Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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199918058

Contact Person:

Telephone Number:

In Reference to: OP:EEO:T:3

Date:
FEB 2 1999

A =
B =
C =
D =
X =

Dear Sir or Madam:

This is in reply to a ruling request dated August 28, 1998, with respect to a proposed disposition of all of your assets to A.

You are a trust (hereafter Appreciation Trust) recognized as exempt under section 501(c)(3) of the Internal Revenue Code (hereafter Code) and classified as a private foundation under section 509(a). Your activities consist of investing and reinvesting assets, collecting the income and paying over annually or at more frequent intervals income as required by the trust agreement to A.

A is a nonprofit corporation founded by B in 1941 and was funded with gifts and bequests. A is recognized as exempt under section 501(c)(3) of the Code and is classified as a private foundation under section 509(a). A's operations consists of investing and reinvesting its assets, collecting the income and paying over at least annually all of its income to organizations recognized as exempt under section 501(c)(3) of the Code and classified as public charities.

B founded C which manufactures components for the automotive industry. C's stock is publicly traded. B had retained control of the corporation through shares held in C. Fifteen days before B's death on January 28, 1968, B created the Appreciation Trust and funded with X shares of capital stock of D. This constituted all of B's ownership in C. Pursuant to the trust agreement, all income of the Appreciation Trust subsequent to the date of B's death (and subject to a limited authority which expired ten years after his death) was to be paid over annually or at more frequent intervals to A. The trust agreement provides that the Appreciation Trust shall continue perpetually except that the trustees in their absolute discretion may distribute the trust

principal to A provided that it is a qualified charitable organization.

D dissolved in 1978 and its holdings in C were distributed pro rata to its stockholders, including the Appreciation Trust.

The trustees of the Appreciation Trust continued to hold stock in C (except for shares which were distributed to A to meet the Appreciation Trust's minimum investment return distribution requirements) until all of the C stock was sold to an outside buyer in December, 1995.

The trustees of the Appreciation Trust have determined it is no longer needed as a separate entity, since A is the sole beneficiary of the Appreciation Trust and there is substantial commonality of management of the Appreciation Trust and A. Since the trust agreement authorizes the trustees in their discretion to distribute principal to A, the trustees have determined that significant efficiencies such as consolidation of investment procedure and bookkeeping functions, the elimination of reports and returns and the elimination of trustees' statutory commissions as well as savings could be accomplished by exercising such discretion and transferring all of the net assets of the Appreciation Trust to A.

Section 507(a) of the Code provides that except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if-

(1) such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such termination, or

(2)(A) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter 42, and

(B) the Secretary notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c), and either such organization pays the tax imposed by subsection (c) (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

Section 507(b)(2) of the Code provides that for purposes of this part, in 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 provides that there is imposed on each organization which is referred to in subsection (a) a tax equal to the lower of (1) the amount which the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the section 501(c)(3) status of such foundation, or (2) the value of the net assets of such foundation.

Section 1.507-1(b)(6) of the Income Tax Regulations (hereafter regulations) provides that if a private foundation transfers all or part of its assets to one or more other private foundations (or one or more private foundations and one or more section 509(a)(1), (2), (3), or (4) organizations) pursuant to a transfer described in section 507(b)(2) and section 1.507-3(c), such transfer foundation will not have terminated its private foundation status under section 507(a)(1).

Section 1.507-1(b)(7) of the regulations provides that neither a transfer of all of the assets of a private foundation nor a significant disposition of assets (as defined in 1.507-3(c)(2)) by a private foundation (whether or not any portion of such significant disposition of assets is made to another private foundation) shall be deemed to result in a termination of the transferor private foundation under section 507(a) unless the transferor private foundation elects to terminate pursuant to section 507(a)(1) or section 507(a)(2) is applicable.

Section 1.507-3(a)(1) of the regulations provides that for purposes of Part II, subchapter F, chapter 1 of the Code, in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee 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 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 which are described in subparagraphs (2), (3) and (4) of this paragraph.

Section 1.507-3(a)(5) of the regulations provides that a transferor private foundation is required to meet its distribution requirements under section 4942 of the Code, even for any taxable year in which it makes a section 507(b)(2) transfer of all of its net assets to another private foundation. The section 507(b)(2) transfer itself may be counted toward satisfaction of such requirement, however, provided that the transfer meets the requirements of section 49492(g).

Section 1.507-3(a)(7) of the regulations provides that, except as provided in section 1.507-3(a)(a)(9), where the transferor private foundation has disposed of all of its assets, sections 4945(d)(4) and 4945(h) of the Code shall not apply to the transferor or transferee foundations with respect to any "expenditure responsibility" grants made by the transferor foundation, except for any information reporting requirements imposed by section 4945 for any year in which any such transfer is made.

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

Section 1.507-3(a)(9)(i) of the regulations 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 section 1.482-1(a)(3)), directly or indirectly, by the same person or persons which effectively controlled the transferor private foundation, for purposes of chapter 42 (section 4940 et seq.) and part II of subchapter F of chapter 1 of the Code (sections 507 through 509), such a transferee private foundation shall be treated as if it were the transferor. However, where proportionality is appropriate, such a transferee private foundation shall be treated as it if were the transferor in 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.

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

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

Section 4940(a) of the Code provides that for the imposition on each private foundation which is exempt from taxation under section 501(a) for the taxable year, with respect to the carrying on of its activities, a tax equal to 2 percent of the net investment income of such foundation for the taxable year.

Section 4941(a) of the Code provides that there is hereby imposed a tax on each act of self-dealing between a disqualified person and a private foundation. The rate of tax shall be equal to 5 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period.

Section 4941(d)(1)(E) of the Code defines the term "self-dealing" as 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 of the Code requires that a private foundation must make qualifying distributions under section 4942(g) for the direct active conduct of exempt purposes.

Section 4942(g)(1)(A) of the Code provides, in pertinent part, that a private foundation does not make any qualifying distribution under section 4942(g) where the contribution is either: (i) to another organization that is controlled by the transferor or by one or more of the transferor's disqualified persons, or (ii) to any private foundation that is not an operating foundation under section 4942(j)(3), unless section 4942(g)(3) is met.

Section 4942(g)(3) of the Code requires that the transferor private foundation, in order to have a qualifying distribution for its grant to another private foundation, must have adequate records to show that the transferee private foundation in fact makes a qualifying distribution that is equal to the amount of the transfer received and that is paid out of the transferee's own corpus within the meaning of section 4942(h). The transferee's qualifying distribution must be expended before the close of the transferee's first taxable year after the transferee's taxable year in which the section 507(b)(2) transfer was received.

Section 4944(a) of the Code provides generally for the imposition of a tax on a private foundation and a foundation manager if investments are made in such a manner as to jeopardize the carrying out of the foundation's exempt purposes. The tax shall be equal to 5 percent of the amount so invested for each year in the taxable period and paid by the private foundation.

Section 4944(c) of the Code provides that there is no tax upon investment the purpose of which is to further exempt purposes.

Section 4945 of the Code imposes a tax on each "taxable expenditure" of a private foundation as defined in section 4945(d). Section 4945(d) defines a taxable expenditure to include, among other things, a grant to another organization, unless such organization is not a private foundation, or unless the donor private foundation exercises "expenditure responsibility" with respect to such grant in accordance with section 4945(h).

Section 4945(d)(4) of the Code provides that for purposes of this section, the term "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to an organization unless (A) such organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation (as defined in section 4940(d)(2)), or (B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h).

Section 4945(d)(5) of the Code provides that a taxable expenditure includes any amount expended by a private foundation for purposes other than exempt purposes under section 170(c)(2)(B).

Section 4945(h) of the Code provides that expenditure responsibility referred to in subsection (d)(4) means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures (1) to see that the grant is spent solely for the purpose for which made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and (3) to make full and detailed reports with respect to such expenditures to the Secretary.

Section 53.4945-5(c)(2) of the regulations provides that if a private foundation makes a grant described in section 4945(d)(4) to a private foundation which is exempt from taxation under section 501(a) for endowment, for the purposes of capital equipment, or for other capital purposes, the grantor foundation shall require reports from the grantee on the use of the

principal and the income (if any) from the grant funds. The grantee shall make such reports annually for its taxable year in which the grant was made and the immediately succeeding two taxable years. Only if it is reasonably apparent to the grantor that, before the end of such second succeeding taxable year, neither the principal, the income from the grant funds, nor the equipment purchased with the grant funds has been used for any purpose which would result in liability for tax and section 4945(d), the grantor may then allow such reports to be discontinued.

Sections 53.4945-6(c)(3) and 1.507-3(b) of the regulations allows a private foundation to make section 507(b)(2) transfers of its assets to organizations exempt under section 501(c)(3) of the Code, not excluding private foundations, without the transfers being taxable expenditures.

The transfer of assets from the Appreciation Trust to A will be a transfer of assets described in section 507(b)(2) of the Code because the transfer of funds will be from one private foundation to another pursuant to a reorganization or liquidation, as stated in section 1.507-3(c)(1) of the regulations. Under section 1.507-3(d), there is no private foundation termination tax in the case of section 507(b)(2) transfers from one private foundation to another private foundation.

The carryover provisions for a Code section 507(b)(2) transfer will be applicable. Similar to section 1.507-3(a)(2)(iii), Example (1), all of the Appreciation Trust's aggregate tax benefit, as defined in section 507(d) of the Code, will be carried over to A. In addition, under sections 1.507-3(a)(1) through (8), any other applicable carryover provisions will be applicable to A, the private foundation transferee.

The proposed transfer of Appreciation Trust's assets to A will not constitute an act of self-dealing under section 4941 of the Code because such transfer of funds is for exempt purposes. Even if the Appreciation Trust and A are controlled by the same persons, the transferees are not considered disqualified persons pursuant to section 53.4946-1(a)(8) of the regulations.

The Appreciation Trust is responsible for meeting its qualifying distribution requirements under section 4942 of the Code. Under section 1.507-3(a)(5) of the regulations, even if a transferor transfers all of its assets to other private foundations, the transferor's obligation to expend for exempt purposes, as required by section 4942(g) of the Code, must still be met.

The proposed transfer of the Appreciation Trust's assets to A will be for program related investments under section 4944(c) of the Code. Thus, the transfer will not constitute a jeopardizing investment within the meaning of section 4944(a).

The proposed transfer of assets is not a taxable expenditure under section 4945(d)(4) of the Code because the Appreciation Trust proposes to exercise expenditure responsibility under section 4945(h) with respect to the transfer.

Based on the facts submitted in this case, we rule as follows:

1. The proposed transfer of the net assets of the Appreciation Trust to A will not affect the status of either the Appreciation Trust or A as an organization described in section 501(c)(3) of the Code.

2. The transfer of the net assets of the Appreciation Trust to A will constitute a transfer described in section 507(b)(2), and will not constitute a termination of private foundation status giving rise to the imposition of the termination tax under section 507(c).

3. For the purposes of Chapter 42 and sections 507 through 509, A will be treated as if it were the Appreciation Trust, and A may take advantage of any special rules or savings provisions of Chapter 42 of the Code to the same extent as the Appreciation Trust could do so if the Trust were to continue in existence.

4. The transfer of the net assets of the Appreciation Trust to A may be counted toward the satisfaction of the Trust's distribution requirements under 4942 to the extent the transfer meets the requirements of section 4942(g).

5. After the transfer of the net assets of the Appreciation Trust to A, the excess distribution carryover of the Trust under section 4942(i), if any, will be added to the excess distribution carryover of A, and may be used by A to reduce its distributable amount under section 4942.

6. After the transfer of the net assets of the Appreciation Trust to A, the Trust's excise tax liability under section 4940, if any, and distribution requirements under section 4942 for its final taxable year may be satisfied by A, and any refund of section 4940 excise tax to which the Trust is entitled may be used by A to offset A's section 4940 excise tax.

7. The transfer of the net assets of the Appreciation Trust to A will not constitute:

   a. an act of self-dealing within the meaning of section 4941;

   b. a jeopardizing investment within the meaning of section 4944; or

   c. a taxable expenditure within the meaning of section 4945.

8. The Appreciation Trust will not be required to exercise expenditure responsibility under sections 4945(d)(4) and 4945(h) with respect to the transfer of its net assets to A.

9. The reasonable and necessary legal, accounting and other expenses incurred to implement the transfer and judicially settle the accounts of the trustees will constitute qualifying distributions under section 4942, and will not constitute taxable expenditures under section 4945.

10. After the transfer of the net assets of the Appreciation Trust to A is consummated, the Trust will no longer be required to file Form 990-PF (Return of Private Foundation) except for its filing of such return for its final taxable ending on the date of the transfer.

We are informing your key District Director of this ruling. Because this ruling could help resolve future questions about your federal income tax status, you should keep it in your permanent records.

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.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert C. Harper, Jr.

Robert C. Harper, Jr.
Chief, Exempt Organizations
Technical Branch 3