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

200049037

Date: SEP 1 1 2000

Contact Person:

Uniform Issue List: 507.00-00
501.03-02
509.01-01
4941.04-00
4942.03-05
4942.03-06
4944.00-00
4945.04-06

Contact Number:

T:EO:RA:T2

Legend:
T =
C =
E =
L =

Dear Sir or Madam:

This is in reply to your rulings request dated September 30, 1999, on T's proposed transfer of approximately four-fifths of its assets to C pursuant to section 507(b)(2) of the Internal Revenue Code.

T, a charitable trust, and C, a nonprofit charitable corporation, are each exempt from federal income tax under section 501(c)(3) of the Code and are private foundations under section 509(a) of the Code. T and C are effectively controlled by the same individuals. T will transfer approximately four-fifths of its assets to C. T will have no grants outstanding that require expenditure responsibility under section 4945(h) of the Code.

Also, T leases its land L at a nominal annual dollar rent to public charity E, which is exempt from federal income tax under section 501(c)(3) of the Code and is not a private foundation under section 509(a) of the Code. T's land L is used by E for E's exempt purposes under section 501(c)(3) of the Code. E operates a youth camp on L.

The following rulings are requested:

1. T's transfer of assets to C will not affect the status of T or C as an organization which is exempt from federal income taxation as described in section 501(c)(3) of the Code.

2. T's transfer of assets to C will constitute a transfer described in section 507(b)(2) of the Code; C will not be treated as a newly created organization for purposes of section 507of the Code; and T's transfer will not result in a termination of the T's private foundation status giving rise to the imposition of the termination tax under section 507 of the Code .

3. For purposes of sections 507 through 509 of the Code, C will possess certain attributes and characteristics of T, as provided by, and in an amount determined under, section 1.507-3(a) of the Income Tax Regulations.

4. T's transfer of assets to C will not constitute an act of self-dealing under section 4941 of the Code .

5. T's transfer of assets to C may be counted toward satisfaction of T's distribution requirements under section 4942 of the Code to the extent the transfer meets the requirements of section 4942(g) of the Code .

6 T's transfer of assets to C will not constitute an investment which jeopardizes the carrying out of exempt purposes within the meaning of section 4944 of the Code.

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7. T's transfer of assets to C will constitute a capital or endowment grant with respect to which T is required to exercise expenditure responsibility in the manner provided in sections 53.4945-5(c)(2) and 53.4945-5(d)(1) of the regulations, and (i) if T exercises such expenditure responsibility, T's transfer of assets will not constitute a taxable expenditure under section 4945(d)(4), and (ii) C's undertaking created by the written Grant Agreement pursuant to which the transfers will be effected constitutes a written commitment meeting the requirements of section 53.4945-5(b)(3) of the Foundation and Similar Excise Taxes Regulations.

8. T's transfer of assets to C will not constitute a taxable expenditure under section 4945(d)(5) of the Code .

9. The reasonable and necessary legal, accounting, and other expenses and costs incurred by T to implement T's transfer of assets to C will constitute qualifying distributions by T under section 4942 of the Code, and will not constitute taxable expenditures by T under section 4945 of the Code .

10. So long as T's lease of land L to public charity E (or a similar lease to another public charity) remains in effect and E (or another public charity) uses land L for exempt purposes, land L will be considered to be used (or held for use) directly in carrying out T's exempt purposes under section 501(c)(3) of the Code, and, therefore, land L will not be taken into account for purposes of computing T's minimum investment return under section 4942(e) of the Code .

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 the 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 provisions of Chapter 42 of the Code.

Section 507(a)(1) of the Code and section 1.507-1(b)(1) of the Income Tax Regulations provide that a private foundation may voluntarily terminate its private foundation status by submitting to the Commissioner a statement of its intention to terminate its private foundation status and by paying the termination tax imposed under section 507(c) 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 under section 507(a)(1) of the Code. This section 507(c) tax is equal to the lower of: (1) the aggregate tax benefit that has resulted from the foundation's exemption from federal income tax under section 501(c)(3) of the Code, or (2) the value of the net assets of the foundation.

Section 507(e) of the Code provides that, for purposes of section 507(c)(2) of the Code, the value of the net assets of the private foundation shall be determined at whichever time the value is higher: (1) the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation or (2) the date on which it ceases to be 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 1.507-3(c)(1) of the 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 other private foundations pursuant to any liquidation or reorganization, including a significant disposition of 25% or more of the transferor foundation's assets.

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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 provides, 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 1.507-1(b)(9) of the regulations provides that a private foundation which transfers all of its assets is not required to file annual information returns required by section 6033 of the Code for its tax years after the tax year of its transfer when it 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 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 tax provisions, listed therein, will carry over to any transferee private foundation that is given a transfer of assets from a transferor private foundation pursuant to section 507(b)(2) of the Code.

Section 1.507-3(a)(9)(i) of the regulations indicates that, if a transferor private foundation transfers assets to a private foundation effectively controlled, directly or indirectly, by the same person or persons who effectively control the transferor private foundation, the 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. The transferee is treated as the transferor in the proportion which the fair market value of the transferor's assets that were transferred bears to the fair market value of all of the assets of the transferor immediately before the transfer.

Revenue Ruling 78-387, 1978-2 C.B. 270, concerns a private foundation that transferred all of its assets to another private foundation that was effectively controlled by the same persons. In accordance with section 1.507-3(a)(9)(i) of the regulations, the transferee foundation is treated as the transferor foundation and, thus, the transferee can use its transferor's excess qualifying distributions carryover, if any, under section 4942(i) of the Code to reduce the transferee's 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 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 any termination of the transferor foundation's status as a private foundation.

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 an act of self-dealing between a private foundation and any of its disqualified persons under section 4946 of the Code.

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 exempt organization under section 501(c)(3) of the Code is not a disqualified person.

Section 4942 of the Code provides that a private foundation must expend qualifying distributions under section 4942(g) of the Code that are for the direct active conduct of exempt purposes. Under section 53.4942(a)-3(a)(2)(i) of the regulations, such qualifying distributions can include the reasonable administrative expenses that are incurred in conduct of an exempt purpose under section 170(c)(2)(B) of the Code.

Section 4942(g)(1)(A) of the Code provides that a private foundation does not make any qualifying distribution under section 4942(g) of the Code where its distribution is a contribution to: (i) an organization 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.

Section 4942(g)(3) of the Code provides 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) of the Code, to show that the transferee foundation in fact subsequently made a qualifying distribution that is equal to the amount of the transfer received and that is paid out of the transferee's own corpus within the meaning of section 4942(h) of the Code. The transferee's qualifying distribution 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.

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 .

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 or 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.

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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.

Sections 53.4945-6(c)(3) and 1.507-3(b) of the regulations allow 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

T will transfer approximately four-fifths of its assets to C. Your requested rulings are discussed below:

1.

T's transfer of assets is to C, which is exempt from federal income tax under section 501(c)(3) of the Code, and will not adversely affect the exemptions from federal income tax under section 501(c)(3) of the Code of T or C.

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 T will transfer approximately four-fifths of its assets to C, T'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 507(b)(2) of the Code and section 1.507-3(a)(1) of the regulations, T's transferee C will not be considered a newly created organization.

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

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

3.

Under section 1.507-3(a) of the regulations, transferee C will be treated as its transferor T for purposes described in that regulation.

4.

Under section 4941 of the Code, T's transfer of assets to C will not be an act of self-dealing because the transfer will be for exempt purposes to C, an organization exempt from federal income tax under section 501(c)(3) of the Code, 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.

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.

Under sections 4942(g)(3) of the Code, T's transfer of assets can 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 T's grant amount is redistributed by C out of C's corpus before the close of C's tax year that follows the tax year of C in which T's transfer is made.

6.

Under section 4944 of the Code, T's transfer of assets to C is for exempt purposes and will not be a jeopardizing investment or result in tax under that section.

7.

T's transfer of approximate four-fifths of its assets to C will be a capital or endowment grant with respect to which T is required to exercise expenditure responsibility in the manner provided in sections 53.4945-5(c)(2) and 53.4945-5(d)(1) of the regulations, and, because T will exercise such expenditure responsibility, T's transfer of assets will not constitute a taxable expenditure under section 4945(d)(4) of the Code. The written Grant Agreement, to be signed by T and C, pursuant to which T's transfer of assets to C will be effected, will be a written commitment under section 53.4945-5(b)(3) of the regulations in which C will agree to meet the expenditure responsibility requirements.

8.

Under section 53.4945-6(c)(3) of the regulations, a private foundation can make a transfer of its assets pursuant to section 507(b)(2) of the Code to an exempt organization under section 501(c)(3) of the Code, including a private foundation, without the transfer being a taxable expenditure under section 4945 of the Code. Thus, T's transfer of assets to C will not be a taxable expenditure under section 4945 of the Code.

9.

Under section 53.4942(a)-3(a)(2)(i) of the regulations, a private foundation's payment of administrative expenses as part of a charitable grant effort may constitute a qualifying distribution. Thus, the legal, accounting, and other necessary expenses incurred to implement T's transfer to C, if reasonable in amount, will be paid to accomplish exempt purposes and will be qualifying distributions under section 4942(g)(1)(A) of the Code.

Under section 53.4945-6(b)(2) of the regulations, a private foundation's payment of reasonable costs for services rendered is not a taxable expenditure under section 4945 of the Code. Thus, the legal, accounting, and other necessary expenses incurred to implement T's transfer to C, if reasonable in amount, will be paid to accomplish exempt purposes and will not be taxable expenditures under section 4945 of the Code.

10.

T's leases its land L at a nominal rent of one dollar per year to E, which operates a youth camp on L as part of E's exempt purposes under section 501(c)(3) of the Code. Under section 53.4942(a)-2(c)(3)(ii)(f) of the regulations, because the land L is used directly in the conduct of exempt purposes under section 501(c)(3) of the Code, T's land L will be excluded in computing T's minimum investment return under section 4942(e)(1)(A) of the Code.

Accordingly, we rule:

1. T's transfer of assets to C will not affect the status of T or C as organizations which are exempt from federal income tax under section 501(c)(3) of the Code .

2. T's transfer of assets to C will constitute a transfer under section 507(b)(2) of the Code; C will not be treated as a newly created organization for purposes of section 507 of the Code; and the transfer will not result in a termination of the T's private foundation status under section 509(a) of the Code giving rise to the imposition of termination tax under section 507(c) of the Code.

3. For purposes of sections 507, 508, and 509 of the Code, C will possess certain attributes and characteristics of T as provided by, and in an amount determined under, section 1.507-3(a) of the regulations.

4. T's transfer of assets to C will not constitute an act of self-dealing under section 4941 of the Code.

5. T's transfer of assets to C may be counted toward satisfaction of T's distribution requirements under section 4942 of the Code to the extent, if any, that T's transfer meets the requirements of section 4942(g)(3) of the Code.

6 T's transfer of assets to C will not constitute an investment which jeopardizes the carrying out of exempt purposes under section 4944 of the Code.

7. T's transfer of assets to C will constitute a capital or endowment grant with respect to which T is required to exercise expenditure responsibility in the manner provided in sections 53.4945-5(c)(2) and 53.4945-5(d)(1) of the regulations, and, if T exercises such expenditure responsibility, T's transfer of assets will not constitute a taxable expenditure under section 4945(d)(4) of the Code. C's written and signed Grant Agreement with T, pursuant to which T's transfer of assets to C will be effected, will constitute a written commitment under section 53.4945-5(b)(3) of the regulations that meets the expenditure responsibility requirements.

8. T's transfer of assets to C will not constitute a taxable expenditure under section 4945(d)(5) of the Code.

9. T's reasonable and necessary legal, accounting, and other expenses and costs to implement its transfer of assets to C will constitute qualifying distributions by T under section 4942(g)(1)(A) of the Code, and will not constitute taxable expenditures by T under section 4945 of the Code.

10. As long as T's lease to public charity E (or a similar lease to another public charity) remains in effect and E (or another public charity) uses land L for exempt purposes under section 501(c)(3) of the Code, T's asset L will be considered to be used (or held for use) directly in carrying out T's exempt purposes and will not be taken into account for purposes of computing T's minimum investment return under section 4942(e) of the Code.

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Because this ruling letter could help to resolve any questions, please keep it in your permanent records and include a copy in your annual return, Form 990-PF.

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

Sincerely,

Joseph Chasin

Joseph Chasin
Acting Manager, Exempt Organizations
Technical Group 2

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