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

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Dear Sir or Madam:

This is in response to your letter dated February 13, 2001, in which you requested certain rulings with respect to a proposed transfer of all of the assets of B to C.

B and C are exempt under section 501(c)(3) of the Internal Revenue Code and are classified as private foundations under section 509(a).

B was originally organized and funded by D. It has always operated exclusively for charitable purposes. C was originally organized and funded by E. It has always operated exclusively for charitable purposes.

D and E recently merged, resulting in the creation of F. The directors of F want to use one foundation, rather than two, to assist F in conducting its charitable activities. B has a three member Board of Directors. These three individuals also serve on the four member Board of C. B and C now share the same officers. The officers and directors of B and C believe that the merger of B and C will simplify operations and reduce overhead expenses, filing requirements and fees, Therefore, B and C propose to merge. C will be the surviving entity. After the merger, C will succeed to all of the assets and liabilities of B, and will continue the charitable mission of B.

B has not notified the Service that it intends to terminate its private foundation status, nor has B ever received notification that its status as a private foundation has been terminated. Furthermore, B has stated that it has not committed willful repeated acts or failures to act or a willful and flagrant act (or failure to act) giving rise to liability for tax under Chapter 42.

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Section 507(a) of the Code provides for the voluntary and involuntary termination of private foundation status. It states, in part, that except for transfers described in section 507(b), an organization's private foundation status will be terminated only if (1) the organization notifies the Service of its intent to terminate or (2) there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act) giving rise to liability for tax under Chapter 42.

Section 507(b)(2) of the Code provides that when a private foundation transfers assets to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization, the transferee foundation shall not be treated as a new organization.

Section 507(c) of the Code imposes a tax on an organization that terminates its private foundation status under section 507(a) of the Code.

Section 1.507-3(a)(5) of the Income Tax Regulations provides 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. Such transfer shall itself be counted toward satisfaction of such requirements to the extent the amount transferred meets the requirements of section 4942(g) of the Code. However, where the transferor has disposed of all of its assets, the record-keeping requirements of section 4942(g)(3)(B) of the Code shall not apply during any period in which it has no assets.

Section 1.507-I (b)(6) of the regulations provides that if a private foundation transfers all or pat-l of its assets to one or'more other private foundations pursuant to a transfer described in section 507(b)(2) of the Code, such transferor foundation will not have terminated its foundation status under section 507(a)(l).

Section 1.507-I (b)(7) of the regulations provides that neither a transfer of all of the assets of a private foundation, nor a significant disposition of assets (as defined in section 1.507-3(c)) by a private foundation (whether or not any portion of such disposition of assets is made to another private foundation), shall be deemed to result in a termination of the transferor private foundation under section 507(a) of the Code, unless the transferor private foundation elects to terminate pursuant to section 507(a)(l) or section 507(a)(2) is applicable.

Section 1.507-I (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)(l) of the regulations provides that in the case of a significant disposition of assets to one or more private foundations within the meaning of paragraph (c) of this subsection, the transferor organization shall not be treated as a newly created organization.

Section 1.507-3(a)(2) of the regulations provides that a transferee organization, in the case of a transfer described in section 507(b)(2) of the Code, shall succeed to the aggregate tax

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benefit of the transferor organization in an amount equal to the amount of such aggregate tax benefit of the transferor organization, multiplied by a fraction the numerator of which is the fair market value of the assets (less encumbrances) transferred to such transferee and the denominator of which is the fair market value of the assets of the transferor (less encumbrances) immediately before the transfer. Fair market value is determined at the time of transfer.

Section 1.507-3(a)(9)(i) of the regulations provides that, if a transferor private foundation transfers assets to a private foundation which is effectively controlled (within the meaning of section 1.482-1A(a)(3)), 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 transferors assets that were transferred bears to the fair market value of all of the assets of the transferor immediately before the transfer.

Section 1.507-3(d) of the regulations provides that unless a private foundation gives notice under section 507(a)(l) of the Code, a transfer of assets described in section 507(b)(2) of the Code will not constitute a termination of the transferor's private foundation status.

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 unless the provisions of 507(a) become applicable.

Section 4940 of the Code imposes a tax on the net investment income of private foundations.

Section 4941 of the Code imposes a tax on each act of selfdealing between a disqualified person and a private foundation.

Section 4942 of the Code requires a private foundation to make specified distributions of income for each taxable year, including the year in which it transfers substantial assets to another private foundation under section 507(b)(2).

Section 4942(g)(l)(A) of the Code defines a 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 any contribution to (i) an organization controlled by the foundation or one or more disqualified persons or (ii) a private foundation which is not an operating foundation, except as otherwise provided; or (B) any amount paid to acquire an asset used directly in carrying out one or more purposes described in section 170(c)(2)(B).

Section 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,

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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 4944 of the Code imposes tax upon a private foundation which invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes.

Section 4945 of the Code imposes tax upon a private foundation's making of any taxable expenditure under section 4945(d).

Section 4945(d)(4) of the Code defines the term taxable expenditure to include any amount paid or incurred by a private foundation as a grant to an organization unless (A) the organization is described in subparagraphs (1), (2), or (3) of section 509(a) of the Code or is an exempt operating foundation as defined in section 4940(d)(2) of the Code, or (B) the private foundation exercises expenditure responsibility with to such grant in accordance with section 4945(h) of the Code. The exercise of expenditure responsibility requires the foundation that makes the transfer to keep detailed records of the way the payment is spent by the recipient foundation.

Section 4945(h) of the Code provides that expenditure responsibility referred to in subsection (d)(4) means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures (1) to see that the grant is spent solely for the purpose for which made, (2) to obtain full and detailed reports with respect to such expenditures, and (3) to make full and detailed reports to the Secretary.

Section 4946(a)(l) of the Code defines the term "disqualified person" as a person who is a substantial contributor to a private foundation, a foundation manager, an owner of more than 20% of a corporation or partnership which is a substantial contributor to the private foundation, a family member of persons described above, or a corporation, partnership, trust or estate of which persons described above own more than 35% of the combined voting power.

Section 53.4945-5(b)(7)(i) of the Foundation and Similar Excise Taxes Regulations refers to the rules relating to the extent to which the expenditure responsibility rules contained in section 4945(d)(4) and (h), and this section apply to transfers of assets described in section 507(b)(2).

Section 53.4945-6(b)(2) of the regulations provides that any expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under section 4945(d)(5) unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence. The determination whether an expenditure is unreasonable shall depend upon the facts and circumstances of the particular case.

Section 53.4945-6(c)(3) of the regulations provides that a transfer of assets of a private foundation under section 507(b)(2) of the Code is not a taxable expenditure if such transfer is to

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an organization described in section 501(c)(3) (other than an organization described in section 509(a)(4)) or treated as so described under section 4947(a)(l).

Section 53.4946-l (a)(8) of the regulations provides that, for purposes of section 4941, the term "disqualified person" does not include any organization described in section 501 (c)(3) (other than an organization described in section 509(a)(4)).

Based on the above facts, the transfer of all of B's assets to C will allow C to continue the charitable activities previously conducted by B. C will be controlled by the same officers and directors that controlled B. Therefore, the transfer of assets from B to C will not endanger the tax exempt status of either entity under section 501 (c)(3).

Under section 507(b)(2) 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 foundation shall not be treated as newly created organization. Thus, the transfer by B to C will constitute in the aggregate an "adjustment, organization, or reorganization" within the meaning of section 507(b)(2). Accordingly, the transfer by B to C will not be treated as a transfer to a newly created organization.

Because B is not terminating its existence and assuming there has been no willful, repeated or flagrant act giving rise to liability under Chapter 42, no tax will be imposed on B under section 507(c) as a result of the transfer of assets from B to C.

Because the individuals who comprise the governing bodies of B and C are almost identical and the officers of B and C are currently the same, B and C should be treated as being effectively controlled by the same persons within the meaning of section 1.507-3(a)(9)(i) of the regulations.

Because B and C are effectively controlled by the same persons, C should be treated as if it were B for purposes of sections 507 through 509 and Chapter 42 of the Code. Therefore, the rulings requested under sections 4940, 4941, 4942, and 4944 would be provided because these rulings are consistent with the approach in section 1.507-3(a)(9)(i) of the regulations which is, in effect, to disregard the change in form of the organization for purposes of Chapter 42.

Because B is transferring all of its assets to C pursuant to a merger, and B and C are controlled by the same persons, C will be treated as B. The transfer will be treated as not having taken place for expenditure responsibility purposes under section 4945(h) of the Code. Thus, the transfer will not be a taxable expenditure under section 4945(d)(4). Therefore, B need not exercise expenditure responsibility with regard to the merger.

Subsequent to the merger, C will be treated as if it were B. Therefore, C will succeed to B's duties to exercise expenditure responsibility and B would be relieved of any duty to exercise expenditure responsibility after the merger.

As a result of the merger, C will be treated as B for purposes of Chapter 42. Therefore, the

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distribution requirements of section 4942 for the year of transfer should be regarded as satisfied by both B and C if, treating B and C as a single organization, the aggregate qualifying distributions for such year by B and C would satisfy its distribution requirement. Because C is treated as taking over B's obligations as of the date of merger, it follows that as of that date B will no longer have any such obligations.

Because B and C are controlled by the same persons, for purposes of Chapter 42 of the Code and sections 507 through 509 of the Code, C will be treated, subsequent to the transfer of all of B's assets, as if it were B, in proportion which the fair market value of the assets (less encumbrances) transferred bears to the fair market value of B 's assets (less encumbrances) immediately before the transfer. Thus C can succeed to B's excess qualifying distributions carryover for purposes of section 4942 of the Code, and in proportions determined in accordance with section 1.507-3(a)(9)(i) of the regulations (consistent with succeeding to B's tax attributes).

Under section 1.507-3(a)(9)(ii) of the regulations, C will be treated as if it were B for purposes of Chapter 42, including section 4940. Accordingly, C would be allowed to report all of the net inwme subject to tax under section 4940 during the year of merger (whether earned by B or C) and pay all of the section 4940 taxes on such inwme for that year.

Provided the expenses incurred by B and C in the transfer of assets to C meet the "good faith" standard of section 53.4945-6 (b)(2) of the regulations, such expenses will not constitute taxable expenditures under section 4945 of the Code and will be considered qualifying distributions under section 4942.

Because C is treated as B for purposes of Chapter 42, C will be allowed to pay B's outstanding grants and treat the qualifying distributions just as B could have if it had made the payments.

Because B, as an organization described in section 501 (c)(3) of the Code, is not a disqualified person with respect to C, the transfer of assets to C will not constitute an act of self-dealing within the meaning of section 4941 of the Code. Further, because C is treated as if it were B, the payment by C of a liability of B will be viewed as a payment of C's own liability, and not as a direct or indirect transfer to, or for the benefit of, some separate entity. Thus, any payment of B's liabilities by C should not be treated as an act of self-dealing.

Because B and C are exempt under section 501(c)(3) and are organized for purposes described in section 170(c)(2)(B), and the reason for the transfer is to carry out more efficiently such exempt purposes, the transfer would not be a jeopardizing investment under section 4944.

Under section 4940(c)(4) of the Code, capital gains and losses are defined as gains and losses from the sale or other disposition of certain property. Because the asset transfer, from B to C, will lack consideration, no sale or other disposition will have occurred, thus, there will be no gain and the assets transfer will not give rise to tax under section 4940 of the Code. Further, because the transfer of assets to C is disregarded (because, in turn, C is treated as if it were B for purposes of Chapter 42). C's basis in the assets transferred to it pursuant to the merger should be the same as the basis of B.

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Because B will have no assets after the proposed transfer to C. it will not be required to tile any information returns under section 6033 for any taxable year after the transfer.

Because B will dispose of all of its assets, the recordkeeping requirements of section 4942(g)(3)(B) will not apply during any period in which it has no assets. Therefore, B's rewrdkeeping under section 4942(g)(3)(B) will not apply afler the merger since B will have disposed of all of its assets.

Under section 507(e) of the Code, the value of B's assets after it has transferred all of its assets to C will be zero. Thus, B's voluntary notice termination of its private foundation status pursuant to section 509(a)(l) will not result in tax under section 507(c) of the Code.

Accordingly, based on the information furnished, we rule as follows:

1. The transfer of all of B's assets to C will not adversely affect either B or C's status as an organization described in section 501(c)(3) of the Code.

2. The transfer of assets will constitute a transfer pursuant to a merger described in section 507(b)(2) of the Code, and, therefore, C will not be treated as a newly created organization for purposes of sections 507 through 509.

3. The merger will not result in the termination of B's private foundation status under section 507(a) of the Code and will not subject B to the tax imposed by section 507(c).

4. B and C are effectively controlled by the same person or persons, as the concept of effective control is used in sections 1.482-(A)(a)(3), formally section 1.482-1 (a)(3), and 1.507-3(a)(9)(i) of the regulations.

5. C will be treated as if it were B for purposes of Chapter 42 and sections 507 through 509 of the Code. As a result, the transfer will not subject B to taxes imposed by sections 4941 through 4945 of the Code.

6. The transfer of assets pursuant to the proposed merger will not be a grant subject to the expenditure responsibility provisions of sections 4945(d)(4) and (h). Therefore, B will not have to exercise expenditure responsibility within the meaning of sections 4945(d)(4) and (h) with respect to the transfer of its assets to C pursuant to the merger. Also, B will not have to comply with the expenditure responsibility rules subsequent to the merger.

7. The transfer of the assets of B to C will not constitute a taxable expenditure under section 4945 of the Code.

8. C will succeed to B's aggregate tax benefits. The provisions of section 4942 of the Code will apply to C in the year the merger occurs as if it were B. Therefore, C will succeed to B's distribution requirements for that taxable year and any taxable year prior to that taxable year, and C will be responsible for reporting all undistributed income

determined under section 4942 for that taxable year and any taxable year prior to that taxable year. Because C succeeds to B's distribution requirements, B will not be required to meet the distribution requirements of section 4942 for the taxable year in which the merger occurs or any later taxable year. C may, for the purposes of determining its distribution requirements under section 4942, reduce its distributable amount by B's excess qualifying distribution carryover, if any, determined as of the end of the taxable year immediately preceding the taxable year of the merger.

9. The provisions of section 4940 of the Code will apply to C in the taxable year in which the merger occurs as if it were B. Therefore, B will not be subject to the excise tax imposed by section 4940 for that portion of its taxable year occurring after the transfer of all of its assets to C pursuant to the merger. Further, B will not be subject to the excise tax imposed by section 4940 for that portion of its taxable year occurring before the transfer of all of its assets to C, pursuant to the merger, if C reports B's net investment income from that portion of B's taxable year and pays any excise tax imposed by section 4940 with respect to such investment income.

IO. C may pay any excise tax imposed section 4940 of the Code with respect to B's net investment inwme for the portion of B's taxable year occurring before the merger as well as reasonable accounting and legal expenses relating to B's termination, without creating liability for any excise tax imposed under Chapter 42 of the Code (including, but not limited to, the tax imposed by section 4945). The payment by C of any excise tax imposed by section 4940 with respect to the taxable year of the merger, that otherwise would have to be paid by B, may be taken into account by C under section 4942(d)(2) for purposes of determining C's distributable amount, and the payment by C of reasonable accounting and legal expenses related to the termination of B may be treated by C as a qualifying distribution under section 4942(g).

11. C may satisfy any grants approved for future payment by B. and each payment of such a grant by C will be classified as a qualifying distribution under section 4942 of the Code by C, and will not be treated as an act of self-dealing under section 4941(d).

12. The transfer will not be treated as an act of self-dealing within the meaning of section 4941(d) of the Code because it will be made for the exempt purposes of C. The transfer will not constitute a willful and flagrant act, or failure to act, that would result in tax under Chapter 42 of the Code. Similarly, any payment by C to or on B's behalf, with respect to any liabilities (including any currently unknown liabilities under Chapter 42 of the Code) that are neither paid nor provided for, will not constitute acts of self-dealing under section 4941.

13. The transfer pursuant to the proposed merger will not be treated as an investment jeopardizing the charitable purpose of B or C under section 4944 of the Code.

14. The transfer of all of B's net assets to C pursuant to the merger will not trigger gross investment inwme or capital gain income within the meaning of section 4940 of the.Code, and therefore the transfer will not result in imposition of tax under section 4940.

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15. B's basis in its assets will carry over to C for purposes of section 4940 of the Code.

16. B will not be required to file the annual return described in section 6033 of the Code for any taxable years subsequent to the year of merger.

17. B will not be required to comply with the rewrdkeeping requirements of section 4942(g)(3)(B) of the Code subsequent to the merger.

18. This ruling request does not constitute a notice of intent to terminate B's private foundation status under section 507(a)(l). A voluntary termination of B's private foundation status will occur when B notifies the Service of its intent to terminate its private foundation status and such voluntary termination will not occur until after the transfer of all of B's assets to C pursuant to the merger. On the date of that voluntary termination, because the value of B's net assets will then equal zero, B will not be liable for any termination tax under section 507(c).

We are informing the Ohio TE/GE office of this action, Please keep a copy of this ruling in your organization's permanent records.

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

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,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

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