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

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Date:

OCT 5 1999

Contact Person:

ID Number:
OP:EP:EO:T:3

Telephone Number:

UIL: 507.00-00
4941.00-00
4942.03-05
4944.00-00
4945.04-05

Legend:

Foundation A =
Foundation B =
Foundation C =

Dear Taxpayer:

This is in response to your letter dated April 22, 1999, as supplemented by subsequent correspondence, wherein you requested certain rulings concerning the federal tax consequences of the proposed transaction described below.

You are a non-profit, non-stock corporation, and your purpose is to carry out charitable activities as described in section 501(c)(3) of the Internal Revenue Code ("Code"). You are exempt from federal income tax under section 501(c)(3) of the Code and are classified as a private foundation within the meaning of section 509(a). A ten-member board of directors governs you. To accomplish your charitable purposes, you are involved in agricultural research and applied biotechnology, and assist other non-profit organizations through grants and employee involvement. You represent that you have no outstanding grants with respect to which you are required to exercise expenditure responsibility under section 4945.

Foundation A is a non-profit corporation and is organized and operated exclusively for religious, charitable, scientific, literary and/or educational purposes. It is exempt from federal income tax as an organization described in section 501(c)(3) of the Code and is classified as a private foundation within the meaning of section 509(a). Two members of its three-member board of directors serve on your board of directors.

Foundation B is a non-profit corporation and is organized and operated exclusively for religious, charitable, scientific, literary and/or educational purposes. It is exempt from federal income tax as an organization described in section 501(c)(3) of the Code and is classified as a private foundation within the meaning of section 509(a). Two

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members of its five-member board of directors serve on your board of directors.

Foundation C is a non-profit corporation and is organized and operated exclusively for religious, charitable, scientific, literary and/or educational purposes. It is exempt from federal income tax as an organization described in section 501(c)(3) of the Code and is classified as a private foundation within the meaning of section 509(a). Two members of its four-member board of directors serve on your board of directors.

You propose to provide grants to Foundation A, Foundation B, and Foundation C. Each grant will consist of cash and securities. The total amount of all three grants combined is less than 25 percent of the fair market value of your net assets. The president of each recipient foundation is required to sign a written agreement wherein the foundation agrees to comply with certain terms. The written agreement is in the form of a bill of sale, and the terms therein include the following. The grant is to be used for endowment or other capital purposes to enable the foundation to carry out its religious, charitable, scientific, literary and/or educational purposes as described in sections 170(c)(2)(B) and 501(c)(3) of the Code. The recipient foundation must return any portion of the grant not used for such purposes. It must submit full and complete annual reports with respect to its use of the grant, maintain financial records of receipts and expenditures with respect to the grant, and make such records available for your inspection. The recipient foundation must comply with all other expenditure responsibility requirements of section 4945. Finally, it must not use the grant for any purposes prohibited under section 4945.

You have incurred legal, accounting and other expenses and costs in connection with providing these grants to the recipient foundations. You represent that these expenses and costs are reasonable and necessary.

Concerning a prior transaction, in a letter dated May 28, 1992, we issued nine rulings approving the proposed merger between you and a private foundation, which had the same name as Foundation A. On June 30, 1992, you and that private foundation merged with you as the surviving foundation. At the time of that requested rulings, none of the parties involved contemplated the transactions that are the subject of this ruling.

Law:

Section 501(c)(3) of the Code provides for the exemption from federal income tax of non-profit organizations organized and operated exclusively for religious, charitable, educational and other exempt purposes.

Section 507(a) of the Code provides that, except as provided in section 507(b), the status of any organization as a private foundation shall be terminated only if it notifies the Secretary of its intent to terminate, or, with respect to such organization, there have

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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, and the Secretary notifies such organization that it is liable for tax imposed by section 507(c).

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.

Section 1.507-3(c) of the Income Tax Regulations ("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 private foundations pursuant to any reorganization, partial liquidation, or any other significant disposition of assets. The term "significant disposition" includes any disposition of 25 percent or more of the transferor private foundation's assets.

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

Section 4942(a) of the Code imposes a tax on the undistributed income of a private foundation.

Section 4942(c) of the Code provides that the term "undistributed income" means, with respect to any private foundation for any taxable year as of any time, 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 53.4942(a)-3(a)(2)(i)(a) of the regulations provides, in pertinent part, that the term "qualifying distribution" means any amount (including program-related investments, as defined in section 4944(c), and reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(1) or (2)(B), other than any contribution to a private foundation which is not an operating foundation (as defined in section 4942(j)(3)).

Section 4942(g)(1)(A) of the Code provides, in pertinent part, 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 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, except as provided in paragraph (3).

Section 4942(g)(3) of the Code provides, in pertinent part, that the term "qualifying distribution" includes a contribution to a section 501(c)(3) organization described in

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sections 4942(g)(1)(A)(i) or (ii) if

(A) not later than the close of the first taxable year after its taxable year in which such contribution is received, such organization makes a distribution equal to the amount of such contribution and such distribution is a qualifying distribution which is treated under section 4945(h) as a distribution out of corpus, and

(B) the private foundation making the contribution obtains adequate records or other sufficient evidence from such organization showing that the qualifying distribution described in subparagraph (A) has been made by such organization.

Section 4944(a) of the Code imposes a tax on any amount invested by a private foundation in a manner that jeopardizes the carrying out of any of its exempt purposes.

Section 4945 of the Code imposes a tax on any taxable expenditure made by a private foundation as defined, in pertinent part, by section 4945(d)(4).

Section 4945(d)(4) of the Code provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to another organization unless –

(A) such organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation (as defined in section 4940(d)(2)), or

(B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h).

Section 53.4945-5(a) of the regulations provides, in pertinent part, that the term "taxable expenditure" includes any amount paid or incurred by a private foundation as a grant to an organization (other than an organization described in section 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 53.4945-5(b)(3) of the regulations concerns the terms of grants. The regulation provides that, in order to exercise expenditure responsibility, the grantor private foundation must require that the grant be subject to a written commitment signed by an appropriate officer, director, or trustee of the grantee, including the grantee's agreement to repay any portion of the grant which is not used for the purposes of the grant, to submit full and complete annual reports on the manner in which the grant funds are spent and the progress made in accomplishing the purposes of the grant, to maintain records of receipts and expenditures, to make its books and records available to the grantor at reasonable times, and not to use any of the funds to carry on propaganda or otherwise attempt to influence legislation within the meaning of

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Code section 4945(d)(1), or to influence the outcome of any specific public election or to carry on directly or indirectly any voter registration drive within the meaning of Code section 4945(d)(2), or to make any grant which does not comply with the requirements of Code sections 4945(d)(3) or 4945(d)(4), or to undertake any activity for any purpose other than one specified in Code section 170(c)(2)(B). The agreement must also clearly specify the purposes of the grant. Such purposes may include contributing for capital endowment, provided that neither the grants nor the income therefrom may be used for purposes other than those described in Code section 170(c)(2)(B).

Section 53.4945-5(c)(2) of the regulations concerns capital endowment grants to exempt private foundations. The regulation provides that, if a private foundation makes a grant to another private foundation for endowment or for other capital purposes, the grantor private foundation must require reports from the grantee private foundation on the uses of the principal and the income (if any) from the grant funds. The grantee must make such reports annually for its tax year in which the grant was made and for its immediately succeeding two tax years. Only if it is reasonably apparent to the grantor that, before the end of such grantee's second succeeding tax year, neither the principal nor the income from the grant funds has been used for any purpose which would result in liability for tax under section 4945(d), may the grantor then allow the grantee's reports to be discontinued.

Section 53.4945-5(d)(1) of the regulations provides, in pertinent part, that, to satisfy the report making requirements of section 4945(h)(3) of the Code, a granting foundation must provide the required information on its annual information return, required to be filed by section 6033, for each taxable year with respect to each grant made during the taxable year which is subject to the expenditure responsibility requirements of section 4945(h). Such information must also be provided on such return with respect to each grant subject to such requirements upon which any amount or any report is outstanding at any time during the taxable year. However, with respect to any grant made for endowment or other capital purposes, the grantor must provide the required information only for any taxable year for which the grantor must require a report from the grantee under section 53.4945-5(d)(2). The requirements of this subparagraph with respect to any grant may be satisfied by submission with the foundation's information return of a report received from the grantee if the information required by section 53-4945-5(d)(2) is contained in such report.

Section 53.4945-5(d)(2) of the Regulations provides that the report required by this paragraph shall include the following information: (i) The name and address of the grantee; (ii) The date and amount of the grant; (iii) The purpose of the grant; (iv) The amounts expended by the grantee (based upon the most recent report received from the grantee); (v) Whether the grantee has diverted any portion of the funds (or the income therefrom in the case of an endowment grant) from the purpose of the grant (to the knowledge of the grantor); (vi) The dates of any reports received from the grantee; (vii) The date and results of any verification of the grantee's reports undertaken

pursuant to and to the extent required under paragraph (c)(1) of this section by the grantor or by others at the direction of the grantor.

Section 53.4945-6(b)(1)(v) of the Regulations provides that any payment which constitutes a qualifying distribution under section 4942(g) or an allowable deduction under section 4940 will not be treated as a taxable expenditure under section 4945(d).

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

Discussion:

A private foundation described in section 501(c)(3) of the Code may make grants to another private foundation. Such grants will not be taxable expenditures, provided the grantor private foundation exercises expenditure responsibility with respect to those grants. See section 4945(d)(4) of the Code and section 53.4945-5(a) of the regulations. In exercising expenditure responsibility, the grantor private foundation must require the grant recipient to comply with the requirements described in section 53.4945-5(b)(3) of the regulations. Where a grant is a capital endowment grant, the requirements of section 53.4945-5(c)(2) also must be satisfied by the grantor private foundation. You propose to make an endowment grant to each of the aforementioned foundations. The terms of these grants, as described above, satisfy the expenditure requirements of section 4945(d)(4) and the regulations thereunder. Hence, making these grants to the foundations will not constitute taxable expenditures.

You have provided sufficient information, as described above, to show that these grants will further charitable purposes described in sections 170(c)(2)(B) and 501(c)(3) of the Code. Hence, your exempt status under section 501(c)(3) will not be adversely affected.

These grants will not constitute a section 507(b)(2) transfer since the total amount of all three grants does not comprise 25 percent or more of your assets. See section 1.507-3(c)(1) of the regulations.

The definition of a disqualified person does not include any organization that is described in section 501(c)(3). See section 53.4946-1(a)(8) of the regulations. Hence, providing the endowment grants to the recipient foundations will not constitute self-dealing within the meaning of section 4941.

The grant you will make to each foundation for endowment purposes is not an investment for the production of income. Rather, such amounts constitute endowment grants that further purposes described in sections 501(c)(3) and 170(c)(2)(B) of the

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Code. Thus, the grants will not constitute investments that jeopardize the carrying out of your exempt purposes under section 4944.

The reasonable and necessary expenses and costs were incurred in connection with providing these endowment grants and to accomplish purposes described in section 170(c)(2)(B) of the Code. Hence, they may be treated as qualifying distributions for purposes of section 53.4942(a)-3(a)(2)(i) of the regulations and are not taxable expenditures for purposes of section 4945(d). See section 53.4945-6(b)(1)(v) of the regulations.

Finally, making the grants to the foundations will not call into question the representations made by you in our May 28, 1992 ruling letter. At the time of your 1992 request for rulings, neither you nor that private foundation contemplated the current proposed transaction described herein. Therefore, the proposed grants to the foundations will not adversely affect the rulings we made in our May 28, 1992 ruling letter.

Based upon the foregoing, we rule as follows:

1. The grant you will provide to each recipient foundation will not adversely affect your exempt status under section 501(c)(3) of the Code.

2. The grant you will provide to each recipient foundation will not constitute a transfer described in section 507(b)(2) of the Code. Also, providing the grants will not have the effect of dispossessing you of any of the attributes or characteristics described in section 1.507-3(a) of the regulations.

3. The grant you will provide to each recipient foundation will constitute capital or endowment grants. Since you will exercise expenditure requirements pursuant to sections 53.4945-5(c)(2) and 53.4945-5(d)(1) of the regulations, these grants will not constitute taxable expenditures within the meaning of section 4945 of the Code.

4. The grant agreement that you and each recipient foundation will execute meets the requirements of section 53.4945-5(b)(3) of the regulations.

5. The reasonable and necessary legal, accounting and other expenses you incur in connection with providing these grants to each recipient foundation will constitute qualifying distribution within the meaning of section 4942 of the Code and will not constitute taxable expenditures within the meaning of section 4945.

6. The grant you will provide to each recipient foundation will not constitute an act of self-dealing within the meaning of section 4941 of the Code.

7. The grant you will provide to each recipient foundation will not constitute a

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jeopardizing investment within the meaning of section 4944 of the Code.

8. The grants you will provide to the recipient foundations will not affect the rulings we issued in our May 28, 1992 ruling letter.

This ruling is conditioned on the understanding that there will be no material change in the facts upon which it is based. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described above. You should keep a copy for your permanent records.

The ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited by others as precedent.

Sincerely,

(signed) Robert C Harper, Jr.

Robert C. Harper, Jr.
ID# 50-03055
Chief, Exempt Organizations
Technical Branch 3

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