



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Release Number: 200715014

Release Date: 4/13/07

Date: January 17, 2007

Contact Person:

Identification Number:

Telephone Number:

Uniform Issue List:

507.01-00

4940.01-00

4942.00-00

4942.03-07

4945.00-00

Employer Identification Number:

LEGEND:

B =

C =

D =

E =

F =

G =

H =

M =

N =

O =

P =

Q =

X =

Dear :

We have considered M's ruling request concerning a transfer of assets under sections 501, 507, 4940, 4941, 4942, 4944 and 4945 of the Internal Revenue Code.

FACTS

M is a private foundation created pursuant to N, a trust agreement dated June 10, 1950, with B as trustor. N provides that, "the principal or corpus of which and all income thereof and increment thereto shall be exclusively devoted to and for religious and charitable, scientific or literary educational purposes."

N appointed B, C, and D as the initial Trustees and appointed E and F as Trustees upon their qualification in accordance with N. With the passing of years, E and F so qualified.

N trust indenture provides that the trustees may terminate M at any time by transferring all of its assets to one or more trusts, corporations, associations, or institutions organized and operated exclusively for religious, charitable, scientific, literary or educational purposes. "Any such transfer to terminate the trust shall be made conditional on the assumption by the transferee or transferees of such obligations then outstanding.."

B and his wife are deceased. The present trustees are C, D, E, F, and G. Except for G, the other four trustees are descendants of B and his wife. M's trustees have met periodically and made distributions upon the approval of all trustees in accordance with N. For its taxable year ending the assets of M were approximately     x    .

The charitable interests and management strategies of M's trustees have diverged in recent years, and they currently are interested in supporting different charities and adopting different management strategies. In order to resolve these differences, the trustees have proposed to reorganize by transferring 25% of M's assets to O, 25% to P, and 25% to Q, while retaining 25% in M.

The transfer was conditioned upon each entity obtaining a determination that it is tax exempt under section 501(c)(3) and as a private foundation under section 509(a). At the time of the transfer of the assets, the trustee who has created the new entity would resign as a trustee of M, and become a director or a trustee of the new entity, together with such trustee's family. Upon completion of the asset transfers, C and his family would be in sole control of and be trustees of M.

G, the existing non-family trustee, will continue as a trustee of M on a year to year basis upon the appointment of the new trustees of M. The designated new trustee of M, to be appointed in accordance with N, is H, who is the child of C; C will continue to serve as a trustee of M. M will exercise expenditure responsibility under section 4945(d) and 4945(f) over the transfer distributions for a period of three years from the date of the transfer distributions.

O, P and Q are exempt under section 501(c)(3) of the Code and are classified as private foundations.

All of the trustees of M, and all of the directors of O, P, and Q, are "disqualified persons" under section 4941(a)(1)(D) of the Code.

It is anticipated that no compensation, contributions to employee benefits plans, deferred compensation, or expense or other accounts will be provided to the directors of P and O. It is anticipated that no compensation, contributions to employee benefit plans, deferred compensation, or expense or other accounts will be provided to the directors of Q, except that the

Director/Secretary/Treasurer will be paid a salary for the value of her services estimated to be approximately      x per year.

### RULINGS REQUESTED

1. The three distributions will be treated as transfers of assets described in section 507(b)(2) of the Internal Revenue Code, and will neither result in the termination of M's private foundation status under Code section 507(b)(1), nor subject M to the tax imposed by Code section 507(c).
2. O, P and Q will not be treated as newly created organizations as a result of M's distributions.
3. The distributions will not constitute either a willful flagrant act (or failure to act) or one of a series of willful repeated acts (or failures to act) giving rise to liability for tax under Chapter 42 of the Code.
4. The transfer distributions by the M to O, P and Q will not be taxable expenditures by M under section 4945(d) of the Code as M will exercise expenditure responsibility under section 4945(d) and 4945(h) of the Code.
5. M and its disqualified persons will neither be deemed to have engaged in an act of self-dealing under Code section 4941, nor be subject to any tax under Code sections 4941 through 4945, as a result of the formation of O, P, and Q, and the distributions.
6. The distributions may be counted toward satisfaction of M's minimum distribution requirements under Code section 4942 to the extent the transfers meet the requirement of Code section 4942.
7. The legal, accounting, and other expenses incurred by M, O, P and Q in connection with this ruling request and effectuating the distributions will not constitute taxable expenditures pursuant to Code section 4945 and will not be considered qualifying distributions under Code section 4942.
8. The distributions will not affect the tax exempt status under Code section 501(c)(3) of M, O, P and Q.

### LAW

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations organized and operated exclusively for the 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 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 Internal Revenue Service a statement of its intention to voluntarily terminate its private foundation

status pursuant to section 507(a)(1) and by paying any termination tax 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 under section 507(a)(1) of the Code, and provides that this section 507(c) tax is equal to the lower of: (1) the aggregate tax benefits that have resulted from the private foundation's exempt status under section 501(c)(3) of the Code, or (2) the value of the net assets of the 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 1.507-1(b)(6) of the Income Tax Regulations provides that if a private foundation transfers all or part of its assets to one or more other private foundations (or one or more private foundations and one or more section 509(a)(1), (2), (3), or (4) organizations) 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).

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 private foundation status under section 509(a) of the Code .

Section 1.507-3(a)(1) of the regulations provides that for purposes of Part II, subchapter F, Chapter 1 of the Code, 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 organization shall not be treated as a newly created organization. Thus, in the case of a significant disposition of assets to one or more private foundations within the meaning of paragraph (c) of this section, the transferee organization shall not be treated as a newly created organization.

Section 1.507-3(a)(2) of the regulations provides that a transferee private foundation succeeds to that percentage of the transferor's "aggregate tax benefit" equal to the fair market value of the assets transferred divided by the fair market value of the assets held by the transferor immediately before the transfer. The fair market value of the assets held and transferred are determined at the time of transfer.

Section 1.507-3(a)(4) of the regulations provides that if a private foundation incurs liability for one or more of the taxes imposed under Chapter 42 of the Code (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in section 507(b)(2) to one or more private foundations, then in any case where transferee liability applies, each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor foundation does not satisfy such liability.

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 itself be counted toward satisfaction of the requirements to the extent the amount transferred meets the requirements of section 4942(g).

Section 1.507-3(a)(7) of the regulations provides that, except as provided in section 1.507-3(a)(9), where the transferor has disposed of all of its assets, during any period in which the transferor has no assets, section 4945(d) and (h) shall not apply to the transferee or the transferor with respect to any "expenditure responsibility" grants made by the transferor. The exception does not apply to information reporting requirements imposed by section 4945 and the regulations thereunder for the year in which the transfer is made.

Section 1.507-3(a)(9)(i) of the regulations provides that, if a private foundation transfers assets to one or more private foundations which 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, 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 its transferor in the proportion which the fair market value of the transferor's assets transferred to the transferee bears to the fair market value of all of the transferor's assets immediately before the transfer.

Section 1.507-3(b) of the regulations provides that a 507(b)(2) transfer of assets from a private foundation to an organization recognized as exempt under section 501(c)(3), including a private foundation, qualifies as a transfer for charitable purposes.

Section 1.507-3(c)(1) of the 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 other 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)(1) 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 reorganization, including a significant disposition of  $\frac{1}{2}$  or more of the transferor foundation's assets.

Section 1.507-3(d) of the regulations provides that if a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in section 507(b)(2), such transferor foundation will not have terminated its private foundation status under section 507(a)(1).

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 under section 507(b)(2) of the Code.

Section 4940(a) of the Code provides for the imposition on each private foundation which is exempt from taxation under section 501(a) for the taxable year, with respect to the carrying on of its activities, a tax equal to 2 percent of the net investment income of such foundation for the taxable year.

Section 4941(a) of the Code imposes a tax on each act of self-dealing between a disqualified person and a private foundation. The rate of tax shall be equal to 5 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period.

Section 4941(d)(1)(E) of the Code defines the term self-dealing to include any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4942(a) of the Code provides for the imposition of a tax on the undistributed income of a private foundation.

Section 4942(c) of the Code defines "undistributed income" as the amount by which the distributable amount exceeds the qualifying distributions of the foundation.

Section 4942(g)(1)(A) of the Code defines "qualifying distribution" as 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 a contribution to (i) an organization controlled directly or indirectly by the foundation or by one or more disqualified persons with respect to the foundation, unless certain requirements are satisfied, or (ii) any private foundation which is not an operating foundation under Code section 4942(j)(3), unless certain requirements are satisfied.

Section 4942(i) of the Code provides that an excess qualifying distribution is a distribution of either undistributed income or corpus with respect to a taxable year beginning after December 31, 1969, that exceeds the distributable amount for that taxable year.

Section 4944(a)(1) imposes a tax on any amount invested by a private foundation in a manner that jeopardizes the carrying out of the foundation's exempt purposes.

Section 4945(a) of the Code imposes a tax on each "taxable expenditure" of a private foundation as defined in section 4945(d).

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(d)(5) of the Code provides that a taxable expenditure includes any amount expended by a private foundation for purposes other than exempt purposes under section 170(c)(2)(B).

Section 4945(h) of the Code defines expenditure responsibility in terms of the grantor private foundation requiring pre-grant inquiry and post-grant reports as to the grantee private foundation on its uses of the grant.

Section 53.4945-5(b)(2) of the regulations provides that expenditure responsibility 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 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 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(b)(3) of the regulations 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, 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 section 4945(d)(1) of the Code, or to influence the outcome of any specific public election, or to carry on 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) of the Code. The agreement must 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 in section 170(c)(2)(B) of the Code.

Section 53.4945-5(c)(2) of the regulations, on capital endowment grants made to private foundations, provides that, if a private foundation makes a grant to another private foundation for endowment or for other capital purposes, the grantor foundation must require reports from the grantee 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) of the Code, may the grantor then allow the grantee's reports to be discontinued.

Section 53.4945-6(b) of the regulations provides that, in general, unreasonable administrative expenditures will ordinarily be regarded as taxable expenditures unless the foundation can demonstrate that they were paid or incurred in the good faith belief that they were reasonable and that their payment was consistent with ordinary business care and prudence.

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

Section 53.4946-1(a)(8) of the 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.

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 foundations are controlled by the same persons under section 1.507-3(a)(9)(i) of the regulations. The transferee is treated as the transferor so that the transferee can reduce its own distributable amount under section 4942 of the Code by its share of the transferor foundation's excess qualifying distributions under section 4942(i) of the Code.

### ANALYSIS

A transfer of assets described in Code section 507(b)(2) does not constitute a termination of the transferor's private foundation status under Code section 507(a)(1) unless the transferor voluntarily gives notice pursuant to Code section 507(a)(1). See section 1.507-1(b)(6) and 1.507-3(d) of the regulations. The transferor foundation is not required to provide such notice. Inasmuch as M has not given notice to the Service of its intent to terminate, it retains its private foundation status and the tax under Code section 507(c) does not apply. See Code section 507(a) and section 1.507-4(b) of the regulations. Because the transferor, M, has not terminated its private foundation status, it continues to be treated as a private foundation.

The transferee foundations (O, P, and Q herein) are treated as possessing the aggregate tax benefits of the transferor, M. See section 1.507-3(a)(1) and 2(i) of the regulations. Moreover, regardless whether the transferor foundation provides notice of its intent to terminate, where transferee liability applies, each transferee foundation is treated as receiving the transferred assets subject to the transferor foundation's prior excise tax liabilities under Chapter 42 (and any penalties resulting therefrom), if any, to the extent the transferor did not previously satisfy those liabilities. See section 1.507-3(a)(1) and (4) of the regulations.

Concerning the implications of the proposed asset transfers under Code section 4941, the definition of "self-dealing" under Code section 4941(d)(1)(E), and the definition of a "disqualified person" under Code section 4946(a)(1)(B) and (D), as set forth above, do not apply to the proposed asset transfers to the three newly created foundations. The proposed transfers from M to O, P and Q are transfers to entities which have been recognized by the Service as tax exempt under Code section 501(c)(3). As such, the three new foundations are not considered disqualified persons for purposes of Code section 4941 pursuant to section 53.4946-1(a)(8) of the regulations.

In addition, the divisive transfers here do not appear to be part of a plan to provide excess compensation to the trustees of the four foundations. All of the family trustees will serve without compensation. The one non-family trustee is paid in accordance with a state funded salary survey. It is represented that the Director/Secretary/Treasurer of Q will be paid reasonable compensation.

As M will transfer % of its assets to three private foundations which are effectively controlled by the same persons who effectively control M, the transferee foundations are treated as though they were the transferor for purposes of Code section 4942. See section 1.507-3(a)(9)(i) of the regulations. Accordingly, the proposed transfers to O, P and Q will not be treated as qualifying distributions of M. In addition, each transferee foundation assumes all obligations with respect to M's "undistributed income" within the meaning of Code section 4942(c), if any, and reduces its own distributable amount under Code section 4942 by M's excess qualifying distributions under Code section 4942(i). Here, proportionality is appropriate, and O, P, and Q will each become responsible for one fourth

of M's undistributed income and succeed to one fourth of M's excess qualifying distributions, if any. See section 1.507-3(a)(9)(i) of the regulations and Rev. Rul. 78-387, above.



Under the Facts set forth above, the proposed transfers to O, P, and Q will not constitute investments jeopardizing the transferor M's exempt purposes, and therefore are not subject to tax under code section 4944(a)(1).

For purposes of Code section 4945, because M will transfer % of its assets to O, P, and Q, all controlled by the same individuals who control M, the transferee foundations will be treated as though they were the transferor for purposes of Code section 4945. See section 1.507-3(a)(9)(i) of the regulations. M will exercise expenditure responsibility under sections 4945(d) and 4945(h) respecting the transfer distributions to the three newly created foundations for a period of three years from the date of each transfer.

The legal, accounting and other expenses incurred by the transferor foundation M and the three transferee foundations O, P and Q in connection with this ruling request should not be considered taxable expenditures under Code section 4945 to the extent that such expenses are reasonable and necessary in light of the legal implications of the proposed asset transfers. For purposes of Code section 4942, these expenses will be considered qualifying distributions.

#### RULINGS

Based on the representations made in your ruling request, and the applicable law, we rule as follows:

1. The three distributions will qualify, insofar as M is concerned, as transfers of assets described in section 507(b)(2) of the Internal Revenue Code, and will neither result in the termination of M's private foundation status under Code section 507(b)(1), nor subject M to the tax imposed by Code section 507(c).
2. O, P and Q will not be treated as newly created organizations as a result of M's distributions.
3. The distributions will not constitute either a willful flagrant act (or failure to act) or one of a series of willful repeated acts (or failures to act) giving rise to liability for tax under Chapter 42 of the Code.
4. The transfer distributions by the M to O, P and Q will not be taxable expenditures by M under section 4945(d) of the Code because M will exercise expenditure responsibility under section 4945(d) and 4945(h) of the Code for a period of three years..
5. M and its disqualified persons will neither be deemed to have engaged in an act of self-dealing under Code section 4941, nor be subject to any tax under Code sections 4941 through 4945, as a result of the formation of O, P, and Q, and the distributions.
6. The distributions may be counted toward satisfaction of M's minimum distribution requirements under Code section 4942 to the extent the transfers meet the requirement of Code section 4942.
7. The legal, accounting, and other expenses incurred by M, O, P and Q in connection with this ruling request and effectuating the distributions will not constitute taxable expenditures

pursuant to Code section 4945 and will not be considered qualifying distributions under Code section 4942.

8. The distributions will not affect the tax exempt status under Code section 501(c)(3) of M, O, P and Q.

This ruling is conditioned on the understanding that there will be no material changes in the facts upon which it is based. This ruling is directed to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent. Please keep a copy of this ruling in your organization's permanent records.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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.

Sincerely,

Debra J. Kawecki  
Manager, Exempt Organizations  
Technical Group 2

Enclosure: Notice 437