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Internal Revenue Service

Department of the Treasury

200045037

Washington, DC 20224

T:EO:RA:T4

Contact Person:

Telephone Number:

In Reference to:

Date: AUG 15 2000

Legend:

B=
C=
D=
E=

Dear Sir or Madam:

This is in response to your letter dated May 9, 2000, in which you requested certain rulings with respect to a proposed transfer of assets from B to C as amended in a letter dated August 9, 2000.

B is exempt under section 501(c)(3) of the Internal Revenue Code and is classified as a private foundation under section 509(a). We have determined that C is tax-exempt under section 501(c)(3) of the Code and is classified as a private foundation under section 509(a) in separate correspondence.

The current trustees of B are D and E. All other former trustees of B are deceased.

The charitable interests and management strategies of E and D have diverged in recent years, and they currently are interested in supporting different charities and adopting different strategies. In addition, D and E hold different views regarding which individuals should be named additional trustees of B.

B's Board of Trustees, therefore, wishes to effectuate a reorganization of its assets by transferring 50 percent of B's assets to C. Upon recognition of the tax exempt status of C and a favorable ruling from the Internal Revenue Service, B will transfer 50 percent of the fair market value of its assets to C.

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Upon reorganization, D will resign as a trustee of B, and B will be managed by its director, E, and individuals subsequently selected by him.

The transfer of assets from B to C will not involve any benefit to a disqualified person. B does not seek to have its status as a private foundation terminated and does not wish to be treated as a newly created organization.

Section 507(a) of the Code provides for the voluntary and involuntary termination of private foundation status. It states, in part, that except for transfers described in section 507(b), an organization's private foundation status will be terminated only if (1) the organization notifies the Service of its intent to terminate or (2) 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.

Section 507(b)(2) of the Code provides that when a private foundation transfers assets 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 new organization.

Section 1.507-1(b)(7) of the Income Tax Regulations provides that neither a transfer of all of the assets of a private foundation, nor a significant disposition of assets (as defined in section 1.507-3(c)(2)) by a private foundation (whether or not any portion of such significant disposition of assets is made to another private foundation), shall be deemed to result in a termination of the transferor private foundation under section 507(a) of the Code, unless the transferor private foundation elects to terminate pursuant to section 507(a)(1) or section 507(a)(2) is applicable.

Section 1.507-3(a)(2) of the regulations provides that a transferee organization, in the case of a transfer described in section 507(b)(2) of the Code, shall succeed to the aggregate tax benefit of the transferor organization in an amount equal to the amount of such aggregate tax benefit of the transferor organization, multiplied by a fraction the numerator of which is the fair market 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 is determined at the time of transfer.

Section 1.507-3(a)(5) of the regulations provides that, except as provided in section 1.507-3(a)(9) (which only relates to 507(b)(2) transfers where all net assets are transferred to one or more controlled private foundations), 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 the requirements to the extent the amount transferred meets the requirements of section 4942(g).

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

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

Section 4942 of the Code requires a private foundation to make specified distributions of income for each taxable year, including the year in which it transfers substantial assets to another private foundation under section 507(b)(2). Section 1.507-3(a)(5) of the regulations allows the transferor foundation to count the assets transferred under section 507(b)(2) toward its section 4942 distribution requirement to the extent that the transferee foundation itself makes qualifying distributions from corpus under section 4942(g) by the end of the transferee's first taxable year after the year in which it receives the transfer.

Section 4942(g)(1)(A) of the Code defines a qualifying distribution as (a) 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 by the foundation or one or more disqualified persons or (ii)a private foundation which is not an operating foundation, except as otherwise provided; or (b)any amount paid to acquire an asset used directly in carrying out one or more purposes described in section 170(c)(2)(B).

Section 4945(d)(4) of the Code defines the term taxable expenditure to include any amount paid or incurred by a private foundation as a grant to an organization unless (A)the organization is described in subparagraphs (1),(2), or (3) of

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section 509(a) of the Code or is an exempt operating foundation as defined in section 4940(d)(2) of the Code, or (B)the private foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h) of the Code. The exercise of expenditure responsibility requires the foundation that makes the transfer to keep detailed records of the way the payment is spent by the recipient foundation.

Section 4945(h) of the Code provides that expenditure responsibility referred to in subsection (d)(4) means that the private foundation is responsible it exert all reasonable efforts and to establish adequate procedures (1) to see that the grant is spent solely for the purpose for which made, (2) to obtain full and detailed reports with respect to such expenditures, and (3) to make full and detailed reports to the Secretary.

Section 53.4945-5(b)(7)(i) of the Foundation and Similar Excise Taxes Regulations refers to the 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).

Section 53.4945-5(c)(2) of the regulations provides that if a private foundation makes a grant described in section 4945(d)(4) to a private foundation which is exempt from taxation under section 501(a) 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 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.

Section 53.4945-6(b)(2) of the regulations provides that any expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under section 4945(d)(5) unless 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 unreasonable shall depend upon the facts and circumstances of the particular case.

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

Based upon the above facts, following the transfer of one-half of B's assets to C, B will continue to conduct its charitable activities. C will also conduct its charitable activities.

Because B is not terminating its existence and because there has been no willful, repeated or flagrant act giving rise to liability under Chapter 42, no tax will be imposed on B under section 507(c) as a result of the transfer of assets from B to C.

Since a transfer of assets as described in section 507(b)(2) will not cause a termination of an organization's private foundation status, the transfer of one-half of B's assets to C will not terminate B's status as a private foundation under section 507(b)(1).

Because B and C will continue to conduct their individual charitable activities following the transfer of assets from B to C, the proposed transfer of assets will not adversely affect the exempt status of B or C.

B's transfer of assets to C will not be a taxable expenditure under section 4945(d), provided B exercises expenditure responsibility over the endowment grants made to C pursuant to section 4945(d)(4).

Because B, as an organization described in section 501(c)(3) of the Code, is not a disqualified person with respect to C, the transfer of assets to C will not constitute an act of self-dealing within the meaning of section 4941 of the Code.

Provided the expenses incurred by B and C in the transfer of assets to C meet the "good faith" standard of section 53.4945-6(b)(2), such expenses will not constitute taxable expenditures under section 4945 and will be considered qualifying distributions under section 4942.

Accordingly, based on the information furnished, we rule as follows:

1. The transfer of one-half of the assets of B to C will qualify as a transfer pursuant to section 507(b)(2) of the Code and will neither result in the termination of B's private foundation status under section 507(b)(1), nor subject B to the tax imposed by section 507(c) of the Code.

2. The proposed transfer of assets by B to C will not constitute either a willful flagrant act (or failure to act or one of a series of willful repeated acts (or failures to act) giving rise to tax liability under Chapter 42 of the Code.

3. The proposed transfer of assets by B to C will not adversely affect the exempt status of B or C under section 501(c)(3) of the Code.

4. Provided B exercises expenditure responsibility over the transferred funds pursuant to section 53.4945-5(c)(2) of the regulations, the proposed transfer of assets by B to C will not be a taxable expenditure by B under section 4945(d).

5. B and its disqualified persons will not be deemed to have engaged in an act of self-dealing under section 4941, nor be subject to any tax under sections 4941 through 4945 as a result of the formation of C and the transfer by B of 50 percent of the fair market value of its assets to C.

6. The reasonable expenditures for expenses incurred by B and C in connection with this ruling request and in effectuating the proposed transfer of assets will not constitute taxable expenditures under section 4945(d)(5) of the Code and will be considered qualifying distributions under section 4942.

7. B's proposed transfer of assets to C will not result in the imposition of any other taxes under Chapter 42 of the Code.

We are informing the TE/GE office of this action. Please keep a copy of this ruling with your organization's permanent records.

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.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

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