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Internal Revenue Service

SIN: 0507.00-00

Department of the Treasury

Washington, DC 20224

Contact Person:

OP:E:EO:T:3

Telephone Number:

In Reference to:

Date:

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Dear Sir or Madam:

This is in response to a letter dated July 12, 1999 requesting rulings on the effects under section 507 and Chapter 42 of the Internal Revenue Code of M's proposed distribution of all M's assets to N, O, and P.

M was established in 1987 by S, who is deceased, for benevolent purposes in order to make grants to other charitable organizations. M is exempt under section 501(c)(3) of the Code and is a private foundation under section 509(a).

N was established in 1999 by T, for benevolent, scientific and educational purposes in order to make grants to other charitable organizations. T is a Director of M. N is exempt under section 501(c)(3) of the Code and is a private foundation under section 509(a).

O was established in 1999 by U, for benevolent, scientific and educational purposes in order to make grants to other charitable organizations. U is a Director of M. O is exempt under section 501(c)(3) of the Code and is a private foundation under section 509(a).

P was established in 1999 by V, for benevolent, scientific and educational purposes in order to make grants to other charitable organizations. V is the nephew of S and is a Director of M.

M now proposes to transfer its net assets to N, O, and P.

Owing to divergent charitable interests and investment philosophy of the Directors of M, management, administration and achievement of the charitable goals of M has been increasingly difficult. Consistent with the intent of M=s founder to have all of the directors involved in charitable activities, the charitable purposes of M would be best achieved by the aforementioned proposal.

M proposes to distribute its assets in the following proportions: 27.5% to N, 27.5% to O and 45% to P. The transferred assets will be held and administered by N, O, and P in a manner consistent with their tax-exempt purposes. Their boards of directors will have the ultimate authority and control over their share of such assets and any income derived from them.

M, N, O and P have been organized and operated for similar exempt purposes described in section 170(c)(2)(B) of the Code. M, N, O and P have determined that M=s charitable purposes will be more effectively accomplished by N, O, and P.

Section 507(a) of the Code states that, except as provided in section 507(b), an exempt organization which is a private foundation can terminate its private foundation status only if it notifies the Service of its intent to terminate or it commits willful repeated acts, or a willful and flagrant act, which give rise to the imposition of a tax under Chapter 42 and it pays the termination tax imposed by section 507(c) or has the tax abated.

Section 507(b)(2) of the Code provides that where a private foundation transfers its assets to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or any other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

Section 1.507-4(b) of the Income Tax Regulations provides that private foundations that make transfers described in section 507(b)(2) are not subject to the tax imposed under section 507(c) with respect to such transfers unless the provisions of section 507(a) become applicable.

Section 1.507-3(c)(1) of the regulations provides that a transfer under section 507(b)(2) of the Code includes a transfer of assets from one private foundation to another private foundation pursuant to a reorganization or liquidation.

Section 1.507-3(a)(1) of the regulations provides that, in a transfer of assets from one private foundation to another private foundation pursuant to a reorganization or liquidation, the

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transferee private foundation shall not be treated as a newly created organization, but shall succeed to the transferor's aggregate tax benefit under Code section 507(d).

Section 1.507-3(a)(5) of the regulations provides that a transferor private foundation is required to meet its distribution requirements under section 4942 of the Code, even for any taxable year in which it makes a section 507(b)(2) transfer of all or part of its net assets to another private foundation. The section 507(b)(2) transfer itself may be counted toward satisfaction of such requirements only if it meets the requirements of section 4942(g).

Section 1.507-3(a)(7) of the regulations provides that (except as provided in subparagraph (9) of section 1.507-3(a)) where the transferor has disposed of all of its assets, during any period in which the transferor has no assets, section 4945(d)(4) and (h) shall not apply to the transferee or the transferor with respect to any "expenditure responsibility" grants made by the transferor. However, this exception does not apply with respect to any information reporting requirements imposed by section 4945 and the regulations thereunder for any year in which any such transfer is made.

Section 1.507-3(a)(9)(i) of the regulations states that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled by the same person or persons who controlled the transferor foundation, the transferee foundation will be treated as if they were the transferor for purposes of Chapter 42 and sections 507 through 509 of the Code.

Section 1.507-3(a)(9)(ii) of the regulations provides that the transferor foundation must meet the filing requirements of sections 6033, 6104 and 6043 of the Code.

Section 1.507-1(b)(9) of the regulations provides that the returns required by section 6033 of the Code must be filed by a foundation for the year in which it transfers all of its assets. This section further provides that the transferor foundation need not file such returns for any taxable year following the year in which the transfer occurred if it has no assets and does not engage in any activity.

Section 4941(a) of the Code imposes a 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" includes 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 53.4941(d)-2(f)(2) of the Foundation and Similar Excise Taxes Regulations states that the fact that a disqualified person receives an incidental or tenuous benefit for the use by the foundation of its income or assets will not, by itself, make such use an act of self-dealing.

Section 53.4946-1(a)(8) of the regulations provides in relevant part that, for purposes of section 4941 of the Code, the term "disqualified person" does not include any organization described in section 501(c)(3).

Section 4942(a) of the Code imposes a tax on the undistributed income of a private foundation. Section 4942(c) defines undistributed income to mean the amount by which the foundation=s distributable amount exceeds its qualifying distributions.

Section 4942(g)(1)(A) of the Code indicates that a private foundation does not make a qualifying distribution under section 4942 when the contribution is either: (1) to another organization that is controlled by the transferor or by one or more of its disqualified persons, or (2) to a private foundation that is not also an operating foundation under section 4942(j)(3), unless the requirements of section 4942(g) are met.

Section 53.4942(a)-3(a)(2)(i) of the regulations defines qualifying distribution as any amount (including reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(1) or 170(c)(2)(B) of the Code.

Section 53.4942(a)-3(e) of the regulations provides that the excess qualifying distributions of a private foundation may be carried over and used to reduce the foundation's minimum distribution requirement for any subsequent taxable year within the specified five-year adjustment period.

Section 4944(a)(1) of the Code imposes a tax upon the making by any private foundation of any investment that jeopardizes the conduct of its exempt purposes.

Section 4945 of the Code imposes a tax on each taxable expenditure made by a private foundation.

Section 4945(d)(4) of the Code provides that the term

"taxable expenditure" includes a grant to an organization (other than an organization described in paragraph (1), (2) or (3) of section 509(a)), unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h).

Section 4945(h) of the Code defines expenditure responsibility to mean that the grantor private foundation is responsible to exert all reasonable efforts and to establish adequate procedures (1) to see that the grant is spent solely for the purpose for which made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and (3) to make full and detailed reports with respect to such expenditures to the Secretary.

Section 53.4945-6(c)(3) of the regulations provides that, if a private foundation makes a transfer of assets (other than a transfer described in subparagraph (1)(i) of this paragraph) pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization to any person, the transferred assets will not be considered used exclusively for purposes described in section 170(c)(2)(B) of the Code unless the assets are transferred to a fund or organization described in section 501(c)(3) (other than an organization described in section 509(a)(4)) or treated as such under section 4947(a)(1).

The transfer of M=s assets to N, O, and P does not involve a change in the manner of M=s operation, nor will its private foundation status be terminated. Thus, M will continue to operate as a tax exempt entity. Likewise, the transfer of the assets from M to N, O, and P will not involve a change in the manner of operation of N, O and P and, therefore, N, O, P will continue to operate as tax exempt entities.

The transfer of assets from M to N, O and P will be a transfer of assets described in section 507(b)(2) of the Code because it is a disposition of more than 25% of the fair market value of the net assets of M, as stated in section 1.507-3(c) of the regulations. Under section 1.507-3(d), there is no private foundation termination tax in the case of section 507(b)(2) transfers from one private foundation to one or more other private foundations.

The carryover provisions for a Code section 507(b)(2) transfer will be applicable. Similar to section 1.507-3(a)(2)(iii), Example (1), all of M's aggregate tax benefit, as defined in section 507(d) of the Code, will be carried over to N, O and P. In addition, under sections 1.507-3(a)(1) through (8),

any other applicable carryover provisions will be applicable to N, O and P, M's transferee.

There will be no acts of self-dealing under section 4941 of the Code. The transfer of assets is not an act of self-dealing because it is a transfer of funds for exempt purposes to exempt section 501(c)(3) organizations. The transferees are not considered disqualified persons pursuant to section 53.4946-1(a)(8) of the regulations.

M is responsible for meeting its qualifying distribution requirements under section 4942 of the Code. Under section 1.507-3(a)(5) of the regulations, even if a transferor transfers all of its assets to other private foundations, the transferor's obligation to expend funds for exempt purposes, as required by section 4942(g) of the Code, must still be met. Further, the legal, accounting and other administrative expenses attributed to the transfer will be treated as qualifying distributions if an amount equal to the sum of such expenses is paid out pursuant to section 4942(g)(3) of the Code.

M=s transfers of funds to N, O and P are not investments. Therefore, they are not investments which jeopardize M=s charitable purposes, or those of N, O or P pursuant to section 4944 of the Code.

There will be no taxable expenditures under section 4945 of the Code. Section 53.4945-6(c)(3) of the regulations indicates that no tax on taxable expenditures is involved where there is a reorganization or transfer of assets under section 507(b)(2), which is the case here. Also, M has no presently outstanding grants for which expenditure responsibility is being exercised.

Accordingly, based upon the representations submitted, we rule that:

1. The transfer of net assets of M to N, O and P will not affect the status of M, N, O or P as an organization described in section 501(c)(3) of the Code and will not result in the termination of private foundation status of M, but will constitute an adjustment between private foundations within the meaning of section 507(b)(2).

2. The transfer will not constitute either a notification of M=s intent to terminate its status as a private foundation under section 507(a)(1), or willful repeated acts (or failure to act) or a willful and flagrant act (or failure to act), within the meaning of section 507(a)(2), by M. Therefore, M will not be liable for the termination tax imposed by section 507(c).

3. The transfer of assets will constitute a significant disposition of assets to one or more private foundations. N, O and P will not be treated as newly created organizations and will be treated as possessing the attributes and characteristics of M. Following the transfer, N, O and P may proportionately reduce their required distributions under section 4942 of the Code, by their proportional amounts of M=s excess qualifying distributions carryover for prior years.

4. The transfer of assets will not constitute a sale or other disposition within the meaning of section 4940(c)(4)(A) of the Code, will not constitute an act of self-dealing within the meaning of section 4941 by M, N, O or P, or by any disqualified person and will not constitute a jeopardizing investment within the meaning of section 4944(a) by M, N, O or P or by any disqualified person.

5. The transfers of assets will not constitute taxable expenditures within the meaning of section 4945 of the Code, and M will not be required to exercise expenditure responsibility under section 4945(h) with respect to the assets transferred to N, O and P.

6. The transfer of assets will not result in any tax due by M under Chapter 42, and

7. Provided M has no assets, M will not be required to file any tax returns for any taxable years subsequent to that in which all assets are distributed. Upon M=s termination, M shall be required to file a return required by section 6043(b) of the Code.

Your key District Director is being furnished a copy of this ruling. You should keep a copy of this ruling letter in your permanent records.

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

Sincerely yours,

(signed) Robert C Harper, Jr.

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