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

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Contact Person:

ID Number:

Telephone Number:

**LEGEND**

- V = \*
- W = \*
- X = \*
- Y = \*
- Z = \*

Dear Applicant:

This is in response to a ruling request dated June 7, 1999, on the application of sections 507(b)(2) and Chapter 42 of the Internal Revenue Code to a proposed asset transfer from X to Y.

**FACTS**

X is a private foundation as defined in Section 509(a) of the Internal Revenue Code of 1986, as amended from time to time, organized as a charitable trust under state law and exempt from taxation under **501(c)(3)** of the Code. V and W established X in 1988 for the purpose of receiving, administering and distributing funds for charitable, religious, scientific, literary, educational and other Section **501(c)(3)** purposes. V and W have been the primary source of funding since inception. V is currently the sole acting Trustee of X. W served as a co-Trustee of X until her death in 1998.

Immediately following the death of W, V formed Y. The current Trustees of Y are V, and his adult children. As with X, Y is a private foundation as defined in Section 509(a) of the Code, exempt from taxation under Section **501(c)(3)** of the Code. The Y was established for the purpose of receiving, administering and distributing funds for charitable, religious, scientific, literary, educational and other Section **501(c)(3)** purposes.

In order to reduce the administrative burden and expense of maintaining two private foundations with identical charitable purposes, the Z family would like to consolidate X and Y. To achieve this end, V, as sole Trustee of X, requests permission to distribute all of the assets of X to Y so that all the funds can be administered together under the name of Y. Once X and Y have been consolidated, the Z family, working with a larger pool of assets earmarked for charity, can make more meaningful charitable gifts to preserve the legacy of W.

X has filed **its** Form **990-PF** for the year ended June **30, 1998**. It has satisfied the **distribution** requirement for all preceding years. X has carryover from prior years which will be transferred to Y. X is not currently under examination by the Internal Revenue **Service**.

The transfer by X of all **its** net asset to Y **will** be without consideration and will not be from current income. After the transfer, X will voluntarily terminate **its** private foundation **status** and **will** comply with the **notification** requirement and other **requirements** of Section 507 and 6033 of the Code. X **will** cease to **exist** **after** the transfer of **its** asset and the termination of **its** private foundation status.

Based upon the **facts** set forth above, and the assumption that the **transaction will** be carried out as previously described, X **requests** the following rulings:

- 1) The transfer by X of all **its assets** to Y **will qualify** as a Section 507(b)(2) transfer, and X's **status** as a private foundation will not terminate as a result of such transfer. Rather, X **will** be terminated for purposes of **Section** 507 when it complies with the **notification** and other requirements of Section 507(a)(1) of the Code the year in which **it is dissolved**.
- 2) **Since** X's private foundation **status will** not terminate as a result of the transfer, X **will** not be subject to any tax under **Section** 507(c) in the year of the transfer. Additionally, there **will** be no termination **tax** imposed under Section 507(c) of the Code upon X's termination in any **tax** year following the year in which the transfer **is** made.
- 3) Y, as the transferee organization, **will not be** treated as a **newly** created organization but **will** be treated, pursuant to Treasury Regulation **Section 1.507-3(a)(1)**, as **possessing** the attributes and characteristics of X (as defined in Treasury Regulation Sections **1.507-3(a)(2)**, (3) and **(4)**). In addition, pursuant to Treasury Regulation Section **1.507-3(a)(5)**, the transfer by X to Y shall be counted as a qualifying **distribution** to the extent of X's current year's undistributed income and to the extent Y satisfies Section 4942(g) of the Code.
- 4) The transfer of asset from X to Y will not constitute an act of self-dealing **within** the meaning of Section 4941 of the Code between X and Y or their respective foundation managers.
- 5) The transfer of **assets** from X to Y **will** not constitute a taxable expenditure within the meaning of **Section** 4945(d) of the Code, and X will not be required to **exercise** expenditure responsibility as defined in Section 4945(h) of the Code **with** respect to such transfer of assets.
- 6) The transfer of asset from X to Y will not **constitute** a "sale or other disposition of property **within** the meaning of Section **4940(c)(4)(A)** of the **Code**.

#### LAW

Section 501 (c)(3) of the Code provides for the exemption from federal income tax of **nonprofit** organizations "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes ..." and other exempt purposes outlined in that section.

Section 509(a) of the Code provides that a 501 (c)(3) organization is a private foundation unless **it is** described in **section** 509(a)(1), (2), (3) or (4) of the Code. Section 509(b) **provides** that a private foundation **will** continue as a **private** foundation unless such status **is** terminated under section 507 of the Code.

Section 507 of the Code describes certain voluntary and involuntary methods by which **a** private foundation will be deemed to be terminated for federal income tax purposes. With respect to the terminations described in section 507(a) of the Code, the termination tax described in section 507(c) of the

Code k imposed on the private foundation unless the Internal Revenue Service abates the tax pursuant to section 507(g) of the Code. Under section 507(a) of the Code, a **private** foundation may terminate its **private** foundation status only **if it notifies** the Service or **it commits** willful repeated act, or a **willful** and flagrant act, which **give rise** to the **imposition** of a tax under Chapter 42 and **it** pays the termination tax or the **Service** abates the tax as mentioned above.

**Section 507(b)(2)** of the Code and section **1.507-3(a)(1)** of the Income Tax Regulations indicate that, in a transfer of **assets** from one private foundation to one or more private foundations 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 provides that the **terms** 'other adjustment, organization, or reorganization' used in section 507(b)(2) of the Code include any partial **liquidation** or any other **significant** disposition of **assets** to one or more private **foundations**, other than transfers for **consideration** or **distributions** out of current income.

**Section 1.507-3(c)(2)** of the regulations provides that a **significant** disposition of **assets** includes any disposition to one or more private foundations for the taxable year exceeding 25% of the fair market value of the **assets** of the transferor foundation at the beginning of the taxable year.

**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 described in section 507(b)(2) of the Code unless section 507(a) of the **Code** k applicable.

Section 1.507-1 (b)(6) and **(7)** of the regulations **state** that a transfer of all or part of a foundation's assets to one or more other private foundations, pursuant to **section 507(b)(2)** of the Code and section **1.507-3(c)** of the regulations, **will not result** in termination of the transferor foundation's **status** as a private foundation.

Section 1.507-3(d) of the regulations provides that unless a private foundation **elects** to terminate and **notifies** the Service under section 507(a)(1) of the Code, a transfer of assets will not result in a **termination** of transferor's private foundation status.

Section **507(c)** of the Code imposes a tax on terminating private foundations equal to the lower of the aggregate tax **benefit** or the value of **its net assets**.

Section 507(e) of the Code defines the 'value of the net assets' as the value determined at whichever **time** such value **is** higher: (1) the first day on which **action** k taken by the organization which culminates in **its** ceasing to be a private foundation, or (2) the date on which the **organization** ceases to be a private foundation.

Section 1.507-1 (b)(Q) of the regulations requires a private foundation that transfers all of **its** net assets to file the annual information return required by section 6033 of the Code. The private foundation does not need to file such information return for any taxable year following the taxable year in which the last of any such transfers occurred, provided that the foundation, in such subsequent taxable years, does not hold legal or equitable **title** to any **assets**.

Section **1.507-3(a)(2)(i)** of the regulations provides that a section 507(b)(2) transferee organization succeeds to the transferor's aggregate tax **benefits** that are attributable to the **assets** transferred.

**Section 1.507-3(a)(9)(i)** of the regulations provides that for the purposes of sections 4940 et **seq.** and section 507-509 of the **Code**, a transferee foundation shall be treated as the transferor where a private

foundation transfers all of **its** assets to one or more private foundations which are **effectively** controlled (**within** the meaning of Section **1.482-1(a)(3)**), directly or indirectly, by the same person or persons which effectively control the transferor foundation.

Section **1.507-3(a)(9)(iii)**, Example (2) **of the** regulations allows a private foundation to make Code section 507(b)(2) transfers of all of its assets to **organizations** exempt under section 501 (c)(3), including private foundations, without creating any *expenditure responsibility* requirement under section 4945(h) on the transferor foundation.

Section **1.482-1A(a)(3)** (formerly **cited** as Section 1.482-1 (a)(3)) of the regulations provides the **definition** of 'controlled' as used in **section 1.507-3(a)(9)(i)** of the regulations. Controlled includes 'any kind of control, direct or indirect, whether legally enforceable, and however exercisable or **exercised**. It **is** the reality of the control that **is decisive**, not its form or the mode of **its exercise**.

Section **4940(a)** of the Code imposes 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 **4940(c)(4)(A)** of the Code provides that, for purposes of **4940 excise** tax, only gains and losses from the sale or other **disposition** of property used for the production of interest, dividends, **rents**, and royalties. and property used for the production of income included In computing the tax imposed by section 511 (except to the extent gain or loss from the sale or other **disposition** of such property is taken into account for purposes of such tax) **is** taken into account in determining capital gain net income.

**Section 4941** of the Code imposes **excise** tax on acts of self-dealing between a private foundation and any of **its** disqualified persons.

Section 4941(d)(i) of the Code defines self-dealing as including the sale or exchange of property *between a foundation and a disqualified person* and the transfer to or use by or for the **benefit** of a disqualified persons.

Section 4945 of the Code imposes an **excise** tax on a private foundation's making of any "taxable expenditure."

**Section 4945(d)(4)** of the Code requires that, for a transfer of **assets** not to be a taxable expenditure, a transferor private foundation must exercise 'expenditure **responsibility**' under section 4945(h) on any transfer to another private foundation which **is** not an "exempt operating foundation' under section **4940(d)(2)** of the Code.

**Section 4945(h)** of the Code provides in pertinent part as follows:

The expenditure **responsibility** referred to in subsection (d)(4) means that the private foundation is **responsible** to exert all reasonable efforts to establish adequate procedures (1) to see that the grant is spent sole for the purpose for **which** made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and (3) to make full and detailed reports with respect to such expenditures to the Secretary.

*Revenue Ruling 78-387, 1978-2 C.B. 270*, holds that a transferee is **entitled** to reduce its **distributable** amount under section 4942 by the amount of the transferor's excess qualifying distributions when a transferee is treated as the transferor under *section 1.507-3(a)(9)*.

**Section 53.4945-6(b)(2)** of the Foundation and Similar Excise Taxes Regulations provides that a private foundation's payment of the reasonable **costs** for services rendered, is not a taxable expenditure.

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Section **53.4945-6(c)(3)** and **1.507-3(b)** of the regulations allow a private foundation to make a **Code** section 507(b)(2) transfer of **its assets** to an organization exempt from tax under section 501 (c)(3) of the Code, including private foundations, **without** the transfers being taxable expenditures.

Section 53.4948-1 (a)(8) of the regulations provides that for the purposes of self-dealing under section **4941**, the term 'disqualified person' shall not include an exempt organization described in section 501 (c)(3).

#### ANALYSIS

Section **1.507-3(c)(1)** of the regulations describes the necessary **criteria** in order to come within the **provisions** of section 507(b)(2) of the **Code**. First, the asset transfer must be from one private foundation to another. Second, the transfer must be pursuant to a liquidation, merger, redemption, **recapitalization**, or other adjustment, **organization**, or reorganization. In **this** context, 'other adjustment, organization, or reorganization' includes any partial liquidation or significant **distribution** of **assets** to one or more private foundations. Third, the transfer must represent 25 percent or more of the fair market value of the net **assets** of the transferring foundation.

The transfer of asset from X to Y qualifies as a section 507(b)(2) transaction. First, both X and Y are **private** foundations. Second, the proposed transfer is an 'other adjustment, organization, or reorganization that constitutes a **significant** distribution of asset **since it** represents 100% of the net asset of X as of the date of the transfer, well exceeding the 25% threshold required by **section 1.507-3(c)(2)** of the regulations.

A transfer under section 507(b)(2) of the Code **will** not result in a termination of a private foundation's status, as such, unless the private foundation gives notice of its intent to terminate or if section 507(a)(2) is applicable. X has not given any notice of **its** intention to terminate and has represented it has not committed any willful act that would cause **termination** under section 507(a)(2). Therefore, the transfer of **assets** from X to Y **will** not result in a termination, either voluntary or involuntary, of X's or Y's status as a private foundation under **section 507(a)**.

Section 507(c) imposes a tax on terminating foundations. The termination tax imposed by section 507(c) does not apply to X or Y because the foundations are not terminating as a result of the transfer.

If X gives proper notice of voluntary termination under section 507(a), at least one day after the transfer, it **will** result in a termination under section 507(c). Section 507(c) imposes a tax on terminating private foundations based on the lower of the aggregate tax **benefit** or the value of the net **assets** of the terminating private foundation. X, as of the date of termination and the date of the commencement of the action that **results** in termination, **will** have net **assets** equal to zero. Accordingly, no tax **will** be imposed by section 507(c).

Following the transfer of **assets**, the transferee foundation succeeds to the aggregate tax benefit of the transferor pursuant to section **1.507-3(a)(2)(i)**. Therefore, Y will succeed to the aggregate tax **benefit** of X.

Both, X and Y have Trustees effectively controlled by V. V is the sole Trustee of X and V along with **his** adult children are Trustees of Y. They are "controlled" by the same persons within the meaning of section **1.482-1A(a)(3)**. Under section **1.507-3(a)(9)(i)**, if the same person or persons control two foundations, the foundations are treated as the same for the purposes of section **4940** et seq. and sections **507-509** of the Code. Therefore:

Under section **4940** of the Code, the transfer will not result in any tax on gross investment income or **capital** gain net income.

Under section **4941** of the Code, the transfer is not an act of self-dealing.

In accordance with sections **1.507-3(a)(9)(i)** and **1.507-3(a)(9)(iii)**, Example (2) of the regulations, the transfer does not constitute a grant under section **4945(d)(4)** of the Code for which expenditure **responsibility** would be required. Therefore, X does not need to exercise expenditure responsibility **with** respect to the transfer.

Under section **53.4945-6(b)(2)** of the regulations, a private foundation's payments of its reasonable **costs** for services rendered are not a taxable **expenditure** under section 4945 of the Code. Thus, X's payment of legal, **accounting**, and other expenses incurred to effectuate the transfer **with** Y, if reasonable in amount, **will** not be taxable expenditures under section 4945.

Pursuant to section 1.507-3(a)(Q) of the regulations, which **treats** the transferee as the transferor for purposes of section **4940** et seq. of the Code, the **distribution** requirements of section **4942** of the Code do not apply to X in the year of the transfer because such distributions **will** be treated as Y's **distributions**. However, the distribution requirements under section 4942 of the Code for the year of the transfer do apply to Y. Additionally, under Rev. **Rul.** 78-387, Y will succeed to the excess qualifying distributions of X.

Furthermore, pursuant to **section 1.507-3(a)(9)(i)** of the regulations, X **will** not be required to **satisfy** the **expenditure responsibility** provisions of section 4945(d)(4) of the Code for any **grants** made by Y after the transfer. However, Y must exercise expenditure responsibility as to any and all **outstanding grants** of X that required X to exercise expenditure **responsibility**.

Based on the information you have submitted and as the transferee foundation is recognized as exempt under section 501 (c)(3) of the Code, under the **facts** described above we rule as follows:

- 1) The transfer by X of all its **assets** to Y **will** qualify as a Section 507(b)(2) transfer, and X's status as a private foundation **will** not terminate as a result of such transfer. Rather, X **will** be terminated for purposes of **Section 507** when it complies **with** the notification and other requirements of Section 507(a)(l) of the Code the year in which it **is** dissolved.
- 2) Since X's private **foundation** status **will** not terminate as a result of the transfer, X **will** not be subject to any tax under Section 507(c) in the year of the transfer, **Additionally**, there will be no termination **tax** imposed under Section 507(c) of the Code upon X's termination in any **tax** year following the year in which the transfer is made.
- 3) **Y**, as the transferee organization, **will** not be treated as a newly created organization but **will** be treated, pursuant to Treasury Regulation Section **1.507-3(a)(1)**, as possessing the attributes and **characteristics** of X (as defined in Treasury Regulation Sections 1.507-3(a)(2), (3) and (4)). In addition, pursuant to **Treasury** Regulation Section **1.507-3(a)(5)**, the transfer by X to Y shall be counted as a qualifying distribution to the extent of X's current year's undistributed income and to the extent Y satisfies Section **4942(g)** of the Code.
- 4) The transfer of **assets** from X to Y will not constitute an act of self-dealing within the meaning of Section 4941 of the Code between X and Y or their respective foundation managers.
- 5) The transfer of **assets** from X to Y will not constitute a taxable expenditure within the meaning of Section 4945(d) of the Code, and X **will** not be required to exercise expenditure responsibility as defined in Section 4945(h) of the Code with **respect** to such transfer of assets.

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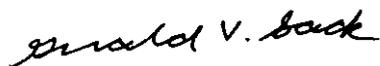
- 6) The transfer of **assets** from X to Y **will** not constitute a "sale or other disposition of property" **within** the meaning of Section **4940(c)(4)(A)** of the Code.

Because this ruling could help resolve future questions about your federal income tax status, you should keep it in your permanent records.

**This** ruling is directed only to the organization that requested it. Section 611 O(k)(3) of the Code **provides** that **it** may not be used or cited as precedent.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of **this** letter.

Sincerely,



Gerald V. Sack  
Manager, Exempt Organizations  
Group 4