

Internal Revenue Service

Department of the Treasury

SIN 507.05-00; 4940.00-00;
4941.00-00; 4942.03-05;
4945.04-06

Washington DC 20224

199908052

No Third Party Contacts

Contact Person:

Telephone Number:

In Reference to: OP:E:EO:T:3

Date

NOV 24 1999

Legend:

X =
Y =

A =
B =
C =
D =

Dear Sir or Madam:

This refers to your rulings request concerning section 507(b)(2) of the Internal Revenue Code (the "Code").

X is exempt under section 501(c)(3) of the Code and a private foundation within the meaning of section 509(a). X was created by A and his two sons, B and C, who all served as its directors since creation.

In 1994, A died and D, the wife of B, was elected a director to fill the vacancy left by A's death. Shortly thereafter, B also died and the remaining directors amended the bylaws to specify that X would only have two directors. X's two directors were C and D who also were its President and Secretary/Treasurer, respectively.

C and D live in different states and the distance made it difficult for them to coordinate their efforts in managing X. As a result, they reorganized X by splitting it into two foundations each of which were run by the family of B and C.

Y was created under the reorganization with purposes substantially similar to those of X. X's articles of incorporation and bylaws are also essentially the same as or identical to those of Y. Y's sole director is C. Y has applied for, and was granted, recognition of exemption under section 501(c)(3) of the Code and classification as a private foundation under section 509.

Under the reorganization, X will transfer fifty percent (50%) of its assets to Y. C will resign as director of X and D will thereafter serve as X's sole director. Before C resigns, however, he and D will amend X's Bylaws to authorize X to be run by only one director.

X has not made any grants with respect to which it must exercise expenditure responsibility within the meaning of section 4945(h) of the Code.

Section 507(a)(1) of the Code provides that, except as provided in section 507(b), the status of an organization as a private foundation shall be terminated if the organization notifies the Secretary in the manner prescribed in the Income Tax Regulations of its intent to accomplish such termination and the organization either pays the tax imposed by section 507(c) (or any portion not abated under section 507(g)) or the tax is abated under section 507(g).

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 on each organization which terminates its private foundation status under section 507(a).

Section 1.507-1(b)(6) of the Income Tax Regulations (the "regulations") 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) of the Code, such transferor foundation will not have terminated its private foundation status under section 507(a)(1).

Section 1.507-3(a)(1) of the regulations provides that in the case of a significant disposition of assets to one or more private foundations within the meaning of paragraph (c) of this section, the transferee organization shall not be treated as a

214

newly created organization. A transferee organization to which this paragraph applies shall be treated as possessing those attributes and characteristics of the transferor organization which are described in subparagraphs (2), (3), and (4) of this paragraph.

Section 1.507-3(a)(2)(i) of the regulations provides that a transferee organization to which this paragraph applies shall succeed to the aggregate tax benefit of the transferor organization in an amount determined as follows: Such amount shall be an amount equal to the amount of such aggregate tax benefit multiplied by a fraction the numerator of which is the fair market value of the assets (less encumbrances) transferred to such transferee and the denominator of which is the fair market value of the assets of the transferor (less encumbrances) immediately before the transfer. Fair market value shall be determined as of the time of transfer.

Section 1.507-3(a)(2)(ii) of the regulations, provides that notwithstanding (i) of this subparagraph, 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 transfer.

Section 1.507-3(a)(4) of the regulations provides that if a private foundation incurs liability for one or more of the taxes imposed under Chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in section 507(b)(2) to one or more private foundations, in any case where transferee liability applies, each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor foundation does not satisfy such liability.

Section 1.507-3(a)(8)(ii) of the regulations provides that the provisions enumerated in subparagraphs (a) through (g) of this subdivision apply to a transferee foundation to the same extent and in the same manner as they would have applied to the transferor foundation had the transfer described in section 507(b)(2) not been effected.

Section 1.507-3(c)(1) of the regulations provides, in part, that a transfer of assets is described in section 507(b)(2) if it is made by a private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or

reorganization. The terms "other adjustment, organization, or reorganization" include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

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

Section 1.507-3(d) of the regulations provides that unless a private foundation voluntarily gives notice pursuant to section 507(a)(1), 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). Such transfer must, nevertheless, satisfy the requirements of any pertinent provisions of Chapter 42.

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

Section 4940(a) of the Code imposes on a private foundation with respect to the carrying on of its activities, a tax equal to 2% of its net investment income for the taxable year.

Section 4941(a) of the Code provides for the imposition of a tax on each act of self-dealing between a disqualified person and a private foundation.

Section 53.4946-1(a)(8) of the Foundation and Similar Excise Tax Regulations (also, the "regulations") provides that, for purposes of section 4941 only, the term "disqualified person" shall not include any organization which is described in section 501(c)(3) (other than an organization described in section 509(a)(4)).

Section 4942(a) of the Code provides, in part, for the imposition of a tax on the undistributed income of a private foundation.

Section 4942(c) of the Code provides, in part, that the term "undistributed income" means, with respect to any private foundation for any taxable year, the amount by which the distributable amount for such taxable year exceeds the qualifying

distributions made before such time out of such distributable amount.

Section 1.507-3(a)(5) of the regulations provides that, except as provided in subparagraph (9) of this paragraph, 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 transfer shall itself be counted toward satisfaction of such requirements to the extent the amount transferred meets the requirements of section 4942(g).

Section 4944(a) of the Code provides generally for the imposition of a tax on a private foundation and a foundation manager if investments are made in such a manner as to jeopardize the carrying out of the foundation's exempt purposes.

Section 4945(a) of the Code imposes a tax on each taxable expenditure (as defined in section 4945(d)) of the private foundation.

Section 4945(d)(4) of the Code provides that the term "taxable expenditure" means an 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 grants in accordance with section 4945(h) of the Code.

Section 53.4945-6(c)(3) of the regulations provides 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) (other than an organization described in section 509(a)(4)).

Section 53.4945-5(b)(7) of the regulations provides that for rules relating to the extent to which the expenditure responsibility rules contained in section 4945(d)(4) and (h) and this section apply to transfers of assets described in section 507(b)(2), see sections 1.507-3(a)(7), 1.507-3(a)(8)(ii)(f) and 1.507-3(a)(9).

Section 1.507-3(a)(7) of the regulations provides that except as provided in subparagraph (9) of this paragraph, where the transferor has disposed of all of its assets, during any period in which the transferor has no assets, section 4945(d)(4)

and (h) shall not apply to the transferee or the transferor with respect to any "expenditure responsibility" grants made by the transferor.

Section 1.507-3(a)(9)(i) of the regulations provides that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled, directly or indirectly, by the same person or persons which effectively controlled the transferor private foundation, for purposes of chapter 42 (section 4940 et seq.) and part II of subchapter F of chapter 1 of the Code (sections 507 through 509) such a transferee private foundation shall be treated as if it were the transferor. However, where proportionality is appropriate, such a transferee private foundation shall be treated as if it were the transferor in the proportion which the fair market value of the assets (less encumbrances) transferred to such transferee bears to the fair market value of the assets (less encumbrances) of the transferor immediately before the transfer.

The proposed transaction involves a significant disposition of assets within the meaning of section 1.507-3(c)(1) of the regulations. Accordingly, the proposed transfer is described in section 507(b)(2) of the Code and not subject to tax under section 507(c). Consistent with the provisions of section 507(b)(2) and the regulations promulgated thereunder, Y, the transferee, will not be treated as a newly created organization. Also, Y will be deemed to possess certain attributes and characteristics of X, the transferor, including being entitled to a pro-rata portion of X's aggregate tax benefit not exceeding the fair market value of the transferred assets at the time of the proposed transfer. In addition, and as long as Y will qualify for exemption under section 501(c)(3) of the Code, the transfer of X's assets to it will constitute a distribution for a charitable purpose and will be not be treated as an act of self-dealing, a jeopardizing investment or taxable expenditure within the meaning of sections 4941, 4944 and 4945.

Based on the foregoing, we rule, as requested, as follows:

1. Y will not be treated as a newly created organization for the purposes of Chapter 42 of the Code.
2. The transfer of fifty percent (50%) of X's assets to Y will not terminate X's private foundation status within the meaning of section 507 of the Code. Therefore, the transfer will not cause any section 507(c) tax to be imposed.

3. For the purposes of Chapter 42 and sections 507 through 509 of the Code, Y will be treated as if it was X in proportion that the fair market value of the assets (less encumbrances, if any) transferred to it bears to the fair market value of X's assets (less encumbrances, if any) immediately before the transfer.

4. The transfer of fifty percent (50%) of X's assets to Y will not constitute a taxable expenditure within the meaning of section 4945(d)(4) of the Code; however, X will need to exercise expenditure responsibility with respect to the transfer.

5. The distribution requirements imposed on X by section 4942 of the Code will apply to Y in the year of transfer and Y (i) will be responsible for reporting its equal share of undistributed income, and (ii) may reduce the amount of distributions it is required to make, pursuant to section 4942 of the Code, by its equal share of X's excess qualifying distribution carryover, if any, determined as of the end of the taxable year immediately preceding the taxable year of transfer.

6. The provisions of section 4940 of the Code will apply to Y in the year of transfer as if it was X. Therefore, Y will report its equal share of X's net investment income and pay any excise tax imposed by reason of section 4940(a).

7. The transfer of fifty percent (50%) of X's assets to Y will not constitute an act of self-dealing within the meaning of section 4941 of the Code, and X will not be a disqualified person with respect to Y for purposes of section 4941.

8. The transfer of fifty percent (50%) of X's assets to Y will not be treated as an investment that jeopardizes X's charitable purposes under section 4944 of the Code.

9. The provisions of section 1.507-3(a)(8)(ii)(a)-(g) of the regulations will apply to Y with respect to the assets that X transfers to it.

We are informing your Key District of this ruling. Please keep a copy of it in your permanent records.

21

199908052

Page 8

We express or imply no opinion as to the federal tax consequences of the transactions under any other provisions of the Code. This ruling is directed to the organization that requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited by others as precedent.

Sincerely,



Kenneth J. Earnest
Acting Chief,
Exempt Organizations
Technical Branch 3

22