199938039

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

Uniform Issue List

507.05-00 4942.03-05
507.07-00 4945.04-00
4940.00-00 4945.04-06
4941.04-00 6033.01-00

6/25/99
OP:E:EO:T:4

Contact Person:

ID Number:

Telephone Number:

Employer Identification Number:
Key District:

Legend:

B =
C =
D =
E =
F =
M =
N =
O =

Dear Applicant:

This in response to the ruling requests contained in your letter dated December 23, 1998. You asked that we rule on the application of section 507 and Chapter 42 of the Internal Revenue Code to M's transfer of all of its assets to two newly created private foundations, N and O.

M was incorporated in April, 1997. M has been recognized by the Service as exempt from federal income tax under section 501(c)(3) of the Code and has been classified as a private foundation under section 509(a). The Directors of M are B, C, D, E, and F. D, E, and F are the children of B and C. Pursuant to the divorce of B and C, the parties want the assets of M divided equally so that B and C each have the right to create a separate private foundation for one-half of the assets held by M. To this end, N and O were incorporated in November, 1998. N

and O both qualify for tax exemption under section 501(c)(3) of the Code. Both are private foundations under section 509(a). B will be one of the Directors of N, and C will be one of the Directors of O. D, E, and F, along with one other individual, are the other Directors (aside from B) of N. D, E, and F, along with their mother, C, constitute the entire membership of the Board of Directors of O. M will transfer an equal portion of its net assets to N and O for no consideration. Thereafter, M will pay all of its remaining liabilities and expenditures, if any, will terminate its activities, and will be dissolved. In connection therewith, the Directors will file a final accounting and will notify the Service of their intention to terminate M's status in an appropriate manner pursuant to section 507(a)(1) of the Code. At the time of termination, there will not have been any willful repeated act (or failure to act) or willful flagrant act (or failure to act) which would give rise to liability for taxes under Chapter 42 of the Code. On the day that M ceases to be a private foundation, it will have no net assets. The transfer of M's assets will not take place until you receive the favorable rulings requested herein.

M has no expenditure responsibility grants outstanding under section 4945(h) of the Code.

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.

The meaning of the terms "liquidation, merger, reorganization, redemption, and recapitalization" is determined by the law of the State in which the private foundation was incorporated or formed. Section 1.507-3(c)(1) of the Income Tax Regulations provides, in part, that "for purposes of section 507(b)(2), the terms 'other adjustment, organization, or reorganization' shall include any partial liquidation or any 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, generally, a "significant disposition of assets" occurs where the aggregate disposition to one or more private foundations for the taxable year is 25% or more of the fair market value of the net assets of the transferor at the beginning of the taxable year.

Section 1.507-1(b)(6) of the regulations provides that, if a private foundation transfers all or part of its assets to one or more private foundations pursuant to a transfer described in section 507(b)(2) and section 1.507-3(c), such transferor foundation will not have terminated its private foundation status under section 507(a)(1). Section 1.507-3(d) provides that unless a private foundation voluntarily gives notice of termination pursuant to section 507(a), 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). Further, section 1.507-4(b) provides that a private foundation which makes a section 507(b)(2) transfer is 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 507(a) of the Code provides that, except as provided in section 507(b), a private foundation can terminate its private foundation status only if it notifies the Service of its intent to terminate (voluntary termination) or it commits willful repeated acts (or failures to act) or a willful or flagrant act (or failure to act) giving rise to liability under Chapter 42 and is notified that it is liable for the termination tax imposed under section 507(c) and the foundation pays the tax imposed by 507(c) or such tax is abated.

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 Code 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.

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), the transferee organization shall not be treated as a newly created organization. Instead, the transferee organization shall be treated as possessing those attributes and characteristics of the transferor organization, which are described in subparagraphs (2), (3) and (4) of this paragraph.

Section 1.507-3(a)(2)(i) of the regulations provides, in part, that a transferee organization to which this paragraph applies shall succeed to the aggregate tax benefit of the transferor organization.

Section 1.507-3(a)(9)(i) of the regulations provides that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled (within the meaning of section 1.482-1(a)(3)), directly or indirectly, by the same person or persons which effectively controlled the transferor private foundation, for purposes of Chapter 42 (section 4940 et seq.) and part II of Subchapter F and Chapter 1 of the Code (sections 507 through 509) such a transferee private foundation shall be treated as if it were the transferor.

Section 1.482-1(a)(3) of the regulations provides that the term "controlled" includes any

kind of control, direct or indirect, whether legally enforceable or not, and however exercisable or exercised, including control resulting from the actions of two or more taxpayers acting in concert. It is the reality of the control that is decisive, not its form or the mode of its exercise.

Section 1.507-3(a)(9)(ii) of the regulations, **Example 2**, provides that where a private foundation transfers all of its assets to three other private foundations, all of which are created and controlled by two trustees of the transferor foundation, then the transferee foundations are treated as if they were the transferor foundation with respect to the exercise of expenditure responsibility over an outstanding grant made by the transferor foundation. Further, inasmuch as the three foundations are treated as the transferor foundation rather than as recipients of "expenditure responsibility" grants, there are no expenditure responsibility requirements which must be exercised under Code 4945(d)(4) and (h) with respect to the transfer of assets to the three foundations.

Section 4940(a) of the Code imposes a 2 percent excise tax on the net investment of a private foundation for each taxable year.

Section 4941(a) of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation. The initial taxes are paid by the disqualified person who participates in the act of self-dealing, and any foundation manager who knowingly participates in the act of self-dealing.

Section 4942(a) of the Code imposes an excise tax on the undistributed income of a private foundation. Section 4942(c) provides, in part, that the term "undistributed income" means, with respect to any private foundation for any taxable year, the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made before such time out of such distributable amount.

Section 4942(g)(1)(A) of the Code provides that the term "qualifying distribution" means any amount (including 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 foundation or one or more disqualified persons with respect to the foundation, except as provided in paragraph (3); or (ii) a private foundation which is not an operating foundation (as defined in subsection (j)(3)), except as provided in paragraph (3).

Section 4942(g)(3)(B) of the Code provides that the term "qualifying distribution" includes a contribution to a section 501(c)(3) organization described in sections 4942(g)(1)(A)(i) or (ii) if the private foundation making the contribution obtains adequate records or other sufficient evidence from such organization showing that the qualifying distribution described in

4942(g)(3)(A) has been made by such organization.

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 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 be counted toward satisfaction of such requirement 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.

Rev. Rul. 78-387, 1978-2 C.B. 270 states that because two private foundations are controlled by the same persons, the transferee foundation shall be treated as if it were the transferor foundation pursuant to section 1.507-3(a)(9) of the regulations. Accordingly, for purposes of determining its distribution requirements under section 4942 of the Code, the transferee private foundation may reduce its distributable amount by the excess qualifying distribution carryover of the transferor foundation.

Section 4945(a) of the Code imposes a tax on each taxable expenditure (as defined in section 4945(d)) of the private foundation. The tax is imposed on the private foundation that makes the expenditure and the foundation manager who agreed to the making of the expenditure knowing that it is a taxable expenditure. Section 4945(d)(4) provides that the term "taxable expenditure" means an amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B).

Section 53.4945-6(c)(3) of the Foundation and Similar Excise Taxes 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).

Section 1.507-3(a)(7) of the regulations provides that, except as provided in subparagraph (9), where the transferor has disposed of all of its assets, during any period in which the transferor has no 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. However, the exception contained in this subparagraph shall not apply with respect to any information reporting requirements imposed by section 4945 and the regulations thereunder for any year in which such transfer is made.

Section 4946(a)(1)(B) of the Code provides that the term "disqualified person", with respect to a private foundation, includes a foundation manager, which term is defined in section 4946(b)(1) to mean an officer, director, or trustee of a foundation.

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

M's transfer, without consideration, of all its assets to N and O constitutes a significant disposition of its assets to other private foundations within the meaning of section 1.507-3(c)(1) of the regulations. Accordingly, the proposed transfer is described in section 507(b)(2) of the Code and will not be subject to tax under section 507(c). Further, in accordance with section 507(b)(2) and underlying regulations, N and O shall not be treated as newly created organizations. Also, they will be deemed to possess certain attributes and charactertistics of M. See section 1.507-3(a)(1).

Inasmuch as M's transfers of all of its assets to N and O are transfers pursuant to section 507(b)(2), they will not result in termination of M's private foundation status under section 509(a) nor will it result in imposition of the foundation status termination tax under section 507(c). See section 1.507-4(b) of the regulations.

Pursuant to sections 1.507-1(b)(6) and (7) of the regulations, M's transfers to N and O should not constitute either a notification of M's intent to terminate its status as a private foundation under Code section 507(a)(1) or any willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) under section 507(a)(2). Therefore, M should not be liable for any tax under section 507(c).

Pursuant to section 1.507-3(a)(1) of the regulations, M's aggregate tax benefits will be transferred to N and O in proportion to the assets transferred to each, and accordingly, N and O will be subject to the proportionate amount of any liability that M may have incurred under Chapter 42 of the Code to the extent not satisfied by M.

Inasmuch as M's grants to N and O will be considered donations , they will not be treated as net investment income under section 4940(a) of the Code or any taxable sale or disposition under that section.

As with the situation described in Rev. Rul. 78-387, after M transfers all of its assets to N and O, M's excess qualifying distributions, if any, under section 4942 of the Code, should be available to be used proportionately by N and O to reduce their distributable amount under section 4942, because N and O are controlled by the same persons who control M. See section 1.482-1(a)(3) of the regulations.

Pursuant to section 1.507-3(a)(5) of the regulations, the record-keeping requirements of section 4942(g)(3)(B) of the Code do not apply to M after it has transferred all of its assets to N

and O.

Under section 1.507-3(a)(7) of the regulations, where a private foundation transfers all of its assets to section 501(c)(3) organizations pursuant to section 507(b)(2), the transfers will not be treated as taxable expenditures under section 4945. Accordingly, M's transfer of all its assets to N and O will not constitute taxable expenditures under section 4945 or otherwise subject M to tax under that section.

Under section 1.507-3(a)(9)(iii), **Example 2**, of the regulations, a private foundation which makes Code section 507(b)(2) transfers of all of its assets to section 501(c)(3) organizations, including private foundations, will not have to face any expenditure responsibility requirement under section 4945(h). Accordingly, M will not have to exercise any expenditure responsibility with respect to its transfers of all of its assets to N and O inasmuch as these foundations are tax exempt under section 501(c)(3).

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

Under section 1.507-1(b)(9) of the regulations, M and its foundation managers will not be required to file the annual information return required by Code section 6033 for any tax year after the tax year in which the last transfers of all of M's assets occur if during such subsequent tax year, M has neither legal nor equitable title to any assets or engages in any activities.

The legal, accounting, and other expenses, if reasonable in amount, incurred by M, N, and O, in connection with this ruling request and in carrying out the transfers of assets, should be considered qualifying distributions under Code section 4942(g)(1)(A) because they are paid to achieve the charitable purposes of making the grants to N and O and, for the same reason, the payments of such costs should not constitute taxable expenditures under section 4945.

Based on the foregoing, we rule as following:

1. M's transfers of all its assets to N and O will constitute a significant disposition of its assets to one or more private foundations under section 507(b)(2) of the Code.

2. M's transfers to N and O will not result in termination of M's private foundation status under section 507(a) but instead will constitute a reorganization between these private foundations under section 507(b)(2).

3. M's transfers to N and O will not constitute notification of M's intent to terminate its private foundation status under section 507(a)(1) of the Code, or any willful repeated acts (or failures to act) or any willful and flagrant act (or failure to act) under section 507(a)(2) by M, and, thus, M will not be liable for any tax imposed by section 507(c).

4. Pursuant to section 507(b)(2) of the Code, transferees N and O will not be treated as newly created organizations.

5. N and O will be treated as possessing the tax attributes and characteristics of M pursuant to sections 1.507-3(a)(2), (3), and (4) of the regulations.

6. M's transfers to N and O will not give rise to any net investment income or constitute any other taxable sale or disposition under section 4940 of the Code.

7. M's transfers to N and O will not constitute any act of self-dealing under section 4941 of the Code by M, N, or O, or any of their foundation managers as defined in section 4946.

8. Upon M's transfers to N and O, they will each succeed to a portion of M's excess qualifying distributions, if any, based upon each transferee foundation's proportionate share of M's total assets received, and the record-keeping requirements of section 4942(a)(3)(B) of the Code will not apply to M during any period in which M has no assets (other than certain contingent beneficial interests, if any).

9. M's transfers of all of its assets to N and O will not constitute taxable expenditures under section 4945 of the Code.

10. M 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 N and O because M will have thus disposed of all of its assets.

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

12. M and its foundation managers will not be required to file the annual information return required under section 6033 of the Code for any tax years following the tax year in which the last transfers of all of M's assets occur if during such subsequent tax years M will have neither legal nor equitable title to any assets nor engages in any activities. Upon

M's dissolution, M will required under section 6043(b) to file its annual return for the year of such dissolution.

13. The legal, accounting, and other expenses, if reasonable in amount, incurred by M, N, and O, in connection with this ruling request and in carrying out the transfers of assets, will be considered qualifying distributions under section 4942(g)(1)(A) of the Code on the basis that they have been made to achieve the charitable purposes of the grants. For the same reason, 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. Any changes that may have a bearing upon your tax status should be reported to your Key District Director.

We are sending a copy of this ruling to your Key District Director for exempt organizations matters. Because this letter could help resolve any questions about your tax status, you should keep it with your permanent records.

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.

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.

Thank you for your cooperation.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4