Two Key Revenue Rulings Provide a Road Map for Private Foundation Terminations

By Robert A. Wexler and Stephanie L. Petit

The Service has greatly simplified the issues affecting terminations of private foundation status, largely eliminating the need for practitioners to request letter rulings unless there are particularly complicated circumstances. Transfers to other private foundations or to public charities that are consistent with the various situations described by IRS are not likely to engender unfavorable tax consequences.

In Rev. Rul. 2002-28, 2002-20 IRB 921, and Rev. Rul. 2003-13, 2003-4 IRB 305, the IRS has given practitioners a user-friendly road map to help navigate the previously murky terrain of private foundation termination. For years, private foundations have been required to parse through the complex logic of Section 507 if they wished to transfer a substantial part of their assets to a "public charity," to convert to public charity status, to merge with another private foundation, to divide into two or more private foundations, or to engage in any other transaction involving a substantial shift in their assets.

Probably more often than necessary, practitioners representing private foundations sought private rulings in circumstances ranging from the complex to the seemingly simple. Because of Section 507's ambiguity and the interplay with Sections 4940 through 4945, the IRS had issued numerous letter rulings, some of which could be read to contradict one another. Now, Rev. Ruls. 2002-28 and 2003-13 have cleared the path in most situations and all but eliminated the need for the vast majority of letter rulings in this area.

BACKGROUND

Section 501(c)(3) organizations are presumed to be private foundations unless they can demonstrate that they fit into at least one of the nine categories in Sections 509(a)(1), with further reference to Sections 170(b)(1)(A)(i) through (vi) and Sections 509(a)(2) through (4). Practitioners and the IRS commonly refer to organizations that fit within one or more of these nine categories as "public charities," although the Code itself does not use that term.

Public charities include specific types of organizations, such as churches, schools, hospitals, and certain government entities, as well as two broad categories of organizations that receive at least one-third of their funds from the public at large or the government. Private foundations, by contrast, tend to receive funds from a single individual, family, or business. For that reason, private foundations are subject to a more restrictive set of operating rules, and donations to private foundations generally receive less favorable tax deduction treatment.

In order to understand Section 507, it is helpful to consider why the tax law favors public charities over private foundations. The Code distinguished among types of charities as early as 1943 by making foundation-like organizations file annual information returns. The Code continued to place various other restrictions on foundations in 1950 and 1954.[1]

The major reform, however, occurred in 1969, when Congress acted in response to what it perceived as "serious abuses by a minority of foundations."[2] One report to

ROBERT A. WEXLER is a principal in the San Francisco law firm of Silk, Adler & Colvin. He is editor of this department and a frequent contributor. STEPHANIE L. PETIT is an associate in the same firm.

Copyright © 2003, Robert A. Wexler and Stephanie L. Petit.

the House of Representatives, for example, criticized the use of foundations to escape estate taxes, to control businesses, to pay obligations to relatives, and to pay annuities, and called the Treasury a "toothless watchdog."[3]

An example of how some foundations could take advantage of their tax-exempt status was described as follows: "[C]ommercial business could capitalize a subsidiary only with after-tax dollars. However, if the company 'donated' tax-deductible money to a foundation, the foundation could set up or buy the same subsidiary for about half the price after taxes to the controlling company. Foundations could lease business assets to taxable subsidiaries which would pay the foundation tax-deductible rent. The rental income received by the foundation would not be taxable. The foundation could accumulate this tax-free income and reinvest or loan the money in the business it controlled."[4]

In TRA '69, Congress enacted a series of restrictive operating rules for private foundations, meant to curb such abuses. With some changes since their initial enactment, these rules are located in Subchapter A of Chapter 42. They include:

- A 2% excise tax on investment income.
- Extremely stringent restrictions on self-dealing.
- A requirement that private foundations annually distribute out at least 5% of their assets.
- A tax (effectively a restriction) on the private foundation's owning greater than 20% of a business enterprise.
- A tax on "jeopardizing investments" (those that jeopardize the organization's ability to carry out its exempt purposes).
- A tax if the private foundation makes a "taxable expenditure."[5] Taxable expenditures include private foundation expenditures for noncharitable purposes, for lobbying and political activity, and other grants that are made without following certain required procedures.

In Section 507, Congress sought to plug a hole but did not intend to prevent private foundations from making prudent business decisions.

The drafters of the 1969 legislation realized, however, that a private foundation still could circumvent these rules. A donor, for example, could make a major gift to a foundation sufficient to establish the foundation's endowment, and receive the charitable deduction. The foundation could then transfer its assets to, or itself become, an organization exempt from income tax under a different provision of the Code, such as Section 501(c)(4), i.e., an organization to which contributions are *not* deductible. In this way, a donor could still receive a deduction, the entity controlling the assets could continue to not pay income tax, and the private foundation operating rules could be ignored. Congress enacted Section 507, the private foundation termination provision, to preclude the possibility of such a situation.[6]

Under Section 507, an organization still can terminate its status as a private foundation and escape the stringent private foundation requirements—*if* it repays to the federal government the lesser of (1) all of the income, estate, and gift tax benefits that it and its substantial contributors ever received as a result of its exempt status, or (2) the foundation's net assets. In this way, Congress sought to plug the hole in the tax law through which it perceived that the precious funds for which donors received tax deductions could find their way out of the charitable stream. At the same time, Congress clearly did not intend to prevent private foundations from making prudent business decisions to close down the foundation, merge with another foundation, or split into two or more foundations.

PARSING SECTION 507

Section 507 provides that a private foundation can terminate its private foundation status and pay a termination tax in one of two ways, voluntarily or involuntarily:

- *Voluntary termination.* Under Section 507(a)(1), a private foundation can voluntarily notify the IRS of its intent to terminate its private foundation status and pay the termination tax.
- *Involuntary termination.* Under Section 507(a)(2), the Service can notify the private foundation that it is liable for the termination tax if "there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act) giving rise to liability for tax under chapter 42."

Section 507(b) then provides two ways in which a private foundation can terminate and not pay the termination tax. Under Section 507(b)(1)(A), the private foundation can distribute its net assets to a public charity that is (and has been continuously for at least 60 months prior to the transfer) a public charity under Section 509(a)(1). The private foundation's status as a private foundation terminates, without the termination tax. Under Section 507(b)(1)(B), if the private foundation itself meets *any* of the public charity tests under Section 509(a) (and not just Section 509(a)(1)) for 60 calendar months and notifies the IRS *before* the beginning of the 60-month period, its private foundation status terminates, again without the termination tax.

Section 507(b)(2) also states that if a private foundation transfers its assets to another private foundation "pursuant to any liquidation, merger, redemption, recapitalization, or other

NOTES

[1] See "Development of the Law and Continuing Legal Issues in the Tax Treatment of Private Foundations," prepared for the Subcommittee on Oversight of the House Ways and Means Committee, 98th Cong., 1st Sess. (WMCP 98-9, 1983).

[2] As described in "Report and Recommendations Concerning Federal Tax Rules Governing Private Foundations," 98th Cong., 1st Sess. (WMCP 98-14, 1983).

[3] WMCP 98-9, *supra* note 1, page 12.

[4] WMCP 98-14, *supra* note 2, page 12.

[5] Sections 4940 through 4945.

[6] Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1969* (JCS-16-70, 12/3/70).

adjustment, organization, or reorganization," the IRS will not treat the transferee private foundation as a newly created organization. In other words, the transferee private foundation will succeed to the tax benefits and detriments, the liabilities and the carryovers, of the transferor private foundation.[7]

The termination tax is imposed by Section 507(c), and is the lesser of the aggregate tax benefits the private foundation and its major donors ever received as a result of being exempt from tax under Section 501(c)(3), and the FMV of the private foundation's net assets.

Practitioners often sought private rulings on relatively straightforward fact patterns, simply because Section 507 is difficult to understand.

Sections 507(d), (e), and (f) further define the amount of the termination tax. More specifically, Section 507(d) defines the aggregate tax benefits, which include the tax that the private foundation would have paid on its income, the tax benefits to certain substantial contributors to the private foundation, and interest on both. Section 507(e) defines when the net assets of the private foundation are valued: the day on which the private foundation acts to terminate its private foundation status, or the day on which it ceases to be a private foundation, whichever yields the higher value. Under Section 507(f), for purposes of determining tax liability where the private foundation transfers assets, the tax is deemed imposed on the first day on which the transferor private foundation takes action to cease being a private foundation. Section 507(g) discusses tax abatement in limited circumstances.

Ambiguities

Section 507 has been a continual source of confusion for practitioners, who often have sought private letter rulings on relatively straightforward fact patterns, simply because of the difficulty of understanding Section 507 and the specific consequences of a private foundation merger or division.[8] As noted above, matters are complicated by the many letter rulings, some of which have seemingly similar fact patterns yet different results.

At the heart of the confusion is the very structure of Section 507 itself. The statute never comprehensively deals with the subject of private foundation terminations. First Section 507(a) offers two ways in which a private foundation can terminate and pay a tax (which in some instances will be zero), and then Section 507(b) offers two ways to terminate without paying the tax. Section 507(b) suggests, but never says, that a private-foundation-to-private-foundation transfer does not trigger a termination, and the statute is silent about when a private foundation must file a notice of termination.

Some of the specific issues that remained unclear until the Service issued the two new Revenue Rulings were:

- Is there ever a requirement that a private foundation notify the IRS of its intent to voluntarily terminate its private foundation status under Section 507(a)(1)?
- If a private foundation does not notify the IRS of its intent to terminate and is not notified by the IRS of a violation, does Section 507 somehow otherwise apply to impose a tax when a private foundation merges, divides, dissolves, or makes a substantial grant of its assets? A plain reading of Section 507 suggests that the answer is "no," but the sheer volume of ruling requests on this topic suggests that many practitioners were not comfortable with this reading of the Code.
- When a private foundation merges, divides, or makes a substantial grant to another private foundation, how do the Section 4942 rules apply to any excess distributions from prior years or to current-year distribution requirements? The Section 4942 Regulations provide some guidance, but the results of letter rulings on this issue have not always been consistent.
- When a private foundation merges, divides, or makes a substantial grant to another private foundation, how are outstanding grants that are subject to expenditure responsibility treated, for purposes of Section 4945, and is the transfer of assets as part of the merger or division itself subject to expenditure responsibility requirements? Again, the letter rulings have not provided a logical road map in their treatment of this issue.
- Section 507(b)(1)(A) provides that transfers to public charities described in Section 509(a)(1) that have been in existence for at least 60 months are not transfers that trigger a private foundation termination. Section 507(b)(1)(B) provides a way for a private foundation to convert to public charity status under Sections 509(a)(1), (a)(2), or (a)(3), and avoid a termination tax. The Code does not make clear what happens if a private foundation makes a transfer to a public charity other than one described in Section 509(a)(1) (e.g., Section 509(a)(2) or (a)(3)) and what happens if a private foundation makes a transfer to a Section 509(a)(1) public charity that has been in existence for less than 60 months.

THE NEW REVENUE RULINGS

The IRS clarified all of these questions in Rev. Ruls. 2002-28 and 2003-13.

Rev. Rul. 2002-28

In Rev. Rul. 2002-28, IRS posited three situations in which a private founda-

NOTES

[7] See Reg. 1.507-3.

[8] A congressional report on the study of the overall state of the federal tax system specifically used the example of letter ruling requests on the consequences of a merger under Section 507 to show inefficiency: "Not only are administrative resources tested and the quantity of issued guidance increased, but settled law may be undermined by creating the appearance of ambiguity in the law." "Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(b) of the Internal Revenue Code of 1986" (JCS-3-01, April 2001).

tion transfers its assets to other private foundations:

- Situation 1 concerns a private foundation which plans to dissolve and distribute its assets in equal shares to three other private foundations. One of the three agrees to exercise expenditure responsibility over all outstanding grants made by the distributor private foundation.
- In Situation 2, a charitable trust is a private foundation, but its trustees decide that its charitable purposes can be accomplished more effectively in corporate form. The trust's trustees create a nonprofit private foundation in corporate form for the purposes of carrying out the trust's activities, and transfer all of the trust's assets and liabilities to the new corporation.
- Situation 3 concerns two private foundations that confine their grantmaking activities to supporting charitable programs in the areas in which they are located. To eliminate the costs of maintaining two private foundations with identical charitable purposes, both private foundations transfer their assets to a third, newly created private foundation.

The Ruling also tells us that in all three situations, the same person who effectively controls the transferor private foundations directly or indirectly controls the transferee private foundations. The Section 507 Regulations look to the Section 482 Regulations for the definition of "effectively controlled."

None of the private foundations has committed the willful repeated acts or failures to act that would trigger a tax under Chapter 42, and none of them has transferred its assets to a public charity or has itself become a public charity. All the transferor private foundations have grants over which they must exercise expenditure responsibility. And last, none are private operating foundations. Thus, the Ruling confines itself to the situation in which a private foundation transfers assets to another private foundation, both of which are controlled by the same persons.

The Ruling asks four questions about each of the three situations.

Is notification to IRS required? The first question is whether a private foundation that transfers all of its assets to another private foundation or foundations is required to notify the IRS that it plans to terminate its private foundation status and pay the termination tax under Sections 507(a) and (c). The answer is no.

If the private foundation does not provide notice and does not terminate, it retains its private foundation status and is not at that time subject to the termination tax. If it chooses to provide notice (thereby terminating), it is subject to the termination tax on the date that it gives notice. If it already has transferred its assets when it provides the notice, however, the termination tax will be zero because the net value of its assets is zero.

What are the filing obligations after the transfer? The Ruling next asks what a private foundation's tax return filing obligations are after it transfers all of its assets to a private foundation or foundations. In the year of the transfer, the distributing private foundation must file a Form 990-PF for the tax year of the transfer, but none for subsequent years during which it does not have title to any assets and does not engage in any activity.

If, in later years, the transferor foundation receives additional assets or resumes activities, it must resume filing a Form 990-PF for those tax years in which it has assets or activities. It continues to be treated as a private foundation until later terminated.

Do the private foundation excise taxes apply? The third question the Ruling asks is what happens when a private foundation transfers all of its assets to a private foundation or foundations that are directly or indirectly controlled by the same person or persons under Sections 4940 through 4945.

Section 4940: Tax on net investment income. Although private foundations as tax-exempt organizations do not generally pay an income tax, under Section 4940 they must pay an annual excise tax equal to 2% of investment income, which can be reduced to 1% under some circumstances. Rev. Rul. 2002-28 tells us that the transactions described in each of the three situations do not give rise to net investment income under Section 4940, because none of the transfers constitutes investments of the transferor. Thus, no net investment income tax is due.

The statute suggests, but never says, that a private-foundation-to-private-foundation transfer does not trigger a termination.

In addition, because the same persons effectively control the transferor and transferee(s), any excess taxes paid by the transferor under Section 4940 can be used by the transferees to offset their own Section 4940 tax liability. In Situation 1, where there is more than one transferee, the transferee private foundations succeed to the right to offset their own taxes by any excess taxes paid by the transferor in proportion to the assets they have received from the transferor—in that situation, equally. Correspondingly, if the transferor were subject to excise tax, the transferees would receive the assets subject to the transferor foundation's liabilities on them.

Section 4941: Prohibition on self-dealing. Section 4941 contains extremely broad rules prohibiting many transactions between a private foundation and "disqualified persons" of the foundation. These typically are substantial contributors, officers, directors, trustees, or anyone having equivalent responsibilities or powers, anyone owning more than 20% of an entity that is a substantial contributor, and a family member of any of the preceding. The Ruling tells us that none of the three situations is a self-dealing transaction under Section 4941, because Section 501(c)(3) organizations are not disqualified persons for purposes of the self-dealing rules.

Section 4942: Minimum payout requirement. Private foundations generally must distribute each year an amount equal to 5% of the FMV of their assets.

The Ruling provides that because the transferee private foundations are treated as though they were the transferor (because they are commonly controlled), the asset transfer is not a qualifying distribution to the transferor foundation under Section 4942. One could infer from the Ruling that a transfer by a private foundation to another private foundation not under common control would constitute a qualifying distribution under Section 4942, but such a reading is not really consistent with Section 4942 (despite some obscure language in Reg. 1.507-3(a)(5)).

In addition, because in the Ruling the same persons effectively controlled the transferor and transferee(s), each transferee foundation assumed all obligations with respect to the transferor's undistributed income, or, if the transferor had excess qualifying distributions, reduced its own distribution requirement. Where there are multiple transferees as in Situation 1, the recipient private foundations become proportionally responsible for the transferor's undistributed income or proportionally succeed to the transferor's excess qualifying distributions. In Situation 1, each transferee private foundation would be responsible for one-third of the transferor's qualifying distributions, or succeed to one-third of the transferor's excess qualifying distributions, because they each received one-third of the transferor private foundation's assets.

Section 4943: Excess business holdings. Under Section 4943, a private foundation and its disqualified persons together may own no more than a 20% interest in a business enterprise. Because a private foundation may receive holdings in excess of 20% by gift or bequest, for example, Section 4943 also provides a timeframe in which the private foundation must divest itself of the holdings. The Ruling explains that whether the transfer subjects the transferee private foundation to a tax under Section 4943 depends on the facts and circumstances.

In the three situations at issue, the same persons controlled the transferor and the transferee. As a result, the disqualified persons and substantial contributors of the transferor and transferee foundations were determined as if the transferee were the transferor. Similarly, the transferor's holding period of the assets is tacked on to the transferee's in determining whether the transferee is subject to tax under Section 4943.

Section 4944: Jeopardizing investments. Section 4944 provides that a private foundation investing in a manner likely to jeopardize its ability to carry out its exempt purposes is subject to a tax. According to the Ruling, however, the transfers discussed are not investments. As such, they were not investments that would jeopardize the transferor foundation's exempt purposes under Section 4944.

Section 4945: Taxable expenditures. A taxable expenditure is any expenditure that a private foundation is not allowed to make. Among other examples, it includes lobbying as defined in Section 4945(e), attempting to influence an election, making grants to individuals for travel, study, or similar purposes unless certain grantee selection procedures are met, and grants to organizations that are not public charities unless the foundation exercises specific oversight called expenditure responsibility. Section 4945 imposes penalties on private foundations that make taxable expenditures, as well as on any private foundation manager who knowingly participated in its making.

Because in each situation in Rev. Rul. 2002-28 the transferees were treated as the transferors, distribution of the assets to the transferees was not a taxable expenditure and no expenditure responsibility had to be exercised over the transfers. Presumably, if the transferor and transferee were not effectively controlled by the same persons, the transfer would require expenditure responsibility reporting, at least as long as the transferor held some assets and remained in existence.

Nevertheless, for any outstanding grants of the transferor over which it still must exercise expenditure responsibility oversight, the transferee foundations must assume this oversight. In Situation 1, one transferee agreed to take over this responsibility, relieving the other two of any obligations. Had there not been such an agreement, however, the Ruling tells us that all three of them would have been required to exercise expenditure responsibility with respect to *all* of the transferor's outstanding grants.

What happens to aggregate tax benefits? Last, the Ruling asks what the implications are for the transferor foundation's aggregate tax benefits, under Section 507(d). The IRS answers that the transferor's aggregate tax benefits are transferred to the transferee foundations, in proportion to the assets transferred to each transferee. This means that if the transferee private foundations terminate in the future, their termination taxes will include the tax benefits enjoyed by the transferor foundation. The termination tax is deferred, rather than excused as is the case of a transfer to certain public charities.

Rev. Rul. 2003-13

Rev. Rul. 2002-28 clarified many of the requirements and consequences of a private foundation distributing its assets to another commonly controlled private foundation. Rev. Rul. 2003-13, using four situations, does the same for a private foundation's distribution of assets to a public charity.

- Situation 1 concerns a private foundation that dissolves and distributes its net assets to a public charity described in Section 509(a)(1), which has been so described for at least 60 consecutive calendar months. (Section 509(a)(1) (by reference to Section 170(b)(1)(A)) describes two main types of public charities—(1) those that are public charities by the nature of their activities, most frequently churches, schools, hospitals, and medical research organizations, and (2) public charities that receive financial support from a broad donor base, determined by a relatively complex mathematical test.)
- Situation 2 is the same as Situation 1, except that the recipient Section 509(a)(1) public charity has been

Practice Notes

Practitioners representing private foundations in terminations should look first to the two Revenue Rulings and strongly consider reserving private letter ruling requests for only those complex scenarios not covered by one of the new Rulings, for example, where the transferee and transferor are not under common control or where there is a factual question about whether common control exists.

in existence for fewer than 60 calendar months immediately preceding the private foundation's distribution of assets to it. The recipient public charity was not formed by a consolidation of other organizations described in Section 509(a)(1) that would have been in existence for a continuous period of 60 calendar months prior to the distribution.

- Situation 3 is the same as Situation 1, except that Section 509(a)(2), not Section 509(a)(1), describes the public charity. Like Section 509(a)(1), Section 509(a)(2) also describes organizations that receive financial support from a broad donor base, but is more typically used for charities that depend on income from the performance of their exempt functions. This includes, for example, income from the sale of educational materials, or admission fees for musical or theatrical performances. The organization must receive at least one-third of its total support from diverse sources, which includes donors and consumers of its exempt-purpose goods or services, and it must not derive more than one-third of its total support from investment income.
- Situation 4 is the same as Situation 1, except that Section 509(a)(3) describes the public charity. A Section 509(a)(3) public charity is called a "supporting organization," because it is organized and operated to support other public charities. Unlike Section 509(a)(1) and Section 509(a)(2) public charities, it need not monitor its sources of financial support.

The Ruling also stipulates that in all four situations, the private foundation had not committed the willful repeated acts or failures to act that would trigger a tax under Chapter 42. None of the private foundations was a private operating foundation under Section 4942(j)(3). None previously terminated its private foundation status, or had such status terminated. None imposed any material restrictions on the transferred assets. (Reg. 1.507-2(a)(8)(i) describes these material restrictions, and they include situations in which the public charity was not the absolute owner of the assets, the public charity did not hold the assets or administer them for its exempt purposes, the governing body of the public charity lacked the ultimate authority and control over the assets and their income, and the public charity's governing body was organized and operated so as not to be independent from the transferor.)

All the transferor private foundations retained sufficient income or assets to pay any Chapter 42 taxes, such as the excise taxes on investment income described above, for the portion of the tax year prior to the distribution, and they paid the taxes when due. Neither the private foundations nor their disqualified persons controlled the recipient public charities. The public charities retained their public charity classification for at least three years following the distributions.

The Ruling asks just two questions—(1) whether a private foundation that distributes all of its net assets to one or more public charities has terminated its foundation status and is liable for tax under Section 507(c), and (2) if a private foundation transfers all of its assets to a public charity, what are the consequences under Sections 4940, 4941, 4942, 4943, 4944, and 4945, respectively?

Question 1: Does a transfer to a public charity terminate private foundation status? The answer is no in each instance, but the different situations are instructive.

Situation 1. According to Rev. Rul. 2003-13, an organization's private foundation status terminates when it distributes all of its net assets to a Section 509(a)(1) public charity or charities that have been in existence and classified as Section 509(a)(1) public charities for the 60 months immediately preceding the distribution. The distributor private foundation in Situation 1 therefore does not need to give notice to the IRS, and is not subject to the termination tax. This example is clearly dealt with in the Code, and therefore Situation 1 is designed simply to reiterate what we already know.

Situations 2, 3, and 4. The next three situations are not addressed at all in Section 507. The Ruling provides that distribution to a public charity described by Section 509(a)(1) but for less than 60 months (as in Situation 2), to a public charity described in Section 509(a)(2) (as in Situation 3), or to a public charity described in Section 509(a)(3) (as in Situation 4) yield a different, but equally workable result, from that in Situation 1. In these situations, the distributing private foundation's status as a private foundation is not terminated unless it gives notice to the IRS.

If it chooses to provide notice and to terminate, it is subject to the termination tax, and its statement to the IRS must set forth the computation and amount of the termination tax. If it provides notice even one day after it distributes its net assets, however, the tax imposed by Section 507(c) will be zero. But if the private foundation does not provide notice and does not terminate, the private foundation is not subject to the termination tax at all. All this is true, even if the private foundation distributes its assets to numerous public charities, all but one of which are described under Section 509(a)(1) and have been so for 60 continuous months.

The Ruling, therefore, provides the comfort that practitioners need—private foundations may make liquidating distributions to public charities described in Sections 509(a)(1), (a)(2),

and (a)(3), without penalty, regardless of how long the public charity has been in existence.

Question 2: What are the consequences under Sections 4940, 4941, 4942, 4943, 4944, and 4945? In light of the answer to the first question, the results here are relatively obvious but nonetheless comforting.

Section 4940: Tax on net investment income. Distributions by the private foundation to each of the public charities in all four situations do not constitute an investment. As such, the distributions do not give rise to net investment income to the transferor under Section 4940.

Section 4941: Prohibition on self-dealing. As in Rev. Rul. 2002-28 above, because the recipient of the assets in each situation is a Section 501(c)(3) organization, which is not a disqualified person for purposes of Section 4941, the distributions are not self-dealing transactions subject to the Section 4941 tax.

Section 4942: Minimum payout requirement. The transfers *are* qualifying distributions under Section 4942, because they are made to public charities and are not self-dealing transactions.

Section 4943: Excess business holdings. The distributions do not cause the private foundation to have excess business holdings because it is transferring and not receiving assets.

Section 4944: Jeopardizing investments. The distributions are not investments at all for purposes of Section 4944, and so are not jeopardizing investments.

Section 4945: Taxable expenditures. These are distributions the private foundation is allowed to make—they are distributions to public charities described in Sections 509(a)(1), (a)(2), and (a)(3). They are not taxable expenditures, and the private foundation has no obligation to exercise expenditure responsibility.

CONCLUSION

The two new Revenue Rulings should dramatically eliminate the need for private letter rulings in this area and free up IRS personnel to deal with more complex issues. Practitioners still might seek a letter ruling from the Service in complex fact patterns with respect to whether a particular transferee private foundation is deemed to be "effectively controlled" by the same persons who control the transferor foundation. In addition, because Rev. Rul. 2002-28 poses a set of facts in which the transferor and transferee are effectively controlled by the same persons, practitioners still might request rulings in the less-usual situation in which the transferee and transferor are unrelated private foundations. A series of letter rulings address some of these issues,[9] and more formal guidance from the Service would always be welcome. ■

NOTES

[9] See Ltr. Ruls. 9326062and 8813073.

Services and Information

THE JOURNAL OF TAXATION

TO ORDER

Subscription Department .... 1-800-950-1216, ext. 1
FAX 1-800-452-9009
E-mail .... orders@riag.com
Internet .... http://www.riahome.com/riajournals
Or mail to:
RIA
117 East Stevens Avenue
Valhalla, NY 10595

CUSTOMER SERVICE

Billing Inquiries, Back Issues,
and Change of Address .... 1-800-431-9025, option 2
Internet .... http://www.riahome.com
Or send correspondence to the above address.

TO PLACE AN AD

Display or
Classified Advertising 800-322-3192
FAX 651-687-7374

EDITORIAL INQUIRIES

Address to: The Journal of Taxation
RIA
395 Hudson Street, 4th floor
New York, NY 10014 212-807-2195
FAX 212-337-4186
E-mail .... joseph.graf@riag.com

PERMISSION TO PHOTOCOPY

Contact: Copyright Clearance Center 978-750-8400
FAX 978-750-4744
Or mail to:
222 Rosewood Drive
Danvers, MA 01923

THE JOURNAL OF TAXATION is available on the Internet as part of RIA's CHECKPOINT System.