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

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Date:

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OP:E:EO:T3

Contact Person:

ID Number:

Telephone Number:

Employer Identification Number:

Legend:

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Dear Sir or Madam:

This is in reference to a ruling request submitted on your behalf by your authorized representatives dated July 21, 1999, concerning a proposed transfer of the assets of a tax-exempt private foundation, X (the "Foundation") to four newly-formed non-profit corporations, B, C, D, and E (collectively the "New Foundations").

The information submitted indicates that the Foundation is a corporation that has been recognized as exempt from federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code (the "Code") and is classified as a private foundation within the meaning of section 509(a) of the Code. The Foundation's purpose is to operate a charitable foundation exclusively for religious, charitable, scientific, literary and educational purposes. The Foundation makes grants to various publicly supported charitable organizations.

The charitable interests and objectives of the trustees of the Foundation have diverged. Consequently, the trustees have decided to reorganize the Foundation by transferring all of the Foundation's assets to B, C, D, and E (the "New Foundations") as follows: one-third of the Foundation's assets to B, one third of the Foundation's assets to C, one-sixth to D, and one-sixth to E. B, C, D, and E have been recognized as exempt from federal income tax as organizations described in section 501(c)(3) of the Code and have been classified as private foundations.

The New Foundations will be controlled generally by the same family members who control the Foundation.

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At least one day following the transfers, the Foundation will dissolve, terminating its existence under state law. At that time, the Foundation will have no assets.

C and E will each assume one-third of the Foundation's distribution obligation under Code section 4942 and B and E will each assume one-sixth of the Foundation's distribution obligation under Code section 4942.

TERMINATION OF PRIVATE FOUNDATION STATUS

Section 507(a) of the Code provides that except as provided in section 507(b), the status of any organization as a private foundation shall be terminated only if (1) such organization notifies the Secretary of its intent to accomplish such termination, or (2) 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 the Secretary notifies such organization that such organization is liable for the tax imposed by section 507(c).

Section 507(b)(2) of the Code provides that 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 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 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 1.507-1(c)(2) of the regulations provides that for purposes of section 507(a)(2)(A) of the Code, the term "willful repeated acts (or failures to act)" means at least two acts or failures to act both of which are voluntary, conscious, and intentional. For purposes of section 507(a)(2)(A), a "willful and flagrant act (or failure to act)" is one which is voluntarily, consciously, and knowingly committed in violation of any provision of Chapter 42 (other than section 4940 or 4948(a)) and which appears to a reasonable man to be a gross violation of any such provision.

Section 1.507-3(c)(1) of the regulations provides, in part, that a transfer of assets is described in section 507(b)(2) of the Code 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(c)(2) of the regulations provides, in part, that the term "significant disposition of assets to one or more private foundations" includes any disposition for the taxable year of 25 percent or more of the fair market value of the net assets of the transferor foundation at the beginning of the taxable year.

Section 1.507-3(d) of the regulations provides that unless a private foundation voluntarily gives notice pursuant to 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 under section 507(a)(1).

The proposed transfers from the Foundation to the New Foundations involve a transfer of more than 25% of the assets of the Foundation. Thus, under section 1.507-3(c)(2) of the regulations, the transaction will result in a significant disposition of the assets of the Foundation. Accordingly, the proposed transfers constitute an "other adjustment, organization, or reorganization" within the meaning of section 1.507-3(c)(1) of the regulations, and, therefore, the transfers will constitute transfers described in section 507(b)(2) of the Code.

As transfers described in section 507(b)(2) of the Code, under sections 1.507-1(b)(6) and 1.507-3(d) of the regulations, the proposed transaction will not result in a termination of the Foundation's private foundation status under section 507(a). Because no termination will take place, the tax imposed by section 507(c) of the Code will not apply. Further, under section 507(b)(2), the New Foundations will not be treated as newly created organizations.

The transfer of the assets of the Foundation to the New Foundations will be a single act and will not be one voluntarily, consciously, and knowingly committed in violation of any provision of Chapter 42, nor would it appear to to a reasonable man to be a gross violation of any such provision. Accordingly, for purposes of section 507(a) of the Code, the proposed transfer will not constitute a willful and flagrant act (or failure to act) within the meaning of section 1.507-1(c) of the regulations, giving rise to liability for tax under Chapter 42 of the Code.

TAX ON NET INVESTMENT INCOME

Section 4940(a) of the Code imposes on each private foundation with respect to the carrying on of its activities a tax equal to two percent of the net investment income of such foundation for the taxable year. The transfers to the New Foundations will not constitute a "sale or other disposition of property or other realizable event" within the meaning of section 4940. Accordingly, the transfer will not constitute a realizable event giving rise to net investment income to either the Foundation or to the New Foundations. Therefore, the transfer will not give rise to tax under section 4940.

SELF-DEALING

Section 4941(a)(1) of the Code imposes a tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(E) of the Code defines "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 4946(a)(1) of the Code defines the term "disqualified person" to include, with respect to a private foundation, any person who is a foundation manager.

Section 53.4946-1(a)(8) of the Foundation and Similar Excise Taxes Regulations provides that for purposes of section 4941 of the Code 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)).

The Foundation will make the contemplated distributions to the New Foundations, all of which are described in section 501(c)(3) and not in section 509(a)(4). Therefore, the New Foundations will not be disqualified persons as to the Foundation at the time of the transfers and no transfer between a

disqualified person and a private foundation will occur. Accordingly, the transfer of the Foundation's assets to the New Foundations will not constitute acts of self-dealing under section 4941 of the Code and the transfers will not subject the Foundation, or the New Foundations to tax under section 4941.

DISTRIBUTION REQUIREMENTS

Section 4942(a) of the Code imposes a tax on the undistributed income of a private foundation.

Section 1.507-3(a)(5) of the regulations provides that, except as provided in section 1.507-3(a)(9), a private foundation is required to meet the distribution requirements of section 4942 of the Code 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.

Section 1.507-3(a)(9)(i) of the regulations provides that in a section 507(b)(2) transfer, if the transferee foundation transfers all of its assets to one or more private foundations which are effectively controlled (within the meaning of section 1.482-1(a)(3) [now redesignated as section 1.482-1A(a)(3)]) by the same person or persons who effectively controlled the transferor private foundation, for purposes of Chapter 42 and sections 507 through 509, such transferee shall be treated as if it were the transferor.

Section 1.482-1A(a)(3) of the regulations provides that the term "controlled" includes any king of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not the form or the mode of its exercise.

Because the New Foundations will be effectively controlled, within the meaning of section 1.482-1A(a)(3), by the same persons who effectively control the Foundation, the transfers from the Foundation of all of its assets to the New Foundations will be transfers described in section 1.507-3(a)(9)(i) of the regulations. Therefore, the New Foundations will be treated as if they were the Foundation. As a result, the Foundation will not be required to meet the section 4942 qualifying distribution requirement in the year in which the transfer of all its assets to the New Foundations Instead, the New Foundations will be responsible for satisfying their proportionate share of the Foundation's distribution requirements under section 4942 to the extent that such distribution requirements are not satisfied by the Foundation.

TAXABLE EXPENDITURES

Section 4945(a) of the Code imposes a tax on each taxable expenditure made by private foundations.

Section 4945(d)(4) of the Code defines the term "taxable expenditure" as an amount paid or incurred by a private foundation as a grant to an organization (other than an organization described in paragraph (1), (2) or (3) of section 509(a)), unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h).

Section 4945(h) of the Code provides that expenditure responsibility means that the private foundation is responsible to exert all reasonable efforts and 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.

Example (2) of section 1.507-3(a)(9)(iii) of the regulations indicates that when all net assets are transferred from one private foundation to one or more controlled foundations, there are no expenditure

responsibility requirements that must be exercised under sections 4945(d)(4) and 4945(d)(h) of the Code with respect to the transfer.

Since the Foundation is transferring all of its assets to the New Foundations, private foundations effectively controlled (within the meaning of section 1.482-1A(a)(3)) by the same person or persons who effectively controlled the Foundation, the transfers meet the requirements of section 1.507(a)(9)(i) of the regulations and, accordingly, the Foundation will not have to exercise expenditure responsibility with respect to the transfers to the New Foundations.

Accordingly, we rule as follows:

1. The proposed transfer will not result in the termination of the Foundation's private foundation status within the meaning of Code section 507(a), but will constitute an "other adjustment organization or reorganization" between private foundations within the meaning of Code section 507(b)(2) because it is a "significant disposition of assets to one or more private foundations" within the meaning of section 1.507-3(a)(1) and (c) of the regulations.

2. Under sections 1.507-1(b)(6) and (7) of the regulations, the proposed transfer will not constitute either a notification of the Foundation's intent to terminate its status as a private foundation under Code section 507(a)(1), or "willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act)" within the meaning of Code section 507(a)(2) by the Foundation and, therefore, the Foundation will not be liable for the tax imposed by Code section 507(c).

3. Under Code section 507(b)(2) and section 1.507-3(a)(1) of the regulations, the New Foundations will not be treated as newly created organizations. Rather, under Code section 507(b)(2) and section 1.507-3(a)(1) of the regulations, the new Foundations will be treated as possessing those attributes and characteristics of the Foundation that are described in sections 1.507-3(a)(2), (3) and (4) of the regulations.

4. The proposed transfer will not give rise to net investment income and will not constitute a "sale or other disposition" within the meaning of Code section 4940(c)(4)(A).

5. The proposed transfer will not constitute an act of self-dealing within the meaning of Code section 4941 by the Foundation or any of the New Foundations.

6. The proposed transfer will not subject the Foundation to any tax liability for a failure to distribute income under Code section 4942(a).

7. Under section 1.507-3(a)(7) and (9) of the regulations, the Foundation will not be required to exercise "expenditure responsibility" under Code section 4945(d) and (h) with respect to the assets transferred in the proposed transfer to the New Foundations because the Foundation will dispose of all of its assets within the meaning of section 1.507-3(a)(7) of the regulations and the New Foundations will be controlled by the same persons who control the Foundation within the meaning of section 1.507-3(a)(9) of the regulations.

8. Under sections 1.507-1(b)(9) and 1.507-3(a)(9) of the regulations, the Foundation will not be required to file the annual information return required by Code section 6033 for any taxable year following the taxable year in which the proposed transfer occurs provided that upon the Foundation's liquidation, dissolution, or termination, the Foundation will file the return required by Code section 6043(b).

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This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

Also, this ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited by others as precedent.

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

Sincerely,

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3

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