TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:

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Identification Number:

Telephone Number:

Employer Identification Number:

Legend:
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Dear :

We have considered your ruling request in which you requested various rulings regarding the proposed merger of F and I and the federal tax consequences that may be associated with the merger.

Facts

F is an A nonprofit corporation recognized as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code (the Code) and is classified as a supporting organization under section 509(a)(3) of the Code. F's foundation status classification has not changed since F was recognized as a supporting organization by the Internal Revenue Service (the Service). F proposes to merge with its supported organization, I, a C nonprofit corporation, that has its base of activities in M, and is recognized as exempt from federal income tax under section 501(c)(3) of the Code and is classified as other than a private foundation under sections 509(a)(1) and 170(b)(1)(A)(ii) of the Code. The purposes of the merger are the consolidation of the two organizations' activities for the sake of greater efficiency and the expansion of their current educational and charitable programs.

F will be the surviving corporation after the merger but will change its name to Y in connection with the merger. F was established in 1946 to teach and expound the ideas of a particular political economist and social philosopher. I was created in 1974 for the purpose of operating a school that provides instruction to impart and develop knowledge of land economics and taxation, including an emphasis on land value taxation and related subjects, and providing training in the particular application of such knowledge. I's classification as a school has not changed since it was initially recognized as exempt by the Service.

I's activities are currently based in two buildings in M. I's educational programs have expanded over the past thirty years to provide academic instruction, professional development courses, and executive courses targeting practitioners whose work is related to land economics, land use, and land taxation. I further states that it regularly co-sponsors a number of seminars and courses with other academic institutions in the United States and internationally, members of the faculties of which have regular and ongoing commitments to teach and develop courses of study for I.

F is the principal source of financial support for I. Between 1974 and 1996, F in addition to expending the majority of its income to support I, made grants to other exempt educational institutions in support of the study of land use, valuation, and tax policy. Since 1997, I has been the sole supported organization of F. At present, there is a large degree of common governance and operation between I and F, since seven of the thirteen current Directors of I also serve on the board of Directors of F, and the President of F serves as the Chair of the Board of I. F typically provides more than 90 percent of the annual support received by I in a given year, with the remainder of I's financial support coming from course tuition and other program-related income generated by I. Funding provided by F is used by I to support both the general charitable, educational, and scientific activities of I as well as special projects undertaken by I related to its mission. In addition, F borrowed the funds necessary for I to acquire one of the two buildings it now uses for its programs. F's assets primarily consist of cash and marketable securities.

I's principal financial assets are two buildings it owns, one of which currently serves as the site of I's administrative offices and contains classrooms that serve as the location for many of I's lectures, seminars, conferences, and other educational programs. The other building is currently used as housing for visiting fellows, as well as for small group meetings. After the resolution of certain zoning issues, I also plans to use this second building as a site for its larger conferences and other educational programs.

The primary purpose of the proposed merger is to allow the post-merger F to expand I's educational and research activities beyond the traditional classroom setting. In particular, the post-merger F plans to devote an increasing portion of its resources to demonstration and public education projects that will enable it to test the validity of the principles developed by I and its predecessors in its field of study. The post-merger F also expects to devote more resources than in the past to public communication and broader dissemination of the results obtained and the lessons learned from its demonstration and public education projects through means such as films, school and community outreach and internet-based education. Other new activities that the post-merger F may undertake include the expansion of its academic

departments and the expansion of its fellowship programs.

I will merge with and into F pursuant to the laws of the States of A and C. The name of the surviving corporation, which will be an A nonprofit corporation, will be Y. You state that the merger has been approved by the Boards of Directors of both I and F . Because neither F nor I have members or shareholders, no other persons are required to approve the proposed merger.

The post-merger F's annual accounting period will be a fiscal year ending June 30, and it will continue to use the cash method for maintaining its books and filing its federal income tax returns. The first year of the post-merger, F's operation as a private foundation is likely to be less than a full twelve months.

Immediately preceding the proposed merger, the articles of incorporation of F will be amended so that (1) F is no longer structured as a supporting organization of I and (2) the purposes of F include the charitable, educational and scientific purposes of I , as well as additional charitable purposes. The articles of incorporation of F will also be amended to provide for certain administrative changes that will not affect the charitable exemption of F, such as a new governance structure and the designation of a new registered office or agent for F. F will continue to have no shareholders or members, and the management and governance of F will continue to be vested in the Board of Directors.

F's bylaws will be amended immediately before the proposed merger to provide that the Board of Directors will have between seven and eighteen members. There will be two classes of directors, one for lineal descendants of F's founder (which will include adopted children) and the other for non-lineal descendants. The lineal descendants cannot constitute a majority of the members of the Board of Directors or any committee thereof. Directors who are lineal descendants of F's founder will be eligible for re-election for an unlimited number of consecutive terms, whereas Directors who are not lineal descendants of F's founder will be eligible to serve two consecutive four-year terms and will be eligible for re-election after a one-year absence from the Board. All directors will have one vote on all matters before the Board of Directors, and all such matters will require the vote of at least a majority of the Directors present at a meeting of the Board of Directors.

After the proposed merger, the post-merger F will engage in the direct conduct of the exempt activities currently conducted by I, including most notably its courses of instruction, seminars, workshops, lectures, financial support of research by selected fellows, examination and dissemination of the research results of the fellows, and publication of materials pertaining to I's areas of expertise, as well as expanded programs of demonstration and public education projects. The post-merger F will use I's facilities in M as the site for many of these exempt activities and as offices for its faculty and administrators.

Through the operation of the post-merger F as a private foundation, the Directors of I and F hope to improve the quality of information available to decision-makers in its areas of study and to improve public discussion and debate by disseminating ideas, information, analysis, and experience to institutions and individuals engaged in these topical areas. To this end, the officers of F and I have developed a set of objectives for the post-merger F which emphasizes

the expansion and dissemination of knowledge in its field of study.

One or more of these specific objectives are intended to be served by each program and activity undertaken by the post-merger F.

F's demonstration and public education projects will be undertaken to transfer the academic knowledge gained from the classroom and research into the field, where F can demonstrate the validity of the academic principles developed by I and its predecessors over the past 55 years. Some of those research and demonstration projects will be conducted directly by F; others will be conducted as joint projects or joint ventures with other governmental, charitable, educational, scientific or professional organizations having expertise or experience in the areas being studied. F will participate directly, through its employees, consultants, officers or directors, in these research and demonstration projects, with its activities ranging from providing the supervision and evaluation of a research and demonstration project conducted by its co-venturer to hiring and managing the individuals who directly implement the research and demonstration project. F intends to use its findings from these demonstration projects to better inform the participants in its educational and research activities as well as public policy makers and members of the general public interested in land policy and taxation.

In all of its dealings with other organizations, F will pursue one or more of the specific objectives it has established. Rarely will F make a grant to another organization for that other organization to use in fulfilling its own purposes. Instead, F will either contract with other organizations for the performance by them of specific tasks directed and supervised by the employed academic staff of F or enter into a joint venture with another organization for the accomplishment of a specific project or program of F where the employed academic staff of both organizations will be actively and directly engaged in the conduct of the project or program.

On infrequent occasions, where unusual circumstances dictate, the post-merger F will make a grant to another governmental or charitable non-governmental organization to assist that organization with one of its projects. Such grants are expected to aggregate on average less than two percent of the post-merger F's annual expenditures. The post-merger F does not intend to make grants to private non-operating foundations or organizations controlled by F.

F anticipates that its adjusted net income will be less than its minimum investment return (as these terms are defined in section 4942 of the Code) under prevailing market conditions. F has adopted an investment policy that emphasizes total return and growth in the value of its assets in inflation-adjusted terms, rather than maximizing current income production. For this reason, the adjusted net income of the post-merger F is expected to be well below 5 percent of the value of its investment assets.

F, after the merger, intends to expend at least 85 percent of its adjusted net income each year directly for the active conduct of its exempt purposes (within the meaning of section 4942(j)(3)(A)) of the Code. However, if market conditions change such that the post-merger F's adjusted net income exceeds its minimum investment return, F will instead expend at least 85 percent of its minimum investment return each year directly for its exempt activities.

F also intends to expend no less than 3 1/3 percent of the value of its net investment assets each year on the active conduct of its exempt purposes. If the current value of F's net investment assets remain stable, this 3 1/3 percent minimum annual expenditure for each full year will be considerably more than F and I expended at the time of requesting these rulings. Excluded from its net investment assets for purposes of this calculation will be the value of its physical facilities and equipment that are used for the conduct and administration of F's exempt activities, including, but not limited to, the owned real estate in M, the leased facilities in A, and any other buildings, structures, and equipment later acquired by F for the conduct of its exempt programs.

Included within the calculation of F's expenditures for this purpose will be amounts paid as private foundation excise taxes under section 4940, as allowed by section 53.4942(b)-1(b)(3) of the Income Tax Regulations (the regulations).

You have requested the following rulings:

1. The proposed merger of I with and into F will have no adverse effect on F's continued entitlement to recognition of exemption under section 501(c)(3).

2. The proposed merger of I with and into F will not result in the recognition of any unrelated business taxable income under sections 511-514 of the Code by I or F.

3. Following the proposed merger, F will be classified as a private operating foundation under section 4942(j)(3) of the Code so long as it makes qualifying distributions that meet the income test of section 4942(j)(3)(A) and the endowment test of section 4942(j)(3)(B)(ii).

4. Following the proposed merger, the property located in M will not be taken into account in determining F's minimum investment return pursuant to section 53.4942(a)-2(c)(3) of the regulations.

5. For purposes of satisfying the operating foundation tests of section 4942(j)(3) for the taxable year immediately following the merger, the merged organization may take into account the qualifying distributions, adjusted net income, minimum investment return, and asset value of the surviving organization for that year and of the operating entity, I, for the three preceding taxable years.

6. If the first taxable year of F following the proposed merger is for a period of less than twelve months, its adjusted net income as defined in section 4942 of the Code shall be determined by its actual income, modifications and deductions for the short taxable year, and its minimum investment return shall be prorated on a daily basis for the short taxable year in accordance with the provisions of section 53.4942(a)-2(c)(5)(iii) of the regulations.

7. Following the proposed merger, the adjusted basis of F's stock and other assets the gain on the sale of which would be subject to tax under section 4940(a) of the Code will be equal to the fair market value of such stock and other assets on the date the proposed merger occurs.

8. If F has an excess business holding (as defined in section 4943(c)(1) at any time during which it is treated as a private foundation, then (a) to the extent that such excess business holding did not result from a purchase by F , F will not be subject to the taxes imposed by section 4943 of the Code so long as it disposes of the excess business holdings within 90 days of the date on which it knows, or has reason to know, of the event that caused it to have such excess business holding and, (b) to the extent that such excess business holding is caused by a change in the holdings of a business enterprise (other than by purchase by F or by its disqualified persons), F will have at least five years to dispose of such business holdings pursuant to section 4943(c)(6) in an amount sufficient for such holdings to constitute a permitted holding of F.

9. Stock bequeathed or contributed to F prior to the date of the proposed merger and held by F on the date the proposed merger occurs will not constitute a jeopardy investment within the meaning of section 4944(a) of the Code.

10. Following the proposed merger, the payment by F to a disqualified person (other than a government official, within the meaning of section 4946(c)) of compensation for personal services as an officer of F will not constitute an act of self-dealing within the meaning of section 4941 of the Code as long as the amount of such compensation is reasonable for the services rendered and not excessive in relation to the magnitude of F's assets and activities.

11. Following the proposed merger, the following persons who will be involved in F's management, educational programs and/or research programs will not be "governmental officials" within the meaning of section 4946(c): a dean and professor at a State University; a professor of economics at a State University in P ; a professor at a government-sponsored university in N ; the Executive Director of a City Planning Commission in O ; State and city planning directors; State and local property tax assessors; presidents, provosts, professors, deans, and other employees of State universities that are hired and/or governed by a Board of Regents; and similar types of government employees so long as the independent performance of policymaking functions is not a significant part of the activities of such persons.

12. Following the proposed merger, payments of compensation (or reimbursements of expenses) by F to or for the benefit of the persons described in ruling request 11, above, will not constitute acts of self-dealing within the meaning of section 4941(d), even if such persons are "disqualified persons" within the meaning of section 4946 (other than section 4946(c)), so long as such payments or reimbursements are for personal services which are reasonable and necessary to carrying out the purposes of F, and are not excessive.

13. Following the proposed merger, payments (or reimbursements) by F (a) of the allocable portions of the costs of (i) Board and Committee meetings attributable to members who are government officials (within the meaning of section 4946(c)) and (ii) other conferences and educational programs attributable to attendees who are government officials and (b) to government officials to attend Board and Committee meetings or other conferences and educational programs of F will not constitute acts of self-dealing so long as such payments (or reimbursements) are only for incidental expenses described in section 53.4941(d)-3(e)(9) or for travel solely from one point in the United States to another in connection with F's educational,

scientific and charitable purposes and do not exceed the actual cost of the transportation involved plus an amount for all other traveling expenses not in excess of 125 percent of the maximum amount payable under section 5702 of title 5, United States Code, which amount will be determined by reference to the then in-effect Federal Travel Regulation Per Diem Bulletin issued pursuant to 41 C.F.R. section 301-11.6.

14. Following the proposed merger, amounts expended by F (1) for F's agreed share of the expenses of demonstration and public education projects undertaken by F and other domestic or foreign organizations described in section 501(c) or domestic or foreign governmental units, bodies or agencies, (2) to fund F's Dissertation Fellowship Program, R, RFP Program, Visiting Fellowship Program and other similar programs operated in substantially the same manner, and (3) to repay a loan that was used to acquire property in M will constitute qualifying distributions directly for the active conduct of the activities constituting the purpose for which F is organized and operated within the meaning of section 4942(j)(3).

15. Following the proposed merger, expenditures on F's Dissertation Fellowship Program, R , Visiting Fellowship Program, RFP Program, and other similar programs operated in substantially the same manner will not constitute taxable expenditures within the meaning of section 4945(d)(3) because such expenditures meet the requirements of section 4945(g).

16. Following the proposed merger, F will not be required to obtain the permission of the Service by filing Form 1128 in order to adopt I's fiscal year beginning with its first taxable year following the merger.

Law

Section 501(a) of the Code provides for the exemption from federal income tax of organizations described in section 501(c)(3) of the Code.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, scientific, or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the advancement of education or science; lessening the burdens of government, and promotion of social welfare.

Section 1.501(c)(3)-1(d)(3)(i) of the regulations provides that the term "educational," as used in section 501(c)(3) of the Code, relates to (a) the instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(d)(5) of the regulations provides that the term "scientific" includes the carrying on of scientific research in the public interest, without regard to whether such research

is classified as fundamental or basic as contrasted with applied or practical, and that such research will be deemed to be carried on in the public interest if (1) the results of such research are made available to the public on a nondiscriminatory basis, (2) the research is performed for the United States or a State or political subdivision thereof, (3) the research is carried on for the purpose of aiding the scientific education of college or university students, or (4) the research is carried on for the purpose of obtaining scientific information which is published in a treatise, thesis, trade publication or in any other form that is available to the interested public.

Sections 1.501(c)(3)-1(d)(1)(ii) and 1.501(c)(3)-1(c)(2) of the regulations provides that even though an organization satisfies one or more of the foregoing definitional requirements, it will not be exempt under section 501(c)(3) of the Code if it is organized or operated for the benefit of private interests or if any part of its net earnings inure to the benefit of any private shareholders or individuals.

Section 511 of the Code imposes a tax on the unrelated business taxable income of any nonprofit organization that is otherwise exempt from federal income tax under section 501(c)(3).

Section 512(a)(1) of the Code defines unrelated business taxable income as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less any allowable deductions.

Section 512(b)(5) of the Code provides that there shall be excluded from unrelated business taxable income all gains or losses from the sale, exchange or other disposition of property other than property which would properly be included in inventory if on hand at the close of the taxable year or which is held primarily for sale to customers in the ordinary course of the organization's trade or business.

Section 513(a) of the Code defines the term unrelated trade or business, in pertinent part, as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is substantially related to an organization's exempt purposes only when the business activity has a substantial causal relationship to the achievement of the exempt purposes for which such organization was formed.

Section 4942(j)(3) of the Code defines a private operating foundation as an organization (A) which makes qualifying distributions directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated equal to substantially all of the lesser of (i) its adjusted net income (as defined in subsection (f), or (ii) its minimum investment return; and (B)(i) substantially more than half of the assets of which are devoted directly to such activities or to functionally related businesses or both, or are stock of a corporation which is controlled by the foundation and substantially all of the assets of which are so devoted, (ii) which normally makes qualifying distributions directly for the active conduct of the activities

constituting the purpose or function for which it is organized and operated in an amount not less than two-thirds of its minimum investment return (as defined in subsection (e)), or (iii) substantially all of the support (other than gross investment income as defined in section 509(e) of the Code of which is normally received from the general public and from 5 or more exempt organizations which are described in section 4946(a)(1)(H) with respect to each other or the recipient foundation; not more than 25 percent of the support (other than gross investment income) of which is normally received from any one such exempt organization; and not more than half of the support of which is normally received from gross investment income. Section 53.4942(b)-1(c) of the regulations defines the term "substantially all" as meaning 85 percent or more.

Section 53.4942(a)-3(a)(2) of the regulations defines the term "qualifying distributions," in part, as "any amount (including program-related investments, as defined in section 4944(c), and reasonable and necessary administrative expenses) paid to accomplish one or more of the purposes described in section 170(c)(1) or (2)(B), other than any contribution to" a non-operating private foundation or to an "organization controlled (directly or indirectly) by the contributing private foundation or one or more disqualified persons with respect to such foundation (except as provided in paragraph (c) of this section."

Section 53.4942(a)-2(c)(1) of the regulations provides that the "minimum investment return" of a private foundation shall be calculated by multiplying "(i) the excess of the aggregate fair market value of all assets of the foundation, other than those described in subparagraphs (2) and (3) of this paragraph, over the amount of the acquisition indebtedness with respect to such assets, by (ii) the applicable percentage (as defined in subparagraph (5) of this paragraph) for such year."

Section 53.4942(a)-2(c)(5) of the regulations provides that the "applicable percentage" for taxable years beginning after December 31, 1975 is five percent.

Section 53.4942(a)-2(c)(2) of the regulations provides, in relevant part, that "the assets taken into account in determining minimum investment return shall not include (v) any assets used (or held for use) directly in carrying out the foundation's exempt purposes."

Section 53.4942(a)-2(c)(3)(i) of the regulations provides, in relevant part, that for purposes of subparagraph (2)(v) of this paragraph, an asset is "used (or held for use) directly in carrying out the foundation's exempt purpose" only if the asset is actually used by the foundation in the carrying out of the charitable, educational, or other similar purpose which gives rise to the exempt status of the foundation. Whether an asset is held for the production of income or for investment rather than used (or held for use) directly by the foundation to carry out its exempt purpose is a question of fact. However, where property is used both for charitable, educational, or other similar exempt purposes and for other purposes, of such exempt use represents 95 percent or more of the total use, such property shall be considered to be used exclusively for a charitable, educational, or other similar exempt purpose. If such exempt use of such property represents less than 95 percent of the total use, reasonable allocation between such exempt and nonexempt use must be made for purposes of this paragraph."

Section 53.4942(a)-2(c)(3)(ii) of the regulations provides, in relevant part, that examples of

assets which are "used (or held for use) directly in carrying out the foundation's exempt purpose" include, but are not limited to "(b) Real estate or the portion of a building used by the foundation directly in its charitable, educational, or other similar exempt activities; and (c) Physical facilities used in such activities, such as paintings or other works of art owned by the foundation which are on public display, fixtures and equipment in classrooms, research facilities and related equipment which under the facts and circumstances serve a useful purpose in the conduct of such activities."

Section 53.4942(b)-3(a) of the regulations provides that, in order to qualify as an operating foundation, a foundation must satisfy the income test and either the assets, endowment or support test by satisfying such tests for any three taxable years during a four-year period consisting of the taxable year in question and the three immediately preceding taxable years or on the basis of an aggregation of all pertinent amounts of income or assets held, received or distributed during such four-year period.

Section 53.4942(b)-3(b) of the regulations provides that "except as provided in subparagraph (2) of this paragraph, an organization organized after December 31, 1969, (a new organization) will be treated as an operating foundation only if it has satisfied the tests set forth in section 53.4942(b)-1 (which describes the income test) and section 53.4942(b)-2 (which describes the assets, endowment and support tests) for its first taxable year of existence. If an organization satisfies such tests for its first taxable year, it will be treated as an operating foundation from the beginning of such taxable year. If such is the case, the organization will be treated as an operating foundation for its second and third taxable years of existence only if it satisfies the tests set forth in section 53.4942(b)-1 and section 53.4942(b)-2 of the regulations by the aggregation method for all such taxable years that it has been in existence."

Section 53.4942(b)-3(c) of the regulations provides that "an organization organized before December 31, 1969 but which is unable to satisfy the tests under section 53.4942(b)-1 and 53.4942(b)-2 of the regulations for its first taxable year beginning after December 31, 1969 on the basis of its operations for taxable years prior to such taxable year by either the three-out-of-four-year method or the aggregation method will be treated as a new organization for purposes of paragraph (b) of this section only if (1) the organization changes its method of operation prior to its first taxable year beginning after December 31, 1972 to conform to the requirements of section 53.4942(b)-1 and section 53.4942(b)-2 of the regulations; (2) the organization has made a good faith determination that it is likely to satisfy the tests set forth in section 53.4942(b)-1 and section 4942(b)-2 prior to its first taxable year beginning after December 31, 1972 on the basis of its income or assets held, received or distributed during its taxable years beginning in 1970 through 1972; and (3) such good faith determination is attached to the return the organization is required to file under section 6033 for its taxable year beginning in 1972."

Section 53.4942(a)-2(d)(1) of the regulations defines "adjusted net income" as "the excess (if any) of (i) the gross income for the taxable year (including gross income from any unrelated trade or business) determined with the income modifications provided by subparagraph (2) of this paragraph over (ii) the sum of the deductions (including deductions directly connected with the carrying on of any unrelated trade or business), determined with the deduction modifications provided by subparagraph (4) of that paragraph, which would be allowed to a corporation

subject to the tax imposed by section 11 for the taxable year."

Section 53.4942(a)-2(c)(1) of the regulations provides that the "minimum investment return" of a private foundation shall be calculated by multiplying "(i) the excess of the aggregate fair market value of all assets of the foundation, other than those described in subparagraphs (2) and (3) of this paragraph, over the amount of the acquisition indebtedness with respect to such assets, by (ii) the applicable percentage (as defined in subparagraph (5) of this paragraph) for such year."

Section 53.4942(a)-2(c)(5)(i) of the regulations provides that the "applicable percentage" for taxable years beginning after December 31, 1975 is five percent.

Section 53.4942(a)-2(c)(5)(iii) of the regulations further provides that "in any case in which a taxable year referred to in this subparagraph is a period less than 12 months, the applicable percentage to be applied to the amount determined under the provisions of subparagraph (1) of this paragraph shall be equal to the applicable percentage for the calendar year in which the short taxable period began, multiplied by a fraction, the numerator of which is the number of days in such short taxable period and the denominator of which is 365."

Section 4940(a) of the Code imposes a two percent annual excise tax on the net investment income of private foundations.

Section 4940(c)(1) of the Code defines the net investment income of a private foundation for purposes of section 4940 as the amount by which the foundation's gross investment income and net capital gains exceed its allowable deductions.

Section 53.4940-1(f)(2)(i) of the regulations provides that the basis for purposes of determining gain from the sale or other distribution of property shall be the greater of (a) fair market value on December 31, 1969, provided that the property was held by the private foundation on December 31, 1969. and continuously thereafter to the date of disposition, or (b) the basis as determined under the normal basis rule (but without regard to section 362(c)).

Section 4943(a)(1) of the Code provides for the imposition of a tax on "the excess business holdings of any private foundation in a business enterprise during any taxable year which ends during the taxable period equal to 5 percent of the value of such holdings."

Section 4943(b) of the Code provides that if the private foundation fails to dispose of its excess business holdings after the initial tax is assessed, there is imposed, at the close of the taxable period with respect to such holdings, an additional 200 percent excise tax on the undisposed excess business holdings.

Section 4940(c)(1) of the Code provides that a private foundation has excess business holdings in a corporation if its holdings exceed its permitted holdings. In general, a private foundation's permitted holdings in a corporation are limited to 20 percent of the corporation's voting stock, reduced by the percentage of the corporation's voting stock owned by all the disqualified persons with respect to the foundation under section 4943(c)(2)(A).

Section 4943(c)(2)(C) of the Code provides that a "private foundation shall not be treated as having excess business holdings in any corporation in which it (together with all other private foundations which are described in section 4946(a)(1)(H) owns not more than 2 percent of the voting stock and not more than 2 percent in the value of all outstanding shares of all classes of stock."

Section 53.4943-2(a)(1)(ii) of the regulations provides that in "any case in which a private foundation acquires excess business holdings, other than as a result of a purchase by the foundation, the foundation shall not be subject to the taxes imposed by section 4943, but only if it disposes of an amount of its holdings so that it no longer has such excess business holdings within 90 days of the date on which it knows, or has reason to know, of the event which caused it to have such excess business holdings."

Section 4944(a) of the Code imposes a tax on any amount invested by a private foundation in a manner that jeopardizes the carrying out of any of its exempt purposes.

Section 53.4944-1(a)(2)(i) of the regulations provides, in relevant part, that "no category of investments shall be treated as per se violation of section 4944." However, this regulation gives several examples of the type of investments and methods that will be closely scrutinized to determine whether the foundation managers have exercised the requisite standard of care and prudence to avoid classification as jeopardy investments. These investments and methods include trading in securities on margin, trading in commodity futures, investments in working interests in oil and gas wells, the purchase of "puts" and "calls" and "straddles," the purchase of warrants and selling short.

Section 53.4944-1(a)(2)(ii)(a) of the regulations provides that "section 4944 shall not apply to an investment made by any person which is later gratuitously transferred to a private foundation. If such foundation furnishes any consideration to such person upon the transfer, the foundation will be treated as having made an investment in the amount of such consideration."

Section 53.4944-1(a)(2)(ii)(b) of the regulations provides that "section 4944 shall not apply to an investment which is acquired by a private foundation solely as a result of a reorganization within the meaning of section 368(a)."

Section 4941 of the Code provides that a tax shall be imposed on acts of self-dealing between a disqualified person and a private foundation.

Sections 4941(a)(1) and 4941(b)(1) of the Code provide for the imposition of taxes on the disqualified person who engages in an act of self-dealing with a private foundation.

Sections 4941(a)(2) and 4941(b)(2) of the Code provide for the imposition of taxes on the managers of a private foundation who knowingly participate in an act of self-dealing with a disqualified person.

Section 4941(d)(1)(D) of the Code provides that "self-dealing" means any direct or indirect "payment of compensation (or payment or reimbursement of expenses) by a private foundation

to a disqualified person."

Section 4941(d)(2)(E) of the Code provides that "except in the case of a government official (as defined in section 4946(c)), the payment of compensation (and the payment or reimbursement of expenses) by a private foundation to a disqualified person for personal services which are reasonable and necessary to carry out the exempt purpose of the private foundation shall not be an act of self-dealing if the compensation or payment or reimbursement is not excessive."

Section 4946(a) of the Code provides, in relevant part, that the term "disqualified person" includes, with respect to a private foundation, a person who is (a) a substantial contributor to the foundation; (b) a foundation manager (within the meaning of subsection(b)(1); (c) an owner of more than 20 percent of (i) the total combined voting power of a corporation; (ii) the profits interests of a partnership, or (iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation; (d) a member of the family (within the meaning of section 4946(d)) of any individual described in subparagraph (a), (b), or (c); or (e) only for purposes of section 4941, a government official (within the meaning of section 4946(c)).

Section 4946(b)(1) of the Code provides that "the term 'foundation manager' means, with respect to any private foundation (1) an officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation), and (2) with respect to any act (or failure to act), the employees of the foundation having authority or responsibility with respect to such act (or failure to act)."

Section 4946(d) of the Code provides that for purposes of subsection (a)(1) of section 4946, the "family" of any individual "shall include only his spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren."

Section 4941(a) and (b) of the Code impose certain excises taxes on acts of self-dealing between private foundations and their disqualified persons.

Section 4941(d) of the Code provides, in relevant part, that "self-dealing" means any direct or indirect "(C) furnishing of goods, services, or facilities between a private foundation and a disqualified person; (D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person and; (F) agreement by a private foundation to make a payment of money or other property to a government official (as defined in section 4946(c)), other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating his government service within a 90-day period."

Section 4946(a)(1)(I) of the Code provides that only for purposes of section 4941, the term "disqualified person" includes a governmental official.

Section 4946(c) of the Code provides that for purposes of subsection (a)(1)(I) and section 4941, the term 'government official' means, with respect to an act of self-dealing described in section 4941, an individual who, at the time of such act, holds any of the following offices or positions (other than as a 'special Government employee', as defined in section 202(a) of title 18 United

States Code): (1) an elective public office in the executive or legislative branch of the Government of the United States; (2) an office in the executive or judicial branch of the Government of the United States, appointment to which was made by the President; (3) a position in the executive, or judicial branch of the Government of the United States (A) which is listed in schedule C of rule VI of the Civil Service Rules, or (B) the compensation or which is equal to or greater than the lowest rate of basic pay for the Senior Executive Service under section 5382 of title 5, United States Code; (4) a position under the House of Representatives or the Senate of the United States held by an individual receiving gross compensation at an annual rate of $15,000 or more; (5) an elective or appointive public office in the executive, legislative, or judicial branch of the government of a State, possession of the United States or political subdivision or other area of any of the foregoing, or of the District of Columbia, held by an individual receiving gross compensation at an annual rate of $20,000 or more; (6) a position as personal or executive assistant or secretary to any of the foregoing; or (7) a member of the Internal Revenue Service Oversight Board."

Section 53.4946-1(g)(2)(i) of the regulations provides that "in defining the term 'public official' for purposes of section 4946(c)(5) and subparagraph (1)(iv) of this paragraph, such term must be distinguished from mere public employment. Although holding a public office is one form of public employment, not every position in the employ of a State or other governmental subdivision (as described in section 4946(c)(5)) constitutes a 'public office.' Although a determination whether a public employee holds a public office depends on the facts and circumstances of the case, the essential element is whether a significant part of the activities of a public employee is the independent performance of policymaking functions. In applying this subparagraph, several factors may be considered as indications that a position in the executive, legislative, or judicial branch of the government of a State, possession of the United States,, or political subdivision or other area of any of the foregoing, or of the District of Columbia, constitutes a 'public office.' Among such factors to be considered in addition to those set forth above, are that the office is created by the Congress, a State constitution, or the State legislature, or by a municipality or other governmental body pursuant to authority conferred on the office and the duties to be discharged by such office are defined either directly or indirectly by the Congress, State constitution, or State legislature, or through legislative authority."

Section 53.4946-1(g)(2)(ii) of the regulations provides, in relevant pert, that the following "are illustrations of positions of public employment which do not involve policymaking functions within the meaning of subdivision (i) of this subparagraph and which are thus not a 'public office' for purposes of section 4946(c)(5) and subparagraph (i)(iv) of this paragraph; (a) the chancellor, president, provost, dean, and other officers of a State university who are appointed, elected, or otherwise hired by a State Board of Regents or equivalent public body and who are subject to the direction and supervision of such body; (b) professors, instructors, and other members of the faculty of a State educational institution who are appointed, elected, or otherwise hired by the officers of the institution or by the State Board of Regents or equivalent public body; (e) physicians, nurses, and other professional persons associated with public hospitals and State boards of health who are appointed, elected, or otherwise hired by the governing board or officers of such hospitals or agencies; and (f) members of police and fire departments, except for those department heads who, under the facts and circumstances of the case, independently perform policymaking functions as a significant part of their activities."

Section 4941(d)(1) of the Code, in relevant part, provides that for purposes of this section, the term "self-dealing" means any direct or indirect "agreement by a private foundation to make any payment of money or other property to a government official (as defined in section 4946(c)), other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating his government service within a 90-day period."

Section 4941(d)(2)(D) of the Code provides that for purposes of paragraph (1) "the furnishing of goods, services or facilities by a private foundation to a disqualified person shall not be an act of self-dealing if such furnishing is made on a basis no more favorable than that on which such goods, services or facilities are made available to the general public."

Section 4941(d)(2)(G) of the Code provides, in pertinent part, that "in the case of a government official (as defined in section 4946(c)), paragraph (1) shall in addition not apply to (vii) any payment or reimbursement of traveling expenses for travel solely from one point in the United States to another point in the United States, but only if such payment or reimbursement does not exceed the actual cost of transportation involved plus an amount for all other traveling expenses not in excess of 125 percent of the maximum amount payable under section 5702 of title 5, United States Code, for like travel by employees of the United States."

Section 53.4941(d)-3(b)(1) of the regulations provides that "under section 4941(d)(2)(D), the furnishing of goods, services, or facilities by a private foundation to a disqualified person shall not be an act of self-dealing if such goods, services, or facilities are made available to the general public on at least as favorable a basis as they are made available to the disqualified person, but that this subparagraph shall not apply, however, in the case of goods, services, or facilities furnished later than May 16, 1973, unless such goods, services or facilities are functionally related, within the meaning of section 4942(j)(5), to the exercise or performance by a private foundation of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(c)(3)."

Section 53.4941(d)-3(b)(2) of the regulations provides, in relevant part, that " for purposes of this paragraph, the term 'general public' shall include those persons who, because of the particular nature of the activities of the private foundation, would be reasonably expected to utilize such goods, services, or facilities. This paragraph shall not apply, however, unless there is a substantial number of persons other than disqualified persons who are actually utilizing such goods, services, or facilities. Similarly, the sale of a book or magazine by a private foundation to disqualified persons shall not be an act of self-dealing if the publication of such book or magazine is functionally related to a charitable or educational activity of the function and the book or magazine is made available to the disqualified persons and the general public at the same price."

Section 53.4941(d)-3(e) of the regulations provides, in relevant part, that under "section 4941(d)(2)(G), in the case of a government official, in addition to the exceptions provided in section 4941(d)(2)(B), (C), and (D), section 4941(d)(1) shall not apply to (7) any payment or

reimbursement of traveling expenses (including amounts expended for meals and lodging, regardless of whether the government official is 'away from home' within the meaning of section 162(a)(2), and including reasonable advances for such expenses anticipated in the immediate future) for travel solely from one point in the United States to another in connection with one or more purposes described in section 170(c)(1) or (2)(B), but only if such payment or reimbursement does not exceed the actual cost of the transportation involved plus an amount for al other traveling expenses not in excess of 125 percent of the maximum amount payable under 5 U,S.C. 5702(a) for like travel by employees of the United States" or "(9) if the government official attends or participates in a conference sponsored by a private foundation, the allocable portion of the cost of such conference and other non-monetary benefits (for example, benefits of a professional, intellectual, or psychological nature, or benefits resulting from the publication or the distribution to participants of a record of the conference), as well as the payment or reimbursement of expenses (including reasonable advances for expenses anticipated in connection with such conference in the near future), received by such government official as a result of such attendance or participation shall not be subject to section 4941(d)(1), so long as the conference is in furtherance of the exempt purposes of the foundation."

Rev. Rul. 74-601, 1974-2 C.B. 385, holds that reimbursements by a private foundation for travel, meals, and lodging expenses incurred by U.S. Congressmen to participate in a conference it cosponsors in a foreign country does not come within the exception to self-dealing set forth in section 4941(d)(2)(G)(vii) of the Code because that section, as well as section 53.4941(d)-3(e)(7)of the regulations, cover only payments for travel from one point in the United States to another point in the United States. In addition, Rev. Rul. 74-601 holds that such reimbursements do not come within the exception to self-dealing set forth in section 53.4941(d)-3(e)(9) because this section "is not intended to extend or state a further exception to the above provisions" and that the "benefits or payments intended to be covered by this section are only those which are an incidental type." As an example of an incidental benefit that would be covered by the exception in section 53. 4941(d)-3(e)(9) of the regulations, Rev. Rul. 74-601 provides that "payment for, or reimbursement of, expenses involved in the preparation of or printing of a report or other paper to be used by the government official as part of his participation in the foreign conference would not be an act of self-dealing under the provisions of section 4941(d)(1) of the Code."

Section 4942(j)(3) of the Code defines a private operating foundation as an organization which makes qualifying distributions directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated equal to substantially all of its adjusted net income and which normally makes qualifying distributions directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated in an amount not less than two-thirds of its minimum investment return.

Section 53.4942(b)-1(b)(1) of the regulations provides, in relevant part, that except as otherwise provided in such regulations, "qualifying distributions are not made by a foundation 'directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose' unless such qualifying distributions are used by the foundation itself, rather than by or through one or more grantee organization which receive such qualifying distributions directly or indirectly from such foundation. Thus, grants made to other organizations to assist them in

conducting activities which help to accomplish their charitable, educational, or other similar exempt purpose are considered an indirect, rather than direct, means of carrying out activities constituting the charitable, educational, or other similar exempt purpose of the grantor foundation, regardless of the fact that the exempt activities of the grantee organization may assist the grantor foundation in carrying out its own exempt activities. However, amounts paid to acquire or maintain assets which are used directly in the conduct of the foundation's exempt activities, such as the operating assets of a museum, public park, or historic site, are considered direct expenditures for the active conduct of the foundation's exempt activities."

Section 53.4942(b)-1(b)(2) of the regulations provides that "if a foundation makes or awards grants, scholarships, or other payments to individual beneficiaries to support active programs conducted to carry out the foundation's charitable, educational, or other exempt purposes, such grants, scholarships, or other payments will be treated as qualifying distributions made directly for the active conduct of the foundation's exempt activities only if the foundation, apart from the making or awarding of the grants, scholarships, or other payments, otherwise maintains some significant involvement (as defined in subdivision (ii) of this subparagraph) in the active programs in support of which such payments were made."

Section 53.4942(b)-1(b)(2)(ii) of the regulations provides, in relevant part, that "a foundation will be considered as maintaining a 'significant involvement' in a charitable, educational, or other similar exempt activity in connection with which grants, scholarships or other payments are made or awarded if (B) the foundation has developed some specialized skills, expertise, or involvement in a particular discipline or substantive area, it maintains a salaried staff of administrators, researchers or other personnel who supervise or conduct programs or activities which support and advance the foundation's work in its particular area of interest, and, as a part of such programs or activities, the foundation makes or awards grants, scholarships, or other payments to individuals to encourage and further their involvement in the foundation's particular area of interest and in some segments of the programs or activities carried on by the foundation (such as grants under which the recipients, in addition to independent study, attend classes, seminars, or conferences sponsored or conducted by the foundation").

Example 4 of section 53.4942(b)-1(d) of the regulations provides that certain fellowship grants made to M.A. and Ph.D. students by an exempt educational organization created for the purpose of training teachers for institutions of higher education constitute qualifying distributions made directly for the active conduct of the organization's exempt activities where (1) only those applicants that indicate a strong interest in teaching in colleges or universities are chosen, (2) the organization conducts annual summer seminars attended by fellowship recipients, its staff, consultants and other interested parties, the purpose of which seminars are to foster and encourage the development of college teaching, and (3) the organization publishes a report of the seminar proceedings along with related studies written by the attendees. The organization's commitment to encouraging individuals to become teachers at institutions of higher learning, its maintenance of a staff and programs designed to further this purpose, and the granting of fellowships to encourage involvement both in its own seminars and in its exempt purposes indicate a significant involvement by the organization beyond the mere granting of fellowships.

Example 5 of section 53.4942(b)-1(d) of the regulations provides that an exempt organization

composed of professional organizations interested in different branches of one academic discipline which trains its own professional staff, conducts its own program of research, selects research topics, sets up and conducts conferences and seminars for the grantees, and which has particular knowledge and skills in the given discipline, carries on activities to advance its study of the discipline, and makes grants to individuals to enable them to participate in activities which it conducts in carrying out its exempt activities is making grants that constitute qualifying distributions made directly for the active conduct of its exempt activities.

Section 4945(d)(3) of the Code provides that a grant by a private foundation to an individual for travel, study or any other similar purpose is a taxable expenditure unless the grant satisfies the provisions of section 4945(g).

Section 4945(g)(3) of the Code provides that section 4945(d)(3) will not apply to an individual grant awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary, if it is demonstrated to the satisfaction of the Secretary that "the purpose of the grant is to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, teaching or other similar capacity, skill or talent of the grantee."

Section 53.4945-4(c)(1) of the regulations provides that, in order to secure the advance approval required by section 4945(g), a private foundation must demonstrate to the satisfaction of the Commissioner that "(i) its grant procedure includes an objective and non-discriminatory selection process (as described in paragraph (b) of this section); (ii) such procedure is reasonably calculated to result in performance by grantees of the activities that the grants are intended to finance; and, (iii) the foundation plans to obtain reports to determine whether the grantees have performed the activities that the grants are intended to finance." No single procedure or set of procedures is required by these regulations.

Section 53.4945-4(c)(3) of the regulations provides that "with respect to grants made under section 4945(g)(3), the private foundation shall require reports on the use of the funds and the progress made by the grantee toward achieving the purposes for which the grant was made. Such reports must be made at least once a year. Upon completion of the undertaking for which the grant was made, a final report must be made describing the grantee's accomplishments with respect to the grant and accounting for the funds received under such grant."

Section 53.4945-4(c)(4)(i) of the regulations provides, in relevant part, that "where the reports submitted under this paragraph or other information (including the failure to submit such reports) indicates that all or any part of a grant is not being used in furtherance of the purpose of such grant, the foundation is under a duty to investigate. While conducting its investigation, the foundation must withhold further payments to the extent possible until any delinquent reports have been submitted."

Section 53.4945-4(c)(4)(ii) of the regulations provides that in cases in which the grantor foundation determines that any part of a grant has been used for improper purposes and the grantee has not previously diverted grant funds to any use not in furtherance of a purpose specified in the grant, the foundation will not be treated as having made a taxable expenditure

solely because of the diversion so long as the foundation (a) is taking all reasonable and appropriate steps either to recover the grant funds or to insure restoration of the diverted funds and the dedication (consistent with the requirements of (b)(1) and (2) of this subdivision) of other grant funds held by the grantee to the purposes being financed by the grant, and (b) withholds any future payments to the grantee after the grantor becomes aware that a diversion may have taken place until it has (1) received the grantee's assurances that future diversions will not occur, and (2) required the grantee to take extraordinary precautions to prevent future diversions from occurring."

Section 53.4945-4(c)(6) of the regulations provides that a "private foundation shall retain records pertaining to all grants to individuals for purposes described in section 4945(d)(3). Such records shall include: (i) all information the foundation secures to evaluate the qualifications of potential grantees; (ii) identification of grantees (including any relationship of the grantee to the foundation sufficient to make grantee a disqualified person of the private foundation within the meaning of section 4946(a)(1)); (iii) specification of the amount and purpose of each grant; and (iv) the follow-up information which the foundation obtains in complying with subparagraphs (2), (3), and (4) of this paragraph."

Rev. Proc. 85-58, 1985-2 C.B. 740, sets forth the procedure to be followed by certain organizations exempt under section 501(a), including organizations exempt under section 501(c)(3), that desire to change their annual accounting periods.

Section 3.01 of Rev. Proc. 85-58 provides, in relevant part, that "except as provided in section 3.03 below, organizations desiring to change their annual accounting periods may effect the change by timely filing the applicable information return, Form 990, Form 990-PF, Form 990-BL, or Form 1065, with the appropriate Internal Revenue Service Center for the short period for which a return is required. The Form should indicate that a change of accounting period is being made."

Section 3.02 of Rev. Proc. 85-58 provides, in relevant part, that the annual information returns referenced in Section 3.01 "must be filed by the fifteenth day of the fifth month following the close of the short period."

Section 3.03 of Rev. Proc. 85-58 provided that "if an organization has previously changed its annual accounting period at any time within the ten calendar years ending with the calendar year that includes the beginning of the short period resulting from the change of an annual accounting period, and if it had a filing requirement at any time during that ten year period, it must file a Form 1128 (Application for Change in Accounting Period) with the appropriate Internal Revenue Service Center with its timely-filed annual information return or Form 990-T,as appropriate, whether or not the filing of the information return or Form 990-T would have otherwise been required for that year. Form 1128 must be filed by the fifteenth day of the fifth month following the close of the short period."

Analysis:

Following the proposed merger, both F and I will continue to be operated for the same

charitable, educational and scientific purposes as before the merger, with the surviving entity conducting all of the charitable, educational and scientific programs formerly conducted by I. In addition, the surviving entity will pursue additional means for disseminating the results of its research, analysis and study to the public through such means as Internet-based instruction, films and demonstration projects.

The classroom instruction, seminars, lectures, and other instructional programs to be continued, as well as the new instructional programs, are educational and the research is both in furtherance of these educational activities and carried on for the purpose of obtaining scientific information made available to the public on a nondiscriminatory basis, and the demonstration and public education projects will accomplish both educational and scientific purposes, as well as lessen the burdens of government.

F does not currently have any shareholders or members, and it will not have any shareholders or members after the proposed merger. F has never been organized or operated for the benefit of any private interests (other than the students, fellows, and other individuals who benefit from the charitable, educational and scientific programs made possible by F's support of I), and it will not do so after the proposed merger. The payment to directors, officers and other individuals of reasonable compensation for services rendered in carrying out your exempt purposes and related investment and administrative functions is not and will not be a violation of the prohibition on private inurement or private benefit as provided in your articles of incorporation.

The organizing documents of I and F currently provide, and the articles of incorporation of the post-merger F will likewise provide, that upon dissolution, all of such organization's assets must be distributed to an organization operated exclusively for the purposes described in section 170(c)(2)(B) and sections 509(a)(1), (2) or (3). Additionally, you state that the merger of I with and into F will allow the post-merger F to expand upon I's charitable, educational, and scientific purposes through the conduct of demonstration and public education projects and related activities that will allow the theories developed by I's faculty and fellows to be tested in the field.

Pursuant to the plan of merger, all of I's assets and liabilities will be transferred by operation of law to F, and I's separate corporate existence will be terminated. You state that immediately prior to the proposed merger, F will amend its charitable purposes to include the charitable, educational and scientific purposes discussed above. The assets transferred by I to F pursuant to the merger will continue to be devoted exclusively to exempt purposes described in section 501(c)(3), and F thereafter will conduct the charitable, educational, and scientific programs formerly conducted by I, as well as the additional programs and projects described above. All amounts expended by F related to the conduct of these activities (including any program-related investments and reasonable and necessary administrative expenses related thereto) are expected to constitute qualifying distributions. Also after the proposed merger, F intends to expend directly for the active conduct of its charitable, educational, and scientific purposes at least 85 percent of its annual adjusted net income and at least 3 1/3 percent of its net investment assets value each year. Provided that F makes distributions that meet these requirements, F will qualify for classification as a private operating foundation.

You state that the post-merger F will use its office buildings in M as offices for the administration

and faculty as well as the location for many of its educational programs, including the annual series of public lectures, the annual conference for State tax judges, seminars for its various research fellows, the property tax course for tax assessors, and the meetings of State and city planning directors. You state that one of these buildings may also continue to be used as housing for Visiting Fellows and other out-of-town faculty for F's educational programs. So long as these buildings are used for such exempt purposes, and so long as neither facility is used for any other non-operating purpose, such as the conduct of investment activities, that exceeds 5 percent of its use, those facilities will be treated as assets used (or held for use) directly in the carrying out of its exempt purposes and their value will not be included in the calculation of F's minimum investment return.

If F merged into I, I would satisfy the section 4942(j)(2) private operating foundation tests for the three (and many more) preceding years because it spent on its school operations far more than its income and virtually all of its assets were devoted to school purposes. Then, on the basis of the three-out-of-four year test of the regulations, the merged entity would be classified as a private operating foundation even if it fails the tests for the year of the merger. If I then merged into a new foundation created in the State of A, the new foundation would meet the tests for private operating status for all years.

The post-merger F expects to satisfy the tests set forth in section 4942(j)(3) of the Code. Because the post-merger F's adjusted net income is expected to be less than its minimum investment return for the foreseeable future, F expects that, after the proposed merger, it will be required to expend an amount equal to substantially all of its adjusted net income in order to continuously qualify as a private operating foundation.

F currently owns an extensive portfolio of investment assets, the income and gains from which it uses to fund the operations of I. Among its investment assets F owned at the time of requesting these rulings approximately of the total outstanding voting stock (or stock of the predecessor corporate entity) in the form of gifts and bequests from its founders and members of his family and thus such stock was acquired other than by purchase. You further state that to the best of the knowledge of F , the persons who would be considered disqualified persons if F were treated as a private foundation collectively own of this company's outstanding voting stock. You state that I does not own any of the voting stock of this company. Thus, on the date that F becomes a private foundation subject to the taxes on excess business holdings under section 4943 (pursuant to its merger with I), F's holding of this company's voting stock, when combined with the holdings of its disqualified persons, are not expected to constitute excess business holdings.

A current officer of both F and I is expected to become an officer of the post-merger F, and this person is a disqualified person with respect to F by virtue of being a foundation manager and a family member of substantial contributors to F. You state that the person has extensive experience in nonprofit and business organization management and governance, is familiar in detail with the affairs of F and I , will devote at least 40 hours per-week to the officer position, and will not be otherwise employed. You state that the services the officer is likely to provide to F include managing F's investment portfolio and leading and managing the work of the Board of Directors. You state that such services are reasonable and necessary for the proper

administration of F's exempt activities and are professional and managerial in nature.

The amount of this officer's compensation will be set by the Compensation Subcommittee of the Nominating and Corporate Governance Committee of the Board, which will be composed entirely of independent Directors, and approved by a majority of the independent members of the Board of Directors of F. In addition, the amount of this officer's compensation will be determined by the independent Compensation Subcommittee to be reasonable for the services provided to F. With the exception of any government official that may serve on F's Board of Directors in the future, you state that the same conclusion applies to the compensation of the other officers of the post-merger F, to the reasonable stipends provided to directors, and to the payment or reimbursement of other reasonable expenses of the officers and directors of the post-merger F for attendance at board and committee meetings and in conducting the activities of F.

A dean and professor at a school of policy studies at a State university, a professor of economics at a State university, a professor at a government-sponsored university in N and the Executive Director of a city planning commission all serve as members F's and/or I's Board of Directors and are expected to be Directors of the post-merger F.

The dean and professor at the State university was appointed (and is subject to removal) by the Regents of the University System of the State and is subject to their direction and supervision in the performance of his duties as a government employee. The economics professor at the State university likewise was hired by the president of the university, who is himself subject to the authority of the State's Board of Regents. Because both the dean and professor and the economics professor are employed in positions that are described within the exception in section 53.4946-1(g)(2)(ii) of the regulations, these persons are not government officials within the meaning of section 4946(c) of the Code. Consequently, the payments or reimbursements by F of the type described above to or on behalf of these persons will not result in an act of self-dealing under section 4941(d). Furthermore, members of the Board of Directors of the post-merger F who are employed as academic officers or faculty members at a State university will also not be government officials within the meaning of section 4946(c) so long as such individuals are described within the exception in section 53.4946-1(g)(2)(ii), so that similar payments or reimbursements to or on behalf of these persons by F will not result in acts of self-dealing under section 4941(d).

The Executive Director of the city planning commission was hired and is supervised by a Board of Commissioners, the members of which are themselves appointed by and responsible to the City's mayor and City Council. The role of the City Planning Department is advisory in nature, and its Executive Director does not exercise any independent policymaking functions as part of her duties since these duties are reserved for the City Council under the City's Charter. Thus, under the facts and circumstances analysis set forth in section 53.4946-1(g)(2)(i) of the regulations, the Executive director is a government employee but not a government official described in section 4946(c) of the Code. You also state that this characterization will also apply to any future member of the Board of Directors of the post-merger F that is employed by a State or local government agency that is controlled by a board of commissioners, a mayor or governor, a city council or State legislature, or other similar person or persons who exercise

independent policymaking functions for such jurisdiction.

Consequently, payments or reimbursements by F of the type described above to or on behalf of the Executive Director or similar persons will not result in acts of self-dealing under section 4941(d).

The professor at the governmental university in N is not a government employee of the United States, any State, possession, political subdivision or other area of any of the foregoing, or the District of Columbia. For this reason, this professor does not fall within any of the categories of persons described in section 4946(c) of the Code and is not to be treated as a government official. You state that this characterization will also apply to any future member of the Board of Directors of the post-merger F who is employed by a foreign government university. For this reason, payments or reimbursements by F of the type described above to or on behalf of the professor at the government-owned university in N or similar persons will not result in acts of self-dealing under section 4941(d).

I holds annual seminars for State and city planning directors from various regions of the United States and does not charge attendees for any of the costs associated with their participation in these seminars. The post-merger F intends to continue these annual seminars and likewise not seek reimbursement of the costs associated with attendees' participation in the seminars. The State and city planning directors who will attend F's annual seminars generally have duties in their jurisdictions similar to those of the Executive Director of the city planning department described above. The role of these planning directors is advisory in nature, and they generally are not expected to exercise any independent policymaking functions as part of their duties. Thus, under the facts and circumstances described in section 4946-1(g)(2)(i) of the regulations, the State and city planning directors are not government officials as defined in section 4946(c) of the Code. As a result, payments (or reimbursements) by F to the State and city planning directors and other similar government employees who attend F's educational programs and payment of the costs of such programs by F will not constitute acts of self-dealing within the meaning of section 4941(d). The same conclusion applies for State and local tax assessors and other State and local government employees who do not exercise policy-making functions and who participate as instructors, students or attendees in other educational programs of F or as compensated fellows or researchers.

Following the proposed merger, F will have six major categories of expenditures:
(1) operating and capital expenses for its classroom instruction, research, seminars, lectures, publications and other activities conducted at its principal facility and secondary facilities leased or rented by it, including salaries and benefits for its academic and support staff employees, compensation to adjunct faculty members and others for course instruction or participation, course development, and similar educational activities, utilities, supplies, State and local taxes and fees, payments on the loan made to acquire one of its buildings, and other capital costs for the purchase and improvement or installation of real estate and equipment needed for these activities, and similar items of expense; (2) administrative expenses for the supervision and direction of its programs and activities, including compensation and benefits for its senior officers, directors and professional consultants; (3) investment management expenses; (4) fellowship and research program costs, including payments to or for the benefit of individual

scholars, researchers or writers under the existing fellowship and research programs of I and potential expansion of or additions to similar programs; (5) demonstration and public education project expenditures, such as the expenditures for the production of films, the expenditures for the project to examine and study State trust land issues in the western parts of the United States, and planning assistance to domestic and foreign governmental units; and (6) the section 4940 federal excise tax on net investment income.

The post-merger F intends to award grants to individuals under I's existing fellowship programs and similar future programs, all on a non-discriminatory basis with respect to the race, religion, cultural background, sex and other personal characteristics of the applicant. Upon receipt of the grant application, one or more members of the employed academic staff of the post-merger F will review the intended research project for compatibility with the mission and objectives of F, for interest to F, for an appropriate research methodology, and for an acceptable time frame for completion of the project. In some circumstances, F will seek the advice of an advisory committee whose members volunteer for the task and who have expertise in the field of study and proposed research topics of the grant applicants. Grant recipients will be selected based on a variety of academic factors, including primarily the prior academic work of the applicant, the interest of the proposed research to F, the quality of the application and the proposed research methodology, and the anticipated ability of the applicant to contribute to the dissemination of the research results through classroom presentations, seminars, publications or other means.

If F discovers that a grantee has applied grant funds to an unauthorized purpose, F will withhold any further grants to the individual until the misapplication is corrected by the grantee, will seek to recover from the grantee any amount of unauthorized expenditures that the recipient cannot restore to the proper purpose, will not make further distributions to the recipient until receiving written assurance that such diversions will not occur in the future, and will require extraordinary precautions on the part of the recipient to prevent future diversions from occurring.

F will retain all relevant records pertaining to grants to individuals for the duration of the research project and for five (5) years following the completion of the research project by the individual. Included in the records retained will be (1) the application, (2) the award letter or agreement, (3) the interim reports of the recipient, (4) the final working paper, dissertation, thesis or other report of the research, (5) documentation of F's staff member's review and approval of the interim and final reports of the recipient, (6) documentation of the amount of the grant and its disbursement by F, (7) documentation of any efforts made by F to correct any misapplication of the grant funds by the recipient, (8) documentation of the dissemination by F of the working paper or other written research product by the recipient, and (9) documentation of the presentation of the research project and results by the recipient at a F seminar, conference or other program attended by at least one F academic staff member.

F currently uses a calendar year annual accounting period, and I currently uses a fiscal year accounting period ending June 30. Neither F nor I have changed its annual accounting period at any time during the past ten calendar years. Additionally, neither F nor I intend to change its annual accounting period at any time prior to the proposed merger. Both F and I have been required to file information returns during the past ten years and have timely filed such returns

with the appropriate Internal Revenue Service Center. Following the merger, you state that F intends to adopt I's fiscal year ending June 30. Pursuant to the terms of Rev. Proc. 85-58, F intends to notify the Internal Revenue Service of the change in its annual accounting period by filing Form 990-PF with the appropriate Internal Revenue Service Center no later than the fifteenth day of the fifth month following the close of the short period. The Form 990 filed by F will indicate that a change of accounting period is being made. Because F will not have changed its annual accounting period at any time within the ten calendar years ending with the calendar year that includes the beginning of the short period resulting from the change of an annual accounting period resulting from the merger, F will not be required to file a Form 1128 with the appropriate Internal Revenue Service Center in order to adopt I's fiscal year ending June 30 as its annual accounting period.

Accordingly, we conclude as follows:

1. The proposed merger of I with and into F will have no adverse effect on F's continued entitlement to recognition of exemption from federal income tax under section 501(c)(3) of the Code.

2. The proposed merger of I with and into F will not result in the recognition of any unrelated business taxable income under sections 511-514 of the Code by I or F.

3. Following the proposed merger, F will be classified as a private operating foundation under section 4942(j)(3) of the Code so long as it makes qualifying distributions that meet the income test under section 4942(j)(3)(A) and the endowment test under section 4942(j)(3))(B)(ii) of the Code.

4. Following the proposed merger, F's real property used primarily for classes, offices and housing will not be taken into account in determining F's minimum investment return pursuant to section 53.4942(a)-2(c)(3) of the regulations.

5. For purposes of satisfying the operating foundation tests of section 4942(j)(3) for the taxable year immediately following the merger, the merged organization may take into account the qualifying distributions, adjusted net income, minimum investment return, and asset value of the surviving organization for that year and of the operating entity, I , for the three immediately preceding taxable years.

6. If the first taxable year of F following the proposed merger is for a period of less than twelve months, its adjusted net income as defined in section 4942 of the Code shall be determined by its actual income, modifications and deductions for the short taxable year, and its minimum investment return shall be prorated on a daily basis for the short taxable year in accordance with the provisions of section 53.4942(a)-2(c)(5)(iii) of the regulations.

7. Following the proposed merger, the adjusted basis of F's stock and other assets, the gain on the sale of which would be subject tax under section 4940(a) of the Code, will be equal to the fair market value of such stock and other assets on the date the proposed merger occurs.

8. If F has an excess business holding (as defined in section 4943(c)(1)) of the Code at any time during which it is treated as a private foundation, then (a) to the extent that such excess business holding did not result from a purchase by F, F will not be subject to the taxes imposed by section 4943 of the Code so long as it disposes of the excess business holding within 90 days of the date on which it knows, or has reason to know, of the event that caused it to have such excess business holding and, (b) to the extent that such excess business holding is caused by a change in the holdings of a business enterprise (other than by purchase by F or by its disqualified persons) F will have at least five years to dispose of such business holdings pursuant to section 4943(c)(6) of the Code in an amount sufficient for such holding to constitute a permitted holding of F.

9. Stock bequeathed or contributed to F prior to the date of the proposed merger and held by F on the date the proposed merger occurs will not constitute a jeopardy investment within the meaning of section 4944(a) of the Code.

10. Following the proposed merger, the payment by F to a disqualified person (other than a government official, within the meaning of section 4946(c) of the Code) of compensation for personal services as an officer of F will not constitute an act of self-dealing within the meaning of section 4941 of the Code as long as the amount of such compensation is reasonable for the services rendered and not excessive in relation to the magnitude of F's assets and activities.

11. Following the proposed merger, the following persons who will be involved in F's management, educational programs and/or research programs will not be "government officials" within the meaning of section 4946(c) of the Code: a dean and professor at a State university; a professor of economics at a State university; a professor at a government sponsored university in N ; the Executive Director of a planning commission; State and city planning directors; State and local property tax assessors; presidents, provosts, professors deans and other employees of State universities that are hired and/or governed by a Board of Regents and similar types of government employees so long as the independent performance of policymaking functions is not a significant part of the activities of such persons.

12. Following the proposed merger, payments of compensation (or reimbursements of expenses) by F to or for the benefit of the persons described in ruling 11, above, will not constitute acts of self-dealing within the meaning of section 4941(d) of the Code, even if such persons are "disqualified persons" within the meaning of section 4946 of the Code (other than section 4946(c)), so long as such payments or reimbursements are for personal services which are reasonable and necessary to carry out the purposes of F and are not excessive.

13. Following the proposed merger, payments (or reimbursements) by F (a) of the allocable portions of the costs of (i) Board and Committee meetings attributable to members who are government officials (within the meaning of section 4946(c) of the Code) and (ii) other conferences and educational programs attributable to attendees who are government officials and (b) to government officials to attend Board and Committee meetings or other conferences and educational programs of F will not constitute acts of self-dealing so long as such payments (or reimbursements) are only for incidental expenses described in section 53.4941(d)-3(e)(9) or for travel solely from one point in the United States to another in connection with F's

educational, scientific and charitable purposes and do not exceed the actual cost of the transportation involved plus an amount for all other traveling expenses not in excess of 125 percent of the maximum amount payable under section 5702 of title 5, United States Code, which amount will be determined by reference to the then in-effect Federal Travel Regulation Per Diem Bulletin issued pursuant to 41 C.F.R. section 301-11.6.

14. Following the proposed merger, amounts expended by F (1) for F's agreed share of the expenses of demonstration and public education projects undertaken by F and other domestic or foreign organizations described in section 501(c) or domestic or foreign governmental units, bodies or agencies, (2) to fund F's fellowship programs and other similar programs operated in substantially the same manner, and (3) to repay a loan that was used to acquire one of the buildings to be used by F will constitute qualifying distributions directly for the active conduct of the activities constituting the purpose for which F is organized and operated within the meaning of section 4942(j)(3) of the Code.

15. Following the proposed merger, expenditures on F's fellowship programs and similar programs operated in substantially the same manner will not constitute taxable expenditures within the meaning of section 4945(d)(3) because such expenditures meet the requirements of section 4945(g) of the Code.

16. Following the proposed merger, F will not be required to obtain the permission of the Internal Revenue Service by filing Form 1128 in order to adopt I's fiscal year beginning with its first taxable year following the merger so long as it complies with the requirements of Rev. Proc. 85-58, 1985-2 C.B. 740.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose.* A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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

Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437