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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200219043

Date:
FEB 12 2002

SIN: 507.00-00

Contact Person:

Identification Number:

Telephone Number:
(202) 283-8954

Legend:
B=
C=

Dear Sir or Madam:

This is in response to your letter dated December 14, 2001, in which you requested certain rulings with respect to a proposed transfer of assets from B to C.

B is exempt under section 501(c)(3) of the Internal Revenue Code and is classified as a private foundation under section 509(a). C is in the process of preparing a Form 1023 application to be filed with the Service seeking 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 five trustees. With the passage of time, two of the trustees have developed charitable interests and management philosophies that differ from the philosophies of the other three and have established C. B believes that its charitable objectives can now be best served by the transfer of 40 percent of its liquid assets to C. The distribution of assets to C will allow the trustees to pursue their respective independent charitable interests and objectives.

B represents that it will exercise the expenditure responsibility required by section 4945(h) of the Code with respect to the transfer of assets to C. B has not notified the Service that it intends to terminate its private foundation status, nor has B ever received notification that its status as a private foundation has been terminated. Furthermore, B has stated that it has not committed 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.

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Section 507(a) of the Code 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(c) of the Code imposes a tax on an organization that terminates its private foundation status under section 507(a) of the Code.

Section 1.507-3(a)(4) of the Income Tax Regulations provides that if a private foundation incurs liability under Chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets under section 507(b)(2) to one or more private foundations, in any case where transferee liability applies each transferee foundation shall be treated as having received the transferred assets subject to such liability to the extent that the transferor foundation does not satisfy such liability.

Section 1.507-3(a)(5) of the 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 all or part 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.

Section 1.507-1(b)(6) of the regulations provides that if a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in section 507(b)(2) of the Code, such transferor foundation will not have terminated its foundation status under section 507(a)(1).

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)) 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 1.507-3(a)(1) of the regulations provides that in the case of a significant disposition of assets to one or more private foundations within the meaning of paragraph (c) of this subsection, the transferor organization shall not be treated as a newly created organization.

Section 1.507-3(a)(2) 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

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

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 unless the provisions of 507(a) become applicable.

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).

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 4944 of the Code imposes tax upon a private foundation which invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes.

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 4946(a)(1) of the Code defines the term "disqualified person" as a person who is a substantial contributor to a private foundation, a foundation manager, an owner of more than 20% of a corporation or partnership which is a substantial contributor to the private foundation, a family member of persons described above, or a corporation, partnership, trust or estate of which persons described above own more than 35% of the combined voting power.

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(b)(2) of the regulations provides that any expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under section 4945(d)(5) unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence. The determination whether an expenditure is unreasonable shall depend upon the facts and circumstances of the particular case.

Section 53.4945-6(c)(3) of the regulations provides that a transfer of assets of a private foundation under section 507(b)(2) of the Code is not a taxable expenditure if such transfer is to an organization described in section 501(c)(3) (other than an organization described in section 509(a)(4)) or treated as so described under section 4947(a)(1).

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Section 53.4946-1(a)(8) of the regulations provides that, for purposes of section 4941, the term "disqualified person" does not include any organization described in section 501(c)(3) (other than an organization described in section 509(a)(4)).

Based on the above facts, following the transfer from B to C, B and C will both conduct their charitable activities.

Under section 507(b)(2) of the Code, 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 newly created organization. Thus, the transfer by B to C 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 will not be treated as a transfer to a newly created organization.

Because a transfer of assets as described in section 507(b)(2) will not cause a termination of an organization's private foundation status, the transfer of B's assets to C will not terminate B's status as a private foundation.

B will not terminate its status as a result of this transaction. Therefore, the transfer of B's assets to C will not result in the imposition of tax under section 507(c) of the Code.

Under section 4940(c)(4) of the Code, capital gains and losses are defined as gains and losses from the sale or other disposition of certain property. Because the asset transfer, from B to C, will lack consideration, no sale or other disposition will have occurred, thus, there will be no gain and the asset transfer will not give rise to tax under section 4940 of the Code.

Because B, as an organization described in section 501(c)(3) of the Code, is not a disqualified person with respect to C, the transfer of assets to C will not constitute an act of self-dealing within the meaning of section 4941 of the Code.

Under section 1.507-3(a)(5) of the regulations, a private foundation is required to meet the distribution requirements of 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. Assuming that B meets its distribution requirements under section 4942 of the Code, for the year in which the transfer is made, the transfer of assets will not give rise to tax under section 4942 of the Code.

Because the proposed transfer of assets to C will be made to accomplish the exempt purposes of B, the transfer will not constitute "investments" for purposes of section 4944 of the Code. Thus, the excise taxes imposed on jeopardizing investments under section 4944(a) of the Code will not apply to the transfer of assets from B to C.

Because C will not be controlled by B, B will be required to exercise expenditure responsibility in accordance with section 4945(h) of the Code, with respect to the transferred

assets. Thus, assuming B exercises expenditure responsibility with respect to the transferred assets, the transfer of assets will not constitute a taxable expenditure under section 4945 of Code.

Provided the expenses incurred by B and C in the transfer of assets to C meet the "good faith" standard of section 53.4945-6(b)(2) of the regulations, such expenses will not constitute taxable expenditures under section 4945 of the Code and will be considered qualifying distributions under section 4942.

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

1. The proposed transfer of forty percent of B's assets to C will qualify as a transfer of assets described in section 507(b)(2) of the Code and will neither result in the termination of B's private foundation status under section 507(a), nor subject B to the tax imposed by section 507(c).

2. The proposed transfer of B's assets will not constitute either a willful flagrant act (or failure to act) or one of a series of willful repeated acts (or failures to act) giving rise to liability for tax under chapter 42 of the Code.

3. C will not be treated as a newly created organization and, as a transferee organization under section 507(b)(2) of the Code, will be treated as possessing the attributes and characteristics of B.

4. The proposed transfer of a portion of B's assets will not constitute a taxable expenditure by B under section 4945(d)(4) of the Code because B will exercise expenditure responsibility under sections 4945(d) and 4945(h) of the Code.

5. The proposed transfer of assets will not constitute a taxable expenditure by B under section 4945(d)(5) of the Code.

6. B and its disqualified persons will not be deemed to have engaged in an act or acts of self-dealing under section 4941 of the Code, or be subject to any tax under section 4941, as a result of the formation of C or the transfer of assets to C.

7. The proposed transfer of assets to C may be counted toward satisfaction of B's minimum distribution requirements under section 4942 of the Code for the tax year of the transfer to the extent that the transfer meets the requirements of section 4942(g)(3) of the Code.

8. Any reasonable legal, accounting, and other expenses incurred by B and C in connection with this ruling request and in effectuating the proposed reorganization and transfer of assets will not constitute taxable expenditures pursuant to section 4945 of the Code and will be considered qualifying distributions under section 4942. We are not ruling on the question of whether any particular expense is reasonable in nature.

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9. The proposed reorganization and transfer of B's assets will not result in the imposition of tax under section 4940 of the Code.

10. The net investment income received by B prior to the transfer of liquid assets from B to C may be apportioned between B and C and includable in the computation of the net investment income of B and C in the taxable year of the transfer in proportion to the amount of assets transferred pursuant to the reorganization.

11. The proposed reorganization and transfer of B's assets to C will not affect the tax exempt status of B or C under section 501(c)(3) of the Code.

These rulings are issued on the assumption that C will be 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