Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Significant Index Nos.
507.00-00
507.01-01
4940.00-00
4941.00-00
4942.00-00
4945.00-00
4945.04-06

Contact Person:

199914048

Telephone Number:

In Reference to:

Date: JAN 12 1999

Legend:
Foundation 1=
Foundation 2=
Foundation 3=
Foundation 4=
R=
S=
T=
U=
V=
W=
X=

Dear Sir or Madam:

This is in response to Foundation 1, 2, 3, and 4's request for certain rulings under sections 507, 4940, 4941, 1942, and 4945 of the Internal Revenue Code (hereafter Code).

Foundation 1 has been recognized exempt under section 501(c)(3) of the Code and classified as a private foundation under section 509(a). Foundation 1 was established by R, now deceased. Foundation 1's purposes include using its funds for charitable, scientific, literary, or educational purposes within the meaning of section 501(c)(3). Foundation 1's directors are S, T, and U, who are the sons of R.

Foundations 2, 3, and 4 have been recognized exempt under section 501(c)(3) and classified as private foundations under section 509(a) of the Code. Foundations 2, 3, and 4 are organized and operated exclusively for charitable, educational, literary, or scientific purposes within the meaning of section 501(c)(3).

S, W, and X serve as the trustees for Foundation 2. T serves as the sole director for Foundation 3. The trustees for Foundation 4 are U and V. Foundation 1 states that each trustee

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for Foundation 1 will serve as a trustee of his respective transferee foundation and will not serve as a trustee on the other two transferee private foundations after the proposed transfer.

Foundation 1 states that the members of its board of directors have determined that their charitable objectives and interests are different and that it would be more efficient to manage their charitable endeavors through separate organizations. In order to accomplish these objectives Foundation 1's board proposes to transfer all of Foundation 1's assets (100 percent) to Foundations 2, 3, and 4, in equal amounts. Foundation 1 represents that the transfer is consistent with the intent of its founder, R, who wished to have all of his children involved in charitable activities.

Foundation 1 states that it will effectively terminate its private foundation status and corporate existence after the transfer of assets is completed. Foundation 1 will provide the notice described in section 507(a) of its intent to terminate its private foundation status after the transfer is completed. Foundation 1 states that it has no accrued obligations from pre-existing charitable pledges or grants which require the exercise of expenditure responsibility.

Section 507(a) of the Code provides that, except as provided in section 507(b), the status of any private foundation shall be terminated only if such organization notifies the Secretary 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, and the Secretary notifies the organization that because of such act 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) of the Code provides that, in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

Section 507(c) of the Code imposes an excise tax on each terminating private foundation equal to the lower of the aggregate tax benefit resulting from such termination or the value of its net assets.

Section 507(e) of the Code provides that, for purposes of section 507(c), the value of the net assets shall be determined at whichever time such value is higher: (1) the first day on which action is taken which culminates in its ceasing to be a private foundation or (2) the date on which it ceases to be a private foundation.

Section 4940 of the Code provides for the imposition of a tax on the net investment income of private foundations.

Section 4941(d)(1)(E) of the Code states that the term "self dealing" means any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4942(a) of the Code imposes an excise tax on the undistributed income (as defined in paragraph (a) of Sec. 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 (if such first day falls within the taxable period as defined in paragraph (c)(1) of this section). For purposes of section 4942 the term "distributed" means distributed as qualifying distributions under section 4942(g).

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

Section 4943(c)(1) of the Code 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) of the Code 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 4945(d)(4) of the Code 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.

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Section 4945(d)(5) of the Code provides that the term "taxable expenditure" does not include amounts paid or incurred by a private foundation as a grant to another organization for purposes specified in section 170(c)(2)(B).

Section 4945(h) of the Code provides that the expenditure responsibility referred to in subsection (d)(4) means that the private foundation is responsible to exert all reasonable efforts to establish adequate procedures to see that the grant is spent 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 Secretary.

Section 4946(a)(1) of the Code provides, in part, that 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)).

Section 4946(a)(1)(B) of the Code defines a disqualified person to include with respect to a private foundation a foundation manager.

Section 4946(b)(1) of the Code states that the term foundation manager includes a trustee of a foundation having the authority or responsibility over the activities of the foundation.

Section 1.507-3(c)(1) of the Income Tax Regulations (hereafter regulations) provides that for purposes of section 507(b)(2) of the Code, the terms "other adjustment, organization, or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Section 1.507-3(c)(2) of the regulations 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.

Section 1.507-3(a)(1) of the regulations provides that in the case of a significant disposition of assets to one or more private foundations within the meaning of paragraph (c) of this section, the transferee organization shall not be treated as a newly created organization. A transferee organization to which

this paragraph applies shall be treated as possessing those attributes and characteristics of the transferor organization.

Section 1.507-3(a)(2)(i) of the regulations provides that a transferee organization to which section 507(b)(2) of the Code applies shall succeed to the aggregate tax benefit of the transferor organization in an amount equal to the amount of 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 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.

Section 1.507-3(a)(5) of the regulations provides that except as provided in subparagraph (9) of this paragraph, 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 1.507-1(b)(9) of the regulations 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.

Section 1.507-3(a)(7) of the regulations provides that except as provided in subparagraph (9) of this paragraph, 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.

Section 1.507-3(d) of the regulations provides that unless a private foundation gives notice under section 507(a)(1) of the Code, a transfer of assets described in section 507(b)(2) will not constitute a termination of the transferor's private foundation status.

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

The transfer of all of Foundation 1's assets to Foundations 2, 3, and 4 under the circumstances described will constitute a transfer as described in section 507(b)(2) of the Code. Therefore, Foundations 2, 3, and 4 will not be treated as newly created organizations. Foundations 2, 3, and 4, as transferee foundations, will be treated as possessing those attributes and characteristics of Foundation 1, the transferor, pursuant to section 1.507-(3)(a)(1) of the regulations.

For purposes of Chapter 42 and Part II of Subchapter F of Chapter I of the Code, Foundations 2, 3, and 4 will be treated as if they were Foundation 1 in the proportion that the fair market value of the assets (less encumbrances) transferred to Foundations 2, 3, and 4 bears to the fair market value of Foundation 1's assets (less encumbrances) immediately before the transfer. Since Foundation 1 has no obligations or existing grants in which it has to exercise expenditure responsibility, Foundation 1 will not be required to exercise expenditure responsibility described in section 4945(h) of the Code during any period in which it has no assets pursuant to section 1.507-3(a)(7) of the regulations (that is, for any year after the year of transfer).

Foundation 1 will transfer all of its assets to Foundations 2, 3, and 4. The transferee private foundations will use the assets transferred from Foundation 1 to accomplish charitable purposes described in section 501(c)(3) and 170(c)(2)(B) of the Code. Therefore, the transfer of assets by Foundation 1 will not be considered a taxable expenditure described in section 4945(d)(5) pursuant to section 1.507-3(a)(5) of the regulations.

Foundation 1 has not given notice of a termination of private foundation status pursuant to section 507(a)(1) of the Code. Therefore, the transfer of all of Foundation 1's assets to Foundations 2,3, and 4 will not terminate Foundation 1's status as a private foundation under section 507(a)(1) and for purposes of the tax imposed by section 507(c).

Based on the above we rule as follows:

1. The transfer of the assets of Foundation 1 to Foundations 2, 3 and 4 as described above constitutes a transfer described in section 507(b)(2).

2. The transfer of the assets of Foundation 1 to Foundations 2, 3 and 4 will not terminate Foundation 1 as a private foundation under section 507(a), and therefore will not result in the imposition of the termination tax under section 507(c).

3. The transfer of assets of Foundation 1 to Foundations 2, 3 and 4 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. The asset transfer will not cause Foundation 1, Foundation 2, Foundation 3, Foundation 4 or any disqualified person, as defined under section 4946, with respect to Foundation 1 , 2 , 3 or 4 to be subject to any tax under sections 4940 through 4945 and Foundation 1 will not be required to exercise expenditure responsibility under section 4945(h) with respect to the transfer.

4. The asset transfer will not be for consideration or 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 Foundation 2, 3 or 4, as the case may be, shall be determined in the same manner as if such assets had continued to be held uninterruptedly by Foundation 1.

5. Each of the Foundations will succeed to one-third of Foundation 1's aggregate tax benefits, but, in any event, none of the foundations will succeed to an aggregate tax benefit in excess of the fair market value at the time of the transfer of the assets that the respective foundations receive under Section 1.507-3(a)(2)(ii) of the regulations

because Foundations 2, 3 and 4 are not effectively controlled by the same persons who control Foundation 1.

6. For purposes of the Chapter 42 private foundation excise tax provisions and sections 507 through 509, Foundations 2, 3 and 4 will each be treated as if it is Foundation 1, but only in the proportion which the net fair market value of the assets transferred to each of the organizations bears to the net fair market value of all of Foundation 1's assets immediately before the transfers. Since Foundations 2, 3 and 4 will each receive one-third of all of Foundation 1's assets, Foundations 2, 3 and 4 will each succeed to one-third of Foundation 1's tax attributes under Chapter 42 and sections 507 through 509 including the following:

   a. For purposes of section 4940, one-third of the net investment income of Foundation 1 for the taxable year of the transfers to Foundations 2, 3 and 4 will be apportioned to Foundations 2, 3 and 4 and will be includable in the computation of the net investment of Foundations 2, 3 and 4 in the taxable year of the transfers.

   b. The transfers to Foundations 2, 3 and 4 will not be realizable events giving rise to net investment income pursuant to section 4940(c)(1). Therefore, such transfers themselves will not give rise to tax under section 4940.

   c. Foundation 1 will be required to meet the section 4942 distribution requirements for its taxable year in which the transfers are made. The transfer of the assets from Foundation 1 to Foundations 2, 3 and 4 may be used in satisfaction of Foundation 1's qualifying distribution requirements under section 4942 provided the requirements of section 4942(g) are met. To the extent that such distribution requirements have not fully been satisfied as of the transfers to Foundations 2, 3 and 4 and in the event that there remains any undistributed income for the taxable year of the transfers by Foundation 1, one-third of such remaining undistributed income will be allocated to Foundation 2, one-third to Foundation 3 and one-third to Foundation 4. Foundations 2, 3 and 4 must distribute their allocable one-third share of such remaining undistributed income not later than the end of their taxable year in which the transfer is made to them by Foundation 1 . For purposes of determining the assumed distribution requirement responsibilities of Foundation 2, 3 and 4

for Foundation 1's taxable year of the transfers, one-third of the value of Foundation 1's assets (calculated on a monthly basis as of the end of each calendar month falling within the taxable year of the transfers from Foundation 1 and then expressed as a monthly average) will be attributed to Foundation 2, one-third to Foundation 3 and one-third to Foundation 4. Foundations 2, 3 and 4 will each be deemed to have held net assets equal to one-third of such monthly average as of the last day of the each month during the Foundations 2, 3 and 4's taxable year of the transfers extending through the last day of the month immediately preceding the transfer. Appropriate adjustments will be made if transfers are made during more than one month.

7. Pursuant to section 507(b)(2) of the Code and section 1.507-3(a)(1) of the regulations, Foundations 2, 3 and 4 will not be treated as newly-created organizations.

8. The transfer of the assets from Foundation 1 to Foundations 2, 3 and 4 may be used in satisfaction of Foundation 1's qualifying distribution requirements under section 4942 provided the requirements of section 4942(g) are met.

9. The legal, accounting and other expenses incurred by Foundations 1, 2, 3, and 4 in connection with this ruling request and in effectuating the proposed transfer will not constitute taxable expenditures pursuant to section 4945 and will be considered qualifying distributions under section 4942.

10. Pursuant to section 507(a)(1) of the Code and section 1.507-1(b) of the regulations, Foundation 1's status as a private foundation will be terminated once it notifies the Service that it will terminate its status.

11. Foundation 1 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 it gives notice that it is terminating its private foundation status.

12. Since the proposed transfer will be made pursuant to section 507(b)(2) of the Code, it will not affect the section 501(c)(3) status of Foundations 1, 2, 3 and 4..

13. Under sections 1.507-1(b)(9) and 1.507-3(a)(9)(ii) of the Regulations, Foundation 1 will not be required to comply with periodic reporting, return and notice provisions under section 6033 and section 6104(b) of the Code for any taxable

year following the taxable year in which the proposed transfer occurs but only if during the subsequent taxable years in question, Foundation 1 has neither legal nor equitable title to any assets, and it engages in no activity. However, Foundation 1 will be required to comply with the notice and public inspection provisions under 6104(d) in connection with its final return.

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

We are informing your key District Director of this ruling.

Sincerely yours,

Kenneth J. Earnest

Kenneth J. Earnest
Acting Chief, Exempt Organizations
Technical Branch 3