Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Contact Person:

Telephone Number:

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Uniform Issue List:
507.00-00
4940.00-00
4941.04-00
4942.03-05
4944.00-00
4945.04-06

Legend:

X =

Y =

Dear Sir or Madam:

This is in reply to your rulings request, dated January 12, 1998, submitted on June 3, requesting rulings as to X's proposed transfer of approximately one-half of its assets to Y pursuant to section 507(b)(2) of the Internal Revenue Code.

X and Y are each recognized as exempt from federal income tax under section 501(c)(3) of the Code and as private foundations under section 509(a).

In this proposed transaction, X will transfer approximately one-half of its assets to Y. X will exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations on its grant to Y. X has described its pre-grant inquiry on Y and its proposed written grant agreement with Y. X has no other expenditure responsibility grants outstanding under section 4945(h) 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 charitable and/or other exempt purposes stated in that section.

Section 509(a) of the Code provides that an organization exempt from federal income tax under section 501(c)(3) of the Code can be a private foundation subject to the private foundation provisions of Chapter 42 of the Code.

Section 507(c) of the Code imposes excise tax on a private foundation that terminates its status as a 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 Income Tax 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 any significant disposition of 25% or more of the transferor private foundation's assets.

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

Section 1.507-3(a)(1) of the regulations indicates that, in a transfer of assets from one private foundation to one or more private foundations pursuant to a reorganization, each transferee private foundation shall not be treated as a newly created organization, but shall succeed to the transferor's aggregate tax benefits under section 507(d) of the Code.

Section 507(d) of the Code indicates, in general, that the aggregate tax benefits of a private foundation refer to the value of its exemption from federal income tax and of the deductions taken by its donors during its existence.

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

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

Section 1.507-3(a)(9)(i) of the regulations indicates that, if a private foundation transfers assets to another private foundation that is effectively controlled, directly or indirectly, by the same person or persons who control the transferor foundation, the transferee foundation will be treated as if it were the transferor foundation, for purposes of sections 4940 through 4948 of the Code and sections 507 through 509 of the Code. The transferee foundation is treated as the transferor in the proportion which the fair market value of the transferor foundation's assets that were transferred bears to the fair market value of all of the assets of the transferor foundation immediately before the transfer.

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 status as a private foundation.

Section 4942 of the Code requires that a private foundation must expend qualifying distributions under section 4942(g) that are for the direct active conduct of exempt purposes. Such qualifying distributions can include reasonable administrative expenses that are incurred in the direct active conduct of an exempt purpose.

Section 4942(g)(1)(A) of the Code provides that a private foundation does not make a qualifying distribution under section 4942(g) where its distribution is a contribution to: (i) another organization that is 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).

Sections 4942(g)(3) of the Code requires that, in order for a grantor private foundation to have a qualifying distribution for its grant to another private foundation which is not an operating foundation under section 4942(j)(3), the grantor must have adequate records, as required by section 4942(g)(3)(B), 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). Such grantee'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 4945 of the Code imposes excise tax on a private foundation's making of any "taxable expenditure" as defined, in pertinent part, by section 4945(d)(4).

Section 4945(d)(4) of the Code requires that a transferor private foundation must exercise "expenditure responsibility" under section 4945(h) on any grant to another private foundation which is not an "exempt operating foundation" under section 4940(d)(2) of the Code in order for its grant not to be a taxable expenditure.

Section 4945(h) of the Code on expenditure responsibility provides, in part, that the grantor private foundation must obtain proper reports from its grantee private foundation as to the grantee's uses of the grant.

Section 53.4945-5(b)(2) of the Foundation and Similar Excise Tax 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, on capital endowment grants to private foundations, 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 also 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 described in section 170(c)(2)(B) of the Code.

Analysis

In this case, X will transfer approximately one-half of its assets to Y. Your specific requested rulings are discussed below:

1.

Under 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 another private foundations pursuant to any reorganization, including a significant disposition of 25% or more of the transferor foundation's assets. Because X will transfer approximately one-half of its assets, X's transfer will be a significant disposition of its assets under section 1.507-3(c)(1) of the regulations and, thus, will be a transfer under section 507(b)(2) of the Code.

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

2.

Under section 1.507-3(a)(1) of the regulations, in a transfer of assets from one private foundation to another private foundation pursuant to a reorganization, Y will be a private foundation transferee under section 507(b)(2) of the Code and will not treated as a newly created organization.

3.

Under section 1.507-3(a)(1) of the regulations, in a transfer of assets from one private foundation to another private foundation pursuant to a reorganization, the transferee private foundation will not be treated as a newly created organization, but will succeed to its proportionate share of its transferor's aggregate tax benefits under section 507(d) of the Code. Thus, X's aggregate tax benefits under section 507(d) of the Code will be transferred to Y in proportion to the amount of X's assets transferred to Y.

4.

X's transfer of assets to Y will be a transfer for exempt purposes under section 501(c)(3) of the Code and will not be any willful and flagrant act, or failure to act, or series of acts, which would result in tax under Chapter 42 of the Code.

5.

Under section 4940 of the Code, X's transfer of assets to Y will not be subject to that excise tax on investment income.

6.

Under section 4941 of the Code, X's transfer of assets to Y is not any act of self-dealing because it is made to Y as an exempt organization under section 501(c)(3), which is not a disqualified person as to X, for purposes of section 4941, pursuant to section 53.4946-1(a)(8) of the regulations.

7.

The legal, accounting, and other expenses, incurred by X and Y for this rulings request and the transfer, if reasonable in amount, will be qualifying distributions under section 4942(g)(1) of the Code.

Under section 53.4945-6(b)(2) of the regulations, a private foundation's payment of its reasonable costs for services rendered is not a taxable expenditure under section 4945 of the Code. Thus, X's payment of legal, accounting, and other expenses, if reasonable in amount, incurred to implement its transfer to Y, will not be taxable expenditures under section 4945.

8.

Because X's transfer will be made to an organization exempt from federal income tax under section 501(c)(3) of the Code for exempt purposes, the transfer will not be a jeopardizing investment or result in tax under section 4944 of the Code.

9.

By its review of Y's financial and other data and its knowledge of Y's managers, X has met its required pre-grant inquiry as to Y under section 53.4945-5(b)(2) of the regulations.

10.

X's grant agreement will meet the grant agreement requirement of section 53.4945-5(b)(3) of the regulations because it requires Y to comply with the purposes and restrictions of X's grant in accordance with that regulation and because X will take all reasonable action to enforce the terms of such grant agreement.

11.

X's transfer of approximately one-half of its assets to Y will not be a taxable expenditure under section 4945 of the Code because X will exercise capital endowment grant expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations on its transfer to Y.

12.

Under section 1.507-3(a)(8) of the regulations, X's transferee, Y, will receive the benefits of any savings provisions or transitional rules under that regulation that were applicable to X.

13.

X's transfer will be made for exempt purposes under section 501(c)(3) of the Code and will not adversely affect the exemptions from federal income tax under section 501(c)(3) of X or Y.

Under section 1.507-4(b) of the regulations, X's transfer to Y pursuant to section 507(b)(2) of the Code will not terminate the private foundation status of X or Y.

Accordingly, we rule that:

1. X's transfer of approximately one-half of its assets to Y will be a transfer pursuant to section 507(b)(2) of the Code, will not result in termination under section 507 of the Code of X's private foundation status under section 509, and will not subject X to termination tax under section 507(c) of the Code.

2. Y will be a transferee private foundation under section 507(b)(2) of the Code and will not be treated as a newly created organization.

3. Y will succeed to X's aggregate tax benefits under section 507 of the Code in proportion to the amount of X's assets transferred to Y.

4. X's transfer will not be any willful and flagrant act, or failure to act, or series of acts, which would result in tax under Chapter 42 of the Code.

5. X's transfer will not be subject to the excise tax on investment income under section 4940 of the Code as to X or Y.

6. X's transfer will not be an act of self-dealing under section 4941 of the Code as to X, Y, or their disqualified persons under section 4946 of the Code.

7. The legal, accounting, and other expenses, incurred by X and Y for this ruling and transfer, if reasonable in amount, will be qualifying distributions under section 4942(g)(1) of the Code, and will not be taxable expenditures under section 4945 of the Code.

8. X's transfer of assets to Y will not be a jeopardizing investment under section 4944 of the Code.

9. X has met its pre-grant inquiry requirements as to Y under section 53.4945-5(b)(2) of the regulations.

10. X will meet the grant agreement requirement under section 53.4945-5(b)(3) of the regulations by requiring Y to enter into the submitted grant agreement and by taking all reasonable actions to enforce the terms of that agreement.

11. X's transfer of approximately one-half of its assets to Y will not be a taxable expenditure under section 4945 of the Code because X will exercise capital endowment grant expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations on its transfer to Y.

12. Under section 1.507-3(a)(8) of the regulations, X's transferee, Y, will receive the benefits of any transitional rules that were applicable to X as a foundation in existence before January 1, 1970.

13. X's transfer will not adversely affect the exemptions from federal income tax of X or Y under section 501(c)(3) of the Code, and X and Y will each retain its private foundation status under section 509 of the Code.

Because this letter could help to resolve any questions about your status, you should keep it in your permanent records.

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

Sincerely,

(signed) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2