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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Contact Person:

Telephone Number:

In Reference to:

OP:E:EO:T:3

Date:

JUL 23 1999

▷ **Significant Index No.**
4941.04-00
4945.04-00

Legend:
M=
N=
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P=
Q=
x=

Dear Sir or Madam:

This is in response to M's request a ruling under section 4941 of the Internal Revenue Code of 1986 submitted on M's behalf by M's authorized representative.

M has been recognized as exempt under section 501(c)(3) of the Code and classified as a private foundations under section 509(a). M's charitable purpose is to assist needy individuals and families in O.

M states that it came into existence upon the death of N, who established M under a living trust. The trust document provided that M was to come into existence upon N's death and be funded by assets owned by the trust. M states that at the time of N's death the trust owned the majority of N's assets.

P serves as the sole trustee of M. P also serves as the sole trustee of the trust. Under the trust document, P is required to distribute the assets of the trust.

The trust document requires P to make distributions after N's death to M equal to 50% of the residuary estate remaining after distributions of certain real property and payment of all estate expenses and debts. The remaining estate after payment of estate taxes, is to be distributed equally to N's two nephews,

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who are not disqualified persons under section 4946 of the Code.

M states that the major asset of the trust was a parcel of real property. The property is subject to a real estate purchase and sale agreement for approximately x dollars. M states that the transaction has not closed and the purchaser has been allowed to make option payments into an escrow account to keep the sale open for up to 18 months.

M states that the property may have environmental problems. The property was formerly used as a gas station and a dumping site during construction of an interstate highway. In addition, the property has an old gasoline storage tank. The property could, therefore, be contaminated. M represents that, under Q state law, property held by the trust is subject to claims for environmental damages. Therefore, M states that P, as trustee, could be held liable for environmental damages or required to incur expenses to defend himself in related litigation. The potential purchaser has only agreed to indemnify P for environmental damages and related expenses to a limited extent.

M states that the M and N's nephews propose to enter into an agreement to indemnify P from any potential liability due to environmental damages and related expenses except for P's gross negligence or intentional misconduct. M states that the agreement will be filed with the Q state court. M states that the filing will have the effect of a final court order.

M represents that under state law a trustee has a right to indemnification from trust property for contract and tort liabilities. M also states that a summary of state law indicates that (a) trust expenses and liabilities are payable out of trust property; (b) a trustee is entitled to indemnification out of trust property for expenses and liabilities of the trust; and (c) a trustee acquires a lien against trust property for trust expenses and liabilities. The potential payments made on P's behalf will be for liability and reasonable and necessary costs incurred because of the environmental costs and potential claims associated with the sale of the property.

Section 4941 of the Code provides for the imposition of tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(E) of the Code states that the term "self dealing" means 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 4941(d)(2)(A) of the Code provides that the transfer of property by a disqualified person to a private foundation is treated as an act of self-dealing if the property is subject to a mortgage or similar lien which the foundation assumes or a mortgage or similar lien which has been placed on the property within a 10 year period ending on the date of the transfer.

Section 4946(a)(1)B) of the Code defines a disqualified person to include with respect to a private foundation a foundation manager.

Section 4946(b)(1) states that the term foundation manager includes a trustee of a foundation having the authority or responsibility over the activities of the foundation.

Section 4945(d)(4) of the Code provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to an organization unless such organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation, or the private foundation exercises expenditure responsibility with respect to such grant.

Section 4945(d)(5) of the Code provides that the term "taxable expenditure" does not include amounts paid or incurred by a private foundation as a grant to another organization for purposes specified in section 170(c)(2)(B).

Section 53.4941(d)-2(f)(3) of the Foundation and Excise Tax Regulations provides that except as provided in Sec. 53.4941(d)-3(c), section 4941(d)(1) shall not apply to the indemnification by a private foundation of a foundation manager, with respect to his defense in a judicial or administrative proceeding involving chapter 42 or State laws relating to mismanagement of funds of charitable organizations, against all expenses (other than taxes, penalties, or expenses of correction) including attorneys' fees, if--

(i) Such expenses are reasonably incurred by him in connection with such proceeding, and

(ii) He is successful in such defense, or such proceeding is terminated by settlement, and he has not acted willfully and without reasonable cause with respect to the act or failure to act which led to liability for tax under chapter 42. Similarly, except as provided in Sec. 53.4941(d)-3(c), section 4941(d)(1) shall not apply to premiums for insurance to reimburse a foundation for an indemnification payment allowed pursuant to this subparagraph.

Section 53.4945-6(b)(1) of the regulations provides that generally expenditures (and reasonable expenses incidental thereto) to acquire investments entered into for the purpose of obtaining income or funds to be used in furtherance of purposes described in section 170(c)(2)(B) ordinarily will not be treated as taxable expenditures under section 4945(d)(5).

M will execute an agreement to indemnify P for potential environmental costs and claims associated with the sale of property conveyed by N. Under state law P has a right to indemnification for potential claims and liabilities associated with the sale of the property described above. Therefore, the creation of an equitable lien and potential subsequent payments for contract liability and costs associated with the sale the property by P on M's behalf will not constitute acts of self dealing under section 4941(d)(1)(E) of the Code.

The establishment of the equitable lien is not self dealing under section 4941(d)(2)(A) of the Code. M represents that state law provides that an equitable lien is created for P on trust property against M and the other beneficiaries for trust expenses and liabilities, including potential claims and expenses arising from the sale of trust property. Thus, the equitable lien in this case is created by operation of law and is, therefore, distinguishable from a mortgage or similar lien, placed on the property by a disqualified person, as described in section 4941(d)(2)(A) of the Code.

M will make payments for potential liability and costs, reasonable and necessarily associated with the sale of property by P. The proceeds of the sale will be used by M to accomplish its charitable purposes described in section 501(c)(3) of the Code. Therefore, the potential expenditures will be made for purposes of acquiring income to be used in furtherance of purposes described in section 170(c)(2)(B) of the Code and will, therefore, not be considered taxable expenditures pursuant to section 53.4945-6(b)(1) of the regulations.

Based on the above we rule as follows:

1. The execution of an agreement to indemnify M's trustee from liabilities and costs associated with the sale of property as described above and the making of payments by M pursuant to the agreement will not constitute acts of self-dealing under section 4941 of the Code.

2. Indemnification payments made under the agreement will not constitute taxable expenditures under section 4945 of the Code.

This ruling is directed only to the organization that requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. This ruling does not purport to rule under any other section of the Code.

Because this letter could help resolve any future questions about M's exempt status, please keep a copy of this ruling in the organization's permanent records.

We are informing M's key District Director of this ruling.

Sincerely yours,

(signed) Robert C Harper, Jr.

Robert C. Harper, Jr.
Chief, Exempt Organizations
Technical Branch 3