



TAX EXEMPT AND
GOVERNMENT ENTITIES

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

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Contact Person:

ID Number:

Telephone Number:

UIL: 507.00-00
4941.04-00
4945.04-06

LEGEND

K =

M =

Dear _____ :

K is requesting an income tax ruling concerning a proposed transfer of K's assets to M.

FACTS

K is exempt under section 501(c)(3) of the Internal Revenue Code and is classified as a nonoperating private foundation within the meaning of section 509(a) of the Code.

M is a foreign charitable foundation. M is not exempt under section 501(c)(3) of the Code. M is controlled by the same five persons who also serve on K's board. K, in its judgment, has determined M is organized and operated as a section 501(c)(3) organization because M has an organizing document which: limits its purposes, operations, and distribution of assets upon dissolution to charitable and educational purposes, prohibits any private benefit or any inurement of its earnings to private persons, allows no more than an insubstantial amount of influencing legislation, and prohibits any political activity. K offers opinion of counsel stating it has sufficient facts concerning the operation and support of M to make a good faith determination M would be classified as a private foundation within the meaning of section 509(a) of the Code if it were a US charitable organization.

K will make a grant constituting more than 25 percent of its assets to M. At least part of the grant will be a capital endowment grant. K will exercise expenditure responsibility over the grant as described in section 4945(h) of the Code. With respect to

the capital endowment grant, K will exercise expenditure responsibility in accordance with section 53.4945-5(c)(2) of the Foundation and Similar Excise Taxes Regulations. K will claim a qualifying distribution for a portion of the grant (the "Distribution Portion"). M will use the Distribution Portion for purposes described in section 170(c)(2)(B) of the Code before the end of its first taxable year following the taxable year in which M receives the grant. Additionally, M will provide a letter to K describing such use and stating that an appropriate out of corpus distribution has been made, as required under section 4942(g)(3) of the Code.

RULINGS REQUESTED

K requests the following rulings:

1. K's grant to M will not be a taxable expenditure within the meaning of section 4945 of the Code.
2. K's grant to M will not constitute an act of self-dealing under section 4941 of the Code.
3. K's Distribution Portion of the grant will be a qualifying distribution within the meaning of section 4942 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 charitable and/or other exempt purposes stated in that section.

Section 509(a) of the Code provides that certain organizations exempt from federal income tax under section 501(c)(3) of the Code are private foundations subject to the private foundation provisions of Chapter 42 of the Code.

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

Section 1.507-3(c)(1) of the regulations defines a transfer under section 507(b)(2) of the Code to include a transfer of assets from one private foundation to one or more other private foundations pursuant to any reorganization or liquidation, including any significant disposition of 25% or more of the transferor foundation's assets.

Section 1.507-3(c)(1) of the regulations provides the term "other adjustment, organization or reorganization" includes any partial liquidation or any other significant disposition of assets to one or more private foundations.

Section 1.507-3(c)(2)(ii) of the regulations defines the term "significant disposition of assets" as the transfer of 25% or more of the foundation's net assets at the beginning of the year, which disposition may be made in a single year or in a series of related dispositions over more than one year.

Section 4941 of the Code imposes an excise tax upon any act of self-dealing

between a private foundation and any of its disqualified persons.

Section 4946(a)(1) of the Code provides a disqualified person, with respect to a private foundation, includes a person who is:

- (A) a substantial contributor (including the creator of the trust) to the foundation,
- (B) a foundation manager,
- (C) an owner of more than 20% of a corporation, partnership, or beneficial interest of a trust which is a substantial contributor to the foundation,
- (D) a family member (including a child or grandchild) of an individual described in (A), (B), or (C) above,

Sections 4946(a)(1)(E) and (G) define a disqualified person as a corporation or trust, in which a person described in subparagraph (A), (B), (C), or (D) holds more than 35 percent of the voting power or beneficial interest.

Section 53.4946-1(a)(5) of the regulations defines the term "combined voting power" to include voting power represented by holdings of voting stock, actual or constructive, but does not include voting rights held only as director or trustee.

Section 4942 of the Code requires a private foundation to expend qualifying distributions under section 4942(g) for the conduct of exempt purposes.

Section 4942(g)(1)(A) of the Code and section 53.4942(a)-3(a)(2)(i) of the regulations provide a "qualifying distribution" is 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 directly or indirectly by the transferor foundation or one or more disqualified persons with respect to the foundation, except as provided in section 4942(g)(3), or (ii) any private foundation that is not an operating foundation under section 4942(j)(3), except as provided in section 4942(j)(3).

Section 4942(g)(3) of the Code and section 53.4942(a)-3(c)(1) of the regulations require that, in order for a transferor private foundation to have a qualifying distribution (including reasonable and necessary administrative expenses thereof) under section 4942(g)(1)(A) for its contribution to (i) a private foundation which is controlled by it or its disqualified persons or (ii) a private foundation which is not an operating foundation under section 4942(j)(3), such transferor private foundation must have adequate records, as required by section 4942(g)(3)(B), to show the transferee foundation subsequently made a qualifying distribution equal to the amount of the transfer received, was paid out of the transferee's own corpus within the meaning of section 4942(h), and was expended by the transferee before the close of its first tax year after the tax year in which it received the grant.

Section 4945 of the Code imposes an excise tax on a private foundation that makes any "taxable expenditure" as defined in section 4945(d) of the Code.

Section 4945(d)(4) of the Code provides if a transferor private foundation exercises "expenditure responsibility" under section 4945(h) of the Code on any grant(s) to another private foundation, which is not an "exempt operating foundation" under section 4940(d)(2) of the Code, its grant will not be a "taxable expenditure."

Section 4945(h) of the Code defines expenditure responsibility and provides the grantor private foundation must make a pre-grant inquiry and require post-grant reports from the grantee private foundation as to the grantee's uses of the grant funds.

Section 53.4945-5(b)(1) of the regulations provides a private foundation will be exercising "expenditure responsibility" under section 4945(h) as long as it exerts all reasonable efforts and establishes adequate procedures: (i) to see the grant is spent solely for the purpose for which it was made, (ii) to obtain full and complete reports from the grantee on how the funds are spent, and (iii) to make full and detailed reports with respect to such expenditures to the Commissioner.

Section 53.4945-5(b)(2) of the regulations provides the grantor private foundation must make a pre-grant inquiry of the grantee private foundation. Such pre-grant inquiry must be complete enough to give a reasonable person assurance the grantee will use the grant funds for exempt purposes.

Section 53.4945-6(c)(2)(ii) of the regulations provides a foreign organization will be treated similar to a section 501(c)(3) organization if, in the reasonable judgment of a foundation manager of the grantor private foundation, the grantee foreign organization is organized and operated as a section 501(c)(3) organization. Reasonable judgment is defined by its generally accepted legal sense within the outlines developed by judicial decisions in the law of trusts.

Section 53.4945-5(a)(5) of the regulations provides if a grantor private foundation makes a good faith determination the foreign grantee organization is described in section 509(a)(1), (2) or (3) of the Code, such grants made to that foreign organization are considered to have been made to an organization described in the aforementioned Code sections. The good faith determination must be based upon an affidavit of the grantee foreign organization or an opinion of counsel (of the grantor or grantee), either of which must set forth sufficient facts concerning the operations and support of the grantee foreign organization for the Internal Revenue Service to determine it would likely qualify as an organization described in section 509(a)(1), (2) or (3) of the Code.

Section 53.4945-5(c)(2) of the regulations provides if a private foundation makes a grant to another private foundation for the grantee's 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 the tax year in which the grant was made and the subsequent two tax years. Only if it is reasonably apparent to the grantor before the end of the 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 of the Code, may the grantor then allow the grantee's reports to be discontinued.

Section 53.4945-6(c)(3) of the regulations indicates that, for purposes of section 4945(d)(5) of the Code, when a private foundation transfers its assets to another foundation in a reorganization or liquidation pursuant to section 507(b)(2) of the Code, the transferor's assets must go to an organization described in section 501(c)(3) of the Code.

ANALYSIS

Ruling Request 1

If a domestic private foundation makes a grant to a foreign organization that did not obtain a ruling or determination letter to show it is described in section 501(c)(3) of the Code or 509(a)(1), (2) or (3), the grant will not be a taxable expenditure if a foreign organization complies with sections 53.4945-6(c)(2)(ii) and 53.4945-5(a)(5) of the regulations.

K states M was created by the persons who control K, M has an organizing document that limits its purposes, operations, and dissolution to charitable and educational purposes, prohibits any private benefit or any inurement of its earnings to private persons and prohibits any political activity. Even though M did not apply for exemption under section 501(c)(3) of the Code, K states it has made a good faith determination M is organized and operated as an organization described in section 501(c)(3) of the Code. Therefore, if K exercises expenditure responsibility with respect to its grants to M, K's grant will not be a taxable expenditure pursuant to section 4945(h) of the Code.

Pursuant to section 53.4945-5(b)(1) of the regulations, K will exert all reasonable efforts and establish adequate procedures to establish the grant is spent solely for the purpose for which it was made, will obtain full and complete reports from M as to how the grant has been spent and will provide full and detailed reports with respect to the expenditure of the grant.

A portion of the grant will be a capital endowment grant. K will comply with section 53.4945-5(c)(2) of the regulations, which requires K to obtain reports from M annually for the tax year in which the grant was made and the two succeeding tax years. The reports may be discontinued only if it is reasonably apparent to K that M will not use the funds of the capital endowment grant for any purpose that would be a taxable expenditure under section 4945(d) of the Code. Because K states it will exercise the required expenditure responsibility, K's grant, including the capital endowment grant, to M will not be a taxable expenditure under section 4945 of the Code.

Section 507(b)(2) of the Code provides 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 will not be treated as a newly created organization. Section 1.507-3(c)(1) of the regulations provides the term "other adjustment, organization or reorganization" includes any partial liquidation or any other significant disposition of assets to one or more private foundations. Section 1.507-3(c)(2)(ii) of the regulations provides the term "significant disposition of assets" means the transfer of 25% or more of the foundation's net assets at the beginning of the year, which disposition may be made in a single year or in a series of related dispositions over more than one year. The proposed transaction involves a transfer of at least 25% of K's assets to M, which will result in a significant disposition of K's assets to M pursuant to any "other adjustment, organization or reorganization." Since K has made a good faith determination M is organized and operated as an organization described in section 501(c)(3) of the Code and has received opinion of counsel on its public charity status, M will be treated as an organization described in section 501(c)(3) of

the Code.

Section 53.4945-6(c)(3) of the regulations provides a private foundation makes a taxable expenditure when it transfers assets pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization to an organization not described in section 501(c)(3) of the Code. Since K has made a good faith determination M is organized and operated as an organization described in section 501(c)(3) of the Code, provided K exercises expenditure responsibility, K's grant to M will not be a taxable expenditure.

Ruling Request 2

K's transfer of assets to M will not be an act of self-dealing under section 4941 of the Code because M is not a disqualified person under sections 4946(a)(1)(E) and (G) of the Code. Section 4946 of the Code states an organization is a disqualified person if persons described in section 4946(a)(1)(A), (B), (C) or (D) of the Code hold more than 35% of the combined voting power or beneficial interest. Section 53.4946-1(a)(5) of the regulations defines "combined voting power" to be voting power represented by holdings of voting stock, but does not include voting rights held only as a director. K states the directors of M do not hold, actually or constructively, any voting stock and the voting power is derived solely from their voting rights as directors. Furthermore, K states no person described in section 4946(a)(1)(A) through (D) holds a beneficial interest in M. Therefore, K's transfer of assets will not be a transfer to a disqualified person and K will not be engaged in self-dealing when it makes the grant to M.

Ruling Request 3

K states M will make a distribution to a recipient organization(s) at least equal to the Distribution Portion received from K before the close of its first tax year after the tax year in which it received the grant. K states the recipient organization(s) will not be under common control, directly or indirectly, with K or M, and the distribution by M will be treated as a distribution out of corpus. Furthermore, K states it will obtain adequate records or sufficient evidence from M showing M has made the out of corpus qualifying distribution at least equal to the Distribution Portion for reasonable and necessary administrative expenses or for one or more purposes described in section 170(c)(2)(B). Therefore, the Distribution Portion of K's grant to M will be a qualifying distribution pursuant to section 4942 of the Code.

This ruling letter is based on the understanding the expenditure responsibility on your grants under section 4945(h) of the Code will include meeting section 53.4945-(b)(5) of the regulations. To augment your understanding of the requirements of a domestic section 501(c)(3) organization engaged in international grantmaking activities, we are including, as an enclosure, a Chief Counsel Advisory directly on point.

CONCLUSION

Based on the facts and information submitted and the representations made, we conclude:

1. K's grant to M will not be a taxable expenditure within the meaning of section 4945 of the Code.

2. K's grant to M will not constitute an act of self-dealing under section 4941 of the Code.
3. K's Distribution Portion of the grant will be a qualifying distribution within the meaning of section 4942 of the Code.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative. This ruling letter does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

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

Sincerely yours,

Debra J. Kawecki
Manager, EO Technical
Technical Group 1

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