200313021

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Date: DEC 31 2002

SIN: 507.00-00

Contact Person:

Identification Number:

Telephone Number:

T:EO:B4

Employer Identification Number:

Legend:
B=
C=

Dear Sir or Madam:

This is in response to a letter dated September 4, 2002, in which you requested certain rulings with respect to a proposed transfer of assets from B to C.

B is exempt under section 501(c)(3) of the Internal Revenue Code and is classified as a private foundation under section 509(a). We have determined that C is tax-exempt under section 501(c)(3) of the Code and classified as a private foundation under section 509(a) in separate correspondence.

Fundamental philosophical differences have arisen among certain of B's trustees making it difficult for B to develop a united approach to grant-making. To eliminate this problem, B proposes to transfer some of its net investment assets to C. C will be effectively controlled by the same trustees that control 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, B has stated that it has not 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)(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 subsection, the transferor organization shall not be treated as a newly created organization.

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(a)(9)(i) of the regulations provides that, if a transferor private foundation transfers assets to a private foundation effectively controlled, directly or indirectly, by the same person or persons who effectively control the transferor private foundation, the transferee foundation will be treated as if it were the transferor foundation, for purposes of sections 4940 through 4948 and sections 507 through 509 of the Code. The transferee is treated as the transferor in the proportion which the fair market value of the transferor's assets that were transferred bears to the fair market value of all of the assets of the transferor immediately before the transfer.

Section 1.507-3(b) of the regulations provides that in order for a transfer of assets, pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization, not to be a taxable expenditure, it must be to an organization described in section 501(c)(3) (other than an organization described in section 509(a)(4)) or

treated as described in section 501(c)(3) under section 4947.

Section 1.507-3(d) of the regulations provides that unless a private foundation gives notice under section 507(a)(1) of the Code, a transfer of assets described in section 507(b)(2) of the Code will not constitute a termination of the transferor's private foundation status.

Section 1.507-4(b) of the regulations provides that the tax on termination of private foundation status under section 507(c) of the Code does not apply to a transfer of assets pursuant to section 507(b)(2) of the Code unless the provisions of 507(a) become applicable.

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 4942 of the Code requires a private foundation to make specified distributions of income for each taxable year, including the year in which it transfers substantial assets to another private foundation under section 507(b)(2).

Section 4942(g)(1)(A) of the Code defines a qualifying distribution as 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), other than any contribution to (i) an organization controlled by the foundation or one or more disqualified persons or (ii) a private foundation which is not an operating foundation, except as otherwise provided; or (B) any amount paid to acquire an asset used directly in carrying out one or more purposes described in section 170(c)(2)(B).

Section 4942(g)(3) of the Code requires that a grantor private foundation, in order to have a qualifying distribution for its grant to another private foundation, which is not an operating foundation under section 4942(j)(3) of the Code, must have adequate records, as required by section 4942(g)(3)(B) of the Code, to show that the grantee private foundation, in fact, subsequently made qualifying distributions that were equal to the amount of the grant and that were paid out of the grantee's own corpus within the meaning of section 4942(h) of the Code. Such grantee foundation's qualifying distributions out of corpus must be expended before the close of the grantee's first tax year after its tax year in which it received the grant.

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. The exercise of expenditure responsibility requires the foundation that

makes the transfer to keep detailed records of the way the payment is spent by the recipient foundation.

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 4946(a)(1) of the Code defines the term "disqualified person" as a person who is a substantial contributor to a private foundation, a foundation manager, an owner of more than 20% of a corporation or partnership which is a substantial contributor to the private foundation, a family member of persons described above, or a corporation, partnership, trust or estate of which persons described above own more than 35% of the combined voting power.

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 53.4945-6(c)(3) of the regulations provides that a transfer of assets of a private foundation under section 507(b)(2) of the Code is not a taxable expenditure if such transfer is to an organization described in section 501(c)(3) (other than an organization described in section 509(a)(4)) or treated as so described under section 4947(a)(1).

Section 53.4946-1(a)(8) of the regulations provides that, for purposes of section 4941, the term "disqualified person" does not include any organization described in section 501(c)(3) (other than an organization described in section 509(a)(4)).

Following the transfer of assets from B to C, both B and C will continue to conduct their respective charitable activities.

Under section 507(b)(2) 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 foundation shall not be treated as newly created organization. Thus, the transfer by B to C will constitute in the aggregate an "adjustment, organization, or reorganization" within the meaning of section 507(b)(2). Accordingly, the transfer by B to C will not be treated as a transfer to a newly created organization.

Because a transfer of assets as described in section 507(b)(2) will not cause a termination of an organization's private foundation status, the transfer of B's assets to C will not terminate B's status as a private foundation.

B will not terminate its status as a result of this transaction. Therefore, the transfer of B's assets to C will not result in the imposition of tax under section 507(c) of the Code.

In this case, B is not selling property to C nor making an investment in C. Rather the transfer of assets is essentially analogous to a gift, and will not be "net investment" within the meaning of section 4940 of the Code. B will not receive any consideration from C, either as dividends or interest or any payment for the assets transferred to it. C will not assume any financial obligations of B other than the grant commitments to be satisfied using the assets to be transferred to it.

For several consecutive years, B has been eligible for the reduced section 4940(e) excise tax rate of 1 percent. Because the proposed transfer is merely a division of one foundation into two foundations, both B and C should continue to be eligible for this reduced rate based on the grants history of B if they continue to meet the section 4940(e) requirements after the proposed transfer.

Because B, as an organization described in section 501(c)(3) of the Code, is not a disqualified person with respect to C, the transfer of assets to C will not constitute an act of self-dealing within the meaning of section 4941 of the Code.

In this case, B and C will each assume their proportionate share of B's undistributed income under section 4942 and reduce their own distributable amount for purposes of section 4942 by their proportionate share of B's excess qualifying distributions under section 4942(i), if any. Thus, B's transfer of assets to C will not be treated by B as a qualifying distribution under section 4942 of the Code.

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.

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.

B's transfer of assets to C will not constitute a taxable expenditure provided B exercises expenditure responsibility over the grant.

Under the asset transfer agreement between B and C, B will transfer responsibility for certain existing obligations and commitments to C for future administration and funding. Therefore, in recognition of the requirements of section 4945, the agreement requires C to exercise expenditure responsibility for any grants or commitments made by B that require the exercise of expenditure responsibility that have been made to grantees under programs and projects C will assume.

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

1. The transfer of assets from B to C will have no adverse effect on the tax-exempt status of either B or C as an organization described in section 501(c)(3) of the Code.

2. The transfer of assets from B to C will constitute a permissible transfer of assets from one private foundation to another private foundation as described in section 507(b)(2) of the Code.

3. The transfer of assets from B to C will not result in the termination of the private foundation status of B pursuant to section 507(a) and, accordingly, will not cause B to be subject to the tax imposed by section 507(c) of the Code.

4. The transfer of assets from B to C will not impose on B or C any tax on investment income pursuant to section 4940 of the Code. Both B and C may use its proportionate share of any excess section 4940 tax paid by B prior to the transfer to offset its section 4940 excise tax liabilities.

5. C will be treated, for purposes of computing its section 4940 excise tax liability in the year in which the transfer of assets occurs and in each subsequent year, as having the same "percentage payout", as defined in section 4940(e)(3)(B) of the Code, as that of B for the year in which the transfer occurs and for each year in the "base period", as defined in section 4940(e)(4)(A) without regard to section 4940(e)(4)(B).

6. The transfer of assets from B to C will not constitute an act of self-dealing as described in section 4941 of the Code.

7. The transfer of assets from B to C will not constitute a qualifying distribution for B under section 4942. B and C will each assume their proportionate share of B's undistributed income under section 4942 and reduce their own distributable amount for purposes of section 4942 by their proportionate share of B's excess qualifying distributions under section 4942(i), if any.

8. Reasonable legal, accounting, organizational and other professional and administrative expenses incurred by B and C, respectively, in order to accomplish the proposed asset transfer, will constitute qualifying distributions under section 4942 of the Code and will not be taxable expenditures under section 4945 of the Code.

9. The transfer of assets from B to C will not result in a jeopardy investment as defined in section 4944 of the Code.

10.The transfer of assets from B to C will not constitute a taxable expenditure as defined in section 4945 of the Code on the part of B so long as B exercises expenditure responsibility under section 4945(h) with respect to the transfer to C by (a) obtaining from the president or treasurer of C, after the transfer of assets, reports of the use by C of the principal of and the income (if any) from the assets transferred to it by B for the calendar year in which the transfer of assets occurs and for the immediately succeeding two taxable years, (b) including in B's Form 990-PF returns for such years reports containing the information specified in section 53.4945-5(d)(2) of the regulations, (c) maintaining in B's permanent records a copy of the asset transfer agreement, each report received from C, and each

report of B's personnel or independent auditors concerning the transfer to C, and (d) taking all reasonable and appropriate actions to correct any diversion by C of the transferred assets and income therefrom from C's charitable purposes.

11.The allocation to C of expenditure responsibility for certain grants made by B as provided pursuant to the asset transfer agreement will relieve B of expenditure responsibility for those grants and impose expenditure responsibility for them on C.

We are informing the 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