



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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4940.00-00
4941.00-00
4942.00-00
4945.00-00

Legend:

B =
X =
Y =

Dear _____ :

This is in reference to a ruling request concerning a proposed transfer of the assets of B (the "Foundation") to two newly formed non-profit corporations (the "New Foundations").

The Foundation is an organization that has been recognized as exempt from federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code and is classified as a private foundation within the meaning of section 509(a) of the Code. The Foundation's sole business is the making of grants for charitable, religious, educational and scientific purposes.

During the period they were married, X and Y created the Foundation. X and Y are substantial contributors with respect to the Foundation.

The Foundation is governed by a five-member Board of Directors. X, Y, and two of their children serve as directors. The fifth director is unrelated to the family.

Subsequent to the formation of the Foundation, X and Y were divorced. As a result of the divorce, X and Y have agreed that it would be desirable to divide the assets of the Foundation and to distribute them to the New Foundations, one created and controlled by X and her family, and one created and controlled by Y and his family. This will allow management of the foundations in keeping with the objective of the founders.

The Foundation plans to distribute approximately one half of its assets to each of the proposed New Foundations.

The proposed New Foundations intend to be recognized as exempt from federal income tax as organizations described in section 501(c)(3) of the Code and classified as private foundations within the meaning of section 509(a).

TERMINATION OF PRIVATE FOUNDATION STATUS

Section 507(a) of the Code provides that except as provided in section 507(b), the status of any organization as a private foundation shall be terminated only if (1) such organization notifies the Secretary of its intent to accomplish such termination, or (2) with respect to such organization, 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, and the Secretary notifies such organization that such organization is liable for the tax imposed by section 507(c).

Section 507(b)(2) of the Code provides that 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 a newly created organization.

Section 1.507-1(b)(6) of the Foundation and Similar Excise Taxes 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 private foundation status under section 507(a)(1).

Section 1.507-3(a)(1) of the regulations provides that a section 507(b)(2) transfer results in a carryover of certain tax attributes and characteristics of the transferor organization to the transferee foundation as described in subparagraphs (2), (3), and (4).

Section 1.507-1(c)(2) of the regulations provides that for purposes of section 507(a)(2)(A) of the Code, the term "willful repeated acts (or failures to act)" means at least two acts or failures to act both of which are voluntary, conscious, and intentional. For purposes of section 507(a)(2)(A), a "willful and flagrant act (or failure to act)" is one which is voluntarily, consciously, and knowingly committed in violation of any provision of Chapter 42 (other than section 4940 or 4948(a)) and which appears to a reasonable man to be a gross violation of any such provision.

Section 1.507-3(c)(1) of the regulations provides, in pertinent part, that a transfer of assets is described in section 507(b)(2) if it is made by a private foundation to another private

foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. For purposes of section 507(b)(2), the terms "other adjustment, organization, or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Section 1.507-3(c)(2) of the regulations provides, in part, that the term "significant disposition of assets to one or more private foundations" includes any disposition for the taxable year of 25 percent or more of the fair market value of the net assets of the transferor foundation at the beginning of the taxable year.

Section 1.507-3(d) of the regulations provides that unless a private foundation voluntarily gives notice pursuant to section 507(a)(1) of the Code, a transfer of assets described in section 507(b)(2) will not constitute a termination of the transferor's private foundation status under section 507(a)(1).

The proposed transfers from the Foundation to the New Foundations involve a transfer of more than 25% of the assets of the Foundation. Thus, under section 1.507-3(c)(2) of the regulations, the transaction will result in a significant disposition of the assets of the Foundation. Accordingly, the proposed transfers constitute an "other adjustment, organization, or reorganization" within the meaning of section 1.507-3(c)(1) of the regulations, and, therefore, will constitute transfers described in section 507(b)(2) of the Code.

Because the proposed transfer by the Foundation is a section 507(b)(2) transfer, no voluntary termination of the Foundation will be deemed to have occurred. Further, at the time of the proposed transfer, the Foundation will have committed no willful repeated acts or failures to act or a willful and flagrant act giving rise to liability under Chapter 42 of the code. Accordingly, the termination tax under Code section 507(c) is not applicable.

As transfers described in section 507(b)(2) of the Code, under sections 1.507-1(b)(6) and 1.507-3(d) of the regulations, the proposed transactions will not result in a termination of the Foundation's private foundation status under section 507(a). Because no termination will take place, the tax imposed by section 507(c) of the Code will not apply. Further, under section 507(b)(2), the New Foundations will not be treated as newly created organizations.

A section 507(b)(2) transfer results in a carryover of certain tax attributes and characteristics of the transferor organization to the transferee foundation. See section 1.507-3(a)(1), (2), (3) and (4) of the regulations.

TAX ON NET INVESTMENT INCOME

Section 4940(a) of the Code imposes on each private foundation with respect to the carrying on of its activities a tax equal to two percent of the net investment income of such foundation for the taxable year. The transfers to the New Foundations will not constitute a "sale or other disposition of property or other realizable event" within the meaning of section 4940 and thus, will not constitute a realizable event giving rise to net

investment income to either the Foundation or to the New Foundations.

SELF-DEALING

Section 4941(a)(1) of the Code imposes a tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4946(a)(1) of the code defines the term "disqualified person" to include, with respect to a private foundation, a person who is a substantial contributor or who is a foundation manager (defined in section 4946(b) as an officer, director, or trustee).

Section 4941(d)(1)(E) of the Code defines "self-dealing" as any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 53.4941(d)-2(f)(2) of the regulations states that the fact that a disqualified person receives an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing. For example, a grant by a private foundation to a section 509(a)(1), (2), or (3) organization will not be an act of self-dealing merely because one of the recipient organization's officers, directors, or trustees is also a manager of or a substantial contributor to the foundation.

The benefits to X and Y and members of their families as a result of the transfer of assets will be incidental or tenuous.

DISTRIBUTION REQUIREMENTS

Section 4942(a) of the Code imposes a tax on the undistributed income of a private foundation.

Section 4942(c) of the Code provides the term "undistributed income" means, with respect to any private foundation for any taxable year as of any time, the amount by which --

- (1) the distributable amount for such taxable year, exceeds
- (2) the qualifying distributions made before such time out of such distributable amount.

Under section 4942(g)(1)(A) of the Code, the term "qualifying distribution" means 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). Section 170(c)(2)(B) purposes include charitable purposes.

Under sections 4942(g)(3)(A) and (B) of the Code, the term "qualifying distribution" includes a grant by a private foundation to another private foundation as long as the transferor maintains adequate records to show that the transferee, 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).

Section 1.507-3(a)(5) of the regulations provides that, except as provided in section 1.507-3(a)(9), a private foundation is required to meet the distribution requirements of section 4942 of the Code for any taxable year in which it makes a section 507(b)(2) transfer of all or part of its net 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). However, where the transferor has disposed of all of its assets, the record keeping requirements of section 4942(g)(3)(B) shall not apply during any period in which it has no assets.

Section 1.507-3(a)(10) of the regulations, by reference to section 1.507-3(a)(9)(i), provides that in a section 507(b)(2) transfer, if the transferee foundation transfers all of its assets to one or more private foundations which are effectively controlled (within the meaning of section 1.482-1(a)(3) [now redesignated as section 1.482-1A(a)(3)]) by the same person or persons who effectively controlled the transferor private foundation, for purposes of Chapter 42 and sections 507 through 509, such transferee shall be treated as if it were the transferor.

Section 1.482-1A(a)(3) of the regulations provides that the term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not the form or the mode of its exercise.

Because the New Foundations will be effectively controlled, within the meaning of section 1.482-1A(a)(3), by the same persons who effectively control the Foundation, the transfers from the Foundation of all of its assets to the New Foundations will be transfers described in section 1.507-3(a)(9)(i) of the regulations. Therefore, the New Foundations will be treated as if they were the Foundation.

Under section 1.507-3(a)(5) of the regulations, the record keeping requirements of section 4942(g)(3)(B) of the Code will not apply to the Foundation during any period in which it has no assets.

TAXABLE EXPENDITURES

Section 4945(a) of the Code imposes a tax on each taxable expenditure made by private foundations.

Section 4945(d)(4) of the Code defines the term "taxable expenditure" as an amount paid or incurred by a private foundation as a grant to an organization (other than an organization described in paragraph (1), (2) or (3) of section 509(a)), unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h).

Section 4945(h) of the Code provides that expenditure responsibility means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to see that the grant is spent solely for the

purpose for which made, to obtain full and complete reports from the grantee on how the funds are spent, and to make full and detailed reports with respect to such expenditures to the Secretary.

Example (2) of section 1.507-3(a)(9)(iii) of the regulations indicates that when all net assets are transferred from one private foundation to one or more controlled foundations, there are no expenditure responsibility requirements that must be exercised under sections 4945(d)(4) and 4945(d)(h) of the Code with respect to the transfer.

Section 4945(d)(4) of the Code provides that the term "taxable expenditure" includes any amount paid or incurred for any purpose other than one specified in section 170(c)(2)(B).

Since the Foundation is transferring all of its assets to the New Foundations, private foundations effectively controlled (within the meaning of section 1.482-1A(a)(3)) by the same person or persons who effectively controlled the Foundation, the New Foundations will be treated as if they were the Foundation. Thus, section 4945 would not apply to the transfer of assets.

FILING REQUIREMENTS

Section 1.507-1(b)(9) of the regulations provides that a private foundation which transfers all of its net assets is required to file the annual information return required by section 6033, and the foundation managers are required to file the annual report of a private foundation required by section 6056, for the taxable year in which such transfer occurs. However, neither such foundation nor its foundation managers will be required to file such returns for any taxable year following the taxable year in which the last of any such transfers occurred, if at no time during the subsequent taxable years in question the foundation has either legal or equitable title to any assets or engages in any activity.

In general, section 6043(b) of the Code provides that any organization which for any of its last 5 taxable years preceding its liquidation, dissolution, termination, or substantial contraction was exempt from taxation under section 501(a) shall file a return and other information with respect to such liquidation, dissolution, termination, or, substantial contraction.

Accordingly, we conclude as follows:

1. The Foundation's transfer of all of its assets to the New Foundations will constitute a significant disposition of its assets to one or more private foundations under section 507(b)(2) of the Code.

2. The Foundation's transfer to the New Foundations will not result in termination of the Foundation's private foundation status under section 507(a) of the Code, but will constitute a

reorganization among these private foundations under section 507(b)(2).

3. The Foundation's transfer of its assets to the New Foundations will not constitute notification of the Foundation's intent to terminate its private foundation status under section 507(a)(1) of the Code, or any willful repeated acts (or failure to act) or any willful and flagrant act (or failure to act) under section 507(a)(2) by the Foundation, and, thus, the Foundation will not be liable for any tax imposed by section 507).

4. Under section 507(b)(2) of the Code, the New Foundations will not be treated as newly created organizations.

5. The New Foundations will be treated as possessing tax attributes and characteristics of the Foundation pursuant to sections 1.507-3(a)(2), (3) and (4) of the regulations.

6. The Foundation's transfer of all of its assets to the New Foundations will not give rise to any net investment income or constitute any other taxable sale or disposition under section 4940 of the Code.

7. The Foundation's transfer of all its assets to the New Foundations will not constitute any act of self-dealing under section 4941 of the Code by the Foundation or the New Foundations, or any of their foundation managers as defined in section 4946.

8. Upon the Foundation's transfer of all its assets to the New Foundations, the New Foundations will each succeed to a portion of the Foundation's excess qualifying distributions, if any, based upon each foundation's proportionate share of the Foundation's total assets received and the record-keeping requirements of section 4942(g)(3)(B) of the Code will not apply to the Foundation during any period in which the Foundation has no assets.

9. The Foundation's transfer of all its assets to the New Foundations will not constitute any taxable expenditures under section 4945 of the Code.

10. The Foundation will not be required to exercise any expenditure responsibility under section 4945(h) of the Code with respect to its transfers of all of its assets to the New Foundations because the Foundation will have thus disposed of all of its assets.

11. Under section 1.507-3(a)(9) of the regulations, for purposes of Chapter 42 and sections 507 through 509 of the Code, the New Foundations will be treated as if each were the Foundation in the proportion that the fair market value of the Foundation's assets

(less encumbrances) transferred to each bears to the fair market value of the Foundation's assets (less encumbrances) immediately before the Foundation's transfer of its assets.

12. The Foundation and its foundation managers will not be required to file the annual information return required under Code section 6033 for any tax years following the tax year in which the last transfers of all the Foundation's assets occur if during such subsequent tax years the Foundation will have neither legal nor equitable title to any assets nor engage in any activity. Upon the Foundation's dissolution, the Foundation will be required by Code section 6043(b) to file its annual return for the year of such dissolution as required by Code section 6043(b).

13. The legal, accounting, and other expenses, if reasonable in amount, incurred by the Foundation and the New Foundations in connection with this ruling request and in carrying out the transfers of assets, will be considered as being made to achieve the charitable purposes of the grants and, thus, the payments of such costs and expenses will not constitute taxable expenditures under section 4945.

The rulings described above are based on your representation that, at the time the transactions take place, the New Foundations will be recognized as organizations described in section 501(c)(3) and classified as private foundations under section 509(a).

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

Also, this ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited by others 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,

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3