Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Contact Person:

Telephone Number:

In Reference to:
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Significant Index Nos.
507.00-00
4940.00-00
4941.00-00
4942.00-00
4943.00-00
4944.00-00
4945.00-00

Legend:
M=
N=
O=
P=
R=
S=
T=
U=
V=
W=
X=
Y=

Dear Sir or Madam:

This is in response to M's request for certain rulings under sections 507, 4940, 4941, 4942, and 4945 of the Internal Revenue Code (hereafter Code).

M has been recognized exempt under section 501(c)(3) of the Code and classified as a private foundation under section 509(a). M was established by a bequest from its founder W, now deceased. M's purposes include using its funds for charitable, scientific, literary, educational, or religious purposes within the meaning of section 501(c)(3) of the Code. M's trustees are R, S, T, U, and V. S, T, and U are the children of W, M's founder. M's governing body also includes three members.

N, O, and P have been recognized as exempt under section 501(c)(3) of the Code and classified as private foundations under section 509(a). N, O, and P are organized and operated exclusively for charitable, educational, literary, or scientific purposes within the meaning of section 501(c)(3).

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M proposes to transfer all (100%) of its assets in equal amounts to N, O, and P. M proposes to wind up its operations and terminate after the transfer of assets has been completed. M states that it may or may not have met the distribution requirements of section 4942 of the Code in the year of its liquidation transfers or the immediately previous year.

R, T, V, and X will serve as the initial trustees for N. After the transfer of assets and liquidation of M, R and V will resign as trustees of N. T and X will serve as the sole trustees of N after M's liquidation and the transfer of assets has been completed.

R, S, and V will serve as the directors for O. After the transfer of assets and liquidation M has been substantially completed, R and V will resign as directors of O. S serves as O's president and will name the successor directors.

P's board of directors is composed of six persons. The directors for P include U and Y, who are the only directors for P who are permitted under P's organizing document to serve an unlimited number of successive terms. Y serves as P's president.

M states that the members of its board of directors have determined to pursue courses of charitable giving independently of one another. As indicated above, in order to accomplish these objectives M's board proposes to transfer all of M's assets (100 percent) to Foundations N, O, and P, in equal amounts, each of which represents the separate philanthropic interests of the family member trustees.

M states that it will effectively terminate its private foundation status and corporate existence after the transfer of assets is completed. M will provide the notice described in section 507(a) of the Code of its intent to terminate its private foundation status after the transfer is completed. M states that it has no pre-existing charitable pledges or grants which require the exercise of expenditure responsibility described in section 4945(h).

Section 507(a) of the Code provides that, except as provided in section 507(b), the status of any private foundation shall be terminated only if such organization notifies the Secretary of its intent to accomplish such termination or, with respect to such organization, there have been either willful or repeated acts or a willful and flagrant act, giving rise to liability for tax under Chapter 42, and the Secretary notifies the organization that because of such act the organization is liable for the tax imposed by section 507(c), and either the organization pays the

tax or the entire amount of 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 an excise tax on each terminating private foundation equal to the lower of the aggregate tax benefit resulting from such termination or the value of its net assets.

Section 507(e) of the Code provides that, for purposes of section 507(c), the value of the net assets shall be determined at whichever time such value is higher: (1) the first day on which action is taken which culminates in its ceasing to be a private foundation or (2) the date on which it ceases to be a private foundation.

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

Section 4941(d)(1)(E) of the Code states that the term "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 excise tax on the undistributed income of a private foundation for any taxable year which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year (if such first day falls within the taxable period as defined in paragraph (c)(1) of this section). For purposes of section 4942 the term "distributed" means distributed as qualifying distributions under section 4942(g).

Section 4943(a) of the Code imposes an excise tax on the excess business holdings of a private foundation.

Section 4943(c)(1) of the Code states that "excess business holdings" means, with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the enterprise which the foundation would have to dispose of to a person other than a disqualified person in order for its remaining holdings in the enterprise to be permitted holdings.

Section 4944(a)(1) of the Code imposes a tax on a private foundation that invests any amount in such manner as to jeopardize the carrying out of any of its exempt purposes.

Section 4945(d)(4) 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 such organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation, or the private foundation exercises expenditure responsibility with respect to such grant.

Section 4945(d)(5) of the Code provides that the term "taxable expenditure" does not include amounts paid or incurred by a private foundation as a grant to another organization for purposes specified in section 170(c)(2)(B).

Section 4945(h) of the Code provides that the expenditure responsibility referred to in subsection (d)(4) means that the private foundation is responsible to exert all reasonable efforts 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)(1) of the Code provides, in part, that 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 4946(a)(1)(B) of the Code defines a disqualified person to include with respect to a private foundation a foundation manager.

Section 4946(b)(1) of the Code states that the term foundation manager includes a trustee of a foundation having authority or responsibility over the activities of the foundation.

Section 1.507-3(c)(1) of the Income Tax Regulations (hereafter regulations) provides that for purposes of section 507(b)(2) of the Code, 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 the term "significant disposition of assets to one or more private foundations" shall include any disposition for a taxable year where the aggregate of the dispositions to one or more private foundations for the taxable year, is 25 percent 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(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 newly created organization. A transferee organization to which this paragraph applies shall be treated as possessing those attributes and characteristics of the transferor organization.

Section 1.507-3(a)(2)(i) of the regulations provides that a transferee organization to which section 507(b)(2) of the Code applies shall succeed to the aggregate tax benefit of the transferor organization in an amount equal to the amount of 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 of the assets of the transferor (less encumbrances) immediately before the transfer. Fair market value shall be determined as of the time of the transfer.

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). However, where the transferor has disposed of all of its assets, the recordkeeping requirements of section 4942(g)(3)(B) shall not apply during any period in which it has no assets. Such requirements are applicable for any taxable year other than a taxable year during which the transferor has no assets.

Section 1.507-1(b)(9) of the regulations provides that a private foundation which transfers all of its net assets is required to file the annual information return required by section 6033, and the foundation managers are required to file the annual report of a private foundation required by section 6056, for the taxable year in which such transfer occurs. However, neither such foundation nor its foundation managers will be required to file such returns for any taxable year following

the taxable year in which the last of any such transfers occurred, if at no time during the subsequent taxable years in question the foundation has either legal or equitable title to any assets or engages in any activity.

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. 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(d) of the regulations provides that unless a private foundation gives notice under 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.

Section 1.507-3(a)(8)(ii) of the regulations provides that the provisions enumerated in subparagraphs (a) through (g) apply to a transferee foundation to the same extent and in the same manner that they would have applied to the transferor foundation had the transfer described in section 507(b)(2) of the Code not been effected. In particular section 1.507-3(a)(ii)(a) refers to the rules for determining the basis of property pursuant to section 507.

The transfer of all of M's assets to Foundations N, O, and P under the circumstances described will constitute a transfer as described in section 507(b)(2) of the Code. Therefore, N, O, and P will not be treated as newly created organizations. The transfer does not constitute a willful or flagrant act described in section 507(b)(2). Assuming M has no assets at the time M notifies the Secretary of intention to terminate its private foundation status, there will be no tax imposed under section 507(c).

N, O, and P, as transferee foundations, will be treated as possessing those attributes and characteristics of M, the transferor, pursuant to section 1.507-(3)(a)(1) of the regulations. Therefore, N, O, and P will each be treated as if they were M for purposes of the Chapter 42 excise tax provisions and sections 507 and 509(a) in the proportion which the net fair market value of the transferred assets bears to the net fair

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market value of all of M's assets immediately before the transfers. N, O, and P will each receive one-third of all of M's assets pursuant to the transfer. Therefore, N, O, and P will each succeed to one-third of M's tax attributes under Chapter 42, including sections 4940 through 4945, and sections 507 and 509.

M will transfer all of its assets to N, O, and P. Because N, O, and P are described in section 501(c)(3) of the Code, they are not disqualified persons with respect to M, pursuant to section 4946(a)(1) of the Code. Therefore, the transfers will not constitute an act of self-dealing within the meaning of section 4941 of the Code.

The assets transferred from M to N, O, and P do not constitute the operation of a business enterprise within the meaning of section 4943(d)(3) of the Code. Therefore, M, N, O, and P will not be subject to the tax imposed on excess business holdings under section 4943.

Assets transferred by M to N, O, and P will be transferred pursuant to a plan of liquidation under section 1.507-3(c)(1) and (2) of the regulations. The transfer of assets constitute transfers described in section 507(b)(2) of the Code and are, therefore, not considered investments for purposes of the tax on jeopardy investments imposed by section 4944.

The transferee private foundations will use the assets transferred from M to accomplish charitable purposes described in sections 501(c)(3) and 170(c)(2)(B) of the Code. Therefore, the transfer of assets by M will not be considered a taxable expenditure described in section 4945(d)(5) pursuant to section 1.507-3(a)(5) of the regulations. Since M has no obligations or existing grants for which it has to exercise expenditure responsibility, M will not be required to exercise expenditure responsibility as described in section 4945(h) of the Code during any period in which it has no assets pursuant to section 1.507-3(a)(7) of the regulations (that is, for any year after the year of transfer).

M has not given notice of a termination of private foundation status pursuant to section 507(a)(1) of the Code. Therefore, the transfer of all of M's assets to N, O, and P will not terminate M's status as a private foundation under section 507(a)(1) and for purposes of the tax imposed by section 507(c). M will be required to file the annual information return required by 6033 pursuant to section 1.507-1(b)(9) of the regulations after the transfer of all of its assets to N, O, and P. In addition, M's foundation managers are required to file the annual report of a private foundation required by section 6056, for the

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taxable year in which such transfer occurs. However, pursuant to section 1.507(b)(9) of the regulations, neither M nor its foundation managers will be required to file such returns for any taxable year following the taxable year in which the last of any such transfers occurred, if at no time during the subsequent taxable years in question the foundation has either legal or equitable title to any assets or engages in any activity.

Based on the above we rule as follows:

1. The transfer of all of M's assets to N, O, and P, as described above constitutes a transfer described in section 507(b)(2) of the Code.

2. As a transfer described in section 507(b)(2) of the Code, the proposed transaction will not result in a termination of M's private foundation status under section 507(a), and therefore will not cause the imposition of the termination tax under section 507(c).

3. When M notifies the Service after the transfer of all of its assets to N, O, and P that it intends to terminate its private foundation status pursuant to section 507(a)(1), no tax under section 507(c) will be imposed on M.

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

5. Since 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, N, O, and P.

6. The proposed transfer will not constitute a willful and flagrant act (or failure to act) giving rise to liability for tax under Chapter 42.

7. N, O, and P will succeed to one-third of M's aggregate tax benefit, but, in any event, none of the foundations will succeed to an aggregate tax benefit in excess of the fair market value at the time of the transfer of the assets that the respective foundations receive under Section 1.507-3(a)(2)(ii) of the regulations because N, O and P are not effectively controlled by the same persons who control M.

8. For purposes of the Chapter 42 private foundation excise tax provisions and sections 507 through 509, N, O, and P will each be treated as if it is M, but only in the proportion

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which the net fair market value of the assets transferred to each of the organizations bears to the net fair market value of all of M's assets immediately before the transfers. Since each of the Successor Foundations will receive one-third of all of M's assets, N, O and P will each succeed to one-third of M's tax attributes under Chapter 42 and sections 507 through 509 including the following:

a. For purposes of section 4940, one-third of the net investment income of M for the taxable year of the transfers to N, O and P will be apportioned to N, O and P and will be includable in the computation of the net investment income of N, O and P in the taxable year of the transfers. N, O, and P will each be entitled to appropriate credits for estimated payments of the tax imposed by section 4940 which have been made by M and for any overpayments of such tax paid.

b. The transfers to N, O, and P will not be realizable events giving rise to net investment income pursuant to section 4940(c)(1). Therefore, such transfers themselves will not give rise to tax under section 4940.

c. N, O, and P will each be responsible for satisfying one-third of M's section 4942 distribution requirement for its taxable year in which the transfers are made to the extent that such distribution requirements have not fully been satisfied as of the transfers to N, O and P. In the event that there remains any undistributed income for M's taxable year immediately preceding the taxable year of the transfers by M, one-third of such remaining undistributed income will be allocated to N, O, and P. N, O, and P must distribute their allocable one-third share of such remaining undistributed income not later than the end of their taxable year in-which the transfer is made to them by M. For purposes of section 4942 of the Code, N, O, and P may reduce their respective distributable amount by their share of any excess qualifying distribution carryover of M.

d. For purposes of determining the assumed distribution requirement responsibilities of N, O, and P for M's taxable year of the transfers, one-third of the value of M's assets (calculated on a monthly basis as of the end of each calendar month falling within the taxable year of the transfers from M and then expressed as a monthly average) will be attributed to N, O, and P. N, O, and P will each be deemed to have held net assets

equal to one-third of such monthly average as of the last day of the each month during the Successor Foundations' taxable year of the transfers extending through the last day of the month immediately preceding the transfer. Appropriate adjustments will be made if transfers are made during more than one month.

9. The proposed transfer of M's assets to N, O, and P will not constitute self-dealing under section 4941 and will not subject M, N, O, and P, or any foundation manager of M, N, O, and P to tax under section 4941.

10. The proposed transfer of M's assets to N, O, and P will not involve the application of section 4943 concerning excess business holdings.

11. The proposed transfer of M's assets to N, O, and P will not constitute a jeopardizing investment with respect to M, N, O, and P under section 4944.

12. The proposed transfer of M's assets will not constitute taxable expenditures within the meaning of section 4945, and M will not be required to exercise expenditure responsibility (as the term is defined in section 4945(h) with respect to the transferred assets.

13. Any exercise expenditure responsibility imposed on M by section 4945(h) with respect to grants made before the transfer proposed transfers to N, O, and P will not subject M to tax under section 4945 and will not subject N, O, and P to tax under section 4945 provided that N, O, and P exercise expenditure responsibility, or, in the alternative one of the Successor Foundations assumes M's duties with respect to the expenditure responsibility grant and exercises such expenditure responsibility.

14. Under sections 1.507-1(b)(9) and 1.507-3(a)(9)(ii) of the Regulations, M will not be required to comply with periodic reporting, return and notice provisions under section 6033 and section 6104(b) of the Code for any taxable year following the taxable year in which the proposed transfer occurs but only if during the subsequent taxable years in question M has neither legal nor equitable title to any assets, and it engages in no activity. However, M will be required to comply with the notice and public inspection provisions under 6104(d) in connection with its final return.

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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.

We are informing your key District Director of this ruling.

Sincerely yours,

Robert C. Harper

Robert C. Harper
Chief, Exempt Organizations
Technical Branch 3

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