trustees shall pay or apply for the benefit of such child or children so much, if any, of the net income and principal of the trust estate as the Trustees in their sole discretion deem appropriate, taking into consideration such circumstances and factors as they deem pertinent. If either of decedents nieces should die without leaving any children surviving her, then the Trustees shall pay to or apply for the benefit of the survivor of decedents nieces so much, if any, of the net income of the trust estate as they may, in their sole discretion, deem appropriate. In making payments under this paragraph, the Trustees may pay more to or apply more for one or more of the beneficiaries than for the other or others and may make payments to or the applications of benefits for one or more of them to the exclusion of the other or others, and their decision shall not be subject to question or objection of any person. Any net income not distributed shall be accumulated and added to principal.
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> Following the death of both of decedents nieces, the Trustees shall pay to or apply for the benefit of their respective surviving children, if any, so much, if any of the net income and principal of the trust estate as the Trustees in their sole discretion deem appropriate, whether for their support or maintenance, or otherwise, and with or without taking into consideration any other income or resources which any of said beneficiaries may have, but taking into consideration their best interests and welfare, including the desirability of augmenting their respective estates and other circumstances and factors which the Trustees deem pertinent. In making such payments, the Trustees may pay more to or apply more for one or more of them than for the others and may make payments or applications of benefits for one or more of them to the exclusion of the other or others, and their decisions shall not be subject to question or objection by any person. Any net income not distributed shall be accumulated and added to principal. The payments mentioned in this paragraph shall continue until the youngest of the surviving children of decedents nieces reaches the age of thirty-five years, at which time the Trustees shall distribute all of the principal and accumulated income, if any, of the trust estate to the

then living children of decedents nieces, share and share alike and not upon the principle of representation. If neither of decedents nieces leaves any surviving children, or if none of their surviving children reaches the age of thirty-five five years, then upon the death of both decedents nieces or upon the death of the last of their surviving children, as the case may be, the balance of the trust estate shall be distributed to X.

D was also a sister of A. D died in ii. By her will and pursuant to court order D created a trust, identified as Z. The dispositive terms of Z, very much like those of Y, provided a present beneficial interest on behalf of two nieces (E and F) who were both children of A, with a non vested wntingent remainder interest in favor or X. The dispositive terms of Z are almost identical to that of Y, set forth in the two preceding paragraphs.

From jj, the Trustees of the two trusts began making periodic distributions to E and F. Until kk, the distributions to the two nieces were equal. Believing the Trustees were not distributing sufficient amounts to her pursuant to the terms of the two Trusts, beginning in kk, F began making requests to the Trustees for larger distributions from the Trusts. The Trustees acceded to most of her requests. Not having similar requests from E, during that same period, the Trustees distributed to E, sums that were larger than in previous years but not as much as was being distributed to F. F continued with demands for greater periodic distributions which led to conflict with the Trustees.

The two trusts were, at the time, invested predominately in one asset, the stock of T. This investment policy caused disputes between the two trustees that served both Y and Z. The investment was remarkably successful. Nevertheless, the investment constituting 90 percent of the assets of each of Y and Z, was deemed inappropriate by one of the Trustees for lack of diversification. The other Trustee suggested that the stock of T itself constituted a "diversified" investment. The two nieces, especially F, wished to retain the investment in the existing concentration, and, thus, sided with one trustee and against the other.

In II the two Trustees adopted a plan of action to increase the distributions to E and F and to reduce the investment in the stock of T to 50 percent of the total assets of the two trusts. Each Trustee, represented by separate counsel, petitioned the appropriate state court having jurisdiction with respect to the two Trusts. In mm, prior to a hearing on the matter, F filed a petition with the same court requesting the court to (a) surcharge the Trustees and their attorneys with respect to excessive trustee and attorney fees, (b) to require the trustees to increase the amount of Trust distributions to take into account her best interests and welfare, including the desirability of augmenting her estate, and (c)to remove both trustees. One Trustee, G, was also the chairman of the Board of X and F asserted that he had a conflict of interest. Thereafter, appearances in the case were made by or on behalf of E, X, and a guardian ad litem representing unborn heirs of E and F. In nn, E and F were oo years of age, respectively, and both were childless and both were unmarried. The Court, as part of its orders, made a finding of fact that a child born to E was thereafter legally adopted by persons not related to E or F.

After protracted mediation of the disputes, with each party represented by counsel, the parties arrived at a settlement with respect to each of the Y and Z. In nn, the court having

jurisdiction of the case, approved the settlements and issued orders to that effect for Y and Z. The terms of the settlement included the following:

1. Cash distributions to F.
2. Distributions of T stock to E having a value that tended to equalize the earlier larger distributions to F.
3. Periodic cash distributions to E and F until Y and Z terminated.
4. Payment of Trustee and professional fees
5. Fifty-five percent of the remaining Trust assets of Y and Z to be distributed in equal shares to E and F.
6. The remainder of the Y and Z assets to be distributed to X.
7. The child born to E and adopted by third persons is neither a contingent future current beneficiary nor a contingent remainder beneficiary of Y or Z, and that she has no interest of any type in Y or Z.

Further conditions of the settlement required (1) approval from the Internal Revenue Service and (2) E and F to establish estate plans that would provide funds to benefit any children born to or adopted by either of them.

The Trustees of Y and Z request the following rulings:

1. With respect to G, in his capacity of foundation manager of X, the proposed termination of the Y and Z and distribution of the Y and Z assets, as provided in the Settlement Agreements, does not constitute an act of self-dealing described in section 4941(d) of the Code.

2. With respect to E and F, the proposed termination of Y and Z and distribution of the Y and Z assets, as provided in the Settlement Agreements, does not constitute an act of self-dealing described in section 4941(d) of the Code.

LAW AND ANALYSIS

Section 4941 (a) of the Code imposes certain excise taxes on direct and indirect acts of self-dealing between a disqualified person and a private foundation, and also imposes a separate excise tax on the participation by any foundation manager in an act of self-dealing between a disqualified person and a private foundation, knowing that it is such an act, unless such participation is not willful and is due to reasonable cause.

Section 4941(d)(l)(E) of the Code defines the term self-dealing to include the transfer to, or use by or for the benefit of, a disqualified person of the inwme or assets of a private foundation.

Section 4946(a)(l)(B) of the Code defines a disqualified person to include a foundation manager.

Section 4946(a)(l)(D) of the Code defines a disqualified person to include a member of the family of a substantial contributor to the foundation.

Section 53.4946-1(h)(3) of the regulations defines member of the family for purposes of section 4946 of the Code to include a lineal descendant.

E and F, nieces of C and D, are disqualified persons with respect to X. They are the children of A, a substantial contributor to X. Since E and F are lineal descendants of A, under section 53.4946-l (h)(3) of the regulations, they would be included as members of the family under section 4946(a)(l)(D) of the Code.

G is a foundation manager of X and is thus a disqualified person within the meaning of section 4946(a)(l)(B) of the Code.

X has a mere unvested contingent future interest in Y and Z which could be defeated either by complete distribution by the Trustees of all assets of Y and Z to E and/or F or the adoption of a child by E or F. The Trustees have complete discretion in making distributions to E and/or F including the purpose of simply augmenting their estates. In the litigation, F had also requested the removal of G due to a conflict of interest. In a fully litigated action, the parties in interest agreed to settle the outstanding disputes. With the approval and order of the court having jurisdiction, all litigated matters were settled. The settlement established the respective rights and interests in the parties. This was not a "friendly' action and all sides were represented by competent legal counsel. There is no suggestion here of any collusion to benefit any party or side to the action.

It cannot be said that X had any greater interest than that which it received in the settlement of the dispute, since the settlement, a product of litigation, by its nature, defines the rights of the parties. Accordingly, whatever E and F received in the settlement represented their own properties and may not be said to be the income or assets of private foundation X. Accordingly, there is no basis for finding any self-dealing under section 4941(d)(l)(E) of the Code.

We hold as follows:

1. With respect to G, in his capacity as a foundation manager of X, the proposed termination of Y and Z and distribution of the Y and Z assets, as provided in the Settlement Agreements, does not constitute an act of "self-dealing" described in section 4941 (d).

2. With respect to each of E and F, the proposed termination of Y and Z and distribution of Y and Z assets, as provided in the Settlement Agreements, does not constitute an act of "self-dealing" described in section 4941 (d).

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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This ruling is limited to the applicability of the provisions of section 4941(d) of the Code and does not purport to rule on any facts that were not represented in the ruling request or any changes of those facts.

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.

This ruling is directed only to the person that requested it. Internal Revenue Code section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

(signed) Robert C Harper, Jr.

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