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

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507.05-00

Contact Person:

ID Number:

Telephone Number:

T:ED:B3

Employer Identification Number:

Legend:

B =
C =
D =
X =
Y =
Z =

Dear Sir or Madam:

This is in reference to a ruling request dated August 3, 2000 submitted by counsel for B, C, and D concerning a proposed transfer of the assets of B (the "Foundation") to two newly formed non-profit corporations.

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 and is classified as a private foundation within the meaning of section 509(a) of the Code. The Foundation's sole business is the making of grants for charitable, religious, educational and scientific purposes, as set forth in its Articles of Association and Bylaws.

X and Y were husband and wife. During the period they were married, they created B, and served as two of the three trustees. Y is the President of B and X is the Secretary of B. Z, one of the children of X and Y, is the third trustee.

X and Y were divorced in 1999. As a result of the divorce, X and Y have agreed that it would be desirable to divide the assets of B and to distribute them to two newly created foundations (the "New Foundations"), one created and controlled by Z and his family, and one created and controlled by Y and her family. This will allow management of the foundations in keeping with the objective of the founders, and will eliminate the strife that would be attendant on maintaining the status quo with X and Y involved in managing the same foundation.

The New Foundations are C and D. C and D 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 within the meaning of section 509(a).

B has distributed approximately one half of its assets to C and the other half to D. At the time of the distributions, B had no expenditure responsibility grants outstanding under section 4945(h) of the Code, and it currently has not such expenditure responsibility. B retains only assets sufficient to cover the costs of this reorganization.

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 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 that 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 1.507-3(a)(1) of the regulations provides that a section 507(b)(2) transfer results in a carryover of certain tax attributes and characteristics of the transferor organization to the transferee foundation as described in subparagraphs (2), (3), and (4).

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, 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 transactions 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 taxpayers represent that 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 a reasonable man to be a gross violation of any such provision. Based upon these representations, 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 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, both 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 4942(c) of the Code provides the term "undistributed income" means, with respect to any private foundation for any taxable year as of any time, the amount by which -

(1) the distributable amount for such taxable year, exceeds

(2) the qualifying distributions made before such time out of such distributable amount.

Under section 4942(g)(1)(A) of the Code, the term "qualifying distribution" means any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B). Section 170(c)(2)(B) purposes include charitable purposes.

Under sections 4942(g)(3)(A) and (B) of the Code, the term "qualifying distribution" includes a grant by a private foundation to another private foundation as long as the transferor maintains adequate records to show that the transferee in fact subsequently made 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).

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. 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 record keeping requirements of section 4942(g)(3)(B) shall not apply during any period in which it has no assets.

Section 1.507-3(a)(10) of the regulations by reference to section 1.507-3(a)(9)(i), 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 kind 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.

Under section 1.507-3(a)(5) of the regulations, the record keeping requirements of section 4942(g)(3)(B) of the Code will not apply to the Foundation during any period in which it has no assets.

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.

Section 4945(d)(4) of the Code provides that the term "taxable expenditure" includes any amount paid or incurred for any purpose other than one specified in section 170(c)(2)(B).

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.

FILING REQUIREMENTS

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.

In general, section 6043(b) of the Code provides that any organization which for any of its last 5 taxable years preceding its liquidation, dissolution, termination, or substantial contraction was exempt from taxation under section 501(a) shall file a return and other information with respect to such liquidation, dissolution, termination, or, substantial contraction.

Accordingly, we conclude as follows:

1. The Foundation's transfer of all of its assets to the New Foundations will constitute a significant disposition of its assets to one or more private foundations under section 507(b)(2) of the Code.

2. The Foundation's transfer to the New Foundations will not result in termination of the Foundation's private foundation status under section 507(a) of the Code, but will constitute a reorganization among these private foundations under section 507(b)(2).

3. The Foundation's transfer of its assets to the New Foundations will not constitute notification of the Foundation's intent to terminate its private foundation status under section 507(a)(1) of the Code, or any willful repeated acts (or failure to act) or any willful and flagrant act (or failure to act) under section 507(a)(2) by the Foundation), and, thus, the Foundation will not be liable for any tax imposed by section 507).

4. Under section 507(b)(2) of the Code, the New Foundations will not be treated as newly created organizations.

5. The New Foundations will be treated as possessing tax attributes and characteristics of the Foundation pursuant to sections 1.507-3(a)(2), (3) and (4) of the regulations.

6. The Foundation's transfer of all of its assets to the New Foundations will not give rise to any net investment income or constitute any other taxable sale or disposition under section 4940 of the Code.

7. The Foundation's transfer of all its assets to the New Foundations will not constitute any act of self-dealing under section 4941 of the Code by the Foundation or the New Foundations, or any of their foundation managers as defined in section 4946.

8. Upon the Foundation's transfer of all its assets to the New Foundations, the New Foundations will each succeed to a portion of the Foundation's excess qualifying distributions, if any, based upon each foundation's proportionate share of the Foundation's total assets received, and the record-keeping requirements of section 4942(g)(3)(B) of the Code will not apply to the Foundation during any period in which the Foundation has no assets.

9. The Foundation's transfer of all its assets to the New Foundations will not constitute any taxable expenditures under section 4945 of the Code.

10. The Foundation will not be required to exercise any expenditure responsibility under section 4945(h) of the Code with respect to its transfers of all of its assets to the New Foundations because the Foundation will have thus disposed of all of its assets.

11. Under section 1.507-3(a)(9) of the regulations, for purposes of Chapter 42 and sections 507 through 509 of the Code, the New Foundations will be treated as if each were the Foundation in the proportion that the fair market value of the Foundation's assets (less encumbrances) transferred to each bears to the fair market value of the Foundation's assets (less encumbrances) immediately before the

Foundation's transfer of its assets.

12. The Foundation and its foundation managers will not be required to file the annual information return required under Code section 6033 for any tax years following the tax year in which the last transfers of all the Foundation's assets occur if during such subsequent tax years the Foundation will have neither legal nor equitable title to any assets nor engage in any activity. Upon the Foundation's dissolution, the Foundation will be required by Code section 6043(b) to file its annual return for the year of such dissolution as required by Code section 6043(b).

13. The legal, accounting, and other expenses, if reasonable in amount, incurred by the Foundation and the New Foundations in connection with this ruling request and in carrying out the transfers of assets, will be considered as being made to achieve the charitable purposes of the grants and, thus, the payments of such costs and expenses will not constitute taxable expenditures under section 4945.

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