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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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4941.04-00
4942.03-05
4944.05-00
4945.04-05

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

B =
C =
x =

Dear :

This is in response to your ruling request regarding the proper treatment of a transfer of part of your assets to another private foundation under I.R.C. §§ 501(c)(3), 507, 4940, 4941, 4942, 4944, and 4945.

Facts:

You have been recognized as an organization described in § 501(c)(3) and classified as a private non-operating foundation under § 509(a). Your founders passed away a number of years ago. Your directors include B and C, both of whom are children of founder. Your primary purpose is to make grants to other organizations recognized as exempt from federal income tax under § 501(c)(3) for charitable purposes.

You state that in the years since the death of your founders, differences of opinion have arisen among B and your members and directors, including C, concerning your management and charitable activities. B and your other members are interested in supporting different charities and operating under different management strategies. To resolve these differences, you propose to establish and fund a charitable trust ("Trust") of which B is a trustee along with one of B's daughters, with another daughter being named successor trustee. You propose to make a capital endowment grant to Trust, in order for B, through the Trust, and you to pursue your respective independent charitable interests and objectives. B has resigned as your director and member. C will continue as your director and a member.

Trust has submitted its Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code from Federal Income Tax but has not received its determination letter from the IRS. For purposes of this ruling, we are presuming and relying upon the fact that Trust will qualify as, and will receive a determination letter from the Internal Revenue Service stating that it is, an organization described in § 501(c)(3) and classified as a private non-operating foundation under § 509(a).

You state that the proposed grant will consist of $x. The proposed grant will be transferred by you in one or more installments but must be fully disbursed to Trust within 30 days of the date of the execution of the proposed grant agreement. The grant agreement includes the expenditure responsibility terms and conditions as required by § 4945(h) and as set forth in Treas. Reg. § 53.4945-5(b)(3). The grant agreement includes provisions requiring reports from Trust in accordance with § 53.4945-5(c). Further, you will fulfill your reporting requirements as set forth in §53.4945-5(d). You state that the grant agreement will be executed as of the later date of, and no distribution to Trust will be made absent (i) receipt of a federal determination letter establishing the federal tax-exempt status of Trust as a private non-operating foundation, and (ii) receipt of this letter ruling.

You state that the proposed grant represents significantly less than 25 percent of the fair market value of your net assets. As such, you state that the proposed transfer will not constitute a "significant disposition of assets" within the meaning of § 1.507-3(c)(2)(ii). You represent that, to the best of your knowledge, you have not engaged in either willful repeated acts, or failures to act, or a willful and flagrant act, or failure to act, giving rise to liability for tax under Chapter 42.

You state that you have conducted an inquiry and are satisfied that you have reasonable assurances that Trust will use the grant for the proper purposes. You are familiar with Trust's two trustees, are the holder of a reversionary interest in the proposed grant pursuant to the Trust Agreement, and will exercise expenditure responsibility within the meaning of § 4945(h). The Grant and Trust Agreements provide that the Trust has limited discretion with respect to any distribution of funds, as well as containing other language to ensure compliance with Chapter 42.

Rulings Requested:

You have specifically requested the following rulings:

1. The proposed grant from you to Trust will not adversely affect your tax exempt status under § 501(c)(3).
2. The proposed grant will not constitute either a willful flagrant act, or failure to act, or one of a series of willful repeated acts, or failures to act, within the meaning of § 507(a)(2)(A).
3. The proposed grant will not give rise to net investment income for you under § 4940.
4. Neither the formation of Trust nor the proposed grant will constitute an act of self-dealing under § 4941.
5. The proposed grant offsets your minimum distribution requirement under § 4942 to the extent that Trust makes qualifying distributions meeting the requirements specified in § 4942(g)(3).
6. The proposed grant will not constitute a jeopardizing investment for you under § 4944.
7. The proposed grant will not constitute a taxable expenditure under § 4945 because you will exercise expenditure responsibility over the transferred assets for the year of the transfer and the two succeeding years, but not thereafter, if it is apparent to you that, before the end of such second succeeding taxable year, neither the principal nor income from the assets distributed in the transfer to Trust have been used for any purpose which would result in liability for tax under § 4945(d).

8. The legal, accounting, and other expenses incurred by you in connection with the letter ruling request, the formation of Trust, and the proposed grant will not constitute taxable expenditures pursuant to § 4945 and, to the extent you are incurring these expenses to accomplish exempt purposes and/or protect itself, will be considered qualifying distributions under Chapter 42.

Law:

I.R.C. § 170(c)(2)(B) provides that the term "charitable contribution" means a contribution or gift to or for the use of a corporation, trust, or community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals.

I.R.C. § 501(c)(3) provides for the exemption from federal tax for organizations that are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

I.R.C. § 507(a)(2) provides that except as provided in § 507(b), the status of any organization as a private foundation shall be terminated only if—

(1) such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such termination, or

(2) (A) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act) giving rise to liability for tax under Chapter 42, and

(B) the Secretary notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c),

and either such organization pays the tax imposed by subsection (c) (for any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

I.R.C. § 4940(a) imposes an annual tax on the net investment income of private foundations.

I.R.C. § 4940(c) 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 paragraph (3).

I.R.C. § 4941(a)(1) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

I.R.C. § 4941(d)(1)(E) provides the term "self-dealing" means any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

I.R.C. § 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.

I.R.C. § 4942(g)(1)(A) provides that, in general, for purposes of this section, the term "qualifying distribution" means any amount (including that portion of reasonable and necessary administrative expenses paid to accomplish one or more purposes described in § 170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons (as defined in § 4946 with respect to the foundation, except as provided in paragraph (3), or (ii) a private foundation which is not an operating foundation, as defined in subsection (j)(3), except as provided in paragraph (3).

I.R.C. § 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 paragraph (1)(A)(i) or (ii) if--

(A) not later than the close of the first taxable year after its taxable year in which such contribution is received, such organization makes a distribution equal to the amount of such contribution and such contribution is a qualifying distribution (within the meaning of paragraph (1) or (2), without regard to this paragraph) which is treated under subsection (h) as a distribution out of corpus (or would be so treated if such § 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.

I.R.C. § 4944(a)(1) imposes an initial tax on a private foundation if it invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes.

I.R.C. § 4944(c) provides that for purposes of this section, investments, the primary purpose of which is to accomplish one or more of the purposes described in § 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes.

I.R.C. § 4945(a) imposes an excise tax on the taxable expenditures of a private foundation.

I.R.C. § 4945(d)(4)(B) provides 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 the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h).

I.R.C. § 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.

I.R.C. § 4946(a) provides that the term "disqualified person" with respect to a private foundation includes a substantial contributor to the foundation (including the creator of a trust), and a foundation manager (including 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).

Treas. Reg. § 1.507-3(a)(1) provides, in part, that in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee organization shall not be treated as a newly created organization. A transferee organization to which this paragraph applies shall be treated as possessing those attributes and characteristics of the transferor organization which are described in subparagraphs (2), (3), and (4) of this paragraph.

Treas. Reg. § 1.507-3(a)(2) provides, in part, that a transferee organization to which this paragraph applies shall succeed to the aggregate tax benefit of the transferor organization.

Treas. Reg. § 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.

Treas. Reg. § 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.

Treas. Reg. § 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.

Treas. Reg. § 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.

Treas. Reg. § 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.

Treas. Reg. § 1.507-3(a)(9)(i) provides that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled (within the meaning of § 1.482-1(a)(3)), directly or indirectly, by the same person or persons which effectively controlled the transferor private foundation, for purposes of chapter 42 (§ 4940 et seq.) and part II of subchapter F of chapter 1 of the Code (§§ 507 through 509) such a transferee private foundation shall be treated as if it were the transferor.

Treas. Reg. § 1.507-3(c)(1) states that a transfer of assets is described in § 507(b)(2) if it is made by a private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. For purposes of § 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.

Treas Reg. § 1.507-3(c)(2)(ii) states, in part, that the term "significant disposition of assets to one or more private foundations" shall include any disposition for a taxable year where any disposition to one or more private foundations for the taxable year is part of a series of related dispositions made during prior years, the total of the related dispositions made during such prior taxable years is 25 percent or more of the fair market value of the net assets of the foundation at the beginning of the taxable year or at the beginning of the first taxable year in which any of the series of related dispositions was made.

Treas. Reg. § 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.

Treas. Reg. § 53.4945-5(b)(2)(i) provides that before making a grant to an organization with respect to which expenditure responsibility must be exercised under this section, a private foundation should conduct a limited inquiry concerning the potential grantee. Such inquiry should be complete enough to give a reasonable man assurance that the grantee will use the grant for the proper purposes.

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

Treas. Reg. § 53.4945-5(c)(2) 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.

Treas. Reg. § 53.4945-6(b)(2) provides that any expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under § 4945(d)(5) unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses win such amounts was consistent with ordinary business care and prudence. The determination whether an expenditure is unreasonable shall depend upon the facts and circumstances of the particular case.

Treas. Reg. § 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 § 509(a)(4)).

Analysis:

Ruling 1:

To be exempt under § 501(c)(3), an organization must be organized and operated exclusively for exempt purposes. You and Trust are organized and operated exclusively to further exempt charitable purposes within the meaning of § 501(c)(3). Pursuant to both the Grant and Trust Agreements the assets to be transferred to Trust are required to be used to further charitable purposes. You represent that you will remain organized and operated for § 501(c)(3) charitable purposes, and that Trust is required to return the grant proceeds should it cease to be organized and operated for § 501(c)(3) charitable purposes. Therefore, the proposed grant will not adversely affect your exempt status.

Ruling 2:

You represent that, to the best of your knowledge, you have not committed either willful repeated acts, or failures to act, or a willful and flagrant act, or failure to act, giving rise to liability for tax under Chapter 42 of the Code. You represent that no distribution of your assets will be made to Trust until this ruling is granted. As such, the transfer of assets pursuant to the proposed grant will not, in and of itself, constitute either a willful flagrant act, or failure to act, or one of a series of such acts within the meaning of § 507(a)(2)(A).

Ruling 3:

Section 4940(a) 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 Trust, which lacks consideration, does not constitute a "sale or other disposition of property" that would generate capital gains subject to the excise tax under § 4940. Therefore, the proposed grant will not be treated as a taxable sale or disposition of property within the meaning of § 4940.

Ruling 4:

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 Trust 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 Trust is not an act of self-dealing because Trust, subject to the caveat in the facts section above, is recognized by the Service as an organization exempt from tax.

Ruling 5:

Section 4942(a) imposes an annual tax on the undistributed income of a private foundation. It requires a private foundation to pay qualifying distributions, as defined in § 4942(g), to accomplish one or more exempt purposes. A "qualifying distribution" includes any amount paid to accomplish one or more purposes, including reasonable and necessary administrative expenses incurred in the direct, active conduct of an exempt purpose, described in § 170(c)(2)(B). Your proposed grant to Trust should itself be counted toward the satisfaction of such requirements to the extent the amount transferred meets the requirements of § 4942(g), which states that the term "qualifying distribution" includes a contribution to a private foundation which is not an operating foundation, such as Trust, if the redistribution requirements specified in § 4942(g)(3) are met. As a result, your proposed grant should offset your minimum distribution requirements under § 4942 to the extent that Trust makes qualifying distributions meeting the requirements specified in § 4942(g)(3).

Ruling 6:

Section 4944 imposes a tax on investments by private foundations which jeopardize their charitable purposes. Section 4944(c) states that investments, the primary purpose of which are to accomplish one or more of the purposes described in § 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes. You will transfer assets pursuant to the proposed grant for a charitable purpose, and no significant purpose of the proposed grant is the production of income or the appreciation of property. As such, the transfer should not constitute a jeopardizing investment for you nor result in the imposition of tax for a jeopardy investment under § 4944.

Ruling 7:

Section 4945(a) imposes an excise tax on the taxable expenditures of a private foundation. A transfer is a taxable expenditure under § 4945(d)(4) unless the transferor complies with the expenditure responsibility requirements of § 4945(h). You have conducted an inquiry within the meaning of § 53.4945-5(b)(2) as is reasonable taking into account Trust's limited discretion with respect to the distribution of funds. Your proposed grant to Trust is for capital endowment purposes. Therefore, the proposed grant should not constitute a taxable expenditure under § 4945 as long as you exercise expenditure responsibility over the transferred assets in accordance with § 4945(h) and § 53.4945-5(c)(2) for the year of the transfer and the two succeeding years, but not thereafter, if it is apparent to you that, before the end of such second succeeding taxable year, neither the principal nor income from the assets distributed to Trust have been used for any purpose which would result in liability for tax under § 4945(d).

Ruling 8:

Section 53.4945-6(b)(2) provides that any expenditures for unreasonable administrative expenses will ordinarily be taxable expenditures under § 4945(d)(5) unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable. Your legal, accounting, and other expenses incurred by you in preparation of this request, the formation of Trust and the proposed grant, to the extent such expenses are incurred in the good faith belief that they are reasonable and that the payments are consistent with ordinary business care and prudence, and are furthering your exempt purposes should not constitute taxable expenditures.

Conclusions:

Based on the foregoing, we rule as follows:

1. The proposed grant from you to Trust will not adversely affect your tax exempt status under § 501(c)(3).
2. The proposed grant will not constitute either a willful flagrant act, or failure to act, or one of a series of willful repeated acts, or failures to act, within the meaning of § 507(a)(2)(A).
3. The proposed grant will not give rise to net investment income for you under § 4940.
4. Neither the formation of Trust nor the proposed grant will constitute an act of self-dealing under § 4941.
5. The proposed grant offsets your minimum distribution requirement under § 4942 to the extent that Trust makes qualifying distributions meeting the requirements specified in § 4942(g)(3).
6. The proposed grant will not constitute a jeopardizing investment for you under § 4944.

7. The proposed grant will not constitute a taxable expenditure under § 4945 because you will exercise expenditure responsibility over the transferred assets for the year of the transfer and the two succeeding years, but not thereafter, if it is apparent to you that, before the end of such second succeeding taxable year, neither the principal nor income from the assets distributed in the transfer to Trust have been used for any purpose which would result in liability for tax under § 4945(d).
8. The reasonable legal, accounting, and other expenses incurred by you in connection with the letter ruling request, the formation of Trust and the proposed grant will not constitute taxable expenditures pursuant to § 4945 and, to the extent you are incurring these expenses to accomplish exempt purposes and/or protect itself, will be considered qualifying distributions under Chapter 42.

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) 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, 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 IRS, we are sending a copy of this letter to your authorized representative.

Enclosure:
Notice 437

Sincerely yours,

Ronald J. Shoemaker
Manager, Exempt Organizations
Technical Group 2