



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Release Number: **201032044**

Release Date: 8/13/2010

May 18, 2010

Contact Person:

Contact Identification Number:

Telephone Number:

Employer Identification Number:

UIL:507.00-00,4940.00-00,4941.00-00,4942.03-05

Legend:

S =

Dear :

This is in reply to your request for rulings dated December 27, 2006, concerning the federal income and excise tax consequences under section 507 and certain sections of Chapter 42 of the Internal Revenue Code ("Code") relating to a proposed transfer of assets, in the manner and for the purposes described below.

Facts

You are exempt from federal income tax under section 501(c)(3) of the Code and are a private foundation under section 509(a) and you are classified as a non-operating foundation. Your purposes are to make grants to other organizations exempt from tax under section 501(c)(3) for charitable, religious, scientific, hospital, medical, literary, and educational purposes either directly or by contributions to organizations that qualify as exempt organizations under section 501(c)(3).

You were incorporated by your founder and all your assets were contributed by him during his lifetime. In addition, you are in receipt of and are anticipating additional receipts as charitable bequests from a trust created by your founder. Your directors consist of founder's daughter, son and a third party. The charitable interests and management strategies of the son and daughter have diverged over the years and they are interested in supporting different charities. Therefore, your directors want to transfer fifty percent (50%) of your assets to S. You represent that the transfer is in the form of a capital endowment. After the proposed transfer, you intend to change your name and you represent that this change is just in your name and that no other changes will be made other than as stated herein.

S is exempt from federal income tax under section 501(c)(3) of the Code and is a private foundation under section 509(a) and is classified as a non-operating foundation. S's purposes are to make grants to other organizations exempt from tax under section 501(c)(3) for charitable, religious, scientific, hospital, medical, literary, and educational purposes either directly or by contributions to organizations that qualify as exempt organizations under section 501(c)(3). As part of the transfer, the son will resign as one of your directors and become a director of S.

You represent that, to the best of your knowledge, neither you nor S have 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 S until the rulings requested herein are granted.

**Rulings Requested**

The following rulings are requested:

1. The transfer will not adversely affect the section 501(c)(3) of the Code tax-exempt status of either you or S. From and after the date of the transfer, both you and S will continue to exist as organizations, which are exempt from taxation under section 501(c)(3).
2. The transfer will qualify as a transfer of assets described in section 507(b)(2) of the Code, and will neither result in the termination of your private foundation status under section 507(b)(1), nor subject you to the tax imposed by section 507(c).
3. The transfer 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) giving rise to liability for tax under Chapter 42 of the Code.
4. Since the transfer will constitute a reorganization as described in section 507(b)(2) of the Code, S will succeed to your attributes and characteristics as described in section 1.507-3(a) of the Income Tax Regulations ("regulations"), and S will succeed to one-half of your excess distributions carryover, if any, available for use under section 4942.
5. The transfer will not give rise to net investment income for either you or S, and will not result in the imposition of tax under section 4940 of the Code, and the tax basis and holding period of the assets distributed to S pursuant to the transfer shall be determined in the same manner as if such assets had continued to be held uninterrupted by you.
6. You and your disqualified persons will not be deemed to have engaged in an act of self-dealing under section 4941 of the Code by effectuating the transfer and taking all actions necessary to effectuate the transfer, including the formation of S.
7. You may count the assets distributed in the transfer toward satisfaction of your minimum distribution requirements under section 4942 of the Code to the extent that S makes qualifying distributions described in section 4942(g).
8. The transfer will not constitute an investment that jeopardizes charitable purposes for either you or S under section 4944 of the Code.
9. You must exercise expenditure responsibility for 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 S have been used for any purpose which would result in liability for tax under section 4945 of the Code.
10. The legal, accounting, and other expenses, paid by you in connection with this ruling request and in effectuating the transfer will not constitute taxable expenditures pursuant to section 4945 of the Code, and will be considered qualifying distributions under section 4942.
11. Neither the formation of S nor the transfer will result in the imposition of any taxes under Chapter 42 of the Code.

## Law

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

Section 507(a) of the Code provides that, except as provided in section 507(b), a private foundation may terminate its private foundation status only under the specific rules set forth in section 507(a).

Section 507(b)(2) of the Code provides 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 foundation shall not be treated as a newly created organization.

Section 507(c) of the Code imposes a tax equal to the lower of the "aggregate tax benefit" resulting from the section 501(c)(3) status or the value of the net assets of such foundation.

Section 507(d) of the Code defines the term "aggregate tax benefit," a term used in section 507(c), as one means to measure the section 507(c) tax.

Chapter 42 of the Code imposes excise taxes on private foundations for net investment income under section 4940(a), acts of self-dealing under section 4941, undistributed income under section 4942(a), excess business holdings under section 4943(a), jeopardy investments under section 4944(a), and taxable expenditures under section 4945(a).

Section 4940 of the Code provides for the imposition of tax on the net investment income of private foundations.

Section 4941(a)(1) of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(E) of the Code states that "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.

Section 4942(a) of the Code imposes an annual tax on the undistributed income of a private foundation. It requires a private foundation to pay qualifying distributions, as defined in section 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 section 170(c)(2)(B).

Section 4942(g)(3) of the Code states that the term "qualifying distribution" includes a contribution to a section 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 distribution 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 section 501(c)(3) organization would be 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) of the Code imposes a 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.

Section 4944(c) of the Code states that, for purposes of this section, investments, the primary purpose of which is to accomplish one or more of the purposes described in section 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.

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

Section 4945(d)(4)(B) of the Code provides that 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 4945(h).

Section 4945(d)(5) of the Code provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation for any purpose other than the one specified in section 170(c)(2)(B).

Section 4945(h) of the Code provides that the "expenditure responsibility" referred to in subsection 4945(d)(4) means that the 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 4946(a) of the Code provides 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 a trustee).

Section 1.507-1(b)(6) of the regulations provides that after a transfer of all or part of a private foundation's assets to one or more private foundations pursuant to a transfer described in section 507(b)(2) of the Code and section 1.507-3(c), such transferor foundation will not have terminated its private foundation status under section 507(a)(1).

Section 1.507-1(b)(7) of the regulations provides that neither a transfer of all the assets of a private foundation nor a significant disposition of assets by a private foundation shall be deemed to result in a termination of the transferor private foundation under section 507(a) of the Code unless the transferor private foundation elects to terminate pursuant to section 507(a)(1) or 507(a)(2).

Section 1.507-3(a)(1) of the regulations states that in the case of a significant disposition of assets to one or more private foundations, within the meaning of paragraph (c) which describes a section 507(b)(2) of the Code 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 sections 1.507-3(a)(2), (3), and (4).

Section 1.507-3(a)(2)(i) of the regulations states, in part, that a transferee organization to which this paragraph applies shall succeed to the transferor's aggregate tax benefit within the meaning of section 507(d), in proportion to the assets transferred to each.

Section 1.507-3(a)(2)(ii) of the regulations provides that, notwithstanding subdivision 1.507-3(a)(2)(i), a transferee organization which is not effectively controlled (within the meaning of Section 1.482-1(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)(5) of the regulations provides that, except as provided in section 1.507-3(a)(9), a private foundation is required to meet the distribution requirements of section 4942 of the Code for any taxable year in which it makes a section 507(b)(2) transfer of all or part of its net assets to another private foundation. Such transfer shall itself be counted toward satisfaction of such requirements to the extent the amount transferred meets the requirements of section 4942(g).

Section 1.507-3(a)(8)(ii) of the regulations, as referenced to section 101(l)(3)(A) of the Tax Reform Act of 1969, provides that the provisions enumerated in subparagraphs (a) through (g) of this subdivision shall apply to the transferee private foundation with respect to the assets transferred to the same extent and in the same manner that they would have applied to the transferor private foundation had the transfer described in section 507(b)(2) of the Code not been effected.

Section 1.507-3(c)(1) of the regulations provides that, as used in section 507(b)(2) of the Code, the term "other adjustment, organization or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations.

Section 1.507-3(c)(2)(ii) of the regulations provides that the term "significant disposition of assets" means the transfer of 25% or more of the fair market value of net assets of the foundation at the beginning of the taxable year, which disposition may be made in a single year or in a series of related dispositions over more than one year.

Section 1.507-3(d) of the regulations provides that, unless a private foundation gives notice pursuant to section 507(a)(1) of the Code, a transfer of assets described in section 507(b)(2) will not constitute a termination of the transferor's private foundation status under section 507(a)(1).

Section 1.507-4(b) of the regulations provides that private foundations that make transfers described in section 507(b)(1)(A) or (2) of the Code are not subject to the termination tax imposed under section 507(c) with respect to such transfers unless the provisions of section 507(a) become applicable.

Section 53.4945-5(c)(2) of the Foundation and Similar Excise Tax Regulations ("foundation regulations") provides that, if a private foundation makes a grant described in section 4945(d)(4) of the Code to a private foundation which is exempt from taxation under section 501(a) for endowment, for the purchase of capital equipment, or for other capital purposes, the grantor foundation shall require reports from the grantee on the use of the principal and the income (if any) from the grant funds. The grantee shall make such reports annually for its taxable year in which the grant was made and the immediately succeeding 2 taxable years. Only if it is reasonably apparent to the grantor that, before the end of such second succeeding taxable year, neither the principal, the income from the grant funds, nor the equipment purchased with the grant funds, has been used for any purpose, which would result in liability for tax under section 4945(d), may the grantor then allow such reports to be discontinued.

Section 53.4945-6(a) of the foundation regulations states that the term "taxable expenditure" includes any amount paid or incurred by a private foundation for any purpose other than the one specified in section 170(c)(2)(B).

Section 53.4945-6(b)(2) of the foundation regulations provides that expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under section 4945(d)(5) of the Code 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 in such amounts was consistent with ordinary business care and prudence.

Section 53.4945-6(c) of the foundation regulations states that if a private foundation makes a transfer of assets pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization to any person, the transferred assets will not be considered used exclusively for purposes described in section 170(c)(2)(B) unless the assets are transferred to a fund or organization described in section 501(c)(3).

Section 53.4946-1(a)(8) of the foundation regulations states that, for purposes of section 4941 only, the term "disqualified person" shall not include any organization which is described in section 501(c)(3).

### Analysis

#### Ruling 1.

To be exempt under section 501(c)(3) of the Code, an organization must be organized and operated exclusively for exempt purposes. You and S are organized and operated to further exempt charitable purposes. You represent that the assets transferred to S will be used to further charitable purposes. You represent that you and S will remain organized and operated for section 501(c)(3) exempt purposes. Thus, your transfer of approximately one-half of your assets to S will not adversely affect the exempt status of you or S under section 501(c)(3).

#### Ruling 2.

Section 1.507-3(c)(1) of the regulations provides that a transfer of assets is described in section 507(b)(2) of the Code 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 section 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. A significant disposition of assets means a distribution where the aggregate value transferred is "...25 percent or more of the fair market value of the net assets of the foundation..." See section 1.507-3(c)(2). Since you are transferring more than 25 percent of the fair market value of your net assets to S, a private foundation, for no consideration, your proposed transfer is a significant disposition of assets that qualifies as a transfer under section 507(b)(2).

Regarding the termination of your private foundation status, section 507(a) of the Code provides that an exempt organization which is a private foundation can terminate its private foundation status only if it notifies the Service of its intent to terminate or, if it commits acts or failures to act giving rise to tax under Chapter 42, and if it pays the termination tax imposed by section 507(c) or has the tax abated. Since you have represented that you have neither notified the Service of any intent to terminate your private foundation status, nor have you committed acts or failures to act giving rise to a tax under Chapter 42, your proposed disposition of assets under section 507(b)(2) does not terminate your private foundation status and does not result in a termination tax imposed by section 507(c).

#### Ruling 3.

You have represented that, to the best of your knowledge, neither you nor S have 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 have represented that no distribution of your assets will be made to S until the rulings requested herein are granted. As such, since you have made the above representations, the transfer of one-half of your assets to S in accordance herein does not in and of itself constitute either a willful flagrant act (or failure to act) or one of a series of such acts giving rise to liability for tax under Chapter 42.

#### Ruling 4.

Section 1.507-3(a)(2)(ii) of the regulations provides that a transferee organization which is not effectively controlled, directly or indirectly, by the same person or persons who effectively control the transferor organization shall not succeed to the aggregate tax benefit in excess of the fair market value of the assets transferred at the time of the transfer. You have stated that your officers/directors will not be officers/directors of S nor is S otherwise effectively controlled by you. Therefore, after the transfer of assets by you to S, S will succeed to the aggregate tax benefits of transferor foundation in proportion to the net fair market value of the assets distributed under section 1.507-3(a)(2) of the regulations so long as the aggregate tax benefit is not in excess of the fair market value of the assets transferred at the time of the transfer.

#### Ruling 5.

Section 4940(a) of the Code 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 S, which lacks consideration, does not constitute a "sale or other disposition of property" that would generate capital gains subject to the excise tax under section 4940.

Section 1.507-3(a)(8)(ii) of the regulations states that transferees will succeed to the attributes related to transferred property to the same extent and in the same manner that would have applied to the transferor had the transfer not occurred. Therefore, the basis and holding period of the transferred assets will carry over to the transferee.

#### Ruling 6.

Whether the distribution of a portion of your assets to S in a section 507(b)(2) of the Code transaction will constitute an act of self-dealing, is governed under section 1.507-3(a) of the regulations and section 4941. Under section 4946 and section 53.4946-1(a)(8) of the foundation regulations, a "disqualified person" does not include an organization described in section 501(c)(3). Therefore, your transfer of assets to S is not an act of self-dealing because S has received a determination letter stating that it is a tax-exempt organization under section 501(c)(3).

#### Ruling 7.

Section 1.507-3(a)(5) of the regulations provides that a private foundation is required to meet the distribution requirements of section 4942 of the Code for any taxable year in which it makes a section 507(b)(2) transfer of all or part of its net assets to another private foundation. Such transfer shall itself be counted toward the satisfaction of such requirements to the extent the amount transferred meets the requirements of section 4942(g), which states that the term "qualifying distribution" includes a contribution to a section 501(c)(3) organization if the redistribution requirements are met. Therefore, the transfer of assets to an uncontrolled foundation offsets the distribution requirement if such foundation follows the redistribution requirements specified in section 4942(g)(3). Since you and S

are not controlled by the same persons, the proposed transfer offsets the distribution requirement if S follows the redistribution requirements specified in section 4942(g)(3).

#### Ruling 8.

Section 4944 of the Code imposes a tax on investments by private foundations which jeopardize their charitable purposes. Under section 4944(c), a transfer pursuant to section 507(b)(2) is not considered an investment for purposes of section 4944 if the transfer of assets was made for the purpose of accomplishing a charitable purpose. Because you will distribute approximately one-half of your assets to S for a charitable purpose, the transfer will not result in the imposition of tax for a jeopardy investment under section 4944.

#### Ruling 9.

Section 4945(a) of the Code imposes an excise tax on the taxable expenditures of a private foundation. A transfer is a taxable expenditure under section 4945(d)(4) unless the transferor complies with the expenditure responsibility requirements of section 4945(h). Your section 507(b)(2) transfer of assets to S is a grant to S for capital endowment purposes. Your transfer to S will not be considered a taxable expenditure as long as you exercise expenditure responsibility over the transfer in accordance with sections 4945(h) and 53.4945-5(c)(2).

#### Ruling 10.

Following section 53.4945-6(b)(2) of the foundation regulations, legal and other expenses incurred by you in preparation of this ruling request and with regard to the transfer, assuming 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, will not constitute taxable expenditures.

As to whether the legal, accounting and other expenses incurred with regard to the preparation of this ruling request and the transfer, section 4942(a) states that 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 section 170(c)(2)(B). Since you are incurring these expenses to accomplish exempt purposes, they will be qualifying distributions under section 4942 of the Code.

#### Ruling 11.

The change in your name after the proposed transfer of assets as described above will not result in the imposition of tax under Chapter 42 of the Code.

#### Conclusion

Accordingly, we rule that:

1. The proposed transfer of one-half of your assets to S will not adversely affect the section 501(c)(3) of the Code tax-exempt status of either you or S.
2. The proposed transfer of one-half of your assets to S will be a transfer under section 507(b)(2) of the Code and will not result in a termination of your private foundation status under section 507(a) of the Code and thus will not result in the imposition of the termination tax under section 507(c).

3. The proposed transfer 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) giving rise to liability for tax under Chapter 42 of the Code.
4. Upon your transfer of one-half of your assets to S, there will be a carryover proportionately of your aggregate tax benefits under section 507(d) of the Code and your tax attributes and characteristics as described in sections 1.507-3(a)(2), (3), and (4), so long as the aggregate tax benefit is not in excess of the fair market value of the assets transferred at the time of the transfer.
5. The proposed transfer of one-half of your assets will not give rise to net investment income or the imposition of tax under section 4940 of the Code, and there will be a carryover of tax basis and holding period of the assets as provided in section 1.507-3(a)(8)(ii) of the regulations.
6. The proposed transfer of one-half of your assets to S will not constitute an act of self-dealing under section 4941 of the Code.
7. The proposed transfer of one-half of your assets to S offsets your minimum distribution requirement if the redistribution requirements specified in section 4942(g)(3) of the Code are met.
8. The proposed transfer of one-half of your assets will not be considered a jeopardizing investment under section 4944 of the Code.
9. You must exercise "expenditure responsibility" for the transferred assets for the year of the transfer and the two succeeding tax years, unless it is apparent to you that, before the end of such second succeeding tax year, neither the principal nor income from the assets distributed in the transfer to S have been used for any purpose which would result in liability for tax under section 4945 or Chapter 42 of the Code.
10. With respect to the legal fees and filing fees incurred in the preparation of this ruling request, payment by you of a portion of such fees that reasonably represents the portion of this ruling request that is intended to protect you, will not be taxable expenditures under section 4945 of the Code and will be considered qualifying distributions under section 4942.
11. The transfer will not give rise to the imposition of excise taxes under Chapter 42 of the Code.

This rulings letter will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see the enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this rulings letter with deletions made, which we intend to make available for public inspection, is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This rulings letter is directed only to the organizations that requested it. Section 6110(k)(3) of the Code provides that this rulings letter may not be used or cited as precedent.

This rulings letter 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 this rulings letter could help to resolve any questions concerning your federal tax status, this rulings letter should be kept in your permanent records.

In accordance with the power of attorney in this case, we are sending a copy of this rulings letter to your tax representative.

Sincerely,

Ronald J. Shoemaker  
Manager, Exempt Organizations  
Technical Group 2

Enclosure: Notice 437

cc: