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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Contact Person:

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509.02-02
4942.03-05

Identification Number:

Telephone Number:

T:EO:BR2

Legend:
P=
S=
M=
N=

Dear Sir or Madam:

This is in reply to your rulings request, and subsequent correspondence, involving sections 507(c), 509(a)(3), and 4942(g) of the Internal Revenue Code, on private foundation P's proposed transfer of all of its assets to a related supporting organization, S.

You, P, are a nonprofit charitable corporation that is exempt from federal income tax under section 501(c)(3) of the Code and that is a private foundation under section 509(a) of the Code.

S is the proposed transferee of P's assets. S is a charitable trust that is exempt from federal income tax under section 501(c)(3) of the Code and that is not a private foundation under section 509(a) of the Code because S is a supporting organization under section 509(a)(3) of the Code for the benefit of M as of the present time. S may operate for the benefit of a possible new community trust N in the future, provided that N is later created in a nearby geographical area, that N is recognized as an exempt "community trust" and not as a private foundation, and that the substitution of N for M is approved by a majority of all of S's governing body in which less than a majority (two of the five persons on your governing body) will be disqualified persons and the other three persons will be appointees of M unrelated to disqualified persons. S may make charity grants to M and to charities as directed by M and approved by a majority of S's trustees. S will not make loans to its disqualified persons or its officials.

M, S's supported organization, is exempt from federal income tax under section 501(c)(3) of the Code and is not a private foundation under section 509(a) of the Code because M is a financially publicly supported "community trust" under section 170(b)(1)(A)(vi) of the Code and section 1.170A-9(e)(11) of the Income Tax Regulations.

After its transfer of all of its assets to S, P will notify the Internal Revenue Service pursuant to section 507(a)(1) of the Code of P's intent to terminate voluntarily its private foundation status under section 509(a) of the Code.

The following rulings are requested:

1. P's transfer of all of its assets to S will not result in the termination of P's private foundation status under section 509(a) of the Code and P will not be subject to termination tax under section 507(c) of the Code upon, or by reason of, the transfer.

2. P will not be subject to termination tax imposed by section 507(c) of the Code upon, or by reason of, providing notice to the Internal Revenue Service of its intent to terminate voluntarily its private foundation status, or, upon, or by reason of, its dissolution, winding up of its affairs, and termination of its existence under its state law.

3. S is not an organization controlled by P within the meaning of section 4942(g)(1)(A) of the Code and section 53.4942(a)-3(a)(3) of the Foundation and Similar Excise Tax Regulations, and, thus, P's transfer of assets to S will be a qualifying distribution by P under section 4942(g) of the Code

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations organized and operated exclusively for charitable and/or other exempt purposes stated in that section.

Section 509(a) of the Code describes organizations exempt from federal income tax under section 501(c)(3) of the Code that are private foundations subject to the private foundation provisions of Chapter 42 of the Code.

Section 507(a)(1) of the Code describes termination of private foundation status under section 509(a) of the Code by means of the private foundation voluntarily so notifying the Internal Revenue Service.

Section 507(c) of the Code imposes excise tax on a private foundation which voluntarily terminates its status as a private foundation under section 509(a) of the Code pursuant to section 507(a)(1) of the Code. This section 507(c) tax is equal to the lower of: (a) the aggregate tax benefits that have resulted from the foundation's exempt status under section 501(c)(3) of the Code or (b) the value of the net assets of the foundation.

Revenue Ruling 2002-28, 2002-1 C.B. 942, in its holding (1), states that, if a private foundation chooses to provide notice under section 507(a)(1) of the Code to the Internal Revenue Service and therefore terminates its private foundation status under section 509(a) of the Code, it is subject to the tax under section 507(c) of the Code; however, if the private foundation has no assets on the day it provides such notice (for example, the private foundation provides such notice at least one day after it transfers all of its assets), the tax under section 507(c) of the Code will be zero.

Revenue Ruling 2003-13, 2003-4 I.R.B. 305, in its holding (1), indicates that the termination of private foundation status tax under section 507(c) of the Code does not apply to a transfer by a private foundation of its assets to a supporting organization under section 509(a)(3) of the Code (unless the private foundation otherwise specifically notifies the Service under section 507(a)(1) of the Code of its intended termination as of the time before its transfer of its assets.)

Section 507(a)(2) of the Code describes a termination of private foundation status under section 509(a) of the Code after prohibited acts by the private foundation and notice by the Internal Revenue Service of the involuntary termination of such private foundation status.

Section 507(b)(1)(A) of the Code describes a termination of private foundation status under section 509(a) of the Code by means of a private foundation transferring all of its assets to a public charity under section 170(b)(1)(A)(vi) and 509(a)(1) of the Code that has been in existence for a continuous period of at least 60 calendar months prior to the transfer.

Section 507(b)(1)(B) of the Code describes a termination of private foundation status under section 509(a) of the Code by means of a private foundation notifying the Internal Revenue Service that it will operate to meet section 509(a)(1), section 509(a)(2), or 509(a)(3) of the Code for a continuous period of 60 calendar months.

Section 1.509(a)-4(j) of the regulations disallows control of a supporting organization by one or more disqualified persons, and indicates, in pertinent parts, that:

> An organization will be considered controlled, for purposes of section 509(a)(3)(C), if the disqualified persons, by aggregating their votes or positions of authority, may require such organization to perform any act which significantly affects its operation or may prevent such organization from performing such act. This includes, but is not limited to, the right of any substantial contributor or his spouse to designate annually the recipients, from among the publicly supported organizations, of the income attributable to his contribution to the supporting organization.
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> A supporting organization will be considered to be controlled directly or indirectly by one or more disqualified persons if the voting power of such persons is 50 percent or more of the total voting power of the organization's governing body or if one or more of such persons have the right to exercise veto power over the actions of the organization.
>
> If the governing body of a foundation is composed of five trustees, none of whom has a veto power over the actions of the foundation, and no more than two trustees are at any time disqualified persons, such foundation will not be considered to be controlled directly or indirectly by one or more disqualified persons by reason of this fact alone.

All pertinent facts and circumstances including the nature, diversity, and income yield of an organization's holdings, the length of time particular stocks, securities, or other assets are retained, and its manner of exercising its voting rights with respect to stocks in which members of its governing body also have some interest, will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization.

Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274 (7th Circuit, August 15, 1979) affirming the Tax Court at 70 T.C. 182 (May 8, 1978), confirms that, if an organization wants to be a supporting organization under section 509(a)(3), a donor does not have the right to substitute his or her change of the named supported organization.

Section 4942 of the Code requires that a private foundation must expend qualifying distributions under section 4942(g) of the Code for the conduct of exempt purposes.

Section 4942(g)(1)(A)(i) of the Code and section 53.4942(a)-3(a)(2) of the Foundation and Similar Excise Tax Regulations provide, in pertinent part, that a "qualifying distribution" is the amount, including that portion of reasonable and necessary administrative expenses, paid by the private foundation to accomplish one or more charitable purposes under section 170(c)(2)(B) of the Code, but not including any contribution to an organization "controlled" directly or indirectly by the transferor private foundation or by one or more disqualified persons with respect to that transferor foundation.

Section 53.4942(a)-3(a)(3) of the regulations defines the term "controlled" for purposes of section 4942(g)(1)(A)(i) of the Code. In general, an organization is "controlled" by a private foundation, or one or more disqualified persons with respect to the foundation, if any of such persons may, by aggregating their votes or positions of authority, require the donee organization to make an expenditure, or prevent the donee organization from making an expenditure, regardless of the method by which the control is exercised or exercisable. "Control" of a donee organization is determined without regard to any conditions imposed upon the donee as part of the distribution or any other restrictions accompanying the distribution as to the manner in which the distribution is to be used, unless such conditions or restrictions are described in section 1.507-2(a)(8) of the Income Tax Regulations. In general, it is the donee, not the distribution, which must be "controlled' by the distributing private foundation for the control provision to apply. Thus, the furnishing of support to an organization and the consequent imposition of budgetary procedures upon that organization with respect to such support shall not in itself be treated as subjecting that organization to the distributing foundation's control. Such budgetary procedures include expenditure responsibility requirements under section 4945(d)(4) of the Code. The "controlled" organization need not be a private foundation; it may be any type of exempt or nonexempt organization, including a school, hospital, operating foundation, or social welfare organization.

Analysis

1.

P's transfer of all of its assets will be made to S, which is exempt from federal income tax under section 501(c)(3) of the Code and which is not a private foundation under section 509(a) of the Code because S is recognized by the Internal Revenue Service as a supporting organization under section 509(a)(3) of the Code for the benefit of M. P's grant of all of its funds to a supporting organization S under section 509(a)(3) of the Code is not one of the specific means provided under sections 507(a)(1), 507(a)(2), 507(b)(1)(A), or 507(b)(1)(B) of the Code for changing P's status as a private foundation under section 509(a) of the Code. Moreover, the grant will not result in any chapter 42 violations. Thus, as in Revenue Ruling 2003-13 in its holding (1), cited above, P's transfer of all of its assets to S will not result in termination of transferor P's private foundation status under section 509(a) of the Code, and, thus, transferor P will not be subject to termination tax under section 507(c) of the Code upon, or by reason of, its transfer of all of its assets to S.

2.

Section 507(c) of the Code imposes excise tax on a private foundation which voluntarily terminates its status as a private foundation pursuant to section 507(a)(1) of the Code by so notifying the Internal Revenue Service. This section 507(c) tax is equal to the lower of: (a) the aggregate tax benefits that have resulted from the foundation's exempt status under section 501(c)(3) of the Code, or (b) the value of the net assets of the foundation. However, the value of P's net assets, after P has transferred all of its assets to S, will be zero. Thus, at that time, and, as stated in Revenue Ruling 2002-28, in its holding (1), cited above, P's voluntary notice to the Internal Revenue Service of its termination of its private foundation status pursuant to section 507(a)(1) of the Code will result in zero termination tax under section 507(c) of the Code.

3.

You represent that, under section 4942(g)(1)(A) of the Code, transferor private foundation P and its disqualified persons under section 4946 of the Code do not control the transferee S, although disqualified persons are included as a minority part of S's governing body. P's transfer of its assets to S will be made for the exempt purposes of S. S is an organization exempt from federal income tax under section 501(c)(3) of the Code and is a supporting organization under section 509(a)(3) of the Code that is not a private foundation. As you represent, S is not controlled by P or P's disqualified persons, and the disqualified persons do not have control of the possible future change of the supported organization from M to N. Thus, P's transfer of its assets for exempt purposes to S, which is exempt under section 501(c)(3) of the Code and is a supporting organization under section 509(a)(3) of the Code, will not be a transfer to a controlled organization under section 4942(g)(1)(A)(i) of the Code, but will be a qualifying distribution by P to S under section 4942(g)(1)(A) of the Code.

Accordingly, we rule that:

1. P's transfer of all of its assets to S will not result in the termination of P's private foundation status under section 509(a) of the Code, and P will not be subject to termination tax under section 507(c) of the Code upon, or by reason of, the transfer of all of P's assets to S.

2. P, after transfer of all of its assets, will not be subject to termination tax imposed by section 507(c) of the Code upon, or by reason of, providing notice under section 507(a)(1) of the Code to the Internal Revenue Service of its intent to terminate voluntarily its private foundation status under section 509(a) of the Code, or, upon, or by reason of, P's dissolution, winding up of its affairs, and termination of its existence under its state law.

3. P's transfer of its assets to S, which is exempt under section 501(c)(3) of the Code and which is a supporting organization under section 509(a)(3) that is for the benefit of M (or later N) and controlled by M (or later N), will be a qualifying distribution made by P to S under section 4942(g)(1) because S is not an organization controlled by P or disqualified persons within the meaning of section 4942(g)(1)(A)(i) of the Code and section 53.4942(a)-3(a)(3) of the regulations

Because this ruling letter could help to resolve any questions, please keep it in your permanent records. This ruling letter 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.

Sincerely,

(signed) Terrell M. Berkovsky

Terrell M. Berkovsky
Manager, Exempt Organizations
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