

199940035

Department of the Treasury

Internal Revenue Service

Uniform Issue List

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply to:

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Employer Identification Number:

Key District:

Legend:

- B =
- C =
- D =
- E =
- F =
- M =
- N =
- O =

Dear Applicant:

This is in response to the ruling requests contained in your letter dated January 12, 1999, as amended by your FAX communication dated June 25, 1999.

M was incorporated in 1997 on a nonprofit basis under the laws of the State of N. M's purpose is to make grants to tax exempt public charities. Following the submission of an exemption application, the Service has determined that M is tax exempt under section 501(c)(3) of the Internal Revenue Code and has also classified M as a private foundation under section 509(a).

You have submitted a detailed list of M's assets as of September 30, 1998. None of the assets are encumbered. M has no liabilities, other than certain pledges to contribute to various charities. Presently, M has no grants outstanding that require it to exercise expenditure responsibility within the meaning of section 4945(h) of the Code.

M's Trustees are B, C, D, and E. B and C were husband and wife when M was established. D is B's brother. E is C's sister.

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O was created in 1998 as an N nonprofit organization whose purpose is to make grants to tax exempt public charities. Following the submission of an exemption application, the Service has determined that O is tax exempt under section 501(c)(3) of the Code and that it is a private foundation under section 509(a).

Presently, O has neither assets nor liabilities. It does not have any grants outstanding that require the exercise of expenditure responsibility within the meaning of section 4945(h) of the Code. However, upon completion of the asset transfer described below, O will receive approximately one-half of the net assets of M, with which it will then conduct its activities.

The Trustees of O are C, E, and F. F is the brother of C and E.

B and C divorced during 1998. In connection with their divorce they agreed that approximately one-half of the net assets of M should be transferred to O. This transfer will be made without any consideration being paid by O to M. After the proposed asset transfer, M will continue in existence with the remaining one-half of its net assets.

Upon completion of the proposed asset transfer, C and E will resign as Trustees of M, with B and D remaining as Trustees. C, E, and F will continue as Trustees of O.

The proposed asset transfer will be made in accordance with the Plan of Reorganization adopted by M and O, a copy of which you have attached to the ruling request. The transfer of assets from M to O will be referred to in this letter as the "Proposed Transfer."

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.

The meaning of the terms "liquidation, merger, reorganization, redemption, and recapitalization" is determined by the law of the State in which the private foundation was incorporated or otherwise formed.

Section 1.507-3(c)(1) of the Income Tax Regulations provides in part that "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, other than transfers for full and adequate consideration or distributions out of current income."

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Section 1.507-3(c)(2) of the regulations provides that, generally, a "significant disposition of assets" occurs where the aggregate dispositions to one or more private foundations for the taxable year is 25% or more of the fair market value of the net assets of the transferor at the beginning of the taxable year.

Section 1.507-1(b)(6) of 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) and section 1.507-3(c), such transferor foundation will not have terminated its private foundation status under section 507(a)(1). Section 1.507-3(d) provides that unless a private foundation voluntarily gives notice of termination 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). Further, section 1.507-4(b) provides that a private foundation which makes a section 507(b)(2) transfer 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.

Section 507(a) of the Code provides that, except as provided in section 507(b), a private foundation can terminate its private foundation status only if it notifies the Service of its intent to terminate (voluntary termination) or it commits willful repeated acts (or failure to act) or a willful and flagrant act (or failure to act) giving rise to liability under Chapter 42 and is notified that it is liable for the termination tax imposed under section 507(c) and the foundation pays the tax imposed by section 507(c) or such tax is abated.

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), the transferee organization shall be treated as possessing those attributes and characteristics of the transferor organization which are described in subparagraphs (2), (3), and (4) of that paragraph.

Section 1.507-3(a)(2)(i) of the regulations provides, in part, that a transferee organization to which this paragraph applies shall succeed to the aggregate tax benefit of the transferor organization.

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, within the meaning of section 1.482-1(a)(3), 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

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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.

Section 1.482-1(a)(3) of the regulations provides that the term "controlled" includes any kind of control, direct or indirect, whether legally enforceable or not, and however exercisable or exercised, including control resulting from the actions of two or more taxpayers acting in concert. It is the reality of the control that is decisive, not its form or the mode of its exercise.

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) of the Code 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)(5) of the regulations provides that, except as provided in subparagraph (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)(7) of the regulations provides that, except as provided in subparagraph (9), where the transferor has disposed of all its assets, during any period in which the transferor has no assets, Code 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. However, the exception contained in this subparagraph shall not apply with respect to any information reporting requirements imposed by section 4945 and the regulations thereunder for any year in which any such transfer is made.

Section 1.507-3(b) of the regulations provides that a transfer of assets pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization will not be treated as a taxable expenditure under section 4945(d)(5) of the Code if made to a section 501(c)(3) organization (other than an organization described in section 509(a)(4) or treated as described in section 501(c)(3) under section 4947).

Section 4940(a) of the Code imposes a 2 percent excise tax on the net investment income of a private foundation for each taxable year.

Section 4941(a) of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation. The initial taxes are to be paid by the disqualified person who participates in the act of self-dealing, and any foundation manager who knowingly participates in the act of self-dealing.

Rev. Rul. 82-136, 1982-2 C.B. 300, holds that a grant by one private foundation to another private foundation did not constitute an act of self-dealing even though a single banking institution was the sole trustee of both foundations and, as such, was a disqualified person. Any benefit received by the trustee is considered merely incidental to the granting foundation's use of its funds for a charitable purpose.

Section 4942(a) of the Code imposes an excise tax on the undistributed income of a private foundation. Section 4942(c) 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 distribution made before such time out of such distributable amount.

Section 4942(g)(1)(A) of the Code provides 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)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons with respect to the foundation, except as provided in paragraph (3); or (ii) a private foundation which is not an operating foundation (as defined in subsection (j)(3)), except as provided in paragraph (3).

Section 53.4942(a)-3(e) of the Foundation and Similar Excise Taxes Regulations provides that excess qualifying distributions may be carried over and used to reduce the private foundation's minimum distribution requirement for any subsequent taxable year within the specified five-year adjustment period.

Rev. Rul. 78-387, 1978-2 C.B. 270, poses the question of whether, for purposes of section 4942(i) of the Code, a transferee private foundation may reduce its "distributable amount" (as defined in section 4942(d)) by the excess qualifying distributions carryover of a transferor private foundation. Under the facts, the transferor foundation is controlled, within the meaning of section 1.482-1(a)(3) of the regulations, by the same persons who control the transferee foundation.

Rev. Rul. 78-387 states that because the two private foundations are controlled by the same persons, the transferee foundation shall be treated as if it were the transferor foundation,

pursuant to section 1.507-3(a)(9)(i) of the regulations. Accordingly, for purposes of determining its distribution requirements under section 4942 of the Code, the transferee private foundation may reduce its distributable amount by the excess qualifying distributions carryover of the transferor foundation.

Section 4943(a)(1) of the Code imposes an annual tax on the value of a private foundation's excess holdings in a business enterprise.

Section 4944(a) of the Code imposes a tax on investments made by a private foundation which jeopardizes the carrying out of its 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. The tax is imposed on the private foundation that makes the expenditure and the foundation manager who agreed to the making of the expenditure knowing that it is a taxable expenditure. Section 4945(d)(4) 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). Under section 4945(d)(5), the term "taxable expenditure" is also defined to mean an amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B).

Section 53.4945-6(c)(3) of the regulations provides that a transfer of assets of a private foundation under section 507(b)(2) of the Code is not a taxable expenditure if such transfer is to an organization described in section 501(c)(3).

Section 53.4945-5(c)(2) of the regulations provides that if a private foundation makes a grant described in Code section 4945(d)(4) to a tax exempt private foundation 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 two 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), the grantor may then allow such reports to be discontinued.

Section 4946(a)(1)(B) of the Code provides that the term "disqualified person", with respect to a private foundation, includes a foundation manager, which term is defined in section 4946(b)(1) to mean an officer, director, or trustee of a foundation.

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Section 53.4946-1(a)(8) of 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)).

The Proposed Transfer involves the transfer of one-half of the net assets of M to O, a newly created private foundation which will be effectively controlled by two individuals who are also trustees of M. The Proposed Transfer will be treated as a significant disposition of assets to another private foundation within the meaning of section 1.507-3(c)(1) of the regulations. Accordingly, the transaction is described in section 507(b)(2) of the Code and will not be subject to tax under section 507(a), but will instead be treated as an adjustment between private foundations within the contemplation of section 507(b)(2). Further, O is considered to be controlled by the same persons who effectively control M. Therefore, O will be treated as if it were the transferor pursuant to section 1.507-3(a)(9)(i).

The Proposed Transfer of assets will not be treated as gross investment income or capital gain net income. Further, it does not represent any interest, dividend, rent, securities loan payment or royalty. Also, the Proposed Transfer is not a gain or loss from the sale of property used to produce the above types of income. Inasmuch as the Proposed Transfer does not generate any investment income, it will not result in the imposition of tax under section 4940 of the Code.

O has been recognized by the Service as tax exempt under section 501(c)(3) of the Code. As such, it will be treated as a disqualified person for purposes of section 4941; see section 53.4946-1(a)(8) of the regulations. Accordingly, the transfer of assets from M to O pursuant to the Proposed Transfer will not constitute an act of self-dealing under section 4941.

Inasmuch as O is tax exempt under section 501(c)(3) of the Code, the Proposed Transfer of assets from M to O will constitute a qualifying distribution if the provisions of section 4942(g)(3)(B) are satisfied, will not be considered a jeopardizing investment under section 4944, and will not be treated as a taxable expenditure under section 4945(d)(5). With respect to the latter, see section 53.4945-6(c)(3) of the regulations.

Based on the foregoing, we rule as follows in response to your various ruling requests:

1. The Proposed Transfer will constitute a significant disposition of assets to a private foundation within the meaning of sections 1.507-3(a)(1) and (c) of the regulations.

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2. The Proposed Transfer will not result in the termination of M's private foundation status within the meaning of section 507(a) of the Code, but instead will constitute an adjustment between private foundations within the contemplation of section 507(b)(2).

3. The Proposed Transfer will not constitute a notification of M's intent to terminate its status as a private foundation under section 507(a)(1) of the Code or willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) within the meaning of section 507(a)(2) by M. Therefore, M will not be liable for the tax imposed by section 507(c).

4. Pursuant to section 507(b)(2) of the Code and section 1.507-3(a)(1) of the regulations, O, the transferee private foundation, will not be treated as a newly created organization.

5. Pursuant to section 1.507-3(a)(1) of the regulations, O, as a transferee private foundation, will be treated as possessing the attributes and characteristics of M that are described in sections 1.507-3(a)(2), (3), and (4) of the regulations.

6. Inasmuch as the Proposed transfer will be treated as an "other adjustment" pursuant to section 507(b)(2) of the Code, it does not constitute a sale or other disposition within the meaning of section 4940(c)(4)(A).

7. Pursuant to section 1.507-3(a)(8)(ii)(a) of the regulations, Code section 4940(c)(4)(B) and the regulations thereunder will apply to O with respect to the assets received from M as a result of the Proposed Transfer to the same extent and in the same manner that they would have applied to M had the transfer described in section 507(b)(2) not been effected.

8. The Proposed Transfer from M to O will not constitute an act of self-dealing within the meaning of section 4941 of the Code because section 53.4946-1(a)(8) of the regulations provides that, for purposes of self-dealing, a section 501(c)(3) organization is not a disqualified person. Further, pursuant to the holding in Rev. Rul. 82-136, 1982-2 C.B. 300, the Proposed Transfer from M to O will not constitute an act of self-dealing within the meaning of section 4941 by any of its foundation managers, as defined by section 4946.

9. The Proposed Transfer will not subject M to any tax liability for a failure to distribute income under section 4942 of the Code, provided that the requirements of section 4942(g)(3) are met.

10. Inasmuch as M is receiving no assets as a result of this transfer, the transfer would not subject M to the tax on excess business holdings imposed by section 4943 of the Code.

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11. The Proposed Transfer will not be treated as a jeopardizing investment within the meaning of section 4944 of the Code because it will be carried out in accordance with section 507(b)(2).

12. The Proposed Transfer of assets under section 507(b)(2) of the Code by M to O will not constitute a taxable expenditure under section 4945(d) as long as the requirements of section 53.4945-5(c)(2) of the regulations are met.

13. Pursuant to section 53.4945-5(c)(2) of the regulations, M will be required to exercise expenditure responsibility under Code section 4945(h) for the year of the transfer and the two immediately succeeding taxable years. After this period, M will no longer be required to exercise expenditure responsibility for the assets transferred to O.

14. The legal, accounting, and other expenses incurred by M and O in connection with this ruling request and in carrying out the Proposed Transfer will not constitute taxable expenditures under section 4945 of the Code pursuant to section 53.4945-6(b)(1)(v) of the regulations. Therefore, these expenses will be considered as qualifying distributions under section 4942.

15. Inasmuch as the Proposed Transfer will be made pursuant to section 507(b)(2) of the Code, it will not affect the section 501(c)(3) status of M or O.

16. O will be deemed to be controlled, directly or indirectly, by the same persons who control M within the meaning of section 1.507-3(a)(9) of the regulations.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon your tax status should be reported to your key District Director.

We are sending a copy of this ruling to your key District Director for exempt organizations matters. Because this letter could help resolve any questions about your tax status, you should keep it with your permanent records.

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.

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

Thank you for your cooperation.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4

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