TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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4941.04-00
4942.03-05
4944.00-00
4945.04-06

Contact Person:

Identification Number:

Telephone Number:

T:EO:B2

Legend:
P =
R =
S =

Dear Sir or Madam:

This is in reply to your rulings request of May 29, 2001, on P's proposed transfer of approximately one-half of its assets to R and S pursuant to section 507(b)(2) of the Internal Revenue Code.

P, R, and S are exempt from federal income tax under section 501(c)(3) of the Code and are private foundations under section 509(a) of the Code. P will transfer approximately one-half of its assets to R and S, and will exercise expenditure responsibility under section 4945(h) of the Code with respect to those grants. P will continue to operate for its exempt purposes and thus will not give notice of termination of its private foundation status under section 507(a)(1) of the Code. P has no expenditure responsibility grants outstanding under section 4945(h) of the Code.

The following rulings are requested:

1. P's transfers will not adversely affect P's exemption from federal income tax under section 501(c)(3) of the Code.

2. Each transfer by P will be a transfer of assets pursuant to section 507(b)(2) of the Code.

3. Because P has not given, and does not plan to give, notice of termination pursuant to section 507(a)(1) of the Code, P's transfers will not constitute a termination of P's status as a private foundation, and P's transfers will not cause P to be subject to tax under section 507(c) of the Code.

4. Following P's transfers, P's attributes and characteristics will carry over as described in section 1.507-3(a) of the Income Tax Regulations.

5. P's transfers will not result in the imposition of net investment income tax under section 4940 of the Code.

6. P's transfers will not be acts of self-dealing under section 4941 of the Code and thus will not give rise to the tax on self-dealing under section 4941.

7. P's transfers will not trigger the tax on jeopardy investments under section 4944 of the Code.

8. P's transfers will not be taxable expenditures under section 4945 of the Code if P exercises expenditure responsibility under section 4945(h) of the Code.

9. Because P's transfers constitute grants for endowment under section 53.4945-5(c)(2) of the Foundation and Similar Excise Tax Regulations, P may satisfy section 4945(h)(3) of the Code by attaching the annual grantee reports of R and of S to P's annual information returns (Forms 990-PF) for P's tax year in which P's transfers are made and for P's following two tax years, provided that such reports contain, or are accompanied by, the information set forth in section 53.4945-5(d)(2) of the regulations.

10. P's reasonable and necessary legal, accounting, and other administrative expenditures, incurred in connection with this rulings request and the transfers, will constitute qualifying distributions under section 4942(g)(1)(A) of the Code and will not be taxable expenditures under section 4945(d)(5) of the Code.

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

Section 509(a) of the Code describes organizations exempt from federal income tax under section 501(c)(3) of the Code are private foundations subject to the provisions of Chapter 42 of the Code.

Section 507(a)(1) of the Code and section 1.507-1(b)(1) of the Income Tax Regulations provide that a private foundation may voluntarily terminate its private foundation status by submitting to the Internal Revenue Service a statement of its intention to voluntarily terminate its private foundation status pursuant to section 507(a)(1) and by paying any termination tax under section 507(c) of the Code.

Section 507(c) of the Code impose excise tax on a private foundation which voluntarily terminates its private foundation status under section 507(a)(1) of the Code, and provides that this section 507(c) tax is equal to the lower of: (1) the aggregate tax benefits that have resulted from the private foundation's exempt status under section 501(c)(3) of the Code, or (2) the value of the net assets of the private foundation.

Section 507(b)(2) of the Code concerns the transfer of assets by one private foundation to one or more other private foundations, and provides that each transferee private foundation shall not be treated as a newly created organization.

Section 1.507-3(c)(1) of the regulations indicates that a transfer under section 507(b)(2) of the Code includes a transfer of assets from one private foundation to one or more other private foundations pursuant to any reorganization, including a significant disposition of 25% or more of the transferor foundation's assets.

Section 1.507-1(b)(9) of the regulations provides that a private foundation which transfers all of its net assets is not required to file annual information returns required by section 6033 of the Code for subsequent tax years after its tax year of such transfer when it has no assets or activities.

Section 1.507-3(a)(5) of the regulations provides that a transferor private foundation is required to meet its charitable distribution requirements under section 4942 of the Code, even for any tax year in which it makes a transfer of its assets to another private foundation pursuant to section 507(b)(2) of the Code.

Section 1.507-3(a)(7) of the regulations provides that, where a private foundation has transferred all of its assets to another private foundation in a transfer under section 507(b)(2) of the Code, it is not required to exercise expenditure responsibility under section 4945(h) of the Code with respect to such transfer.

Section 1.507-3(a)(9)(i) of the regulations provides that, if a private foundation transfers assets to one or more private foundations which are effectively controlled directly or indirectly within the meaning of section 1.482-1(i)(4) of the regulations by the same persons who effectively control the transferor foundation, each transferee foundation will be treated as if it were the transferor foundation, for purposes of sections 4940 through 4948 and sections 507 through 509 of the Code. Each transferee is treated as its transferor in the proportion which the fair market value of the transferor's assets transferred to the transferee bears to the fair market value of all of the transferor's assets immediately before the transfer.

Section 1.507-3(a)(9)(ii) of the regulations provides that a transfer of assets under section 507(b)(2) of the Code does not relieve the transferor private foundation from filing its own final tax year return as required by section 6043(b) of the Code.

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

Sections 1.507-1(b)(7) and 1.507-3(d) of the regulations provide that a transferor foundation's transfer of assets under section 507(b)(2) of the Code will not constitute any termination of the transferor foundation's private foundation status under section 509(a) of the Code .

Section 4940 of the Code imposes excise tax on certain investment income of a private foundation.

Section 4941 of the Code imposes excise tax on any act of self-dealing between a private foundation and any of its disqualified persons under section 4946 of the Code.

Section 53.4946-1(a)(8) of the regulations provides that, for purposes of self-dealing under section 4941 of the Code, an exempt organization under section 501(c)(3) of the Code is not a disqualified person with respect to the private foundation.

Section 4942 of the Code provides that a private foundation must expend annual qualifying distributions under section 4942(g) of the Code for the direct active conduct of exempt purposes.

Section 4942(g)(1)(A) of the Code provides that a private foundation's qualifying distributions under section 4942(g) of the Code include reasonable and necessary administrative expenses, but do not include any contribution to: (i) an organization controlled by the transferor or by one or more of the transferor's disqualified persons, or (ii) a private foundation that is not an operating foundation under section 4942(j)(3) of the Code. Under section 53.4942-3(a)(2)(i) of the regulations, such qualifying distributions include the reasonable administrative expenses that are incurred in conduct of an exempt purpose under section 170(c)(2)(B) of the Code.

Revenue Ruling 78-387, 1978-2 C. B. 270, describes the carryover of a transferor private foundation's excess qualifying distributions under section 4942(i) of the Code where the transferor and the transferee foundations are controlled by the same persons under section 1.507-3(a)(9)(i) of the regulations. The transferee is treated as the transferor so that the transferee can reduce its own distributable amount under section 4942 of the Code by its share of the transferor foundation's excess qualifying distributions under section 4942(i) of the Code.

Section 4944 of the Code imposes excise tax on any jeopardizing investment made by a private foundation.

Section 4945 of the Code imposes excise tax on any private foundation's making of a taxable expenditure under section 4945(d) of the Code.

Section 4945(d)(4)(B) of the Code requires that, in order to avoid making a taxable expenditure, a transferor private foundation must exercise expenditure responsibility under section 4945(h) of the Code on its grants to another private foundation.

Section 4945(h) of the Code provides that, in order to exercise expenditure responsibility under section 4945(h), the grantor private foundation must: under section 4945(h)(1), see that its grant is spent solely for the grant's purpose; under section 4945(h)(2), obtain complete reports from the grantee foundation on how the funds are spent; and, under section 4945(h)(3), make reports to the Internal Revenue Service with respect to such grants.

Sections 53.4945-6(c)(3) allows a private foundation to transfer its assets to exempt organizations under section 501(c)(3) of the Code pursuant to section 507(b)(2) of the Code, without the transfers being taxable expenditures under section 4945(d) of the Code, provided that any applicable expenditure responsibility under section 4945(h) of the Code is met.

Section 53.4945-5(b)(2) of the regulations provides that expenditure responsibility includes a requirement that the grantor private foundation must make a pre-grant inquiry of the prospective grantee private foundation. Thus, before making a grant, the grantor must conduct a limited inquiry of the potential grantee. Such pre-grant inquiry must be complete enough to give a reasonable person assurance that the grantee will use the grant for the proper exempt purposes. This inquiry should concern matters such as the identity, prior history, and experience of the grantee organization and its managers, and any knowledge which the grantor has, based on prior experience or other information which is readily available, concerning the management, activities, and practices of the grantee foundation. The scope of this inquiry may vary from case to case depending upon the size and purpose of the grant, the period of time over which it is to be paid, and the prior experience which the grantor has had with respect to the capacity of the grantee to use the grant for the proper purposes.

Section 53.4945-5(c)(2) of the regulations provides that, if a private foundation makes a grant to another private foundation for endowment or for other capital purposes, the grantor foundation must require reports from the grantee foundation on the uses of the principal and the income (if any) from the grant funds. The grantee must make such reports annually for its tax year in which the grant was made and for its immediately succeeding two tax years. Only if it is reasonably apparent to the grantor, before the end of such grantee's second succeeding tax year, that neither the principal nor the income from the grant funds has been used for any purpose which would result in liability for tax under section 4945(d) of the Code, may the grantor then allow the grantee's reports to be discontinued.

Section 53.4945-5(b)(3) of the regulations provides, that, in order to exercise expenditure responsibility, the grantor private foundation must require that the grantee organization be made subject to a written commitment, signed by an appropriate officer, director, or trustee of the grantee, to repay any portion of the amount granted which is not used for the purposes of the grant, to submit full and complete annual reports on the manner in which the grant funds are spent and the progress made in accomplishing the purposes of the grant, to maintain records of receipts and expenditures, and to make its books and records available to the grantor at reasonable times, and not to use any of the funds to carry on propaganda or otherwise attempt to influence legislation within section 4945(d)(1) of the Code, or to influence the outcome of any specific public election, or to carry on any voter registration drive within the meaning of section 4945(d)(2), or to make any grant which does not comply with the requirements of section 4945(d)(3) or 4945(d)(4), or to undertake any activity for any purpose other than one specified in section 170(c)(2)(B) of the Code. The agreement must clearly specify the purposes of the grant. Such purposes may include contributing for capital endowment, provided that neither the grants nor the income therefrom may be used for purposes other than those in section 170(c)(2)(B) of the Code.

Section 53.4945-5(d)(1) of the regulations provides that, with respect to a grant made for endowment or capital purposes, the grantor foundation's annual reporting requirement under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations may be satisfied by submitting in the grantor foundation's annual information return (Form 990-PF) the report(s) received from the grantee foundation(s) containing the information required by section 53.4945-5(d)(2) of the regulations.

Section 53.4945-5(d)(2) of the regulations provides that the grantor report under section 4945(h) of the Code must contain: the name and address of the grantee; the date and amount of the grant; the purpose of the grant; the amounts expended by the grantee; whether the grantee has diverted any portion of the grant (or income from an endowment grant) from the purpose of the grant; the date of the report received from the grantee; and the dates and results of any grantor verification of the grantee's report where the grantor has reason to doubt the grantee report's reliability.

Analysis

1.

P's transfers of assets to R and S will be for exempt purposes under section 501(c)(3) of the Code. P's transfers will not adversely affect P's exemption from federal income tax under section 501(c)(3) of the Code.

2.

Under section 507(b)(2) of the Code and section 1.507-3(c)(1) of the regulations, a transfer under section 507(b)(2) of the Code includes a transfer of assets from one private foundation to one or more other private foundations pursuant to any reorganization, which includes any significant disposition of 25% or more of the transferor's assets. Because P will be in such a reorganization by its transfers of approximately one-half of its assets, P's transfers of assets to R and S will be transfers under section 507(b)(2) of the Code.

3.

Under section 1.507-4(b) of the regulations, P's transfers of assets pursuant to section 507(b)(2) of the Code will not terminate P's private foundation status under section 509(a) of the Code, and will not result in termination tax under section 507(c) of the Code.

4.

Under section 1.507-3(a) of the regulations, P's transfers will result in the carryover of any savings provisions applicable to P as provided in accordance with sections 1.507-3(a)(1) through (8) of the regulations.

5.

P's transfers of assets to R and S will not result in tax under section 4940 of the Code.

6.

P's transfers of assets will be made for exempt purposes to R and to S, which are organizations exempt from federal income tax under section 501(c)(3) of the Code. Under section 53.4946-1(a)(8) of the regulations, because P is exempt from federal income tax under section 501(c)(3) of the Code, P is not a disqualified person as to R or S under section 4946 of the Code for purposes of section 4941 of the Code. Because P's transfers of assets will not be transfers between a disqualified person and a private foundation, P's transfers will not be acts of self-dealing under section 4941 of the Code.

7.

P's transfers of its assets to R and S will not be jeopardizing investments or result in tax under section 4944 of the Code.

8.

P must exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations on its transfers of some of its assets to R and to S because the exception under section 1.507-3(a)(7) of the regulations to expenditure responsibility for a transfer of all assets does not apply to P because P's transfer to R and S consists of approximately one-half, rather than all, of P's assets.

9.

Under section 53.4945-5(d)(1) of the regulations, because P's transfers are grants for capital endowment under section 53.4945-5(c)(2) of the regulations, P can satisfy its expenditure responsibility grantor reporting under section 4945(h)(3) of the Code by including in P's annual information returns on Forms 990-PF for the tax year in which the transfers are made and for the following two tax years the annual grantee reports made by R and by S where such return or report contain the grant information required by section 53.4945-5(d)(2) of the regulations.

10.

Under section 53.4942(a)-3(a)(2)(i) of the regulations, a private foundation's payment of administrative expenses as part of its charitable effort may constitute a qualifying distribution under section 4942(g)(1)(A) of the Code. Thus, the legal, accounting, and other necessary expenses incurred to implement P's transfers to R and S, if reasonable in amount, will be paid to accomplish exempt purposes, and will be qualifying distributions under section 4942(g)(1)(A) of the Code.

Accordingly, we rule that:

1. P's transfers will not adversely affect P's exemption from federal income tax under section 501(c)(3) of the Code.

2. P's transfers to R and S will be transfers of assets pursuant to section 507(b)(2) of the Code.

3. P's transfers will not constitute a termination of P's status as a private foundation and will not cause P to be subject to tax under section 507(c) of the Code.

4. P's transfers will result in carryovers of P's attributes, characteristics, and any savings provisions as provided in section 1.507-3(a) of the regulations.

5. P's transfers will not result in tax under section 4940 of the Code.

6. P's transfers will not be acts of self-dealing under section 4941 of the Code and will not result in tax under section 4941 of the Code.

7 P's transfers will not result in any tax on jeopardizing investments under section 4944 of the Code.

8. P's transfers of some of its assets to R and S will not be taxable expenditures under section 4945 of the Code because P will exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations on its transfers of some of its assets to R and S.

9. Because P's transfers are grants for capital endowment under section 53.4945-5(c)(2) of the regulations, P can satisfy section 4945(h)(3) of the Code by attaching the annual grantee reports made by R and S to P's annual information returns on Forms 990-PF for P's tax year in which P's transfers are made and for P's following two tax years, where such reports contain, or are accompanied by, the information required by section 53.4945-5(d)(2) of the regulations.

10. P's reasonable and necessary legal, accounting, and other administrative expenditures, incurred in connection with this rulings request and its transfers, will be qualifying distributions under section 4942(g)(1)(A) of the Code.

Because this rulings letter could help to resolve any questions, please keep it in your permanent records.

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

Sincerely,

(signed) Terrell M. Berkovsky

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2