DEPARTMENT OF THE TREASURY 199941052
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

JUL 23 1999

SIN - 507-05.00; 4940.02-00; 4941.00-00
4945.04-06
No Third Party Contacts

Contact Person:

ID Number:

Telephone Number:

Legend:

X =
Y =

A =
B =
C =

x =
y =
z =

Dear Sir or Madam:

This refers to your rulings request relating to sections 507 and 4940 through 4946 of the Internal Revenue Code (the "Code").

X is exempt under section 501(c)(3) of the Code and a private foundation described in section 509(a). X was created and operated to pursue the charitable interests of A, and her late husband, B. The market value of X's assets as of September 30, 1998 was x dollars. Upon the death of A, X will receive the assets remaining in the A Trust, created under B's will, after payment of expenses and any applicable taxes.

After the death of B, a dispute arose between C, the only child of A & B, and the trustees of X. C asserted that she was entitled to be named a trustee of X in accordance with discussions which she had with her father prior to his death. While X's trustees disagree with C's assertions, they reached an agreement with C to resolve the dispute in order to avoid a continuing dispute over the governance of X which would result in the incurrence of legal fees and other expenses thereby reducing the assets available for charitable purposes. The resolution also furthers the charitable purpose of X since it provides for the creation of an endowment for Y, the new foundation created by C, to use to make charitable gifts. The significant components of the agreement are the following:

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1. Within 15 days after the date the IRS issues the rulings requested herein and assuming Y is determined to be exempt under section 501(c)(3) of the Code, X will transfer to Y cash and marketable securities having an aggregate value of y dollars (the "Initial Settlement Transfer").

2. Upon receipt by X of the assets from the A Trust, X will transfer to Y an amount, not to exceed 50% of the amount which X receives from the A Trust, equal to y dollars adjusted by the increase in the United States Government Consumer Price Index for all Urban Consumers from December 31, 1997 through the end of the calendar year prior to the death of A (the "Final Settlement Transfer").

Y has applied for and received recognition of exemption under section 501(c)(3) of the Code. Y is classified as a private foundation described in section 509(a). Y is not controlled by X and does not include the current trustees of X.

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 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 a tax on each organization which terminates its private foundation status under section 507(a).

Section 1.507-1(b)(6) of the Income Tax Regulations (the "regulations") provides 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) of the Code, such transferor foundation will not have terminated its private foundation status under section 507(a)(1).

Section 1.507-3(c)(1) of the regulations provides, in part, that a transfer of assets is described in section 507(b)(2) if it is made by a private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. The terms "other adjustment, organization, or reorganization" 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(d) of the regulations provides that unless a private foundation voluntarily gives notice pursuant to 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 under section 507(a)(1). Such transfer must, nevertheless, satisfy the requirements of any pertinent provisions of Chapter 42.

Section 1.507-4(b) of the regulations provides that private foundations which make transfers described in section 507(b)(2) are not subject to the tax imposed under section 507(c) with respect to such transfers unless the provisions of section 507(a) become applicable.

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 which are described in subparagraphs (2), (3), and (4) of this paragraph.

Section 1.507-3(a)(2)(i) of the regulations 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 transfer.

Section 1.507-3(a)(2)(ii) of the regulations, provides that notwithstanding (i) of this subparagraph, a transferee organization which is not effectively controlled (within the meaning of section 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 transfer.

Section 1.507-3(a)(4) of the regulations provides that if a private foundation incurs liability for one or more of the taxes imposed under Chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in section 507(b)(2) to one or more private foundations, in any case where transferee liability applies, each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor foundation does not satisfy such liability.

Section 4940(a) of the Code imposes on a private foundation with respect to the carrying on of its activities, a tax equal to 2% of its net investment income for the taxable year.

Section 4941(a) of the Code provides for the imposition of a tax on each act of self-dealing between a disqualified person and a private foundation.

Section 53.4946-1(a)(8) of the Foundation and Similar Excise Tax Regulations (also, the "regulations") provides that, for purposes of 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)).

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.

Section 4945(a) of the Code imposes a tax on each taxable expenditure (as defined in section 4945(d)) of the private foundation.

Section 4945(d)(4) of the Code provides that the term "taxable expenditure" means an amount paid or incurred by a private foundation as a grant to an organization unless the private foundation exercises expenditure responsibility with respect to such grants in accordance with section 4945(h) of the Code.

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 purchase 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 2 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 under section 4945(d), the grantor may then allow such reports to be discontinued.

The proposed transactions involve a private foundation's transfer of part of its assets for capital endowment of an entity that qualified for exemption under section 501(c)(3) of the Code and not a notification of its termination as a private foundation. Accordingly, the proposed transfer is not a transfer described in section 507(a) of the Code which is subject to tax under section 507(c). In addition, and as long as Y will qualify for exemption under section 501(c)(3) of the Code, the transfer of X's assets to Y will constitute a distribution for a charitable purpose and will not adversely affect the exempt status of X, nor will it be treated as investment income, an act of self-dealing, a jeopardizing investment or taxable expenditure within the meaning of sections 4940, 4941, 4944 and 4945.

Based on the foregoing, we rule, as requested, as follows:

1. Neither the Initial Settlement Transfer nor the Final Settlement Transfer will result in the termination of X as a private foundation under section 507 of the Code.

2. Neither the Initial Settlement Transfer nor the Final Settlement Transfer will result in any tax to X under section 507(c) of the Code.

3. The Initial Settlement Transfer will not result in the transfer, pursuant to section 1.507-3(a)(2), (3) or (4), from X to Y of the tax attributes in excess of the fair market value of the assets transferred at the time of transfer.

4. The Initial Settlement Transfer and the Final Settlement Transfer will not constitute acts of self-dealing under section 4941 of the Code.

5. The Initial Settlement Transfer and the Final Settlement Transfer will not result in a tax on investment income under section 4940 of the Code.

6. The Initial Settlement Transfer and the Final Settlement Transfer will not be

jeopardizing investments under section 4944 of the Code.

7. If X exercises the expenditure responsibility for transfers for endowments set forth in section 53.4945-5(c)(2) of the regulations with respect to the Initial Settlement Transfer and with respect to the Final Settlement Transfer, then the Initial Settlement Transfer and the Final Settlement Transfer, respectively, will not be taxable expenditures under section 4945 of the Code.

8. The Initial Settlement Transfer and the Final Settlement Transfer will not adversely affect X's exemption from federal income tax under section 501(c)(3) of the Code.

9. If reasonable in amount, X's payment of legal, accounting and other expenses incurred to reach the settlement with C and to implement the Initial Settlement Transfer and the Final Settlement Transfer will not be taxable expenditures under section 4945 of the Code.

We are informing your Key District of this ruling. Please keep a copy of it in your permanent records.

We express or imply no opinion as to the federal tax consequences of the transactions under any other provisions of the Code. This ruling is directed to the organization that requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited by others as precedent.

Sincerely,

(signed) Robert C Harper, Jr.

Robert C. Harper, Jr.
50-03055
Chief, Exempt Organizations
Technical Branch 3