

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201603033**
Release Date: 1/15/2016

Third Party Communication: None
Date of Communication: Not Applicable

Index Number: 501.03-02, 507.06-00,
507.07-00, 4940.02-01, 4941.04-00, 4942.03-
05, 4944.05-00, and 4945.04-00.

Person To Contact: _____, ID No

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:EO3
PLR-T-103445-15

Date:
October 14, 2015

EIN:

Legend:

Foundation =
Transferee =

TY: Ending

Dear _____:

This is in response to the letter dated October 28, 2014, and additional submissions dated January 12, 2015, October 8, 2015, and October 14, 2015, in which Foundation's counsel requested on behalf of Foundation rulings under sections 501, 507, 4940, 4941, 4942, 4944, and 4945 of the Internal Revenue Code.¹

BACKGROUND

Based on the documents and representations submitted on behalf of Foundation, the relevant facts on which Foundation's request for rulings is based are as follows:

The Internal Revenue Service (IRS) has recognized Foundation as an organization described in section 501(c)(3) and classified it as a private foundation under section 509(a).

Foundation was established to assist in a family tradition of charitable giving. Foundation has eight directors who no longer agree on how to carry out Foundation's exempt purposes. Foundation's directors propose to transfer a portion of Foundation's

¹ The Internal Revenue Code of 1986, as amended, to which all subsequent "section" references are made unless otherwise indicated.

assets to Transferee for capital endowment purposes to enable Transferee to engage in charitable activities (the proposed transfer). The IRS has recognized Transferee as an organization described in section 501(c)(3) and classified it as a private foundation under section 509(a). After the proposed transfer, Foundation will engage in broad charitable activities. Foundation will continue to have the same eight directors, but five of those directors will also constitute the directors of Transferee.

Under the proposed transfer, Foundation will transfer approximately 78 percent of its total net assets, which consist of cash, money market funds, and publicly held securities, to Transferee for no consideration. Foundation represents that it will exercise expenditure responsibility over all assets transferred to Transferee. Foundation also represents that (i) it will not seek to terminate its private foundation status under section 507 and it will continue to operate for exclusively charitable purposes with the remaining share of its assets, (ii) it has never committed any willful, repeated acts (or failures to act) or committed a willful and flagrant act (or failure to act) giving rise to tax under chapter 42, (iii) Transferee is effectively controlled, directly or indirectly, by the same person or persons who effectively control Foundation as provided in Treas. Reg. Sec. 1.507-3(a)(2)(ii), and (iv) any legal, accounting, and other expenditures incurred in connection with the proposed transfer will be reasonable, necessary, and consistent with ordinary business care.

RULINGS REQUESTED, LAW, and ANALYSIS

Requested Rulings 1 and 2:

- 1. The proposed transfer from Foundation to Transferee will constitute a significant distribution of assets described in section 507(b)(2); and, solely for purposes of applying section 507(b)(2) and Chapter 42 to Foundation, the Transferee will not be treated as a newly created organization as a result of the proposed transfer of assets.*
- 2. The proposed transfer will not be described in section 507(a) and, therefore, will not result in the imposition of the termination tax under section 507(c) on Foundation.*

Section 507(c) imposes the so-called "termination tax" on a private foundation if the foundation is "referred to" in section 507(a). Section 507(a) provides that, except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if (1) it notifies the Secretary of its intent to accomplish such a 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 liability for tax under Chapter 42, and the Secretary notifies such organization that it is liable for the tax imposed by section 507(c), and either such organization pays the tax (or any portion not abated under section 507(g)) or the entire amount of such tax is abated under section 507(g).

Section 507(b)(2) provides that in the case of a transfer of assets of any private

foundation to another private foundation pursuant to any liquidation or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization. A transfer described in section 507(b)(2) is referred to as a "section 507(b)(2) transfer."

The exception in section 507(a) for what is "provided in subsection (b)" excludes section 507(b)(2) transfers from imposition of the termination tax. Accordingly, a transfer of assets described in section 507(b)(2) from one private foundation to another does not trigger the termination tax on the transferor private foundation if the transferee private foundation involved in the transfer "is not . . . treated as a newly created organization." This is explained in more detail in the applicable regulations. Treas. Reg. Sec. 1.507-3(a)(1) states that in the case of a transfer of assets described in section 507(b)(2), including a significant disposition of assets to one or more private foundations within the meaning of paragraph (c) of Treas. Reg. Sec. 1.507-3, the transferee organization will not be treated as a newly created organization. Similarly, Treas. Reg. Sec. 1.507-1(b)(6) provides that if a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in section 507(b)(2) and Treas. Reg. Sec. 1.507-3(c), such transferor foundation will not have terminated its private foundation status under section 507(a)(1).

Treas. Reg. Sec. 1.507-3(c)(1) describes the terms "other adjustment, organization, or reorganization" as including any significant distribution of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income. The term "significant disposition of assets to one or more private foundations" is defined by Treas. Reg. Sec. 1.507-3(c)(2) as any disposition or series of dispositions where the aggregate value transferred is 25 percent or more of the fair market value of the net assets of the transferor foundation at the beginning of the taxable year. Foundation will transfer approximately 78 percent of its net assets to Transferee. Foundation will not receive any consideration for the amounts transferred, and none of the amounts will be out of current income. Accordingly, Foundation's proposed transfer will constitute a significant disposition of assets that will qualify as a section 507(b)(2) transfer.

Treas. Reg. Sec. 1.507-4(b) provides, in part, that a private foundation that makes transfers described in section 507(b)(2) is "not subject to the tax imposed under section 507(c) with respect to such transfers unless the provisions of section 507(a) become applicable." Foundation has represented that it has not and will not notify the Secretary of any intent to terminate its status as a private foundation within the meaning of section 507(a)(1) and that it has not either committed willful repeated acts (or failures to act) or committed a willful and flagrant act (or failure to act) which gives rise to tax under Chapter 42 within the meaning of section 507(a)(2). Therefore, because the proposed transfer will be described in section 507(b)(2) and because Foundation will not give the notice described in section 507(a)(1) or be described in section 507(a)(2), Foundation's proposed transfer of assets to Transferee will not be described in section 507(a), and

Transferee will not be treated as a newly created organization for this purpose.

The conclusion that Transferee will not be treated as a newly created organization is reached herein only for purposes of responding to Foundation's request for the ruling that the proposed transfer will not subject Foundation to the tax imposed by section 507(c) because the transfer will be described in section 507(b)(2). Section 6110(j)(3) provides, in part, that unless "the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent." For this purpose, section 6110(b)(1)(A) provides that a "written determination" generally means "a ruling, determination letter, technical advice memorandum, or Chief Counsel advice." The request for rulings to which this letter is directed was submitted by Foundation, not by Transferee. Accordingly, Transferee may not use or cite this letter as precedent. See also, section 11.02 of Rev. Proc. 2015-1, 2015-1 I.R.B. 1, 59.

Requested Ruling 3: *The proposed transfer will be in furtherance of Foundation's section 501(c)(3) purposes.*

Section 501(a) exempts from federal income tax organizations that are described in section 501(c). Section 501(c)(3) describes organizations that are organized and operated exclusively for charitable and other designated exempt purposes. Organizations described in section 501(c)(3) must operate exclusively for an exempt purpose.

Revenue Ruling 64-182, 1964-1 C.B. 186, provides that a corporation organized exclusively for charitable purposes is entitled to exemption under section 501(c)(3) where it is shown to be carrying on through contributions and grants a charitable program commensurate in scope with its financial resources.

Foundation will transfer an amount equal to approximately 78 percent of the fair market value of its assets to Transferee, which is recognized by the IRS as being described in section 501(c)(3) and as being exempt under section 501(a). Foundation will continue to operate to further its exempt purposes following the proposed transfer of assets in a manner commensurate in scope with its remaining financial resources. Accordingly, Foundation's proposed transfer of assets will be in furtherance of its section 501(c)(3) purposes.

Requested Ruling 4: *The proposed transfer will not result in the production of investment income or a taxable sale or disposition of property and, thus, will not result in the imposition of tax under section 4940 on Foundation.*

Section 4940(a) 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 section 4940(c)(3). Section 4940(c)(2) provides, in part, that for purposes of section 4940, the term "gross investment income" means

the gross amount of income from interest, dividends, rents, payments with respect to securities loans, and royalties. Section 4940 does not define "capital gain net income." However, Treas. Reg. Sec. 53.4940-1(f)(1) provides, in relevant part, that in determining capital gain net income for purposes of the tax imposed by section 4940, there shall be taken into account only capital gains and losses from the sale or other disposition of property held by a private foundation for investment purposes.

In the context of applying sections 507(b)(2) and 4940 to a transfer of all of a private foundation's assets to one or more other private foundations, Rev. Rul. 2002-28, 2002-1 C.B. 941, states that section 507(b)(2) transfers do not constitute investments of the transferor for purposes of section 4940, and, therefore, the transfers do not give rise to net investment income subject to tax under section 4940(a). Foundation's proposed transfer of its assets to Transferee is similar to those in Rev. Rul. 2002-28, supra, in that it is a transfer described in section 507(b)(2).

Foundation proposes to distribute an amount equal to approximately 78 percent of the fair market value of its assets to Transferee. Foundation will not receive any form of consideration for the proposed transfer. Accordingly, the proposed transfer to Transferee will not result in the production of net investment income (including capital gains from a taxable sale or disposition of property) and will not result in the imposition of tax under section 4940 on Foundation.

Requested Ruling 5: *The proposed transfer will not constitute an act of self-dealing with respect to Foundation under section 4941.*

Section 4941(a)(1) imposes taxes on each act of self-dealing between a disqualified person and a private foundation. Taxes are imposed on both the self-dealers involved in an act of self-dealing and on any foundation managers who knowingly participate in an act of self-dealing. Even though section 4941 does not impose a tax on a private foundation when an act of self-dealing occurs, a foundation with respect to which there has been an act of self-dealing is required to report it to the IRS on its annual information return, which is the Form 990-PF in this case.

Section 4941(d)(1)(E) provides that the term "self-dealing" includes 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 4946(a)(1) defines the term "disqualified person." Treas. Reg. Sec. 53.4946-1(a)(8) provides that the term "disqualified person" does not include organizations that are exempt under section 501(c)(3). Thus, Transferee, by definition, will not be a "disqualified person" with respect to Foundation.

In Situation 1 in Rev. Rul. 2002-28, supra, P is recognized as exempt from federal income tax under section 501(c)(3) and is classified as a private foundation under section 509(a). Pursuant to a plan of dissolution, after satisfying all of its outstanding liabilities, P distributes all of its remaining assets in equal shares to X, Y, and Z. Rev.

Rul. 2002-28, states, in part, that the transfers in question are to section 501(c)(3) organizations, which are not treated as disqualified persons for purposes of section 4941. Rev. Rul. 2002-28 concludes that the transfers do not constitute self-dealing transactions and are not subject to tax under section 4941(a)(1).

Foundation's proposed transfer of assets to Transferee will not constitute an act of self-dealing, because Transferee is recognized by the IRS as an organization described in section 501(c)(3) and exempt from tax under section 501(a).

With respect to the request for a ruling this letter is directed to Foundation, and not to Transferee or any disqualified persons with respect to Foundation or Transferee. As previously stated, section 6110(j)(3) provides, in part, that unless "the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent." Accordingly, neither Transferee nor any disqualified persons with respect to Foundation or Transferee may use or cite this letter as precedent. See section 11.02 of Rev. Proc. 2015-1, supra, at 59.

Requested Ruling 6: The proposed transfer to Transferee may be counted toward the satisfaction of Foundation's minimum distribution requirement to the extent the amounts transferred meet the requirements of section 4942(g)(3).

Treas. Reg. Sec. 1.507-3(a)(5) provides that except as provided in Treas. Reg. Sec. 1.507-3(a)(9) (relating to section 507(b)(2) transfers in which all of the transferor's assets are transferred to one or more effectively controlled transferee private foundations), a private foundation is required to meet the distribution requirements of section 4942 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 a transfer itself will be counted toward satisfaction of those requirements to the extent the amount transferred meets the requirements of section 4942(g), including the recordkeeping requirements of section 4942(g)(3)(B).

In the case of a section 507(b)(2) transfer, Treas. Reg. Sec. 1.507-3(a)(3) provides that a substantial contributor to a transferor foundation will be treated as a substantial contributor to the transferee organization(s). Section 4946(a)(1)(B) provides that a foundation manager, such as a director, is a disqualified person with respect to the foundation. Accordingly, since all eight of the directors of Foundation are remaining as directors of Foundation and five of them are also directors of Transferee, a majority of Foundation's directors will be disqualified persons with respect to both of the private foundations involved in the proposed transfer. Moreover, Foundation has represented that Transferee is an effectively controlled organization. Thus, Transferee will be controlled by persons who are disqualified persons with respect to Foundation. Accordingly, the proposed transfer to Transferee will be treated as a qualifying distribution only to the extent that the requirements of section 4942(g)(3) are satisfied.

Section 4942(g)(1)(A) states, in part, that a “qualifying distribution” includes any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or disqualified persons with respect to the foundation or (ii) any private foundation that is not an operating foundation under section 4942(j)(3), except as provided in section 4942(g)(3). Transferee will not be an operating foundation.

Section 4942(g)(3) provides that the term “qualifying distribution” includes a contribution to (i) another charitable organization controlled directly or indirectly by the transferor foundation or one or more disqualified persons with respect to the transferor or (ii) a private non-operating foundation if two requirements are satisfied. The first such requirement is that the transferee organization satisfies certain “pass-through” requirements. See section 4942(g)(3)(A). The second requirement is that the transferor obtains adequate records or other sufficient evidence from the transferee organization(s) showing that the required pass-through distributions were made. See section 4942(g)(3)(B).

Accordingly, if Transferee makes qualifying distributions in the manner required by the pass-through rules of section 4942(g)(3)(A) and if Foundation obtains sufficient records to satisfy the recordkeeping requirements of section 4942(g)(3)(B), then Foundation may count as qualifying distributions those portions of the amounts distributed to Transferee that satisfy the requirements of section 4942(g)(3)(A) and (B).

Requested Ruling 7: *The proposed transfer will not result in the imposition of tax under section 4944 on Foundation.*

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.

Neither section 4944 nor the regulations thereunder define “invest” or “investment.” However, as mentioned previously in the context of section 4940, in the context of applying sections 507(b)(2) and 4944 to a transfer of all of a private foundation’s assets to one or more other private foundations, Rev. Rul. 2002-28, supra, states that section 502(b)(2) transfers do not constitute investments for purposes of section 4944.

Accordingly, the proposed transfer will not constitute an investment that jeopardizes Foundation’s exempt purposes and will not be subject to tax under section 4944(a)(1).

Requested Ruling 8: *The proposed transfer will not constitute a taxable expenditure under section 4945(d)(4), provided that Foundation exercises expenditure responsibility to the extent required by section 4945(h) with respect to the proposed transfer to Transferee, and will not result in the imposition of tax under section 4945.*

Section 4945(a) imposes a tax on each "taxable expenditure" of a private foundation. Section 4945(d)(4) provides that the term "taxable expenditure" includes any amount paid or incurred by a private foundation (such as, in this case, Foundation) as a grant to a private non-operating foundation (such as, in this case, Transferee) unless the grantor foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h).

Treas. Reg. Sec. 53.4945-4(a)(2) provides that for purposes of section 4945, the term "grants" includes such expenditures as "payments to exempt organizations to be used in furtherance of such recipient organizations' exempt purposes." The IRS has recognized Transferee as an organization described in section 501(c)(3) and classified as private foundation under section 509(a). Transferee is not an operating foundation.

Treas. Reg. Sec. 53.4945-6(c)(3) allows a private foundation to transfer its assets to exempt organizations described in section 501(c)(3), including private foundations, pursuant to section 507(b)(2), without the transfers being taxable expenditures under section 4945. However, Treas. Reg. Sec. 53.4945-6(c)(3) does not override the requirement under section 4945(d)(4) that grants to private, non-operating foundations be subject to the expenditure responsibility requirements of section 4945(h). Such an override is available under Treas. Reg. Sec. 1.507-3(a)(9) when the transfer of assets is a section 507(b)(2) transfer of all of the transferor's assets, but it is not available when the transfer does not constitute a transfer of all of the transferor's assets, as is the case here. Consequently, Foundation will have to exercise expenditure responsibility with respect to its grants to Transferee, including the proposed transfer of assets described in section 507(b)(2), to avoid liability for tax under section 4945.

Request Ruling 9: All Foundation's legal, accounting and other expenses related to this request for rulings and the associated asset transfer, if reasonable in amount, will be qualifying distributions for purposes of section 4942(g)(1)(A), and will not be taxable expenditures for purposes of section 4945.

Section 4942(g)(1)(A) and Treas. Reg. Sec. 53.4942(a)-3(a)(2)(i) provide, in part, that the term "qualifying distribution" means any amount, including "reasonable and necessary administrative expenses," paid to accomplish one or more purposes described in section 170(c)(1) or (2)(B). Section 170(c)(2)(B) lists the following purposes: "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." These purposes are the same as the purposes listed in section 501(c)(3). Thus, a grant by a private foundation to another organization described in section 501(c)(3) ordinarily is an amount paid to accomplish a purpose described in section 170(c)(2)(B) and may be considered to be a qualifying distribution.

Assuming that Foundation's legal, accounting, and other expenses incurred in

connection with this ruling request and with effecting the proposed transfer will be reasonable and consistent with ordinary business care and prudence and paid to accomplish one or more purposes described in section 170(c)(2)(B), such expenses will be considered qualifying distributions under section 4942.

Section 4945(a) imposes a tax on each "taxable expenditure" of a private foundation. Section 4945(d)(5) provides that the term "taxable expenditure" includes any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B). Treas. Reg. Sec. 53.4945-6(b)(2) provides that legal, administrative, and other expenses incurred by a private foundation are not taxable expenditures if 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. The determination whether an expenditure is reasonable depends upon the facts and circumstances of a particular case. Thus, Foundation's payment of reasonable legal, accounting, and other expenses relating to the creation of Transferee and the transfer of assets to it, assuming that Foundation can demonstrate ordinary business care and prudence, will not constitute taxable expenditures under section 4945.

RULINGS

Based on the foregoing, and assuming the accuracy of the facts and representations set forth herein, we rule as follows:

1. The proposed transfer from Foundation to Transferee will constitute a significant distribution of assets described in section 507(b)(2); and, solely for purposes of applying section 507(b)(2) and Chapter 42 to Foundation, the Transferee will not be treated as a newly created organization as a result of the proposed transfers of assets.
2. The proposed transfer will not be described in section 507(a) and, therefore, will not result in the imposition of the termination tax under section 507(c) on Foundation.
3. The proposed transfer will be in furtherance of Foundation's section 501(c)(3) purposes.
4. The proposed transfer will not result in the production of investment income or a taxable sale or disposition of property and, thus, will not result in the imposition of tax under section 4940 on Foundation.
5. The proposed transfer will not constitute an act of self-dealing with respect to Foundation under section 4941.
6. The proposed transfer may be counted toward the satisfaction of Foundation's minimum distribution requirement to the extent the amounts transferred meet the requirements of section 4942(g)(3).
7. The proposed transfer will not result in the imposition of tax under section 4944 on Foundation.
8. The proposed transfer will not constitute a taxable expenditure under section

4945(d)(4), provided that Foundation exercises expenditure responsibility to the extent required by section 4945(h), and will not result in the imposition of tax under section 4945.

9. All Foundation's legal, accounting, and other expenses related to this request for rulings and the associated asset transfer, if reasonable in amount, will be qualifying distributions for purposes of section 4942(g)(1)(A), and will not be taxable expenditures for purposes of section 4945.

The rulings contained in this letter are based upon information and representations submitted by or on behalf of Foundation (accompanied by a penalty of perjury statement executed by an individual with authority to bind Foundation) and upon the understanding that there will be no material changes in the facts. This office has not verified any of the material submitted in support of the request for rulings, and such material is subject to verification on examination.

No ruling is granted as to whether Foundation qualifies as an organization described in sections 501(c) or 509(a).

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 specifically described, and, except as expressly provided in this letter, no opinion is expressed or implied concerning the federal income tax consequences of any aspects of any transaction or item of income set forth above.

Because it could help resolve questions concerning federal income tax status, this ruling should be kept in Foundation's permanent records.

A copy of this letter must be attached to any tax return to which it is relevant. Alternatively, if Foundation files its return electronically, this requirement may be satisfied by attaching a statement to the return that provides the date and control number of this letter.

This ruling will be made available for public inspection under section 6110 after certain deletions of identifying information are made. For details, see the enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling, showing the deletions that we intend to make on the version that will be made available to the public, is attached to the Notice 437. If Foundation disagrees with our proposed deletions, it should follow the instructions in the Notice 437.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to each of Foundation's authorized representatives.

This letter is directed only to Foundation. Section 6110(k)(3) provides that it may not be used or cited as precedent by anyone else.

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

Sincerely,

Kenneth M. Griffin
Chief
Exempt Organizations Branch 3
(Tax Exempt & Government Entities)

Encl.: Notice 437, Notice of Intention to Disclose
Redacted copy of this letter

cc: