

Section 507.—Termination of Private Foundation Status

26 CFR 1.507-1, 1.507-2, 1.507-3, 1.507-4, 1.507-7;
Special rules; Transfers to publicly supported organizations; Liability in case of transfers.
(Also §§ 4940, 4941, 4942, 4943, 4944, 4945;
53.4940-1, 53.4941(a)-1, 53.4942(a)-3.)

Transfers of assets. This ruling describes the responsibilities of a private foundation relating to section 507 and chapter 42 (sections 4940-4945) of the Code when it transfers all of its assets to one or more public charities described in sections 509(a)(1), 509(a)(2), or 509(a)(3).

Rev. Rul. 2003-13

ISSUES

If a private foundation distributes all of its net assets to one or more public charities described in § 509(a)(1), § 509(a)(2) or § 509(a)(3) of the Internal Revenue Code under the facts described below:

1. Has the private foundation terminated its foundation status and is the private foundation liable for tax under § 507(c)?

2. What are the consequences of the distribution under:

- (a) § 4940;
- (b) § 4941;
- (c) § 4942;
- (d) § 4943;
- (e) § 4944; and
- (f) § 4945?

FACTS

Each of the following situations assumes that: (i) the private foundation has 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; (ii) the private foundation is not an operating foundation within the meaning of § 4942(j)(3); (iii) the transferee organizations are not controlled (directly or indirectly) by the private foundation or by one or more disqualified persons with respect to the private foundation; (iv) the private foundation has not previously terminated (or had terminated) its private foundation status; (v) the transferee organization is a public charity described in § 509(a)(1), § 509(a)(2), or § 509(a)(3) that retains its public charity

classification for at least three years following the date of the distribution; (vi) the private foundation does not impose any material restrictions as described in § 1.507-2(a)(8)(i) on the transferred assets, and (vii) the private foundation retains sufficient income or assets to pay any chapter 42 taxes, such as the tax imposed under § 4940 for the portion of the taxable year prior to the distribution, and pays such taxes when due.

Situation 1. *P* is recognized as exempt from federal income tax under § 501(c)(3) and is classified as a private foundation under § 509(a). Pursuant to a plan of dissolution, *P* distributes all its net assets to *X*.

X is recognized as exempt from federal income tax under § 501(c)(3) and is not a private foundation because *X* is described in § 509(a)(1) (*i.e.* an organization described in § 170(b)(1)(A) (other than clauses (vii) and (viii))). *X* has been in existence and so described for a continuous period of at least 60 calendar months immediately preceding the distribution. After *P* distributes all its net assets, *P* files articles of dissolution with the appropriate state authority.

Situation 2. The facts are the same as Situation 1, except that *X* has been in existence for fewer than 60 calendar months immediately preceding the distribution, and was not formed as a result of a consolidation of other organizations described in § 509(a)(1) that would have been in existence for a continuous period of 60 calendar months prior to the distribution had they continued in existence.

Situation 3. The facts are the same as Situation 1, except that *X* is an organization described in § 509(a)(2).

Situation 4. The facts are the same as Situation 1, except that *X* is an organization described in § 509(a)(3).

LAW

Section 507(a) 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 of its intent to accomplish such termination, or (2) 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 a liability for tax under chapter 42, and the Secretary notifies such organization that it is liable for the tax imposed by § 507(c). Under § 507(a)(1) and (2), the organization's private foundation

status is terminated when the organization pays the tax imposed by § 507(c) or the entire amount of such tax is abated under § 507(g).

Section 507(b)(1)(A) provides that the private foundation status of any organization, with respect to which there have not been either willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) giving rise to a liability for tax under chapter 42, shall be terminated, if the private foundation distributes all its net assets to one or more organizations described in § 170(b)(1)(A) (other than clauses (vii) and (viii)) each of which has been in existence and so described for a continuous period of at least 60 calendar months immediately preceding such distribution.

Section 507(c) imposes a tax on each organization whose private foundation status is voluntarily or involuntarily terminated under § 507(a). The tax imposed is the lower of (1) the amount that the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the § 501(c)(3) status of such foundation, or (2) the value of the net assets of the foundation.

Section 1.507-1(b)(1) provides that in order to terminate its private foundation status under § 507(a)(1), an organization must submit a statement to the Manager, Exempt Organizations Determinations, Tax Exempt and Government Entities Division (TE/GE), of its intent to terminate its private foundation status under § 507(a)(1). Such statement must set forth in detail the computation and amount of tax imposed under § 507(c). Unless the organization requests abatement of such tax pursuant to § 507(g), full payment of such tax must be made at the time the statement is filed under § 507(a)(1). An organization may request the abatement of all of the tax imposed under § 507(c), or may pay any part thereof and request abatement of the unpaid portion of the amount of tax assessed. If the organization requests abatement of the tax imposed under § 507(c) and such request is denied, the organization must pay such tax in full upon notification by the Service that such tax will not be abated.

Section 1.507-1(b)(7) provides that a transfer of all the assets of a private foundation does not result in a termination of the transferor private foundation under § 507(a), unless the transferor private foundation

dation elects to terminate pursuant to § 507(a)(1), or § 507(a)(2) is applicable.

Section 1.507-2(a)(1) provides that under § 507(b)(1)(A), a private foundation, may terminate its private foundation status by distributing all its net assets to one or more organizations described in § 170(b)(1)(A) (other than clauses (vii) and (viii)) each of which has been in existence and so described for a continuous period of at least 60 calendar months immediately preceding such distribution. As § 507(a) does not apply to such a termination, a private foundation that makes such a termination is not required to give the notification described in § 507(a)(1). A private foundation that terminates its private foundation status under § 507(b)(1)(A) does not incur tax under § 507(c) and, therefore, no abatement of such tax under § 507(g) is required.

Section 1.507-2(a)(4) provides that an organization that terminates its private foundation status pursuant to § 507(b)(1)(A) will remain subject to the provisions of chapter 42 until it distributes all its net assets to distributee organizations described in § 507(b)(1)(A).

Section 1.507-2(a)(7) provides that a private foundation will meet the requirement that it “distribute all of its net assets” within the meaning of § 507(b)(1)(A) only if it transfers all its right, title, and interest in and to all its net assets to one or more organizations referred to in § 507(b)(1)(A).

Section 1.507-2(a)(8)(i) provides, in part, that to effectuate a transfer of “all of its right, title, and interest in and to all of net assets,” a transferor private foundation may not impose any material restriction or condition that prevents the transferee organization from freely and effectively employing the transferred assets, or the income derived therefrom, in furtherance of its exempt purposes.

Section 1.507-3(e) provides that if a private foundation transfers all or part of its assets to one or more organizations described in § 509(a)(1), (2), or (3) and, within a period of 3 years from the date of such transfers, one or more of the transferee organizations lose their § 509(a)(1), (2), or (3) status and become private foundations, then the transfer will be treated as a transfer described in § 507(b)(2) and the provisions of § 1.507-3(a) shall be treated as applying to such transferee from the date any such transfer was made to it.

Section 1.507-4(b) provides that private foundations that make transfers described in § 507(b)(1)(A) or (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 1.507-7(a) provides that the value of net assets for purposes of § 507(c) shall be determined at whichever time such value is higher: (1) the first day action is taken by the organization that culminates in its ceasing to be a private foundation, or (2) the date it ceases to be a private foundation.

Section 1.507-7(b)(1) provides that in the case of a termination under § 507(a)(1), the date of action referred to in § 1.507-7(a)(1) shall be the date the terminating foundation gives the notification described in § 507(a)(1).

Section 4940(a) generally imposes an excise tax on a private foundation’s net investment income for the taxable year.

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 under 4940(c)(3).

Section 53.4940-1(f)(1) provides that a distribution of property for purposes described in § 170(c)(1) or (2)(B) that is a qualifying distribution under § 4942 shall not be treated as a sale or disposition of property.

Section 4941(a)(1) imposes a tax on each act of self-dealing between a disqualified person and a private foundation. Section 53.4946-1(a)(8) provides that, for purposes of § 4941, the term “disqualified person” shall not include any organization described in § 501(c)(3) (other than an organization described in § 509(a)(4)).

Section 4942(a) generally imposes a tax on the undistributed income of a private foundation (other than an operating foundation under § 4942(j)(3)) for any taxable year, that has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year.

Section 4942(c) defines “undistributed income” for any taxable year as the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made out of such distributable amount for such taxable year.

Section 4942(d) defines “distributable amount” as the amount equal to the sum of

the minimum investment return, plus certain other amounts, reduced by the sum of the taxes imposed on such private foundation for the taxable year under subtitle A and § 4940.

Section 4942(g)(1)(A) defines “qualifying distribution” as 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 a contribution to (i) an organization controlled directly or indirectly by the foundation or by one or more disqualified persons with respect to the foundation, unless certain requirements are satisfied, or (ii) any private foundation that is not an operating foundation under § 4942(j)(3), unless certain requirements are satisfied.

Section 53.4942(a)-3(a)(3) provides, in part, that control of a donee organization is determined without regard to any conditions imposed upon the donee as part of the distribution or any other restrictions accompanying the distribution as to the manner the distribution is to be used, unless such conditions or restrictions are described in § 1.507-2(a)(8).

Section 4943(a)(1) imposes a tax on the “excess business holdings” (as defined in § 4943(c)) of any private foundation in a business enterprise.

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

Section 4945 imposes a tax on any “taxable expenditure” (as defined in § 4945(d)) made by a private foundation.

Section 4945(d)(4)(A) states that the term “taxable expenditure” includes any amount paid or incurred by a private foundation as a grant to an organization unless the organization is described in paragraph (1), (2), or (3) of § 509(a) or is an exempt operating foundation (as defined in § 4940(d)(2)).

Section 4945(h) provides that the expenditure responsibility referred to in § 4945(d)(4) means a private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to (1) see that the grant is spent solely for the purpose for which made, (2) obtain full and complete reports from the grantee on how the funds are spent, and (3) make full and detailed reports with respect to such expenditures to the Secretary.

Section 4946 provides that the term ‘disqualified person’ includes a substantial contributor to a private foundation.

In Rev. Rul. 75-289, 1975-2 C.B. 215, a private foundation defined in § 509 distributed all its net assets to an organization, described in § 170(b)(1)(A)(vi), that had been in existence for only 20 months. The organization was formed as a result of a consolidation of two organizations each of which would have been an organization described in § 170(b)(1)(A)(vi) and in existence for a continuous period of 60 calendar months before the distribution had they continued in existence. The ruling held that the private foundation had terminated its private foundation status under § 507(b)(1)(A).

ANALYSIS

SECTION 507

Under § 507(b)(1)(A), an organization’s status as a private foundation is terminated if the organization distributes all its net assets to one or more organizations described in § 509(a)(1) (i.e., organizations described in § 170(b)(1)(A) (other than in clauses (vii) and (viii))) each of which has been in existence and so described for a continuous period of at least 60 calendar months immediately preceding the distribution. An organization that terminates its private foundation status under § 507(b)(1)(A) is not required to give notice under § 507(a)(1) and is not subject to the tax described in § 507(c). See § 1.507-2(a)(1).

If a private foundation distributes all its net assets to one or more public charities, at least one of which is described in § 509(a)(1) and has been so described for fewer than 60 calendar months immediately preceding the distribution or is described in §§ 509(a)(2) or (3), then the rules of § 507(b)(1)(A) do not apply. In this case, the distributions do not cause the private foundation to terminate its private foundation status. See § 1.507-1(b)(7). The private foundation may choose to terminate its private foundation status by submitting a statement of its intent to terminate its private foundation status under § 507(a)(1) to the Manager, Exempt Organizations Determinations, Tax Exempt and Government Entities Division (TE/GE). See § 1.507-1(b)(1). Such statement must set

forth in detail the computation and amount of tax imposed under § 507(c). See § 1.507-1(b)(1). If the private foundation has no net assets on the day it provides notice (e.g., it provides notice at least one day after it distributes all its net assets), the tax imposed by § 507(c) will be zero. See § 507(a)(1) and § 507(c); and §§ 1.507-7(a) and (b). A submission of a Form 990-PF marked “Final” does not constitute notice of termination of private foundation status under § 507(a)(1). See § 1.507-1(b)(1).

In Situation 1, *P* transfers all its net assets to *X*, which is described in § 509(a)(1) and has been so described for a continuous period of at least 60 calendar months immediately preceding the distribution. Accordingly, the distribution is subject to the rules of § 507(b)(1)(A), rather than the rules of § 507(a)(1). See § 507(b)(1)(A) and § 1.507-2(a)(1).

Because the distribution is described in § 507(b)(1)(A), *P*’s status as a private foundation is terminated upon the distribution and *P* is not subject to the tax described in § 507(c). See § 1.507-2(a)(1) and § 1.507-4(b). *P* is not required to give notice under § 507(a)(1) to terminate its private foundation status.

In Situation 2, *X* is an organization described in § 509(a)(1) that has been in existence and so described for fewer than 60 calendar months immediately preceding the distribution. In Situation 3, *X* is an organization described in § 509(a)(2). In Situation 4, *X* is an organization described in § 509(a)(3). Accordingly, the distributions in Situations 2, 3, and 4 are not subject to the rules of § 507(b)(1)(A). See § 507(b)(1)(A) and § 1.507-2(a)(1).

Because the distributions in Situations 2, 3, and 4 are not described in § 507(b)(1)(A), *P*’s status as a private foundation is not terminated unless it gives notice under § 507(a)(1). See § 1.507-1(b)(1) and § 1.507-1(b)(7). If *P* does not provide notice and does not terminate, *P* is not subject to the tax under § 507(c).

If *P* chooses to provide notice, and therefore terminates, it is subject to the tax under § 507(c) on the date it provides notice; however, if *P* has no net assets on the day it provides notice (e.g., it provides notice at least one day after it distributes all its net assets), the tax imposed by § 507(c) will be

zero. See § 507(a)(1) and § 507(c); and §§ 1.507-7(a) and (b).

SECTION 4940

In Situations 1, 2, 3, and 4, the distributions do not constitute an investment of *P* for purposes of § 4940; therefore the distributions do not give rise to net investment income under § 4940(a). See § 53.4940-1(f)(1).

SECTION 4941

In Situations 1, 2, 3, and 4, the distributions are to § 501(c)(3) organizations, which are not treated as disqualified persons for purposes of § 4941. See § 53.4946-1(a)(8). Thus, the distributions do not constitute self-dealing transactions and are not subject to tax under § 4941(a)(1).

SECTION 4942

In Situations 1, 2, 3, and 4, the distributions are paid to accomplish one or more purposes described in § 170(c)(2)(B) and are not made to organizations controlled directly or indirectly by *P* or by one or more disqualified persons with respect to *P*. Thus, the distributions are qualifying distributions for purposes of § 4942(g)(1)(A).

SECTION 4943

In Situations 1, 2, 3, and 4, the distributions do not cause *P* to have excess business holdings subject to tax under § 4943(a).

SECTION 4944

In Situations 1, 2, 3, and 4, the distributions do not constitute investments for purposes of § 4944 and therefore are not jeopardizing investments subject to tax under § 4944(a)(1).

SECTION 4945

In Situations 1, 2, 3, and 4, the distributions are to organizations described in §§ 509(a)(1), (2), or (3). Therefore, the distributions are not taxable expenditures under § 4945. See § 4945(d)(4)(A). *P* will not be required to exercise expenditure responsibility with respect to the distributions under § 4945(d)(4) or (h).

HOLDINGS

Under the facts of the ruling:

1. A private foundation that distributes all its net assets to one or more organizations described in § 509(a)(1) (*i.e.*, organizations described in § 170(b)(1)(A) (other than in clauses (vii) and (viii))) each of which has been in existence and so described for a continuous period of at least 60 calendar months immediately preceding the distribution terminates its private foundation status under § 507(b)(1)(A). The private foundation is not required to file a notice of termination under § 507(a)(1) and is not liable for tax under § 507(c).

A private foundation that distributes all its net assets to one or more public charities, at least one of which is described in § 509(a)(1) and has been so described for fewer than 60 calendar months immediately preceding the distribution or is described in §§ 509(a)(2) or (3), does not terminate its private foundation status unless it gives notice under § 507(a)(1). If the private foundation does not provide notice and does not terminate, the private foundation is not subject to tax under § 507(c). If the private foundation chooses to provide notice, and therefore terminates, it is subject to the tax under § 507(c) on the date notice is given; however, if the private foundation has no net assets on the day it provides notice (*e.g.*, it provides notice at least one day after it distributes all its net assets), the tax imposed by § 507(c) will be zero.

If the private foundation elects to terminate its private foundation status under § 507(a)(1), it must submit a statement to the Manager, Exempt Organizations Determinations, Tax Exempt and Government Entities Division (TE/GE), of its intent to terminate its private foundation status under § 507(a)(1). Such statement must set forth in detail the computation and amount of tax imposed under § 507(c). The submission of a Form 990-PF marked "Final" does not constitute notice of termination of private foundation status under § 507(a)(1).

2. (a) The distribution does not give rise to net investment income and is not subject to tax under § 4940(a).

(b) The distribution does not constitute a self-dealing transaction and is not subject to tax under § 4941(a)(1).

(c) The distribution constitutes a qualifying distribution for the transferor private foundation under § 4942.

(d) The distribution does not result in excess business holdings and is not subject to tax under § 4943(a).

(e) The distribution does not constitute an investment jeopardizing the transferor private foundation's exempt purposes and is not subject to tax under § 4944(a)(1).

(f) The distribution is not a taxable expenditure described in § 4945.

DRAFTING INFORMATION

The principal author of this revenue ruling is Theodore R. Lieber of the Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, contact Theodore R. Lieber at (202) 283-8999 (not a toll-free call).

Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners

26 CFR 1.671-1: Grantors and others treated as substantial owners; scope

The Internal Revenue Service will treat an Indian tribe as the grantor and owner of a trust for the receipt of gaming revenues under the Indian Gaming Regulatory Act (25 U.S.C. sections 2701-2721) (IGRA) for the benefit of minors or legal incompetents if the trust conforms to the procedures of this revenue procedure. See Rev. Proc. 2003-14, page 319.

Section 1234B.—Gains or Losses From Securities Futures Contracts

Until further notice, the Internal Revenue Service will not require information reporting under section 6045 with respect to securities futures contracts. See Notice 2003-8, page 310.

Section 1256.—Section 1256 Contracts Marked to Market

Until further notice, the Internal Revenue Service will not require information reporting under section 6045 with respect to securities futures contracts. See Notice 2003-8, page 310.

Section 4940.—Excise Tax Based on Investment Income

Responsibilities of a private foundation relating to section 507 and chapter 42 (sections 4940-4945) when it transfers all of its assets to one or more organizations described in section 509(a). See Rev. Rul. 2003-13, page 305.

Section 4941.—Taxes on Self-Dealing

Responsibilities of a private foundation relating to section 507 and chapter 42 (sections 4940-4945) when it transfers all of its assets to one or more organizations described in section 509(a). See Rev. Rul. 2003-13, page 305.

Section 4942.—Taxes on Failure to Distribute Income

Responsibilities of a private foundation relating to section 507 and chapter 42 (sections 4940-4945) when it transfers all of its assets to one or more organizations described in section 509(a). See Rev. Rul. 2003-13, page 305.

Section 4943.—Taxes on Excess Business Holdings

Responsibilities of a private foundation relating to section 507 and chapter 42 (sections 4940-4945) when it transfers all of its assets to one or more organizations described in section 509(a). See Rev. Rul. 2003-13, page 305.

Section 4944.—Taxes on Investments Which Jeopardize Charitable Purpose

Responsibilities of a private foundation relating to section 507 and chapter 42 (sections 4940-4945) when it transfers all of its assets to one or more organizations described in section 509(a). See Rev. Rul. 2003-13, page 305.

Section 4945.—Taxes on Taxable Expenditures

Responsibilities of a private foundation relating to section 507 and chapter 42 (sections 4940-4945) when it transfers all of its assets to one or more organizations described in section 509(a). See Rev. Rul. 2003-13, page 305.