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

MAR 19 2001

SIN: .0507.00-00; .4941-00-00

E:EO:R3

Employer Identification Number:

LEGEND:

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X =

Dear Sir or Madam:

This is in response to a letter dated January 21, 2000, requesting rulings under section 507 on the Internal Revenue Code and other provisions of the Code concerning your (the foundation's) proposed termination of private foundation status.

The foundation has requested the following rulings:

1. As of the date of the filing of the notice of termination of private foundation status pursuant to section 507(a)(1) of the Code and section 1.507-1(b) of the Regulations, the foundation will be deemed to have ceased to exist for purposes of Subchapter F of Chapter 1 and Chapter 42 and to have been reconstituted as a newly organized entity that will not qualify as an organization described in section 501(c)(3).

2. If the foundation terminates its status as a private foundation under section 507(a)(1) of the Code, the Service will exercise its authority under section 507(g) to abate the tax imposed by section 507(c).

3. After the date of the filing of the notice under section 507(a)(1) of the Code, Chapter 42 will not apply to the foundation. Accordingly, the sale of assets of the foundation as described herein will not be subject to tax on self-dealing under section 4941.

4. After the date of filing the notice under section 507(a)(1) of the Code, the foundation will not be required to file annual information returns pursuant to section 6033.

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The foundation was incorporated in X for educational purposes. Specifically, the foundation educates children through research, seminars and conferences, publishing literature, curriculum enrichment and the training of teachers. The foundation is exempt under section 501(c)(3) of the Code, a private foundation within the meaning of section 509(a), and is a private operating foundation within the meaning of section 4942(j)(3).

Since the foundation's inception, it has received substantially all of its funds from contributions and interest-free loans from its founder and foundation manager N, and publishing revenues. The foundation has a patent application pending for its O. N has recently concluded that the foundation's publishing activities can no longer generate enough income to be self-supporting if it must operate within the constraints applicable to tax exempt organizations. Consequently, the foundation's Board of Directors has proposed that it terminate its private foundation status by filing a notice of such termination with the Service under section 507(a)(1) of the Code and requests that the amount of tax due under section 507(c) be abated pursuant to section 507(g)(1). The foundation will then sell its assets, less the loans payable to N, at fair market value as determined by means of an independent appraisal to a general business corporation controlled by N that will take over the foundation's publishing activities as a for-profit taxable enterprise. It is expected that most of the purchase price will be represented by the assumption of promissory notes payable to N. After the sale, the foundation will adopt a plan of liquidation and distribute any remaining assets to one or more unrelated charitable organizations described in section 507(g)(1) of the Code.

Section 507(a)(1) of the Code and section 1.507-1(b)(1) of the Income Tax Regulations provide that, except as provided in section 507(b), the status of any organization as a private foundation shall be voluntarily terminated only if such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such termination, and either such organization pays the tax imposed by subsection (c) (or any portion not abated under subsection (g)) or has the entire amount of such tax abated under subsection (g).

Section 507(c) of the Code provides that there is imposed on each organization which is referred to in subsection (a) a tax equal to the lower of - -

(1) the amount which the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the section 501(c)(3) status of such foundation, or

(2) the value of the net assets of the foundation.

Section 507(g)(1) of the Code provides that the Secretary may abate the unpaid portion of the assessment of any tax imposed by subsection (c), or any liability in respect thereof, if the private foundation distributes all of its net assets to one or more organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)) each of which has been in existence and so described for a continuous period of at least 60 calendar months.

Section 509(a) of the Code provides that, unless otherwise excepted, organizations recognized as exempt under section 501(c)(3) of the Code are classified as private foundations.

Section 509(b) provides generally that once an organization is classified as a private foundation, it shall be treated as a private foundation until such status is terminated under section 507.

Section 4941(a)(1) of the Code imposes a tax on the disqualified person on each act of self-dealing between a disqualified person and private foundation.

Section 4941(a)(2) of the Code imposes a tax on the private foundation manager who participated in the act of self-dealing for which a self-dealing tax was imposed under section 4941(a)(1).

Section 4941(b) of the Code imposes additional self-dealing taxes unless the self dealing acts are corrected.

Section 4941(d)(1)(A) and (B) of the Code provides that the term "self-dealing" means any direct or indirect sale or exchange, or leasing, of property between a private foundation and a disqualified person.

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 4946(a)(1) of the Code includes substantial contributors, foundation managers and business entities that are controlled by disqualified persons as disqualified persons.

Section 6033 of the Code requires private foundations to file annual information returns.

Section 1.507-1(b)(2) of the regulations indicates that a voluntary termination of private foundation status under section 507(a)(1) of the Code does not relieve a private

foundation and /or any of its disqualified persons of any liability for taxes under Chapter 42 of the Code.

Section 1.507-9(a) of the regulations provides that no tax that is imposed under the provisions of Chapter 42 of the Code shall be abated under section 507(g), which concerns the abatement of termination tax under section 507(c).

Ruling #1

Termination of private foundation status pursuant to section 507(a)(1) of the Code requires both notice to the Service and payment of the tax imposed by section 507(c) or abatement of the tax pursuant to section 507(g). The foundation has asked for abatement under section 507(g)(1). Section 507(g)(1) permits abatement in cases where a private foundation transfers all of its net assets to one or more public charities described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)). The foundation has represented that this transfer will not occur by or on the date its files the notice of termination. On the date the foundation proposes to submit its notice of intent to terminate it would not have paid the termination tax imposed by section 507(c). In addition, after the date the foundation submits its notice to terminate, but before the date the foundation distributes its net assets to charities described in section 507(g)(1), the foundation will sell its assets to a corporation controlled by N. After the foundation completes this sale of assets, it will then distribute its net assets to charities described in section 507(g)(1). Since the transfer of all its net assets to appropriate public charities will not occur by or on the date the foundation submits its notice of intent to terminate, the Commissioner would not have the discretion to abate the termination tax under section 507(g)(1) on the date the foundation submits its notice of intent to terminate. Thus, on the date the foundation submits its notice it would not have paid the section 507(c) tax. Nor would the tax be abated. Therefore, on the date foundation files the notification it would not have terminated its private foundation status under section 507(a)(1) and it would still be treated as a private foundation under section 509(b), subject to the Chapter 42 requirements.

Ruling #2

The foundation requested in ruling request two that the Service rule that if the foundation terminates is status as a private foundation under section 507(a)(1) of the Code, the Service will exercise its authority under section 507(g) to abate the termination tax imposed by section 507(c). In ruling request one, the foundation asked that the Service rule that the termination is effective on the date it submits its notification of intent to terminate its private foundation status. However, under the facts of the proposed transaction, on the date the foundation submits its notice of intent to terminate its private foundation status, it would not have terminated its private

foundation status. Nor would the foundation have met the criteria for abatement specified in section 507(g)(1) because it would not have distributed its net assets to public charities. Therefore, ruling request two involves a hypothetical situation. Accordingly, pursuant to section 8.02 of Rev. Proc. 2001-4, 2001 I.R.B. 121, 134, the Service declines to issue a ruling on this issue. In addition, the Service pursuant to section 8.01 of Rev. Proc. 2001-4 may decline to issue a ruling when appropriate in the interest of sound tax administration or on other grounds whenever warranted by the facts and circumstances of a particular case.

Ruling # 3

As discussed in response to ruling request one, at the time of the proposed sale of the foundation's assets, the foundation would not have terminated its private foundation status and would still be subject to the requirements of section 4941 of the Code.

Furthermore, the substance of the proposed transaction described above is the sale of the foundation's assets to a disqualified person. This would clearly be an act of self-dealing as defined in section 4941(d)(1) of the Code, subjecting the business entity controlled by N and N, separately as foundation manager, to self-dealing taxes under sections 4941(a)(1) and (2). Further, the business entity and N would be subject to additional taxes under section 4941(b) unless the self-dealing act is corrected. In addition, under section 1.507-1(b)(2) and -9(a) of the regulations any future termination under section 507 would not negate any tax assessed pursuant to section 4941.

Ruling # 4

As discussed in response to ruling request one, on the date the foundation files the notice described in section 507(a)(1) of the Code, it would not have terminated its private foundation status and would still be subject to the annual filing requirements of section 6033.

These rulings are based on the understanding that there will be no material changes in the facts upon which they are based.

These rulings are directed only to the organizations that requested them. Section 6110(k)(3) of the Code provides that they may not be used or cited by others as precedent.

These rulings do not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

Please keep a copy of this ruling in your permanent records.

Sincerely,

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

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