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

Date: AUG 13 1999

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T:4

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LEGEND:
B =
C =
D =

Dear Taxpayer:

This is in response to a ruling request dated April 15, 1999, on the application of sections 507 through 509 and 4940 through 4946 of the Internal Revenue Code to a proposed asset transfer from B to C.

B is a private foundation that was created in 1989 under D law. B's main activities are in the field of education, primarily to benefit young people with low to moderate economic means. C is a private foundation, also created under D law, whose purposes include significant educational as well as medical, scientific, and public welfare activities.

B and C were founded by the same individuals and are corporations dedicated to similar charitable purposes. All of the members of B's board of directors are members of C's board of directors. Additionally, two of the three officers of B serve as officers of C.

B and C have determined that substantial administrative savings can be achieved, and duplication of effort be avoided, by consolidating B's assets and activities with those of C, a much larger organization. In addition, to improved efficiency in operations, the consolidation will enhance the charitable purposes of both B and C. B proposes to transfer all of its assets to C. A short time after such transfer, B will liquidate and dissolve under D law.

LAW

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes ..." and other exempt purposes outlined in that section.

Section 509(a) of the Code provides that a 501(c)(3) organization is a private foundation unless it is described in section 509(a)(1), (2), (3) or (4) of the Code. Section 509(b) provides that a private foundation will continue as a private foundation unless such status is terminated under section 507.

Section 507 of the Code describes certain voluntary and involuntary methods by which a private foundation will be deemed to be terminated for federal income tax purposes. With respect to the

terminations described in section 507(a) of the Code, the termination tax described in section 507(c) of the Code is imposed on the private foundation unless the Internal Revenue Service abates the tax pursuant to section 507(g) of the Code. Under section 507(a) of the Code, a private foundation may terminate its private foundation status only if it notifies the Service or it commits willful repeated acts, or a willful and flagrant act, which give rise to the imposition of a tax under Chapter 42 and it pays the termination tax or the Service abates the tax as mentioned above.

Section 507(b)(2) of the Code and section 1.507-3(a)(1) of the Income Tax Regulations indicate that, in a transfer of assets from one private foundation to one or more private foundations pursuant to any "liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization" the transferee foundation shall not be treated as a newly-created organization.

Section 1.507-3(c) of the Income Tax Regulations provides that the terms "other adjustment, organization, or reorganization" used in section 507(b)(2) of the Code include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for consideration or distributions out of current income.

Section 6043(b) of the Code provides, in part, that any exempt organization that for any of the last five taxable years proceeding its liquidation, dissolution, termination or substantial contraction was exempt under section 501(a) shall file such return and information with respect to such liquidation, dissolution, termination or substantial contraction as the Secretary, shall by forms or regulations prescribe.

Section 6043(b)(1), in part, exempts from the requirement in section 6043(b) entities other than private foundations whose gross receipts are normally not more than $5,000.00 in each taxable year. Section 1.507-3(c) of the regulations provides that the terms "other adjustment, organization, or reorganization" used in section 507(b)(2) of the Code include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for consideration or distributions out of current income.

Section 1.507-3(c)(2) of the regulations provides that a significant disposition of assets includes any disposition to one or more private foundations for the taxable year exceeding 25% of the fair market value of the assets of the transferor foundation at the beginning of the taxable year.

Section 1.507-4(b) of the regulations provides that the tax on termination of private foundation status imposed by section 507(c) of the Code does not apply to a transfer described in section 507(b)(2) of the Code unless section 507(a) of the Code is applicable.

Section 1.507-1(b)(6) and (7) of the regulations state that a transfer of all or part of a foundation's assets to one or more other private foundations, pursuant to section 507(b)(2) of the Code and section 1.507-3(c) of the regulations, will not result in termination of the transferor foundation's status as a private foundation.

Section 1.507-3(d) of the regulations provides that unless a private foundation elects to terminate and notifies the Service under section 507(a)(1) of the Code, a transfer of assets will not result in a termination of transferor's private foundation status.

Section 507(c) of the Code imposes a tax on terminating private foundations equal to the lower of the aggregate tax benefit or the value of its net assets.

Section 507(e) of the Code defines the "value of the net assets" as the value determined at whichever time such value is higher: (1) the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation, or (2) the date on which the organization ceases to be a private foundation.

Section 1.507-1(b)(9) of the regulations requires a private foundation that transfers all of its net assets to file the annual information return required by section 6033 of the Code. The private foundation does not need to file such information return for any taxable year following the taxable year in which the last of any such transfers occurred, provided that the foundation, in such subsequent taxable years, does not hold legal or equitable title to any assets.

Section 1.507-3(a)(2)(i) of the regulations provides that a section 507(b)(2)-transferee organization succeeds to the transferor's aggregate tax benefits that are attributable to the assets transferred.

Section 1.507-(3)(a)(9)(i) of the regulations provides that for the purposes of sections 4940 et seq. and section 507-509 of the Code, a transferee foundation shall be treated as the transferor where a private foundation transfers all of its assets to one or more private foundations which are effectively controlled, directly or indirectly, by the same person or persons which effectively control the transferor foundation.

Section 1.507-3(a)(9)(iii), Example (2) of the regulations allows a private foundation to make Code section 507(b)(2) transfers of all of its assets to organizations exempt under section 501(c)(3), including private foundations, without creating any expenditure responsibility requirement under section 4945(h) on the transferor foundation.

Section 1.482-1(a)(3) of the regulations provides the definition of "controlled" as used in section 1.507-3(a)(9)(i) of the regulations. Controlled includes "any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control that is decisive, not its form or the mode of its exercise.

Section 4940 of the Code imposes a tax equal to 2% of the net investment income of a private foundation that is exempt from taxation under section 501(a) of the Code.

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

Section 4941(d)(1) of the Code defines self-dealing as including the sale or exchange of property between a foundation and a disqualified person and the transfer to or use by or for the benefit of a disqualified persons under section 4946 of the Code.

Section 4944(a) of the Code imposes an excise tax on a private foundation's making of any jeopardy investment.

Section 4945 of the Code imposes an excise tax on a private foundation's making of any "taxable expenditure."

Section 4945(d)(4) of the Code requires that, for a transfer of assets not to be a taxable expenditure, a transferor private foundation must exercise "expenditure responsibility" under section 4945(h) on any transfer to another private foundation which is not an "exempt operating foundation" under section 4940(d)(2) of the Code.

Section 4945(h) of the Code provides in pertinent part as follows:

> The expenditure responsibility referred to in subsection (d)(4) means that the private foundation is responsible to exert all reasonable efforts to establish adequate procedures (1) to see that the grant is spent solely for the purpose for which made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and (3) to make full and detailed reports with respect to such expenditures to the Secretary.

Revenue Ruling 78-387, 1978-2 C.B. 270, holds that a transferee is entitled to reduce its distributable amount under section 4942 by the amount of the transferor's excess qualifying distributions when a transferee is treated as the transferor under section 1.507-3(a)(9).

Section 53.4945-6(b)(2) of the Foundation and Similar Excise Taxes Regulations provides that a private foundation's payment of the reasonable costs for services rendered, is not a taxable expenditure.

Section 53.4945-6(c)(3) and 1.507-3(b) of the regulations allow a private foundation to make a Code section 507(b)(2) transfer of its assets to an organization exempt from tax under section 501(c)(3) of the Code, including private foundations, without the transfers being taxable expenditures.

Section 53.4946-1(a)(8) provides that for the purposes of self-dealing under section 4941, the term "disqualified person" shall not include an exempt organization described in section 501(c)(3).

ANALYSIS

Section 1.507-3(c)(1) of the regulations describes the necessary criteria in order to come within the provisions of section 507(b)(2) of the Code. First, the asset transfer must be from one private foundation to another. Second, the transfer must be pursuant to a liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. In this context, "other adjustment, organization, or reorganization" includes any partial liquidation or significant distribution of assets to one or more private foundations. Third, the transfer must represent 25 percent or more of the fair market value of the net assets of the transferring foundation.

The transfer of assets from B to C qualifies as a section 507(b)(2) transaction. First, both B and C are private foundations. Second, the proposed transfer is an "other adjustment, organization, or reorganization" that constitutes a significant distribution of assets since it represents 100% of the net assets of B as of the date of the transfer, well exceeding the 25% threshold required by section 1.507-3(c)(2) of the regulations.

A transfer under section 507(b)(2) of the Code will not result in a termination of a private foundation's status, as such, unless the private foundation gives notice of its intent to terminate or if section 507(a)(2) is applicable. B has not given any notice of its intention to terminate and has represented it has not committed any willful acts that would cause termination under section 507(a)(2). Therefore, the transfer of assets from B to C will not result in a termination, either voluntary or involuntary, of B's or C's status as a private foundation under section 507(a).

Section 507(c) imposes a tax on terminating foundations. The termination tax imposed by section 507(c) does not apply to B or C because the foundations are not terminating as a result of the transfer.

If B gives proper notice of voluntary termination under section 507(a), at least one day after the transfer, it will result in a termination under section 507(c). Section 507(c) imposes a tax on terminating private foundations based on the lower of the aggregate tax benefit or the value of the net assets of the terminating private foundation. B, as of the date of termination and the date of the commencement of the action that results in termination, will have net assets equal to zero. Accordingly, no tax will be imposed by section 507(c).

Following the transfer of assets, the transferee foundation succeeds to the aggregate tax benefit of the transferor pursuant to section 1.507-3(a)(2)(i). Therefore, C will succeed to the aggregate tax benefit of B.

B and C have identical boards of directors. Additionally, two out of three officers of B are officers of C. They are "controlled" by the same persons within the meaning of section 1.482-1(a)(3). Under section

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1.507-3(9)(i), if the same person or persons control two foundations, the foundations are treated as the same for the purposes of section 4940 et seq. and sections 507-509 of the Code. Therefore:

> Under section 4940 of the Code, the transfer will not result in any tax on gross investment income or capital gain net income.
>
> Under section 4941 of the Code, the transfer is not an act of self-dealing.
>
> Under section 4944 of the Code, the transfer is not a jeopardy investment.

In accordance with sections 1.507-3(a)(9)(i) and 1.507-3(a)(9)(iii), Example (2) of the regulations, the transfer does not constitute a grant under section 4945(d)(4) of the Code for which expenditure responsibility would be required. Therefore, B does not need to exercise expenditure responsibility with respect to the transfer.

Under section 53.4945-6(b)(2) of the regulations, a private foundation's payments of its reasonable costs for services rendered is not a taxable expenditure under section 4945 of the Code. Thus, C's payment of legal, accounting, and other expenses incurred to effectuate the transfer with B, if reasonable in amount, will not be taxable expenditures under section 4945.

Pursuant to section 1.507-3(a)(9) of the regulations, which treats the transferee as the transferor for purposes of section 4940 et seq. of the Code, the distribution requirements of section 4942 of the Code do not apply to B in the year of the transfer because such distributions will be treated as C's distributions. However, the distribution requirements under section 4942 of the Code for the year of the transfer do apply to C. Additionally, under Rev. Rul. 78-387, C will succeed to the excess qualifying distributions of B.

Furthermore, pursuant to section 1.507-3(a)(9)(i) of the regulations, B will not be required to satisfy the expenditure responsibility provisions of section 4945(d)(4) of the Code for any grants made by C after the transfer. However, C must exercise expenditure responsibility as to any and all outstanding grants of B that required B to exercise expenditure responsibility.

Based on the information you have submitted and as the transferee foundation is recognized as exempt under section 501(c)(3) of the Code, under the facts described above we rule as follows:

1. B's transfer of all its assets to C will constitute a transfer under section 507(b)(2) of the Code, will not result in the termination of B's private foundation status under section 507, and will not cause the imposition of any termination tax under section 507(c).

2. B's transfer of all its assets to C will not adversely affect the exemption of B from federal income tax under section 501(c)(3) of the Code.

3. The transfer does not constitute a willful and flagrant act (or failure to act) giving rise to liability for tax under Chapter 42 of the Code.

4. The notification to the Service by B, at least one day after B's transfer of all its assets to C, that B intends to terminate its private foundation status pursuant to section 507(a)(1) of the Code and its subsequent dissolution will result in (i) the termination of B's private foundation status and (ii) a zero tax liability under section 507(c).

5. C will succeed to the aggregate tax benefits of B.

6. B's transfer of all its assets to C will be treated as a transfer of all the assets to a private foundation which is effectively controlled by the same persons for purposes of section 1.507-3(a)(9)(i) of the regulations, and

therefore C will be treated as though it were B for purposes of sections 4940 through 4948, and sections 507 through 509 of the Code.

7. B's transfer of all its assets to C will not result in a tax on investment income under section 4940 of the Code.

8. B's transfer of all assets to C will not constitute a "sale" or other disposition of property" within the meaning of section 4940(c)(4)(A) of the Code and will not subject B to tax under section 4940 of the Code.

9. The tax basis and holding period of the transferred assets in the hands of C will be determined in the same manner as if such assets continued to be held by B for all purposes as required and authorized by the Code.

10. Any persons who were substantial contributors with respect to B will be substantial contributors with respect to C, as provided under section 1.507-3(a)(3) of the regulations.

11. Provided that after the transfer of all of B's assets to C the latter does not have "excess business holdings" as defined in section 4943(c) of the Code, the transfer by B to C will not result in liability for the tax on excess business holdings imposed by section 4943(a).

12. C will succeed to the advance approval granted B under section 4945(g) of the Code, regarding its grant-making procedures and scholarship program, which program will be continued by C without any material change from the way in which it has been conducted by B.

13. B's transfer of all its assets to C will not constitute an act of self-dealing under section 4941 of the Code.

14. B's transfer of all its assets to C will not be a jeopardizing investment under section 4944 of the Code.

15. C's distributable amount under section 4942(d) for the taxable year in which the proposed transfer occurs will be increased by the distributable amount of B for its taxable year in which the proposed transfer occurs as if C had held the assets for the entire year. All distributions by B and C made in the taxable year of the proposed transfer will be treated as distributions made by C. B will, therefore, not be subject to the distribution requirements of section 4942 of the Code in the year of the proposed transfer. Additionally, C will succeed to all B's excess qualifying distributions.

16. C's payment of legal, accounting, and other expenses incurred to effectuate the transfer by B to C, if reasonable in amount, will not be a taxable expenditure under section 4945 of the Code.

17. B will not be required to exercise expenditure responsibility under section 4945(h) with respect to the transfer of assets to C. C, and not B, will be responsible to exercise expenditure responsibility for outstanding grants made by B which are subject to expenditure responsibility, if any, and for any and all grants made by C after the transfer date which are subject to expenditure responsibility.

18. B will not be required for any taxable year subsequent to termination of its private foundation status under section 507(a)91) of the Code to comply with the periodic reporting, return and notice provisions of section 6033 and 6104(b) of the Code. B will be required upon termination to file the return required under section 6043(b) of the Code.

19. In order to terminate, B must file the statement and tax computation under section 507(c), required under section 1.507-1(b)(1) of the regulations with the District Director.

20. This ruling request, the rulings requested herein and any other communications with the Service do not constitute voluntary notice of an intent to terminate the private foundation status of B under section 507(a)(1).

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We are informing your key District Director of this ruling. Because this ruling could help resolve future questions about your federal income tax status, you should keep it in your permanent records.

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 as precedent.

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

Sincerely,

Gerald V. Sack

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4