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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

M =
N =
P =
R =
S =
T =
x =

Dear

We have considered your letter of December 18, 2012 (as supplemented by your letter of October 23, 2013), in which you request rulings on the federal tax consequences of the transactions described below.

Facts

*The Interested Parties*

The parties interested in this request are M and R.

M was organized as a nonprofit corporation under state law prior to 1970. It is organized exclusively for religious, charitable, civic, educational, literary, and scientific purposes within the meaning of §§ 170(c)(2)(B) and 501(c)(3) of the Internal Revenue Code.

M is recognized as exempt from federal income tax under § 501(c)(3), and is classified as a private non-operating foundation under § 509(a). M accomplishes its purposes by making grants to other charitable and educational organizations in the United States and in foreign countries. The amount of M's excess qualifying distributions carryover (within the meaning of § 53.4942(a)-3(e) of the Foundation and Similar Excise Taxes Regulations) from its 2011 tax year to its 2012 tax year was approximately $2,733x. M has been funded almost exclusively by contributions of cash and stock from N, a corporation. Thus N, as a substantial contributor to M

(within the meaning of § 507(d)(2)), is a disqualified person (within the meaning of § 4946(a)(1)(A)) with respect to M.

N recently reorganized its business operations into two publicly-traded companies, resulting in a part of N's business being conducted by P. In conjunction with the reorganization, N created R to carry out certain philanthropic activities formerly carried out by M.

R is organized exclusively for religious, charitable, civic, educational, literary, and scientific purposes within the meaning of §§ 170(c)(2)(B) and 501(c)(3). R is recognized as exempt from federal income tax under § 501(c)(3) and is classified as a private non-operating foundation under § 509(a). R intends to provide grants to other organizations in the United States and in foreign countries to fund activities that are aligned with, and are in furtherance of, R's charitable purposes.

*The Transfer*

To effectuate the philanthropic purposes of both M and R, M has assigned the following grant commitments to R (hereinafter, the "Assigned Grants"):

- M's rights and obligations under a grant agreement between M and S ("Grant 1"). S is an organization described in § 501(c)(3) and is classified as other than private foundation under § 509(a)(1). At the time of the assignment, M remained obligated to disburse $3x to S.

- M's rights and obligations under a grant agreement between M and T ("Grant 2"). T is an organization described in § 501(c)(3) and is classified as other than private foundation under § 509(a). At the time of the assignment, M remained obligated to disburse $11x to T.

In addition, M has transferred the following assets to R subject to the terms and conditions set forth in an endowment grant agreement (the "Endowment Agreement"):

- Cash in the amount of $168.8x (the "Cash"); and

- Approximately 11x shares of N stock (the "Shares").

The Cash and the Shares make up the "Grant Assets." The transfer of the Grant Assets and the assignment of Grant 1 and Grant 2 to R make up the "Transfer."

*The Endowment Agreement*

Pursuant to the Endowment Agreement, M and R agree that the transfer of the Grant Assets is intended as an endowment grant within the meaning of § 53.4945-5(c)(2). Before entering into the Endowment Agreement, M considered the identity, prior history, and experience of R and its managers. In light of that analysis, M asserts that it is reasonably assured that R will use the Grant Assets for proper charitable purposes.

In support of this ruling request, M and R provided a copy of the Endowment Agreement, executed by their respective corporate presidents. M declared that all documents submitted with the ruling request are true, complete, and correct.

Under the terms of the Endowment Agreement, R must maintain separate accounts and records for the Grant Assets and any income earned thereon. R must use the Grant Assets, and earnings thereon, only for religious, charitable, scientific, literary, or educational purposes within the meaning of § 170(c)(2)(B). Furthermore, R is prohibited from using any portion of the Grant Assets, including any income earned thereon, to purchase products or services from N or any of its affiliated entities, or from any employee, officer or director of N or any of its affiliated entities.

R shall return or repay to M any Grant Assets, including earnings on such assets, if M, in its sole discretion, determines that R has not performed in accordance with the Endowment Agreement, or if any portion of the Grant Assets is not used for the purposes permitted under the terms of the Endowment Agreement. Furthermore, R must return or repay any Grant Assets, including earnings on such assets, not expended in accordance with the terms of the Endowment Agreement within thirty days of the termination of the grant for any reason, or of a demand by M for return or repayment of any portion of the Grant Assets pursuant to the provisions of the Endowment Agreement.

R shall not use the Grant Assets, or any income earned thereon, to carry on propaganda, or otherwise to attempt, to influence legislation within the meaning of § 4945(d)(1), to influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive within the meaning of § 4945(d)(2), or to undertake any activity for any purpose other than charitable purposes described in § 170(c)(2)(B).

R may use the Grant Assets to make a grant (a "Secondary Grant") to one or more individuals or organizations (each a "Secondary Grantee"). The Endowment Agreement provides that, except for the Assigned Grants, R is under no obligation to make any specific Secondary Grants, and there is no agreement, oral or written, whereby M may cause the selection of any Secondary Grantee by R. Although M and R anticipate that R will enter into Secondary Grants with a number of M's current grantees, except for the Assigned Grants, R will exercise discretion and control over the Secondary Grantee selection process and will make such selections independently of M.

Before making any Secondary Grant:

- R must enter into a written grant agreement memorializing the terms and conditions under which the grant is made and the grant funds are expended.

- With respect to any Secondary Grant to an organization other than an organization described in § 4945(d)(4)(A), R agrees to exercise expenditure responsibility with respect to such Secondary Grantee within the meaning of § 4945(h) and § 53.4945-5, including making such reports to the IRS on its annual information return as are required by § 4945(h)(3) and § 53.4945-5(d).

- With respect to any Secondary Grant to an individual for travel, study, or similar purposes, R shall comply with the requirements of § 4945(g) and § 53.4945-4.

R must submit an annual report to M at the close of each taxable year until the Grant Assets are expended in full, the Endowment Grant is otherwise terminated, or M gives R written notice that it may discontinue the reports. M will evaluate R's performance under the Grant Agreement prior to the end of the second succeeding taxable year following the taxable year in which the Endowment Grant is made, and, pursuant to § 53.4945-5(c)(2), give written notice to R only after ascertaining that neither the principal, the income from the Grant Assets, nor any equipment purchased with the Grant Assets, has been used for any purpose that would result in liability for tax under § 4945(d).

R agrees to keep a systematic accounting record of the receipt and disbursement of the Grant Assets so that such receipts and expenditures are shown separately on R's books and records in an easily verifiable form. R must keep such records, as well as copies of the reports submitted to M and supporting documentation, for at least four years after the completion of the use of any portion of the Grant Assets, or M provides notice to R that it may discontinue the reports, whichever is earlier. M reserves the right to audit R's books and records relating to the expenditure of any of the Grant Assets for no less than four years following the close of R's annual accounting period during which the use of the Grant Assets is completed, or M provides notice that R may discontinue submitting annual reports, whichever is earlier.

*Representations*

M has not, and will not, notify the Internal Revenue Service (the "Service") of its intention to terminate its private foundation status prior to, or immediately after, the Transfer. M represents that, to the best of its knowledge and belief, it has not committed willful repeated acts (or failures to act), nor has it committed any willful or flagrant act (or failure to act) that would give rise to liability for tax under Chapter 42 of the Internal Revenue Code. The Service has not notified M that it is liable for the tax imposed under § 507(c) as a result of any such acts (or failures to act).

At the time of the Transfer, both M and R were governed by a three-member board of directors and shared a common director. This shared director, who also served as the president and principal executive officer of both M and R, was an employee of N at the time of the Transfer. In addition, all of the other officers and directors of M and R at the time of the Transfer were either employed by N or employed by P, a wholly-owned subsidiary of N. Consequently, M and R maintain that, at the time of the Transfer, R was effectively controlled (within the meaning of § 1.482-1A(a)(3)) by the same person, N, that effectively controlled M.

Rulings Requested

The following rulings have been requested:

1. The Transfer will not adversely affect the tax exempt status of either M or R as an organization described in § 501(c)(3).

2. The Transfer qualifies as a transfer of assets described in § 507(b)(2), and will neither result in the termination of M's private foundation status under § 507(a) nor subject M to the tax imposed by § 507(c).

3. R will succeed to M's attributes and characteristics described in subparagraphs (2), (3) and (4) of § 1.507-3(a) of the Income Tax Regulations.

4. Effectuating the Transfer and engaging in such actions as are necessary to effectuate the Transfer will not constitute an act of self-dealing within the meaning of § 4941.

5. M may not treat the distribution of the Grant Assets as a qualifying distribution described in § 4942(g).

6. R will not succeed to any of M's excess qualifying distributions under § 53.4942(a)-3(e).

7. The Transfer will not constitute an investment that jeopardizes the carrying out of M's exempt purposes within the meaning of § 4944(a).

8. M has met its pregrant inquiry requirements as to R under § 53.4945-5(b)(2).

9. M has met the "written commitment" requirement under § 53.4945-5(b)(3) by requiring R to enter into the Endowment Agreement, so long as M takes all reasonable actions to enforce the terms of the Endowment Agreement.

10. The Transfer will not be a taxable expenditure under § 4945 because M will exercise capital endowment grant expenditure responsibility over the Grant Assets transferred to R; however, M will not be required to exercise expenditure responsibility with respect to the Assigned Grants or any Secondary Grants made by R to Secondary Grantees.

11. The legal, accounting, and other expenses paid by M and R to obtain this ruling and to effectuate the Transfer, if reasonable in amount, will not constitute taxable expenditures under § 4945(d)(5).

12. R will receive the benefit of any transitional rules that were applicable to M as a foundation in existence before January 1, 1970.

13. The Transfer will not constitute a willful and flagrant act (or failure to act), and will not constitute one in a series of acts (or failures to act) that would cause M to incur any taxes under Chapter 42 of the Internal Revenue Code.

Law

I.R.C. § 501(a) exempts from federal income taxation organizations described in § 501(c).

I.R.C. § 501(c)(3) describes organizations organized and operated exclusively for charitable and other designated exempt purposes.

I.R.C. § 507(a) provides that, except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if (1) it notifies the Secretary of its intent to accomplish such termination, or (2) with respect to such organization, 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, and the Secretary notifies such organization that it is liable for the tax imposed by subsection (c), and either such organization pays the tax (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

I.R.C. § 507(b)(2) provides that 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 a newly created organization.

I.R.C. § 507(c) imposes a tax on the termination of a private foundation under the circumstances described in § 507(a). The tax is equal to the lesser of the aggregate tax benefit resulting from the tax exempt status of the private foundation and the value of the net assets of such foundation.

I.R.C. § 507(d)(1) defines "aggregate tax benefit" as the sum of the following amounts:

> (i) the aggregate increases in tax under chapters 1, 11 and 12 of the Internal Revenue Code that would have been imposed on the substantial contributors to the private foundation if the charitable income, estate and gift tax deductions were disallowed for contributions made after February 28, 1913;
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> (ii) the aggregate increases in tax under chapter 1 that would have been imposed on the private foundation's income for taxable years beginning after December 31, 1912 if the foundation had not been exempt under § 501(c)(3) or if deductions under § 642(c) had been limited to 20 percent of taxable income (in the case of a trust); and
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> (iii) interest on the amounts described in items (i) and (ii) above from the first date each amount would have been due and payable until the date when the organization ceases to be a private foundation.

I.R.C. § 509(a) defines the term "private foundation" to mean any domestic or foreign organization described in § 501(c)(3) other than an organization described in § 509(a)(1), (2), (3), or (4).

I.R.C. § 4941(a)(1) imposes a tax on each act of self-dealing between a disqualified person and a private foundation.

I.R.C. § 4941(d)(1)(E) provides that the term "self-dealing" includes 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.

I.R.C. § 4942(a) imposes a tax on the undistributed income of a private foundation for any taxable year which has not been distributed by the first day of the second (or any succeeding) taxable year following such taxable year.

I.R.C. § 4942(c) defines "undistributed income" for any taxable year as the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made before such time out of such distributable amount.

I.R.C. § 4942(d) defines "distributable amount" as an amount equal to the sum of the minimum investment return, plus certain other amounts, reduced by the sum of the taxes imposed for the taxable year under subtitle A and § 4940.

I.R.C. § 4942(g)(1)(A) defines "qualifying distribution" as any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in § 170(c)(2)(B), other than any contribution to: (i) an organization controlled (directly or indirectly) by the foundation or disqualified persons with respect to the foundation, except as provided in paragraph (3), or (ii) a private foundation which is not an operating foundation (as described in subsection (j)(3)), except as provided in paragraph (3).

I.R.C. § 4942(g)(3) provides that the term "qualifying distribution" includes a contribution to a § 501(c)(3) organization described in paragraph (1)(A)(i) or (ii) if—

> (A) not later than the close of the first taxable year after its taxable year in which such contribution is received, such organization makes a distribution equal to the amount of such contribution and such distribution is a qualifying distribution (within the meaning of paragraph (1) or (2), without regard to this paragraph) which is treated under subsection (h) as a distribution out of corpus (or would be so treated if such § 501(c)(3) organization were a private foundation which is not an operating foundation), and
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> (B) the private foundation making the contribution obtains adequate records or other sufficient evidence from such organization showing that the qualifying distribution described in subparagraph (A) has been made by such foundation.

I.R.C. § 4942(i) provides for a carry-over of the amount by which qualifying distributions during the five preceding taxable years (other than amounts required to be distributed out of corpus under § 4942(g)(3)) have exceeded the distributable amounts for such years.

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

I.R.C. § 4945(a) imposes a tax on each taxable expenditure of a private foundation.

I.R.C. § 4945(d)(4) provides that the term "taxable expenditure" includes any amount paid or incurred by a private foundation as a grant to a private non-operating foundation unless the grantor foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h).

I.R.C. § 4945(d)(5) provides that the term "taxable expenditure" includes any amount paid or incurred by a private foundation for any purpose other than one specified in § 170(c)(2)(B).

I.R.C. § 4945(h) provides that the 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 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.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that for an organization to be exempt as an organization described in § 501(c)(3), it must be both organized and operated exclusively for one or more of the purposes specified in such section.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3).

Treas. Reg. § 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized and operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Treas. Reg. § 1.507-1(b)(1) provides that in order for a private foundation to terminate its private foundation status under § 507(a)(1), an organization must submit a statement to the Service of its intent to terminate its private foundation status under § 507(a)(1). Such statement must set forth in detail the computation and amount of tax imposed under § 507(c). Unless the organization requests abatement of such tax pursuant to § 507(g), full payment of such tax must be made at the time the statement is filed under § 507(a)(1).

Treas. Reg. § 1.507-1(b)(6) 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 § 507(b)(2) and

§ 1.507-3(c), such transferor foundation will not have terminated its private foundation status under § 507(a)(1).

Treas. Reg. § 1.507-3(a)(1) provides that in the case of a transfer of assets from one private foundation to another private foundation pursuant to a liquidation, merger, redemption, recapitalization or other adjustment, organization or reorganization, including a significant disposition of assets to one or more private foundations within the meaning of paragraph (c), the transferee organization shall not be treated as a newly created organization. Rather, the transferee organization shall be treated as possessing those attributes and characteristics of the transferor organization that are described in subparagraphs (2), (3), and (4) of this paragraph.

Treas. Reg. § 1.507-3(a)(2)(i) provides that (except as provided in subdivision (ii)) a transferee organization to which this paragraph (a) applies will succeed to the aggregate tax benefit of the transferor organization in an amount equal to the amount of such aggregate tax benefit 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 shall be determined as of the time of the transfer. The transferor foundation retains that portion of the aggregate tax benefit not allocated to the transferee foundation.

Treas. Reg. § 1.507-3(a)(2)(ii) provides that, notwithstanding subdivision (i) of this subparagraph, a transferee organization which is not effectively controlled (within the meaning of § 1.482-1(a)(3)) [i.e., § 1.482-1A(a)(3)], directly or indirectly, by the same person or persons who effectively control the transferor organization shall not succeed to an aggregate tax benefit in excess of the fair market value of the assets transferred at the time of the transfer. Treas. Reg. § 1.482-1A(a)(3) provides that the term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise.

Treas. Reg. § 1.507-3(a)(2)(iii) provides examples to illustrate the provisions of subparagraph (2), including—

> Example (2). Pursuant to a transfer described in § 507(b)(2), M, a private foundation, transfers all of its assets, which immediately prior to the transfers have a fair market value of $100,000. The assets were transferred to the following organizations at the following fair market values (determined at the time of the transfer) $40,000 to N, a private foundation, $30,000 to O, a private foundation, and $30,000 to P, an organization described in § 170(b)(1)(A)(vi). Immediately before the transfer M's aggregate tax benefit was $50,000. Therefore, N succeeds to M's aggregate tax benefit to the extent of $20,000 ($50,000 x $40,000/$100,000) and O succeeds to M's aggregate tax benefit to the extent of $15,000 ($50,000 x $30,000/$100,000). The remaining $15,000 of M's aggregate tax benefit is maintained by M as M has not terminated under section 507.
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> Example (3). Assume the same facts as in Example (2) except that the transfers were made as follows: M transferred $30,000 to N on January 1, 1972, $40,000 to P on July 1, 1972, and $30,000 to O on December 31, 1972. Further, assume that the fair market

value of the assets and the aggregate tax benefit do not change during 1972 and that O is not effectively controlled (directly or indirectly) by the same person or persons who effectively control M. N succeeds to M's aggregate tax benefit to the extent of $15,000 ($50,000 x $30,000/$100,000). However, since $40,000 of the remaining $70,000 ($100,000 - $30,000) of assets of M was transferred to P on July 1, 1972, immediately before the transfer to O, the fair market value of the assets held by M is $30,000 ($70,000 - $40,000). On the other hand, because P is not a private foundation, M's aggregate tax benefit immediately before the transfer to O remains $35,000 ($50,000 - $15,000). Therefore, before applying subdivision (ii) of this subparagraph, O would succeed to $35,000 ($35,000 x $30,000/$30,000) of M's aggregate tax benefit. However, applying subdivision (ii) of this subparagraph since M transferred only $30,000 to O, O shall succeed to only $30,000 of M's aggregate tax benefit. The remaining $5,000 ($35,000 - $30,000) of M's aggregate tax benefit is retained by M as M has not terminated under § 507.

Treas. Reg. § 1.507-3(a)(3) provides that in the event of a transfer of assets described in § 507(b)(2), any person who is a "substantial contributor" (within the meaning of § 507(d)(2)) with respect to the transferor foundation shall be treated as a "substantial contributor" with respect to the transferee foundation, regardless of whether such person meets the $5,000-two percent test with respect to the transferee organization at any time.

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

Treas. Reg. § 1.507-3(a)(5) provides that, except as provided in subparagraph (9) of this paragraph, a private foundation is required to meet the distribution requirements of § 4942 for any taxable year in which it makes a § 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 such requirements to the extent the amount transferred meets the requirements of § 4942(g).

Treas. Reg. § 1.507-3(a)(6) provides that, for purposes of § 4943(c)(4), (5), and (6), whenever a private foundation makes a § 507(b)(2) transfer of all or part of its net assets to another private foundation, the applicable period of time described in § 4943(c)(4), (5), or (6) shall include both the period during which the transferor foundation held such assets and the period during which the transferee foundation holds such assets.

Treas. Reg. § 1.507-3(a)(8)(i) provides that, except as provided in subdivision (ii) of this subparagraph or subparagraph (6) or (9) of this paragraph, whenever a private foundation makes a transfer of assets described in § 507(b)(2) to one or more private foundations, the transferee foundation:

(a) Will not be treated as being in existence prior to January 1, 1970, with respect to any transferred assets;

(b) Will not be treated as holding the transferred assets prior to January 1, 1970; and

(c) Will not be treated as having engaged in, or become subject to, any transaction, lease contract, or other obligation with respect to the transferred assets prior to January 1, 1970.

Treas. Reg. § 1.507-3(a)(8)(ii) provides that, notwithstanding subdivision (i) of this subparagraph, the provisions enumerated in (a) through (g) of this subdivision shall apply to the transferee foundation with respect to the assets transferred to the same extent and in the same manner that they would have applied to the transferor foundation had the transfer described in § 507(b)(2) not been effected:

(a) I.R.C. § 4940(c)(4)(B) and the regulations thereunder with respect to basis of property,

(b) I.R.C. § 4942(f)(4) and the regulations thereunder with respect to distributions of income,

(c) Section 101(1)(2) of the Tax Reform Act of 1969 (83 Stat. 533), as amended by section 1301 and 1309 of the Tax Reform Act of 1976 (90 Stat. 1713, 1729), with respect to the provisions of section 4941,

(d) Section 101(1)(3)(A) of the Tax Reform Act of 1969 (83 Stat. 534) with respect to the provisions of § 4942, but only if the transferor qualified for the application of such section immediately before the transfer, and at least 85 percent of the fair market value of the net assets of the transferee immediately after the transfer was received pursuant to the transfer,

(e) Section 101(1)(3)(B) through (E) of the Tax Reform Act of 1969 (83 Stat. 534) with respect to the provisions of § 4942,

(f) Section 101(1)(5) of the Tax Reform Act of 1969 (83 Stat. 535) with respect to the provisions of § 4945, and

(g) Section 101(1)(6) of the Tax Reform Act of 1969 (83 Stat. 535) with respect to the provisions of § 508(e).

Treas. Reg. § 1.507-3(a)(9)(i) provides that if a private foundation transfers all if its net assets to one or more private foundations which are effectively controlled (within the meaning of § 1.482-1(a)(3) [i.e., § 1.482-1A(a)(3)]), directly or indirectly, by the same person or persons which effectively controlled the transferor private foundation, for purposes of §§ 4940 through 4948 and §§ 507 through 509, such a transferee foundation shall be treated as if it were the transferor. However, where proportionality is appropriate, such a transferee private foundation shall be treated as if it were the transferor in the proportion which the fair market value of the

assets (less encumbrances) transferred to such transferee bears to the fair market value of the assets (less encumbrances) of the transferor immediately before the transfer.

Treas. Reg. § 1.507-3(a)(9)(iii) includes the following example:

> Example (2), A and B are the trustees of the P charitable trust, a private foundation, and are the only substantial contributors to P. On July 1, 1973, in order to facilitate accomplishment of diverse charitable purposes, A and B create and control the R Foundation, the S Foundation and the T Foundation and transfer the net assets of P to R, S, and T. As of the end of 1973, P has an outstanding grant to Foundation W and has been required to exercise expenditure responsibility with respect to this grant under sections 4945(d)(4) and (h). Under these circumstances, R, S, and T shall each be treated as if they are P in the proportion the fair market value of the assets transferred to each bears to the fair market value of the assets of P immediately before the transfer.

Treas. Reg. § 1.507-3(c)(1) provides that a transfer of assets is described in § 507(b)(2) if it is made by a private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. This shall include any organization or reorganization described in subchapter C of chapter 1. For purposes of § 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.

Treas. Reg. § 1.507-3(d) provides that, unless a private foundation gives notice pursuant to § 507(a)(1), a transfer of assets described in § 507(b)(2) will not constitute a termination of the transferor's private foundation status under § 507(a)(1).

Treas. Reg. § 1.507-4(b) provides that private foundations that make transfers described in § 507(b)(1)(A) or (2) are not subject to the termination tax imposed under § 507(c) with respect to such transfers unless the provisions of § 507(a) become applicable.

Treas. Reg. § 53.4941(d)-2(f)(1) provides that the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation constitutes an act of self-dealing.

Treas. Reg. § 53.4942(a)-3(a)(2)(i) defines the term "qualifying distribution" as any amount (including reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in § 170(c)(1) or (2)(B), other than a contribution to: (a) a private foundation which is not an operating foundation, except as provided in paragraph (c) of this section, or (b) an organization controlled (directly or indirectly) by the contributing private foundation, except as provided in paragraph (c) of this section.

Treas. Reg. § 53.4942(a)-3(e)(1) provides that if in any taxable year for which an organization is subject to the initial excise tax imposed by § 4942(a) there is created an excess of qualifying distributions (as determined under subparagraph (2) of this paragraph), such excess may be

used to reduce distributable amounts in any taxable year of the adjustment period (as defined in subparagraph (3) of this paragraph).

Treas. Reg. § 53.4942(a)-3(e)(2) provides that an excess of qualifying distributions is created for any taxable year if: (i) the total qualifying distributions treated as made out of the undistributed income for such taxable year or as made out of corpus with respect to such taxable year exceeds (ii) the distributable amount for such taxable year.

Treas. Reg. § 53.4942(a)-3(e)(3) provides that the taxable years in the adjustment period are the five taxable years immediately following the taxable year in which the excess of qualifying distributions is created.

Treas. Reg. § 53.4945-5(a)(1) provides that, under § 4945(d)(4), the term "taxable expenditure" includes any amount paid or incurred by a private foundation as a grant to an organization (other than an organization described in § 509(a)(1), (2), or (3)), unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with § 4945(h).

Treas. Reg. § 53.4945-5(a)(6)(i) provides that a grant by a private foundation to a grantee organization which the grantee organization uses to make payments to another organization (the secondary grantee) shall not be regarded as a grant by the private foundation to the secondary grantee if the foundation does not earmark the use of the grant for any named secondary grantee and there does not exist an agreement, oral or written, whereby such grantor foundation may cause the selection of the secondary grantee by the organization to which it has given the grant. For purposes of this subdivision, a grant described herein shall not be regarded as a grant by the foundation to the secondary grantee even though such foundation has reason to believe that certain organizations would derive benefits from such grant so long as the original grantee organization exercises control, in fact, over the selection process and actually makes the selection completely independently of the private foundation.

Treas. Reg. § 53.4945-5(b)(1) provides that a private foundation is not an insurer of the activity of the organization to which it makes a grant. Thus, satisfaction of the requirements of § 4945(d)(4) and (h) will ordinarily mean that the grantor foundation will not have violated § 4945(d)(1) or (2). A private foundation will be considered to be exercising "expenditure responsibility" under § 4945(h) as long as it exerts all reasonable efforts and establishes adequate procedures—

(i) To see that the grant is spent solely for the purpose for which 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.

Treas. Reg. § 53.4945-5(b)(2)(i) provides that before making a grant to an organization with respect to which expenditure responsibility must be exercised under this section, a private foundation should conduct a limited inquiry concerning the potential grantee. Such inquiry

should be complete enough to give a reasonable man assurance that the grantee will use the grant for the proper purposes. The inquiry should concern itself with matters such as: (a) the identity, prior history, and experience (if any) of the grantee organization and its managers; and (b) any knowledge which the private foundation has (based on prior experience or otherwise) of, or other information which is readily available concerning, the management, activities, and practices of the grantee organization.

Treas. Reg. § 53.4945-5(b)(3) provides that, except as provided in subparagraph (4) of paragraph (b), in order to meet the expenditure responsibility requirements of § 4945(h), a private foundation must require that each grant to an organization with respect to which expenditure responsibility must be exercised be made subject to a written commitment signed by an appropriate officer, director, or trustee of the grantee organization. Such commitment must include an agreement by the grantee—

(i) To repay any portion of the amount granted which is not used for the purposes of the grant,

(ii) To submit full and complete annual reports on the manner in which the funds are spent and progress made in accomplishing the purposes of the grant, except as provided in paragraph (c)(2) of this section,

(iii) To maintain records of receipts and expenditures and to make its books and records available to the grantor at reasonable times, and

(iv) Not to use any of the funds—

(a) To carry on propaganda, or otherwise to attempt, to influence legislation,

(b) To influence the outcome of any specific public election, or to carry on any voter registration drive,

(c) To make any grant which does not comply with the requirements of § 4945(d)(3) or (4), or

(d) To undertake any activity for any purpose other than one specified in § 170(c)(2)(B).

The agreement must also clearly specify the purposes of the grant. Such purposes may include contributing for capital endowment, for the purchase of capital equipment, or for general support provided that neither the grants nor the income therefrom may be used for purposes other than those described in § 170(c)(2)(B).

Treas. Reg. § 53.4945-5(c)(2) provides that if a private foundation makes a grant described in section 4945(d)(4) to a private foundation which is exempt from taxation under § 501(a) for endowment, for the purchase of capital equipment, or for other capital purposes, the grantor foundation shall require reports from the grantee on the use of the principal and the income (if any) from the grant funds. The grantee shall make such reports annually for its taxable year in

which the grant was made and the immediately succeeding two taxable years. Only if it is reasonably apparent to the grantor that, before the end of such second succeeding taxable year, neither the principal, the income from the grant funds, nor the equipment purchased with the grant funds has been used for any purpose which would result in liability for tax under § 4945(d), may the grantor then allow such reports to be discontinued.

Treas. Reg. § 53.4945-5(d)(1) provides that to satisfy the report making requirements of § 4945(h)(3), a granting foundation must provide the required information on its annual information return, required to be filed by § 6033, for each taxable year with respect to each grant made during the taxable year which is subject to the expenditure responsibility requirements of § 4945(h). Such information must also be provided on such return with respect to each grant subject to such requirements upon which any amount or any report is outstanding at any time during the taxable year. However, with respect to any grant made for endowment or other capital purposes, the grantor must provide the required information only for any taxable year for which the grantor must require a report from the grantee under paragraph (c)(2) of this section.

Treas. Reg. § 53.4945-5(e)(1)(i) provides that any diversion of grant funds (including the income therefrom in the case of an endowment grant) by the grantee to any use not in furtherance of a purpose specified in the grant may result in the diverted portion of such grant being treated as a taxable expenditure of the grantor under § 4945(d)(4).

Treas. Reg. § 53.4945-5(e)(1)(ii) provides that, in any event, a grantor will not be treated as having made a taxable expenditure under § 4945(d)(4) solely by reason of a diversion by the grantee, if the grantor has complied with subdivision (iii)(a) and (b) or (iv)(a) and (b) of this subparagraph, whichever is applicable.

Treas. Reg. § 53.4945-5(e)(1)(iii) provides that in cases in which the grantor foundation determines that any part of a grant has been used for improper purposes and the grantee has not previously diverted grant funds, the foundation will not be treated as having made a taxable expenditure solely by reason of the diversion so long as the foundation:

> (a) Is taking all reasonable and appropriate steps either to recover the grant funds or to insure the restoration of the diverted funds and the dedication (consistent with the requirements of (b)(1) and (2) of this subdivision) of the other grant funds held by the grantee to the purposes being financed by the grant, and
>
> (b) Withholds any further payments to the grantee after the grantor becomes aware that a diversion may have taken place (hereinafter referred to as "further payments") until it has:
>
> (1) Received the grantee's assurances that future diversions will not occur, and
>
> (2) Required the grantee to take extraordinary precautions to prevent future diversions from occurring.

Treas. Reg. § 53.4945-5(e)(1)(iv) provides that in cases where a grantee has previously diverted funds received from a grantor foundation, and the grantor foundation determines that any part of a grant has again been used for improper purposes, the foundation will not be treated as having made a taxable expenditure solely by reason of such diversion so long as the foundation:

> (a) Is taking all reasonable and appropriate steps to recover the grant funds or to insure the restoration of the diverted funds and the dedication (consistent with the requirements of (b)(2) and (3) of this subdivision) of other grant funds held by the grantee to the purposes being financed by the grant, except that if, in fact, some or all of the diverted funds are not so restored or recovered, then the foundation must take all reasonable and appropriate steps to recover all of the grant funds, and
>
> (b) Withholds further payments until:
>
> (1) Such funds are in fact so recovered or restored,
>
> (2) It has received the grantee's assurances that future diversions will not occur, and
>
> (3) It requires the grantee to take extraordinary precautions to prevent future diversions from occurring.

Treas. Reg. § 53.4945-5(e)(1)(v) provides that the phrase "all reasonable and appropriate steps" (as used in subdivisions (iii) and (iv) of this subparagraph) includes legal action where appropriate, but need not include legal action if such action would in all probability not result in the satisfaction of execution on a judgment.

Treas. Reg. § 53.4945-5(e)(2) provides that a failure by the grantee to make the reports required by paragraph (c) of this section (or the making of inadequate reports) shall result in the grant's being treated as a taxable expenditure by the grantor unless the grantor:

> (i) Has made the grant in accordance with paragraph (b) of this section,
>
> (ii) Has complied with the reporting requirements contained in paragraph (d) of this section,
>
> (iii) Makes a reasonable effort to obtain the required report, and
>
> (iv) Withholds all future payments on this grant and on any other grant to the same grantee until such report is furnished.

Treas. Reg. § 53.4945-6(b)(1) includes among the types of expenditures that ordinarily will not be treated as taxable expenditures under § 4945(d)(5), expenditures to acquire investments entered into for the purpose of obtaining income or funds to be used in furtherance of purposes described in § 170(c)(2)(B), reasonable expenses with respect to such investments, and any payment that constitutes a qualifying distribution under § 4942(g).

Treas. Reg. § 53.4946-1(a)(8) provides that, for purposes of § 4941 only, the term "disqualified person" shall not include any organization that is described in § 501(c)(3) (other than an organization described in § 509(a)(4)).

Rev. Rul. 78-387, 1978-2 C.B. 270, concerns a private foundation, M, which has a carryover of excess qualifying distributions as described in § 4942(i) and § 53.4942(a)-3(e). M transferred all of its net assets to another private foundation, N, in a transfer qualifying under § 507(b)(2). M is controlled, within the meaning of § 1.482-1A(a)(3), by the same persons who control N. Because the transferee foundation, N, is treated as if it were the transferor foundation, M, pursuant to § 1.507-3(a)(9)(i), it is held that, for purposes of determining its distribution requirements under § 4942, N may reduce its distributable amount by the excess qualifying distributions carryover of M.

Rev. Rul. 2002-28, 2002-1 C.B. 941, posits various situations in which a transferor private foundation transfers all of its assets to one or more private foundations that are effectively controlled by the same persons that effectively control the transferor. In the context of § 4942, it is concluded that the transfers to the transferee foundations are not treated as qualifying distributions of the transferor foundation. Where a private foundation transfers all of its assets to one private foundation, the transferee foundation assumes all obligation with respects to the transferor's "undistributed income" within the meaning of § 4942(c), if any, and reduces its own distributable amount by the transferor foundation's excess qualifying distributions under § 4941(i).

Analysis

*Issue 1: Whether the transfer of the Grant Assets would adversely affect the status of either M or R as a tax-exempt organization described in § 501(c)(3).*

To be described in § 501(c)(3), each of M and R must be operated exclusively for exempt purposes within the meaning of § 1.501(c)(3)-1(c)(1) by engaging primarily in activities that accomplish exempt purposes. To that end, neither M nor R may allow its net earnings to inure to the benefit of private shareholders or individuals within the meaning of § 1.501(c)(3)-1(c)(2), and neither may serve private interests within the meaning of § 1.501(c)(3)-1(d)(1)(ii).

Each of M and R is currently recognized by the Service as an organization described in § 501(c)(3). As private non-operating foundations, M and R accomplish their respective missions by making grants to other charitable and educational organizations. M states that it determined that the transfer of the Grant Assets to R under the terms of the Endowment Agreement would further M's charitable purposes. Such terms require R to use the Grant Assets solely for charitable purposes described in § 170(c)(2)(B), or to return such assets to M. Furthermore, R is forbidden from using the Grant Assets to purchase products or services from N, its affiliates or subsidiaries, or any employees, officers, or directors thereof. Under these circumstances, we do not find that the transfer of the Grant Assets would result in the inurement of M's net earnings to the benefit of private shareholders or individuals within the meaning of § 1.501(c)(3)-1(c)(2), cause either M or R to be operated for the benefit of private interests within the meaning of § 1.501(c)(3)-1(d)(1)(ii), or result in either M or R engaging in activities

other than activities in furtherance of an exempt purpose within the meaning of § 1.501(c)(3)-1(c)(1). Accordingly, we conclude that the transfer of the Grant Assets from M to R under the terms of the Endowment Agreement will not adversely affect the status of either M or R as a tax-exempt organization described in § 501(c)(3).

*Issue 2: Whether the transfer of the Grant Assets qualifies as a transfer of assets described in § 507(b)(2), whether the transfer will result in the termination of M's private foundation status under § 507(a), and whether the transfer will subject M to the tax imposed under § 507(c).*

Under § 1.507-3(c)(1), a transfer of assets is described in § 507(b)(2) if it is a transfer from one private foundation to another private foundation pursuant to a liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, including any organization or reorganization described in subchapter C of Chapter 1 of the Internal Revenue Code (concerning corporate distributions and adjustments). N reorganized by forming P and transferring to P some of the business activities formerly conducted by N. In conjunction with the reorganization of its business activities, N created R in order to transfer to R some of the activities currently conducted by M. The transfer of the Grant Assets from M, a private foundation, to R, a private foundation, was meant to provide R with funds with which to carry out its activities. Accordingly, the transfer of the Grant Assets is a transfer by a private foundation to another private foundation pursuant to an organization or reorganization described in subchapter C and is, therefore, a transfer of assets described in §507(b)(2).

Treas. Reg. § 1.507-1(b)(6) provides that when a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in § 507(b)(2), such transferor foundation will not have terminated its private foundation status under § 507(a)(1). In addition, § 1.507-3(d) provides that unless a private foundation voluntarily gives notice pursuant to § 507(a)(1), a transfer of assets described in § 507(b)(2) will not constitute termination of the transferor's private foundation status under § 507(a)(1).

M specifically states that it has not given notice, nor will it give notice, to the Service of an intention to terminate its private foundation status in accordance with § 507(a)(1). Accordingly, M has not voluntarily terminated its private foundation status.

M represents that it has not engaged in acts (or failures to act) that would give rise to liability under Chapter 42 of the Internal Revenue Code. Based upon M's representation, M's private foundation status has not been terminated involuntarily.

As M's status as a private foundation has not been terminated voluntarily or involuntarily, and as M's status as a private foundation will not be terminated as a result of the transfer of the Grant Assets, M will not be subject to the tax imposed upon such terminations under § 507(c).

*Issue 3: Whether R will succeed to M's attributes and characteristics described in §1.507-3(a)(2), (3) and (4).*

Under Treas. Reg. § 1.507-3(a)(1), in the case of a transfer of assets from one private foundation to another private foundation described in § 507(b)(2), the transferee organization is

treated as possessing those attributes and characteristics of the transferor organization that are described in §1.507-3(a)(2), (3), and (4). As discussed above, the transfer of the Grant Assets is a transfer described in § 507(b)(2). Therefore, § 1.507-3(a)(1) applies.

Treas. Reg. § 1.507-3(a)(2)(i) provides that when the transferee and transferor organizations are effectively controlled (within the meaning of § 1.482-1A(a)(3)) by the same persons, the transferee organization succeeds to the aggregate tax benefit of the transferor in an amount equal to the amount of such aggregate tax benefit (within the meaning of § 507(d)(1)), multiplied by a fraction the numerator of which is the fair market value of the assets (less encumbrances) transferred and the denominator of which is the fair market value of the assets of the transferor (less encumbrances) immediately before the transfer. At the time of the Transfer, R and M were controlled by the same persons. Therefore, R will succeed to a fraction of M's aggregate tax benefit, calculated as described above. As M is not terminating under § 507 and will continue as a private non-operating foundation after the Transfer, M will retain the portion of its aggregate tax benefit that is not passing to R. See Treas. Reg. § 1.507-3(a)(2)(iii), Examples (2) and (3).

Furthermore, in the event of a transfer of assets described in § 507(b)(2), § 1.507-3(a)(3) provides that any person who is a "substantial contributor" (within the meaning of § 507(d)(2)) with respect to the transferor foundation will be treated as a "substantial contributor" with respect to the transferee foundation. Therefore, any person who is a disqualified person with respect M at the time of the Transfer will be considered a "substantial contributor" with respect to R as a result of the Transfer.

Finally, if a private foundation incurs liability for one or more of the taxes imposed under Chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in § 507(b)(2), in any case where transferee liability applies § 1.507-3(a)(4) provides that the transferee foundation will be treated as receiving the transferred assets subject to such liability to the extent the transferor foundation does not satisfy such liability. Therefore, should M have incurred liability for any Chapter 42 tax prior to, or as a result of, the Transfer, R will be treated as receiving the Grant Assets subject to such liability to the extent that M does not satisfy the liability where transferee liability applies.

*Issue 4: Whether effectuating the Transfer and engaging in such actions as are necessary to effectuate the Transfer would constitute an act of self-dealing within the meaning of § 4941.*

I.R.C. § 4941(a) imposes a tax on each act of self-dealing between a disqualified person and a private foundation. Under § 53.4941(d)-2(f)(1), the transfer of the assets of a private foundation to a disqualified person, or the use of such assets by or for the benefit of a disqualified person, constitutes an act of self-dealing. However, under § 53.4946-1(a)(8), for purposes of § 4941, the term "disqualified person" does not include an organization described in § 501(c)(3) (aside from an organization described in § 509(a)(4)).

The Transfer resulted in the transfer of the assets of M, a private foundation, to R, an organization described in § 501(c)(3). As an organization described in § 501(c)(3), R is not a disqualified person with respect to M for purposes of § 4941. Therefore the Transfer does not

constitute a transfer of the assets of a private foundation to a disqualified person. Accordingly, the Transfer does not constitute an act of self-dealing within the meaning of § 4941.

*Issue 5: Whether M may treat the distribution of the Grant Assets as a qualifying distribution under § 4942(g).*

M and R are private non-operating foundations. I.R.C. § 4942 requires private non-operating foundations to make a certain amount of "qualifying distributions" each year or incur a tax. "Qualifying distributions," generally, include grants to public charities and private operating foundations that are not controlled by the grantor private foundation and direct expenditures for charitable purposes.

Treas. Reg. § 1.507-3(a)(5) provides, generally, that a private foundation making a transfer described in § 507(b)(2) must satisfy its distribution requirements under § 4942 for the taxable year in which the transfer is made. It further provides that the transfer will count as a distribution in satisfaction of the transferor foundation's distribution requirement under § 4942 subject to the provisions of § 4942(g). Under § 4942(g)(3) and § 53.4942(a)-3(c)(1), a grant by a private non-operating foundation to another private non-operating foundation (or to another organization controlled by disqualified persons with respect to the transferor) is not treated as a qualifying distribution by the transferor foundation for purposes of § 4942 except to the extent that the transferee makes one or more distributions that would be qualifying distributions under § 4942(g) prior to the close of the transferee's first taxable year following the taxable year in which it received the transfer and the distributions are treated as being made out of corpus. Since the transfer of the Grant Assets to R is intended as an endowment grant, M does not anticipate that R will redistribute the full amount of the assets received from M within the time period, and in the manner, required by § 4942(g)(3). Therefore, M may not treat the transfer of the Grant Assets as a qualifying distribution under § 4942(g).

*Issue 6: Whether R may use any of M's excess qualifying distributions carryover to reduce its distributable amount.*

M had an excess qualifying distributions carryover from its 2011 tax year to its 2012 tax year. Where a private foundation that has excess qualifying distributions distributes all of its net assets to one or more private foundations controlled by the same persons who control the transferor foundation, the transferee foundation(s) may make use of the transferor's carryover. See Rev. Rul. 78-387; Rev. Rul. 2002-28; and § 1.507-3(a)(9)(i). While M and R were both controlled by N at the time of the Transfer, M did not distribute *all* of its net assets in a transfer qualifying under § 507(b)(2), but only a part of its net assets. Therefore, because M did not distribute all of its net assets to R, R may not use any of M's excess qualifying distributions carryover to reduce its distributable amount under § 4942(d). Proportionality is appropriate where all the net assets are transferred to two or more private foundations, but not where only part of the net assets is transferred.

*Issue 7: Whether the Transfer will constitute an investment that jeopardizes the carrying out of exempt purposes within the meaning of § 4944.*

I.R.C. § 4944(a)(1) imposes an excise tax on any amount invested by a private foundation in a manner that jeopardizes the carrying out of the foundation's exempt purposes. Pursuant to the Transfer, M made an outright assignment of its rights and obligations under Grant 1 and Grant 2 to R. In addition, M made a direct grant of the Grant Assets to R in the form of an endowment grant. The transfers were made to accomplish M's exempt mission in the aftermath of the reorganization of N's business operations and to endow R so that it can pursue its exempt mission. Except for a contingent right to recover a portion of the Grant Assets if R were to violate the terms of the Endowment Agreement, M retained no interest in the Grant Assets, the income therefrom, or any assets that R may acquire with the Grant Assets. Because M made the Transfer without consideration and without any expectation of repayment, the production of income, or the appreciation of property, the Transfer does not constitute an investment of an amount in a manner to jeopardize the carrying out of exempt purposes within the meaning of § 4944(a)(1).

*Issue 8: Whether M has met its pregrant inquiry requirements as to R under § 53.4945-5(b)(2).*

Treas. Reg. § 53.4945-5(b)(2)(i) describes the limited inquiry that a private foundation must conduct concerning the potential grantee before making a grant to an organization with respect to which expenditure responsibility must be exercised. Such inquiry should concern itself with matters such as: (a) the identity, prior history, and experience (if any) of the grantee organization and its managers, and (b) any knowledge which the private foundation has (based on prior experience or otherwise) of, or other information which is already available concerning, the management, activities, and practices of the grantee organization, and should be complete enough to give a reasonable person assurance that the grantee will use the grant assets for the proper purposes.

M represents that it conducted a pregrant inquiry into the identity, prior history, and experience of R and its managers based on a review of all information that was readily available to M concerning the management, activities, and practices of R. At the time of the Transfer, all of the officers and directors M and R were either employees of N or of P, a wholly owned subsidiary of N. Thus, provided that the findings of M's inquiry would cause a reasonable person to conclude that R will use the Grant Assets for the proper purposes, M will have met its obligation to conduct a pregrant inquiry under § 53.4945-5(b)(2)(i).

*Issue 9: Whether M has met the "written commitment" requirement under § 53.4945-5(b)(3) by requiring R to enter into the Endowment Agreement.*

Treas. Reg. § 53.4945-5(b)(3) provides that in order to meet the expenditure responsibility requirements of § 4945(h), a private foundation must require that each grant to an organization with respect to which expenditure responsibility must be exercised be made subject to a written commitment that clearly specifies the purposes of the grant and that includes an agreement by the grantee—

> (i) To repay any portion of the amount granted which is not used for the purposes of the grant,

(ii) To submit full and complete annual reports on the manner in which the funds are spent and progress made in accomplishing the purposes of the grant,

(iii) To maintain records of receipts and expenditures and to make its books and records available to the grantor at reasonable times, and

(iv) Not to use any of the funds—

(a) To carry on propaganda or otherwise to attempt to influence legislation,

(b) To influence the outcome of any specific public election, or to carry on any voter registration drive,

(c) To make any grant which does not comply with the requirements of § 4945(d)(3) or (4), or

(d) To undertake any activity for any purpose other than one specified in § 170(c)(2)(B).

The written commitment must be signed by an appropriate officer, director, or trustee of the grantee foundation.

As the copy of the Endowment Agreement includes the provisions described in § 53.4945-5(b)(3), and provided that R's president, as signer on behalf of R, qualifies as an "appropriate officer, director, or trustee," M has met the "written commitment" requirement under § 53.4945-5(b)(3).

*Issue 10: Whether the Transfer is a taxable expenditure under § 4945 if M exercises capital endowment grant expenditure responsibility over the assets transferred to R under the Endowment Agreement, but does not exercise expenditure responsibility with respect to the Assigned Grants or with respect to any Secondary Grants made by R to Secondary Grantees using the Grant Assets.*

I.R.C. § 4945(a)(1) imposes a tax on each taxable expenditure of a private foundation. Under § 4945(d)(4), the term "taxable expenditure" includes any amount paid or incurred by a private foundation as a grant to an organization (other than a public charity or exempt operating foundation) unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with § 4945(h).

Under § 4945(h), a private foundation will be considered to be exercising expenditure responsibility as long as it exerts all reasonable efforts and establishes adequate procedures—(1) to see that the grant is spent solely 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 Commissioner.

The transfer of the Grant Assets from M, a private foundation, to R, a private foundation, would be considered a taxable expenditure described in § 4945(d)(4) unless M exercises expenditure

responsibility with respect to the Grant Assets in accordance with § 4945(h). M will be considered to have exercised expenditure responsibility in accordance with § 4945(h) if, first, it has made the pregrant inquiry described in § 53.4945-5(b)(2), second, it has entered into a written grant agreement meeting the requirements of § 53.4945-5(b)(3), third, it requires reports from R on its use of the Grant Assets that meet the grantee reporting requirements of § 53.4945-5(c), fourth, it makes reports to the Service meeting the requirements of § 53.4945-5(d), and, fifth, in the event R diverts any of the Grant Assets (including the income therefrom) to any use not in furtherance of a purpose specified in the Endowment Agreement, or fails to make the reports required by § 53.4945-5(c), takes reasonable action in accordance with § 53.4945-5(e).

Issue 8, above, addresses the pregrant inquiry requirement under § 53.4945-5(b)(2).

Issue 9, above, addresses the written commitment requirement under § 53.4945-5(b)(3).

Under § 53.4945-5(c)(2), if a private foundation makes a grant described in § 4945(d)(4) to another private foundation, and the purpose of the grant is to increase the grantee's endowment, the grantor foundation must require reports from the grantee concerning the use of the principal and any income derived from the grant funds. The grantee must make such reports annually for its taxable year in which the grant was made and for the immediately succeeding two taxable years. Thereafter, the grantor may cease requiring such reports if it is reasonably apparent to the grantor that, before the end of such second succeeding taxable year, neither the principal, the income from the grant funds, nor the equipment purchased with the grant funds has been used for any purpose which would result in liability for tax under § 4945(d).

The Endowment Agreement requires R, as grantee, to submit an annual report to M as of the close of its taxable year in which the grant is made and all such subsequent periods until the grant assets are expended in full, the grant is otherwise terminated, or M has provided R with written notice that R may discontinue such reports under the conditions described in § 53.4945-5(c)(2).

M represents that it will make the required reports to the Service with respect to the transfer of the Grant Assets as required by § 53.4945-5(d).

Therefore, in light of the above, we conclude that the transfer of the Grant Assets to R would not be a taxable expenditure within the meaning of § 4945(d)(4) so long as M obtains reports from R on its use of the Grant Assets in accordance with § 53.4945-5(c)(2), submits annual reports to the Service in accordance with § 53.4945-5(d), and takes reasonable action regarding any noncompliance with the Endowment Agreement in accordance with § 53.4945-5(e).

Under § 53.4945-5(a)(6), a grant by a private foundation to a grantee organization which the grantee organization uses to make payments to another organization (a secondary grantee) is not regarded as a grant by the grantor foundation to the secondary grantee if the grantor foundation does not earmark the use of the grant for any named secondary grantee and there

exists no agreement whereby such grantor foundation may cause the selection of the secondary grantee by the grantee organization.

M represents that it has not earmarked the use of the Grant Assets for any named Secondary Grantee, and there exists no agreement, oral or written, whereby M may cause the selection of a Secondary Grantee by R. Rather, the Endowment Agreement assigns the duty to exercise discretion and control over the Secondary Grantee selection process to R, and requires R to enter into a grant agreement with each Secondary Grantee and to exercise expenditure responsibility with respect to any Secondary Grant. Therefore, M will not be treated as making a grant to any Secondary Grantee and need not exercise expenditure responsibility with respect to any Secondary Grant made by R.

While a private foundation cannot assign away its expenditure responsibility required under § 4945(d)(4), the recipients under Grant 1 and Grant 2 are both organizations described in § 501(c)(3) and are classified as public charities under § 509(a)(1). Accordingly, neither Grant 1 nor Grant 2 imposed upon M an obligation to exercise expenditure responsibility. M assigned all of its obligations, responsibilities, and duties with respect to the Assigned Grants to R. M and R have not presented any facts that would support the conclusion that Grant 1 or Grant 2 should become subject to expenditure responsibility by M where no such responsibility existed prior to the assignment of those grants to R. Accordingly, M is not required to exercise expenditure responsibility with respect to the Assigned Grants.

*Issue 11: Whether the legal, accounting, and other expenses paid by M and R to obtain this ruling and to effectuate the Transfer, if reasonable in amount, will constitute taxable expenditures under § 4945(d)(5).*

Under § 5945(d)(5), any amount paid or incurred by a private foundation for any purpose other than one specified in § 170(c)(2)(B) is a taxable expenditure subject to tax under § 4945(a). Under § 53.4945-6(b)(1), reasonable expenses with respect to program-related investments and other investments, and qualifying distributions under § 4942(g), are not treated as taxable expenditures under § 4945(d)(5). Conversely, under § 53.4945-6(b)(2), any expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under § 4945(d)(5).

The facts indicate that the Transfer is a reasonable transaction for legitimate stated purposes. Therefore, the administrative expenses to obtain the ruling and effectuate the Transfer, to the extent the amounts are reasonable, will not constitute taxable expenditures under § 4945(d)(5).

*Issue 12: Whether R will receive the benefit of any transitional rules that are applicable to M as a foundation in existence before January 1, 1970.*

M was organized prior to 1970, and funded, in part, with shares of N stock. The Grant Assets that M transferred to R include shares of N stock.

Under § 1.507-3(a)(8)(i), the general rule with respect to the Chapter 42 consequences of a § 507(b)(2) transfer is that the transferee foundation: (1) will not be treated as having been in

existence before January 1, 1970, with respect to the transferred assets; (2) will not be treated as having held the transferred assets before January 1, 1970; and (3) will not be treated as having engaged in, or become subject to, any transaction, lease, contract, or other obligation with respect to the transferred assets before January 1, 1970.

However, § 1.507-3(a)(8)(ii) provides that this general rule does not apply to the special rules or saving provisions contained in § 4940(c)(4)(B) (relating to basis of property), § 4942(f)(4) (relating to distributions of income), and section 101(1) of the Tax Reform Act of 1969.

Under Issue 2, above, we concluded that the transfer of the Grant Assets from M to R is a transfer of assets described in § 507(b)(2). Therefore R will receive the benefits of the saving provisions or provisional rules described in § 1.507-3(a)(8)(ii) that would have applied to M with respect to the transferred assets had the Transfer not been effected.

*Issue 13: Whether the Transfer will not constitute a willful and flagrant act (or failure to act) or one in a series of acts (or failures to act) that would cause M to incur any taxes under Chapter 42 of the Internal Revenue Code.*

The status of an organization as a private foundation may be involuntarily terminated under § 507(a)(2) if, with respect to the organization, 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.

Issue 4 addresses the application of § 4941 to the Transfer. Issue 7 addresses the application of § 4944 to the Transfer. Issue 10 addresses the application of § 4945 in connection with M's obligations under §§ 53.4945-5(c)(2), 53.4945-5(d), and 53.4945-5(e).

Furthermore, M represents that, to the best of its knowledge and belief, it has not committed willful repeated acts (or failures to act), nor has it committed any willful or flagrant act (or failure to act) that would give rise to liability for tax under Chapter 42 of the Internal Revenue Code. The Service has not notified M that it is liable for the tax imposed under § 507(c) as a result of any such acts (or failures to act).

Consequently, with respect to the issues discussed above, the Transfer will not constitute either a willful repeated act (or failure to act) or a willful and flagrant act (or failure to act) within the meaning of § 507(a)(2)(A).

Conclusions

In light of the foregoing, we rule as follows:

1. The Transfer will not adversely affect the tax exempt status of either M or R as an organization described in § 501(c)(3).

2. The Transfer qualifies as a transfer of assets described in § 507(b)(2). Accordingly, the Transfer will neither result in the termination of M's private foundation status under § 507(a) nor cause M to be subject to the tax imposed under § 507(c).

3. R will succeed to M's attributes and characteristics described in §1.507-3(a)(2), (3) and (4), including a fraction of M's aggregate tax benefit as determined under § 1.507-3(a)(2)(i).

4. Effectuating the Transfer and engaging in such actions as are necessary to effectuate the Transfer will not constitute an act of self-dealing within the meaning of § 4941.

5. M may not treat the Transfer as a qualifying distribution within the meaning of § 4942(g).

6. R may not use M's excess qualifying distributions as defined in § 53.4942(a)-3(e) to reduce its distributable amount under § 4942(d).

7. The Transfer will not constitute the investment of an amount in a manner as to jeopardize the carrying out of exempt purposes within the meaning of § 4944(a)(1).

8. M has met its pregrant inquiry requirement under § 53.4945-5(b)(2) so long as the findings of such inquiry would have caused a reasonable person to conclude that R will use the Grant Assets for the proper purposes.

9. M has met the "written commitment" requirement under § 53.4945-5(b)(3) by requiring R to enter into the Endowment Agreement.

10. The Transfer will not be a taxable expenditure within the meaning of § 4945(d) so long as M obtains reports from R on its use of the Grant Assets in accordance with § 53.4945-5(c)(2), submits annual reports to the Service in accordance with § 53.4945-5(d), and takes reasonable action regarding any noncompliance with the Endowment Agreement in accordance with § 53.4945-5(e). However, M need not exercise expenditure responsibility over the Assigned Grants or over any Secondary Grant made by R using the Grant Assets.

11. The legal, accounting, and other expenses paid by M and R to obtain this ruling and to effectuate the Transfer, if reasonable in amount, will not constitute taxable expenditures within the meaning of § 4945(d).

12. With respect to the Grant Assets, R will receive the benefit of any transitional rules as provided under § 1.507-3(a)(8)(ii) that may be applicable to M as a foundation in existence before January 1, 1970.

13. With respect to the Internal Revenue Code provisions and Regulations promulgated thereunder, as addressed in this letter, the Transfer will not constitute either a willful

repeated act (or failure to act) or a willful and flagrant act (or failure to act) within the meaning of § 507(a)(2)(A).

This ruling will be made available for public inspection under § 6110 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.

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 by others as precedent.

This ruling is based on the facts as they were presented, and on the understanding that there will be no material changes in these facts. This ruling 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. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representatives.

Sincerely,

Mary Jo Salins
Acting Manager, EO Technical

Enclosure
Notice 437