S,N:507.00-00

200120041

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

Date: FEB 21 2001

Contact Person:
Danny Smith
Identification Number:
50-06769
Telephone Number:
(202) 622-7732

T:EO:B4

Legend:
B=
C=
D=

Dear Sir or Madam:

This is in response to your letter dated November 15, 2000, in which you requested certain rulings with respect to a proposed transfer of assets from B to C.

B is exempt under section 501(c)(3) of the Internal Revenue Code and is classified as a private foundation under section 509(a). C has submitted an application for recognition of exemption under section 501(c)(3) of the Code and classification as a private foundation under section 509(a).

The Board of Directors of B consists of four family members of D. As management of B begins to shift to the second generation of D family members, there is a recognition that the charitable interests of one branch of D have diverged in recent years from those of other branches. Accordingly, B proposes to distribute approximately one-fourth of its assets to C.

B represents that it will exercise the expenditure responsibility required by section 4945(h) of the Code with respect to the transfer of assets to C. Neither B nor C is seeking to have its status as a private foundation terminated and C 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.

198

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 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 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)(4) of the regulations provides that if a private foundation incurs liability under Chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets under section 507(b)(2) to one or more private foundations, in any case where transferee liability applies each transferee foundation shall be treated as having received 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 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 foundation), 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 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 be a taxable expenditure, it must be to an organization described in section 501(c)(3) (other than an organization described in section section 509(a)(4) or treated as described in section 501(c)(3) under section 4947.

Section 4940(a) of the Code imposes a tax on the net investment income of private foundations.

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 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 4942(g)(3) of the Code requires that a grantor private foundation, in order to have a qualifying distribution for its grant to another private foundation, which is not an operating foundation under section 4942(j)(3) of the Code, must have adequate records, as required by section 4942(g)(3)(B) of the Code, to show that the grantee private foundation, in fact, subsequently made qualifying distributions that were equal to the amount of the grant and that were paid out of the grantee's own corpus within the meaning of section 4942(h) of the Code. Such grantee foundation's qualifying distributions out of corpus must be expended before the close of the grantee's first tax year after its tax year in which it received the grant.

Section 4943(a)(1) of the Code provides that there is hereby imposed on the excess business holdings of any private foundation in a business enterprise during any taxable year which ends during the taxable period a tax equal to 5 percent of the value of such holdings.

Section 4944 of the Code imposes tax upon a private foundation which invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes.

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 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.

Section 4945(h) of the Code provides that expenditure responsibility referred to in subsection (d)(4) means that the private foundation is responsible to 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.

202

Section 53.4942(a)-3(c)(1) of the Foundation and Similar Excise Taxes Regulations states that a transfer from one private foundation to another private foundation will be a qualifying distribution under section 4942(g) of the Code if (i) Not later than the close of the first taxable year in which such contribution is received, such donee organization makes a distribution equal to the full amount of such contribution and such distribution is a qualifying distribution (within the meaning of paragraph (a) of this section, without regard to this paragraph) which is treated under paragraph (d) of this section as a distribution out of corpus (or would be so treated if such section 501(c)(3) organization were a private foundation which is not an operating foundation; and (ii) The private foundation making the contribution obtains adequate records or other sufficient evidence from such donee organization (such as a statement by an appropriate officer, director,or trustee of such organization) showing (except as otherwise provided in this subparagraph) (a) that the qualifying distribution described in subdivision (i) of this subparagraph has been made by such organization, (b) the names and addresses of the recipients of such distribution and the amount received by each, and (c) that the distribution is treated as distribution out of corpus under paragraph (d) of this section (or would be so treated if the donee organization were a private foundation which is not a operating foundation).

Section 53.4945-5(b)(7)(i) of the 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.

Based on the above facts, following the transfer from B to C, B and C will both conduct their charitable activities.

Under section 507(b)(2) of the Code, 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. Thus, the transfer by B to C will constitute in the aggregate an "adjustment, organization, or reorganization" within the meaning of section 507(b)(2). Accordingly, the transfer by B to C will not be treated as a transfer to a newly created

201

organization.

B will not terminate its status as a result of this transaction. Therefore, the transfer of B's assets to C will not result in the imposition of tax under section 507(c) of the Code.

Under section 4940(c)(4) of the Code, capital gains and losses are defined as gains and losses from the sale or other disposition of certain property. Because the asset transfer, from B to C, will lack consideration, no sale or other disposition will have occurred, thus, there will be no gain and the asset transfer will not give rise to tax under section 4940 of the Code.

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.

Under section 1.507-3(a)(5) of the regulations, 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. Assuming that B meets its distribution requirements under section 4942 of the Code, for the year in which the transfer is made, the transfer of assets will not give rise to tax under section 4942 of the Code.

Because the transfer of assets from B to C does not involve "excess business holdings", within the meaning of section 4943, the asset transfer will not give rise to tax to B under section 4943 of the Code.

Because the proposed transfer of assets to C will be made to accomplish the exempt purposes of B, the transfer will not constitute "investments" for purposes of section 4944 of the Code. Thus, the excise taxes imposed on jeopardizing investments under section 4944(a) of the Code will not apply to the transfer of assets from B to C.

Because C will not be controlled by B, B will be required to exercise expenditure responsibility in accordance with section 4945(h) of the Code, with respect to the transferred assets. Thus, assuming B exercises expenditure responsibility with respect to the transferred assets, the transfer of assets will not constitute a taxable expenditure under section 4945 of the Code.

Because the asset transfer will be a transfer described in section 507(b)(2) of the Code, C will succeed to approximately one-fourth of the aggregate tax benefits of B. Therefore, following the transfer, C will be able to reduce proportionately its amount of required distributions under section 4942 of the Code by the amount, if any, of B's excess qualifying distributions carryover for prior years as defined in section 4942(i) 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) of the regulations, such expenses will not constitute taxable expenditures under section 4945 of the Code and will be considered qualifying distributions under section 4942.

202

Under section 1.507-3(a)(8)(ii) of the regulations, the provisions enumerated in subparagraphs (a) through (g) thereof apply to C with respect to the assets transferred to the same extent and in the same manner that they would have applied to B had the transfer described in section 507(b)(2) of the Code not been effected.

Because the asset transfer will be a transfer described in section 507(b)(2) of the Code, C will be subject to approximately one-fourth of any liability which B will have incurred under Chapter 42 of the Code, to the extent not satisfied by B.

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

1. The transfer of assets of B to C will qualify as a transfer pursuant to section 507(b)(2) of the Code and C will not be treated as newly created organization within the meaning of section of 507(b)(2) of the Code.

2. The transfer of assets will not subject B to a termination tax under section 507(c) of the of the Code.

3. The transfer of assets from B to C will not constitute a sale or other disposition of property within the meaning of section 4940 of the Code; thus, the transfer of assets will not result in the imposition of additional tax under section 4940 of the Code.

4. The transfer of assets will not subject B to tax for self-dealing within the meaning of section 4941 of the Code.

5. The transfer of assets will not subject B to tax for failure to distribute income under section 4942 of the Code provided that B otherwise meets its distribution requirements under section 4942 for the taxable year.

6. The transfer of assets will not subject B to tax under section 4943 of the Code.

7. The transfer of assets will not constitute an investment which jeopardizes the carrying out of B's exempt purposes within the meaning of section 4944 of the Code.

8. The transfer of assets will not constitute a taxable expenditure under section 4945 of the Code provided that B exercises expenditure responsibility as set forth in section 53.4945-5(c)(2) of the regulations.

9. C will succeed to approximately one-fourth of the aggregate tax benefits of B, including any excess qualifying distributions under section 4942 of the Code.

10.The legal, accounting, and other expenses (including filing fees), if any, incurred by either C or B in connection with this ruling request will not constitute taxable expenditures under section 4945 of the Code and will be considered qualifying distributions under section 4942 of the Code.

11.The provisions of section 1.507-3(a)(8)(ii) (a) through (g) of the regulations will apply to C with respect to the assets transferred from B.

12. C will be treated as having received the transfer of assets subject to one-fourth of any liability B has incurred under Chapter 42 of the Code, to the extent not satisfied by B.

13. The transfer of assets will not adversely affect the status of B or C as organizations exempt from Federal income tax under section 501(c)(3) of the Code or as organizations, donations to which are deductible under section 170 of the Code.

These rulings are issued on the condition that C receive exempt status under section 501(c)(3) of the Code.

We are informing the TE/GE office of this action. Please keep a copy of this ruling in 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.

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.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

204