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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: JUN 25 2004

Contact Person:

Identification Number:

Telephone Number:

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4943.00-00
4943.03-00
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4943.04-01

Employer Identification Number:

Legend

A =
B =
C =
D =
E =
F =

Dear Sir or Madam:

This letter amends and supercedes our letter dated June 25, 2004.

We have considered A's June 28, 2003, ruling request, to extend the period with which A may dispose of certain excess business holdings as defined in Section 4943 of the Internal Revenue Code.

STATEMENT OF FACTS

A was recognized by the Service as exempt from federal income tax under section 501(c)(3) of the Code and was classified as a private foundation within the meaning of Code Section 509(a) of the Code. A is organized and operated for exclusively charitable purposes through the making of grants and contributions to various charities selected from time to time by its Board of Directors.

C organized A and contributed to A various assets. Among the assets contributed were common membership interests in B, a limited liability company. The contributed interests represented 50% of the common membership interests in B. Following this contribution, neither C nor any member C's family (within the meaning of Code Section 4946(d)) owned any membership interests in B. At the time of the contribution, C's brother owned the other

outstanding common membership interests of B. Subsequently, the brother transferred all but of the common membership interests he held to E , a partnership created and operated for the benefit of D's descendants. None of D, E, or D's descendants, have any relationship with A that would fit any of them within the categories of disqualified person with respect to A, as set forth in section 4946(a)(l) of the Code.

In addition to the above-described common membership interests, there are two classes of preferred membership interests issued to specialized trading entities. None of these entities or their respective owners is related to A, to C , or to any other holder of a common membership interest. Members holding common membership interests have all voting rights delegated to the members. Pursuant to B's Amended and Restated Operating Agreement (the "Operating Agreement"), B is governed by a Board of Managers. This Board of Managers is elected by the common members. The common members also share substantially all income and losses of B. B has been treated as a partnership for federal income tax purposes and has not elected to be treated as an association taxable as a corporation.

Under the Operating Agreement, the common membership interests are not transferable without consent of the Board of Managers. In the event a common member receives an offer to purchase the member's interest, the remaining common members and B have a right of first refusal at the lower of the offered price or fair market value as determined by an appraisal procedure. Such rights of first refusal were waived in connection with the transfers made by C and D.

B is a securities and futures clearing firm. B's revenues are derived primarily, but not entirely, from commissions earned on transactions and interest received from financing activities.

After C's contribution of his interest in B to A, B continued to operate its various business activities, but operational stresses began to manifest. Because B's business is capital intensive, the more successful it became, the greater was its need to increase invested capital. Accordingly, the members had to inject additional capital into B. In the past, C and D would be in a position to invest any needed capital. However, once A acquired the interests formerly owned by C, it became much more difficult, if not impossible, for B to obtain capital from its members.

Accordingly, B decided that the best, and perhaps only realistic, alternative was to sell B. This fit with A's need to dispose of its excess business holdings in B by February

Various approaches to dispose of B were considered, and various firms were investigated to assist in the sale process. After various discussions and negotiations, on October B executed an agreement with F, retaining it to represent B in a sale, merger,

consolidation or recapitalization. As described in the agreement, F was to develop a sales strategy, prepare a "Confidential Memorandum" to introduce potential purchasers or investors, identify and screen potential purchasers, initiate high level contact with potential purchasers approved by B, coordinate the due diligence process, and participate in structuring and negotiating the final transaction.

On March ., F received a preliminary non-binding proposal to acquire B. This proposal was considered in depth by B, and months of intensive due diligence by the buyer's employees and representatives followed. After the initial proposal was made, and during the due diligence process, market conditions began to turn extremely negative, and the initial offer was substantially modified to propose a merger with a delayed sale. The modified offer was rejected by B.

F continued in its sales efforts. However, the impact of the tragedy of September 11, 2001, on the capital markets put all realistic attempts to sell B to an end for the foreseeable future. The value of B in the marketplace has deteriorated and it may take time for B to realize something approaching its true value from sale. B, it appears, could be sold today for a fraction of its true value.

A's Directors have recently approached F to discuss the conditions under which F would attempt to market A's 50% interest. F concluded that a sale of a non-controlling interest to a third party would be very unlikely because, in addition to the state of the economy and the business environment as a whole, the interest has not historically paid any distributions (even in years in which a profit was earned), substantial capital would be required of any proposed purchaser, and A does not have a controlling interest to sell. Given the fact that a sale of B as a whole is unlikely for a period of time, A's Board of Directors considered various alternatives for the disposition of B's excess business holdings. They have tentatively ruled out seeking to sell to the other common members because of the absence of any viable third party offer that would indicate the true value of the interest and the lack of any pressure to compel these common members to pay full value due to their right of first refusal under the Operating Agreement.

Accordingly, A decided to proceed with the other common members of B to continue to market B in the same manner as has been the case since the summer of 2000. A's Board of Directors, with the advice of F, is confident that the capital markets will improve over the next several years and that a transaction is likely to be consummated that will generate for A's interest, a price that will reflect the true value of A's interest.

RULING REQUESTED

That A is granted a five year extension of the period, that would end on February in which it must dispose of its common membership interests in B that were originally acquired by gift on February and constitute excess business holdings under Section 4943 of the Code.

STATEMENT OF LAW

Section 501(c)(3) of the Internal Revenue Code exempts from federal income tax organizations organized and operated for charitable purposes.

Section 509(a) of the Code provides that, unless specifically excepted, a domestic or foreign organization described in section 501(c)(3) is a private foundation and subject to the excise taxes

Section 4943(a) of the Code imposes a tax on the excess business holdings of any private foundation in a business enterprise during any taxable year.

Section 4943(c)(1) of the Code defines excess business holdings as the amount of interest in an enterprise that a private 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)(A) of the Code provides, in part, 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 voting stock owned by all disqualified persons.

Section 4943(c)(2)(B) of the Code provides generally that the permitted holdings are 35 percent if one or more third persons who are not disqualified persons have effective control of the corporation.

Section 4943(c)(2)(C) of the Code provides that 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 2 percent of the voting stock and not more than 2 percent in value of all outstanding shares of all classes of stock.

Section 4943(c)(3) of the Code provides that the permitted holdings of a private foundation in an unincorporated business enterprise will be determined using the principles of

Section 4943(c)(2) of the Code, except that a partnership's profits interest will be considered the equivalent of voting stock.

Section 4943(c)(6) of the Code provides a five-year period for a private foundation to dispose of excess business holdings acquired by gift or bequest by stating generally 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 that enterprise, the interest of the foundation in such enterprise shall be treated as held by a disqualified person during the five-year period beginning on the date of such change.

Section 4943(c)(7) of the Code permits a five-year extension of the divestiture period provided by Section 4943(c)(6) for disposing of excess business holdings consisting of an unusually large gift or bequest of diverse business holdings or holdings with complex corporate structures, provided the following conditions are met:

(A) the foundation must establish that-

(i) diligent efforts to dispose of such holdings have been made within the initial five-year period, and

(ii) the disposition was not possible (except at a price substantially below fair market value) because of the size and complexity or diversity of the holdings, and

(B) before the close of the initial five-year period -

(i) the foundation submits a plan to the Secretary for disposing of all the excess business holdings involved in the extension and

(ii) the foundation submits a copy of the plan to the Attorney General (or other appropriate State official) having responsibility with respect to the foundation's disposition of the excess business holdings and submits any response as part of its ruling request, and

(C) the Secretary determines that such plan can reasonably be expected to be carried out before the close of the extension period.

Section 4946(a)(1) of the Code provides that the term "disqualified persons" with respect to a private foundation includes, generally, a substantial contributor, a foundation manager

(which includes an officer, director or trustee), the owner of more than 20% of a business or trust which is a substantial contributor, a family member of any of the preceding, a corporation, trust, estate or partnership, more than 35% of which is owned or held by any of the foregoing, or certain government officials.

Section 4946(d) of the Code provides that for purposes of the definition of disqualified persons, the family of an individual includes only the individual's spouse, ancestors, children, grandchildren, great-grandchildren, and their respective spouses.

Section 53.4943-6(b)(1) of the Foundation and Similar Excise Taxes 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 in this section shall not commence until the date on which the distribution of such holdings from the estate or trust to the foundation occurs.

ANALYSIS

A acquired its entire interest in B through a gift from C on February 11, 1999. A's interest in B is of a size that would be considered an excess business holding subject to the tax imposed by Section 4943 of the Code. Pursuant to Section 4943(c)(6) of the Code, A had five years from the date of the gift to dispose of that portion of its interest in B that constitutes an excess business holding. A anticipated that it was not going to be able to complete a disposition of the interest within such five-year period. In consideration of this A submitted its request to extend the initial five-year period. If certain requirements described in Code Section 4943(c)(7) are satisfied, the Secretary of the Treasury has the authority to extend for an additional five-year period, the time during which a private foundation must dispose of excess business holdings acquired by gift.

The Foundation's excess business holding in B is a result of an unusually large gift of diverse business holdings and/or complex business structures within the meaning of section 4943(c)(7) of the Code. Disposition within the initial five-year period was not possible, except at a price substantially below fair market value.

First, a preliminary offer for B was in March of , twenty-five months after the gift. That range of values was one negotiated at arm's length, and it was a meaningful one, as is evidenced by the months of due diligence undertaken by the prospective purchaser. Only external events, such as the drastic decline of the economy and the market, precluded that transaction from closing.

Secondly, the holdings in B are diverse and involve complex business structures. B's business activity not only requires substantial capital investment but also membership in numerous stock exchanges and clearing organizations. Many governmental regulatory agencies oversee and monitor B's business activities. The result of this diversity and complexity is that potential purchasers are few in number. Even when a party goes to contract, the due diligence and conditions to closing would result in a substantial period being necessary to close the transaction. Overlaying the foregoing is the fact that B's very business is most susceptible to a downturn in the market and the economy, which in fact occurred, and, hence, a sale, if possible at all at the present time, would have to be at a fire sale price.

In addition, the nonmarketable, non-controlling nature of the A's interest in B serves to deter offers that reflect its full fair market value. Under the Operating Agreement, if any holder of a membership interest seeks to sell or transfer all or any portion of the interest, B and the other common members must be offered the opportunity to purchase the interest at the same terms. This right is intended to prevent the members from having an unwanted partner, but also serves to discourage potential purchasers whose offers can be thwarted by the intervention of another existing member. Furthermore, a purchaser of A's interest will only be admitted as a member of B with the approval of a majority vote of the Managers. This restriction effectively serves to dampen the price a willing buyer will pay for A's interest. Additionally, the Operating Agreement provides that a majority of interests held by the common members must approve any action by B requiring member consent. As the holder of only 50% of the voting interests, A by itself cannot compel any action by B. Thus, any prospective purchaser of A's interest in B presumably can demand substantial discounts in the price it will pay for the nonmarketable, non-controlling membership interest held by A.

Accordingly, because of the size, complexity and diversity of the business of B and the non-controlling, nonmarketable interest in it held by A, A's excess business holdings in B can be sold, if at all under the economic conditions prevailing, only at a price which is substantially below its true value.

A's plan is to continue to cooperate with F in its continuing engagement to sell B. The other common members are in agreement. A's Board of Directors is wholly satisfied with F's attention to the project and performance to date and believes that the inability to date to close a sale has been due to economic circumstances beyond its control. Any sale in the current financial climate would be for a price that is substantially less than B's true value and hence would result in an amount payable to A that is below market and ultimately would limit the proceeds available for the charities to be benefited by A.

The investment banker informed A that economic conditions are gradually improving and that it should be able to arrange for a sale of B at a price that approximates its true value within the next three to four years. A's Board of Directors reasonably anticipates that any such sale

will be structured either as a transfer of A's common interests, in which case A will receive the consideration directly from the buyer, or as a sale of assets, after which B would be promptly liquidated and the proceeds would be distributed to A and other members. In any event, by allowing A to retain its interest beyond February , will facilitate the consummation of a transaction that will maximize the proceeds that will be available for distribution to the charitable interests served by A.

The Charitable Trust Division of the state's Attorney General has authority over all charitable organizations in the state. The plan for disposing of the A's interest was submitted to the Charitable Trust Division and it had no objections to the plan.

A provided information showing that the bequest was an unusually large bequest of a diverse business. A represented that it has engaged in diligent efforts to dispose its excess building holdings during the initial 5-year period and was unable to do so by reason of the complexity of the industry of the business, the regulatory issues, and the change in the market due to the events of September 11, 2001. It has provided a timely plan for disposing of all its excess business holdings if the period of time to dispose of these assets is extended, and submitted this plan to the Attorney General in the state that it is located who accepted the plan.

Based on the information submitted we rule that as provided in section 4943(c)(7) of the Code, A is granted a five-year extension of time to February , to dispose of its excess business holdings.

This ruling is based on the understanding that there will be no material change in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Service. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

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

Please keep a copy in your permanent records. 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 yours,

Michael Seto
Manager, Exempt Organizations
Technical Group 1