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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Contact Person:

Uniform Issue List
501.03-02 4940.02-01
507.04-00 4941.00-00
507.05-00 4942.03-02
507.06-00 4942.03-05
507.07-00 4943.03-00
4944.00-00
4945.04-00
4946.01-00

Identification Number:

Telephone Number:

T:EO:B2

Employer Identification Number:

LEGEND
X =
P =
S =
T =
U =

Dear Sir or Madam:

We have received X's request for a ruling dated March 28, 2000, concerning the treatment, under Sections 507(b)(2) and 4941 of the Internal Revenue Code, of the proposed transfer of assets from a private foundation to three newly created private foundations.

FACTS

X is a grant-making private foundation recognized as exempt under 501(c)(3). X is controlled by its members, P, who is the Chairman of the Board and President, and his three sons (Sons), S, T, and U. X plans to transfer sixty percent of the fair market value of its net assets, in twenty-percent increments, to each of the three Transferee Foundations. The Transfer agreement provides that, in accordance with Section 4945(d) and (h), X will exercise expenditure responsibility with respect to all amounts transferred to the Transferee Foundations for the period required by Regulation Section 54.4945-5(c)(2). The Transfer Agreements further provide that S,T, and U will resign as members and directors, effective March 31, 2001. The Transfer agreements provide that P will remain X's sole member after March 31, 2001. P will not serve as director, officer or employee of any of the Transferee Foundations. The Transfer agreement further provides that upon X's dissolution, all remaining net assets will be transferred in the manner provided for in the Articles of Incorporation and By-Laws. X's proposed amended Articles of Incorporation and proposed amended By-Laws provide that upon the incapacity or death of P, all of X's remaining net assets will be transferred, in equal shares, to those of the Transferee Foundations that are then in existence and exempt from federal income tax. After

the transfer of its remaining net assets to the Transferee Foundations, X will wind up its affairs and terminate its private foundation status and corporate existence.

Foundations A, B, and C will be recognized as exempt from federal income tax under Section 501(c)(3) and will also be classified as private nonoperating foundations as described in Section 509(a). U is the sole member of Foundation A, S the sole member of Foundation B, and T the sole member of Foundation C.

For a five-year period beginning September 1, 2001, P will for a fee provide investment, corporate governance, management and grant-making consulting services to each of the Transferee Foundations on a part-time basis.

For the two-year period commencing April 1, 2001, X and the Transferee Foundations will share overhead expenses and X will provide office space and administrative support services, including supplies and equipment, to the Transferee Foundations. X's employees will provide the Transferee Foundations with the administrative support they need to conduct their operations. The Support Agreements provide that, except for expenses that are unique to a party, the sharing of expenses and administrative support costs will be allocated among X and Transferee Foundations, pro rata, on the basis of the relative value of the assets of each party on the day the agreement becomes effective.

RULINGS REQUESTED

1. Both X's initial transfer of sixty percent (60%) of its net assets and its subsequent transfer of its remaining net assets to the Transferee Foundations will constitute transfers under Section 507(b)(2).

2. X's transfers under Section 507(b)(2) will not result in a termination of its private foundation status under Section 509 and will not result in any private foundation status termination tax under Section 507(c).

3. Because the proposed transfer will be made pursuant to Section 507(b)(2), X's transfers to the Transferee Foundations will not adversely affect the exemptions from federal income tax under Section 501(c)(3) of X or the Transferee Foundations.

4. Pursuant to Section 507(b)(2) and Regulation section 1.507-3(a)(1), the Transferee Foundations will not be treated as newly created organizations.

5. Upon each transfer from X to the Transferee Foundations, the Transferee Foundations will succeed to a portion of X's aggregate tax benefits under Section 507(d) in proportion to the amount of X's assets transferred to each.

6. The transfers of assets from X to the Transferee Foundations will not be for consideration and will not be treated as a sale or exchange of property subject to tax. The tax basis and holding period of the transferred assets in the hands of the Transferee Foundations

shall be determined in the same manner as if such assets had continued to be held uninterruptedly by X.

7. X's transfers of assets to the Transferee Foundations will not constitute or trigger, as the case may be, (a) gross investment income or capital gain net income within the meaning of Section 4940; (b) an act of self-dealing under Section 4941; (c) excess business holdings under Section 4943; (d) an investment that jeopardizes charitable purposes under Section 4944; or (e) a taxable expenditure under Section 4945, as long as any required expenditure responsibility is exercised by X. The asset transfer will not cause X, the Transferee Foundations, or any disqualified person, as defined under Section 4946, with respect to X or the Transferee Foundations to be subject to any tax under Sections 4940 through 4945.

8. X will be required to exercise expenditure responsibility under Section 4945(h) as set forth in Regulation section 53.4945-5(c)(2) with respect to its initial transfer of assets to the Transferee Foundations. X will not be required to exercise expenditure responsibility under Section 4945(h) with regard to the final transfer of its assets to the Transferee Foundations. However, the Transferee Foundations will be required to exercise expenditure responsibility over any grants made by X which, at the time of the final transfer, required expenditure responsibility to be exercised.

9. X's and the Transferee Foundations' legal, accounting, and other expenses, if reasonable in amount, in connection with this rulings request and in effectuating the proposed transfers will not be taxable expenditures under Section 4945, and will be qualifying distributions under Section 4942(g)(1)(A).

10. For purposes of Sections 4940 through 4945 and Sections 507 through 509, after the final transfer by X of its remaining net assets, the Transferee Foundations will each be treated as if they are X, but only in the proportion which the net fair market value of the assets transferred to each of the Transferee Foundations bears to the net fair market value of all of X's assets immediately before the transfers. The Transferee Foundations will each succeed to a portion of X's tax attributes including the following:

a. For purposes of Section 4940, one-third of the net investment income of X for the taxable year of the final transfers to the Transferee Foundations will be apportioned to the Transferee Foundations and will be includable in the computation of the net investment of the Transferee Foundations in the taxable year of such final transfers.

b. X will be required to meet the Section 4942 distribution requirements for its taxable year in which the final transfers are made. The transfer of the assets from X to the Transferee Foundations may be used in satisfaction of X's qualifying distribution requirements under Section 4942 provided the requirements of Section 4942(g) are met. To the extent that the distribution requirements have not been fully satisfied by X at the time of the final transfers to the Transferee Foundations, and there remains any undistributed income for the taxable year of the transfers, such remaining undistributed income will be allocated to the Transferee Foundations. The Transferee Foundations must distribute their allocable share of such remaining undistributed income not later than the end of the taxable year in which X makes the

transfer to them.

11. After the final transfer of its assets to the Transferee Foundations, pursuant to Section 507(a)(1) and Regulation section 1.507-1(b), X's status as a private foundation will be terminated once it notifies the Service that it will terminate its status. X will not be liable for any termination tax under Section 507(c) if the value of its net assets equals zero at such time it gives notice that it is terminating its private foundation status.

12. After the final distribution of its assets to the Transferee Foundations, under Regulation sections 1.507-1(b)(9), X will not be required to comply with periodic reporting, return and notice provisions of the Code for any taxable year following the taxable year in which the proposed final transfer to the Transferee Foundations occurs if, during the subsequent taxable years in question, X has neither legal nor equitable title to any assets, and it engages in no activity. However, X will be required to comply with the notice and public inspection provisions of the Code in connection with its final return.

13. The proposed sharing of X's office space, administrative support staff, supplies, equipment and related items, the charging of a fee for such expenses incurred by X and the payment for such expenses by each of the Transferee Foundations under the Support Agreement for each Transferee Foundation's share of office overhead expenses, including rental expense, administrative support, supply and equipment expense, and related expenses will not constitute acts of direct or indirect self-dealing under Section 4941 by X, the Transferee Foundations or any disqualified person with respect to X or the Transferee Foundations, as defined under Section 4946, and will not affect the exempt status under Section 501(c)(3) of X or any of the Transferee Foundations.

14. Payments by each of the transferee foundations to P under the Consulting Agreement for investment, corporate governance, management and grant-making consulting services will not constitute direct or indirect self-dealing under section 4941 of the Code by X or the transferee foundations or any disqualified person with respect to them as defined under section 4946 (including without limitation P), and will not affect the exempt status under section 501(c)(3) of X or any of the transferee foundations.

15. The provision by P of investment, corporate governance, management and grant-making consulting services for a fee will not constitute direct or indirect self-dealing under section 4941 of the Code by X, the transferee foundations, or any disqualified person with respect to X or the transferee foundations as defined under section 4946 (including without limitation P), and will not affect the exempt status under section 501(c)(3) of the Code of X or any of the transferee foundations.

STATEMENT OF LAW

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

Section 507(a) provides that, except as provided in Section 507(b), the status of any private foundation shall be terminated only if such organization notifies the Service 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 of the Code, and the Service notifies the organization that because of such acts, 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) 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 newly created foundation.

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

Section 507(d) provides that the aggregate tax benefit of a private foundation refers to the value of its exemption from federal income tax and of the deductions taken by its donors throughout its existence.

Regulation section 1.507-1(b)(6) provides, in part, 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 Regulation section 1.507-3(c), such transferor foundation will not have terminated its private foundation status under Section 507(a)(1).

Regulation section 1.507-3(c)(1) indicates that a transfer is described in Section 507(b)(2) if it is a transfer of assets from one private foundation to one or more other private foundations pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization. The term "other adjustment, organization or reorganization includes any significant disposition of the transferor's assets.

Regulation section 1.507-3(c)(2) 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.

Regulation section 1.507-3(d) provides that unless a private foundation gives notice under 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.

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

Regulation section 1.507-1(b)(9) 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.

Regulation section 1.507-3(a)(1) provides, in pertinent part, that in the case of a transfer of assets subject to the provisions of Section 507(b)(2) of the Code, the transferee organization shall not be treated as a newly created organization. Thus, in the case of a significant disposition of assets to one or more private foundations, the transferee shall be treated as possessing the attributes and characteristics of the transferor organization. A transferee organization to which this paragraph applies shall be treated as possessing those attributes and characteristics of the transferor organization which are described in subparagraphs (2), (3), and (4) of this paragraph.

Regulation section 1.507-3(a)(2)(i) provides that a transferee organization to which this paragraph applies shall succeed to the aggregate tax benefit of the transferor organization in an amount determined as follows: Such amount shall be an amount equal to the amount of such 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 value 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.

Regulation section 1.507-3(a)(2)(ii) provides that notwithstanding subdivision (i) of this subparagraph, a transferee organization which is not effectively controlled (within the meaning of Sec. 1.482-1(a)(3)), directly or indirectly, by the same person or persons who effectively control the transferor organization shall not succeed to an aggregate tax benefit in excess of the fair market value of the assets transferred at the time of the transfer.

Regulation section 1.507-3(a)(7) provides that 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.

Regulation section 1.507-3(a)(8) provides that certain tax attributes of a transferor private foundation will carry over to any transferee private foundation that receives a Code Section 507(b)(2) transfer of assets.

Regulation section 1.507-3(a)(8)(ii) provides that the provisions enumerated in subparagraphs (a) through (g) thereof 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) not been effected. In particular, Regulation section 1.507-3(a)(8)(ii)(a) refers to the rules for determining the basis of property pursuant to Section 507.

Regulation section 1.507-3(a)(5) provides that except as provided in subparagraph (9) thereof, 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 4940(a) imposes an excise tax on the "net investment income" of private foundations.

Section 4940(c)(1) provides that, for purposes of Section 4940(a), the net investment income of a private foundation is the amount by which (A) the sum of the gross investment income and the capital gain net income of the foundation exceeds (B) the deductions allowed by Section 4940(c)(3).

Section 4941(a) imposes an excise tax on each act of "self-dealing" between "a disqualified person"' and a private foundation.

Section 4941(d)(1) defines self-dealing to include, in pertinent part, any direct or indirect:

> (A) sale or exchange, or leasing, of property between a private foundation and a disqualified person;
>
> (B) lending of money or other extension of credit between a private foundation and a disqualified person;
>
> (C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;
>
> (D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;
>
> (E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a)(1) provides, in pertinent part, that the term "disqualified person" with respect to a private foundation includes:

> (A) a substantial contributor to the foundation;

(B) a foundation manager (within the meaning of subsection (b)(1);

(D) a member of the family of an individual who is a substantial contributor or a foundation manager;

(C) an owner of more than 20 percent of-
(i) the total combined voting power of a corporation,
(ii) the profit interests of a partnership, or
(iii) the beneficial interest of a trust or unincorporated enterprise

(E) a corporation of which persons who are foundation managers, substantial contributors or members of the family of such persons own more than 35 percent of the total combined voting power;

(F) a partnership in which persons who are foundation managers, substantial contributors or members of the family of such persons own more than 35 percent of the profits interest;

(G) a trust or estate in which persons who are foundation managers, substantial contributors or members of the family of such persons own more than 35 percent of the beneficial interest.

Section 4946(a)(2) provides that the term "substantial contributor" means a person who is described in Section 507(d)(2).

Section 4946(b) provides that the term "foundation manager" with respect to any private foundation to include an officer, director, or trustee of a foundation (or any individual having powers or responsibilities similar to those of officers, directors, or trustees of foundation), and with respect to any act (or failure act), the employees of the foundation having authority or responsibility with respect to such act (or failure to act).

Section 4946(d) provides that the term "members of the family" of a disqualified person with respect to a private foundation includes only such person's spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren and great grandchildren.

Regulation section 53.4941(d)-1(a) provides, in pertinent part, that for purposes of Section 4941, it is immaterial whether the transaction results in a benefit or a detriment to the private foundation.

Regulation section 53.4946-1(a)(8) provides that, for purposes of the 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)).

Revenue Ruling 82-136, 1982-2 C.B. 300, provides that a grant by one private foundation

200204039

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 thus was a disqualified person. Any benefit received by the trustee was merely incidental to the granting foundation's use of its funds for a charitable purpose.

Section 4941(d)(2)(E) provides that, except in the case of a government official (as defined in Section 4946(c)), the payment of compensation (and the payment or reimbursement of expenses) by a private foundation to a disqualified person for personal services which are reasonable and necessary to carry out the exempt purpose of the private foundation shall not be an act of self-dealing if the compensation (or payment or reimbursement) is not excessive.

Regulation section 53.4941 (d)-3 (c) provides, in pertinent part, that, under Section 494 1 (d)(2)(E), the payment of compensation (and the payment or reimbursement of expenses, including reasonable advances for expenses anticipated in the immediate future) by a private foundation to a disqualified person for the performance of personal services which are reasonable and necessary to carry out the exempt purpose of the private foundation shall not be an act of self-dealing if such compensation (or payment or reimbursement) is not excessive. This exemption applies without regard to whether the person who receives the compensation (or payment or reimbursement) is an individual.

Regulation section 53.4941(d)-2(d)(3) provides, in pertinent part that the furnishing of goods, services, or facilities by a disqualified person to a private foundation shall not be an act of self-dealing if they are furnished without charge. Thus, for example, the furnishing of goods such as pencils, stationery, or other incidental supplies, or the furnishing of facilities such as a building, by a disqualified person to a foundation shall be allowed if such supplies or facilities are furnished without charge. Similarly, the furnishing of services (even though such services are not personal in nature) shall be permitted if such furnishing is without charge.

Section 4942(a) imposes an excise tax on the undistributed income (as defined in paragraph (a) of Regulation section 53.4942(a)-2) 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. For purposes of Section 4942 the term "distributed" means distributed as qualifying distributions under Section 4942(g).

Section 4942(g)(1) provides that a "qualifying distribution" means -

(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 (directly or indirectly) by the foundation or one or more disqualified persons (as defined in Section 4946) with respect to the foundation, except as provided in Section 4942(g)(3), or (ii) a private foundation which is not an operating foundation (as defined in Section 49420)(3)), except as provided in Section 4942(g)(3), or

(B) any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in Section 170 (c) (2) (B).

Section 4942(g)(3) provides that the term "qualifying distribution" includes a contribution to a Section 501 (c)(3) organization described in Section 4942(g)(A)(i) or (ii) (i.e., a private foundation) if -

(A) not later than the close of the first taxable year after its taxable year in which such contribution is received, such organization makes a distribution equal to the amount of such contribution and such distribution is a qualifying distribution (within the meaning of Section 4942(g)(1) or (2), without regard to this paragraph) which is treated under Section 4942(h) as a distribution out of corpus (or would be so treated if such Section 5 01 (c)(3) organization were a private foundation which is not an operating foundation), and

(B) the private foundation making the contribution obtains adequate records or other sufficient evidence from such organization showing that the qualifying distribution described in (A), above, has been made by such organization.

Regulation section 53.4942(a)-3(e) 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.

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

Section 4943(c)(1) 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) 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 4942(a)(2) imposes a tax on a foundation manager who participates in the making of an investment knowing that it is jeopardizing the carrying out of any of the foundation's exempt purposes.

Section 4942(c) provides that investments, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes.

Regulation section 53.4944-3(a)(1) provides that a "program-related investment" shall not be classified as an investment, which jeopardizes the carrying out of the exempt purposes of a private foundation. A "program-related investment" is an investment for which The primary purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(B); no significant purpose of the investment is the production of income or the appreciation of property; and no purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(D) regarding political activity.

Section 4945(a) imposes a tax on the "taxable expenditures" made by a private foundation.

Section 4945(d)(4) 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) provides that the term taxable expenditure also includes amounts paid or incurred by a private foundation for purposes other than those specified in Section 170(c)(2)(B) (i.e., for recognized charitable purposes).

Section 4945(h) provides that the expenditure responsibility referred to in subsection (d)(4) thereof means that the private foundation is responsible to exert all reasonable efforts to establish adequate procedures to see that the grant is expended 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 Service. With regard to grants made to another private foundation, Section 4945(h) defines expenditure responsibility in terms of requiring proper pre-grant and post-grant reports from its grantee private foundation on the grantee's uses of a grant.

Regulation section 53.4945-5(c)(2) 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 5 0 1 (c)(3) for endowment or for other capital purposes, the grantor foundation shall only require reports from the grantee on the use of the principal and the income (if any) from the grant funds annually for its taxable year in which the grant was made and the immediately succeeding two taxable years. If it is reasonably apparent to the grantor before the end of such second succeeding taxable year that neither the principal, the income from the grant funds, nor any equipment purchased from the grant funds has been used for any purpose which would result in liability under Section 4945(d), the grantor may allow the reports to be discontinued.

Regulation section 1.507-3(a)(9)(i) 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 Regulation section 1.482-1(a)(3) [redesignated as 1.482-IA(3)]), directly or indirectly, by the same persons which effectively controlled the transferor private foundation, the transferee private foundation is to be treated as if it were the transferor private foundation for purposes of Chapter 42 of the Code and Sections 507- 509. However, where proportionality is appropriate, such a transferee private foundation shall be treated as if it were 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.

Regulation section 53.4945-6(b)(1), in pertinent part, provides that certain expenditures will not be treated as taxable expenditures under Section 4945(d)(5). These expenditures include:

(A) Expenditures to acquire investments entered into for the purpose of obtaining income or funds to be used in furtherance of purposes described in Section 170(c)(2)(B) (i.e., recognized charitable purposes);

(B) Reasonable expenses with respect to investments described in A.

Regulation section 53.4945-6(b)(2), 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.

Regulation section 53.4945-6(c)(3) provides that if a private foundation makes a transfer of assets pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization to any person, the transferred assets will not be considered used exclusively for purposes described in Section 170(c)(2)(B) unless the assets are transferred to a fund or organization described in Section 501(c)(3) or treated as so described under Section 4947(a)(1).

ANALYSIS OF RULINGS REQUESTED

1. Both the proposed initial transfer of a portion of X's net assets and the subsequent transfer of its remaining net assets to the Transferee Foundations meet the requirements of Section 507(b)(2) and the Regulations thereunder. Regulation section 1.507-3(c)(1) provides that a transfer is described in Section 507(b)(2) if it is a transfer from one private foundation to another private foundation pursuant to any liquidation, merger, recapitalization or other adjustment, organization or reorganization. Regulation section 1.507-3(c)(1) provides that the terms other adjustment, organization or reorganization includes a significant disposition of assets to one or more private foundations. A significant disposition of assets to one or more private foundations is defined by Regulation section 1.507-3(c)(2) to include a disposition where the aggregate 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 transferor foundation at the beginning of the taxable year. In this case, X will make an initial transfer of approximately 60 percent of its net assets to the Transferee Foundations. The final transfer to the Transferee Foundations in a future year will consist of 100 percent of X's remaining net assets. Both of these transfers meet the requirements set forth.

2. Under Section 507(a), the status of an organization as a "private foundation" will be terminated only if either (a) the private foundation notifies the Secretary of its intent to terminate its status as a private foundation; or (b) there have been willful and flagrant acts giving rise to liability for taxes under Chapter 42 of the Code and the Secretary notifies the private foundation of its liability for a termination tax under Section 507(c). Under Regulation sections 1.507-1(b)(6), 1.5073(d), and 1.507-4(b), a transfer under Section 507(b)(2) is not deemed to result in a termination of private foundation status unless the transferor elects to terminate its

status. Further, a termination tax under Section 507(c) is imposed on any private foundation that voluntarily terminates its status. X has not given notice of its intent to terminate its status as a private foundation, nor has it been advised by the Secretary of any liability for the tax under Section 507(c). X's transfers under Section 507(b)(2) will not result in termination of X's private foundation status under Section 509 and will not result in any private foundation status termination tax under Section 507(c).

3. The transfers by X to the Transferee Foundation will be made for exempt purposes. It is assumed that each of the Transferee Foundations will be determined by the Service to be exempt under Section 501(c)(3). The transfers will not be made until and unless such determination is made by the Key District Director. Accordingly, X's proposed transfers to the Transferee Foundations will not. adversely affect the respective exemptions from federal income tax under Section 501(c)(3) of X or the Transferee Foundations.

4. When a transfer from one private foundation to another private foundation is made pursuant to Section 507(b)(2) and Regulation section 1.507-3(a)(1), the transferee foundations are not treated as newly-created organizations. Rather, the transferee foundations succeed to certain tax attributes and characteristics of the transferor. Because the proposed transfer from X to the Transferee Foundations is to be made pursuant to Section 507(b)(2), the Transferee Foundations will not be treated as newly created organizations.

5. Under Regulation section 1.507-3(a)(1), a transferee in a Section 507(b)(2) transfer is treated as possessing the attributes and characteristics of the transferor foundation, including its "aggregate tax benefit". Under Regulation section 1.507-3(a)(2)(i), each transferee succeeds to the aggregate tax benefit of the transferor in an amount equal to the aggregate tax benefit of the transferor multiplied by a fraction, the numerator of which is the fair market value of the net assets transferred to the transferee and the denominator of which is the fair market value of the net assets of the transferee immediately before the transfer. Accordingly, upon each transfer from X to a Transferee Foundation, the Transferee Foundation will succeed to a portion of X's aggregate tax benefits under Section 507(d) in proportion to the amount of X's assets transferred to each.

6. X will not receive any consideration from the Transferee Foundations for transfer of assets. Because the transfers of assets from X to the Transferee Foundations will not be for consideration and will be transfers under Section 507(b)(2), the transfers will not be treated as a sale or exchange of property subject to tax. Rather, the tax basis of the assets transferred to the Transferee Foundations will carry over and will remain as the tax basis of the assets in the hands of the Transferee Foundations.

7. Section 4940(a) imposes on each private foundation with respect to the carrying on of its activities a tax on the net investment income of such foundation for the taxable year. X will receive no consideration for the transfers. Therefore, the transfers to the Transferee Foundations will not constitute a "sale or other disposition of property or other realizable event" giving rise to net investment income to either X or the Transferee Foundations. Therefore, the transfers will not give rise to tax under Section 4940.

For purposes of the Section 4941 prohibitions on self-dealing by disqualified persons, the term "disqualified person" does not include any organization which is described in Section 501(c)(3). X will make the contemplated transfers to the Transferee Foundations; all of which are described in Section 501(c)(3). Therefore, the Transferee Foundations will not be disqualified persons as to X at the time of the transfers, and no transfer between a disqualified person and a private foundation will occur. Accordingly, the transfers of X's assets to the newly created private foundations will not constitute acts of self-dealing under Section 4941 and the transfers will not subject X or the Transferee Foundations to tax under Section 4941.

Section 4943 imposes a tax annually on the value of a private foundation's excess holdings in a business enterprise. Provided that none of the assets transferred would place X or the Transferee Foundations in the position of having excess business holdings, the proposed transfers do not involve the application of Section 4943 concerning excess business holdings.

Section 4944(a)(1) imposes a tax on a private foundation that invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes. The transfers will not be "investments" within the ordinary meaning of the term. Moreover, even if they were, then they would constitute program-related investments. Section 4944(c) and Regulation section 53.4944-3(a)(1) provide that an investment, the primary purpose of which is to accomplish one or more of the purposes described in Section 170(c)(2)(B) of the Code and no significant purpose of which is the production of income or the appreciation of property, is a program-related investment and will not be considered as an investment which would jeopardize the carrying out of a private foundation's exempt purposes. The Transferee Foundations are organizations described in Section 501(c)(3), the primary purpose of the transfers will be to accomplish one or more of the purposes described in Section 170(c)(2)(B). Since the proposed transfers constitute an "adjustment, organization, or reorganization" within the meaning of Regulation section 1.507-3(c)(1), the production of income or the appreciation of property will not be a significant purpose of the transfers within the meaning of Section 4944(c) and Regulation section 53.4944-3(a)(1). Accordingly, the transfers will not be considered to be investments jeopardizing charitable purposes within the meaning of Section 4944.

Section 4945(a) of the Code imposes a tax on each taxable expenditure made by a private foundation. The term "taxable expenditure" is defined by Section 4945(d)(4) as an amount paid or incurred by a private foundation as a grant to an organization (other than an organization described in paragraph (1), (2) or (3) of Section 509(a)), unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h). Thus as long as expenditure responsibility, if required, is exercised by X, the transfers will not be taxable expenditures.

8. Under Section 4945(d)(4), a private foundation must exercise expenditure responsibility over grants made to other private foundations in order to ensure that the grant is spent solely for the purpose for which it is made. X will be required to exercise expenditure responsibility under Section 4945(h) as set forth in Regulation section 53.4945-5(c)(2) with respect to its initial transfer of assets to the Transferee Foundations. However, no expenditure responsibility need be exercised after the final transfer of assets, while X has no assets, except for information reporting requirements under section 4945 for the year of the final transfer. See

section 1.507-3(a)(7) of the regulations.

9. Section 4942(g)(1)(A) includes as qualifying distributions for purposes of calculating the excise tax on undistributed income under Section 4942(a) amounts paid to accomplish one or more purposes of Section 170(c)(2)(B). A transfer of assets to an organization that is exempt under Section 501 (c)(3) pursuant to any liquidation, merger, redemption, recapitalization or other adjustment is considered to be a transfer for exempt purposes described in Section 170(c)(2)(b) under Regulation section 53.4945-6(c)(3). Further, under Regulation section 53.4945-6(b)(1), expenditures to acquire investments for the purpose of obtaining income or funds to be used in furtherance of exempt purposes are not taxable expenditures. Also, under Regulation section 53.4945-6(b)(2) amounts paid for compensation and consulting fees are not taxable expenditures if the amounts are paid in the good faith belief that they were reasonable and consistent with ordinary business care. Because of the potential impact of a negative ruling hereunder on the exempt status of both X and each of the Transferee Foundations, the expenses incurred by X and the Transferee Foundations for legal, accounting, and other expenses, if reasonable in amount, in connection with this rulings request and in effectuating the proposed transfers will be qualifying distributions under Section 4942(g)(1)(A), and will not be taxable expenditures under Section 4945.

10. X and the Transferee Foundations are not effectively controlled by the same persons, within the meaning of section 1.507-3(a)(9)(i) of the regulations. Therefore, the Transferee Foundations only succeed to X's tax attributes described in sections 1.507-3(a)(2), (3), and (4). Under section 1.507-3(a)(4), the Transferee Foundations receive the assets subject to any chapter 42 liabilities owed and not paid by X, such as taxes owed under section 4940. The transfers to the Transferee Foundations (non-operating private foundations) will not constitute qualifying distributions by X under section 4942(g)(1) unless the requirements of section 4942(g)(3) are met.

11. The excise tax imposed by Section 507(c) on the voluntary termination of a private foundation under Section 507(a)(1) is equal to the lower of. (a) the aggregate tax benefits that have resulted from the foundation's Section 501(c)(3) status, or (b) the value of the net assets of the foundation. X will not be liable for any termination tax under Section 507(c) if it has no net assets when it gives notice that it is terminating its private foundation status.

12. Regulation section 1.507-1(b)(9) 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 under Section 6056, for the year the transfer occurs, but not for any taxable year following the year in which such transfer occurs, 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. Thus, after the final distribution of its assets to the Transferee Foundations, under Regulation sections 1.507-1(b)(9), X will not be required to comply with periodic reporting, return and notice provisions of the Code for any taxable year following the taxable year in which the proposed final transfer to the Transferee Foundations occurs if during the subsequent taxable years in question, X has neither legal nor equitable title to any assets, and it engages in no activity. However, X will be required to comply with the notice and public inspection provisions of the

Code in connection with its final return.

13. Under Section 4941(d)(1)(C), "self-dealing" includes the direct or indirect furnishing of services between a private foundation and a disqualified person. Code Section 4941(d)(1)(A) also defines self-dealing to include the direct or indirect sale, exchange or leasing of property between a private foundation and a disqualified person. Thus, the proposed sharing of X's office space and administrative overhead expenses by X and the Transferee Foundations, and the payment by the Transferee Foundations to X for such expenses would be prohibited acts of self-dealing except for the fact that the transaction is not considered to be between a private foundation and a disqualified person.

Section 4946(a)(1) includes in the definition of "disqualified person" with respect to a particular foundation a "foundation manager", and the family members of a foundation manager. Section 4946(b) defines "foundation manager" as an officer, director or trustee of a private foundation; under certain circumstances, employees of a foundation can also be foundation managers. Section 4946(d) defines members of the family to include a disqualified person's spouse, ancestors, children, grandchildren and great grandchildren.

Before and after the transfers by X to the Transferee Foundations, P is and will be a foundation manager of X and as such will be a disqualified person with respect to X. Although they will not continue as foundation managers of X, P's Sons, as family members, will continue to be disqualified persons with respect to X. Similarly, each of his three Sons will be a foundation manager of the newly established foundation of which each is the sole member. P, as a family member, will also be a disqualified person with regard to each Transferee Foundation. Thus, any transactions defined as self-dealing, unless excepted by the Code or the Regulations, engaged in by any of the four individuals directly or indirectly with X would subject them to the excise tax on self-dealing under Section 4941. Similarly, any transaction defined as self-dealing, unless excepted by the Code or the Regulations, engaged in by P with one of the Transferee Foundations would subject him to the excise tax on self-dealing. Under Regulation section 53.4941(d)-1(a), in determining whether self-dealing has occurred, it is immaterial if these transactions result in a benefit or detriment to the foundations.

For purposes of the self-dealing prohibition under Section 4941, Regulation section 53.4946-1(a)(8), provides that an organization which is exempt under Code Section 501(c)(3) is not considered to be a disqualified person with regard to a private foundation. Thus, transactions engaged in directly between two private foundations are not considered to be acts of self-dealing. Because private foundations are not considered to be disqualified persons with regard to another private foundation, and because the Support Agreement is solely between X and the Transferee Foundations, no direct self-dealing results.

While neither the Code nor the Regulations specifically define "indirect self-dealing", the Regulations under Section 4941 provide many examples thereof. All of these examples involve situations in which the private foundation was not directly engaged in the transaction at issue. No consideration is given by the Regulations to possible indirect self-dealing based on the relationship of the foundation managers of either the transferor or transferee foundations. Similarly, in Revenue Ruling 82-136, a grant from one private foundation to another was not

considered to be an act of self-dealing where the trustee of both private foundations was the same entity. The trustee, as a foundation manager, was a disqualified person with regard to both entities. However, any benefit received by the trustee was considered to be incidental.

Although the same individuals are considered to be disqualified persons with regard to X and the Transferee Foundations, no indirect self-dealing results from transactions directly between two private foundations, which are not disqualified persons with regard to the other.

Accordingly, the charge to each of the Transferee Foundations by X and the payment by each of the Transferee Foundations to X for each Transferee Foundation's share of office overhead expenses, including rental expense, office staff expense, supply and equipment expense and related expenses will not constitute direct or indirect self-dealing under Section 4941 by X, the Transferee Foundations, or any disqualified person with respect to X or the Transferee Foundations as defined under Section 4946, and will not affect the exempt status under Section 501(c)(3) of X or any of the Transferee Foundations.

Also, under the circumstances presented, the expense-sharing arrangement will not constitute a business enterprise subject to the excess business holdings provisions of section 4943.

14 and 15. Section 4941(d)(1)(1)) defines "self-dealing" to include any direct or indirect payment of compensation to a disqualified person. Section 4941(d)(2)(E) provides that, except in the case of a government official, where the payment is for personal services which are reasonable and necessary to carry out the exempt purposes of the private foundation, and where the compensation is not excessive, the payment of compensation to a disqualified person shall not be an act of self dealing. Code Section 4941(d)(1)(C) also defines self-dealing to include the direct or indirect furnishing of services between a private foundation and a disqualified person unless the services are furnished to the private foundation by the disqualified person without charge and are used solely for exempt purposes. The distinction between the services for which compensation can be paid and those which must be provided without charge is based on whether the services are considered to be "personal services". The consulting services contemplated fit within the definition of "personal services". See Madden v. Commissioner, T.C.M 1997-395 ("The services in the regulations are essentially professional and managerial in nature.") The providing of services and the receipt of compensation for the services fits within the exception discussed above as long as the compensation paid is not excessive, and the services are reasonable and necessary to carry out the exempt purposes of the Transferee Foundations.

CONCLUSION

Accordingly, we rule that:

1. Both X's initial transfer of sixty percent (60%) of its net assets and its subsequent transfer of its remaining net assets to S, T, and U will constitute transfers under section 507(b)(2) of the Code.

2. X's transfers of assets to S, T, and U under section 507(b)(2) of the Code will not result in a termination of its private foundation status under section 509 and will not result in any private foundation status termination tax under section 507(c) of the Code.

3. X's transfers to S, T, and U will not adversely affect the exemptions from federal income tax under section 501(c)(3) of P, S, T, or U.

4. Pursuant to section 507(b)(2) and section 1.507-3(a)(1) of the Income Tax Regulations, transferees S, T, and U will not be treated as newly created organizations.

5. Upon each transfer from X to the transferee foundations, the transferee foundations will succeed to a portion of X's aggregate tax benefits under section 507(d) of the Code in proportion to the amount of X's assets transferred to each.

6. The transfers of assets from X to S, T, and U will not be for consideration and will not be treated as a sale or exchange of property subject to tax. The tax basis and holding period of the transferred assets in the hands of the transferee foundations shall be determined in the same manner as if such assets had continued to be held uninterruptedly by X.

7. X's transfers of assets to the transferee foundations will not constitute or result in: (a) gross investment income or capital gain net income within the meaning of section 4940 of the Code; (b) an act of self-dealing under section 4941; (c) excess business holdings under section 4943; (d) an investment that jeopardizes charitable purposes under section 4944; or (e) a taxable expenditure under section 4945, as long as any required expenditure responsibility is exercised by X. The asset transfer will not cause X, the transferee foundations, or any disqualified person, as defined under section 4946, with respect to X or the transferee foundations to be subject to any tax under sections 4940 through 4945, as long as any required expenditure responsibility is exercised by X.

8. X will be required to exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the Foundation and Similar Excise Tax Regulations with respect to its initial transfer of assets to the transferee foundations. X will not be required to exercise expenditure responsibility under section 4945(h) of the Code with regard to the final transfer of its assets to the transferee foundations.

9. The legal, accounting, and other expenses, if reasonable in amount, of X, S, T, and U, in connection with this rulings request and in effectuating the proposed transfers, will not be taxable expenditures under section 4945 of the Code, and will be qualifying distributions under section 4942(g)(1)(A) of the Code.

10. For purposes of sections 4940 through 4945 and sections 507 through 509 of the Code, after the final transfer by X of its remaining net assets, the transferee foundations will not be proportionally treated as X, but will be treated as possessing X's tax attributes described in section 1.507-3(a)(2)-(4) of the regulations. The transferee foundations will succeed to X's unpaid tax liabilities to the extent of the value of assets transferred. X will be required to meet the section 4942 distribution requirements for its tax year in which the final transfers are made.

The transfer of the assets from X to the transferee foundations may be used in satisfaction of X's qualifying distribution requirements under section 4942 provided the requirements of section 4942(g)(3) are met.

11. After the final transfer of its assets to the transferee foundations, pursuant to section 507(a)(1) of the Code and section 1.507-1(b) of the regulations, X's status as a private foundation will be terminated once it notifies the Internal Revenue Service that it will terminate its status. X will not be liable for any termination tax under section 507(c) of the Code if the value of its net assets equals zero at such time when it gives notice that it is terminating its private foundation status.

12. After the final distribution of its assets to the transferee foundations, under section 1.507-1(b)(9) of the regulations, X will not be required to comply with periodic reporting, return and notice provisions of the Code for any tax year following the tax year in which the proposed final transfer to the transferee foundations occurs if, during the subsequent tax years, X has neither legal nor equitable title to any assets, and it engages in no activity. However, X will be required to comply with the notice and public inspection provisions of the Code in connection with its final return.

13. The proposed sharing of X's office space, administrative support staff, supplies, equipment and related items, the charging of a fee for such expenses incurred by X and the payment for such expenses by each of the transferee foundations under the Support Agreement for each transferee foundation's share of office overhead expenses, including rental expense, administrative support, supply and equipment expense, and related expenses will not constitute acts of direct or indirect self-dealing under section 4941 of the Code by X, the transferee foundations, or any disqualified person with respect to X or the transferee foundations as defined under section 4946 of the Code, and will not affect the exempt status under section 501(c)(3) of X or any of the transferee foundations.

14. Payments by each of the transferee foundations to P under the Consulting Agreement for investment, corporate governance, management and grant-making consulting services, if reasonable and not excessive, will not constitute direct or indirect self-dealing under section 4941 of the Code by X or the transferee foundations or any disqualified person with respect to them as defined under section 4946 (including without limitation P), and will not affect the exempt status under section 501(c)(3) of X or any of the transferee foundations.

15. The provision by P of investment, corporate governance, management and grant-making consulting services for a fee, if reasonable and not excessive, will not constitute direct or indirect self-dealing under section 4941 of the Code by X, the transferee foundations, or any disqualified person with respect to X or the transferee foundations as defined under section 4946 (including without limitation P), and will not affect the exempt status under section 501(c)(3) of the Code of X or any of the transferee foundations.

Except as we have ruled above, we express no opinion as to the tax consequences of X's transactions under the cited provisions of the Code or under any other provisions of the Code.

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

Because this letter could help resolve any future questions about X's tax status, X should keep a copy of this ruling in X's 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.

Sincerely,

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2