



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

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Contact Person:

UIL: 507.02-00
4940.00-00
4941.00-00
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4945.04-06

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

P=
J=
B=
S=
A=
M=

Dear _____ :

P and J request rulings under sections 507, 4940, 4941, 4942, 4944 and 4945 of the Internal Revenue Code concerning P's transfer under section 507(b)(2) of one-half of its assets to J.

STATEMENT OF FACT

P is exempt under section 501(c)(3) of the Code and is a private foundation. The officers and Board of Directors of P currently consist of three individuals, B, S and A. P annually makes grants and contributions to tax exempt organizations in its geographic locale. S, a daughter of P's original members, lives 120 miles away in another city. S is active in charitable organizations in that city.

As a result of S's desire to further charitable causes in her community, she created J. J is exempt under section 501(c)(3) of the Code and is a private foundation. The officers and Board of Directors of J consist of S and her husband, M.

P's Board of Directors decided J could more effectively further charitable causes in J's community if P transferred one-half of its assets to J (the "Transfer"). The Transfer is conditioned on the receipt of a favorable private letter ruling from the Service.

P states it has never notified the Service that it intends to terminate its private foundation status, nor has P ever received notification its status as a private foundation has been terminated. Furthermore, P states it has not committed willful repeated acts or failures to act or a willful or flagrant act (or failure to act) giving rise to liability for tax under Chapter 42 of the Code.

Law

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 provides that in the case of a transfer of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, the transferee foundation shall not be treated as a newly created organization for purposes of section 507(a).

Section 1.507-3(c)(1) of the regulations provides 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 1.507-1(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 the transferor has disposed of all of its assets, during any period in which the transferor has no assets, section 4945(d)(4) and (h) shall not apply to the transferee or the transferor with respect to any 'expenditure responsibility' grants made by the transferor. However, the exception contained in this subparagraph shall not apply with respect to any information reporting requirements imposed by section 4945 and the regulations there under for any year in which any such transfer is made.

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.

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 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(g)(1)(A) of the Code defines the term "qualifying distribution" to mean--(A) 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 (directly or indirectly) by the foundation or one or more disqualified persons with respect to the foundation or (ii) a private foundation which is not an operating foundation; or (B) any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c)(2)(B).

Section 4942(g)(3) of the Code defines the term "qualifying distribution" to included a contribution to a section 501(c)(3) organization described in paragraph (1)(A)(i) or (ii) if--(A) not later than the close of the first taxable year after its taxable year in which such contribution is received, such organization makes a distribution equal to the amount of such contribution and such distribution is a qualifying distribution (within the meaning of paragraph (1) or (2), without regard to this paragraph) which is treated under subsection (h) as a distribution out of corpus (or would be so treated if such section 501(c)(3) organization were a private foundation which is not an operating foundation), and (B) the private foundation making the contribution obtains adequate records or other sufficient evidence from such organization showing that the qualifying distribution described in subparagraph (A) has been made by such organization.

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

Section 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.

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 on expenditure responsibility provides, in part, that the grantor private foundation must obtain proper reports from its grantee private foundation as to the grantee's uses of the grant.

Section 53.4945-5(b)(2) of the regulations provides that expenditure responsibility includes a requirement that the grantor private foundation must make a pre-grant inquiry of the prospective grantee private foundation. Thus, before making a grant, the grantor must conduct a limited inquiry of the potential grantee. Such pre-grant inquiry must be complete enough to give a reasonable person assurance that the grantee will use the grant for the proper exempt purposes. This inquiry should concern matters such as the identity, prior history, and experience of the grantee organization and its managers, and any knowledge which the grantor has, based on prior experience or other information which is readily available, concerning the management, activities, and practices of the grantee foundation. The scope of this inquiry may vary from case to case depending upon the size and purpose of the grant, the period of time over which it is to be paid, and the prior experience which the grantor has had with respect to the capacity of the grantee to use the grant for the proper purposes.

Section 53.4945-5(b)(3) of the regulations provides, that, in order to exercise expenditure responsibility, the grantor private foundation must require that the grantee organization be made subject to a written commitment, signed by an appropriate officer, director, or trustee of the grantee, to repay any portion of the amount granted which is not used for the purposes of the grant, to submit full and complete annual reports on the manner in which the grant funds are spent and the progress made in accomplishing the purposes of the grant, to maintain records of receipts and expenditures, and to make its books and records available to the grantor at reasonable times,

and not to use any of the funds to carry on propaganda or otherwise attempt to influence legislation within section 4945(d)(1) of the Code, or to influence the outcome of any specific public election, or to carry on any voter registration drive within the meaning of section 4945(d)(2), or to make any grant which does not comply with the requirements of section 4945(d)(3) or 4945(d)(4), or to undertake any activity for any purpose other than one specified in section 170(c)(2)(B) of the Code. The agreement must clearly specify the purposes of the grant. Such purposes may include contributing for capital endowment, provided that neither the grants nor the income there from may be used for purposes other than those in section 170(c)(2)(B) of the Code.

Section 53.4945-5(c)(2) of the regulations, on capital endowment grants made to private foundations, provides that, if a private foundation makes a grant to another private foundation for endowment or for other capital purposes, the grantor foundation must require reports from the grantee foundation on the uses of the principal and the income (if any) from the grant funds. The grantee must make such reports annually for its tax year in which the grant was made and for its immediately succeeding two tax years. Only if it is reasonably apparent to the grantor, before the end of such grantee's second succeeding tax year, that neither the principal nor the income from the grant funds has been used for any purpose which would result in liability for tax under section 4945(d) of the Code, may the grantor then allow the grantee's reports to be discontinued.

Analysis

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, which includes any significant disposition of 25% or more of the transferor's assets. Because P will be transferring approximately one-half of its assets, P's transfer of assets to J will be a transfer under section 507(b)(2) of the Code.

P's transfer of assets to J will not be investment income, will not be a taxable disposition of property, and will not result in tax under section 4940 of the Code. Under section 4944 of the Code, P's transfer of its assets to J will not constitute a jeopardizing investment or result in tax under that section.

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

Section 1.507-3(a)(9)(i) of the regulations provides that for purposes of Chapter 42 and sections 507 through 509 of the Code, J will be treated as if it were P in the proportion to which the fair market value of the assets (less encumbrances) transferred to J bears to the fair market value of the assets (less encumbrances) of P immediately before the transfer.

The attributes under Chapter 42 and sections 507 through 509 of the Code transferred to J from P include the minimum distribution requirements under section 4942, and the right to reduce its

distributable amount under section 4942 by the amount of any excess qualifying distribution carryover.

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

Under section 53.4945-6(c)(3) of the regulations, a private foundation can transfer its assets to private foundations pursuant to section 507(b)(2) of the Code without the transfer being a taxable expenditure under section 4945. Thus, P's transfer of assets will not be a taxable expenditure under section 4945 of the Code.

P must exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations on its transfer of some of its assets to J, because the exception under section 1.507-3(a)(7) to expenditure responsibility for a transfer of all assets does not apply to P because P's transfer to J consists of approximately one-half, rather than all, of P's assets.

Conclusion

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

1. The transfer of one-half of the assets from P to J will qualify as a transfer under section 507(b)(2) of the Code. Because P will not terminate, P will not be subject to any tax under section 507(c) of the Code.
2. The proposed transfer of assets from P to J will not give rise to net investment income and, therefore, will not give rise to the imposition of tax under section 4940 of the Code for P, P will not be required to pay the tax imposed by section 4940 in the tax year of distribution and P and J will report their share of net investment income for the year of distribution and pay the tax imposed by section 4940 on such share based on investment income earned by the respective foundation.
3. The proposed transfer of assets to J will not be treated as an investment that jeopardizes the charitable purposes of P.
4. The proposed transfer of assets from P to J will not constitute an act of self-dealing which will result in an excise tax under section 4941 of the Code.
5. Assuming J pays the distribution requirements of P, P will not be required to meet P's distribution requirements under section 4942 for the taxable year in which P transfers one-half of its assets. P's and J's minimum distributable amount will be determined on a prorata basis determined on asset ownership during the taxable year of the transfer. Likewise, P and J will be credited with a proportionate amount of the qualifying distributions actually made by the respective foundation in the fiscal year of the transfer.

6. The proposed transfer of assets from P to J will not constitute a taxable expenditure, within the meaning of section 4945 of the Code because P will be required to exercise expenditure responsibility with respect to one-half of the assets it transferred to J. J, however, will not be required to exercise expenditure responsibilities over the assets transferred by P.

This ruling is based on the understanding there will be no material changes in the facts upon which it is based.

This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides 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.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael Seto
Manager, Exempt Organizations
Technical Group 1