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

200119062

Date: FEB 15 2001

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4943.04-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

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Dear Sir or Madam:

We have considered M's ruling request dated November 24, 1999, as supplemented and modified in a submission dated December 26, 2000. wherein M requested a ruling under section 4943(c)(7) of the Internal Revenue Code for an 18 month extension through May 31, 2001, to dispose of certain excess business holdings resulting from an unusually large gift of stock.

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FACTS

M was incorporated in 1994. The Service has recognized M as exempt from federal income tax as an organization described in section 501 (c)(3) of the Code. M is also a private foundation within the meaning of section 509(a).

B and C were the founders of M and substantial contributors to it. M received its first charitable contribution on December 1, 1994, consisting of cash in the amount of $201x, publicly traded marketable securities with a value of approximately $51x, and 150x shares of common stock of N, a publicly held corporation, The common stock of N was traded on the W under an identified ticker symbol until a certain date in the summer of 1999. The stock was delisted from the W that same summer. It is now traded on the Z. B and C, the children of B and C, and certain trusts established for the benefit of the children and grandchildren of B and C (including the D trust), also owned shares of common stock of N on December 1, 1994.

B and C, who were both active with M, have since passed away. The 150x shares of common stock of N that were contributed to M by B and C represented approximately 3.28% of the total shares of common stock of N issued and outstanding as of December 1, 1994. This number of shares represented, and continues to represent, a significant holding in N, as well as an unusually large gift to M.

The aggregate number of shares of common stock of N held by B and C, the children of B and C, and the trusts for the benefit of the children and grandchildren of B and C, represented approximately 36.28% of the common shares of N as of December 1, 1994. M's interest in N on that date exceeded the amount of "permitted holdings" that a private foundation may own under section 4943(c)(Z) of the Code and could have constituted an excess business holding, absent the application of the five year period to dispose of gifts and bequests granted by section 4943(c)(6).

M has made diligent and continuous efforts to dispose of the 150x shares of N common stock throughout the five year grace period of Code section 4943(c)(6) but has been unable to do so.

N owns and operates one of the largest publicly traded companies in a certain health care field in the United States. N is licensed to operate managed care plans in various states.

N contracts with large and medium-sized governmental or private sector employers and multiple employer trusts. In recent years, N has focused its marketing efforts on mid-sized and small employer groups, usually with less than I.000 employees. N's profits have declined in recent years for a number of reasons, including the loss of a large private label health care organization relationship, a decline in N's indemnity insurance membership (in its health care field) because of nonrenewals, and a highly competitive managed care environment in the locations where N conducts its business. You have furnished financial data for N for the years ended December 31, 1994, through December 31, 1998.

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M has been unable to dispose of its holdings in N during the initial five year period following December 1, 1994, for all of the following reasons:

First, the public market for N's common stock has always been limited and remained limited throughout the initial five-year period. N's stock was listed on the W until the summer of 1999, but trading has never been active. N's stock was delisted from the W in the summer of 1999, and is now traded on the Z. The approximate number of record holders of N's common stock as of December, 1998, was x, and this limited number of holders has consistently affected M's ability to sell 150x shares of N's common stock for fair market value on the open market. Also, for a one year period ending in November, 1999, the average price per share of common stock of N declined to approximately 35% of the price for the one year period ending in November, 1995.

Second, M was unable to have its holding in N, or any portion thereof, redeemed during the initial five year period because N is a disqualified person with respect to M. B and C, the children of B and C, and the D trusts, owned more than 35% of the combined voting power of N during the five year period beginning in late 1994. As a result, a sale or exchange of property between M and N would have constituted an act of self-dealing between M and a disqualified person under section 4941 of the Code (unless the requirements of section 4941(d)(2)(F) were satisfied).

Third, the Directors of M also believed that N would be acquired by way of a takeover between late 1994 and late 1996, and the consummation of a takeover would have enabled M to dispose of its entire holding in N at fair market value. N performed well financially between 1988 and 1996. However, when N began to encounter financial problems during 1997, the possibility that M would be able to dispose of its business holdings in N as a result of a takeover within the initial 5-year period became less realistic.

Fourth, in mid-1999, N entered into a Debenture and Note Purchase Agreement with 0, P, and E (the "investors"). At the time of submission of this ruling request, N believed that the transactions described within this Agreement would occur prior to the end of 2004, and that M would be able to dispose of its entire holding in N for fair market value as a result of such transactions. Later, however, this Agreement was superseded by a Recapitalization Agreement, as described in your submission of December 26, 2000.

N was generally profitable from 1988 to 1996, before reporting substantial losses in 1997 and 1998. As a result, N began negotiating with its senior noteholders and line of credit lender to restructure its credit. In 1998, N considered the possibility of seeking and receiving an equity investment from an unrelated third party. Shortly thereafter, N commenced discussions with several investment funds and a subsidiary of a large nationally known industrial conglomerate. At about the same time, N also began discussions with E, a well known health consultant and investor who was familiar with N and 0 through its principal, F.

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In November, 1998, E and R (a group of advisors from 0 and P) made a proposal to take N private in a leveraged buyout. After due consideration, a Special Committee appointed by N determined that the offer contained an unacceptable number of conditions, and, accordingly, recommended that the offer be rejected.

In April, 1999, N's Board of Directors considered the report of U, an investment banking firm, relating to proposals set forth in a Letter of Intent from E and R dated in March, 1999. At that time, U stated its opinion that the proposals set forth in the Letter of Intent were fair from a financial point of view to N and its stockholders. The Board of Directors also took into account the fact that the proposals made by E and R were an integral part of the debt restructuring negotiations that were ongoing with S and T. After considering all the relevant information, and with advice from N's investment banker, outside legal counsel, and debt restructuring specialist, the Board of Directors of N authorized the execution of the Letter of Intent with the E/R Group. Upon its execution, N was able to obtain agreements from S and T to waive the existing loan defaults and restructure its debt. Definitive documents were executed by all parties in June, 1999.

In your original submission, you furnished details of the Debenture and Note Purchase Agreement. We will not outline the terms herein because, based on your more recent submission, it appears that this particular Agreement was never implemented. Instead, on March 1, 2000, N and an investor group comprised of 0, E, and D, entered into a Recapitalization Agreement with S and T, N's current lenders. The investor group made a loan of $8,000x to N, which will be converted into equity upon regulatory approvals. S and T also agreed to convert all of their debt in N into equity at the same time.

The investor group loan and all of N's other outstanding debt will automatically be exchanged for convertible preferred stock upon regulatory approval of N's change of control and the authorization of additional common shares by N's stockholders. At the time of your December submission, regulatory approval had been obtained from all but one of the states where N conducts significant operations, and the remaining approval was expected within the next 30 days. Additional shares of the authorized common stock were approved on October 25, 2000. When the exchange is completed, S and Twill own approximately 63 percent of N, the investor group will own approximately 23 percent of N, and the existing stockholders will own approximately 14 percent of N. You also provided additional information about the outstanding voting stock of N upon the completion of the recapitalization in two tables.

N's reconstituted Board of Directors is comprised of E, F, and G of the investor group. The Board also includes H, a current Director; I, N's Chief Financial Officer and recently elected Director; and J (son of B and C), who will continue to serve as Chairman of the Board of Directors and as one of N's Directors. You also informed us that the composition of N's Board of Directors is controlled by a covenant contained in the March 1, 2000 Recapitalization Agreement wherein the investor group elects four (4) members of the Board, one (1) member of the Board is to be selected by S and T when the Recapitalization Agreement closes, and the currently existing stockholders will be entitled to elect two (2) members of the Board.

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As soon as N obtains the appropriate regulatory approvals regarding the change of control, N's loans from 0, E, and D, and N's existing indebtedness to S and T, will be exchanged for preferred stock. The preferred stock is convertible into an additional 30,000x common shares upon receipt of the required regulatory approvals and approval of the increase in the number of authorized shares of N common stock by N's stockholders, which shares of preferred stock will vote on all matters submitted to N's stockholders, except for the election of Directors, on an as-converted basis.

Upon completion of all the above described transactions, the outstanding voting securities of N will be held as follows: (a) Existing stockholders - approximately 5,000x shares=1 3.7% of total; (b) S – 15,000x shares=43.2% of total; (c) T – 7,000x shares=20.1% of total; (d) 0 – 5,000x shares=14.4% of total; (e) E – 2,500x shares=7.2% of total; and (f) D trusts – 500x shares=1.4% of total. Combined percentages=1 00%.

After the recapitalization, J, D. the other trusts for the benefit of the children and grandchildren of B and C, and M, will have the following holdings in N: J - 645x shares=1.8562%; D – 1,201x shares (rounded)=3.4556%; trusts for the grandchildren of B and C – 303x shares=0.8720%; M – 150x shares=0.4317%. The cumulative percentage of these four holdings is 6.6155%.

The relatives of B and C and family-related entities are no longer in control of N. J is no longer N's Chief Executive Officer, a position that he held for many years. He now has a consulting contract with N. Other members of N's prior management team, including H, Senior Vice President and General Counsel, now have two-year employment contracts with N. N's investors are looking for a return on their equity, have effective control of N's Board of Directors at this time, and have hired N's new President and Chief Executive Officer, and Chief Financial Officer.

As required under section 4943(c)(7) of the Code, you have provided a copy of M's plan of disposition of its holdings in N to the Attorney General of V, directed to the department which regulates charities. Your law firm has not received a response from the Attorney General and no response is expected.

LAW

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)(l) of the Code defines the term "excess business holdings" to mean, with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the enterprise which the 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.

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Section 4943(c)(Z)(A) of the Code provides that the permitted holdings of any private foundation in an incorporated business enterprise are: (i) 20 percent of the voting stock, reduced by (ii) the percentage of the voting stock owned by all disqualified persons.

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)(l)(H)) owns not more than 2 percent of the voting stock and not more than 2 percent in value of all classes of stock.

Section 53.4943-3(b)(4)(i) of the Foundation and Similar Excise Taxes Regulations provides that a private foundation is not treated as having excess business holdings in any incorporated business enterprise in which it (together with all other private foundations described in section 4946(a)(l)(H)) actually or constructively 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. If, however, the private foundation, together with all other private foundations described in section 4946(a)(l)(H) actually or constructively owns more than 2 percent of either the voting stock or the value of the outstanding shares of all classes of stock in any incorporated business enterprise, all the stock in such business enterprise classified as excess business holdings under section 4943 is treated as excess business holdings. For purposes of this paragraph, any stock owned by a private foundation which is treated as held by a disqualified person under section 4943(c)(4)(8), (5) or (6) shall be treated as actually owned by the private foundation.

Section 4946(a)(l)(H) of the Code provides that for purposes of section 4943, the term ‘disqualified person” includes a private foundation which is effectively controlled (directly or indirectly) by the same person or persons who control the private foundation in question, or one where substantially all of the contributions were made (directly or indirectly) by the same person or persons described in subparagraph (A), (B), or (C), or members of their families, who made (directly or indirectly) substantially all of the contributions to the private foundation in question.

Section 4943(c)(6)(A) of the Code provides that, with certain exceptions not applicable here, if after May 26, 1969, there is a change in the holdings in a business enterprise (other than by purchase (i.e., by gift or bequest) by the private foundation or by a disqualified person) which causes the private foundation to have excess business holdings in such enterprise, the interest of the foundation in such enterprise (immediately after such change) shall (while held by the foundation) be treated as held by a disqualified person (rather than by the foundation) during the 5-year period beginning on the date of such change in holdings.

Section 53.4943-6(a)1)(i) of the regulations provides that paragraph (6) of section 4943(c) prescribes transition rules for a private foundation, which, but for such paragraph, would have excess business holdings in a business enterprise after May 26, 1969 (other than by purchase by such foundation or by a disqualified person) to the extent that section 4943(c)(5) (relating to certain holdings acquired under a pre-May 26, 1969, will or trust) does not apply.

In the case of a private foundation which has no excess business holdings immediately prior to the gratuitous receipt in question (determined without regard to sections 4943(c)(4), (5), or (6) of the Code), section 4943(c)(6)(A) applies, and the entire interest of the foundation in the

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enterprise in question is treated as held by a disqualified person throughout the 5-year period beginning on the date of change in the holdings. Section 4943(c)(6) and section 53.4943-6(a)(l)(i) of the regulations are applicable to M as a result of B and C's gift of common stock to M. Accordingly, B and C are treated as holders of the 150x shares of common stock of N throughout the initial 5-year period of December 1, 1994, through November 30, 1999.

Section 4943(c)(7) of the Code was added by section 307(a) of the Tax Reform Act of 1984, P.L. 98-369. It applies to business holdings with respect to which the five-year period under section 4943(c)(6) ends on or after November 1, 1983. The purpose of section 4943(c)(7) is to give the Secretary discretion to extend the five-year relief period of section 4943(c)(6) for disposing of post-May 26, 1969, gratuitous acquisitions of holdings in a business enterprise. The Secretary's authority is exercisable "in the case of an unusually large gift or bequest of diverse holdings or holdings with complex corporate structures" if the following requirements are met:

(A) the foundation establishes that -
(i) diligent efforts to dispose of such holdings have been made within the initial 5-year period, and
(ii) disposition within the initial 5-year period has not been possible (except at a price substantially below fair market value) by reason of such size and complexity or diversity of such holdings,

(B) before the close of the initial 5-year period -
(i) the private foundation submits to the Secretary a plan for disposing of all of the excess business holdings involved in the extension, and
(ii) the private foundation submits the plan described in clause (i) to the Attorney General (or other appropriate State official) having administrative or supervisory authority or responsibility with respect to the foundation's disposition of the excess business holdings involved and submits to the Secretary any response received by the private foundation from the Attorney General (or other appropriate State official) to such plan during such 5-year period, and

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

ANALYSIS

M has submitted information which shows that B and C gave a large number of shares of common stock in N to M. Pursuant to the provisions of section 4943(c)(6)(a) of the Code, M was required to dispose of these shares of N stock within 5 years in order to avoid being placed in a position of having excess business holdings. As M has described, after diligent efforts, M was unable to dispose of any of these shares within the allotted five-year period. M requests an additional 18 months within which to dispose of these shares. M has presented a Recapitalization Agreement which will enable M to dispose of its excess business holdings within the 18 months. When this Agreement is fully executed, M will own not more than 2

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percent of the voting stock and not more than 2 percent in value of all outstanding shares of all classes of stock in N, thereby complying with the provisions of section4943(c)(2)(C) and section 53.4943-3(b)(4)(i) of the regulations. And, as required under section 4943(c)(7), you have submitted your plan to dispose of the excess business holdings of M to the V Attorney General.

RULING

Based on the application of the facts and representations outlined above to the relevant law, we conclude that M will satisfy the provisions of section 4943(c)(7) of the Code. As such, we rule that M may have an eighteen (18) extension to May 31, 2001, in order to dispose of its excess business holdings in N.

This ruling is based on the understanding that that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon your tax status should be reported to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service Office. The mailing address is: Internal Revenue Service, TE/GE Customer Service. P.O. Box 2508, Cincinnati, OH 45201. The telephone number there is 877-829-5500 (a toll free number).

We are sending a copy of this ruling to the Ohio TE/GE Customer Service Office. Because this letter could help resolve any questions about your tax status, you should keep it with 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.

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.

Thank you for your cooperation.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

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