TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **201244020**
Release Date: 11/2/2012

Date: August 10, 2012

XXXXXX
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XXXXXX

Contact Person:
XXXXXX
Identification Number:
XXXXXX
Telephone Number:
XXXXXX
Employer Identification Number:
XXXXXX

Uniform Issue List:
507.05-00
507.06-00
507.07-00

Legend:
A = XXXXXX
B = XXXXXX
C = XXXXXX
D = XXXXXX
X = XXXXXX
Y = XXXXXX
Z = XXXXXX
Date 1 = XXXXXX
Date 2 = XXXXXX

Dear :

This letter supersedes our letter dated July 25, 2012, which was in reply to your letter of November 30, 2009, concerning the federal income and excise tax consequences under § 507 and certain sections of chapter 42 of the Internal Revenue Code (Code) relating to a proposed partial transfer of assets, in the manner and for the purposes described below.

Facts

You are exempt from federal income tax pursuant to § 501(c)(3) and are classified as a private foundation within the meaning of § 509(a). You were organized by A on Date 1 to provide financial support to organizations for religious, charitable, scientific, and educational purposes within the meaning of § 501(c)(3). In Date 2, you were funded with a grant from Z in a § 507(b)(2) transfer.

You make grants to organizations that qualify as § 501(c)(3) exempt organizations, including providing funding to scholarship programs administered by educational institutions. For the most recent tax year, you represent that you have an excess qualifying distribution carryover, as defined by § 4942(i).

You are governed by a four-member board of directors comprised of A, B, C, and D. All board members are related parties. A and B are married to each other. B and C are siblings, and D is their cousin. In addition, several other family members serve as grant advisors to you.

You state that you have not and will not notify the IRS of your intent to terminate your status pursuant to § 507(a)(1). You further state that you have never either willfully repeated acts (or failures to act) or committed a willful and flagrant act (or failure to act) which gives rise to tax under Chapter 42. You also state that currently and at the time of the proposed distribution of assets from you to X and Y, there are not and will not be any willful repeated act (or failure to act) or willful flagrant act (or failure to act) which would give rise to liability for taxes under Chapter 42.

Because of a divergence of charitable interests of your directors and management, administration and achievement of your charitable goals has been increasingly difficult. To eliminate the conflict in management, your board of directors desires to distribute an amount equal to one-third of your assets to each of two new foundations, X and Y.

X and Y are nonprofit, non-stock corporations organized under applicable state law, and intend to apply for and be recognized as exempt from federal income tax as organizations described in § 501(c)(3) and classified as private foundations within the meaning of § 509(a). You represent that you will not make transfers to X or Y for full and adequate consideration or out of current income.

As part of the proposed transfers, you represent that X and Y will be effectively controlled by the same persons who effectively control you. You state that C and D intend to resign from your board of directors upon the issuance of this ruling. C will serve as a director of X, and D will serve as a director of Y. In addition, the members serving as grant advisors will also resign and serve as officers of X and Y. Then, A and B intend to fill your vacant board of director and officer positions with members of their family. After the distributions to X and Y, you will retain one-third of your assets and remain in operation as a private foundation.

Rulings Requested

You have requested the following rulings:

1. If the proposed transfers to X and Y constitute transfers described in § 507(b)(2).

2. If X and Y will be treated as newly created organizations following the proposed transfers.

3. If the proposed transfers will cause your termination as a private foundation under § 507(a) and result in the imposition of any termination tax under § 507(c).

4. If X and Y will succeed to that part of your "aggregate tax benefit" that is attributable to the assets transferred, based on your assets held just before the transfer.

5. If, after the proposed transfers are completed, your excess qualifying distribution carryover will be added to each of X and Y's excess qualifying distribution carryovers.

6. If X and Y will be treated as if they are you (the transferor) for purposes of §§ 4940 to 4944.

7. If the proposed transfer of two-thirds of your assets to X and Y will trigger:

    a. Gross investment income or capital gain income within the meaning of § 4940 and the excise tax on net investment income;

    b. An act of self-dealing under § 4941 and the excise tax imposed on self-dealing;

    c. A qualifying distribution under § 4942;

    d. An investment that jeopardizes charitable purposes under § 4944 and the excise tax imposed on jeopardizing investments;

    e. A taxable expenditure under § 4945 and the requirement that you exercise expenditure responsibility with respect to the transfers.

Law

Section 501(c)(3) provides, in part, for the exemption from federal income tax of corporations 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.

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Section 507(a)(1) states 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 § 507(a)(1) and by paying any termination tax under § 507(c).

Section 507(b)(2) states that when one private foundation transfers assets to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee private foundation shall not be treated as a newly created organization.

Section 507(c) imposes an excise tax equal to the lower of: (1) the aggregate tax benefits that have resulted from the private foundation's exempt status under § 501(c)(3), or (2) the value of the net assets of the private foundation on an organization that voluntarily terminates its private foundation status.

Section 4940(a) imposes an annual tax on the net investment income of private foundations.

Section 4940(c)(1) defines net investment income as the amount by which the sum of the gross investment income and the capital gain net income exceeds the deductions allowed by § 4940(c)(3).

Section 4941(a) imposes an excise tax on acts of self-dealing between a private foundation and any of its disqualified persons as defined in § 4946.

Section 4942(a) imposes on the undistributed income of a private foundation for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year (if such first day falls within the taxable period), a tax equal to 30 percent of the amount of such income remaining undistributed at the beginning of such second (or succeeding) taxable year.

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

Section 4944(a)(1) imposes a tax on any amount invested by a private foundation in a manner that jeopardizes the carrying out of the foundation's exempt purposes.

Section 4944(c) provides that a transfer pursuant to § 507(b)(2) is not considered an investment for purposes of § 4944 if the transfer of assets was made for the purpose of accomplishing a charitable purpose.

Section 4945(a) imposes a tax on the taxable expenditures of a private foundation.

Section 4945(d)(4) states, in part, that for purposes of this section, the term "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to an organization unless such organization is described in paragraph (1) or (2) of § 509(a), is an organization described in § 509(a)(3), or is an exempt operating foundation, or the private foundation exercises expenditure responsibility with respect to such grant in accordance with § 4945(h).

Section 4945(h) defines the term "expenditure responsibility" to mean that a private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to see that the grant is spent solely for the purpose for which made, to obtain full and complete reports from the grantee on how the funds are spent, and to make full and detailed reports with respect to such expenditures to the Secretary.

Section 1.507-1(b)(6) states that if a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in § 507(b)(2) and § 1.507-3(c), such transferor foundation will not have terminated its private foundation status under § 507(a)(1).

Section 1.507-3(a)(1) states that in the case of a significant disposition of assets to one or more private foundations, within the meaning of § 1.507-3(c) which describes a § 507(b)(2) transfer, the transferee organization shall not be treated as a newly created organization, but shall succeed to those attributes and characteristics of the transferor organization described in § 1.507-3(a)(2), (3) and (4), which include its aggregate tax benefit, substantial contributors, and chapter 42 tax and penalty liabilities.

Section 1.507-3(a)(2) states that a transferee organization to which this paragraph applies shall succeed to the fair market value (less encumbrances) of the transferor organization's aggregate tax benefit in proportion to the assets transferred to the transferee. However, a transferee organization which is not effectively controlled (within the meaning of § 1.482-1(a)(3) [now effectively retitled § 1.482-1A(a)(3)]), directly or indirectly, by the same person or persons who effectively control the transferor

organization shall not succeed to an aggregate tax benefit in excess of the fair market value of the assets transferred at the time of the transfer.

Section 1.507-3(a)(3) states that, for purposes of § 507(d)(2), in the event of a transfer of assets described in § 507(b)(2), any person who is a "substantial contributor" (within the meaning of § 507(d)(2)) with respect to the transferor foundation will be treated as a "substantial contributor" with respect to the transferee foundation, regardless of whether such person meets the $5,000-two percent test with respect to the transferee organization at any time.

Section 1.507-3(a)(4) states that, if a private foundation incurs a liability for one or more of the taxes imposed under chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in § 507(b)(2) to one or more private foundations, in any case where transferee liability applies, each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor foundation does not satisfy such liability.

Section 1.507-3(a)(5) states that, except as provided in subparagraph (9) of this paragraph, a private foundation is required to meet the distribution requirements of § 4942 for any taxable year in which it makes a § 507(b)(2) transfer of all or part of its net assets to another private foundation.

Section 1.507-3(a)(6) provides that when a private foundation makes a § 507(b)(2) transfer of all or part of its net assets to another private foundation, the applicable period of time described in § 4943(c)(4), (5), or (6) shall include both the period during which the transferor foundation held such assets and the period during which the transferee foundation holds such assets.

Section 1.507-3(a)(8)(ii) sets forth certain rules that apply to the transferee foundation with respect to the assets transferred in a § 507(b)(2) transfer to the same extent and in the same manner that they would have applied to the transferor foundation had the § 507(b)(2) transfer not been effected, mostly in the nature of transitional rules of limited scope for the Tax Reform Act of 1969.

Section 1.507-3(c)(1) states that for purposes of § 507(b)(2), the terms "other adjustment, organization, or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Section 1.507-3(c)(2) defines the term "significant disposition of assets to one or more private foundations" as any disposition or series of dispositions where the cumulative

total of dispositions is 25 percent or more of the fair market value of the net assets of the foundation at the beginning of the taxable year.

Section 1.507-3(d) states that unless a private foundation voluntarily gives notice pursuant to § 507(a)(1), a transfer of assets described in § 507(b)(2) will not constitute a termination of the transferor's private foundation status under § 507(a)(1). Such transfer must not constitute either a willful and flagrant act (or failure to act) or one of a series of willful repeated acts (or failures to act) giving rise to liability for tax under chapter 42.

Section 1.507-4(b) states that private foundations which make transfers described in § 507(b)(2) are not subject to the tax imposed under § 507(c) with respect to such transfers unless the provisions of § 507(a) become applicable.

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

Section 53.4946-1(a)(8) states that, for purposes of § 4941 only, the term "disqualified person" shall not include any organization which is described in § 501(c)(3) (other than an organization described in § 509(a)(4)).

Analysis

Ruling 1

Section 507(b)(2) describes a transfer from one private foundation to another private foundation according to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. Section 1.507-3(c)(1) describes the terms "other adjustment, organization, or reorganization" as including any partial liquidation or any other significant distribution of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income. The term "significant disposition of assets to one or more private foundations" is defined by

§ 1.507-3(c)(2) as any disposition or series of dispositions where the aggregate value transferred is 25 percent or more of the fair market value of the net assets of the foundation at the beginning of the taxable year. Since you are transferring more than 25 percent of the fair market value of your net assets to X and Y, for no consideration, your proposed transfer is a significant disposition of assets that qualifies as a transfer under § 507(b)(2). However, this ruling is contingent upon both X and Y being recognized by the IRS as exempt from federal income tax as organizations described in § 501(c)(3) and classified as private foundations within the meaning of § 509(a).

Rulings 2 and 3

When a private foundation makes a transfer described in § 507(b)(2), the transferee foundation is not treated as a newly created organization under § 1.507-3(a)(1). Since your transfer is described in § 507(b)(2), as discussed in Ruling 1 above, X and Y will not be treated as newly created organizations.

As discussed in Ruling 1 above, the proposed transfers will constitute a significant distribution of assets described in § 507(b)(2). You have stated that you intend to continue to operate as a private foundation after the proposed transfers, and you further represent that you have not ever either committed willful repeated acts (or failures to act) or committed a willful and flagrant act (or failure to act) that gives rise to tax under Chapter 42. Therefore, the proposed transfers will not cause your termination as a private foundation under § 507(a) and will not result in the imposition of any termination tax under § 507(c).

Rulings 4, 5 and 6

Under § 1.507-3(a)(9)(i), if a private foundation transfers all of its net assets to another private foundation which is effectively controlled by the same person or persons which effectively controlled the transferor private foundation, the transferee private foundation is treated as if it were the transferor. Here, you are transferring less than all of your net assets, so X and Y are not treated as you for all private foundation purposes. Instead, X and Y will be treated as possessing your attributes and characteristics which are described in §§ 1.507-3(a)(2), (3), (4), and, to the extent applicable, (6) and (8)(ii), and none of your excess qualifying distribution carryovers under § 4942 will transfer to X or Y. Given your representation that you are effectively controlled by the same persons that control X and Y, they will succeed to a portion of your aggregate tax benefit without regard to the fair market value of assets received.

Under § 1.507-3(a)(5), except as provided in subparagraph (9) of § 1.507-3(a), a private foundation must meet the distribution requirements of § 4942 for any taxable year in which it makes a § 507(b)(2) transfer of all or part of its net assets to another private

foundation. The transfer itself shall be counted toward satisfaction of such requirements to the extent the amount transferred meets the requirements of § 4942(g)(3), which states that the term "qualifying distribution" includes a contribution to a § 501(c)(3) organization if the redistribution requirements are met. Therefore, your proposed transfer shall be counted toward the satisfaction of your distribution requirements to the extent the amount transferred meets the redistribution requirements of § 4942(g)(3).

Ruling 7

a. Section 4940

Section 4940(c) imposes an excise tax on investment income received by private foundations. Investment income includes capital gains from the sale or other disposition of property. The transfer of assets by you to X and Y, which lacks consideration, does not constitute a "sale or other disposition of property" that would generate capital gains subject to excise tax under § 4940. Therefore, the transfer will not be treated as a taxable sale or disposition of property within the meaning of § 4940.

b. Section 4941

Section 4941(a) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation. Sections 4941 and 1.507-3(a) determine whether the proposed transfer of part of your assets to X and Y will constitute an act of self-dealing between a private foundation and its disqualified persons, as defined in § 4946. Under § 53.4946-1(a)(8) a "disqualified person" does not include organizations that are exempt under § 501(c)(3). Therefore, your transfer of assets to X and Y is not an act of self-dealing if X and Y are recognized by the IRS as an organization exempt from tax under § 501(c)(3). Again, the ruling is contingent upon both X and Y being recognized by the IRS as exempt from federal income tax as organization described in § 501(c)(3) and classified as private foundations within the meaning of § 509(a).

c. Section 4942

Under § 1.507-3(a)(5), except as provided in subparagraph (9) of § 1.507-3(a), a private foundation must meet the distribution requirements of § 4942 for any taxable year in which it makes a § 507(b)(2) transfer of all or part of its net assets to another private foundation. The transfer itself shall be counted toward satisfaction of such requirements to the extent the amount transferred meets the requirements of § 4942(g)(3), which states that the term "qualifying distribution" includes a contribution to a § 501(c)(3) organization if the redistribution

requirements are met. Therefore, the proposed transfers shall be counted toward the satisfaction of your distribution requirements to the extent the amount transferred meets the redistribution requirements of § 4942(g)(3).

d. Section 4944

Section 4944 imposes a tax on investments by private foundations that jeopardize their charitable purposes. Under § 4944(c), a transfer pursuant to § 507(b)(2) is not considered an investment for purposes of § 4944 if the transfer of assets was made for the purpose of accomplishing a charitable purpose. Because you will distribute approximately one-third of your assets to each X and Y with the goal of enabling X and Y to pursue separate charitable goals, the proposed transfers will not result in the imposition of tax for a jeopardizing investment under § 4944.

e. Section 4945

Your § 507(b)(2) proposed transfer of assets to X and Y is a grant to both X and Y for capital endowment purposes. Because neither X nor Y is treated as you under § 1.507-3(a)(9), the transfers are a taxable expenditure under § 4945(d)(4) unless you comply with the expenditure responsibility requirements of § 4945(h). Your proposed transfers to X and Y will not be considered taxable expenditures as long as you exercise expenditure responsibility over the transfers in accordance with § 4945(h) and § 53.4945-5(c)(2). Section 53.4945-5(c)(2) requires the grantee to make annual reports for the year in which the grant is made and the immediately succeeding two years.

Rulings

1. The proposed transfers to X and Y are transfers described in § 507(b)(2).

2. Pursuant to § 507(b)(2), X and Y will not be treated as newly created organizations following the proposed transfers.

3. The proposed transfers will not cause your termination as a private foundation under § 507(a) and will not result in the imposition of any termination tax under § 507(c).

4. X and Y will succeed to that part of your "aggregate tax benefits" that is attributable to the assets transferred, based on the fair market value (less encumbrances) of the assets held just before the proposed transfers.

5. After the proposed transfers are completed, your excess qualifying distribution carryover will not be added to each of X and Y's excess qualifying distribution carryovers.

6. After the proposed transfers, X and Y will be treated as possessing your tax attributes and characteristics as described in § 1.507-3(a)(2), (3), and (4).

7. The proposed transfers of two-thirds of your assets to X and Y:

   a. Will not give rise to any net investment income or constitute any other taxable sale or disposition under § 4940.

   b. Will not constitute an act of self-dealing by you, X or Y under § 4941.

   c. Will constitute a qualifying distribution under § 4942 only to the extent that X and Y meet the redistribution requirements under § 4942(g)(3). X and Y will not succeed to any of your excess qualifying distributions under § 4942.

   d. Will not constitute an investment that jeopardizes charitable purposes under § 4944.

   e. Will not constitute a taxable expenditure as long as you follow the expenditure responsibility requirements of § 4945(h) and § 53.4945-5 with respect to the capital endowment grants. You will be required to exercise expenditure responsibility with respect to the transferred assets under § 4945(h) and § 53.4945-5 with respect to the capital endowment grants.

This ruling will be made available for public inspection under § 6110 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 organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolved questions

concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

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

Sincerely,

Mary Jo Salins
Manager, Exempt Organizations
Technical Group 4

Enclosure
Notice 437