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

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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Contact Person:

Uniform Issue List: 507.00-00
4940.00-00
4941.04-00
4942.03-05
4943.00-00
4944.00-00
4945.00-00

Identification Number:

Telephone Number:

T:EO:B2

Employer Identification Number:

LEGEND:
B =
C =
D =
E =
F =
x =

Dear Sir or Madam:

We have considered your ruling request dated February 5, 2001, in which you requested certain rulings with respect to a transfer of all of the assets of B to C.

E died testate in 1971. E's Will created a testamentary trust for the benefit of E's spouse, F. At F's death in 1999, E's Will directed the Trustee to hold a portion of the testamentary trust as a separate trust, known as B. The Will directs the Trustee to manage B for the benefit of worthy philanthropic charitable causes and in the interest of the public welfare through the alleviation of human suffering and the advancement of science, education, and the cultural arts. The assets currently comprising B have a fair market value of approximately $385x.

In 1991, F created D. At F's death, Article IX of D directed the Trustee to hold the remainder of F's trust estate as a separate trust known as C. Article IX of D directs the Trustee to use C's income exclusively for contributions to organizations, including government bodies, operated for charitable purposes, for educational purposes, for supplementing the needs for the health and comfort of sick and elderly people, for care and education of needy children through qualified children's homes, for the prevention of cruelty to children, or to help defray the expenses of surgical treatment of cancer or heart disease to indigent people in the community. The assets currently comprising C have a fair market value of approximately $5,823x.

Both B and C are exempt under section 501(c)(3) of the Internal Revenue Code (the

"Code") and are classified as private foundations under section 509(a).

The Trustee of both B and C proposes to file a petition with the state circuit court for an order permitting the Trustee to transfer all of the assets of B to C. If the court grants the Trustee's petition, the Trustee proposes to transfer all of the assets of B to C pursuant to section 507(b)(2) of the Code. Thereafter, should the Service issue the rulings requested, the Trustee intends to notify the Service of its intent to terminate B's status as a private foundation pursuant to section 507(a)(1) and to terminate B.

The Trustee will not receive any funds from the proposed transfer or benefit directly or indirectly from the proposed transfer. Rather, the Trustee proposes this transfer in order to avoid a duplication of efforts and for administrative convenience and economy.

The following rulings are requested:

1. The proposed transfer of all of the assets of B to C pursuant to section 507(b)(2) of the Code, to be followed by the termination of B's status as a private foundation pursuant to 507(a)(1), will not result in the imposition of the termination tax under section 507(c).

2. The proposed transfer will not result in either net investment income within the meaning of section 4940 of the Code or the imposition of the excise tax under section 4940.

3. The proposed transfer will not constitute an act of self-dealing under section 4941 of the Code and, therefore, will not result in the imposition of the excise tax under section 4941.

4. B's distribution requirement for the taxable year of the proposed transfer may be fulfilled by C, B will not be required to comply with the record keeping requirements of section 4942(g)(3)(B) of the Code, and B will not be subject to the excise tax under section 4942.

5. The proposed transfer will not result in excess business holding under section 4943 of the Code and, therefore, will not result in the imposition of the excise tax under section 4943.

6. The proposed transfer is not an investment that jeopardizes charitable purposes under section 4944 of the Code and, therefore, will not result in the imposition of the excise tax under section 4944.

7. The proposed transfer is not a taxable expenditure under section 4945 of the Code and, therefore, will not result in the imposition of the excise tax under section 4945.

Section 507(a) of the Code provides that, except as provided in section 507(b), an exempt organization that 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 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 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 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 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 (the "regulations") provides that private foundations that make transfers described in section 507(b)(2) of the Code are not subject to the tax imposed under section 507(c) with respect to such transfers unless the provisions of section 507(a) apply.

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. Additionally, for purposes of section 507(b)(2), the terms "other adjustment, organization, or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Section 1.507-3(c)(2) of the regulations defines the term "significant disposition of assets to one or more private foundations" to include any disposition for a taxable year where the disposition is 25 percent or more of the fair market value of the net assets of the foundation at the beginning of the taxable year.

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.

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)(5) of the regulations provides that a transferor private foundation is required to meet its distribution requirements under section 4942 of the Code 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. Such transfer shall itself be counted toward satisfaction of such requirements to the extent the amount transferred meets the requirements of section 4942(g). However, when 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. Such

requirements are applicable for any taxable year other than a taxable year during which the transferor has no assets.

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 provides 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 which 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 under section 507(a)(1).

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 Foundation and Similar Excise Taxes Regulations (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 4942(g)(3) of the Code provides that a transferor private foundation, in order to have a qualifying distribution for its grant to another private foundation, must have adequate records, as required by section 4942(g)(3)(B), to show that the transferee foundation in fact subsequently made a qualifying distribution that is equal to the amount of the transfer received and that is paid out of the transferee's own corpus within the meaning of section 4942(h). The transferee's qualifying distribution must be expended before the close of the transferee's first tax year after the transferee's tax year in which it received the transfer.

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.

Revenue Ruling 78-387, 1978-2 C.B. 270, describes the carryover of a transferor private foundation's excess qualifying distributions under section 4942(i) of the Code where the transferor and the transferee foundations are controlled by the same persons under section 1.507-3(a)(9)(i) of the regulations. The transferee is treated as the transferor so that the transferee can reduce its own distributable amount under section 4942 of the Code by its share of the transferor foundation's excess qualifying distributions under section 4942(i).

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).

Analysis:

Your requested rulings are discussed below:

1.

The proposed transfer of all of the assets of B to C will be a transfer of assets described in section 507(b)(2) of the Code. That is, the proposed transfer will be a disposition of more than twenty-five percent of the fair market value of the net assets of B to another private foundation for the taxable year in which the proposed transfer will occur.

However, the proposed transfer will not, in and of itself, terminate B's status as a private foundation. Rather, this must be accomplished by notice to the Service under section 507(a)(1) of the Code. Consequently, the proposed transfer will not give rise to a termination tax under section 507(c). Furthermore, the proposed transfer will not affect the private foundation status of either B or C.

After the proposed transfer is complete, and after the Trustee notifies the Service of its intent to terminate B's status as a private foundation under section 507(a)(1) of the Code, the termination tax under section 507(c) will be zero because the value of B's assets at that time will be zero.

2.

C, 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. Rather, C will be treated as though it were B for purposes of section 4940 of the Code. Therefore, B's transfer of all of its assets to C will not result in a tax on net investment income under section 4940(a)

3.

The proposed transfer of all of the assets of B to C will not be an act of self-dealing because the proposed transfer will be to C, an organization exempt from federal income tax under section 501(c)(3) of the Code and a private foundation under section 509(a). The proposed transfer, therefore, will be for exempt purposes to an organization exempt from federal income tax. Moreover, C, as the transferee, is not a disqualified person under section 53.4946-1(a)(8) of the regulations. Since the proposed transfer will not be an act of self-dealing under section 4941(d) of the Code, it will not result in the excise tax under section 4941(a).

4.

The proposed transfer of all of the assets of B to C will be a transfer under section 507(b)(2) of the Code. After the proposed transfer, C will be treated as if it were B pursuant to section 1.507-3(a)(9)(i) of the regulations. Thus, B's excise tax liability under section 4942(a) of the Code for its final tax year, if any, may be satisfied by C, and B will not be liable for the excise tax under section 4942(a). Additionally, C can reduce the amount of its required distributions under section 4942(d) by the amount, if any, of B's excess qualifying distribution carryover from prior years.

Furthermore, since the same Trustee controls both B and C, the proposed transfer to C will not be deemed a qualifying distribution under section 4942(g)(1)(A)(i) of the Code. Therefore, the proposed transfer will not require B to comply with the record keeping requirements of section 4942(g)(3)(B).

5.

Provided that none of the assets transferred to C would cause it to have excess business holdings as that term is defined in section 4943(c), the proposed transfer from B to C will not result in liability for the excise tax on excess business holdings imposed by section 4943(a).

6.

The proposed transfer will not be an investment that jeopardizes the conduct of B's exempt purposes within the meaning of section 4944 of the Code. The primary purpose of the proposed transfer of all of the assets of B to C will be to accomplish one or more of the purposes under section 501(c)(3) of the Code because C is recognized as exempt under section 501(c)(3). Moreover, since the proposed transfer will constitute an "adjustment, organization, or

reorganization" within the meaning of section 1.507-3(c)(1) of the regulations, the production of income or appreciation of property will not be a significant purpose of the proposed transfer within the meaning of 4944(c). Therefore, the proposed transfer will not result in the imposition of the excise tax under section 4944(a).

7.

Since the proposed transfer is a transfer to an organization described in section 501(c)(3) of the Code, such transfer does not constitute a taxable expenditure under section 53.4945-6(c)(3) of the regulations. Therefore, the proposed transfer will not result in the imposition of the excise tax under section 4945(a).

Conclusion:

Accordingly, we rule that:

1. The proposed transfer of all of the assets to B to C under section 507(b)(2) of the Code, to be followed by the termination of B's status as a private foundation under section 507(a)(1), will not result in the imposition of the termination tax under section 507(c).

2. The proposed transfer will not result in either net investment income within the meaning of section 4940(c) of the Code or the imposition of the excise tax under section 4940(a).

3. The proposed transfer will not constitute an act of self-dealing within the meaning of section 4941(d) of the Code, and will not result in the imposition of the excise tax under section 4941(a).

4. B's distribution requirement for the taxable year of the proposed transfer may be fulfilled by C. B will not be required to comply with the record keeping requirements of section 4942(g)(3)(B) of the Code. B will not be subject to the excise tax under section 4942(a).

5. The proposed transfer will not result in excess business holdings under section 4943(c) of the Code, and will not result in the imposition of the excise tax under section 4943(a).

6. The proposed transfer is not an investment that jeopardizes charitable purposes under section 4944 of the Code, and will not result in the imposition of the excise tax under section 4944(a).

7. The proposed transfer is not a taxable expenditure under section 4945(d) of the Code, and will not result in the imposition of the excise tax under section 4945(a).

Because this ruling letter could help to resolve any questions, please keep it in your permanent records.

This ruling letter 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.

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,

(signed) Terrell M. Berkovsky
Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2