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

200221067

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: FEB. 28, 2002

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Dear Sir or Madam:

This is in response to your letter dated November 14, 2001, in which you requested certain rulings with respect to a proposed transfer of all of the assets of B to C, D and E.

B, C, D and E are exempt under section 501(c)(3) of the Internal Revenue Code and are classified as private foundations under section 509(a).

B is currently managed and controlled by trustees who are members of three branches of F. With the passage of time, the trustees have developed divergent charitable interests and investment philosophies, making it increasingly difficult to manage B. Therefore, the trustees have decided that the charitable goals of B would best be carried out by the transfer of B's assets to three new foundations, C, D and E. The distribution of assets to C, D, and E will allow the three branches of F to pursue their respective independent charitable interests and objectives.

There will be no consideration for the proposed transfer of assets and the transfer will not be from current income as B intends to make a substantial gift to G immediately prior to the transfer. B will cease to exist after the transfer of assets.

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 1.507-3(a)(5) of the Income Tax Regulations provides that a transferor private foundation is required to meet its charitable distribution requirements under section 4942 of the Code, 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. However, where the transferor has disposed of all of its assets, the record-keeping requirements of section 4942(g)(3)(B) of the Code shall not apply during any period in which it has no assets.

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 transferee organization 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)(8)(i) and (ii) of the regulations provides that, in a section 507(b)(2) transfer, the provisions enumerated in subparagraphs (a) through (g) thereof apply to the transferee foundation with respect to the assets transferred to the same extent and in the same manner that they would have applied to the transferor foundation had the transfer described in section 507(b)(2) not been effected.

Section 1.507-3(a)(9)(i) of the regulations provides that, if a transferor private foundation transfers assets to a private foundation which is effectively controlled (within the meaning of section 1.482-1A(a)(3)), 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 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 regard 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(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)).

Based on the above facts, the transfer of all of B's assets to C, D and E will allow C, D and E to continue the charitable activities previously conducted by B. Therefore, the transfer of assets from B to C, D and E will not endanger the tax exempt status of B.

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. The transfer by B to C, D and E 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, D and E will not be treated as a transfer to a newly created organization.

Because B is not terminating its existence and assuming there has been no willful, repeated or flagrant act giving rise to liability under Chapter 42, no tax will be imposed on B under section 507(c) as a result of the transfer of assets from B to C, D and E.

Because B, C, D and E are effectively controlled by the same persons, C, D and E will be treated as if they were B for purposes of sections 507 through 509 and Chapter 42 of the Code. Therefore, the rulings requested under sections 4940, 4941, 4942, and 4944 would be provided because these rulings are consistent with the approach in section 1.507-3(a)(9)(i) of the regulations which is, in effect, to disregard the change in form of the organization for purposes of Chapter 42.

Because B is transferring all of its assets to C, D and E pursuant to a merger, and B, C, D and E are controlled by the same persons, C, D and E will be treated as B. The transfer will be treated as not having taken place for expenditure responsibility purposes under section 4945(h) of the Code. Thus, the transfer will not be a taxable expenditure under section 4945(d)(4). Therefore, B need not exercise expenditure responsibility with regard to the merger.

Subsequent to the merger, C, D and E will be treated as if they were B. Therefore, C, D and E will succeed to B's duty to exercise expenditure responsibility with respect to any outstanding grants for which expenditure responsibility is required and B would be relieved of any duty to exercise expenditure responsibility after the merger.

As a result of the merger, C, D and E will be treated as B for purposes of Chapter 42. Therefore, the distribution requirements of section 4942 for the year of transfer should be regarded as satisfied by B, C, D and E if, treating B, C, D and E as a single organization, the aggregate qualifying distributions for such year by B, C, D and E would satisfy its distribution requirement. Because C, D and E are treated as taking over B's obligations as of the date of merger, it follows that as of that date B will no longer have any such obligations.

Because B, C, D and E are controlled by the same persons, for purposes of Chapter 42 of the Code and sections 507 through 509 of the Code, C, D and E will be treated, subsequent to the transfer of all of B's assets, as if they were B, in proportion which the fair market value of the assets (less encumbrances) transferred bears to the fair market value of B 's assets (less encumbrances) immediately before the transfer. Thus C, D and E can succeed to B's excess qualifying distributions carryover for purposes of section 4942 of the Code, and in proportions determined in accordance with section 1.507-3(a)(9)(i) of the regulations (consistent with succeeding to B's tax attributes).

Under section 1.507-3(a)(9)(i) of the regulations, C, D and E will be treated as if they were B for purposes of Chapter 42, including section 4940. Accordingly, C, D and E would be allowed to report all of the net income subject to tax under section 4940 during the year of merger (whether earned by B, C, D or E) and pay all of the section 4940 taxes on such income for that year.

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

Because B, C, D and E are exempt under section 501(c)(3) and are organized for purposes described in section 170(c)(2)(B), and the reason for the transfer is to carry out more efficiently such exempt purposes, the transfer would not be a jeopardizing investment under section 4944.

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, D, and E will lack consideration, no sale or other disposition will have occurred, thus, there will be no gain and the assets transfer will not give rise to tax under section 4940 of the Code. Further, because the transfer of assets to C, D and E is disregarded (because, in turn, C, D and E are treated as if they were B for purposes of Chapter 42), C's, D's and E's basis in the assets transferred to them pursuant to the merger should be the same as the basis of B.

Because B will dispose of all of its assets, the recordkeeping requirements of section 4942(g)(3)(B) will not apply during any period in which it has no assets. Therefore, B's recordkeeping under section 4942(g)(3)(B) will not apply after the merger since B will have disposed of all of its assets.

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

1. The proposed transfer of assets will not affect the continued qualification of B as an organization described in section 501(c)(3) of the Code that is exempt from federal income tax under section 501(a) of the Code and will not result in the termination of private foundation status of B, but will constitute an adjustment between private foundations within the contemplation of section 507(b)(2) of the Code.

2. The proposed transfer will not constitute either a notification of B's intent to terminate its status as a private foundation under section 507(a)(1) of the Code, or willful repeated acts (or failures to act), within the meaning of section 507(a)(2) of the Code, by B. Therefore, B will not be liable for the termination tax imposed by section 507(c) of the Code.

3. The proposed transfer will constitute a significant disposition of assets to one or more foundations and C, D and E will not be treated as newly created organizations and will be treated as possessing the attributes and characteristics of B. Following the transfer, C, D and E may proportionately reduce their required distributions under section 4942 of the Code, by their proportional amounts of B's excess qualifying distributions carryover for prior years.

4. The proposed transfer will not constitute a sale or other disposition within the meaning of section 4940(c)(4)(A) of the Code, will not constitute an act of self-dealing within the meaning of section 4941 of the Code by B, C, D and E or by any disqualified person and will not constitute a jeopardizing investment within the meaning of section 4944(a) of the Code by B, C, D or E or by any disqualified person.

5. The proposed transfer will not constitute a taxable expenditure within the meaning of section 4945 of the Code, and B will not be required to exercise expenditure responsibility under section 4945(h) of the Code with respect to the assets transferred to C, D and E.

6. The contemplated transaction will not result in any tax due by B under Chapter 42 of the Code.

7. After distributing all of its assets in the transaction described above, B will not be required to file any tax returns for any taxable years subsequent to that in which all assets are distributed. Upon B's termination, it will be required to file a return required by section 6043(b) 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