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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Contact Person:

Uniform Issue List: 507.00-00
501.03-02
509.03-00
4940.00-00
4941.04-00
4942.03-05
4944.00-00
4945.04-06

Identification Number:

Telephone Number:

T:ED:B2

Legend:
X =
Y =

Dear Sir or Madam:

This is in reply to your rulings request of June 22, 2001, on X's proposed transfer of all of its assets to Y in a merger of X into Y pursuant to section 507(b)(2) of the Internal Revenue Code.

X and Y are nonprofit corporations exempt from federal income tax under section 501(c)(3) of the Code and are private foundations under section 509(a) of the Code. X and Y are effectively controlled by the same persons. X's merger into Y under state law will result in the transfer by operation of law of all of X's assets to Y. X has no expenditure responsibility grants outstanding under section 4945(h) of the Code.

The following rulings are requested:

1. The transfer by operation of law of the assets of X to Y pursuant to the merger will not affect the status of either X or Y as an organization which is exempt from federal income taxation and is described in section 501(c)(3) of the Code.

2. The transfer by operation of law of the assets of X to Y pursuant to the merger will constitute a transfer described in section 507(b)(2) of the Code, and the transfer will not result in a termination of X's private foundation status giving rise to the imposition of the termination tax under section 507(c) of the Code.

3. If X terminates its private foundation status at least one day after the transfer of all of its net assets to the Y and so notifies the Internal Revenue Service pursuant to section 507(a)(1) of the Code, then X will not be liable for the tax imposed under section 507(c) because X will not have any assets after such termination and payment of expenses.

4. Both prior to and after the transfer by operation of law of the assets of X to Y pursuant to the merger, X and Y are effectively controlled by the same persons within the meaning of section 1.482-1(i)(4) of the Income Tax Regulations, so that the transfer of assets by X to Y will be treated as a transfer of all of X's assets to a private foundation controlled by the same persons who control Y within the meaning of section 1.482-1(i)(4). Thus, pursuant to section 1.507-3(a)(9)(i) of the regulations, the transfer will not subject X to the taxes imposed by sections 4941 through 4945 of the Code because, after the transfer, Y will be treated as if Y were X for purposes of Chapter 42 and section 509 of the Code.

5. Y will succeed to the aggregate tax benefit, if any, of X.

6. As the transferee of the net assets of X, Y will receive the benefit of any transitional rules or savings provisions applicable to X, as enumerated in sections 1.507-3(a)(8)(i) and (ii) of the regulations.

7. X's transfer of assets to Y will not constitute a "sale or other disposition" of property within the meaning of section 4940(c)(4)(A) of the Code and will not give rise to net investment income for X or Y. Therefore, the transfer of assets will not result in an imposition of additional taxes on X or Y under section 4940 of the Code and will not subject X to the two percent excise tax on any gain that might otherwise be imposed.

8. The transfer of the assets by X to Y pursuant to the merger will not constitute an act of self-dealing within the meaning of section 4941 of the Code and therefore will not result in the imposition of tax under section 4941 of the Code.

9. After X's transfer of assets to Y pursuant to the merger, Y may reduce the amount of its required distributions under section 4942 of the Code by the amount, if any, of the excess qualifying distribution carryover of X for prior years, as defined by section 4942(i) of the Code. Further, Y's distributable amount under section 4942(d) of the Code for its tax year in which the transfer occurs will be increased by the distributable amount for X for its tax year in which the transfer occurs, as if Y had held the assets for the entire tax year. All qualifying distributions made by Y during the entire year, and all qualifying distributions made by X during its tax year in which the transfer occurs will be treated as if made by Y. Therefore, the distribution requirements of X under section 4942 of the Code in the year of the transfer may be fulfilled by Y.

10. X will not be required to comply with the recordkeeping requirements under section 4942(g)(3)(B) of the Code with respect to the transfer of assets to Y pursuant to the merger after such transfer by operation of law of all of X's assets to Y.

11. The transfer of the assets of X to Y pursuant to the merger will not constitute an investment which jeopardizes the carrying out of exempt purposes within the meaning of section 4944 of the Code.

12. The transfer of the assets of X to Y pursuant to the merger will not constitute a taxable expenditure under section 4945 of the Code and therefore will not result in the imposition of tax under section 4945 of the Code, and neither X nor Y will be required to exercise expenditure responsibility over the assets transferred to Y pursuant to the merger.

13. The reasonable and necessary legal, accounting and other expenses and costs incurred by X to implement the transfer of its assets to Y will constitute qualifying distributions by X under section 4942 of the Code, and will not constitute taxable expenditures by X under section 4945 of the Code.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations organized and operated exclusively for the charitable and/or other exempt purposes stated in that section.

Section 509(a) of the Code describes organizations exempt from federal income tax under section 501(c)(3) of the Code are private foundations subject to the provisions of Chapter 42 of the Code.

Section 507(a)(1) of the Code and section 1.507-1(b)(1) of the Income Tax Regulations provide that a private foundation may voluntarily terminate its private foundation status by submitting to the Internal Revenue Service a statement of its intention to voluntarily terminate its private foundation status pursuant to section 507(a)(1) and by paying any termination tax under section 507(c) of the Code.

Section 507(c) of the Code impose excise tax on a private foundation which voluntarily terminates its private foundation status under section 507(a)(1) of the Code, and provides that this section 507(c) tax is equal to the lower of: (1) the aggregate tax benefits that have resulted from the private foundation's exempt status under section 501(c)(3) of the Code, or (2) the value of the net assets of the private foundation.

Section 507(b)(2) of the Code concerns the transfer of assets by one private foundation to one or more other private foundations, and provides that each transferee private foundation shall not be treated as a newly created organization.

Section 1.507-3(c)(1) of the regulations indicates that a transfer under section 507(b)(2) of the Code includes a transfer of assets from one private foundation to one or more other private foundations pursuant to any reorganization, including a significant disposition of 25% or more of the transferor foundation's assets.

Section 1.507-3(a)(1) of the regulations provides that, in a transfer of assets from one private foundation to one or more private foundations pursuant to a reorganization, each transferee private foundation shall not be treated as a newly created organization, but shall succeed to the transferor's aggregate tax benefits under section 507(d) of the Code.

Section 507(d) of the Code indicates that the aggregate tax benefits of a private foundation refer to the value of its exemption from federal income tax and of the deductions taken by its donors during its existence.

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

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 tax year in which it makes a transfer of its assets to another private foundation pursuant to section 507(b)(2) of the Code. Also, where a private foundation transfers all of its assets, any recordkeeping requirements under section 4942(g)(3)(B) of the Code do not apply when the foundation has no assets.

Section 1.507-3(a)(7) of the regulations provides that, where a private foundation has transferred all of its assets to another private foundation in a transfer under section 507(b)(2) of the Code, it is not required to exercise expenditure responsibility under section 4945(h) of the Code with respect to such transfer.

Section 1.507-3(a)(9)(i) of the regulations provides that, if a private foundation transfers assets to one or more private foundations which are effectively controlled directly or indirectly within the meaning of section 1.482-1(i)(4) of the regulations by the same persons who effectively control the transferor foundation, each 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. Each transferee is treated as its transferor in the proportion which the fair market value of the transferor's assets transferred to the transferee bears to the fair market value of all of the transferor's assets immediately before the transfer.

Section 1.507-3(a)(9)(ii) of the regulations provides that a transfer of assets under section 507(b)(2) of the Code does not relieve the transferor private foundation from filing its own final tax year return as required by section 6043(b) of the Code.

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 under section 507(b)(2) of the Code.

Sections 1.507-1(b)(7) and 1.507-3(d) of the regulations provide that a transferor foundation's transfer of assets under section 507(b)(2) of the Code will not constitute any termination of the transferor foundation's private foundation status under section 509(a) of the Code .

Section 4940 of the Code imposes excise tax on certain investment income of a private foundation.

Section 4941 of the Code imposes excise tax on any act of self-dealing between a private foundation and any of its disqualified persons under section 4946 of the Code.

Section 53.4946-1(a)(8) of the regulations provides that, for purposes of self-dealing under section 4941 of the Code, an exempt organization under section 501(c)(3) of the Code is not a disqualified person.

Section 4942 of the Code requires that a private foundation must expend annual qualifying distributions under section 4942(g) of the Code for the conduct of exempt purposes.

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) of the Code.

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

Section 4945(d)(4)(B) of the Code requires that, in order to avoid making a taxable expenditure, a transferor private foundation must exercise expenditure responsibility under section 4945(h) of the Code on its grants to another private foundation.

Section 4945(h) of the Code defines expenditure responsibility in terms of the grantor private foundation requiring pre-grant inquiry and post-grant reports as to the grantee private foundation on its uses of the grant. Section 4945(h) of the Code provides that, in order to exercise expenditure responsibility under section 4945(h), the grantor private foundation must, under section 4945(h)(1) of the Code, see that its grant is spent solely for the grant's purpose, must, under section 4945(h)(2) of the Code, obtain complete reports from the grantee foundation on how the funds are spent; and must, under section 4945(h)(3) of the Code, report to the Internal Revenue Service with respect to such grants.

Analysis

1.

X's transfer of all of its assets by merger under state law into Y is for exempt purposes under section 501(c)(3) of the Code and will not adversely affect the exemptions of X or Y under section 501(c)(3) of the Code.

2.

Under section 507(b)(2) of the Code and section 1.507-3(c)(1) of the regulations, a transfer under section 507(b)(2) of the Code includes a transfer of assets from one private foundation to one or more other private foundations pursuant to any reorganization or liquidation or merger, which includes any significant disposition of 25% or more of the transferor foundation's assets. Because X will be in such a reorganization by its transfer by merger of all of its assets to Y, X's transfer of all of its assets will be a transfer under section 507(b)(2) of the Code.

Under section 1.507-4(b) of the regulations, X's transfer of its assets pursuant to section 507(b)(2) of the Code will not terminate X's private foundation status under section 509(a) of the Code and will not result in termination tax under section 507(c) of the Code.

3.

Section 507(c) of the Code imposes excise tax on a private foundation which voluntarily terminates its status as a private foundation pursuant to section 507(a)(1) of the Code. This section 507(c) tax is equal to the lower of: (a) the aggregate tax benefits that have resulted from the foundation's exempt status under section 501(c)(3) of the Code or (b) the value of the net assets of the foundation. The value of X's net assets, after X has transferred all of its assets to Y, will be zero. Thus, at that time, X's voluntary notice to the Internal Revenue Service of its termination of its private foundation status pursuant to section 507(a)(1) of the Code will not result in termination tax under section 507(c) of the Code.

4.

Section 1.507-3(a)(9)(i) of the regulations provides that, if a transferor private foundation transfers its assets to another private foundation which is effectively controlled, directly or indirectly, by the same persons who effectively control the transferor private foundation within the meaning of section 1.482-1(i)(4) of the regulations, then the transferee private foundation will be treated as if it were the transferor private foundation for purposes of sections 4940 through 4948 and sections 507 through 509 of the Code. Because Y's control is effectively by the same persons who control X, X's transfer will be a transfer to a transferee organization that is effectively controlled by the same persons who control the transferor so that X's transfer is within section 1.507-3(a)(9) of the regulations.

5.

Under section 507(b)(2) of the Code and section 1.507-3(a)(1) of the regulations, in this transfer of assets under section 507(b)(2) of the Code, X's aggregate tax benefits under section 507(d) of the Code will be transferred to Y.

6.

Under section 1.507-3(a)(8) of the regulations, X's transferee Y will receive the benefits, if any, of the transitional rules and savings provisions of that regulation that were applicable to X.

7.

X's transfer of assets to Y will not result in tax under section 4940 of the Code.

8.

X's transfer of assets will be made for exempt purposes under section 501(c)(3) of the Code to Y, which is exempt from federal income tax under section 501(c)(3) of the Code. Under section 53.4946-1(a)(8) of the regulations, because Y is exempt from federal income tax under section 501(c)(3) of the Code, Y is not a disqualified person as to X under section 4946 of the Code for purposes of section 4941 of the Code. Because X's transfer of assets will not be a transfer between a disqualified person and a private foundation, X's transfer will not be an act of self-dealing between a disqualified person and a private foundation under section 4941 of the Code.

9.

As in Revenue Ruling 78-387, cited above, after X transfers all of its assets to Y, X's excess qualifying distributions, if any, under section 4942(i) of the Code, may be used by Y to reduce Y's distributable amount under section 4942 of the Code by the amount, if any, of X's excess qualifying distributions carryover under section 4942(i) of the Code.

Transferee Y, in its tax year in which the transfer occurs, can increase its distributable amount under section 4942(d) of the Code by X's distributable amount for X's tax year in which X's transfer occurs. Transferee Y can treat transferor X's qualifying distributions for X's tax year of its transfer as if made by transferee Y, in addition to any qualifying distributions made by Y alone. Thus, X's distribution requirements under section 4942 of the Code for its tax year of its transfer can be fulfilled by transferee Y.

10.

Under section 1.507-3(a)(5) of the regulations, any recordkeeping requirement under section 4942(g)(3)(B) of the Code as to transferor X will not apply after X has transferred all of its assets to Y.

11.

X's transfer of its assets to Y for exempt purposes under section 501(c)(3) of the Code will not be a jeopardizing investment or result in tax under section 4944 of the Code.

12.

Sections 53.4945-6(c)(3) allows a private foundation to transfer its assets to exempt organizations under section 501(c)(3) of the Code pursuant to section 507(b)(2) of the Code, without the transfers being taxable expenditures under section 4945(d) of the Code, provided that any applicable expenditure responsibility under section 4945(h) of the Code is met. Thus, the transfer of assets from X to Y will not be a taxable expenditure under section 4945 of the Code.

Section 1.507-3(a)(7) of the regulations provides that, where a private foundation transfers all of its assets to one or more exempt organizations under section 501(c)(3) of the Code pursuant to section 507(b)(2) of the Code, such transferor foundation will have no expenditure responsibility requirement under section 4945(h) of the Code. Thus, X will not have to exercise expenditure responsibility under section 4945(h) of the Code with respect to its transfer of all of its assets to Y.

13.

Under section 53.4942(a)-3(a)(2)(i) of the regulations, a private foundation's payment of administrative expenses as part of a charitable effort may constitute a qualifying distribution. Thus, the legal, accounting, and other necessary expenses, incurred to implement X's transfer to Y, if reasonable in amount, will be paid to accomplish exempt purposes and will be qualifying distributions under section 4942(g)(1)(A) of the Code.

Accordingly, we rule that:

1. The transfer by operation of law of the assets by X to Y pursuant to the merger will not affect the status of either X or Y as an organization which is exempt from federal income taxation and is described in section 501(c)(3) of the Code.

2. The transfer by operation of law of the assets of X to Y pursuant to the merger will constitute a transfer described in section 507(b)(2), and the transfer will not result in a termination of X's private foundation status giving rise to the imposition of the termination tax under section 507(c) of the Code.

3. If X terminates its private foundation status at least one day after the transfer of all of its net assets to the Y and so notifies the Internal Revenue Service pursuant to section 507(a)(1) of the Code, then X will not be liable for the tax imposed under section 507(c) because X will not have any assets after such termination and payment of expenses.

4. Both prior to and after the transfer by operation of law of the assets of X to Y pursuant to the merger, X and Y are effectively controlled by the same persons within the meaning of section 1.482-1(i)(4) of the regulations, so that the transfer of assets by X to Y will be treated as a transfer of all of X's assets to a private foundation controlled by the same persons who control Y within the meaning of section 1.482-1(i)(4). Thus, pursuant to section 1.507-3(a)(9)(i) of the regulations, after the transfer, Y will be treated as if Y were X for purposes of Chapter 42 and section 509 of the Code.

5. Y will succeed to the aggregate tax benefits, if any, of X under section 507(d) of the Code.

6. As the transferee of the net assets of X, Y will receive the benefit of any transitional rules or savings provisions applicable to X, as enumerated in section 1..507-3(a)(8)(i) and (ii) of the regulations.

7. X's transfer of assets to Y will not result in tax under section 4940 of the Code.

8. The transfer of the assets by X to Y pursuant to the merger will not be an act of self-dealing and will not result in tax under section 4941 of the Code.

9. After X's transfer of assets to Y pursuant to the merger, Y may reduce the amount of its required distributions under section 4942 of the Code by the amount, if any, of the excess qualifying distribution carryover of X for prior years, as defined by section 4942(i) of the Code. Further, Y's distributable amount under section 4942(d) of the Code for its tax year in which the transfer occurs can be increased by the distributable amount for X for its tax year in which the transfer occurs, as if Y had held the assets for the entire tax year. All qualifying distributions made by Y during the entire year, and all qualifying distributions made by X during its tax year in which the transfer occurs can be treated as if made by Y. Therefore, X's distribution requirements under section 4942 of the Code in the year of the transfer can be fulfilled by Y.

10. X will not be required to comply with the recordkeeping requirements under section 4942(g)(3)(B) of the Code with respect to the transfer of assets to Y pursuant to the merger after such transfer by operation of law of all of X's assets to Y.

11. The transfer of the assets of X to Y pursuant to the merger will not constitute an investment which jeopardizes the carrying out of exempt purposes within the meaning of section 4944 of the Code.

12. The transfer of all of the assets of X to Y pursuant to the merger will not constitute a taxable expenditure under section 4945 of the Code and therefore will not result in the imposition of tax under section 4945, and neither X nor Y will be required to exercise expenditure responsibility over the assets transferred to Y pursuant to the merger.

13. The reasonable and necessary legal, accounting and other expenses and costs incurred by X to implement the transfer of its assets to Y will constitute qualifying distributions by X under section 4942(g)(1)(A) of the Code, and will not constitute taxable expenditures by X under section 4945 of the Code .

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

This rulings letter is directed only to the organizations that requested it. Section 6110(k)(3) of the Code provides that this rulings letter may not be used or cited as precedent.

Sincerely,

(signed) Terrell M. Berkovsky

Terrell M. Berkovsky
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Technical Group 2