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

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Contact Person:

Uniform Issue List: 507.00-00
509.00-00
4941.04-00
4942.03-05
4945.04-06

Contact Number:

OP:E:EO:T:2

Legend:
X =
Y =
Z =

Dear Sir or Madam:

This is in reply to your rulings request of March 2, 1998, and subsequent correspondence, on X's proposed transfer of all of its assets to Y and Z pursuant to section 507(b)(2) of the Internal Revenue Code.

X, Y, and Z are exempt from federal income tax under section 501(c)(3) of the Code and are private foundations under section 509(a). X will transfer all of its assets to Y and Z. This will be in accord with a settlement agreement and state court order among the parties. X has no expenditure responsibility grants outstanding under section 4945(h) of the Code.

You request the following rulings:

1. If the X makes all distributions that are required by the Settlement Agreement and the Order, and has no assets at least one day prior to notifying the Internal Revenue Service of its intent to terminate its status as private foundation under section 507, X will not be subject to a termination tax under section 507.

2. Neither the trustees of Y nor those of Z will be required to exercise expenditure responsibility as defined in section 4945(h) in order to avoid triggering a taxable expenditure as defined in section 4945(d) with respect to any distribution made by X to Y and Z pursuant to the Order.

3. The trustees of Z will not be required to exercise expenditure responsibility as defined in section 4945(h), in order to avoid triggering a taxable expenditure as defined in section 4945(d), with respect to any distribution made by Y, and the trustees of Y will not be required to exercise expenditure responsibility as defined in section 4945(h), in order to avoid triggering a taxable expenditure as defined in section 4945(d), with respect to any distribution made by Z.

4. If, during the year in which X distributes all of its assets to Y and Z, X makes qualifying distributions as defined in section 4942(g) that are at least equal in amount to its distributable amount as defined in section 4942(d) for the current year and all prior years, then: (a) X will not be subject to tax under section 4942; and (b) neither Y nor Z will be required to make any distributions during the year in which they receive distributions from X pursuant to the Order, in order to avoid a tax under section 4942.

5. Each of Y and Z will succeed to a pro rata share, based on the amount of the distribution each trust receives from X pursuant to the Order, of any excess section 4942 distributions as described in section 4942(i) that had been made by X prior to making distribution to Y and Z.

6. No distribution directed to be made by the Order will constitute an act of self-dealing under section 4941.

7. The reimbursement of legal fees and costs by X, Y, and Z, as provided in the Settlement Agreement, to the trustees, will not constitute an act of self-dealing.

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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 provides that a private foundation may voluntarily terminate its private foundation status by submitting notice to the Service of its intent to terminate its private foundation status pursuant to section 507(a)(1) of the Code and by paying the foundation status termination tax, if any, under section 507(c) of the Code.

Section 507(c) of the Code impose excise tax on a private foundation which voluntarily terminates its private foundation status 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 exemption from federal income tax under section 501(c)(3) of the Code or (b) the value of the foundation's net assets on such termination.

Section 507(b)(2) of the Code provides that, in a transfer of assets by one private foundation to one or more other private foundations pursuant to a reorganization, each transferee foundation shall not be treated as a newly created organization.

Section 1.507-3(c)(1) of the Income Tax Regulations provides that a transfer under section 507(b)(2) of the Code includes a transfer of assets from one private foundation to one or more other private foundations pursuant to any reorganization, which includes a significant disposition of 25% or more of the transferor's assets.

Section 1.507-3(a)(1) of the regulations provides that, in a transfer of assets from one private foundation to one or more other private foundations pursuant to a reorganization, each transferee foundation shall not be treated as a newly created organization, but shall succeed to the transferor's aggregate tax benefits under section 507(d) of the Code.

Section 507(d) of the Code provides that a private foundation's aggregate tax benefits refer to the value of its exemption from federal income tax and of the deductions taken by its donors during its existence.

Section 1.507-3(a)(9)(ii) of the regulations indicates that a transfer of assets pursuant to section 507(b)(2) of the Code does not relieve the transferor private foundation from filing its own final annual return.

Section 1.507-1(b)(9) of the regulations provides that a private foundation which transfers all of its net assets is not required to file annual information returns required by section 6033 of the Code for tax years after the tax year of such transfer when the transferor foundation has no assets or activities.

Section 1.507-3(a)(5) of the regulations indicates that a transferor private foundation is required to meet its charitable distribution requirements under section 4942 of the Code, even for any tax year in which it makes a transfer under section 507(b)(2) of its assets to another private foundation.

Section 1.507-3(a)(7) of the regulations provides that a private foundation that transfers all of its assets to one or more other private foundations in transfers pursuant to section 507(b)(2) of the Code is not required to exercise expenditure responsibility under section 4945(h) of the Code as to those transfers.

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Section 1.507-3(a)(9)(i) of the regulations indicates that, where a transferor private foundation transfers assets to one or more other private foundations, which are controlled by the same person or persons who control the transferor foundation, each 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. Each transferee is treated as the transferor in the proportion which the fair market value of the transferor's assets that were transferred to each bears to the fair market value of all of the assets of the transferor immediately before the transfer.

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.

Sections 1.507-1(b)(7) and 1.507-3(d) of the regulations provide that a transferor foundation's transfer of assets under section 507(b)(2) of the Code will not constitute a termination of the transferor foundation's status as a private foundation under section 509(a) of the Code.

Section 4940 of the Code imposes excise tax on certain investment income of a private foundation.

Section 4941 of the Code imposes excise tax on any act of self-dealing between a private foundation and any of its disqualified persons under section 4946 of the Code.

Section 4941(d)(2)(B) of the Code indicates that the lending of money to a private foundation by a disqualified person is not an act of self-dealing under section 4941 of the Code where there is no interest charge and the money is used for exempt purposes.

Section 53.4946-1(a)(8) of the Foundation and Similar Excise Taxes Regulations provides that, for purposes of self-dealing under section 4941 of the Code, an organization exempt from federal income tax under section 501(c)(3) of the Code is not a disqualified person.

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

Section 4942(g)(1)(A) of the Code provides that a private foundation does not make any qualifying distribution under section 4942(g) where the distribution is a contribution to either: (i) another organization that is controlled by the transferor or by one or more of the transferor's disqualified persons, or (ii) any private foundation which is not an operating foundation under section 4942(j)(3) of the Code.

Section 4942(g)(3) of the Code requires that a transferor private foundation, in order to have a qualifying distribution for its grant to another private foundation, must have adequate records, as required by section 4942(g)(3)(B), to show that the transferee private foundation, in fact, subsequently made qualifying distributions that were equal to the amount of the transfer received and that were paid out of the transferee's own corpus within the meaning of section 4942(h). Such transferee private foundation's qualifying distributions must be expended before the close of the transferee's first tax year after the transferee's tax year in which it received the transfer.

Revenue Ruling 78-387, 1978-2 C.B. 270, describes the carryover of a transferor private foundation's excess qualifying distributions under section 4942(i) of the Code where the transferor and the transferee foundation are controlled by the same person(s) under section 1.507-3(a)(9)(i) of the regulations. Under that regulation, the transferee is treated as the transferor, so that the transferee can reduce its own distributable amount under section 4942 of the Code by the amount, if any, of its transferor's excess qualifying distributions carryover under section 4942(i) of the Code.

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

Section 4945(d)(4) of the Code requires that, in order to avoid making a taxable expenditure, a transferor private foundation must exercise expenditure responsibility under section 4945(h) of the Code on its grants to another private foundation.

Section 4945(h) of the Code defines expenditure responsibility in terms of the grantor private foundation requiring pre-grant and post-grant reports from the grantee private foundation on the grantee's uses of the grant.

Section 4945(d)(5) of the Code provides that a taxable expenditure includes any amount expended by a private foundation for purposes other than exempt purposes.

Sections 53.4945-6(c)(3) allows a private foundation to make transfers of its assets pursuant to section 507(b)(2) of the Code to organizations exempt from federal income tax under section 501(c)(3) of the Code, including private foundations, without the transfers being taxable expenditures under section 4945 of the Code.

Analysis

X will transfer all of its assets to Y and Z. Your requested rulings are discussed below:

1.

Under section 507(b)(2) of the Code and section 1.507-3(c)(1) of the regulations, a transfer under section 507(b)(2) of the Code includes a transfer of assets from one private foundation to one or more other private foundations pursuant to any reorganization, including a significant disposition of 25% or more of the transferor's assets. Because X will be in such a reorganization by its disposition of all of its assets to Y and Z, X's transfers to Y and Z will be transfers under section 507(b)(2) of the Code.

Under section 1.507-4(b) of the regulations, X's transfers of assets pursuant to section 507(b)(2) of the Code will not cause termination of X's private foundation status under section 509(a) of the Code and, thus, will not result in any termination tax under section 507(c) of the Code.

Section 507(a)(1) of the Code and section 1.507-1(b)(1) of the regulations provide that a private foundation can voluntarily terminate its private foundation status by submitting notice to the Service of its intention to terminate its private foundation status and by paying the termination tax, if any, under section 507(c) of the Code. Thus, X will terminate its private foundation status when it notifies the Service pursuant to section 507(a)(1) of the Code.

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. This section 507(c) tax is equal to the lower of: (a) the aggregate tax benefits that have resulted from the foundation's section 501(c)(3) status, or (b) the value of the net assets of the foundation. In this case, the value of X's assets, after X transfers all of its assets to Y and Z, will be zero. Thus, as of that time, X's voluntary notice to the Service of its termination of its private foundation status pursuant to section 507(a)(1) of the Code will not result in termination tax under section 507(c) of the Code.

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2.

Section 53.4945-6(c)(3) of the regulations indicates that a private foundation can make transfers of its assets pursuant to section 507(b)(2) of the Code to organizations exempt from federal income tax under section 501(c)(3), including private foundations, without the transfers being taxable expenditures under section 4945. Thus, X's transfers to Y and Z will not be taxable expenditures under section 4945 of the Code.

Section 1.507-3(a)(7) of the regulations provides that, where a private foundation transfers of all of its assets pursuant to section 507(b)(2) of the Code to organizations exempt under section 501(c)(3) of the Code, including private foundations, the transfers do not create any expenditure responsibility requirement under section 4945(h) of the Code. Thus, X will not be required to exercise expenditure responsibility under section 4945(h) of the Code with respect to its transfer of all of its assets to Y and Z.

3.

Because Y and Z are distinct private foundations, Y will not be required to exercise any expenditure responsibility under section 4945(h) of the Code with respect to any distributions to be made by Z, and Z will not be required to exercise any expenditure responsibility under section 4945(h) of the Code with respect to any distributions to be made by Y.

4.

If X, during its tax year of its transfers to Y and Z, makes its own qualifying distributions under section 4942(g) of the Code that are equal in amount to at least its own distributable amount under section 4942 for its current tax year and for all its prior tax years not already met by X under section 4942, X will not be liable for tax under section 4942, and Y and Z will not be required to make any qualifying distributions on account of X.

5.

As in Revenue Ruling 78-387, described above, after X transfers all of its assets to Y and Z, X's excess qualifying distributions, if any, under section 4942(i) of the Code may be used by Y and Z to reduce each's distributable amount under section 4942 by each's proportionate share of the amount, if any, of X's excess qualifying distributions carryover under section 4942(i) of the Code.

6.

Under section 4941 of the Code, X's transfers of its assets to Y and Z will not be acts of self dealing because the transfers are made for exempt purposes under section 501(c)(3) of the Code to organizations exempt from federal income tax under that section 501(c)(3) of the Code, which are not disqualified persons for purposes of section 4941 of the Code pursuant to section 53.4946-1(a)(8) of the regulations.

7.

Under section 4941(d)(2)(B) of the Code, reimbursements by X, Y, or Z of the reasonable legal fees and expenses, advanced by individuals acting as trustees on behalf of X, Y, or Z for the transactions involved in this rulings request, will not be acts of self-dealing under section 4941 of the Code.

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Accordingly, we rule that:

1. When X transfers all of its assets to Y and Z and has no assets at least one day prior to its notifying the Service of its intent to terminate its private foundation status pursuant to section 507(a)(1) of the Code, X will not be liable for any foundation termination tax under section 507(c) of the Code.

2. X's transfers of all of its assets to Y and Z will not require X, Y, or Z to exercise expenditure responsibility under section 4945(h) of the Code with respect to those transfers.

3. Transferee Y will not be required to exercise expenditure responsibility under section 4945(h) of the Code with respect to any distribution to be made by Z, and transferee Z will not be required to exercise expenditure responsibility under section 4945(h) of the Code with respect to any distribution to be made by Y.

4. If X, during its tax year of its transfers to Y and Z, makes its own qualifying distributions under section 4942(g) of the Code equal in amount to at least X's distributable amount under section 4942 for its current tax year and for all prior tax years not already met by X under section 4942, X will not be liable for excise tax under section 4942 of the Code, and Y and Z will not be required to make any qualifying distributions on account of X.

5. Y and Z will succeed to each's proportionate share, based on the amount of X's assets transferred to each, of X's excess qualifying distributions carryover, if any, under section 4942(i) of the Code.

6. Transfers and distributions of funds by X, Y, and Z for the transactions described in this rulings request will not be acts of self-dealing under section 4941 of the Code.

7. Reimbursements of the reasonable legal fees and costs, incurred by the individuals acting as trustees on behalf of X, Y, and Z, for the transactions described in this rulings request, will not be acts of self-dealing under section 4941 of the Code.

Because this 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(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

(signed) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2