S/N: 507.00-00

200333036

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: JUN 19 2003

Contact Person:

Identification Number:

Telephone Number:

T:EO:B4

Employer Identification Number:

Legend:
B=
C=
D=
E=

Dear Sir or Madam:

This is in response to a letter dated March 21, 2003, which requested certain rulings with respect to a proposed transfer of assets from B to C as amended in a letter dated June 12, 2003.

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 has submitted an application for recognition of exemption under section 501(c)(3) of the Code and classification as a private foundation under section 509(a).

B was established jointly by D and E by Trust agreement dated April 23, 1996. D and E each contributed an equal amount to B in 1996 and no additional contributions have been made since that time. D died on August 5, 2002 survived by her six children.

Recently, differences of opinion have arisen among E, the surviving founding donor of B, and the children of D, the deceased founding donor of B, as to the management and charitable activities of B. To resolve the discord concerning the management and charitable activities of B, B proposes to transfer one half of its assets (securities and cash) to C. The distribution of assets to C will allow E and the children of D 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.

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 1.507-1(b)(6) of the Income Tax 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 the 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 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)(4) of the 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 1.507-3(a)(9)(i) of the regulations provides that, if a transferor private foundation transfers assets to a private foundation effectively controlled, directly or indirectly, by the same person or persons who effectively control the transferor private foundation, the 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. The transferee is treated as the transferor in the proportion which the fair market value of all the assets of the transferor's assets that were transferred bears to the fair market value of all of the assets of the transferor immediately before the 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 53.4945-5(c)(2) of the regulations provides, in part, that if a private foundation makes a grant described in section 4945(d)(4) to a private foundation which is exempt from taxation under section 501(a) for endowment or other capital purposes the grantor foundation shall require reports from the grantee on the use of the principal and the income (if any) from the funds. The grantee shall make such reports annually for its taxable year in which the grant was made and the immediately succeeding two taxable years. Only if it is reasonably apparent to the grantor that, before the end of such second succeeding taxable year, neither the principle, nor the income from the grant funds has been used for any purpose which would result in liability for tax under section 4945(d), the grantor may then allow such reports to be discontinued.

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).

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)).

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.

Because this transfer of assets from B to C is described in section 507(b)(2) of the Code, C will be deemed to possess certain attributes and characteristics of B, including being entitled to a pro-rata portion of the aggregate tax benefit of B not exceeding the fair market value of the transferred assets at the time of the proposed transfer.

Because the majority of the Trustees of B are also the majority of the Trustees of C, B and C are effectively controlled by the same persons. Thus, section 1.507-3(a)(9)(i) of the

regulations provides that for purposes of Chapters 42 and sections 507 through 509 of the Code, C will be treated as if it were B in the proportion which the fair market value of the assets (less encumbrances) transferred to C bears to the fair market value of the assets (less encumbrances) of B immediately before the transfer.

The attributes under Chapter 42 and sections 507 through 509 of the Code transferred to C from B include the minimum distribution requirements under section 4942 of the Code, and the right to reduce its distributable amount under section 4942 of the Code by the amount of any excess qualifying distribution carryover.

The proposed transfer of assets from B to C is for endowment purposes and C will not make a qualifying distribution equal to the amount of grant it will receive from B. Thus, the proposed transfer from B to C will not be treated by B as a qualifying distribution under section 4942 of the Code.

Because the proposed transfer of assets from B to C will be made to accomplish the exempt purposes of B and C, 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 proposed transfer of assets from B to C.

B is not selling property to C nor making an investment in C. Rather the proposed transfer of assets is a grant, essentially analogous to a gift, and will not be "net investment" income to C within the meaning of section 4940 of the Code.

Provided B exercises expenditure responsibility, pursuant to section 4945(d)(4) of the Code, with regard to the assets transferred to C, B will not be subject to the excise tax on taxable expenditures under section 4945.

As provided under section 53.4945-5(c)(2) of the regulations, B will require reports from C on the use of the principal and the income (if any) from the transferred funds. C will make such reports annually for its taxable year in which the grant was made and the immediately succeeding two taxable years. Only if it is reasonably apparent to B that, before the end of such succeeding taxable year, neither the principle, nor the income from the transferred funds has been used for any purpose which would result in liability for tax under section 4945(d), B may then allow such reports to be discontinued.

Because B, as an organization described in sections 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.

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

1. The proposed transfer of fifty percent of the assets of B to C will constitute a transfer as described in section 507(b)(2) of the Code.

2. As a transfer described in section 507(b)(2), the proposed transaction will not result in a termination of the foundation status of B under section 507(a) and will not cause the imposition of the termination tax described in section 507(c).

3. C will not be treated as a newly created organization.

4. C will succeed to the aggregate tax benefit of B in proportion to the assets transferred.

5. C will be treated as if it were B for the purposes of sections 4940 through 4948 and sections 507 through 509 of the Code in the proportion to the assets transferred.

6. Following the transfer, C may proportionately reduce its required distributions under section 4942 of the Code, by its proportional amounts of B's excess qualifying distributions carryover for prior years as defined in section 4942(i).

7. The proposed transfer of assets of B to C will not give rise to net investment income and is not subject to tax under section 4940(a) of the Code.

8. The provisions of section 1.507-3(a)(8)(ii)(a) through (g) of the regulations will apply to C with respect to the assets transferred from B.

9. The proposed transfer of assets of B to C will not constitute self-dealing under section 4941 of the Code because for purposes of section 4941 the term disqualified person does not include an organization described in section 501(c)(3).

10. The proposed transfer of assets of B to C will not constitute a jeopardizing investment within the meaning of section 4944 of the Code.

11. Since B proposes to exercise expenditure responsibility under section 4945(h) of Code with respect to the assets transferred to C, such transfer will not constitute a taxable expenditure under section 4945(d)(4).

12. The proposed transfer of assets of B to C are for endowment or capital purposes and therefore section 53. 4945-5(c)(2) of the regulations applies to the transfer and requires that B shall receive reports from C on the use of the principal and the income (if any) from the transferred funds. C shall make such reports annually for its taxable year in which the transfer was made and the immediately succeeding two taxable years. Only if it is reasonably apparent to B that, before the end of such second succeeding taxable year, neither the principle, nor the income from the transferred funds has been used for any purpose which would result in liability for tax under section 4945(d), B may then allow such reports to be discontinued.

These rulings are issued on the assumption that C is recognized as exempt under section 501(c)(3) of the Code.

We are informing the 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