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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200241056

Date: JUL 19 2002

Contact Person:

Uniform Issue List: 507.00-00
501.03-02
509.03-00
4940.00-00
4941.04-00
4942.03-05
4945.04-06
6033.02-01

Identification Number:

Telephone Number:

T:EO:B2

Legend:
X =
Y =

Dear Sir or Madam:

This is in reply to your rulings request dated September 25, 2001, concerning private foundation X's proposed transfer of all of its assets to private foundation Y pursuant to section 507(b)(2) of the Internal Revenue Code.

X and Y are nonprofit charitable corporations that are exempt from federal income tax under section 501(c)(3) of the Code and are private foundations under section 509(a) of the Code. Y is also recognized as an operating foundation under section 4942(j)(3) of the Code. X and Y are effectively controlled by the same persons. X and Y were created by for-profit companies which are affiliated. X will transfer all of its assets to Y to reduce administrative costs. X's scholarships, which have been awarded by X but will be payable after the date of transfer of X's assets, may be paid by Y. X will have no expenditure responsibility grants outstanding under section 4945(h) of the Code at the time of its transfer of its assets to Y. After the transfer of all its assets, X will notify the Internal Revenue Service of its intent to terminate its private foundation status under section 509(a) of the Code pursuant to section 507(a)(1) of the Code with the notice effective no earlier than the date of such notice to the Service when X will have no assets or activities.

The following rulings are requested:

1. The transfer of X's assets to Y pursuant to the merger will constitute a transfer of assets described in section 507(b)(2) of the Code and will not cause Y to be treated as a newly created organization or result in termination of X's private foundation status under section 507(a) of the Code.

2. The transfer of X's assets to Y pursuant to the merger will not result in imposition of the termination tax under section 507(c) of the Code.

3. If X notifies the Internal Revenue Service, at least one day after all of its net assets are transferred to Y, that X intends to terminate its private foundation status, that notice will be effective to terminate its private foundation status under section 507(a)(1) of the Code, and X will owe no termination tax because X will have no assets upon such termination.

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4. X will only be required to file the annual return under section 6033 of the Code for the year in which the merger takes place and not for subsequent years.

5. The transfer of X's assets to Y pursuant to the merger will not affect either foundation's exemption from taxation under section 501(c)(3) of the Code.

6. As a result of the merger, Y will succeed to X's "aggregate tax benefit".

7. X and Y are effectively controlled by the same person and therefore, as a result of the merger, Y will be treated as X for purposes of Chapter 42 of the Code, section 4940 and following, and sections 507 and 509 of the Code.

8. As a result of the merger, Y will succeed to X's "excess qualifying distributions" carryover and, thus, may reduce its "distributable amount".

9. The transfer of all X's assets to Y pursuant to the merger will not trigger any "gross investment income" or "capital gain net income" under section 4940, and Y will succeed to the tax bases and holding periods of X's assets for purposes of section 4940.

10. Y may report, and pay any taxes under section 4940 on, X's net investment income, if any, in the year of the merger.

11. The transfer of all X's assets to Y pursuant to the merger will not constitute an act of self-dealing resulting in the imposition of tax under section 4941, or be treated under section 4944 as an investment that jeopardizes either foundation's charitable purposes.

12. If section 4942(a) applies to X, the transfer of assets from X to Y pursuant to the merger would not subject X to any tax under section 4942(a) for failure to distribute income or subject X to the recordkeeping requirements of section 4942(g)(3)(B).

13. The transfer of assets from X to Y pursuant to the merger will not constitute a "taxable expenditure" under section 4945 and therefore will not subject X to tax under section 4945, nor will X be required to exercise expenditure responsibility or comply with information reporting requirements of section 4945 with respect to the transfer of assets pursuant to the merger.

14. Payments by Y, if any, to organizations described in sections 509(a)(1), (2), or (3), of grants awarded but not yet disbursed by X, will not constitute taxable expenditures by Y under section 4945, and Y may treat such payments as qualifying distributions.

15. Any reasonable legal, accounting, and other necessary expenses paid to implement the transfer of assets from X to Y pursuant to the merger will be paid to accomplish a purpose described in section 170(c)(1) or 170(c)(2)(B) and thus will constitute qualifying distributions under section 4942 and will not constitute taxable expenditures for either X or Y under section 4945.

16. The basis of the assets that are transferred to Y pursuant to the merger will be the same in the hands of Y as the basis of such assets was in the hands of X.

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) of the Code 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. This section 507(c) tax is equal to the lower of: (a) the aggregate tax benefits that have resulted from the private foundation's exempt status under section 501(c)(3) of the Code or (b) 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 or liquidation, including a significant disposition of 25% or more of the transferor foundation's assets as of the beginning of its tax year.

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 indicates 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.

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, the transferor private foundation is not required to exercise expenditure responsibility under section 4945(h) of the Code with respect to such transfer, except for its information reporting for its year of the transfer.

Section 1.507-3(a)(8) of the regulations provides that certain tax provisions will carry over to a transferee private foundation that receives a transfer of assets from another private foundation pursuant to section 507(b)(2) of the Code.

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 of the Code 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 each 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.

Section 4942(a)(1) of the Code provides that an operating foundation under section 4942(j)(3) 0tc is subject to the requirements for such status under that section 4942(j)(3) of the Code rather than under section 4942(a) of the Code .

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. Under that regulation, 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 amount, if any, of the transferor foundation's excess qualifying distributions under section 4942(i) of the Code.

Section 4942(g)(1)(A) of the Code and section 53.4942(a)-3(a)(2)(i) of the regulations provide that a "qualifying distribution" is 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) of the Code, other than any contribution to: (i) an organization controlled directly or indirectly by the transferor foundation or one or more disqualified persons with respect to the foundation, except as provided in section 4942(g)(3) of the Code, or (ii) any private foundation that is not an operating foundation under section 4942(j)(3) of the Code, except as provided in section 4942(g)(3) of the Code. Under section 53.4942-3(a)(2)(i) of the regulations, such qualifying distributions include the reasonable administrative expenses that are incurred in conduct of an exempt purpose under section 170(c)(2)(B) of the Code.

Sections 4942(g)(3)(A) and 4942(g)(3)(B) of the Code require 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 private 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). That transferee private foundation's qualifying distributions 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 4944 of the Code imposes tax on the making of jeopardizing investments.

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) 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.

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, including private foundations, pursuant to section 507(b)(2) of the Code, without the transfers being taxable expenditures under section 4945 of the Code.

Analysis

1.

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) includes a transfer of assets from one private foundation to one or more other private foundations pursuant to any reorganization or liquidation, including any significant disposition of 25% or more of the transferor private foundation's assets. Because X will make such a disposition by transfer of all of its assets to Y, X's transfer of assets to Y will be a transfer under section 507(b)(2) of the Code.

Under section 507(b)(2) of the Code and section 1.507-3(a)(1) of the regulations, in a transfer of assets under section 507(b)(2) of the Code, the transferee private foundation, Y, will not be treated as a newly created organization.

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 cause termination of X's private foundation status under section 509(a) of the Code.

2.

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 cause termination of 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 private foundation status pursuant to section 507(a)(1) of the Code. This tax under section 507(c) of the Code is equal to the lower of: (a) the aggregate tax benefits that have resulted from the foundation's exemption from federal income tax under section 501(c)(3) of the Code, or (b) the value of the net assets of the foundation. After X transfer all of its assets to Y, the value of X's assets will be zero when X notifies the Internal Revenue Service of its voluntary termination of private foundation status pursuant to section 507(a)(1) of the Code and, thus, such termination of X's private foundation status under section 509(a) of the Code pursuant to a notice under section 507(a)(1) of the Code will result in zero termination tax under section 507(c) of the Code.

4.

Under section 1.507-1(b)(9) of the regulations, X will not be required meet the annual reporting requirements of section 6033 of the Code for any tax years after the tax year of X's transfer of all of its assets to Y when X will have no assets or activities.

5.

X's transfer of assets to Y will be for exempt purposes under section 501(c)(3) of the Code. X's transfer will not adversely affect the exemptions from federal income tax under section 501(c)(3) of the Code of X or Y.

6.

Under section 1.507-3(a)(2)(i) of the regulations, upon X's transfer of all of its assets to Y, Y will succeed to X's aggregate tax benefits under section 507(d) of the Code.

7.

Under section 1.507-3(a)(9)(i) of the regulations, X and Y are effectively controlled by the same persons so that X's transfer of all of its assets to Y will allow transferee private foundation Y to be treated as its transferor private foundation X for purposes of Chapter 42 of the Code and sections 507 and 509 of the Code.

8.

As in Revenue Ruling 78-387, described above, after X's transfer of all of its assets to Y, X's excess qualifying distributions, if any, under section 4942 of the Code may be used by X or by its transferee Y to reduce the distributable amount of X and/or Y 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.

9.

Under section 4940 of the Code, X's transfer of its assets to Y for exempt purposes under section 501(c)(3) of the Code will not result in tax under section 4940 of the Code.

Under section 1.507-3(a)(8)(ii)(a) of the regulations, the tax bases and holding periods of X's assets transferred to Y will carry over to Y for purposes of section 4940 of the Code.

10.

Under section 1.507-3(a)(9)(i) of the regulations, transferee Y will be treated as its transferor X after X's transfer of all of its assets to Y pursuant to section 507(b)(2) of the Code. Thus, after X transfers all of its assets to Y, X's excise tax liability under section 4940 of the Code for X's final tax year may be satisfied by Y, and any refund to which X is entitled may be used by Y to offset its excise tax under section 4940 of the Code.

11.

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

Under section 4944 of the Code, X's transfer of its assets to Y for exempt purposes will not constitute jeopardizing investments or result in tax under that section.

12.

Under section 1.507-3(a)(9)(i) of the regulations, transferee Y will be treated as its transferor X, so that X's undistributed income under section 4942(c) of the Code, if not already distributed by X, must be taken into account by Y in Y's distribution requirements as the successor to its transferor X. If X qualifies as an operating foundation under section 4942(j)(3) of the Code, as stated in section 4942(a)(1) of the Code, the requirements of section 4942(j)(3) of the Code, instead of section 4942(a) of the Code, would apply.

Under section 1.507-3(a)(5) of the regulations, X will not be required to meet recordkeeping requirements, if any, under section 4942(g)(3)(B) of the Code with respect to its transfer of all of its assets to Y.

13.

Section 1.507-3(a)(7) of the regulations provides that, if a private foundation transfers all of its assets to one or more transferee private foundations pursuant to section 507(b)(2) of the Code, such transferor foundation does not incur any expenditure responsibility requirement under section 4945(h) of the Code with respect to such transfer of all of its assets pursuant to section 507(b)(2) of the Code. Thus, when X transfers all of its assets to Y, pursuant to section 507(b)(2) of the Code, X will not be required to exercise any expenditure responsibility under section 4945(h) of the Code with respect to its transfer of all of its assets to Y pursuant to section 507(b)(2) of the Code.

Section 53.4945-6(c)(3) of the regulations indicates that a private foundation can transfer 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, provided that any expenditure responsibility under section 4945(h) is met. X's transfer, which is a transfer of all of its assets that is not subject to expenditure responsibility requirements under section 4945(h) of the Code, will be made to exempt transferee Y for exempt purposes under section 501(c)(3) of the Code and, thus, will not be a taxable expenditure or result in tax under section 4945 of the Code.

14.

Under section 1.507-3(a)(9)(I) of the regulations, X's transfer of all of its assets and liabilities to Y will allow transferee private foundation Y to be treated as its transferor X. Y's payment of X's grants, already awarded by X but to be paid after the transfer by Y, including payment of scholarship grants to college students pursuant to scholarship procedures as approved for X under section 4945(g) of the Code, will not constitute taxable expenditures or subject X or Y to tax under section 4945 of the Code. Payments by transferee Y that would have been qualifying distributions paid by transferor X but for the transfer of assets to Y will be qualifying distributions under section 4942 of the Code by Y when paid by Y as X's transferee.

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15.

Under section 53.4945-6(b)(2) of the regulations, a private foundation's payment of its reasonable costs for services rendered is not a taxable expenditure under section 4945 of the Code. Thus, the legal, accounting, and other expenses, if reasonable in amount, for this rulings request and the transfer of assets, will not be taxable expenditures under section 4945 of the Code.

Under section 4942(g)(1)(A) of the Code, a qualifying distribution for exempt purposes includes the reasonable and necessary administrative expenses of grants for exempt purposes. Thus, the legal, accounting, and other expenses for this rulings request and the transfer of assets, if reasonable in amount, will be qualifying distributions under section 4942(g)(1)(A) of the Code.

16.

Under section 1.507-3(a)(8)(ii)(a) of the regulations, the tax bases and holding periods of X's assets transferred to Y will carry over to Y for purposes of section 4940 of the Code. Thus, the bases of X's assets transferred to Y will be the same for Y as the bases of such assets were for X.

Accordingly, we rule:

1. The transfer of X's assets to Y pursuant to the merger will constitute a transfer of assets described in section 507(b)(2) of the Code, and will not cause Y to be treated as a newly created organization, or result in termination of X's private foundation status under section 507(a) of the Code.

2. The transfer of X's assets to Y pursuant to the merger will not result in imposition of the termination tax under section 507(c) of the Code.

3. If X notifies the Internal Revenue Service, at least one day after all of its net assets are transferred to Y, that X intends to terminate its private foundation status, that notice will be effective to terminate its private foundation status under section 507(a)(1) of the Code, and X will owe no termination tax because X will have no assets upon such termination.

4. X will only be required to file the annual return under section 6033 of the Code for the year in which the merger takes place and not for subsequent years.

5. The transfer of X's assets to Y pursuant to the merger will not affect either foundation's exemption from taxation under section 501(c)(3) of the Code.

6. As a result of the merger, Y will succeed to X's "aggregate tax benefit" defined in section 507(d) of the Code.

7. X and Y are effectively controlled by the same person and, therefore, as a result of the merger, Y will be treated as X for purposes of Chapter 42 of the Code, section 4940 and following, and sections 507 and 509 of the Code.

8. As a result of the merger, Y will succeed to X's "excess qualifying distributions" carryover and, thus, may reduce its "distributable amount" under section 4942 of the Code.

9. The transfer of all X's assets to Y pursuant to the merger will not trigger any "gross investment income" or "capital gain net income" under section 4940 of the Code, and Y will succeed to the tax bases and holding periods of X's assets for purposes of section 4940 of the Code.

10. Y may report, and pay any taxes under section 4940 of the Code on, X's net investment income, if any, in the year of the merger.

11. The transfer of all X's assets to Y pursuant to the merger will not constitute an act of self-dealing resulting in the imposition of tax under section 4941 of the Code, or be treated under section 4944 of the Code as an investment that jeopardizes either foundation's charitable purposes.

12. Section 4942(a) of the Code will apply to X if X is not an operating foundation subject to sections 4942(a)(1) and 4942(j)(3) of the Code. Under either section 4942(a) or 4942(j)(3) of the Code, X's transfer of all its assets to Y pursuant to the merger will not subject X by reason of the transfer to any tax under section 4942(a) for failure to distribute income, and will not subject X to the recordkeeping requirements of section 4942(g)(3)(B) of the Code for years after the year of the transfer of all X's assets to Y.

13. The transfer of assets from X to Y pursuant to the merger will not constitute a taxable expenditure under section 4945 of the Code. X will not be required to exercise expenditure responsibility with respect to its transfer of all of its assets to Y pursuant to the merger. X will comply with the information reporting requirements of section 4945 of the Code for the year of its transfer. Thus, X will not be subject to tax under section 4945 of the Code.

14. Payments by Y, if any, to organizations described in sections 509(a)(1), 509(a)(2), or 509(a)(3) of the Code, of grants awarded but not yet disbursed by X, will not constitute taxable expenditures by Y under section 4945 of the Code, and Y may treat such payments as qualifying distributions under section 4942 of the Code.

15. Any reasonable legal, accounting, and other necessary expenses paid to implement the transfer of assets from X to Y pursuant to the merger will be paid to accomplish a purpose described in section 170(c)(1) or 170(c)(2)(B) of the Code and thus will constitute qualifying distributions under section 4942 and will not constitute taxable expenditures for either X or Y under section 4945.

16. The basis of the assets that are transferred to Y pursuant to the merger will be the same in the hands of Y as the basis of such assets was in the hands of X.

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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,

Joseph Chasin
Acting Manager, Exempt Organizations
Technical Group 2