

# **Bond Case Briefs**

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## **IRS: Settlement Agreement Won't Result in Self-Dealing.**

The IRS ruled that the execution, delivery, and performance of a settlement agreement providing for the purchase of limited partnership interests by the trustees of a private foundation will not result in self-dealing.

Dear \* \* \*

We have considered your ruling request dated October 5, 2012. You are requesting a ruling under § 4941 of the Code with regard to a Settlement Agreement affecting certain testamentary bequests to a private foundation described in §§ 501(c)(3) and 509(a).

### **FACTS**

A and B are the surviving children of C. C, a resident of State, died on Date 1.

D is a limited partnership, in which each of A, B and C held certain partnership interests at the time of C's death. The assets held by C at C's death included a x% general partnership interest in D and a y% limited partnership interest in D (collectively, the "Interests").

E is a private foundation described in §§ 501(c)(3) and 509(a) of the Code. The two Executors of C's estate also serve as the two co-Trustees of E.

Prior to C's death, A, B and C executed an agreement granting each of A and B the right, upon C's death, to purchase one-half of C's limited partnership interests in D at a price equal to the value of those interests as of the date of C's death as determined by an independent qualified appraiser, subject to increase or decrease equal to the final determination of the value of those interests in the federal estate tax proceedings for C's estate (the "First Option").

C's Will, as submitted for probate in the court with jurisdiction over C's estate, bequeathed C's general partnership interest in D outright to E.

The Will further directed the Executors to offer (subject to the terms and conditions of the Partnership Agreement of D) in writing to each of A and B the option to purchase for cash up to one-half of C's limited partnership interests in D that C owned at C's death, at its value as finally fixed and determined for federal estate tax purposes after independent appraisal (the "Second Option").

In addition, C's Will provided that the residue of C's estate, after satisfaction of certain specific bequests set forth in C's Will and after satisfaction of debts, administrative expenses and taxes attributable to C's estate, would pass to E.

Subsequent to submission to the court of C's Will for probate, a series of arbitration and court proceedings were launched involving A, B, the Executors and the Trustees. Each of the First Option, the Second Option and the bequests to E was challenged as part of the various proceedings. In addition, the Executors filed claims against A and B for alleged over distributions from D to A and B.

After approximately z years of litigation and arbitration proceedings regarding the Interests, the Attorney General of State intervened in an attempt to help resolve the parties' disputes. With the help of the Attorney General of State, A, B, the Executors and the Trustees entered into a Settlement Agreement, effective as of Date 2.

Under the Settlement Agreement, A and B will purchase all of the Interests at a price set forth in the Settlement Agreement. This price is equal to the value of the Interests as reported by C's estate for federal estate tax purposes. In addition, A and B will pay a designated amount in settlement of all additional claims made by the Executors against A and B with regard to the Interests.

The Attorney General of State consented to the Settlement Agreement. On Date 3, the court with jurisdiction over C's estate issued an order approving the Settlement Agreement.

## RULING REQUESTED

The execution, delivery, and performance of the Settlement Agreement, and the consummation by the parties of the transactions contemplated therein, will not constitute acts of direct or indirect self-dealing under § 4941, and none of the parties to the Settlement Agreement, including their executors, trustees, directors, officers, owners, employees, agents, and attorneys, will be liable for tax under § 4941 for such actions.

## LAW

Section 4941(a) 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 it is such an act, unless such participation is not willful and is due to reasonable cause.

Section 4941(d)(1)(A) provides that for purposes of § 4942 the term self-dealing means any direct or indirect sale or exchange, or leasing, of property between a private foundation and a disqualified person.

Section 4941(d)(1)(E) defines self-dealing to include any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation. Section 4946(a) provides that the term "disqualified person" with respect to a private foundation includes a substantial contributor to the foundation, a family member of a substantial contributor (including children), and foundation managers (including trustees and individuals with similar powers or responsibilities).

Section 53.4946-1(a)(1)(i) of the Foundation and Similar Excise Tax Regulations, with reference to § 507(d)(2) of the Code, defines the term "substantial contributor" as (1) any 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 and bequests received by the private foundation in the year of such contribution; and (2) in the case of a trust, the creator of the trust.

In *Rockefeller v. United States*, 572 F. Supp. 9 (E.D. Ark. 1982), aff'd 718 F.2d 290 (8th Cir. 1983), cert. den. 466 U.S. 962 (1984), the court held that purchase by a decedent's son, who was also executor of the estate, of estate property earmarked for a private foundation was indirect self-dealing.

In *Estate of Reis v. Comm'r*, 87 T.C. 1016 (1986), the court held that because a foundation which was a beneficiary of an estate had an expectancy interest in the estate, sale of estate property

otherwise passing from the estate to the foundation constituted acts of indirect self-dealing under § 4941.

## ANALYSIS

Self-dealing under § 4941 may occur by virtue of the transfer of property held in an estate to which a private foundation has an interest or expectancy. *Rockefeller v. United States*, 572 F. Supp. 9 (E.D. Ark. 1982), *aff'd* 718 F.2d 290 (8th Cir., 1983), *cert. den.* 466 U.S. 962 (1984); *Reis*, 87 T.C. 1016 (1986). Absent the litigation and arbitration proceedings, E arguably had an expectancy under the terms of C's will (as submitted for probate) either in the Interests themselves or, with regard to the limited partnership interests, in an amount of money equal in value to the option price. In fact, E's ultimate expectancy with regard to the Interests depended on final resolution of the litigation and arbitration proceedings.

Although the parties to the Settlement Agreement could have awaited the end of those proceedings, doing so may have taken many more years, cost a considerable amount in legal fees, and ultimately resulted in less property for E. Instead, the parties chose to settle the dispute. All parties to the Settlement Agreement were represented by independent counsel, and there is no suggestion of collusion to benefit any particular party. The Attorney General of State participated in facilitating the Settlement Agreement and consented to its terms. The court with appropriate jurisdiction over C's estate has approved the Settlement Agreement.

Entering into the Settlement Agreement will eliminate the risk that E's expectancy with regard to the Interests might be reduced if the litigation and arbitration proceedings continued, will preclude the need to expend additional charitable funds pursuing the litigation, and will allow E to access the property passing to it from C's estate and begin to use that property in furtherance of its charitable activities. Because the Settlement Agreement was the product of arm's-length negotiations, including the participation and consent of the Attorney General of State and approval of the court with jurisdiction over C's estate, E's expectancy in C's estate with regard to the Interests is established by the Settlement Agreement. All parties acting in performance of the Settlement Agreement are viewed as merely carrying out their legal rights and obligations with regard to the Interests.

## RULING

Accordingly, based on the facts and circumstances discussed above, we rule that the execution, delivery and performance of the Settlement Agreement, and the consummation by the parties of the transactions contemplated therein, does not give rise to self-dealing under § 4941, and no tax under § 4941 is due with regard to the transactions described in the Settlement Agreement.

This ruling will be made available for public inspection under § 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. 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.

Because it could help resolve questions concerning federal tax liabilities, this ruling should be kept 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.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Matthew L. Giuliano

Manager, Exempt Organizations

Guidance Group 1

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