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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

SIN: 507.00-00

Contact Person:

T:EO:RA:T:3

Telephone Number:

In Reference to:

Legend:

M -
N -
O -

Date: FEB 8 2000

Dear Sir or Madam:

This is in response to letters dated November 3, 1999 and December 17, 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.

M, a trust, was formed in 1949 by O 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).

M's trust document states that M is to terminate no later than five years after the death of O. O died in 1997. Therefore, M must terminate by 2002.

M now proposes to transfer its net assets to N. N, a trust, was formed in 1999 for benevolent purposes in order to make grants to other charitable organizations. N is exempt under section 501(c)(3) of the Code and is a private foundation under section 509(a).

The transfer of all of M's assets to N will consolidate the family foundations which are each pursuing similar charitable purposes. As a result, after the transfer, there will be more efficient administration and a reduction in operating costs. M will effectively terminate immediately after the transfer of its assets is made to N. No trustee of M or N will receive any funds from the proposed transfer or benefit directly or indirectly from the proposed transfer.

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 507(c) of the Code imposes a tax on each terminating private foundation equal to the lower of the aggregate tax benefit

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resulting from the section 501(c)(3) status of such foundation or the value of its net assets.

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 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 it 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 1.507-3(d) of the regulations provides that unless a private foundation voluntarily gives notice under section 507(a)(1) of the Code, a transfer of assets described in section 507(b)(2) will not constitute a termination of the transferor's private foundation status.

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 4940 of the Code provides for the imposition of a tax on the net investment income of private foundations.

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 53.4946-1(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)(3) 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 4943(a)(1) of the Code provides for the imposition of a tax on excess business holdings of a private foundation.

Section 4943(c)(1) of the Code provides that the term "excess business holdings" means the amount of stock or other interest in any business 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.

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(a) 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 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 will not involve a change in the manner of operation of N and, therefore, N will continue to operate as a tax exempt entity.

The transfer of assets from M to N 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.

Because M has not notified the Secretary of its intention to terminate its status as a private foundation and because the proposed transfer will be treated as a section 507(b)(2) transfer, N will be deemed to possess certain attributes and characteristics of M, including being entitled to a pro-rata portion of M's aggregate tax benefit not to exceed the fair market value of the transferred assets at the time of the proposed transfer.

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. In addition, under sections 1.507-

3(a)(1) through (8), any other applicable carryover provisions will be applicable to N, M's transferee.

The transfer will be treated as a transfer of all assets of M to N which is effectively controlled by the same persons under section 1.507-3(a)(9)(i) of the regulations. Thus, the distribution requirements of section 4942 of the Code will not apply to M in the year of the transfer because such distributions will be treated as N's distributions.

N, as the transferee foundation, will not be treated as a newly created organization because the proposed transfer is a transfer of all of the assets of a private foundation to another private foundation. Consequently, N will be treated as though it were M for purposes of section 4940 of the Code. Therefore, M's transfer of all of its assets to N will not result in a tax on investment income under section 4940.

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 an exempt section 501(c)(3) organization. The transferee is not considered a disqualified person pursuant to section 53.4946-1(a)(8) of the regulations.

Provided that none of the assets transferred to N would place N in a position of having excess business holdings as defined in section 4943(c) of the Code, the proposed transfer of all of the assets of M to N will not result in liability for tax on excess business holdings imposed by section 4943(a).

M's transfer of funds to N is not an investment. Therefore, it is not an investment which jeopardizes M's charitable purposes, or those of N 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 will not affect the status of M or N 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.

2. The transfer of net assets from M to N will constitute a transfer described in section 507(b)(2) of the Code.

3. The transfer of assets from M to N will not terminate the status of M as a private foundation under section 507(a)(1) of the Code, and therefore, will not result in the imposition of a termination tax under section 507(c).

4. Assuming M notifies the Commissioner that it intends to terminate its private foundation status pursuant to section 507(a)(1) of

the Code at least one day after the effective transfer of all of its assets and liabilities to N, the amount of the termination tax under section 507(c) will be zero.

5. After the transfer, N will be deemed to possess certain attributes and characteristics of M including being entitled to a pro-rata portion of M's aggregate tax benefit not exceeding the fair market value of the transferred assets at the time of the proposed transfer because the transfer is described in section 507(b)(2) of the Code.

6. After the transfer is consummated, the excess qualifying distribution carryover under section 4942(i) of the Code of M, if any, will be added to the excess qualifying distribution carryover of N, and may be used by N to reduce its distributable amount under section 4942 of the Code.

7. The transfer of all the assets of M to N will not result in (a) net investment income within the meaning of section 4940 of the Code; (b) an act of self-dealing under section 4941; (c) excess business holdings under section 4943; (d) an investment that jeopardizes charitable purposes under section 4944; (e) a taxable expenditure under section 4945; or (f) liability for any taxes (whether imposed upon M or N, or any disqualified person with respect to such foundations) under sections 4940, 4941, 4942, 4943, 4944 and 4945.

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(k)(3) of the Code provides that it may not be cited as precedent.

Sincerely yours,

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3

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