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

200246035

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: AUG 21 2002

Contact Person:

Identification Number:

Telephone Number:

SIN: 507.00-00

T:EO:B4

Employer Identification Number:

Legend:
B=
C=
D=

Dear Sir or Madam:

This is in response to a letter dated April 30, 2002, which requested certain rulings with respect to a proposed transfer of assets from B to C.

B and C are exempt under section 501(c)(3) of the Internal Revenue Code and are classified as private foundations under section 509(a). Both B and C were established by members of the D family. C's Board of Directors consists of two members of the D family. Both of these individuals sit on B's Board.

During recent years, B's Board of Directors has had discussions concerning the long term charitable goals and programs to be supported by B, and what investment strategies were appropriate given these goals. At various times, various directors have favored contrary courses of action. Because of the possibility that the overall long term charitable goals and investment strategies of the members and directors of B will diverge, B's members and directors have agreed to transfer some of its assets to C. The initial transfer to C will be comprised of a grant of one million dollars in stock. In no event will the total value of assets transferred to C exceed 25 percent of the total value of the assets of B. Following the transfer, both B and C will carry on their respective charitable goals and programs. As part of the transfer, B and C entered into an expenditure responsibility agreement as required by section 4945 of the Code.

B has not notified the Service that it intends to terminate its private foundation status, nor has B ever received notification that its status as a private foundation has been terminated.

Furthermore, there is no indication that B has committed 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.

Section 507(a) of the Code states, in part, that except for transfers described in section 507(b), an organization's private foundation status will be terminated only if (1) the organization notifies the Service of its intent to terminate or (2) 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.

Section 507(b)(2) of the Code provides that when a private foundation transfers assets 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 new organization.

Section 507(c) of the Code imposes a tax on an organization that terminates its private foundation status under section 507(a) of the Code.

Section 1.507-1(b)(7) of the Income Tax Regulations provides that neither a transfer of all of the assets of a private foundation, nor a significant disposition of assets (as defined in section 1.507-3(c)(2)) by a private foundation (whether or not any portion of such 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) of the Code, 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)(2)(i) of the regulations provides that a transferee organization, in the case of a transfer described in section 507(b)(2) of the Code, shall succeed to the aggregate tax benefit of the transferor organization in an amount equal to the amount of such aggregate tax benefit of the transferor organization, 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 is determined at the time of transfer.

Section 1.507-3(c)(1) of the regulations provides that for purposes of section 507(b)(2), 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 distribution of assets to one or more private foundations" shall include any disposition for a taxable where the aggregate of the dispositions is twenty-five (25%) percent or more of the fair market value of the net assets of the foundation at the beginning of the taxable year.

Section 4940 of the Code imposes a tax on the net investment income of private foundations.

Section 4941 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 includes in the definition of self-dealing any direct or indirect transfer to, or use for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4944 of the Code imposes tax upon a private foundation which invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes.

Section 4945 of the Code imposes tax upon a private foundation's making of any taxable expenditure under section 4945(d).

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

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 detailed reports with respect to such expenditures, and (3) to make full and detailed reports to the Secretary.

Section 53.4945-5(b)(7)(i) of the Foundation and Similar Excise Taxes Regulations refers to the rules relating to the extent to which the expenditure responsibility rules contained in section 4945(d)(4) and (h), and this section apply to transfers of assets described in section 507(b)(2).

Section 53.4945-5(c)(2) of the regulations provides that, if a private foundation makes a grant to another private foundation for endowment or for other capital purposes, the grantor private foundation must require reports from the grantee private foundation on the uses of the principal and income (if any) from the grant funds. The grantee must make such reports annually for its tax year in which the grant was made and for its immediately succeeding two tax years. Only if it is reasonably apparent to the grantor that, before the end of such grantee's second succeeding tax year, neither the principal nor the income from the grant funds has been used for any purpose which would result in liability for tax under section 4945(d), may the grantor then allow the grantee's reports to discontinue.

Section 53.4945-6(b)(2) of the regulations provides that any expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under section 4945(d)(5) unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was

consistent with ordinary business care and prudence. The determination whether an expenditure is unreasonable shall depend upon the facts and circumstances of the particular case.

Based on the above facts, following the transfer of assets from B to C, both B and C will continue to conduct their respective charitable activities.

Because the transfer of assets from B to C will not exceed 25% or more of the fair market value of the assets of B, it should not be considered a significant disposition of assets from one private foundation to another, within the meaning of section 507(b)(2) of the Code and section 1.507-3(c)(2) of the regulations. Therefore, the transfer would not result in the termination of the private foundation status of B.

Because B's transfer of assets to C is not a reorganization or significant disposition of assets under section 507(b)(2) of the Code, the transfer of assets will not result in C being treated under that section as possessing any of the tax attributes or characteristics of B.

The transfer of assets from B to C will not be a taxable expenditure as long as B exercises expenditure responsibility over the grant as described in section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations.

Because C has two foundation managers in common with B, these managers will be disqualified persons with respect to the proposed transfer. However, the transfer will not constitute an act of self-dealing because no funds will be disbursed either to the managers or for their use. Therefore, the proposed transfer of assets from B to C will not result in the imposition of tax under section 4941 of the Code.

In this case, the grant from B to C is one for endowment and C will not make a qualifying distribution equal to the amount of the grant it will receive from B. Thus, B's grant to C will not be treated by B as a qualifying distribution under section 4942 of the Code.

In this case, B is not selling property to C nor making an investment in C. Rather the transfer of stock is a grant, essentially analogous to a gift, and will not be "net investment" within the meaning of section 4940 of the Code. B's tax basis in the granted stock will carry over to C pursuant to section 1015(a) of the Code and any gain or loss would be computed at the time of any future sale by C.

Because the proposed transfer of assets to C will be made to accomplish the exempt purposes of B and C, the transfer will not constitute "investments" for purposes of section 4944 of the Code. Thus, the excise taxes imposed on jeopardizing investments under section 4944(a) of the Code will not apply to the transfer of assets from B to C.

Provided the expenses incurred by B and C in the transfer of assets to C meet the "good faith" standard of section 53.4945-6(b)(2), such expenses will not constitute taxable expenditures under section 4945 of the Code.

Accordingly, based on the information furnished, we rule as follows:

1. The proposed transfer of assets to C will not jeopardize the classifications of B or C as private foundations described in sections 501(c)(3) and 509(a) of the Code.

2. The proposed transfer of assets to C will not result in a termination of private foundation status of B within the meaning of section 507(a), nor will it constitute an adjustment between private foundations under section 507(b)(2) or have the effect of dispossessing B of any of the attributes or characteristics described in section 1.507-3(a) of the regulations.

3. The proposed transfer of assets to C will not constitute a taxable expenditure under section 4945 of the Code, provided that B exercises expenditure responsibility under section 4945(h) of the Code with respect to the transfer.

4. The proposed procedures of B constitute adequate expenditure responsibility under section 4945(h) with respect to the assets to be transferred.

5. The proposed transfer of assets to C will not be an act of self-dealing within the meaning of section 4941 of the Code and therefore will not result in the imposition of tax under that section.

6. The proposed transfer of assets to C will not constitute qualifying distributions within the meaning of section 4942 of the Code.

7. The proposed transfer of assets to C will not constitute a sale or disposition of property within the meaning of section 4940 of the Code, nor will it give rise to net investment income, and will therefore not result in the imposition of any excise tax under section 4940 of the Code.

8. The proposed transfer of assets to C will not constitute an investment on the part of B, and therefore B will not be subject to the tax on jeopardizing investments within the meaning of section 4944 of the Code.

9. The payment of the legal, accounting and other expenses (including filing) incurred by B and C in connection with this ruling request will not constitute a taxable expenditure under section 4945 of the Code.

We are informing the Ohio TE/GE office of this action. Please keep a copy of this ruling in your organization's permanent records.

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

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4