

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

199929047

Date: APR 28 1999

Contact Person:

ID Number:

Uniform Issue List: 507.01-00
4945.04-06

Contact Number:

OP: E: EO: T: 2

Legend:

X =

Y =

Z =

Dear Sir or Madam:

This is in reply to your rulings request of November 19, 1997, and subsequent correspondence, concerning X's proposed transfers of all of its assets to Y pursuant to section 507(b)(2) of the Internal Revenue Code.

X is a domestic nonprofit corporation that is exempt from federal income tax under section 501(c)(3) of the Code and is a private foundation under section 509(a) of the Code.

Y is a foreign charitable foundation created and located in foreign nation Z. Y does not expect to apply for exemption from federal income tax under section 501(c)(3) of the Code but, having been created by the persons who control X, Y has an organizing document that limits its purposes, operations, and dissolution to charitable and educational purposes, that prohibits any private benefit or any inurement of its earnings to private persons, that allows no more than an insubstantial amount of influencing of legislation, and that prohibits any political activity.

While X and Y are controlled by the same persons, X will transfer all of its assets to Y by a series of grants over a period of three years. X's grants will be for Y's capital endowment in order to transfer X's funds to Y located in foreign nation Z where X and its directors have been conducting X's exempt activities since its creation. X will exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the Foundation and Similar Excise Taxes Regulations with respect to its grants to Y. After X's grants have been paid, X will dissolve under its state law and, when X has no assets, X will voluntarily terminate its private foundation status under section 509(a) of the Code by notice to the Internal Revenue Service pursuant to section 507(a)(1) of the Code.

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

Section 509(a) of the Code provides that certain organizations exempt from federal income tax under section 501(c)(3) of the Code are private foundations subject to the private foundation provisions of Chapter 42 of the Code.

252

Section 507(a)(1) of the Code allows a private foundation to voluntarily terminate its classification as a private foundation under section 509(a) of the Code by notifying the Internal Revenue Service and paying any termination tax due under section 507(c) of the Code.

Section 507(c) of the Code imposes excise tax on a private foundation that voluntarily terminates its status as a private foundation pursuant to section 507(a)(1) of the Code. This termination tax is equal to the lower of: (a) the aggregate tax benefits that have resulted from the foundation's exempt status under section 501(c)(3) of the Code, or (b) the value of the net assets of the foundation.

Section 507(b)(2) of the Code provides that, in a transfer of assets by one private foundation to another private foundation, the transferee foundation shall not be treated as a newly created organization.

Section 1.507-3(c)(1) of the Income Tax Regulations provides that a transfer under section 507(b)(2) of the Code includes a transfer of assets from one private foundation to another private foundation pursuant to any reorganization or liquidation, including a significant disposition of 25% or more of the transferor's assets.

Section 1.507-4(b) of the regulations provides that the tax on termination of private foundation status under section 507(c) of the Code does not apply to a transfer of assets pursuant to section 507(b)(2) of the Code.

Sections 1.507-1(b)(7) and 1.507-3(d) of the regulations provide that a transferor foundation's transfer of assets under section 507(b)(2) of the Code will not result in termination of the transferor foundation's status as a private foundation.

Section 1.507-3(a)(7) of the regulations provides that a private foundation that has transferred all of its assets to another private foundation in a transfer under section 507(b)(2) of the Code is not subject to the expenditure responsibility requirement of section 4945(h) of the Code.

Section 4945 of the Code imposes excise tax on a private foundation that makes any "taxable expenditure" as defined in section 4945(d) of the Code.

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

Section 4945(h) of the Code defines expenditure responsibility and provides that the grantor private foundation must make a pre-grant inquiry and require post-grant reports from the grantee private foundation as to the grantee's uses of the grant funds.

Section 53.4945-5(b)(2) of the Foundation and Similar Excise Taxes Regulations provides that the grantor private foundation must make a pre-grant inquiry of the grantee private foundation. Such pre-grant inquiry must be complete enough to give a reasonable person assurance that the grantee will use the grant funds for exempt purposes.

Section 53.4945-5(b) of the regulations provides that the grantor private foundation must require that its grant be subject to a written commitment, signed by an officer, director, or trustee of the grantee, which includes the grantee's agreement to repay any portion of the grant which is not used for the purposes of the grant, to submit complete annual reports on the manner in which the grant funds are spent and the progress made in accomplishing the purposes of the grant, to maintain records of receipts and expenditures, to make its books and records available to the grantor at reasonable times, and not to use any of the funds to carry on propaganda or otherwise attempt to influence legislation under section 4945(d)(1) of the Code, or to influence the outcome of any specific public election or to carry on directly or indirectly any voter registration drive under section 4945(d)(2), or to make any grant which does not comply with the requirements of sections 4945(d)(3) and 4945(d)(4), or to undertake any activity for any purpose other than ones specified in section 170(c)(2)(B). The grant agreement must specify the purposes of the grant, which can include contributing for the grantee's capital endowment, provided that neither the grant nor the income therefrom may be used for purposes other than those described in section 170(c)(2)(B) of the Code which includes charitable and educational purposes.

Section 53.4945-5(c)(2) of the regulations provides that, if a private foundation makes a grant to another private foundation for the grantee's endowment or for other capital purposes, the grantor private foundation must require reports from the grantee private foundation on the uses of the principal and the income, if any, from the grant funds. The grantee must make such reports annually for its tax year in which the grant was made and for its immediately succeeding two tax years. Only if it is reasonably apparent to the grantor, before the end of such grantee's second succeeding tax year, that neither the principal nor the income from the grant funds has been used for any purpose which would result in liability for tax under section 4945 of the Code, may the grantor then allow the grantee's reports to be discontinued.

Section 4945(d)(5) of the Code provides that a grant by a private foundation must be made for charitable, educational, or other exempt purposes in order not to be a taxable expenditure.

Section 53.4945-6(c)(3) of the regulations indicates that, for purposes of section 4945(d)(5) of the Code, when a private foundation transfers its assets to another foundation in a reorganization or liquidation pursuant to section 507(b)(2) of the Code, the transferor's assets must go to an organization described in section 501(c)(3) of the Code.

Analysis

Your requested rulings are discussed below:

1.

Under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations, X must exercise expenditure responsibility under those sections with respect to its grants to Y. Because X will exercise the required expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations, X's grants to Y, for Y's endowment for charitable and educational purposes described in section 501(c)(3) of the Code, will not be taxable expenditures by X under section 4945 of the Code.

2.

Under section 1.507-3(a)(7) of the regulations, after X has transferred all of its assets to Y, X will no longer be required to exercise expenditure responsibility under section 4945(h) of the Code.

3.

Section 507(c) of the Code imposes excise tax on a private foundation which voluntarily terminates its status as a private foundation under section 509(a) by notice to the Internal Revenue Service pursuant to section 507(a)(1) of the Code. This tax is equal to the lower of: (a) the aggregate tax benefits that have resulted from the foundation's exempt status under section 501(c)(3) of the Code, or (b) the value of the net assets of the foundation. After X has transferred all of its assets to Y, the value of X's assets will be zero and, thus, X's voluntary notice to the Service of its termination of its private foundation status pursuant to section 507(a)(1) of the Code will not result in termination tax under section 507(c) of the Code.

Accordingly, we rule that:

1. X's transfers of its assets to Y, by a series of grants over three years while X exercises expenditure responsibility on such grants under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations, will not be taxable expenditures under section 4945 of the Code.

2. After X has transferred all of its assets to Y, X will not be required to continue to exercise expenditure responsibility under section 4945(h) of the Code with respect to any of its grants to Y.

3. After X has transferred all of its assets to Y, X's notice to the Service to voluntarily terminate its private foundation status under section 509(a) of the Code pursuant to section 507(a)(1) of the Code will not result in termination tax under section 507(c) of the Code.

This ruling letter is based on the understanding that your expenditure responsibility under section 4945(h) of the Code on your grants will include meeting section 53.4945-(b)(5) of the regulations, which provides that, with respect to a grant to a foreign organization that is not considered described in section 509(a)(1), 509(a)(2), or 509(a)(3) of the Code, your grant terms agreement with the foreign grantee organization will be satisfied if the agreement imposes restrictions on the uses of your grants substantially equivalent to the limitations imposed on a domestic private foundation under section 4945(d) of the Code. Such restrictions may be phrased in appropriate terms under foreign law or custom, and ordinarily will be considered sufficient if an affidavit or opinion of counsel of the grantor or grantee is obtained stating that, under foreign law or custom, the grant agreement imposes restrictions on the uses of the grants substantially equivalent to the restrictions imposed on a domestic private foundation.

199929047

Because this letter could help to resolve any questions about your status, you should keep it in your permanent records.

This ruling letter is directed only to the organization that requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

~~(signed) Garland A. Carter~~

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2

256