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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: MAY 23 2003

Contact Person:

Uniform Issue List: 4941.04-00

Identification Number:

Telephone Number :

T:EO:BR2

Legend:
C =
E =
F =
F1 =
F2 =
L =
M =
T =
T1 =
T2 =
x =
y =

Dear Sir or Madam:

This is in reply to T's letter, requesting rulings that the sale of real property to a private foundation will not be a direct or indirect act of self-dealing under section 4941(d)(1)(A) of the Internal Revenue Code as to T, F, F1 or F2.

Decedent C is the substantial contributor who created first private foundation trust T and later private operating foundation F, both being created years prior to the acquisition and the proposed sale of property L by the parties in this ruling letter.

T is a charitable trust that is exempt from federal income tax under section 501(c)(3) of the Code and is a private foundation under section 509(a) of the Code. T provides major financial support to F. Individual T1, a son of a first cousin of C, is one of the two trustees of T. T2, the other and unrelated bank trustee of T, is not on the governing body of F. T would exert expenditure responsibility under section 4945(h) of the Code as to its grants to F.

F is a nonprofit charitable corporation that is exempt from federal income tax under section 501(c)(3) of the Code, is a private foundation under section 509(a) of the Code, and is an operating foundation under section 4942(j)(3) of the Code. F operates site E, open to the public, which must not exceed 50 acres. The directors of F are not compensated. F has T1 as one of F's seven directors.

Under the terms of C's trust, T or F could only buy adjacent property for any additions to site E. Until expansion of E in recent years by its acquisition of adjacent property M, L was the next-to-adjacent residential real property next to M. Previously anticipating E's expansion and rising local urban land prices, F1 and F2, nephews of C, bought the property L for its eventual transfer to the next-to-adjacent exempt use site E.

F1 and F2 propose to sell property L to trust T for the same price of x dollars, which they paid for L years ago. L is now worth about y dollars (considerably more than x). The costs relating to the sale transaction, such as transfer taxes, title fees or taxes, insurance, and other settlement costs will be conventionally and reasonably allocated between buyer T and sellers F1 and F2. F1 and F2 do not have any position or vote in T. T and F have approved the purchase. F1 and F2 are only two of the seven directors of F. T1 is only one of the two directors of T.

The following rulings are requested:

1. Sellers F1 and F2 are not disqualified persons under section 4946 of the Code with respect to trust T, and the purchase of the real property L by trust T from F1 and F2 will not constitute a "direct" act of self-dealing under section 4941 of the Code.

2. The purchase of L by T from F1 and F2 will not constitute an "indirect" act of self-dealing under section 4941 of the Code, even though F1 and F2 are disqualified persons with respect to F, one trustee T1 of T is also a director of F, and the real property L will be held by T for use by F.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations organized and operated exclusively for the charitable and/or other exempt purposes stated in that section.

Section 509(a) of the Code describes organizations exempt from federal income tax under section 501(c)(3) that are private foundations subject to the provisions of Chapter 42.

Section 4941(a)(1) of the Code imposes a tax on any act of self-dealing between a private foundation and a disqualified person as defined in section 4946.

Section 4941(d)(1)(A) of the Code provides, in pertinent part, that the term "self-dealing" means any direct or indirect sale of property between a private foundation and a disqualified person as defined in section 4946.

Section 53.4941(d)-1 of the Foundation and Similar Excise Tax Regulations provides that an act of self-dealing can be a direct or indirect transaction, and it is immaterial whether the transaction results in a benefit to the private foundation.

Section 53.4941(d)-1(b)(1) of the regulations provides that "indirect" self-dealing shall not include any transaction between a disqualified person and an organization controlled by a private foundation if:

(i) The transaction results from a business relationship which was established before such transaction constituted an act of self-dealing (without regard to this paragraph (b)),

(ii) The transaction was at least as favorable to the organization controlled by the foundation as an arm's-length transaction with an unrelated person, and

(iii) Either:

(a) The organization controlled by the foundation could have engaged in the transaction with someone other than a disqualified person only at a severe economic hardship to such organization, or

(b) Because of the unique nature of the product or services provided by the organization controlled by the foundation, the disqualified person could not have engaged in the transaction with anyone else, or could have done so only by incurring severe economic hardship; see example (2) of section 53.4941(d)-1(b)(8), which states:.

> Example (2). Private foundation W owns the controlling interest of the voting stock of corporation X, a manufacturer of certain electronic computers. Corporation Y, a disqualified person with respect to W, owns the patent for, and manufactures, one of the essential component parts used in the computers. X has been making regular purchases of the patented component from Y since 1965, subject to the same terms as all other purchasers of such component parts. X could not buy similar components from another source. Consequently, X would suffer severe economic hardship if it could not continue to purchase these components from Y, since it would then be forced to develop a computer which could be constructed with other components. Under these circumstances, the continued purchase by X from Y of these components shall not be an indirect act of self-dealing between W and Y.

Section 53.4941(d)-1(b)(5) of the regulations describes a controlled organization to describe indirect self-dealing between a disqualified person and an organization controlled by a private foundation. The regulation provides that a controlled organization can be an operating foundation. 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. An organization will be considered to be controlled by a private foundation, or by a private foundation and disqualified persons, if such persons are able, in fact, to control the organization (even if their aggregate voting power is less than 50 percent 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.

Section 4946 of the Code defines the disqualified persons subject to section 4941.

Section 53.4946-1(a)(8) of the regulations provides that, for purposes of self-dealing under section 4941 of the Code, an exempt organization under section 501(c)(3) is not a disqualified person.

Section 4946(a)(1)(A) of the Code provides that a disqualified person includes a person who is a substantial contributor, as defined in section 507(d)(2), to the private foundation. Section 507(d)(2) provides that a substantial contributor is a person who contributed or bequeathed an aggregate amount of more than $5,000 to the private foundation, if such amount is more than 2 percent of the total contributions received by the foundation before the close of the tax year of the foundation in which the contribution is received by the foundation from such person.

Section 4946(a)(1)(B) of the Code provides that a disqualified person includes a foundation manager described in section 4946(b)(1).

Section 4946(b)(1) of the Code provides that a foundation manager is an officer, director, or trustee of the private foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation).

Section 4946(a)(1)(C) of the Code provides that a disqualified person includes a person who is an owner of more than 20 percent of:

(i) the total combined voting power of a corporation,
(ii) the profits interest of a partnership, or
(iii) the beneficial interest of a trust or unincorporated enterprise,

which is a substantial contributor to the foundation.

Section 4946(a)(1)(D) of the Code provides that a disqualified person includes a member of the family, as defined in section 4946(d), of any individual described in section 4941(a)(1)(A), 4941(a)(1)(B), or 4941(a)(1)(C), cited above.

Section 4946(d) of the Code provides that the family of any individual shall include only his or her spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren. It is noted that this provision does not include brothers or sisters, nephews or nieces, or cousins.

Section 4946(a)(1)(E) of the Code provides that a disqualified person includes a corporation in which persons described in section 4946(a)(1)(A), 4946(a)(1)(B), 4946(a)(1)(C), or 4946(a)(1)(D) own more than 35 percent of the profits interest.

In this case, F1 and F2 are directors only of F, and are not trustees of T. Under the definition of control by majority voting or by veto power as described in section 53.4941(d)-1(b)(5) of the regulations, F1 and F2 do not control T and do not control T's decision to purchase their real property L. F1 and F2, nephews of C, are, as directors of F, disqualified persons, under section 4946 of the Code, with respect to F, but not as to the purchaser T. T's purchase of L from F1 and F2 will not be any direct self-dealing sale to T by any of T's disqualified persons, as defined in section 4946, which does not include nephews as members of the family. Further, based on the unique facts and circumstances described, such as the lack of control of foundations F or T by the sellers F1 and F2, considering L being adjacent to E, the sale of L at a price considerably less than fair market value, and the necessity of L for E's mission, the sale by F1 and F2 of L to expand the exempt use site E will not be an indirect act of self-dealing between F1 and F2 as to T (or F) under section 4941 of the Code. See section 53.4941(d)-1(b)(1) of the regulations.

Accordingly, we rule that:

1. Sellers F1 and F2 are not disqualified persons under section 4946 of the Code with respect to purchaser T, and the purchase of the real property L by T from F1 and F2 will not constitute any direct act of self-dealing under section 4941 of the Code.

2. T's purchase of L from F1 and F2 will also not constitute an indirect act of self-dealing under section 4941 of the Code, even though: F1 and F2, nephews of C, are disqualified persons as two of the seven directors of F; T1, one of the two trustees of T, and son of a cousin of C, is one of F's seven directors; and the real property L will be held by T for use by private operating foundation F at site E founded by C.

Because this ruling letter could help to resolve any questions, please keep it in your permanent records.

This ruling letter 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.

Sincerely,

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2