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

Date: MAR 2 2001

W/L: 507.00-00

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Dear Sir or Madam:

This is in response to your letter dated December 6, 2000, in which you requested certain rulings with respect to a proposed transfer of all of the assets of B to C and D.

B is exempt under section 501(c)(3) of the Internal Revenue Code and is classified as a private foundation under section 509(a). Both C and D have submitted an application for recognition of exempt status under section 501(c)(3) of the Code and classification as a private foundation under section 509(a).

B is managed and controlled by directors who are all related by blood or marriage. With the passage of time, family members have differed slightly over which organizations should be beneficiaries of B's charitable largesse. Moreover, the two branches of the family have relocated to different areas of the country. The F branch of the family lives in the Southeast while the G branch lives in the Northeast.

B believes that the transfer of assets, in equal shares, to C and D will serve to ensure that philosophical and geographic differences do not create obstacles for future generations of descendants, and will allow the two branches of the family to participate more conveniently and effectively in the fulfillment of B's charitable mission. C will be governed by the G branch of the family. D will be governed by the F branch.

After the transfer, C and D will continue the charitable mission of B. Additionally, C and D will assume the expenditure responsibility of B. B has one outstanding grant to E over which it

468

is required to exercise expenditure responsibility. B's directors have been carefully monitoring this grant to E, and have received all required reports. B's expenditure responsibility over its grants will be assumed by C and D, either collectively or by assignment between them.

In the taxable year following the distribution of all of B's net assets to C and D, it is anticipated that B will notify the Service of its intention to voluntarily terminate its status as a private foundation pursuant to section 507(a)(1).

Section 507(a) of the Code provides for the voluntary and involuntary termination of private foundation status. It states, in part, that except for transfers described in section 507(b), an organization's private foundation status will be terminated only if (1) the organization notifies the Service of its intent to terminate or (2) there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act) giving rise to liability for tax under Chapter 42.

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

Section 507(e) of the Code provides that, for purposes of section 507(c)(2) of the Code, the value of the net assets of the private foundation shall be determined at whichever time the value is higher: (1) the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation or (2) the date on which it ceases to be a private foundation.

Section 1.507-3(a)(5) of the Income Tax Regulations provides that a transferor private foundation is required to meet its charitable distribution requirements under section 4942 of the Code, even for any taxable year in which it makes a transfer of its assets to another private foundation. Such transfer shall itself be counted toward satisfaction of such requirements to the extent the amount transferred meets the requirements of section 4942(g) of the Code. However, where the transferor has disposed of all of its assets, the record-keeping requirements of section 4942(g)(3)(B) shall not apply during any period in which it has no assets.

Section 1.507-1(b)(7) of the regulations provides that neither a transfer of all of the assets of a private foundation, nor a significant disposition of assets (as defined in section 1.507-3(c)(2)) by a private foundation (whether or not any portion of such disposition of assets is made to another private foundation), shall be deemed to result in a termination of the transferor private foundation under section 507(a) of the Code, unless the transferor private foundation elects to terminate pursuant to section 507(a)(1) or section 507(a)(2) is applicable.

Section 1.507-1(b)(9) of the regulations provides that a private foundation which transfers all of its assets is not required to file annual information returns required by section 6033 of the Code for its tax years after the tax year of its transfer when it has no assets or activities.

Section 1.507-3(a)(1) of the regulations provides that in the case of a significant disposition

469

of assets to one or more private foundations within the meaning of paragraph (c) of this subsection, the transferee organization shall not be treated as a newly created organization.

Section 1.507-3(a)(2)(i)of the regulations provides that a transferee organization, in the case of a transfer described in section 507(b)(2) of the Code, shall succeed to the aggregate tax benefit of the transferor organization in an amount equal to the amount of such aggregate tax benefit of the transferor organization, multiplied by a fraction the numerator of which is the fair market value of the assets (less encumbrances) transferred to such transferee and the denominator of which is the fair market value of the assets of the transferor (less encumbrances) immediately before the transfer. Fair market value is determined at the time of transfer.

Section 1.507-3(a)(8)(ii) of the regulations provides that, in a section 507(b)(2) transfer, the provisions enumerated in subparagraphs (a) through (g) thereof apply to the transferee foundation with respect to the assets transferred to the same extent and in the same manner that they would have applied to the transferor foundation had the transfer described in section 507(b)(2) not been effected.

Section 1.507-3(a)(9)(i) of the regulations provides that, if a transferor private foundation transfers assets to a private foundation effectively controlled, directly or indirectly, by the same person or persons who effectively control the transferor private foundation, the transferee foundation will be treated as if it were the transferor foundation, for purposes of sections 4940 through 4948 and sections 507 through 509 of the Code. The transferee is treated as the transferor in the proportion which the fair market value of the transferor's assets that were transferred bears to the fair market value of all of the assets of the transferor immediately before the transfer.

Section 1.507-3(b) of the regulations provides that in order for a transfer of assets, pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization, not to be a taxable expenditure, it must be to an organization described in section 501(c)(3) (other than an organization described in section 509(a)(4)) or treated as described in section 501(c)(3) under section 4947.

Section 1.507-4(b) of the regulations provides that the tax on termination of private foundation status under section 507(c) of the Code does not apply to a transfer of assets pursuant to section 507(b)(2) of the Code.

Section 4940 of the Code imposes a tax on the net investment income of private foundations.

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

Section 4942 of the Code requires a private foundation to make specified distributions of income for each taxable year, including the year in which it transfers substantial assets to another private foundation under section 507(b)(2).

920

Section 4942(g)(1)(A) of the Code defines a qualifying distribution as any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled by the foundation or one or more disqualified persons or (ii) a private foundation which is not an operating foundation, except as otherwise provided; or (B) any amount paid to acquire an asset used directly in carrying out one or more purposes described in section 170(c)(2)(B).

Section 4942(g)(3) of the Code requires that a grantor private foundation, in order to have a qualifying distribution for its grant to another private foundation, which is not an operating foundation under section 4942(j)(3) of the Code, must have adequate records, as required by section 4942(g)(3)(B) of the Code, to show that the grantee private foundation, in fact, subsequently made qualifying distributions that were equal to the amount of the grant and that were paid out of the grantee's own corpus within the meaning of section 4942(h) of the Code. Such grantee foundation's qualifying distributions out of corpus must be expended before the close of the grantee's first tax year after its tax year in which it received the grant.

Section 4945 of the Code imposes tax upon a private foundation's making of any taxable expenditure under section 4945(d).

Section 4945(d)(4) of the Code defines the term taxable expenditure to include any amount paid or incurred by a private foundation as a grant to an organization unless (A) the organization is described in subparagraphs (1), (2), or (3) of section 509(a) of the Code or is an exempt operating foundation as defined in section 4940(d)(2) of the Code, or (B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h) of the Code. The exercise of expenditure responsibility requires the foundation that makes the transfer to keep detailed records of the way the payment is spent by the recipient foundation.

Section 4945(h) of the Code provides that expenditure responsibility referred to in subsection (d)(4) means that the 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 detailed reports with respect to such expenditures, and (3) to make full and detailed reports to the Secretary.

Section 53.4945-5(b)(7)(i) of the Foundation and Similar Excise Taxes Regulations refers to the rules relating to the extent to which the expenditure responsibility rules contained in section 4945(d)(4) and (h), and this section apply to transfers of assets described in section 507(b)(2).

Section 53.4945-6(c)(3) of the regulations allows a private foundation to make transfers of its assets pursuant to section 507(b)(2) of the Code to organizations exempt from federal income tax under section 501(c)(3) of the Code, including private foundations, without the transfers being taxable expenditures under section 4945 of the Code.

Because B intends to transfer more than 25 percent of the fair market value of its assets to C and D, the transfer will constitute a significant disposition of B's assets. The transfer will thus be a transfer between private foundations within the meaning of section 507(b)(2) of the Code.

Because B will not notify the Service of its intent to terminate its private foundation status until at least one day after the transfer of B's assets to C and D has been accomplished, section 507(a)(1) of the Code will not apply to the transfers. Also, the Service has not notified B that its private foundation status is being terminated under section 507(a)(2) of the Code. Therefore, the transfer of B's assets to C and D will not result in the imposition of a termination tax under section 507(c) of the Code.

Section 507(b)(2) of the Code provides that, in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization. Thus, the transfer by B to C and D will constitute in the aggregate an "adjustment, organization, or reorganization" within the meaning of section 507(b)(2). Accordingly, the transfer by B to C and D will not be treated as a transfer to a newly created organization.

Because C and D will be treated as if they were B, they will succeed to the attributes and characteristics of B. Accordingly, the proposed reorganization and transfer itself will not constitute an event giving rise to net investment income to either C or D and consequently will not give rise to an excise tax under section 4940 of the Code.

Under section 1.507-3(a)(9)(i) of the regulations, C and D will each be treated as if they were B and, as such, the proposed transfer will subject C and D to its proportionate share of any excise tax imposed by section 4940 on B. As a result, both C and D will include its pro rata share of B's excise tax in its computation of net investment income for the taxable year of the proposed reorganization and transfer.

Because B is exempt under section 501(c)(3), and assuming C and D receive classification under section 501(c)(3), they are not considered disqualified persons for purposes of self-dealing. Therefore, the proposed transfer will not constitute self-dealing, and the excise tax on acts of self-dealing imposed by section 4941 will not apply to B, C or D.

Because C and D are controlled by B for purposes of Chapter 42 of the Code and sections 507 through 509 of the Code, C and D will be treated subsequent to the transfer of B's assets, as if were B, in the proportion which the fair market value of the assets (less encumbrances) transferred bears to the fair market value of B's assets (less encumbrances) immediately before the transfer. Thus C and D can succeed to B's excess qualifying distributions carryover for purposes of section 4942 of the Code, and in proportions determined in accordance with section 1.507-3(a)(9)(i) of the regulations (consistent with succeeding to B's tax attributes).

Because B is transferring all of its assets to C and D pursuant to a reorganization and B, C and D are controlled by the same persons, C and D will be treated as B. The transfer will be

472

treated as not having taken place for expenditure responsibility purposes under section 4945(d)(4). Thus, the transfer will not be a taxable expenditure under section 4945(d)(4).

Under section 1.507-3(a)(9)(iii) (example 2) of the regulations, C and D must exercise expenditure responsibility with respect to any outstanding grants made by B prior to the transfer and over which B is required to exercise responsibility. Nevertheless, according to the regulations, C or D may agree separately by assignment to exercise expenditure responsibility over outstanding pre-transfer grants, thus contractually delegating that expenditure responsibility. Furthermore, because effective control is and will be present, B itself is not required to exercise expenditure responsibility with respect to either (1) the grants it has made prior to the proposed transfer or (2) grants that it has made to effect its reorganization and transfer under section 507(b)(2). As previously indicated, C and D will assume expenditure responsibility over the grant to E, either collectively or by assignment between them.

Under section 507(e) of the Code, the value of B's assets after it has transferred all of its assets to C and D will zero. Thus, B's voluntary notice of termination of its private foundation status pursuant to section 507(a)(1) will not result in tax under section 507(c) of the Code.

Accordingly, based on the information furnished, we rule as follows:

1. The proposed reorganization and transfer of all of B's net assets in equal shares to C and D will constitute a transfer pursuant to a reorganization under section 507(b)(2) of the Code.

2. The proposed reorganization and transfer of assets will not subject B to any termination tax imposed by section 507(c) of the Code.

3. Neither C or D will be treated as newly-created organizations for purposes of sections 507-509 of the Code.

4. The proposed reorganization and transfer of assets from B to C and D in equal shares will not constitute a sale or disposition of property under section 4940 of the Code.

5. The proposed reorganization and transfer of assets will subject C and D to any excise tax imposed by section 4940 of the Code on B in the taxable year(s) of the proposed transfer; C and D will include its pro rata share of B's excise tax in its computation of net investment income for the taxable year of the proposed reorganization and transfer.

6. The proposed reorganization and transfer of assets from B to C and D in equal shares will not constitute an act of self-dealing under section 4941 of the Code.

7. C and D will succeed to B's excess qualifying distributions and carry-over for the taxable year of the proposed transfer, as determined under section 4942(i) of the Code and in proportions determined in accordance with section 1.507-3(a)(9)(i) of the regulations (consistent with succeeding to B's tax attributes).

473

8. The proposed reorganization and transfer of assets from B to C and D in equal shares will not constitute a taxable expenditure within the meaning of section 4945 of the Code.

9. B will be relieved of expenditure responsibility (as the term is defined in section 4945(h) of the Code) if C and D, separately or jointly, assume(s) expenditure responsibility for any outstanding grants over which B currently exercises expenditure responsibility under section 4945 of the Code (specifically a grant to E).

10.The voluntary termination of B's status as a private foundation in the taxable year following the taxable year of the proposed transfer will not constitute a taxable termination under section 507 of the Code, and the termination tax under section 507(c) will not be imposed.

These rulings are issued on the assumption that C and D are recognized as exempt under section 501(c)(3) of the Code.

We are informing the Ohio TE/GE office of this action. Please keep a copy of this ruling in your organization's 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 used or cited as precedent.

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.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

474