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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Contact Person:

Uniform Issue List : 0507.00-00
4940.00-00
4941.04-00
4942.03-05
4944.00-00
4945.04-06

Contact Identification Number:

Telephone Number:

Employer Identification Number:

Legend:
P =
R =

Dear :

You requested the following rulings in a letter dated :

1. The proposed division of all of P's assets between P and R will constitute a transfer of assets described in section 507(b)(2) of the Code and will not result in the imposition of a termination tax pursuant to section 507(c) of the Code.

2. For purposes of Chapter 42 and sections 507 through 509 of the Code, after the division of assets, each of P and R will be treated as a transferee foundation.

3. The transfers from P are not subject to tax under section 4940 of the Code.

4. All of P's "aggregate tax benefit" as defined in section 507(d)(1) of the Code will be carried over in equal shares of one-half each to P and R . Each of P and R may use its one-half share of any excess section 4940 tax paid by P before the transaction to offset its own section 4940 tax liability.

5. P's transfer of one-half of its assets to R will not constitute self-dealing under section 4941 of the Code.

6. P's transfers of assets incident to the division will not constitute qualifying distributions. Each of P and R will assume its one-half share of P's "undistributed income" before the transaction and reduce its own distributable amount for purposes of section 4942 of the Code by its one-half share of P's "excess qualifying distributions" before the transaction.

7. P's transfer of one-half of its assets to R incident to the division will not constitute a jeopardizing investment within the meaning of section 4944(a) of the Code.

8. P's transfer of one-half of its assets to R incident to the division will not constitute a taxable expenditure within the meaning of section 4945 of the Code and P will have no expenditure responsibility as set forth in sections 4945(d)(4) and 4945(h) with respect to the transfer.

P and R are nonprofit corporations exempt from federal income tax under section 501(c)(3) of the Code and are private foundations under section 509(a) of the Code. P with local court approval will transfer approximately one-half of its assets to R.

In a letter dated May 3, 2007, you stated that P has agreed to exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations as to its transfer of approximately half of its assets to R and that P has met the reasonable pre-grant inquiry required for expenditure responsibility.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations organized and operated exclusively for the charitable and/or other exempt purposes stated in that section.

Section 509(a) of the Code describes organizations exempt from federal income tax under section 501(c)(3) of the Code that are private foundations subject to the provisions of Chapter 42 of the Code.

Section 507(a)(1) of the Code and section 1.507-1(b)(1) of the Income Tax Regulations provide that a private foundation may voluntarily terminate its private foundation status by submitting to the Internal Revenue Service a statement of its intention to voluntarily terminate its private foundation status pursuant to section 507(a)(1) of the Code and by paying the private foundation status termination tax under section 507(c) of the Code.

Section 507(c) of the Code imposes excise tax on a private foundation which voluntarily terminates its private foundation status under section 507(a)(1) of the Code, and provides that this section 507(c) tax is equal to the lower of: (1) the aggregate tax benefits that have resulted from the private foundation's exempt status under section 501(c)(3) of the Code, or (2) the value of the net assets of the private foundation.

Section 507(b)(2) of the Code concerns the transfer of assets by one private foundation to one or more other private foundations, and provides that each transferee private foundation shall not be treated as a newly created organization.

Section 1.507-3(c)(1) of the regulations indicates that a transfer under section 507(b)(2) of the Code includes a transfer of assets from one private foundation to one or more other private foundations pursuant to any reorganization, including a significant disposition of 25% or more of the transferor private foundation's assets.

Section 1.507-3(a)(5) of the regulations provides that a transferor private foundation is required to meet its charitable distribution requirements under section 4942 of the Code, even for any tax year in which it makes a transfer of its assets to another private foundation pursuant to section 507(b)(2) of the Code.

Section 1.507-3(a)(7) of the regulations provides that, where a private foundation has transferred all of its assets to another private foundation in a transfer under section 507(b)(2) of the Code, it is not required to exercise expenditure responsibility under section 4945(h) of the Code with respect to such transfer.

Section 1.507-3(a)(9)(i) of the regulations provides that, if a private foundation transfers assets to one or more private foundations which are effectively controlled directly or indirectly within the meaning of section 1.482-1(i)(4) of the regulations by the same persons who effectively control the transferor foundation, each transferee foundation will be treated as if it were the transferor foundation, for purposes of sections 4940 through 4948 and sections 507 through 509 of the Code. Each transferee is treated as its transferor in the proportion which the fair market value of the transferor's assets transferred to the transferee bears to the fair market value of all of the transferor's assets immediately before the transfer.

Section 1.507-3(a)(9)(ii) of the regulations provides that a transfer of assets under section 507(b)(2) of the Code does not relieve the transferor private foundation from filing its own final tax year return as required by section 6043(b) of the Code.

Section 1.507-4(b) of the regulations provides that the tax on termination of private foundation status under section 507(c) of the Code does not apply to a transfer of assets under section 507(b)(2) of the Code.

Sections 1.507-1(b)(7) and 1.507-3(d) of the regulations provide that a transferor private foundation's transfer of assets under section 507(b)(2) of the Code will not constitute termination of the transferor foundation's private foundation status under section 509(a) of the Code .

Section 4940 of the Code imposes excise tax on certain investment income of a private foundation.

Section 4941 of the Code imposes excise tax on any act of self-dealing between a private foundation and any of its disqualified persons under section 4946 of the Code.

Section 53.4946-1(a)(8) of the Foundation and Similar Excise Tax Regulations provides that, for purposes of self-dealing under section 4941 of the Code, an exempt organization under section 501(c)(3) of the Code is not a disqualified person.

Section 4942 of the Code requires that a private foundation must expend annual qualifying distributions under section 4942(g) of the Code for the conduct of exempt purposes.

Revenue Ruling 78-387, 1978-2 C.B. 270, describes the carryover of a transferor private foundation's excess qualifying distributions under section 4942(i) of the Code where the transferor and the transferee foundations are controlled by the same persons under section 1.507-3(a)(9)(i) of the regulations. The transferee is treated as the transferor so that the transferee can reduce its own distributable amount under section 4942 of the Code by its share of the transferor foundation's excess qualifying distributions under section 4942(i) of the Code.

Section 4944 of the Code imposes excise tax on any private foundation’s making of a jeopardizing investment.

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

Sections 53.4945-6(c)(3) of the regulations allows a private foundation to transfer its assets to exempt organizations under section 501(c)(3) of the Code, including private foundations, pursuant to section 507(b)(2) of the Code, without the transfers being taxable expenditures under section 4945 of the Code.

Section 4945(d)(4) of the Code requires that, in order to avoid making a taxable expenditure, a transferor private foundation must exercise expenditure responsibility under section 4945(h) of the Code on its grants to another private foundation. For example, in Hans S. Mannheimer Charitable Trust v. Commissioner, 93 T.C. 15 (July 12, 1989), the Tax Court held that section 4945(h) requires expenditure responsibility on a grant by a private foundation to another private foundation regardless of the familiarity of the private foundations with each other.

Section 4945(h) of the Code defines expenditure responsibility in terms of the grantor private foundation requiring pre-grant inquiry and post-grant reports as to the grantee private foundation on its uses of the grant.

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

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

Section 53.4945-5(b)(3) of the regulations provides, that, in order to exercise expenditure responsibility, the grantor private foundation must require that the grantee organization be made subject to a written commitment, signed by an appropriate officer, director, or trustee of the grantee, to repay any portion of the amount granted which is not used for the purposes of the grant, to submit full and complete annual reports on the manner in which the grant funds are spent and the progress made in accomplishing the purposes of the grant, to maintain records of receipts and expenditures, and to make its books and records available to the grantor at reasonable times, and not to use any of the funds to carry on propaganda or otherwise attempt to influence legislation within section 4945(d)(1) of the Code, or to influence the outcome of any specific public election, or to carry on any voter registration drive within the meaning of section 4945(d)(2), or to make any grant which does not comply with the requirements of section 4945(d)(3) or 4945(d)(4), or to undertake any activity for any purpose other than one specified in section 170(c)(2)(B) of the Code. The agreement must clearly specify the purposes of the grant. Such purposes may include contributing for capital endowment, provided that neither the grants nor the income therefrom may be used for purposes other than those in section 170(c)(2)(B) of the Code.

Analysis

1.

Under section 507(b)(2) of the Code and section 1.507-3(c)(1) of the regulations, a transfer under section 507(b)(2) of the Code includes a transfer of assets from one private foundation to one or more other private foundations pursuant to any reorganization, which includes any significant disposition of 25% or more of the transferor's assets. Because P will be in such a reorganization by its transfer of approximately one-half of its assets to R, P's transfer of assets to R will be a transfer under section 507(b)(2) of the Code.

Under section 1.507-4(b) of the regulations, P's transfer of assets pursuant to section 507(b)(2) of the Code will not terminate P's private foundation status under section 509(a) of the Code and thus will not result in private foundation termination tax under section 507(c) of the Code.

2.

For purposes of Chapter 42 of the Code and section 507 through 509 of the Code, R will be treated as having received assets as a transferee foundation pursuant to section 507(b)(2) of the Code as approximately one-half of P's assets are being transferred to R as the transferee private foundation. P and R will thus remain private foundations.

3.

P's transfer of assets to R will not be investment income or a taxable disposition of property and will not result in tax under section 4940 of the Code.

4.

Section 507(b)(2) and section 1.507-3(a)(1) of the regulations provide that, in a section 507(b)(2) transfer, a transferee organization will not be treated as a newly created organization. The transferee organization is treated as possessing those attributes and characteristics of the transferor organization which are described in sections 1.507-3(a)(2), (3) and (4).

5.

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

6.

Under section 1.507-3(a)(9)(i) of the regulations, P's transfer will result in R being treated as P for purposes of section 4942 of the Code so that: (a) P's distribution requirements under section 4942 for the tax year of its transfer may be satisfied by R; and (b) P's qualifying distributions during P's tax year of its transfer may be treated as made by R. As in Revenue Ruling 78-387,

cited above, R may reduce its required distributions under section 4942 of the Code, including those for R's tax year of the transfer, by the amount, if any, of P's excess qualifying distributions carryover under section 4942(i) of the Code as of the time of P's transfer.

7.

Under section 4944 of the Code, P's transfer of assets to R will not constitute jeopardizing investments or result in tax under that section.

8.

Under section 53.4945-6(c)(3) of the regulations, a private foundation can transfer its assets to private foundations pursuant to section 507(b)(2) of the Code without the transfer being a taxable expenditure under section 4945 of the Code. Thus, P's transfer of assets to R will not be a taxable expenditure under section 4945 of the Code. However, P must exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations on its transfers of some of its assets to R. because the exception under section 1.507-3(a)(7) of the regulations to expenditure responsibility for a transfer of all assets does not apply to P because P's transfer to R consists of one-half, rather than all, of P's assets. Section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations have long specifically provided that expenditure responsibility is required when one private foundation provides funds to another private foundation for capital endowment. In Hans S. Mannheimer Charitable Trust v. Commissioner, 93 T.C. 15 (July 12, 1989), the Tax Court upheld the position that section 4945(h) of the Code requires expenditure responsibility on a grant by a private foundation to another private foundation regardless of the familiarity of the private foundations with each other. Here, P is reorganized as to its assets and governing persons but P and R under section 507(b)(2) of the Code keep the same private foundation status and entity forms as before the transfers, and P's transfers are to another private foundation R as endowment and are thereby within section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations.

Accordingly, we rule that:

1. The transfer of approximately one-half of P's assets to R will constitute a transfer of assets described in section 507(b)(2) of the Code and will not result in a termination tax under section 507(c) of the Code.

2. For purposes of Chapter 42 of the Code and sections 507 through 509 of the Code, after the transfer of P's assets, R will be treated as a transferee private foundation.

3. P's transfers of assets under section 507(b)(2) of the Code will not be subject to tax under section 4940 of the Code.

4. All of P's aggregate tax benefit as defined under section 507(d) of the Code will be divided in proportion to the assets transferred here in equal shares of one-half to each private foundation P and R. Each private foundation P or R may use its one-half share of any excess tax paid under section 4940 of the Code by P before the section 507(b)(2) transaction to offset P's or R's own tax liability under section 4940 of the Code.

5. P's transfers of assets to R under section 507(b)(2) of the Code will not be self-dealing under section 4941 of the Code.

6. P's transfers of assets to R under section 507(b)(2) of the Code will not be qualifying distributions under section 4942 of the Code. Each foundation may assume a one-half share of P's section 4942 undistributed income before the transfers and may reduce its own distributable amount for purposes of section 4942 of the Code by one-half of P's excess qualifying distributions before the transfers.

7. P's transfers of assets will not subject P or R to the tax on jeopardizing investments under section 4944 of the Code.

8. P's transfers of approximately one-half of its assets to R will not be any taxable expenditure under section 4945 of the Code because P will exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations with respect to the transferred assets as a capital endowment grant by P to R.

This rulings letter 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 rulings letter with deletions made, which 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.

Because this rulings letter could help to resolve any questions, please keep it in your permanent records. This rulings letter is directed only to the organizations that requested it. Section 6110(k)(3) of the Code provides that this rulings letter may not be used or cited as precedent.

Sincerely,

Debra J. Kawecki
Manager, Exempt Organizations
Technical Group 2

Enclosure: Notice 437