200009068

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

Date: DEC 03 1999

Contact Person:

Uniform Issue List: 507.01-00
509.01-01
4940.00-00
4941.04-00
4942.03-05
4944.00-00
4945.04-06

Contact Number:

OP:E:EO:T:2

Legend:

X =

Y =

Dear Sir or Madam:

This is in reply to your rulings request of March 3, 1999, as modified by your letter of November 19, 1999, on X's proposed transfer of one-half of its assets to Y pursuant to section 507(b)(2) of Code.

X and Y are exempt from federal income tax under section 501(c)(3) of the Code and are private foundations under section 509(a) of the Code.

X will transfer one-half of its assets to Y in order to divide X's capital endowment funds. Two of the four directors of X will be directors of Y. X will exercise expenditure responsibility under section 4945(h) of the Code with respect to this capital endowment grant to Y.

The following rulings are requested:

1. The transfer of assets from X to Y will not adversely affect X's or Y's exemption from federal income taxation under Code Section 501(c)(3).

2.a. The transfer of assets from X to Y will be a transfer of assets described in Code Section 507(b)(2).

2.b. As X has not given and does not plan to give notice of termination pursuant to Code Section 507(a)(1), the transfer of assets to Y will not constitute a termination of X's status as a private foundation, and the transfer of assets to Y will not cause X to be subject to the tax imposed by Code Section 507(c).

3. The transfer of assets from X to Y will not give rise to any tax on investment income pursuant to Section 4940.

4. The transfer of assets from X to Y will not be an act of self-dealing under Code Section 4941 of the Code and, thus, will not give rise to the excise tax on self-dealing transactions imposed under Code Section 4941.

5. The transfer of assets from X to Y will not be a jeopardy investment under Code Section 4944 and, thus, will not give rise to the excise tax on investments which jeopardize charitable purpose imposed pursuant to Code Section 4944.

373

6. a. The transfer of assets from X to Y will not be a taxable expenditure under section 4945 of the Code because X will exercise expenditure responsibility under Code Section 4945(h) and Treasury Regulation Section 53.4945-5(c)(2) with respect to the transfer.

b. The proposed transfer of assets from X to Y constitutes a grant for endowment, as contemplated in Treasury Regulation Section 53.4945-5(c)(2) and, thus, Y must only deliver its annual grantee report to X and X must only attach such report to its annual tax return for the tax year that includes the Transfer Date and the following two years.

7. X's legal, accounting and other expenditures incurred to make the transfer of assets to Y, if reasonable in amount, will not be taxable expenditures under Code Section 4945, but will be qualifying distributions under Code Section 4942(g)(1)(A).

8. The transfer of assets from X to Y may be counted toward the satisfaction of X's distribution requirements under Code Section 4942(g) of the Code for the year in which the Transfer Date occurs to the extent that the requirements of Code Section 4942(g)(3) are satisfied.

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

Section 509(a) of the Code provides that exempt organizations exempt under section 501(c)(3) can be further classified as private foundations that are thus subject to the private foundation provisions of the Code.

Section 507(c) of the Code imposes tax on a private foundation that terminates its status as a private foundation.

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

Section 1.507-4(b) of the regulations provides that the tax on termination of private foundation status imposed by section 507(c) of the Code does not apply to a transfer of assets pursuant to section 507(b)(2) of the Code.

Section 1.507-3(c)(1) of the Income Tax Regulations indicates 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 that includes any significant disposition of 25% or more of the transferor private foundation's assets.

Section 1.507-3(a)(1) of the regulations indicates that, in a transfer of assets from one private foundation to one or more private foundations pursuant to a reorganization, each transferee private 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 indicates, in general, that the aggregate tax benefits of an exempt private foundation refer to the value of its exemption from federal income tax and the deductions taken by its donors during its existence.

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 taxable year in which it makes a transfer of its assets to another private foundation pursuant to section 507(b)(2) of the Code.

Section 1.507-3(a)(8) of the regulations provides that certain transferor private foundation tax attributes, listed therein, will carry over to a transferee private foundation that receives a transfer of assets from a transferor foundation pursuant to section 507(b)(2) of the Code.

Section 1.507-3(a)(9)(i) of the regulations provides that, if a private foundation transfers assets to one or more private foundations that are effectively controlled directly or indirectly within the meaning of section 1.482-1(i)(4) of the regulations by the same persons who effectively control the transferor foundation, then each transferee private foundation will be treated as if it were the transferor private foundation for purposes of sections 4940 through 4948 and sections 507 through 509 of the Code. Each transferee foundation is treated as the transferor in the proportion which the fair market value of the transferor foundation's assets that were transferred bears to the fair market value of all of the assets of the transferor foundation immediately before the transfer.

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

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

Section 4942(g)(1)(A) of the Code provides that such qualifying distributions can include reasonable administrative expenses that are incurred in the conduct of an exempt purpose.

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

Sections 4942(g)(3) of the Code requires that a grantor private foundation, in order to have a qualifying distribution for its grant to another private foundation, which is not an operating foundation under section 4942(j)(3) of the Code, must have adequate records, as required by section 4942(g)(3)(B) of the Code, to show that the grantee private foundation, in fact, subsequently made qualifying distributions that were equal to the amount of the grant and that were paid out of the grantee's own corpus within the meaning of section 4942(h) of the Code. Such grantee foundation's qualifying distributions out of corpus must be expended before the close of the grantee's first tax year after its tax year in which it received the grant.

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

Section 4945(d)(4) of the Code requires that a transferor private foundation must exercise "expenditure responsibility" under section 4945(h) on any grant to another private foundation that is not an "exempt operating foundation" under section 4940(d)(2) of the Code in order for its grant not to be a taxable expenditure.

Section 4945(h) of the Code on expenditure responsibility provides, in part, that the grantor private foundation must make a pre-grant inquiry and require proper reports from the grantee private foundation as to the grantee's uses of the grant .

375

Section 53.4945-5(b)(2) of the regulations, concerning pre-grant inquiry, provides that expenditure responsibility under section 4945(h) of the Code includes a requirement that the grantor private foundation must make a pre-grant inquiry of the prospective grantee private foundation. Thus, before making a grant, the grantor private foundation must conduct a limited inquiry of the potential grantee. Such pre-grant inquiry must be complete enough to give a reasonable person assurance that the grantee will use the grant for the proper exempt purposes. This inquiry should concern matters such as the identity, prior history and experience of the grantee organization and its managers, and any knowledge which the grantor has, based on prior experience or on other information which is readily available, concerning the management, activities, and practices of the grantee foundation. The scope of this inquiry may vary from case to case depending upon the size and purpose of the grant, the period of time over which it is to be paid, and the prior experience which the grantor has had with respect to the capacity of the grantee to use the grant for the proper purposes.

Section 53.4945-5(c)(2) of the regulations, concerning capital endowment grants to exempt private foundations, 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, before the end of such grantee's second succeeding tax year, that 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(b)(3) of the regulations, on the terms of grants, provides, that, in order to exercise expenditure responsibility, the grantor private foundation must require that the grantee organization be made subject to a written commitment signed by an appropriate officer, director, or trustee of the grantee, including agreement by the grantee to repay any portion of the amount granted 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 and 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 section 4945(d)(1) of the Code, 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 section 4945(d)(2), or to make any grant which does not comply with the requirements of section 4945(d)(3) or 4945(d)(4), or to undertake any activity for any purpose other than one specified in 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 section 170(c)(2)(B) of the Code.

Analysis

X will transfer one-half of its assets to Y. Your requested rulings are discussed below:

1.

Under section 501(c)(3) of the Code, X is an exempt charity that can donate assets to another exempt charity Y and, thus, X's transfer to exempt charity Y will not affect the section 501(c)(3) exemption of either X or Y.

2.

Under 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 another private foundation pursuant to any reorganization or liquidation, including a significant disposition of 25% or more of the transferor foundation's assets. Because X will transfer all of its assets, X's transfer will be a significant disposition of its assets under section 1.507-3(c)(1) of the regulations and, thus, will be a transfer under section 507(b)(2) of the Code.

Under section 1.507-3(d) of the regulations, X's transfer of assets to Y pursuant to section 507(b)(2) of the Code will not terminate X's private foundation status under section 509(a) of the Code.

Under section 1.507-4(b) of the regulations, X's transfer of assets to Y pursuant to section 507(b)(2) of the Code will not result in foundation termination tax on X under section 507(c) of the Code.

3.

Under section 4940 of the Code, X's transfer of assets to Y will not result in any income under section 4940 of the Code to X or Y.

4.

Under section 4941 of the Code, X's transfer of assets to Y will not be an act of self-dealing because the transfer will be for exempt purposes to an organization Y which is exempt from federal income tax under section 501(c)(3) of the Code and which is not a disqualified person, for purposes of section 4941 of the Code, pursuant to section 53.4946-1(a)(8) of the regulations.

5.

X's transfer of assets to Y is made for exempt purposes under section 501(c)(3) of the Code and will not be a jeopardizing investment or result in tax under section 4944 of the Code.

6.

X's transfer of one-half of its assets to Y will not be a taxable expenditure under section 4945 of the Code so long as X exercises the capital endowment grant expenditure responsibility required by section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations.

X will meet its required pre-grant inquiry as to Y under section 53.4945-5(b)(2) of the regulations.

X mustmeet the written grant terms agreement requirement of section 53.4945-5(b)(3) of the regulations by X's written agreement with Y requiring Y to agree to the purposes and restrictions of the grant in accordance with the requirements of that regulation and by taking all reasonable action to enforce the terms of such grant agreement.

Y must send its annual grantee report, as submitted, to meet section 53.4945-5(c) of the regulations and such report should be attached to the annual tax return of X to satisfy section 53.4945-5(d) of the regulations.

Because X's transfer of assets to Y constitutes a grant for Y's endowment under section 53.4945-5(c)(2) of the regulations, Y will submit its annual grantee report to grantor X, and X will attach Y's report to X's annual return, only for the tax year of X's transfer and the following two tax years.

7.

Under section 53.4945-6(b)(2) of the regulations, a private foundation's payment of its reasonable costs for services rendered is not a taxable expenditure under section 4945 of the Code. Thus, the legal, accounting, and other expenses, if reasonable in amount, for this rulings request and the transfer, will not be taxable expenditures under section 4945 of the Code.

Under section 4942 of the Code, a distribution for exempt purposes includes the reasonable and necessary administrative expenses of a grant for exempt purposes. Thus, the legal, accounting, and other expenses, for this rulings request and the transfers, if reasonable in amount, will be qualifying distributions under section 4942 of the Code.

8.

Under sections 4942(g)(3) of the Code, X's transfer of assets will be counted toward satisfaction of its distribution requirements under section 4942 of the Code for the year of the transfer to the extent, if any, that X's grant amount is redistributed by Y out of Y's corpus before the close of Y's tax year that follows the tax year of Y in which X's transfer is made.

Accordingly, we rule that:

1. X's transfer of one-half of its assets to Y will not adversely affect the exemptions of X or Y from federal income taxation under section 501(c)(3) of the Code.

2.a. X's transfer will be a transfer of assets under section 507(b)(2) of the Code.

2.b. X's transfer will not be a termination of X's status as a private foundation, and the transfer will not subject X to tax under section 507(c) of the Code.

3. X's transfer will not result in tax on investment income under section 4940 of the Code.

4. X's transfer will not be an act of self-dealing and will not result in tax under section 4941 of the Code.

5. X's transfer will not be a jeopardizing investment and will not result in tax under section 4944 of the Code.

6.a. X's transfer of one-half of its assets to Y will not be a taxable expenditure under section 4945 of the Code because X will exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations with respect to its transfer.

6.b. X's transfer of one-half of its assets to Y will be a grant for endowment under section 53.4945-5(c)(2) of the regulations and, thus, Y will submit its annual grantee report to X, and X will attach Y's report to X's annual return, for the tax year of such transfer and the following two tax years.

7. X's legal, accounting, and other expenditures incurred to make the transfer of assets to Y, if reasonable in amount, will not be taxable expenditures under section 4945 of the Code, but will be qualifying distributions under section 4942(g)(1)(A) of the Code.

8. X's transfer of one-half of its assets to Y may be counted toward satisfaction of X's own distribution requirements under section 4942(g) of the Code for the tax year in which the transfer occurs to the extent that the requirements of section 4942(g)(3) of the Code are met.

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 this ruling letter may not be used or cited as precedent.

Sincerely,

(signed) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2