Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Contact Person:

Telephone Number:

In Reference to:

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Date:
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E.I.N.:

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X=

Y=

Dear Sir or Madam:

This is in response to a ruling request submitted on your behalf by your authorized representatives. You are seeking rulings on the effects under section 507 and Chapter 42 of the Internal Revenue Code (hereafter "Code") of a proposed transaction as more fully set forth below.

X is a Trust that has been recognized as exempt from federal income tax under section 501(c)(3) of the Code and as a private foundation described in section 509(a).

X was created by A and B to honor the memory of D. The initial trustees of X were A, B, and C, all of whom are now deceased. The Current Trustees of X are E, F, and G. E and F were the brothers of D, and are the children of A and B. G is the wife of E.

Over the years the Current Trustees have operated X in a cooperative fashion with minimal disagreements. However, as the time approaches where the children of the Current Trustees assume managerial responsibilities the Current Trustees anticipate the

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potential for greater disagreement as each family has divergent charitable interests. In order to avoid this anticipated conflict, the Current Trustees propose to divide X in such a way that the family of F will have control over approximately one-half of the assets of X and the family of E will retain control over approximately one-half of the assets.

In connection with the proposed division of X's assets, F has formed Y. Y has subsequently been recognized as exempt from federal income tax under section 501(c)(3) of the Code and as a private foundation described in section 509(a).

Pursuant to a Reorganization Agreement executed in connection with the proposed transaction, X will transfer approximately fifty percent (50%) of its assets to Y. In connection with this transfer, F will resign as a trustee of X and will have no further involvement with X. F will be replaced by an individual to be designated by E.

X will not notify the Internal Revenue Service (the "Service") of its intent to terminate its private foundation status. Furthermore, at the time the distribution to Y is made, X will not have committed any flagrant repeated act (or failure to act) or wilful and flagrant act (or failure to act) that could give rise to liability for excise tax under Chapter 42 of the Code.

X has no outstanding grants as to which it must exercise expenditure responsibility under section 4945 of the Code. X intends to exercise expenditure responsibility over the assets transferred to Y for the year of the transfer and the next two succeeding years but not thereafter provided it is satisfied that none of such assets have been used for any purpose that would result in tax liability under section 4945 of the Code.

Section 507(a)(1) of the Code provides that the status of an organization as a private foundation shall be terminated if the organization notifies the Secretary or his delegate in the manner prescribed in the Income Tax Regulations of its intent to accomplish such termination and the organization pays the tax imposed by section 507(c) or the tax is abated under section 507(g).

Section 507(b)(2) 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

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organization.

Section 507(c) of the Code imposes a tax on each organization described in section 507(a) equal to the lower of the amount which the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the section 501(c)(3) status of such foundation, or the value of the net assets of the foundation.

Section 1.507-3(d) of the Income Tax Regulations (hereafter "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(c)(1) of the regulations provides that for purposes of section 507(b)(2) the terms "other adjustment, organization or reorganization" shall include a significant disposition of assets. Section 1.507-3(c)(2) provides that the term "significant disposition of assets" includes any disposition by a foundation in a taxable year to one or more other private foundations which is 25 percent or more of the fair market value of the net assets of the distributing foundation at the beginning of the taxable year.

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 foundation to the transferee foundation.

Section 1.507-3(a)(2) of the regulations provides that a transferee private foundation succeeds to the part of the transferor's "aggregate tax benefit" that is attributable to the assets transferred, based on the transferor's assets held just before the transfer. However, the fair market value of assets held and transferred is determined at the time of transfer.

Section 1.507-3(a)(3) of the regulations provides that for purposes of section 507(b)(2) of the Code, in the event of a transfer of assets described in section 507(b)(2), any person who is a "substantial contributor" with respect to the transferor foundation shall be treated as such with respect to the transferee foundation, regardless of whether the person meets the $5,000 - two percent limit with respect to the transferee organization at any time.

Section 1.507-3(a)(4) of the regulations provides that if a private foundation incurs liability for one or more of the taxes imposed under Chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in section 507(b)(2) to one or more private foundations, in any case where transferee liability applies each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor foundation does not satisfy such liability.

Section 1.507-3(a)5) of the regulations provides that except as provided in subparagraph (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 the requirements to the extent the amount transferred meets the requirements of section 4942(g).

Section 1.507-3(a)(7) of the regulations provides that except as provided in subparagraph (9), where the transferor had disposed of all of its assets section 4945(d)(4) and (h) shall not apply to the transferee or the transferor with respect to any "expenditure responsibility" grants made by the transferor.

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 private foundations that make transfers described in section 507(b)(2) of the Code are not subject to the tax imposed under section 507(c) with respect to such transfers unless the provisions of section 507(a) become applicable.

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

Section 4942(a) imposes a 15 percent excise tax on amounts that should have been paid as qualifying distributions during the taxable year.

Section 4942(g)(1)(A) provides that 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), other than any contribution to: (i) an organization controlled directly or indirectly by the transferor foundation or by one or more disqualified persons with respect to the foundation, except as provided in section 4942(g)(3), or (ii) any private foundation that is not an operating foundation under section 4942(j)(3), except as provided in section 4942(g)(3).

Section 53.4946-1(a)(8) of the Foundation and Similar Excise Taxes Regulations (hereafter also "regulations") provides that for the purposes of section 4941 of the Code, the term "disqualified person" does not include any organization described in section 501(c)(3).

Section 4945(a) of the Code imposes an excise tax on the taxable expenditures made by a private foundation. Section 4945(d)(4) provides, in part, that the term "taxable expenditure" means any amount paid or incurred as a grant to an organization unless such an organization is a public charity described in section 509(a)(1), (2), or (3)], or is an exempt operating foundation (as defined in section 4940(d)(2) of the Code, or the private foundation exercises expenditure responsibility in accordance with section 4945(h).

Section 4945(d)(4) provides that the term "taxable expenditure" includes any amount paid by a private foundation as a grant to an organization [other than an organization described in sections 509(a)(1), (2), or (3) unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h).

Section 4945(h) provides that expenditure responsibility means 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 or his delegate.

Section 53.4945-5(b)(7)(i) of the 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 described in section 4945(d)(4) to

a private foundation which is exempt from taxation under section 501(a) for endowment, for the purchase of capital equipment, or for other capital purposes, the grantor foundation shall require reports from the grantee on the use of the principal and income (if any) from the grant funds. The grantee shall make such reports annually for its taxable year in which the grant was made and the immediately succeeding two taxable years.

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).

In this case, X will not notify the Service of its intent to terminate its private foundation status. Furthermore, X has represented and warranted that there has not been either repeated acts (or failure to act), or a willful and flagrant act (or failure to act) giving rise to liability under Chapter 42 of the Code. Additionally, pursuant to sections 1.507-1(b)(6) and (7) of the regulations the transfer by X to Y of fifty percent (50%) of its assets will not constitute either a notification of X's intent to terminate its status as a private foundation under section 507(a)(1) of the Code or any willful repeated acts (or failures to act) or a willful and flagrant act) (or failure to act) under section 507(a)(2) of the Code. Therefore, the transfer by X of approximately fifty percent (50%) of its assets to Y will not terminate X's status as a private foundation and will not subject it to the termination tax imposed by section 507(c) of the Code.

Because there will be a transfer of in excess of twenty-five percent (25%) of the total assets of X, the transfer will be a significant disposition of the assets owned by X as described in section 507(b)(2) of the Code. The transfer will therefore qualify as an "adjustment or reorganization" under section 507(b)(2) of the Code and Y will succeed to the aggregate tax benefit of X as to the transferred assets to the extent permitted by section 1.507-3(a)(2) of the regulations.

Section 53.4946-1(a)(8) of the regulations indicates that for purposes of section 4941, the term "disqualified person" does not include any organization described in section 501(c)(3) of the Code. Because Y is described in section 501(c)(3), Y will not be treated as a disqualified person for purposes of section 4941. Thus, the transfer of assets by X to Y, will not constitute an act of self-dealing under section 4941 of the Code.

Additionally, since section 1.507-3(b) of the regulations

allows a private foundation to make a section 507(b)(2) transfer of its assets to organizations exempt under section 501(c)(3), including private foundations, without the transfer being taxable expenditures under section 4945 of the Code, the transfer by X of approximately fifty percent (50%) of its assets to Y will not constitute a taxable expenditure under section 4945 of the Code. Furthermore, since X has represented that it will exercise expenditure responsibility with respect to the assets it transfers to Y, as required by section 4945(h) of the Code, the transfer will not constitute a taxable expenditure.

X has represented that it will require reports from Y for the year of transfer plus the next two succeeding years as to the use of principal and income from such assets. Hence, X will fulfill its expenditure responsibility as required by section 4945 of the Code.

Since the payment of the accounting and legal fees incurred to implement the transfer constitutes "reasonable and necessary administrative expenses" such amounts will qualify as a qualifying distribution as such term is defined in section 4942(g)(1)(A) of the Code.

Based on the information submitted and the representations made therein, we rule as follows:

1. The transfer by X of approximately fifty percent (50%) of its assets to Y will not terminate the status of X as a private foundation under section 507(a) of the Code or subject it to a termination tax liability under section 507(c) of the Code.

2. The transfer of the assets will qualify as an "adjustment or reorganization" under section 507(b)(2) of the Code so that (i) the transfer will not be a taxable expenditure as described in section 4945 of the Code; and (ii) Y will succeed to the aggregate tax benefit of X as to the transferred assets to the extent permitted under section 1.507-3(a)(2) of the regulations.

(3) The transfer of assets by X will not be an act of self-dealing and will not subject X or its trustees to any tax under section 4941 of the Code.

(4) The reasonable and necessary legal, accounting and other expenses incurred to implement the transfer will constitute qualifying distributions under section 4942 of

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the Code and will not constitute taxable expenditures under section 4945 of the Code.

(5) X may count its transfer to Y toward satisfaction of its section 4942 distribution requirements to the extent that Y makes qualifying distributions described in section 4942(g) of the Code.

(6) X will have to exercise responsibility for the transferred assets for the year of the transfer and two succeeding years, but not thereafter, if it is apparent to X that, before the end of such second succeeding taxable year, neither the principal, income from the grant funds nor any equipment purchased [with] grant funds has been used for any purpose that would result in tax liabilities under section 4945 of the Code.

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

Because this ruling may help resolve future questions about your exempt status, you should keep a copy of this ruling in your permanent records.

Sincerely,

Kenneth J. Earnest
Acting Chief,
Exempt Organizations
Technical Branch 3