



Exempt Organizations Technical Guide

TG 62: Excise Taxes on Taxable Expenditures - IRC Section 4945

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I. Overview

- (1) Organizations that are exempt from taxation under Section 501(c)(3) of the Internal Revenue Code (Code) and do not fall into any of the public charity categories under Section 509(a) are called private foundations. Private foundations raise complex and interrelated issues regarding the application of Chapter 42.

A. Background / History

- (1) Under Chapter 42, excise taxes are imposed pursuant to Section 4945 with respect to taxable expenditures made by private foundations and certain trusts subject to Chapter 42.
- (2) Congress enacted Section 4945, part of the Tax Reform Act of 1969 (P.L. 91-172), to curb perceived abuses of private foundations. The perceived abuses included the following:
 - a. Attempting to influence legislation;
 - b. Engaging in political activities;
 - c. Distributing funds to individuals for use in vacations and interludes between jobs;
 - d. Subsidizing the preparation of materials furthering specific political viewpoints;
 - e. Failing to have adequate controls to ensure that the funds be used exclusively for exempt purposes.
- (3) Section 4945 curbs abuse not covered by the other remedial provisions of Chapter 42. See background and general explanation of Section 4945 in General Explanation of the Tax Reform Act of 1969 (Blue Book), prepared by the Staff of the Joint Committee on Internal Revenue Taxation, December 3, 1970. Some transactions, however, may result in Section 4941 tax in addition to Section 4945 tax. See Rev. Rul. 77-161, 1977-1 C.B. 358.
- (4) The Pension Protection Act of 2006, Public Law 109-280 ("PPA 2006"), Section 1212, also amended the Code for Chapter 42 excise taxes. Most of the first tier excise tax rates, as well as the limits on foundation manager taxes were doubled. The amendments apply to excise taxes imposed by Section 4945.
- (5) Regarding the filing requirements for private foundations, for tax years beginning on or after July 2, 2019, Section 3101 of Public Law 116-25 requires that returns by exempt organizations be filed electronically. If an organization is filing Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation, for a tax year beginning on or after July 2, 2019, the organization must file the return electronically. Limited exceptions apply.

- (6) Electronic filing requirements have not changed for Form 990-PF filers with tax years beginning before July 2, 2019 (which includes calendar year 2019 Forms 990-PF). Required electronic filing for calendar year filers applies for tax years beginning in 2020 and later.
- (7) There are new reporting standards for net assets, and Part II of Form 990-PF was updated to reflect the Financial Accounting Standard Board's (FASB's) reclassification of net assets into two classes, net assets without donor restrictions and net assets with donor restrictions.
- (8) The Taxpayer Certainty and Disaster Tax Relief Act passed on December 20, 2019, included legislation that reduced the 2% excise tax on net investment income of private foundations to 1.39%. At the same time, the legislation repealed the 1% special rate that applied if the private foundation met certain distribution requirements. The changes are effective for taxable years beginning after December 20, 2019.
- (9) For tax years beginning in 2020, an individual liable for a Chapter 42 excise tax does not have the option to file jointly with the organization with respect to which the excise tax relates. Beginning with tax year 2020, Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the IRC, has been revised to identify whether the filer is the organization or an individual. Accordingly, for tax years after 2019, an agent preparing Form 4720 to report individual excise tax liability during an examination will no longer convert Form 4720 to "Form 4720-A." The revenue agent will, instead, complete Form 4720 identifying the filer as an individual as described in the instructions for Form 4720.

B. Relevant Terms

- (1) **Correction:** Defined in Section 4945(i)(1) as, with respect to any taxable expenditure, (A) recovering part or all of the expenditure to the extent recovery is possible, and where full recovery is not possible such additional corrective action as is prescribed by the Secretary by regulations, or (B) in the case of a failure to comply with Section 4945(h)(2) or (3), obtaining or making the report in question.
- (2) **Expenditure Responsibility:** Defined in Section 4945(h) as the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures:
 - a. To see that the grant is spent solely for the purpose for which made,
 - b. To obtain full and complete reports from the grantee on how the funds are spent, and
 - c. To make full and detailed reports with respect to such expenditures to the Secretary.
- (3) **Taxable Expenditure:** Defined in Section 4945(d) as any amount paid or incurred by a private foundation:

- 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, directly or indirectly, any voter registration drive,
 - c. As a grant to an individual for travel, study, or other similar purposes by such individual,
 - d. As a grant to an organization unless such organization is described in Section 509(a)(1) or Section 509(a)(2), is an organization described in Section 509(a)(3) (other than an organization described in clause (i) or (ii) of Section 4942(g)(4)(A)), is an exempt operating foundation, or the private foundation exercises expenditure responsibility with respect to such grant, or
 - e. For any purpose other than one specified in Section 170(c)(2)(B).
- (4) **Taxable Period:** Defined in Section 4945(i)(2) as, with respect to any taxable expenditure, the period beginning with the date on which the taxable expenditure occurs and ending on the earlier of (A) the date of mailing a notice of deficiency with respect to the tax imposed by Section 4945(a)(1) under Section 6212, or (B) the date on which the tax imposed by Section 4945(a)(1) is assessed.

C. Law / Authority

- (1) Section 4945 was enacted to deter private foundations from making inappropriate expenditures. Excise taxes are imposed on private foundations and their managers for expenditures that fall within the definition of "taxable expenditures." Nonexempt charitable trusts treated as private foundations under Section 4947(a)(1) and split-interest trusts described in Section 4947(a)(2) are also subject to Section 4945, except as provided under Section 4947.
- (2) There are five categories of taxable expenditures. Taxable expenditures are amounts paid or incurred by private foundations:
 - a. To carry on propaganda, or otherwise attempt to influence legislation (Section 4945(d)(1));
 - b. To influence the outcome of any specific public election, or to carry on a partisan voter registration drive (directly or indirectly) (Section 4945(d)(2));
 - c. As a grant to an individual for travel, study, or other similar purposes, unless the grant meets certain requirements (Section 4945(d)(3));
 - d. As a grant to an organization unless such organization is a public charity or unless the grantor private foundation exercises "expenditure responsibility" over the grant (Section 4945(d)(4)); and
 - e. For any purpose other than one specified in Section 170(c)(2)(B) (specifically religious, charitable, scientific, literary, or educational purposes, to foster certain amateur sports competition, or for the prevention of cruelty to children or animals) (Section 4945(d)(5)).

- (3) If a private foundation makes an expenditure that falls within the definition of any of these categories of taxable expenditures, Section 4945(a)(1) imposes an excise tax that is to be paid by the private foundation. When the private foundation is subject to the Section 4945(a)(1) tax, its managers may also be subject to initial excise taxes under Section 4945(a)(2) if they know that an expenditure is a taxable expenditure and agree to make such taxable expenditure. However, this initial tax is not applicable if the agreement to make such taxable expenditure is not willful and is due to reasonable cause. The taxes described in Sections 4945(a)(1) and (a)(2) are known as "first tier" taxes.
- (4) An additional excise tax of much greater severity is imposed under Section 4945(b)(1) on the private foundation if it fails to correct the taxable expenditure within the taxable period. Section 4945(b)(2) taxes are imposed on the foundation managers if they refuse to agree to part or all of the correction. The taxes described in Section 4945(b)(1) and (b)(2) are known as "second tier" taxes. This two tier tax structure is parallel to the tax sanctions imposed under Sections 4941 through 4944, although taxes on managers are only imposed under Sections 4941, 4944, and 4945. If the private foundation repeatedly or flagrantly violates Section 4945, the IRS may terminate its status. Such action may make the private foundation liable for termination tax under Section 507(c).
- (5) A private foundation exempt from federal income tax under Section 501(c)(3) cannot, as a substantial part of its activities, carry on propaganda or otherwise attempt to influence legislation. The definition of substantiality is irrelevant for purposes of Section 4945. Any amount spent or incurred by a private foundation in an attempt to influence legislation is a taxable expenditure under Section 4945. A private foundation may also lose its exempt status if the legislative activity is substantial, resulting in status as a taxable private foundation (still subject to Section 4945).
- (6) Private foundations are not permitted to make the Section 501(h) election and be covered by the lobbying expenditures tests under Section 4911, although regulations under Sections 4911 and 4945 share some rules for determining lobbying expenditures.

II. Requirements

- (1) Generally, Section 4945 contains excise taxes to discourage private foundations from engaging in legislative and political activities, making grants to individuals without prior approval of the IRS, making grants to organizations (other than public charities) without exercising adequate control and supervision over the use thereof, and providing grants for noncharitable purposes.

A. Attempting to Influence Legislation (Lobbying)

- (1) Section 4945(d)(1) provides that a taxable expenditure includes any amount paid or incurred by a private foundation to carry on propaganda or otherwise to attempt to influence legislation, also known as lobbying. Treasury Regulation (Treas. Reg.) 53.4945-2(a)(1) lists two types of activities that constitute lobbying. They are:
 - a. Grassroots lobbying (or indirect lobbying), and
 - b. Direct lobbying.

A.1. Grassroots Lobbying

- (1) Grassroots lobbying or indirect lobbying is communication that attempts to influence the opinion of the general public, or any segment of the general public about legislation. Forms of communications include propaganda and other materials affecting public opinion.
- (2) A communication is a grassroots lobbying communication if it:
 - a. Refers to specific legislation;
 - b. Reflects a view on the legislation; and
 - c. Encourages the recipient of the communication to take action with respect to the legislation. See Treas. Regs. 53.4945-2(a)(1) and 56.4911-2(b)(2)(ii).
- (3) The specific rule for communications with members under Section 4911 generally does not apply to private foundations. See Treas. Reg. 53.4945-2(a)(2).

A.2. Direct Lobbying

- (1) Direct lobbying involves the attempts to influence legislation through communications with members or employees of a legislative body or other government officials or employees who may participate in the formulation of legislation, but only if the principal purpose of the communication is to influence legislation. These communications include attempts to influence the legislative process through the discussion with or presentation of materials to members of a legislative body. See Treas. Regs. 53.4945-2(a)(1) and 56.4911-2(b)(1).
- (2) A communication is a direct lobbying communication if it:
 - a. Refers to specific legislation; and

- b. Reflects a view on the legislation. See Treas. Regs. 53.4945-2(a)(1) and 56.4911-2(b)(1)(ii).

Example: A private foundation that communicates its support for or opposition to a specific legislative proposal through an oral or written statement presented to a member of a legislative body is attempting to influence legislation within the meaning of Sections 4945(d)(1) and 4945(e)(2).

- (3) As with grassroots lobbying, a private foundation's communication with a member of a legislative body need not expressly support or oppose the legislative proposal under consideration for Sections 4945(d)(1) and 4945(e)(2) to apply.

Example: The presentation of a partisan analysis of a proposed bill to a member of the legislature may constitute an attempt to influence legislation.

- (4) Direct lobbying activities are not limited to communications or conversations with the members of a legislative body. Lobbying communications directed toward other governmental officials who participate in the formulation of legislation may be classified as direct lobbying but only if the principal purpose of the communication is to influence legislation. See Treas. Reg. 56.4911-2(b)(1)(i)(B).
- (5) Lobbying communications to the voting public with respect to a ballot initiative or similar procedure constitute direct (not grassroots) lobbying communications. See Treas. Reg. 56.4911-2(b)(1)(iii). Such was the case in *Parks v. Commissioner*, 145 T.C. 278 (2015), *aff'd sub nom.*, *Parks Foundation v. Commissioner*, 717 F. App'x 712 (9th Cir. 2017), which provides a good analysis of lobbying and identifying what is a "lobbying communication." In this case, a private foundation provided funding for radio advertisements regarding a ballot measure in Oregon. Upon completing the examination, the agent advised the foundation the expenditures were taxable. The foundation argued that, except for the two radio messages that specifically referred to a ballot measure by name, the radio messages were not direct lobbying communications because they did not "refer to" the ballot measures by mentioning any ballot measure by name. The IRS argued that a communication can "refer to" a ballot measure without identifying it by name. The court agreed with the IRS.
- (6) The pertinent regulations examples address grass roots lobbying but are equally applicable in the case of direct lobbying. Treas. Reg. 56.4911-2(b)(4)(ii)(B), Example (1) provides that a pamphlet distributed by organization Y states that the "President's plan for a drug-free America," which will establish a drug control program, should be passed. The pamphlet encourages readers to "write or call your senators and representatives and tell them to vote for the President's plan." No legislative proposal formally bears the name "President's plan for a drug-free America," but that and similar terms have been widely used in connection with specific legislation pending in Congress that was initially proposed by the President. Thus, the pamphlet refers to specific legislation, reflects a view on the legislation, and encourages readers to act with respect to the legislation. The pamphlet is a grass roots lobbying communication.

- (7) By contrast, Treas. Reg. 56.4911-2(b)(4)(ii)(A), Example (4) indicates a pamphlet distributed by organization Z discusses the dangers of drugs and encourages the public to send their legislators a coupon, printed with the statement "I support a drug-free America." The term "drug-free America" is not widely identified with any of the many specific pending legislative proposals regarding drug issues. The pamphlet does not refer to any of the numerous pending legislative proposals, nor does the organization support or oppose a specific legislative proposal. The pamphlet is not a grass roots lobbying communication.
- (8) Finally, Treas. Reg. 56.4911-2(d)(1)(iii), Example (1) provides that a non-membership organization includes in its newsletter an article about problems with the use of pesticide X that states in part: "Legislation that is pending in Congress would prohibit the use of this very dangerous pesticide. Fortunately, the legislation will probably be passed. Write your congressional representatives about this important issue." This is a grass roots lobbying communication that refers to and reflects a view on specific legislation and that encourages recipients to act with respect to that legislation.
- (9) On the basis of the principles illustrated in the regulatory examples, the Tax Court held that a communication "refers to" a ballot measure within the meaning of the regulations if it either refers to the measure by name or, without naming it, employs terms widely used in connection with the measure or describes the content or effect of the measure. *Parks v. Commissioner*, 145 T.C. 278 (2015), *aff'd sub nom., Parks Foundation v. Commissioner*, 717 F. App'x 712 (9th Cir. 2017).

A.3. Legislation Defined

- (1) Legislation is defined to include the following:
- a. Action by the Congress, any State legislature, any local council, or similar legislative body, or by the public in a referendum, ballot initiative, constitutional amendment, or similar procedure. See Treas. Reg. 56.4911-2(d)(1).
 - b. Action by Indian tribal governments is also within the definition of legislation since Indian tribal governments are treated as state governments pursuant to Section 7871 for purposes of Sections 4911 and 4945. See Section 7871(a)(7) and Treas. Reg. 305.7871-1(a)(8) and (9).
 - c. Proposed treaties to be submitted by the President to the Senate for its advice and consent from the time the President's representative begins to negotiate its position with the prospective parties to the proposed treaty. See Treas. Reg. 56.4911-2(d)(1)(i).
 - d. Foreign as well as domestic laws. See Rev. Rul. 73-440, 1973-2 C.B. 177.
 - e. Actions during a legislative confirmation process, considering nominees for certain non-elected government offices, such as judgeships and executive

cabinet positions, constitute attempts to influence legislation within the meaning of Section 4945(d)(1). See Notice 88-76, 1988-2 C.B. 392.

- (2) The definition of legislation does not include action by executive, judicial, or administrative bodies such as school boards, housing authorities, sewer and water districts, zoning boards, and other similar federal, state, and local bodies whether elective or appointive. See Treas. Reg. 56.4911-2(d)(3) and (4).
- (3) The definition of action is limited to the introduction, amendment, enactment, defeat, or repeal of Acts, bills, resolutions, or similar items. See Treas. Reg. 56.4911-2(d)(2).
- (4) Specific legislation, under Treas. Reg. 56.4911-2(d)(1)(ii), includes:
 - a. Legislation that has already been introduced in a legislative body; and
 - b. A specific legislative proposal that an organization either supports or opposes.
- (5) As to a referendum, ballot initiative, constitutional amendment, or other measure that is placed on the ballot by petitions signed by a required number or percentage of voters, an item becomes specific legislation when the petition is first circulated among voters for signature. See Treas. Reg. 56.4911-2(d)(1)(ii).
- (6) Specific legislation is illustrated by the following example.

Example: A private foundation based in State A states in its newsletter that State Z has passed a bill and that State A should pass such a bill. The organization urges readers to write their legislators in favor of such a bill. No such bill has been introduced into the legislature of State A. However, the private foundation has cited to and given its view on a specific legislative proposal. Further, the private foundation has encouraged its readers to act thereon. Consequently, the bill is considered specific legislation. See Treas. Reg. 56.4911-2(d)(1)(iii).

A.4. Exceptions to the Prohibition on Lobbying

- (1) Section 4945(e) and Treas. Reg. 53.4945-2(d) provide that certain activities specifically be excepted from the prohibition of attempting to influence legislation or lobbying. These permissible activities include the following:
 - a. Providing nonpartisan analysis, study, or research to the general public or legislative officials;
 - b. Examinations and discussions of broad social, economic, and similar problems;
 - c. Providing technical advice or assistance to a requesting legislative body; and
 - d. Self-defense communications – communications to a legislative body concerning a decision which might affect the private foundation’s existence, powers and duties, tax-exempt status, or deductibility of contributions.

A.5. Nonpartisan Analysis, Study, or Research – Defined

- (1) Probably the most important single exception permits private foundations to engage in any nonpartisan analysis, study, or research (which includes educational activities) and to distribute the results of these activities to the general public and legislative officials. See Treas. Reg. 53.4945-2(d)(1)(ii). The reason for the exception is that Congress did not want to discourage the educational activities of private foundations.
- (2) A nonpartisan analysis, study, or research is an objective and independent exposition of a particular subject matter. A study may advocate a position or viewpoint so long as there is a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion. However, where an analysis, study, or research merely presents unsupported opinion, distorted facts, inflammatory and disparaging terms, or conclusions based more on strong feelings rather than objective factual evaluations, it is not educational and nonpartisan. See Treas. Reg. 53.4945-2(d)(1)(ii), Rev. Proc. 86-43, 1986-2 C.B. 729, and *Parks v. Commissioner*, 145 T.C. 278 (2015), *aff'd sub nom.*, *Parks Foundation v. Commissioner*, 717 F. App'x 712 (9th Cir. 2017).
- (3) A nonpartisan analysis, study, or research may also contain findings or recommendations supporting or opposing specific legislation or proposed legislation so long as it contains a sufficiently full and fair exposition of all relevant facts to enable individuals to form an independent opinion.

Example: A private foundation's study that advocates the adoption of legislation and includes a discussion of only those facts supporting its position while omitting a discussion of all other relevant facts that do not support its position would not be considered nonpartisan and educational.

- (4) If a communication, analysis, study, or research reflects a view on specific legislation and directly encourages the recipient to act with respect to that legislation, it is not nonpartisan and, thus, not described within this exception. See Treas. Reg. 53.4945-2(d)(1)(vi). A communication, analysis, and the like, directly encourages the recipient to act if it does one or more of the following:
 - a. States that the recipient should contact a legislator or an employee of a legislative body, or should contact any other government official or employee who may participate in the formulation of legislation;
 - b. States the address, telephone number, or similar information of a legislator or an employee of a legislative body;
 - c. Provides a petition, tear-off postcard or similar material for the recipient to communicate with a legislator, an employee of a legislative body, or with another government official or employee who may participate in the formulation of legislation. See Treas. Reg. 56.4911-2(b)(2)(iii)(A), (B), (C), and (iv).
 - d. Use of nonpartisan study and analysis for lobbying by a private foundation or a public charity.

- (5) If a private foundation uses its nonpartisan analysis, study, or research for lobbying, the nonpartisan analysis may be deemed as a grass roots lobbying communication. See Treas. Regs. 53.4945-2(d)(1)(v)(A) and 56.4911-2(b)(2)(v).
- (6) If a public charity uses a private foundation grant to finance a nonlobbying study, research, communication, and so forth, and the public charity then uses it in lobbying, that private foundation's grant ordinarily will not be deemed a lobbying expenditure. However, if that private foundation made that grant to that public charity primarily to be used for lobbying or knew (or should have known) that the public charity would use that grant for lobbying, then that grant would be a taxable expenditure. See Treas. Reg. 53.4945-2(d)(1)(v)(B).
- (7) The following are examples from the regulations illustrating this exception. (For more examples, see Treas. Reg. 53.4945-2(d)(1)(vii).)
- a. M, a private foundation, establishes a research project to collect information showing the dangers of using pesticides to raising crops. The information collected includes data about proposed legislation, pending before several State legislatures, which would ban the use of pesticides. The project takes favorable positions on such legislation without producing a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion on the pros and cons of the use of pesticides. This project is not within the exception for nonpartisan analysis, study, or research because it is designed to present information merely on one side of the legislative controversy.
 - b. N, a private foundation, establishes a research project to collect information about the dangers of using pesticides to raise crops. The research project examines and reports the pros and cons of using of pesticides to raise crops. The information is collected and distributed in the form of a published report which analyzes the effects and costs of the use and nonuse of various pesticides under various conditions on humans, animals, and crops. The report also presents the advantages, disadvantages, and economic cost of allowing the continued use of pesticides unabated, of controlling the use of pesticides, and of developing alternatives to pesticides. Even if the report sets forth conclusions that the disadvantages as a result of using pesticides are greater than the advantages of using pesticides and that prompt legislative regulation of the use of pesticides is needed, the project is within the exception for nonpartisan analysis, study or research since it is designed to present information on both sides of the legislative controversy and presents a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion.
 - c. O, a private foundation, establishes a research project to collect information on the presence or absence of disease in humans from eating food grown with pesticides and the presence or absence of disease in humans from eating food not grown with pesticides. As part of the research project, O hires a consultant who prepares a 'fact sheet' which calls for curtailing the use of pesticides. The 'fact sheet' addresses the merits of several specific legislative

proposals to curtail the use of pesticides in raising crops which are currently pending before State legislatures. The 'fact sheet' presents reports of experimental evidence tending to support its conclusions but omits any reference to reports of experimental evidence tending to dispute its conclusions. O distributes 10,000 copies to citizens' groups. Expenditures by O in connection with this work of the consultant are not within the exception for nonpartisan analysis, study, or research.

- d. Organization Z researches, writes, prints and distributes a study on the use and effects of pesticide X. A bill is pending in the U.S. Senate to ban the use of pesticide X. Z's study leads to the conclusion that pesticide X is extremely harmful and that the bill pending in the U.S. Senate is an appropriate and much needed remedy to solve the problems caused by pesticide X. The study contains a sufficiently full and fair exposition of the pertinent facts, including known or potential advantages of the use of pesticide X, to enable the public or an individual to form an independent opinion or conclusion as to whether pesticides should be banned as provided in the pending bills. In its analysis of the pending bill, the study names certain undecided Senators on the Senate committee considering the bill. Although the study meets the three part test for determining whether a communication is a grass roots lobbying communication, the study is within the exception for nonpartisan analysis, study or research, because it does not directly encourage recipients of the communication to urge a legislator to oppose the bill. (Assume the same facts as above, except that, after stating support for the pending bill, the study concludes: "You should write to the undecided committee members to support this crucial bill." The study is not within the exception for nonpartisan analysis, study or research because it directly encourages the recipients to urge a legislator to support a specific piece of legislation.)
- e. Organization M pays for a bumper sticker that reads: 'STOP ABORTION: Vote NO on Prop. X!' M also pays for a 30-second television advertisement and a billboard that similarly advocate opposition to Prop. X. Considering the limited scope of the communications, none of the communications is within the exception for nonpartisan analysis, study or research. First, none of the communications rises to the level of analysis, study or research. Second, none of the communications is nonpartisan because none contains a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion. Therefore, each communication is a lobbying communication.

- (8) The case of *Haswell v. United States*, 500 F.2d 1133 (Ct. Cl. 1974), cert. denied, 419 U.S. 1107 (1975), discussed the meaning of "nonpartisan analysis, study, or research" under Treas. Reg. 1.501(c)(3)-1(c)(3)(iv), noting by analogy the definition under Section 4945(e) and regulations thereunder, which make clear that projects designed to present information on one side of a legislative controversy, or that fail to report available information that would tend to dispute conclusions advocated, are partisan. The court stated that nonpartisan analysis, study, or research requires a fair exposition of both sides of an issue and noted

that the term "nonpartisan" relates to issues rather than organized political parties. The court concluded that the organization's materials were partisan and prepared in a manner that would present most forcefully its position rather than full and fair objective expositions that would enable the audience to reach an independent conclusion.

- (9) *Parks v. Commissioner*, 145 T.C. 278 (2015), *aff'd sub nom.*, *Parks Foundation v. Commissioner*, 717 F. App'x 712 (9th Cir. 2017), held that most of the communications at issue did not qualify as nonpartisan analysis, study, or research, reasoning that they presented distortions of fact and substantial use of inflammatory and disparaging terms, and were otherwise not educational.

A.6. Presenting Results of Nonpartisan Analysis, Study or Research

- (1) A private foundation may choose any suitable means, including oral and written presentations, to distribute the results of its nonpartisan analysis, study, or research. A private foundation may distribute reprints of speeches, articles, and reports or present information through conferences, meetings, discussions, and public forums. Also, results may be made available through news media, including radio, television, newspapers, and the internet. See *Treas. Reg.* 53.4945-2(d)(1)(iv).
- (2) Occasionally a private foundation will choose to present the results of its nonpartisan analysis, study, or research through a series of programs or presentations. If the series as a whole is nonpartisan and educational, then any individual presentation within the series will not result in a taxable expenditure even though it is not, by itself, nonpartisan and educational. Generally, all presentations occurring within a six-month period may qualify for treatment as a series. Nevertheless, all facts and circumstances of each situation will normally determine if a specific presentation is part of a series. See *Treas. Reg.* 53.4945-2(d)(1)(iii).

A.7. Examinations and Discussions of Broad Social, Economic and Similar Positions

- (1) Examinations and discussions of broad social, economic, and similar problems are neither direct lobbying communications nor grassroots lobbying communications. Thus, a private foundation's discussions or communications with members and employees of a legislative body and other officials involved in the formulation of legislation are not deemed direct lobbying so long as such discussions or communications do not address the merits of specific legislation and so long as such discussion does not directly encourage recipients to take action with respect to legislation. See *Treas. Regs.* 53.4945-2(d)(4) and 56.4911-2(c)(2).
- (2) For example, a private foundation's discussions with members of the general public on problems that are being considered by Congress or other legislative

bodies are not deemed grassroots lobbying only if the followings conditions are satisfied:

- a. The discussions are not directly addressed to specific legislation being considered; and
- b. The discussions do not directly encourage recipients of the communication to contact a legislator, an employee of a legislative body, or a government official or employee who may participate in the formulation of legislation. See Treas. Regs. 53.4945-2(d)(4) and 56.4911-2(c)(2).

A.8. Providing Technical Advice or Assistance to Legislative Bodies

- (1) Under Section 4945(e)(2), a private foundation is not attempting to influence legislation if it is providing technical advice or assistance to a governmental body, a governmental committee, or a subdivision of either of the foregoing. The technical advice or assistance must be made in response to a written request from such governmental body or committee. The request must be in the name of the governmental body, committee, or subdivision. See Treas. Regs. 53.4945-2(d)(2)(i) and (ii).
- (2) Similarly, the response, oral or written, from the private foundation must be made available to every member of the requesting governmental body. See Treas. Reg. 53.4945-2(d)(2)(i). It may include opinions or recommendations with respect to legislation, but only if they are specifically requested or are directly related to the information so requested. Because such advice or assistance may be given only at the express request of a governmental body, committee or subdivision, such advice or assistance need not qualify as nonpartisan analysis, study or research. See Treas. Reg. 53.4945-2(d)(2)(ii).
- (3) Section 4945(e)(2) corresponds to the position taken in Rev. Rul. 70-449, 1970-2 C.B.111. In that revenue ruling, a university described in Section 501(c)(3) was requested by a Congressional committee to furnish a representative from its faculty to provide expert testimony on a pending legislation. The revenue ruling concluded that the university did not engage in prohibited legislative activity within the meaning of Section 501(c)(3), since it was merely responding to an official request of a Congressional committee, and it did not initiate the appearance.
- (4) The following are examples illustrating this exception. (For more examples, see Treas. Reg. 53.4945-2(d)(2)(iii).)
 - a. A, an official of the State Department, makes a written request in his official capacity for information from foundation Y relating to the economic development of country M and for the opinions of Y as to the proper position of the United States in pending negotiations with M concerning a proposed treaty involving a program of economic and technical aid to M. Y's furnishing of such information and opinions constitutes technical advice or assistance.
 - b. In response to a telephone inquiry from Senator X's staff, organization B sends Senator X a report concluding that the Senate should not advise and

consent to the nomination of Z to serve as a Supreme Court Justice. Because the request was not in writing, and because the request was not from the Senate itself or from a committee or subcommittee, B's report is not within the scope of the exception for responses to requests for technical advice.

Accordingly, B's report is a lobbying communication unless the report is within the scope of the exception for nonpartisan analysis, study or research.

- c. Assume the same facts as in example above, except that B's report is sent in response to a written request that Senator X sends to B. The request from Senator X is a request from the Senator as an individual member of the Senate rather than from the Senate itself or from a committee or subcommittee. Accordingly, B's report is not within the scope of the exception for responses to requests for technical advice and is a lobbying communication unless the report is within the scope of the exception for nonpartisan analysis, study or research.
- d. Assume the same facts as in example above, except that B's report is sent in response to a written request from the Senate committee that is considering the nomination for an evaluation of the nominee's legal writings and a recommendation as to whether the candidate is or is not qualified to serve on the Supreme Court. The report is within the scope of the exception for responses to requests for technical advice and is not a lobbying communication.

A.9. Decisions Affecting the Powers and Duties of a Private Foundation

- (1) Under Section 4945(e), a private foundation may appear or communicate with a legislative body about a decision of that body that might affect the existence of the foundation, its powers and duties, its tax-exempt status, or the deductibility of contributions to it (the "self-defense" exception). See Treas. Reg. 53.4945-2(d)(3)(i). Hence, a private foundation may communicate with an entire legislative body, its committees or subcommittees, or individual legislators, members of their staffs or representatives of the executive branch who are involved in the legislative process to express its opposition or support to particular legislation (or legislative decisions) that affects the powers of the private foundation. However, the private foundation may not communicate with the general public with respect to that legislation. The private foundation may make expenditures in order to initiate legislation if such legislation concern matters which might affect its existence, powers and duties, tax-exempt status, or deductibility of contributions. Therefore, under this "self-defense" exception, funds expended for such purpose are not considered as attempting to influence legislation and not taxable expenditures.
- (2) The following examples illustrate this exception. (For more examples, see Treas. Reg. 53.4945-2(d)(3)(ii).)

- a. A bill is being considered by Congress which would, if enacted, restrict the power of a private foundation to engage in transactions with certain related persons. Under the proposed bill a private foundation would lose its exemption from taxation if it engages in such transactions. W, a private foundation, writes to the congressional committee considering the bill, arguing that the enactment of such a bill would not be advisable, and subsequently appears before such committee to make its arguments. In addition, W requests that the congressional committee consider modification of the 2% de minimis rule of Section 4943(c)(2)(C). Expenditures paid or incurred with respect to such submissions do not constitute taxable expenditures since they are made with respect to a possible decision of Congress which might affect the existence of the private foundation, its powers and duties, its tax-exempt status, or the deduction of contributions to such foundation.
- b. A State legislature is considering the annual appropriations bill. Z, a private foundation which has performed contract research for the State, appears before the appropriations committee in order to attempt to persuade the committee of the advisability of continuing the program. Expenditures paid or incurred with respect to such appearance are not made with respect to possible decisions of the State legislature which might affect the existence of the private foundation, its powers and duties, its tax-exempt status, or the deduction of contributions to such foundation, but rather merely affect the scope of the private foundation's future activities.

A.10. Situations that do not Constitute Attempts to Influence Legislation or Lobbying

- (1) Three specific situations that do not constitute attempts to influence legislation are:
 - a. Projects jointly funded by a private foundation and a governmental body;
 - b. Grants to public charities not earmarked for lobbying; and
 - c. Certain expenditures by program-related investment recipients. See Treas. Reg. 53.4945-2(a)(3)-(6).

A.11. Jointly Funded Projects

- (1) Treas. Reg. 53.4945-2(a)(3) provides that private foundations will not be treated as lobbying by making expenditures to fund discussions with members of legislative bodies or officials of governmental bodies provided:
 - a. The subject of such discussions is a program which is jointly funded by the foundation and the Government or is a new program which may be jointly funded by the foundation and the Government;
 - b. The discussions are undertaken for the purpose of exchanging data and information on the subject matter of the programs; and

- c. Such discussions are not undertaken by foundation managers in order to make any direct attempt to persuade governmental officials or employees to take positions on specific legislative issues other than such program.
- (2) Similarly, a private foundation is not treated as lobbying merely by making expenditures to fund another organization's program upon the condition that the recipient obtain a matching support appropriation from a governmental body. See Treas. Reg. 53.4945-2(a)(3). These activities would not constitute taxable expenditures as attempts to influence legislation.

A.12. Grants to Public Charities

- (1) A general support grant awarded by a private foundation to a public charity described in Sections 509(a)(1), (2), or (3) will not constitute a taxable expenditure described in Section 4945(d)(1), whether or not the public charity has made a Section 501(h) election, if the award is not earmarked for use to attempt to influence legislation. A grant is earmarked if the grant is given pursuant to an oral or written agreement that it will be used for specific purposes. See Treas. Reg. 53.4945-2(a)(5)(i) and (6)(i). The following example illustrates this provision.

Example: A private foundation, W, makes a general support grant to Z, a public charity described in Section 509(a)(1). Z informs W that, as an insubstantial portion of its activities, it attempts to lobby the State legislature concerning changes in the mental health laws. W has not earmarked the grant to be used to attempt to influence any legislation. Even if Z subsequently uses the grant for legislative activities, the grant is not a taxable expenditure under Section 4945(d)(1). For additional examples, see Treas. Reg. 53.4945-2(a)(7)(ii).

- (2) A specific project grant awarded by a private foundation to fund a specific project of a public charity is not a taxable expenditure if the:
 - a. Grant is not earmarked for use to attempt to influence legislation; and
 - b. Amount of such grant, together with other grants by the same foundation for the same project for the same year, is less than or equal to the amount budgeted by the grantee organization for nonlobbying expenditures within the special project budget. See Treas. Reg. 53.4945-2(a)(6)(ii).
- (3) If the grant is for more than one year, the aforementioned provision applies to each year of the grant with the amount of the grant measured by the amount actually disbursed by the private foundation in each year or divided equally between years, at the option of the grantor private foundation. The same method of measuring the annual amount must be used in all years of a grant.

Example: A private foundation, M, makes a specific project grant of \$150,000 to P, a public charity described in Section 509(a)(1). In the grant application, P stated that the total budgeted cost of the project is \$200,000, and that of this amount \$20,000 is allocated to attempts to influence legislation related to the project. M relies on the budget figures provided by P in determining the amount P will spend on influencing legislation, and M has no reason to doubt the accuracy

or reliability of P's budget figures. In making the grant, M did not earmark any of the funds from the grant to be used for attempts to influence legislation. M's grant of \$150,000 to P will not constitute a taxable expenditure under Section 4945(d)(1) because M did not earmark any of the funds for attempts to influence legislation and because the amount of its grant (\$150,000) does not exceed the amount allocated to specific project activities that are not attempts to influence legislation (\$200,000 – \$20,000 = \$180,000). For additional examples, see Treas. Reg. 53.4945-2(a)(7)(ii).

- (4) If a public charity loses its Section 501(c)(3) status because of its attempts to influence legislation, a grant that has been made by a private foundation to that public charity will not be a taxable expenditure if certain conditions are satisfied.
- The grant is a general support or specific project grant;
 - The recipient organization had received a ruling or determination letter, or an advance ruling or determination letter that it is described in Section 501(c)(3) and Section 509(a);
 - The private foundation has no knowledge that the IRS has revoked the public charity's Section 501(c)(3) status; and
 - The private foundation does not control that public charity directly or indirectly. See Treas. Reg. 53.4945-2(a)(7). (See Treas. Reg. 53.4945-2(a)(7)(ii) for examples.)

A.13. Certain Expenditures by Program-Related Investment Recipients

- (1) Any amount paid or incurred by a recipient of a program-related investment (as defined in Treas. Reg. 53.4944-3) in connection with an appearance before, or communication with, any legislative body with respect to legislation or proposed legislation of direct interest to such recipient shall not be attributed to the grantor foundation, if:
- The foundation does not earmark its funds to be used for any activities described in Section 4945(d)(1); and
 - A deduction under Section 162 is allowable to the recipient for such amount. See Treas. Reg. 53.4945-2(a)(4).

B. Public Elections and Voter Registration Drives

- (1) Section 4945(d)(2) provides that a taxable expenditure includes any amount paid or incurred by a private foundation to influence the outcome of any specific election, or to carry on, directly or indirectly, any voter registration drive. A private foundation may make expenditures to fund voter registration drives, provided that these activities satisfy the requirements of Section 4945(f).

Note: Section 4955 also imposes excise taxes on expenditures made by Section 501(c)(3) organizations in participation or intervention in any political campaign on behalf of or in opposition to any candidate for public office. Section 4955(e)

provides that if a Section 4955 tax is imposed with respect to a political expenditure made by a private foundation, that expenditure is not treated as a taxable expenditure for purposes of Section 4945.

B.1. Influencing the Outcome of a Specific Election

- (1) A private foundation influences the outcome of a specific public election if it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office. See Treas. Reg. 53.4945-3(a)(2). The term "candidate for public office" means an individual who offers himself or herself, or is proposed by others, as a contestant for an elective national, state, or local public office. These definitions share common terms with Section 501(c)(3). See Notice 88-76, 1988-2 C.B. 392. Thus, Section 501(c)(3) precedent is instructive, except that expenditures for voter registration drives that do not meet the requirements of Section 4945(f) are strictly prohibited.
- (2) Activities which constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate include, but are not limited to the following:
 - a. Publishing or distributing written or printed statements or making oral statements on behalf of or in opposition to a candidate;
 - b. Paying salaries or expenses of campaign workers; and
 - c. Conducting or paying the expenses of conducting a voter registration to the geographic area covered by the campaign.
- (3) The IRS has held that certain activities, however, do not constitute political participation or intervention. For example, attempting to influence the confirmation of federal judicial nominees is not deemed to be influencing the outcome of a public election under Section 4945(d)(2). See Notice 88-76, 1988-2 C.B. 392. The rationale is that federal judges are not elected but appointed. Thus, attempts to influence the Senate's confirmation of a federal judge do not constitute influencing the outcome of a public election for purposes of Sections 501(c)(3) or 4945(d)(2), but instead constitute influencing legislation for purposes of Sections 501(c)(3), 4911, and 4945(d)(1). Also, see the following revenue rulings:
 - a. Rev. Rul. 72-512, 1972-2 C.B. 246 (holding that a university was not participating in political campaigns of when it offered a political science course that required students to participate in political campaigns of candidates of their choice);
 - b. Rev. Rul. 70-321, 1970-1 C.B. 129 (holding that an organization formed to collect and collate campaign speeches, recorded interviews, comments, and other materials of a candidate for a historically important elective office for donation to a university or public library advances education for purposes of Section 501(c)(3)).

B.2. Permitted Voter Registration Drives

- (1) Under Section 4945(f), an exempt Section 501(c)(3) organization may engage in nonpartisan voter registration activities provided that certain requirements are satisfied. If an organization meets these requirements, an amount paid or incurred by a private foundation is not considered a taxable expenditure even though the use of such amount is otherwise described in Section 4945(d)(2). These requirements under Section 4945(f) and Treas. Reg. 53.4945-3(b) are as follows:
- a. The organization engaging in the voter registration activities must be described in Section 501(c)(3) and exempt from taxation under Section 501(a);
 - b. The voter registration activities must be nonpartisan. They must not be confined to one specific election period or carried out in fewer than 5 states;
 - c. The organization must spend substantially all its income directly for the active conduct of activities constituting the purpose or function for which it is organized and operated. This provision is satisfied if an organization spent at least 85% of its income for the active conduct of activities constituting the purpose or function for which it is organized and operated rather than to make grants to fund the activities of other organizations;
 - d. The organization must also receive at least 85% of its total support (other than gross investment income) from other exempt organizations, the general public, governmental units (described in Section 170(c)(1)), or any combination of these sources. The organization may not receive more than 25% of such support from a single exempt organization, neither may the organization receive more than 50% of its total support from investment income (defined in Section 509(e)); and
 - e. Contributions to an organization for voter registration activities must not be subject to conditions that they be used only in specified states, possessions of the United States, or political subdivisions or other areas of the foregoing, or the District of Columbia, or that they may be used only in one specified election period.
- (2) A private foundation may provide funds to certain exempt Section 501(c)(3) organizations to engage in certain nonpartisan voter registration activities.
- (3) If a private foundation makes a grant to an organization described in Section 4945(f) (whether or not a private foundation), the grantor need not exercise expenditure responsibility with respect to that grant. Even if a grant to such an organization is earmarked for voter registration purposes generally, such a grant will not be treated as a taxable expenditure under Section 4945(d)(2) or (4) if such earmarking does not violate Section 4945(f)(5).

B.3. 85% Support Test

- (1) The 85% support test of Section 4945(f)(4) is determined on an aggregate basis over a five-year period consisting of the current tax year and the immediately preceding four tax years. See Section 4945(f) and Treas. Reg. 53.4945-3(b)(3)(i).
- (2) If an organization has completed at least one but less than four years, the support test is determined by aggregating all the support received during the current tax year and during each preceding taxable year. See Treas. Reg. 53.4945-3(b)(3)(iii).

B.4. Advance Ruling Information

- (1) Treas. Reg. 53.4945-3(b)(4) and Rev. Proc. 2024-5, 2024-1 I.R.B. 262 (annually updated), provide that an eligible Section 501(c)(3) organization may obtain an advance ruling or determination of its status under Section 4945(f). Form 8940, Request for Miscellaneous Determination, is used for this purpose.
 - a. Such an advance ruling will be issued to an organization if it submits evidence establishing that it can reasonably be expected to meet the requirements of Section 4945(f) for the initial tax year. The organization will then be treated as satisfying the requirements of an organization described in Section 4945(f) for the first tax year.
 - b. An organization which, pursuant to an advance ruling, has been treated as satisfying the requirements of Section 4945(f) (without the withdrawal of such treatment by notification during such year), but which ultimately fails to meet the Section 4945(f) requirements for the taxable year, will lose its Section 4945(f) status, from the first day of its next taxable year until such time as the organization meets the requirements under Section 4945(f).
- (2) An organization's advance ruling is not effective beyond the end of its first tax year. Grantors and contributors may rely upon the advance ruling during the advance ruling year. Thus, grants made by a private foundation will not cause it to have a taxable expenditure. Once notice of the change of status of the organization is made and publicized in the Internal Revenue Bulletin by the IRS, grantors and contributors may no longer rely on the advance ruling.
- (3) The grantors or contributors may not rely upon the advance ruling regardless of whether the IRS had issued the notice of the change of status, if they:
 - a. Were responsible for, or were aware of, the fact that the organization did not satisfy the requirements of Section 4945(f) at the end of the taxable year for which the organization had obtained the advance ruling, or
 - b. Acquired knowledge that the IRS had notified the organization that it would lose its Section 4945(f) determination. See Treas. Reg. 53.4945-3(b)(4).

B.5. Section 4945(d)(2) and Grants to Public Charities

- (1) A grant awarded by a private foundation to a public charity described in Section 509(a)(1), (2), or (3) is not a taxable expenditure described in Section 4945(d)(2) if the award is not earmarked for use to influence the outcome of a specific

election or carry on any voter registration drive and if there is no oral or written agreement whereby the private foundation may cause the recipient to engage in the aforementioned activities or to select the recipient to which the grant is to be devoted.

- (2) A grant is earmarked if the grant is given pursuant to an oral or written agreement that it will be used for specific purposes. See Treas. Reg. 53.4945-2(a)(5)(i).

C. Section 4945(d)(3) Grants to Individuals

- (1) Section 4945(d)(3) provides that a taxable expenditure includes any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or similar purposes by such individual, unless such grant satisfies the requirements of Section 4945(g).

- (2) Congress enacted Section 4945(d)(3) to curb the misuse of grants by some private foundations. Specifically, grants made to individuals purportedly for educational purposes were in fact used to serve private interests.

Example: Some private foundations awarded grants to enable the grantees to take vacations abroad, to have paid interludes between jobs and to prepare materials furthering specific political viewpoints.

- (3) Simply stated, Section 4945(d)(3) provides that all grants awarded by private foundations to individuals for travel, study, or similar purposes constitute taxable expenditures unless Section 4945(g) applies to such grants. Two underlying issues arise from Section 4945(d)(3).
 - a. Whether the expenditure constitutes a "grant" within the meaning of Section 4945(d)(3).
 - b. Whether the grant, if otherwise described in Section 4945(d)(3), falls within Section 4945(g).

C.1. Section 4945(d)(3) Grants Defined

- (1) The definition of grants, for purposes of Section 4945(d)(3) include, but are not limited to, such expenditures as:
 - a. Scholarships
 - b. Fellowships
 - c. Internships
 - d. Prizes
 - e. Awards
 - f. Loans (for purposes described in Section 170(c)(2)(B))
 - g. Program-related investments
 - h. Payments that support other exempt organizations (See Treas. Reg. 53.4945-4(a)(2))

- (2) A scholarship is defined to include any amount paid to, or for the benefit of, a graduate or undergraduate student for the pursuit of his/her studies. See Treas. Reg. 1.117-3(a). It is a "no-strings" educational grant, with no requirements of any substantial quid pro quo from the recipient such as providing future services. See Rev. Rul. 77-44, 1977-1 C.B. 355.
- a. Fellowships and internships include similar payments for the benefit of an individual for the pursuit of his/her studies (see Section 117 and regulations thereunder).
 - b. Prizes and awards include payments made to individuals in recognition of past educational, literary, artistic, or scientific accomplishments (see Section 74(b)). If the prize or award was restricted to be used by the recipient for his/her studies, it would be a Section 4945(d)(3) grant.
 - c. Long-term, low-interest loans made to students may be considered as grants described in Section 4945(d)(3). See Rev. Rul. 77-434, 1977-2 C.B. 420.
- (3) Grants do not ordinarily include:
- a. Salaries or other compensation paid to employees (defined under Section 61); and
 - b. Payments (including reimbursements for travel expenses such as transportation, board, and lodging) to persons for personal services in assisting a foundation in planning, evaluating or developing projects or areas of program activity by consulting, advising, or participating in conferences organized by the foundation. See Treas. Reg. 53.4945-4(a)(2) and Rev. Rul. 74-125, 1974-1 C.B. 327.
 - c. See also Rev. Rul. 81-293, 1981-2 C.B. 218 (foundation grant to individual who independently hired and compensated research assistants with the grant funds was held not to be foundation grants to the research assistants under Section 4945(d)(3)).

C.2. Grants that are not Section 4945(d)(3) Grants

- (1) Treas. Reg. 53.4945-4(a)(3)(i) provides that grants to individuals for purposes other than for travel, study or similar purposes are not taxable expenditures under Section 4945(d)(3) even if the requirements of Section 4945(g) are not met.

Example: If a private foundation makes grants to indigent individuals to enable them to purchase furniture, such grants are not taxable expenditures within the meaning of Section 4945(d)(3) even if the requirements of Section 4945(g) are not met. However, such grants must still meet the requirements of Sections 4945(d)(5) and 170(c)(2)(B) to not be treated as taxable expenditures.

- (2) A type of grant that does not fall within Section 4945(d)(3) is a grant that does not finance any future activities of a grantee.

Example: In Rev. Rul. 75-393, 1975-2 C.B. 251, a private foundation made grants to individuals in recognition of past literary works. They were not made to

finance any activities and no conditions were imposed on the manner in which it could be expended by the grantee. The IRS concluded the grants were made not for study, travel or similar purpose, and, thus, do not fall within Section 4945(d)(3).

- (3) Similar conclusions are reached in Rev. Rul. 77-380 (situation 1), 1977-2 C.B. 419 and Rev. Rul. 76-460, 1976-2 C.B. 371. In the former, a private foundation made a grant each year to an individual whose work represented the best example of investigative reporting. Since the grant was awarded for recognition of past achievement and had no conditions for its use, it was not a Section 4945(d)(3) grant and not otherwise a taxable expenditure. In the latter, a private foundation made grants to winners of a craft contest, and there were no restrictions for the use of the grants. The IRS concluded that they were not grants for study or similar purpose but furthered educational purposes and thus were not taxable expenditures.
- (4) However, in Rev. Rul. 76-461, 1976-2 C.B. 372, the IRS concluded that a private foundation's grant to a high school senior for winning a science fair contest was a Section 4945(d)(3) grant. Although the grant was made in recognition of a past achievement, the grant was conditioned upon the student attending college. Since the grant was intended to finance future educational activities of the grantee and conditions were imposed on the way the award could be used, it was a grant described in Section 4945(d)(3) and subject to the requirements thereof. See also situation 2 (in which an award for travel was treated as a Section 4945(g)(2) grant) and situation 3 (in which an award for study was treated as an Section 4945(g)(1) grant) of Rev. Rul. 77-380, 1977-2 C.B. 419.

C.3. Grants to Organizations Subsequently Awarded to Individuals

- (1) Private foundations occasionally make grants to other organizations that in turn award the grants to individuals for educational or similar purposes. These grants will not be considered as grants made to individuals (Section 4945(d)(3) grants) if:
 - a. Private foundations do not earmark the use of the grants for any named individuals; and
 - b. There are no agreements, written or oral, whereby the private foundations may cause the selection of the individual grantees by the grantee organizations. See Treas. Reg. 53.4945-4(a)(4)(i).
- (2) If a grantor private foundation has reason to believe that certain individuals would derive benefits from its grant to the grantee organization, such grant still would be considered as a grant to the grantee organization (and not to the individuals) so long as the grantee organization:
 - a. Exercises control over the selection process; and
 - b. Makes the selection completely independent of the grantor private foundation.

Example: A private foundation provides grants to a high school for use as college scholarships. The high school's officials evaluate all the student scholarship

applications and advise the private foundation of the selected recipients. The private foundation has always approved the recipients selected even though it retains final authority to select and determine the amounts of grants made to the recipients. Since the private foundation retains such authority, the selections of the recipients for the grants by the school officials are not made completely independent of the private foundation. Therefore, the grants are Section 4945(d)(3) grants, and the private foundation must seek advance approval pursuant to Section 4945(g). Otherwise, the grants would be considered as taxable expenditures.

C.4. Grants to Public Charities Subsequently Awarded to Individuals

- (1) When the intermediate grantee organizations are described in Section 509(a)(1), (2) or (3), grants for use by individuals will not be considered as grants to those persons if the:
 - a. Projects, for which the grants are used, are supervised by the public charities; and
 - b. Public charities control the selection of the individual recipients. See Treas. Reg. 53.4945-4(a)(4)(ii).
- (2) However, the grantor private foundation may play a limited role in the selection process. Specifically, it may suggest candidates for the grants if there is an objective manifestation of control over the selection process by the grantee public charity.
- (3) Rev. Rul. 77-212, 1977-1 C.B. 356 illustrates the requirement that the public charity controls the selection process. In this revenue ruling, a private foundation provides grants to a vocational school (which is described in Section 509(a)(1)) that are used to purchase tools for students. The students submit grant applications with lists of needed tools to the selection committee composed of representatives of the private foundation. The recipients are selected on ability and financial needs. The grants are made to the vocational school which then purchases the tools for the students. The IRS concluded that the grants are deemed to be made to the individual students by the private foundation because the foundation retained the authority to select the grantee students. See Treas. Reg. 53-4945-4(a)(4)(iv) for additional examples.

C.5. Grants to Governmental Agencies Subsequently Awarded to Individuals

- (1) When a private foundation makes a grant to a governmental agency described in Section 170(c)(1) for use by an individual, the grant will not be subject to the requirements of Section 4945(d)(3) and (g) if the governmental agency satisfies the IRS in advance that its grant program:
 - a. Furthers a charitable purpose described in Section 170(c)(2)(B);

- b. Requires that the individual grantee submit to the governmental agency reports which must be done in a manner that satisfies the requirements of Treas. Reg. 53.4945-4(c)(3); and
 - c. Requires that the governmental agency investigate jeopardized grants in a manner substantially similar to that described in the meaning Treas. Reg. 53.4945-4(c)(4). See Treas. Reg. 53.4945-4(a)(4)(iii).
- (2) If these requirements are satisfied, these grants will not be subject to Section 4945(d)(3) even if the grantor private foundation exercises considerable control over the selection of individual grantees.

C.6. Renewal of Grants

- (1) A renewal of a grant is not treated as a new grant if:
- a. The grantor has no information indicating that the original grant is being used for any purpose other than that for which it was made;
 - b. Any reports due at the time of the renewal decision pursuant to the terms of the original grant have been furnished; and
 - c. Any additional criteria and procedures for renewal are objective and nondiscriminatory.
- (2) Also, an extension of the period over which a grant is to be paid shall not itself be regarded as a grant or a renewal of a grant. See Treas. Reg. 53.4945-4(a)(3)(iii).

C.7. Advance Approval of Section 4945(g)

- (1) If a grant is described in Section 4945(d)(3), it is a taxable expenditure unless it satisfies the requirements of Section 4945(g). Section 4945(g) provides, in effect, that any grant to an individual for travel, study, or similar purposes is not a taxable expenditure if it was awarded on an objective and nondiscriminatory basis; was made pursuant to a procedure approved in advance by the IRS; and either:
- a. Constituted a scholarship or fellowship grant not includible as gross income pursuant to Section 117(a) and was used to study at an educational organization described in Section 170(b)(1)(A)(ii);
 - b. Constituted a prize or award not includible as gross income pursuant to Section 74(b)(1) and (2) (but disregarding (3)) and the recipient is selected from the general public (Note: If the prize or award is not intended to finance a future activity of the recipient and imposes no conditions on the recipient as to how it may be spent, advance approval of the grant-making procedure for such prize or award is not required because such a prize or award is not a grant for travel, study, or other similar purposes); or
 - c. Had the purpose of achieving a specific objective, producing a report or other similar product, or improving or enhancing a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee. See Section 4945(g)(1), (2) and (3).

- (2) A Section 4945(d)(3) grant must satisfy five requirements in order not to be treated as a taxable expenditure. Each of these requirements are discussed below.

C.8. Grants Made on an Objective and Nondiscriminatory Basis

- (1) For a foundation to establish that its grants to individuals are made on an objective and nondiscriminatory basis, the grants must be awarded in accordance with a program that is consistent with:
 - a. The existence of the private foundation's exempt status under Section 501(c)(3);
 - b. The allowance of deductions to individuals under Section 170 for contributions to the grantor private foundation; and
 - c. Specific rules on establishing a pool of potential grantees, selection criteria, and the individuals making the selection. See Treas. Reg. 53.4945-4(b)(1).
- (2) The first and second requirements are self-explanatory. The third requirement is discussed below.

C.9. Pool of Potential Grantees

- (1) The pool of potential grantees must ordinarily be selected on criteria reasonably related to the purposes of the grants and must be sufficiently broad to ensure that the giving of grants would further a Section 170(c)(2)(B) purpose. The pool ordinarily must be sufficiently large to constitute a charitable class.
- (2) However, selection from a pool is not necessary, where taking into account the purposes of the grant, one or several persons are selected because they are exceptionally qualified to carry out these purposes; or it is otherwise evident that the selection is particularly calculated to accomplish the charitable purpose of the grant rather than to benefit particular persons or a particular class of persons. Hence, a private foundation may impose reasonable restrictions on the pool of potential grantees. See Treas. Reg. 53.4945-4(b)(2).

C.10. Selection Criteria

- (1) The criteria used in selecting grant recipients from the potential grantees should be related to the purpose of the grant. Criteria for selecting scholarship recipients might include (but are not limited to) the following:
 - a. Prior academic performance;
 - b. Performance on tests designed to measure ability and aptitude for college work;
 - c. Recommendations from instructors;
 - d. Financial need; and

- e. Other facts and circumstances such as the conclusions which the selection committee might draw from a personal interview as to the individual's motivation, character, ability, and potential. Treas. Reg. 53.4945-4(b)(3).
- (2) For example, in Rev. Rul. 76-340, 1976-2 C.B. 370, selection criteria (in addition to academic standing, personal history, financial need) for a private foundation's scholarship program included the cost of the program the potential grantee proposes to pursue and whether he/she is likely to finance it with the private foundation's assistance. The IRS permitted the use of these two criteria since it would assure that the private foundation's grants would support the completion of the grantee's educational program.
 - (3) In contrast, the IRS, in Rev. Rul. 85-175, 1985-2 C.B. 276, did not permit the use of criteria that gave preference to family members and relatives of the contributors to the private foundation. Such criteria were in fact not in adherence to the objective and nondiscriminatory requirement. If a substantial part of the private foundation's activities was the awarding of grants on this basis, the organization would jeopardize its exempt status under Section 501(c)(3).

C.11. Persons Making Selections

- (1) The persons or group of persons who select the grantees should not be in a position to derive a private benefit, directly or indirectly from selection of grant recipient. See Treas. Reg. 53.4945-4(b)(4).

C.12. Grants Designed to Benefit a Specific Racial or Ethnic Minority Group

- (1) A private foundation may provide scholarships that are specifically geared toward racial or ethnic minorities and not be in violation of the objective and nondiscriminatory requirement of Section 4945(g).
- (2) For example, see Treas. Reg. 53.4945-4(b)(5), Example 2:

Example: X company has organized a private foundation which, as its sole activity, provides 100 college scholarships per year to children of X company's employees. It also provides 20 college scholarships per year to a certain ethnic minority group. All members of this ethnic minority group (other than disqualified persons with respect to the private foundation) living in State Z are eligible to apply for these scholarships. It is estimated that at least 400 persons will be eligible to apply for these scholarships each year. Selection of the recipients are based on prior academic performance, performance on certain tests designed to measure ability and aptitude for college works, and financial need. Under these circumstances, the operation of this scholarship program by the private foundation: (1) is consistent with the existence of the private foundation's exempt status under Section 501(c)(3); (2) utilizes objective and nondiscriminatory criteria in selecting scholarship recipients from among the applicants; and (3) utilizes a selection committee which appears likely to make objective and nondiscriminatory selections of grantees.

C.13. Grant Making Information – Advance Approval

- (1) In addition to requiring that grants be awarded on an objective and nondiscriminatory basis, Section 4945(g) requires that Section 4945(d)(3) grants be awarded "pursuant to a procedure approved in advance" by the IRS. To secure such approval, the private foundation must demonstrate the following:
 - a. Its grant procedure includes an objective and non-discriminatory selection process (see Treas. Reg. 53.4945-4(b));
 - b. Its grant procedure is reasonably calculated to result in performance by grantees of the activities intended to be financed; and
 - c. It will obtain reports from the grantees to determine whether they have performed the activities that the grants are intended to finance.
- (2) No single procedure or set of procedures is required and variant factual situations will determine what precautions are appropriate in each case. Treas. Reg. 53.4945-4(c)(1). Nevertheless, a procedure (or set of procedures) must include methods—
 - a. To supervise the use of scholarships, fellowships, and other types of Section 4945(d)(3) grants,
 - b. To investigate "jeopardized" or "diverted" grants, and
 - c. To retain records of scholarships, fellowships and grants made. See Treas. Regs. 53.4945-4(c)(2), (3), (4), (5) and (6).

C.14. Supervision of Scholarships, Fellowships and Other Section 4945(d)(3) Grants

- (1) Pertaining to scholarships and fellowships paid directly to the individual grantee, a grantor private foundation must arrange to receive a report of the courses taken at an educational organization and grades received by the grantee. The report must be verified by that educational organization and be obtained at least once per year. If no courses are taken (for example, the grantee is preparing a research paper, project, or doctoral thesis), the grantor private foundation must receive an annual progress report that has been approved by the faculty member supervising the grantee or an appropriate university official. A final report is also required upon the completion of the grantee's study at the educational organization. See Treas. Reg. 53.4945-4(c)(2). Special rules apply for scholarship and fellowship grants paid to educational organizations—see Treas. Reg. 53.4945-4(c)(5).
- (2) With respect to other types of Section 4945(d)(3) grants, the private foundation must require an annual report on the use of the funds and the progress made by the grantee toward achieving the purposes for which the grant was made. A final report describing the grantee's accomplishments and accounting for the funds

received is also required upon completion of the project. See Treas. Reg. 53.4945-4(c)(3).

C.15. Investigation of Jeopardized or Diverted Grants

- (1) A grantor private foundation must ensure that its grantees do not use the grants for purposes other than the original exempt purposes. Where a private foundation has information indicating that all or any part of a permitted Section 4945(g) grant is not being used in furtherance of grant purposes, it is obligated to investigate. Failure to investigate and correct such abuse may result in the grants becoming taxable expenditures. While conducting the investigation, the private foundation must withhold further payments of the grant to the extent possible until any delinquent reports have been submitted. See Treas. Reg. 53.4945-4(c)(4)(i).
- (2) Where the grantor private foundation determines that the grantee has used all or part of a grant for improper purposes and the grantee has not previously diverted grant funds, that grant will not be a taxable expenditure because of the diversion, provided the private foundation complies with two conditions:
 - a. It takes all reasonable and appropriate steps either to recover the grant funds or to ensure the restoration of the diverted funds and the dedication of other grant funds held by the grantee to the proper grant purposes; and
 - b. It withholds any further payments to the grantee after it becomes aware that a diversion may have taken place until it receives the grantee's assurances that future diversions will not occur. Further, it requires the grantee to take extraordinary precaution to prevent future diversions from occurring.
- (3) If the private foundation fails to comply with the first condition (number 2a, above), the amount of the taxable expenditure shall be the amount of the diversion plus the amount of any further payments to the same grantee. If the private foundation complies with condition number 2a, but not with condition 2b, the amount of the taxable expenditure shall be the amount of such further payments. See Treas. Reg. 53.4945-4(c)(4)(ii).
- (4) If the grantee has previously diverted funds received from the grantor private foundation and it determines that all or part of the grant has been used for improper purposes, the grant will not be a taxable expenditure by reason of such diversion, provided the private foundation complies with two conditions. These two conditions are identical to those described in numbers 2a and b above, except the following:
 - a. The private foundation may resume further payments only if the misappropriated or diverted grant funds are recovered or restored rather than merely receiving assurance that future diversions will not occur. See Treas. Reg. 53.4945-4(c)(4)(iii).
- (5) The phrase "all reasonable and appropriate steps" above, includes legal action where appropriate. Legal action is not necessary if it would in all probability not

result in satisfaction on execution of a judgement. See Treas. Reg. 53.4945-4(c)(4)(iv).

- (6) Special rules apply for scholarship and fellowship grants paid to educational organizations—see Treas. Reg. 53.4945-4(c)(5).

C.16. Retention of Records

- (1) Every private foundation making grants to individuals for purposes described in Section 4945(d)(3) must retain certain records with respect to such grants. These records must include:
- a. Information used to evaluate the qualifications of potential grantees;
 - b. Identification of the grantees (including any relationship of any grantee to the private foundation), the amount and purpose of each grant; and
 - c. All grantee reports and other follow-up data obtained in administering the private foundation's grant program. See Treas. Reg. 53.4945-4(c)(6).

C.17. Submission of Request for Approval of Grant-Making Information

- (1) The request for advance approval of grant-making procedures must fully describe the private foundation's grant procedure (such as a system of standards, processing procedures, and so on) for awarding grants and for ascertaining that such grants are used for the proper purposes. The request may be submitted to EO Determinations. See Treas. Reg. 53.4945-4(d)(2) and Rev. Proc. 2024-5, 2024-1 I.R.B. 262 (annually updated).
- a. In *John Q. Shunk Ass'n. Inc. v. United States*, 626 F. Supp. 564 (E.D. Ohio 1985), the court held that advance approval under 4945(g) is a mandatory, substantive requirement. See also *German Society of Maryland, Inc. v. Commissioner*, 80 T.C. 741 (1983).
 - b. However, taxes for failure to acquire advance approval of the IRS may be abated under Section 4962.
- (2) The request must contain the following:
- a. A statement describing the selection process;
 - b. A description of the terms and conditions under which the foundation ordinarily makes such grants, which is sufficient to enable the IRS to determine whether the grants awarded under such procedures would meet the requirements of Section 4945(g)(1), (2), or (3);
 - c. A detailed description of the private foundation's procedure for exercising supervision over grants; and
 - d. A description of the foundation's procedures for review of grantee reports, for investigation where diversion of grant funds from their proper purposes is indicated, and for recovery of diverted grant funds.

- (3) The approval procedure does not contemplate a series of separate approvals of particular grant programs. Once a private foundation's grant procedures are approved by the IRS, such grant-making procedures apply to a new grant program so long as the procedures do not materially change. See Treas. Reg. 53.4945-4(d)(1).
- (4) If a private foundation submits a proper request for approval of its grant-making procedures and the IRS does not notify it within 45 days that the procedures are not acceptable, then the procedures shall be considered as approved from the date of submission until receipt of actual notice that such procedures are not acceptable. Any grants made under those procedures will not be taxable expenditures. If a grant is made to an individual after the IRS notifies the private foundation that its procedures are disapproved, the grant is a taxable expenditure. See Treas. Reg. 53.4945-4(d)(3).
 - a. In Rev. Rul. 81-46, 1981-1 C.B. 514, a private foundation had not received a reply to a request for approval of its grant-making procedures within 45 days of its submission and, thereafter, awarded several installment grants. Prior to the completion of grant payments, the IRS notified the private foundation that its grant-making procedures were not approved. Nevertheless, the IRS held that the remaining payments of the installment would not be taxable expenditures since the private foundation was already obligated to make them. However, any renewals of grants awarded during the period would be taxable expenditures since the renewal would be discretionary.
- (5) A private foundation may request an approval of its grant procedures with its submission of Form 1023, Application for Recognition of Exemption under Section 501(c)(3). A full and complete disclosure of its grant-making procedures and information required by Treas. Reg. 53.4945-4(d)(1) must be submitted in conjunction with the application. The IRS has 45 days, as in a separate request situation, to rule on the procedures. Approval of the private foundation's exemption application does not in itself constitute approval of the organization's grant procedures unless the exemption letter so provides. A private foundation may also request approval using Form 8940.
 - a. In Rev. Rul. 86-77, 1986-1 C.B. 334, the 45-day rule was applied, and no taxable expenditures were found in a situation where the private foundation's exemption application did not specifically request advance approval but provided a full and complete disclosure of its grant making procedures.

C.18. Employer Related Scholarship Programs and Loan Programs

- (1) Many private companies have established private foundations to fund scholarship programs for employees and/or their children. These employee educational grants appear to be compensation, and the educational grants to the children of the employees appear to be compensation or provide an employment incentive to the employee-parents. Therefore, grants made by the private foundations pursuant to these employer-related scholarship programs are not scholarships or fellowship grants subject to Section 117(a) and are taxable expenditures pursuant

to Section 4945(d)(3). Nonetheless, if a private foundation satisfies seven conditions and a percentage test outlined in Rev. Proc. 76-47, 1976-2 C.B. 670, and further clarified by Rev. Proc. 85-51, 1985-2 C.B. 717, the IRS will assume the contrary. These requirements are summarized below as follows (for further detail, see the cited revenue procedures):

- a. Inducement: the employer-related scholarship program must not be used by the employer and the private foundation as an inducement to recruit or retain employees to continue their employment;
- b. Selection Committee: must be comprised of individuals totally independent and separate from the private foundation and the employer. These individuals may not be employees or former employees and should be knowledgeable in the educational field;
- c. Eligibility Requirements: must be related to the purpose of the grant program. Potential recipients must be able to meet the admission requirements of and attend an educational organization. If a minimum period of employment is required to qualify for such scholarships, this period may not exceed three years;
- d. Objective Standard: selection must be based upon objective standards that are unrelated to employment of the recipient or to the employer's line of business;
- e. Employment: once awarded, a scholarship may not be terminated if the recipient (or his/her parents) is no longer employed with that employer;
- f. Course of Study: the courses of study for which the scholarship are available must not be limited to those that would benefit the employer or private foundation;
- g. Other Requirements: the employer-related scholarship program must meet all other requirements of Section 117 and the regulations thereunder; and
- h. Percentage Test: if the employer-related scholarship program provides grants to employees' children, the scholarships awarded must not exceed: (i) 25% of the number of employees' children who were eligible, applied for scholarships, and were considered by the selection committee in selecting the recipients; or (ii) 10% of the number of employees' children who were eligible (whether or not they submitted an application) in that year. See Rev. Proc. 85-51, 1985-2 C.B. 717 for requirements in determining the number of employees' children who can be eligible recipients for purposes of the 10% test. If the employer-related scholarship program provides grants to employees, the scholarships awarded must not exceed 10% of the number of employees who were eligible, were applicants for such grants, and were considered by the selection committee in selecting the recipients of grants in that year.
- i. If the employer-related scholarship program satisfies the seven conditions but not the percentage test, the program may nevertheless qualify if, in view of all

the facts and circumstances, its primary purpose is to educate recipients in their individual capacities. See Section 4 of Rev. Proc. 76-47 for facts and circumstances test requirements. See Rev. Rul. 86-90, 1986-2 C.B. 184 for application of the facts and circumstances test to a program involving one scholarship awarded to a child in an employee pool of thousands.

- (2) Only employer-related grant programs must satisfy Rev. Proc. 76-47. An employer-related grant program is defined as a program that:
 - a. Treats some or all the employees (or their children) of a particular employer as a group from which recipients of some or all the private foundation's grants will be selected;
 - b. Limits the potential recipients to individuals who are employees (or their children) of a particular employer; or
 - c. Otherwise gives such individuals a preference or priority over others in being selected as recipients of such grants.
- (3) For specific examples, see the following guidance:
 - a. Rev. Rul. 79-131, 1979-1 C.B. 368, holds that an employer-funded scholarship program for all students in a community is not an employer-related grant program as defined in Rev. Proc. 76-47.
 - b. Rev. Rul. 79-365, 1979-2 C.B. 389, holds that a private foundation's scholarship program for children of deceased or retired employees of a particular company is an employer-related scholarship program within the scope of Rev. Proc. 76-47.
 - c. Rev. Rul. 81-217, 1981-2 C.B. 217, which held that scholarship programs in which a public charity also had involvement were employer-related programs under Rev. Proc. 76-47.
 - d. Rev. Proc. 94-78, 1994-2 C.B. 833, permits rounding off of the number of employer-related scholarship or loan grants.
 - e. Rev. Rul. 2003-32, 2003-1 C.B. 689, which held that a scholarship program for employees or children of employees of a particular employer if the employee was seriously injured or killed as the result of a qualified disaster was an employer-related program that met the requirements of Rev. Proc. 76-47.
- (4) Long-term or short-term educational loans made under an employer-related educational loan program may qualify as grants described in Section 4945(g)(3), provided they meet the requirements in Rev. Proc. 80-39, 1980-2 C.B. 772. The requirements of Rev. Proc. 80-39 are essentially the same as those in Rev. Proc. 76-47 (concerning educational grants). If a private foundation's employer-related program encompasses educational loans and scholarship or fellowship grants to the same group of eligible employees or employees' children, the percentage tests apply to the total number of individuals receiving combined grants of

scholarships, fellowships, and educational loans. For more details, see Rev. Proc. 80-39.

C.19. Employer Related Emergency Funds Programs

- (1) A company controlled private foundation often provides grants or loans to employees in "emergency" circumstances. For example, funds are sometimes provided for employees who:
 - a. Suddenly incur extraordinary medical expenses on their own behalf or on behalf of members of their families;
 - b. Experience emergencies arising from natural disasters such as hurricanes, tornadoes, fires, floods, or earthquakes not covered by insurance or other resources. In the past, public notices, such as Notice 92-45, 1992-2 C.B. 375 (Organizations Providing Relief to Victims of Hurricanes Andrew and Iniki) and Notice 93-41, 1993-2 C.B. 332 (Organizations Providing Relief to Victims of the Midwest Floods) provided relaxation from strict adherence to the Chapter 42 requirements imposed on private foundations during national disaster situations;
 - c. Suffer physical injuries or financial losses by way of being victims of violent crimes that are not covered by insurance or other resources; and
 - d. Need funds for funeral or burial expenses.
- (2) In the legislative history of the Victims of Terrorism Tax Relief Act of 2001, Congress set forth guidelines for company-controlled private foundations in providing disaster relief to company employees and directed the IRS to issue prompt guidance, which was provided in Publication (Pub.) 3833, Disaster Relief, Providing Assistance Through Charitable Organizations.

C.20. Grants Constituting Scholarship, Prize or Achieving a Specific Objective

- (1) In addition to satisfying the Section 4945(g) requirements of objective and nondiscriminatory basis and grant procedures approved in advance, a grant described in Section 4945(d)(3) must satisfy either of the following two requirements in order not to be a taxable expenditure.
 - a. It constitutes a scholarship, fellowship, prize, or award under Sections 4945(g)(1) or (2).
 - b. The purpose of the grant is to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee.
- (2) Scholarship or fellowship grants that would be subject to the provisions of Section 117(a) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) and are to be used for study at an educational organization

described in Section 170(b)(1)(A)(ii), will not be taxable expenditures under Section 4945. See Section 4945(g)(1).

- a. Prior to the Tax Reform Act of 1986, Section 117 scholarships excludible from gross income included amounts for room, board, laundry service, and similar services or accommodations, and included payments to non-degree candidates as well as degree candidates. The Section 4945(g)(1) language “(as in effect on the day before the date of the enactment of the Tax Reform Act of 1986)” [Oct. 22, 1986] thus treats such amounts as permissible scholarship grants for purposes of Section 4945(g).
 - b. For this purpose, an educational organization includes a for-profit school that meets the requirements of Section 170(b)(1)(A)(ii), even though it cannot receive tax-deductible contributions.
- (3) If a Section 4945(d)(3) grant does not constitute either a scholarship, fellowship or prize, it may still satisfy Section 4945(g)(3) as a grant made for a "specific objective." Two revenue rulings highlight this requirement in the context of grants or loans for education.
- a. In Rev. Rul. 77-44, 1977-1 C.B. 355, a private foundation made scholarship grants to students who planned to teach in the public schools. However, the private foundation did not require such future services for the students to receive the scholarship grants. The grants were made on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the IRS. Since the grants were awarded to recipients who pledged (though not obligated) to render future services, the scholarship grants were not Section 117(a) scholarships described in Section 4945(g)(1) and were not excluded from classification as taxable expenditures. However, since the grants were made to attract students to be public school teachers as well as to improve the recipients' teaching skills, they were made for the specific objective of improving public education and for the improvement of the recipients' teaching skills. Thus, the scholarship grants qualified as grants under Section 4945(g)(3) and were not taxable expenditures. See also *Beneficial Foundation v. United States*, 8 Cl.Ct. 639 (1985).
 - b. In Rev. Rul. 77-434, 1977-2 C.B. 420, a private foundation made long-term, low-interest educational loans to students. The recipients were required to use the loans at a specific educational institution described in Section 170(b)(1)(A)(ii). Although the loans were not scholarships or prizes, the educational loans were made to further the education of the recipients and were narrow and definite to ensure the use of the loans for Section 501(c)(3) purposes. Thus, the educational loans qualified as grants described in Section 4945(g)(3). See also Treas. Reg. 53.4944-3(b), Example (9) (interest-free educational loan is program-related investment); loans for charitable purposes and other program-related investments are treated as grants under Treas. Reg. 53.4945-4(a)(2).

D. Grants to Organizations Section 4945(d)(4)

- (1) Before the Tax Reform Act of 1969, many private foundations awarded grants to organizations, including other private foundations, without taking any precautions to ensure the proper use of funds or to recover funds in the event of misuse. In many cases, grantee organizations had diverted funds designated for charitable purposes to nonexempt purposes. Congress enacted Section 4945(d)(4) to curb these abuses.
- (2) Under Section 4945(d)(4) the term "taxable expenditure" includes any amount that a private foundation pays or incurs as a grant to an organization other than a qualifying public charity described below unless the grantor foundation exercises "expenditure responsibility" with respect to the grants. The requirements of expenditure responsibility are described in Section 4945(h) and are discussed below.

D.1. Grants Defined

- (1) The term "grants" is broadly defined for the purposes of Section 4945. Section 4945(d)(4) grants include payments to other exempt and nonexempt organizations for use in carrying out either the grantor's or grantee's exempt purposes. Grants may be for capital endowment, for the purchase of capital equipment, or for the general support of the grantee organization's activities. Grants may include loans for Section 170(c)(2)(B) purposes and "program-related investments," such as investments in small businesses that assist in neighborhood renovation. See Treas. Reg. 53.4945-4(a)(2).
- (2) Conversely, Section 4945(d)(4) grants do not include payments for consultant and personal services in assisting an exempt organization in planning, evaluating, or developing program activities. See Treas. Reg. 53.4945-4(a)(2).

D.2. Grants to Public Charities, Exempt Operating Foundations, and Certain Other Organizations

- (1) Generally, grants made by a private foundation to public charities that are described in Sections 509(a)(1), 509(a)(2), 509(a)(3) (with some exceptions), and exempt operating foundations described in Section 4940(d)(2) do not constitute taxable expenditures, even if the private foundation does not exercise expenditure responsibility over the grants. These entities (referred to as qualifying public charities in Rev. Proc. 2017-53, 2017-40 I.R.B 263) include:
 - a. Churches, schools, hospitals, medical and agricultural research organizations, governmental units, certain organizations related to colleges and universities and publicly supported organizations described in Section 170(b)(1)(A) (see Section 509(a)(1));
 - b. Organizations which normally receive more than one-third of their support from gifts, membership fees, and the like, and not more than one-third of their support from gross investment income and unrelated business income (see Section 509(a)(2);

- c. Section 509(a)(3) supporting organizations, except for certain supporting organizations referred to as disqualified supporting organizations in Rev. Proc. 2017-53, namely a non-functionally integrated Type III supporting organization under Treas. Reg. 1.509(a)-4(i), or any other supporting organization if a disqualified person of the private foundation directly or indirectly controls the supporting organization or a supported organization (see Section 4945(d)(4)(A)(ii)); and
 - d. Exempt operating private foundations that are described in Section 4940(d)(2).
- (2) Grants made to certain organizations are treated as grants made to Section 509(a)(1) organizations and, therefore, are not taxable expenditures. These organizations include:
- a. Organizations described in Section 170(c)(1), Section 511(a)(2)(B) or Treas. Reg. 1.509(a)-2(a);
 - b. Foreign governments, their agencies or instrumentalities, or international organizations designated as such by Executive Order under 22 U.S.C. 288, even if not described in Section 501(c)(3); and
 - c. Instrumentalities of a domestic political subdivision of a state. See Rev. Rul. 81-125, 1981-1 C.B. 515.

Note: However, grants made to these organizations must be used for charitable purposes described in Section 170(c)(2)(B). See Treas. Reg. 53.4945-5(a)(4).

- (3) Native American tribal governments are treated as state governments and, therefore, are described in Section 170(c)(1) for purposes of subchapter A of chapter 42, including Section 4945. Section 7871(a)(1)(A) and (7)(B).
- (4) Rev. Proc. 2018-32, 2018-23 I.R.B. 739, sets forth the extent to which private foundation grantors may rely on the listing of an organization's public charity status in IRS databases, and provides safe harbors for determining that a grantor's grant will not cause the grantor to be considered to be responsible for, or aware of, an act that results in an organization's loss of public charity classification. See also Notice 2006-109, 2006-2 C.B. 1121, as modified by Rev. Proc. 2009-32, 2009-2 I.R.B. 142, and Notice 2014-4, 2014-1 I.R.B. 274, which provide criteria for private foundations to determine the type of a supporting organization that lacks an IRS determination as to type, and Announcement 85-88, 1988-25 I.R.B. 21, with respect to exempt operating foundations.

D.3. Grants to Foreign Organizations

- (1) Many foreign organizations do not have rulings or determination letters to show that they are described in Sections 501(c)(3) or 509(a)(1), (2), or (3). Hence, grants they receive from private foundations may be taxable expenditures under Section 4945(d)(4) or Section 4945(d)(5). These grants are not taxable expenditures if a foreign organization meets two tests.

- a. The first test, in Treas. Reg. 53.4945-6(c)(2)(ii), concerns foreign grantee organizations that do not have Section 501(c)(3) rulings. Generally, a foreign organization will be treated as akin to a Section 501(c)(3) organization if in the "reasonable judgement" of a foundation manager of the grantor private foundation, the grantee foreign organization is organized and operated as a Section 501(c)(3) organization. Reasonable judgement is defined by its generally accepted legal sense within the outlines developed by judicial decisions in the law of trusts. This test does not apply to "testing for public safety" organizations described in Section 501(c)(3) and 509(a)(4).
 - b. The second test, in Treas. Reg. 53.4945-5(a)(5), provides that if a grantor private foundation makes a "good faith" determination that the foreign grantee organization is a qualifying public charity, such grants made to that foreign organization are considered to have been made to a qualifying public charity. The good faith determination ordinarily must be based upon current written advice received from a qualified tax practitioner, which must set forth sufficient facts concerning the operations and support of the grantee foreign organization to demonstrate that it would likely qualify as a qualifying public charity.
- (2) Rev. Proc. 2017-53, 2017-40 I.R.B. 263, provides guidelines that qualified tax practitioners may use for preparing written advice on which a domestic private foundation ordinarily may rely in making an equivalency determination that the foreign grantee of a grant made for Section 170(c)(2)(B) purposes (other than a grant described in Section 507(b)(2) and 1.507-3 (c)) is a qualifying public charity. A private foundation may make an equivalency determination that a foreign grantee is an organization described in Section 501(c)(3) and is a qualifying public charity even though the grantee lacks a determination letter from the IRS recognizing it as tax-exempt. Thus, a grant to such an organization would not need to be maintained in a separate fund and would ordinarily be treated as a qualifying distribution and not a taxable expenditure.
 - (3) In *Thorne v. Commissioner*, 99 T.C. 67 (1992), the court held that a foundation did not make a good faith determination and thus a grant to a foreign organization without exercise of expenditure responsibility was a taxable expenditure.

D.4. Earmarked Grants

- (1) Occasionally, a private foundation makes a grant to another organization to enable that recipient to make grants to other grantee organizations (secondary grantees). In such a case, the private foundation is not regarded to have made the grant to the secondary grantees if the private foundation does not earmark the use of the grant for any named secondary grantees, and if there does not exist an oral or written agreement whereby the grantor private foundation may cause the selection of the secondary grantee by the organization to which it has given the grant. See Treas. Reg. 53.4945-5(a)(6).
- (2) If a grantor private foundation has reason to believe that certain secondary organizations would derive benefits from its grant to the initial grantee

organization, such grant still would be considered as a grant to that organization (and not to the secondary grantee organizations) so long as the initial grantee organization:

- a. Exercises control over the selection process; and
- b. Makes the selection completely independent of the grantor private foundation.

D.5. Expenditure Responsibility

- (1) A private foundation must maintain expenditure responsibility over grants it made to organizations (other than qualifying public charities) for the grants not to be taxable expenditures. That private foundation will be exercising expenditure responsibility under Section 4945(h) if it meets three requirements. The private foundation must:

- a. See that the grant is spent solely for the purpose for which made (in addition see Pre-grant Inquiry Requirement Section 4945(h)(1) below);
- b. Obtain full and complete reports from the grantee concerning the use of funds; and
- c. Submit full and detail reports describing its expenditures to the IRS.

- (2) A private foundation must strictly comply with these requirements.

Example: In *Hans S. Mannheimer Charitable Trust v. Comm.*, 93 T.C. 35 (1989), a private foundation made grants to two other private foundations. All three had been established by the same person and had offices and trustees in common. The grantor private foundation made several grants to the two other private foundations but failed to obtain annual reports from them as required by Section 4945(h)(3). Nevertheless, the grantor was informed of the activities of the grantee organizations. The Tax Court concluded that the grantor failed to exercise expenditure responsibility requirements even if it was informed of the activities of the recipients.

- (3) A partial transfer of assets from one private foundation to another, including a transfer pursuant to Section 507(b)(2), generally requires that the transferor foundation exercise expenditure responsibility with respect to the transfer, except as provided in Treas. Reg. 53.4945-5(b)(7). See Treas. Reg. 53.4945-5(c)(2). This is so even if the same persons control the two foundations. See Rev. Rul. 82-136, 1982-2 C.B. 300. If a private foundation transfers all of its assets to one or more private foundations not effectively controlled by the same persons that effectively control the transferor, then expenditure responsibility with respect to the transfer is limited as provided in Treas. Reg. 1.507-3(a)(7). If a private foundation transfers all of its assets to one or more private foundations effectively controlled by the same persons that effectively control the transferor (and thus treated as the transferor for Section 4945 purposes), then the transferor foundation need not exercise expenditure responsibility with respect to the transfer, but the transferee foundation or foundations assume responsibility for

any outstanding expenditure responsibility grants made by the transferor. See Treas. Reg. 1.507-3(a)(9) and Rev. Rul. 2002-28, 2002-1 C.B. 941.

D.6. Pre-grant Inquiry Requirement Section 4945(h)(1)

- (1) Before a private foundation makes a grant to an organization subject to expenditure responsibility, it should conduct a limited pre-grant inquiry to ensure that the grant will be used for proper purposes. See Treas. Reg. 53.4945-5(b)(2)(i).
- (2) The pre-grant inquiry should include:
 - a. The identity, prior history, and experience of the grantee organization and its managers;
 - b. Whether the grantee has a history of compliance or noncompliance with the terms of previous grants, and any knowledge concerning the management, activities, and practices of the grantee organization.
- (3) The scope of the pre-grant inquiry will vary in each case depending on:
 - a. The size and purpose of the grant;
 - b. The period over which it will be paid; and
 - c. Any prior experience the grantor has had with the grantee. See Treas. Reg. 53.4945-5(b)(2)(i).
- (4) Ordinarily, no further pre-grant inquiry is necessary where a grantee has properly used all prior grants and filed the required reports. See Treas. Reg. 53.4945-5(b)(2)(ii) for examples illustrating the pre-grant inquiry rule.

D.7. Terms of Grant Agreements

- (1) Compliance with the expenditure responsibility provisions of Section 4945(h) will also require the grantor organization to make all Section 4945(d)(4) grants subject to a written commitment signed by an appropriate officer, director, or trustee of the grantee organization.
- (2) The commitment must include provisions:
 - a. Clearly stating the purposes of the grant. Such purposes may include contributing to capital endowment, purchase of capital equipment, specific program or series of programs, or general support of the grantee organization, provided that neither the grants nor the income thereof may be used for non-Section 170(c)(2)(B) purposes.
 - b. Indicating that the grantee organization must repay any funds not used for grant purposes.
 - c. Indicating that the grantee organization must submit annual reports on the use of funds (unless the grant is to a private foundation for endowment or other capital purposes (see Treas. Reg. 53.4945-5(c)(2)), and in which case

the reports may be discontinued after three years in appropriate circumstances).

- d. Indicating that complete records of receipts and expenditures must be maintained, and to make such records available to the grantor. The grantee organization must also agree not to use funds in a manner inconsistent with the provisions of Section 4945(d)(1) through (5), including the requirement not to make any grant which does not comply with the requirements of Section 4945(d)(3) or (4). See Treas. Reg. 53.4945-5(b)(3).

D.8. Program-Related Investments

- (1) If the purpose of the grant is to make a program-related investment (PRI), the written agreement must provide that the funds be used only for the purposes of the investment and to repay any portion thereof not used for such purposes. Such repayment is limited to the extent permitted by applicable law concerning distributions to holders of equity interests. See Treas. Reg. 53.4945-5(b)(4).
- (2) The grantee organization also must:
 - a. Submit full and complete annual financial reports for the life of the PRI (except as provided in Treas. Reg. 53.4945-5(c)(2); see discussion of *Charles Stewart Mott Foundation v. United States*, 938 F.2d 58 (6th Cir. 1991) *infra*);
 - b. Maintain adequate books and records; and
 - c. Make such books and records available to the grantor private foundation.

Note: The information in each of these specified items must be in the form ordinarily required by commercial investors under similar circumstances.
- (3) The grantee organization must also agree not to use any of the grant funds for the following activities:
 - a. It must not carry on propaganda, or otherwise attempt to influence legislation, within the meaning of Section 4945(d)(1). See also Treas. Reg. 53.4945-2(a)(4).
 - b. It must not influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive within the meaning of Section 4945(d)(2).
 - c. In the case of a recipient which is a private foundation, it must not make any grant which does not comply with the requirements of Section 4945(d)(3) or (4). See Treas. Reg. 53.4945-5(b)(4)(iv).
- (4) The term "program-related investment" (PRI) is defined in Section 4944(c) and Treas. Reg. 53.4945-5(b)(4). A PRI is an investment whose primary purpose is to accomplish one or more of the purposes described in Section 170(c)(2)(B), no significant purpose of which is the production of income or the appreciation of property, and no purpose of the investment is to influence legislation or participate in political campaigns. A PRI is generally treated as a grant for

purposes of Section 4945 but is sometimes subject to special rules such as Treas. Reg. 53.4945-5(b)(4). See Treas. Reg. 53.4945-4(a)(2) and 53.4945-5(a)(2).

D.9. Grants to Foreign Organizations

- (1) If the grant is to a foreign organization, the written grant agreement must impose restrictions which are substantially equivalent to the limitations placed on domestic private foundations by Section 4945(d). Such restrictions may be phrased in appropriate terms under foreign law or custom and ordinarily will be considered sufficient if an affidavit or opinion of counsel (of the grantor or grantee) is obtained stating that, under foreign law or custom, the agreement imposes restrictions on the use of the grant substantially equivalent to the restrictions imposed on a domestic private foundation. See Treas. Reg. 53.4945-5(b)(5).
- (2) With respect to activities in foreign countries, the failure of a foreign private foundation that is described in Section 4948(b) to comply with the requirements in Treas. Reg. 53.4945-5(b)(3) and (4) to set forth certain terms in written grant agreements is not a prohibited transaction under Section 4948(c). See Treas. Reg. 53.4945-5(b)(6).

D.10. Reporting Requirements of the Grantee Organization

- (1) Section 4945(h)(2) provides that the grantor private foundation, in exercising expenditure responsibility, must receive reports from the grantee organization on the use of the grant. The reports, in accordance with Treas. Reg. 53.4945-5(c)(1), must show:
 - a. How the funds are used in compliance with the terms of the grant, and
 - b. The progress made by the grantee in fulfilling the purposes of the grant.
- (2) These reports must be submitted at the end of the grantee organization's annual accounting period during which the first grant is received and all subsequent accounting periods until the grant funds are expended in full or the grant is otherwise terminated. After all the grant funds are spent, a final summary report must be submitted to the grantor.
- (3) An exception to the annual reporting requirement is if a grant is made to another private foundation exempt under Section 501(a) and is used by that grantee private foundation for endowment, capital equipment, or other capital purposes. The grantee private foundation must make reports on the use of principal and income during the year of the grant and the two immediately succeeding taxable years. If at any time thereafter it becomes reasonably apparent to the grantor private foundation that the principal, income or the equipment purchased therefrom has not been used for any purpose other than those permitted under 4945(d), such grantor private foundation may then allow further grantee reports to be discontinued. See Treas. Reg. 53.4945-5(c)(2).

- (4) The grantor private foundation need not independently verify the reports submitted by the grantee organization unless it has reason to doubt the accuracy or reliability of the reports. See Treas. Reg. 53.4945-5(c)(1).

D.11. Reporting Requirements of the Grantor

- (1) Section 4945(h)(3) requires the grantor private foundation exercising expenditure responsibility to submit annual reports to the IRS on all grants made. The reports must be submitted on or with the Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as a Private Foundation. See Treas. Reg. 53.4945-5(d)(1). The grantor private foundation may satisfy its filing requirements with respect to any grant made to a grantee organization by submitting the report received from the grantee organization.
- (2) The report must include the following information:
- a. The name and address of the grantee;
 - b. The date, amount, and purpose of each grant;
 - c. The amounts spent by the grantee organization (based on the most recent report received from the grantee organization);
 - d. Whether the grantee private foundation has diverted any portion of the funds (or the income therefrom if it is an endowment grant) from the purpose of the grant (to the knowledge of the grantor);
 - e. The dates of any reports received from the grantee; and
 - f. If the grantor private foundation has been required, pursuant to Treas. Reg. 53.4945-5(c)(1), to verify the grantee organization's reports, the date and results of any such verification must be submitted. See Treas. Reg. 53.4945-5(d)(2).
- (3) If a grantor private foundation awarded a grant to a private foundation exempt under Section 501(a) for capital endowment, equipment, or other capital purposes, the grantor foundation need only submit reports for taxable years for which it required reports from the grantee organization. See Treas. Regs. 53.4945-5(c)(2) and 53.4945-5(d)(1).
- (4) An example of a failure of a grantor private foundation to comply with the reporting requirements is illustrated in *Charles Stewart Mott Foundation v. United States*, 938 F. 2d 58 (6th Cir. 1991). In this case, the private foundation made a 12-year interest-free loan grant for program-related investment purposes to be distributed in equal amounts over 12 years to a non-Section 501(c)(3) organization. The grantor private foundation failed to file an annual report on the loan grant for years 6 and 7 in violation of Treas. Reg. 53.4945-5(b)(4)(ii). The Sixth Circuit held that private foundation's distributions made to the recipient under the loan grant for years 6 and 7 are taxable expenditures. It concluded that, under the expenditure responsibility requirement of Section 4945(h)(3), the grantor private foundation must file an annual report for every year of the duration

of the loan grant. Also, because the recipient was not a private foundation, the grantor private foundation did not qualify for the exception in Treas. Regs. 53.4945-5(c)(2) and 53.4945-5(d)(1) to the annual reporting requirement. See also Rev. Rul. 77-213, 1977-1 C.B. 357 and *Hans S. Mannheimer Charitable Trust v. Commissioner*, 93 T.C. 35 (1989).

D.12. Recordkeeping Requirements of the Grantors

- (1) In addition to filing the annual report of its grant-making activities, grantor private foundations are required to retain records with respect to all their expenditure responsibility grants and to make them available to the IRS on request. The required records must include a copy of—
 - a. Each such grant agreement entered into during the taxable year;
 - b. Each report received from the grantee organization during the taxable year; and
 - c. The results of independent audits or investigations that have been conducted during the year with respect to its "expenditure responsibility" grants. See Treas. Reg. 53.4945-5(d)(3).

D.13. Reports Received After the Close of Grantor's Accounting Year

- (1) Data contained in reports received by a grantor private foundation after the close of its accounting year, but before the due date of its Form 990-PF for that year, do not need to be reported on that return, but may be reported on the grantor's Form 990-PF for the year in which such reports are received from a grantee organization. See Treas. Reg. 53.4945-5(d)(4).

D.14. Violations of Expenditure Responsibility Requirements

- (1) Violations of the expenditure responsibility requirements of Section 4945(h) fall into one of three categories:
 - a. The diversion of grant funds by a grantee organization to an improper use.
 - b. The grantee organization's failure to submit complete reports to the grantor.
 - c. A failure of the grantor private foundation to take certain expenditure responsibility actions. See Treas. Reg. 53.4945-5(e).

D.15. Diversion of Grant by Grantee Organization

- (1) The diversion of grant funds by a grantee organization to any use not in furtherance of a purpose specified in the grant may result in the diverted portion of the grant being a taxable expenditure under Section 4945(d)(4). However, the mere use of grant funds for activities not planned in the original budget is not treated as a diversion. The use of the grant funds must be inconsistent with the original purposes of the grant as described in the grant agreement. See Treas. Reg. 53.4945-5(e)(1).

Example: The original budget in a grant agreement provides a schedule of estimated expenditures such as salaries, consultant fees, operating expenses, and other similar expenses. If the actual expenditures for salaries, operating expenses, and so on differ from the estimated expenditures, such deviation is not a diversion of grant funds, assuming the use of the grant funds was consistent with the grant purposes.

- (2) The actual rules on diversions of grant funds by grantee organizations are identical to the rules on diversion of individual grants. Read above for a discussion of the diversion rules and see Treas. Reg. 53.4945-5(e)(1).

D.16. Grantee Organization's Failure to Submit Reports

- (1) If a grantee organization fails to submit an adequate report to the grantor private foundation in accordance with Section 4945(h)(2), such failure may cause the grant to be a taxable expenditure. However, if the grantor private foundation takes the corrective actions described in (2) below, the grant will not be a taxable expenditure by reason of a grantee organization's failure to submit adequate reports.
- (2) The grantor private foundation must take the following corrective actions:
 - a. It must withhold all future payments under the grant or any other grant to the same grantee organization until the delinquent report is submitted; and
 - b. It must make a reasonable effort to obtain the missing report from the grantee.
- (3) If these steps are taken and if the grantor private foundation has otherwise complied with Section 4945(h), the grant will not be treated as a taxable expenditure. See Treas. Reg. 53.4945-5(e)(2).

D.17. Grantor Violations of Section 4945(h)

- (1) A grant may be a taxable expenditure because the grantor private foundation did not comply with the requirements of Section 4945(h) in one or more of the following ways:
 - a. It failed to conduct an appropriate pre-grant inquiry;
 - b. It failed to obtain the required grant agreement from the grantee; or
 - c. It failed to file one of the required grantor reports with the IRS. See Treas. Reg. 53.4945-5(e)(3).
- (2) For example, in Rev. Rul. 77-213, 1977-1 C.B. 357, a private foundation failed to include a grant report with the original annual information return but corrected the omission on an amended return that was filed after its due date. The IRS held that the untimeliness of the amended return precluded it from nullifying the private foundation's failure to submit the report with the original return. Hence, the private foundation failed to exercise the expenditure responsibility requirements of Section 4945(h)(3). The amended return may have constituted a correction of the

failure to make the required report but did not nullify the expenditure responsibility violation. See Treas. Reg. 53.4945-1(d)(2).

E. Expenditures for Noncharitable Purposes Section 4945(d)(5)

- (1) Section 4945(d)(5) provides that the definition of "taxable expenditure" includes any amount paid or incurred by a private foundation for any purpose other than one described in Section 170(c)(2)(B) (this provision serves as a "catch-all" prohibition).
- (2) Section 170(c)(2)(B) purposes include:
 - a. Religious, charitable, scientific, literary, or educational purposes, or
 - b. To foster national or international amateur sports competition (but only if no part of its activities involves the provision of athletic facilities or equipment), or
 - c. For the prevention of cruelty to children or animals.
- (3) Thus, any expenditure for a purpose which is not described in Section 170(c)(2)(B) is a taxable expenditure. See Treas. Reg. 53.4945-6(a). Unlike Section 501(c)(3), which requires expenditures for nonexempt purposes to be more than insubstantial before loss of exemption occurs, Section 4945(d)(5) imposes liability for excise tax under Section 4945(a) on any expenditures for nonexempt purposes, whether substantial or not. Thus, a private foundation could be liable for tax under Section 4945(d)(5) for engaging in an activity which did not further an exempt purpose and yet retain its exempt status under Section 501(c)(3) because the activity was insubstantial.

E.1. Prohibited Expenditures

- (1) Expenditures that are subject to Section 4945(d)(5) include all payments made to either individuals or organizations for noncharitable purposes. These improper purposes include wrongful distributions, excessive compensation arrangements, and unreasonable payments for goods and services.
- (2) For example, an unrestricted grant by a private foundation to a cemetery not described in Section 170(c)(2)(B) is a taxable expenditure under Section 4945(d)(5). See Rev. Rul. 80-97, 1980-1 C.B. 257.
- (3) *Underwood v. United States*, 461 F. Supp. 1382 (N.D. Tex. 1978), held that a private foundation's refund of a contribution conditioned upon deductibility was not a taxable expenditure after it had been determined by the IRS that the contribution was not deductible, as the Foundation was no longer entitled to it, and thus the refund was not an "amount paid or incurred" by the foundation.
- (4) *Larchmont Foundation, Inc. v. Commissioner*, 72 T.C. 131 (1979), vacated and remanded, 659 F.2d 1085 (7th Cir. 1981), held that a foundation's failure to substantiate the nature and purpose of certain expenditures listed on its return resulted in taxable expenditures.

- (5) *Gladney v. Commissioner*, 745 F.2d 955 (5th Cir. 1984), held that a charitable trust that made noncharitable liquidating distributions pursuant to a state court order prior to terminating its private foundation status under Section 507 made taxable expenditures under Section 4945(d)(5).
- (6) *Thorne v. Commissioner*, 99 T.C. 67 (1992), held grants to an individual to write a book where the foundation had not sought advance approval from the IRS, and to family members of foundation managers, were taxable expenditures under Section 4945(d)(5).
- (7) Notice 99-36, 1999-1 C.B. 1284, alerted Section 501(c)(3) organizations about certain charitable split-dollar insurance transactions that purport to give rise to charitable contribution deductions under Section 170 or 2522 and noted that private foundations and foundation managers participating in them may be subject to tax under Section 4945.
- (8) *Parks v. Commissioner*, 145 T.C. 278 (2015), *aff'd sub nom., Parks Foundation v. Commissioner*, 717 F. App'x 712 (9th Cir. 2017), held that payments for several radio messages that did not constitute lobbying communications but were not educational resulted in taxable expenditures under Section 4945(d)(5).

E.2. Permitted Expenditures

- (1) Treas. Reg. 53.4945-6(b)(1) describes several types of expenditures which will not be treated as taxable expenditures under Section 4945(d)(5). They include the following:
 - a. Expenditures made to acquire investments and related investment expenses (for the purpose of obtaining income or funds to be used in furtherance of purposes described in Section 170(c)(2)(B));
 - b. Expenditures made to pay taxes;
 - c. Expenditures made to pay expenses that qualify as deductions for purposes of determining Section 511 unrelated business income tax;
 - d. Payments constituting a deduction under Section 4940 or qualifying distributions under Section 4942(g);
 - e. Reasonable expenditures to evaluate, acquire, modify, and dispose of program-related investments; and
 - f. Business expenditures by the recipient of a program-related investment.
- (2) For example, in Rev. Rul. 77-161, 1977-1 C.B. 358, a private foundation made a loan to a disqualified person. The loan was at a reasonable interest rate, adequately secured and met prudent investment standards. The IRS concluded that the loan was not automatically a taxable expenditure under Section 4945(d)(5) even though it was a self-dealing act under Section 4941.
- (3) Conversely, any unreasonable administrative expenses, including salaries, consultant fees, and other fees for services rendered are taxable expenditures

under Section 4945(d)(5) unless the foundation can demonstrate that the expenses were paid or incurred in the good faith belief that they were reasonable and that payment or incurring of such expenses in such amounts was consistent with ordinary business care and prudence. See Treas. Reg. 53.4945-6(b)(2).

Example: In *Kermit Fischer Foundation v. Commissioner*, T.C. Memo. 1990-300, the sole trustee of a private foundation received annual compensation of as much as \$45,000 during the tax years under examination. In addition, the private foundation paid the costs of his office, two automobiles, and a computer while its assets during this same tax years never exceeded \$211,268. The Tax Court concluded that the trustee's salary was excessive and unreasonable in view of facts and circumstances. It cited the following facts and circumstances for its conclusion: the trustee kept no records of services performed and time spent thereof, payments of compensation correlated with his personal financial needs and was in irregular amounts, the large amount of the salary received in relation to the private foundation's small corpus, and the small percentage of money actually donated to charity. As to the other expenditures, the court noted that the rental of office space and purchase of the computer and automobiles were not necessary to the operations and investments of the private foundation. Thus, the Tax Court held that these expenditures were taxable expenditures under Section 4945(d)(5).

- (4) Under certain circumstances, a private foundation may indemnify a foundation manager for expenses incurred in contesting a Chapter 42 tax and in certain state legal proceedings. See Treas. Reg. 53.4941(d)-2(f)(3) as to "reasonable administrative expenses" being a Section 170(c)(2)(B) expense.
- (5) For example, in Rev. Rul. 82-223, 1982-2 C.B. 301, a private foundation suffered a loss of assets in a transaction involving its foundation manager. The foundation manager's actions were not willful or without reasonable cause. State officials sued the manager under state laws relating to the mismanagement of funds of charitable organizations. Under an existing indemnification agreement, the foundation proposed to indemnify the manager for attorney fees, court costs, and the amount paid in settlement of the suit from its own assets.
- (6) The private foundation also proposed to pay the premiums for an insurance policy that would provide liability insurance to its foundation manager for liabilities, including settlement amounts, arising from a state mismanagement proceeding. The premiums paid by the foundation would be treated as part of the compensation paid to the manager. The purchase of insurance for indemnification is a common practice which enables an organization to attract and retain qualified management personnel. Therefore, payments of the premiums for such an insurance policy would not be taxable expenditures within the meaning of Section 4945(d)(5) and Treas. Reg. 53.4945-6(b)(2) because such expenses constitute reasonable administrative expenses and, thus, are incurred for charitable purposes within the meaning of Section 170(c)(2)(B).
- (7) Similarly, the payment of attorney's fees and court costs in connection to the foundation manager's employment would ordinarily be treated as part of his/her

compensation and, if reasonable, would not be an unreasonable administrative expense under Treas. Reg. 53.4945-6(b)(2). However, the proposed indemnification of the settlement amount would constitute a payment in satisfaction of the foundation manager's personal liability. As such, it would primarily benefit the foundation manager, would be unreasonable administrative expense under Treas. Reg. 53.4945-6(b)(2), and would constitute an expenditure for a purpose other than one of the charitable purposes specified in Section 170(c)(2)(B).

E.3. Grants to Public Organizations Should Not Be Earmarked for Prohibited Activities

- (1) A grant made to a public organization that is described in Section 509(a)(1), (2), or is not a taxable expenditure under Section 4945(d) if the following requirements are met:
 - a. The grant is not earmarked to be used for any activities described in Sections 4945(d)(2) or (d)(5), or that violates Sections 4945(d)(3) or (d)(4); and
 - b. An oral or written agreement does not exist whereby the private foundation may cause the public organization to engage in the prohibited activities. See Treas. Reg. 53.4945-2(a)(5).

E.4. Grants to Noncharitable Organizations

- (1) Since a private foundation cannot make an expenditure for a purpose other than a purpose described in Section 170(c)(2)(B), a private foundation may not make a grant to an organization other than an organization described in Section 501(c)(3). There are two exceptions to this rule:
 - a. If the grant itself constitutes a direct charitable act or the making of a Section 4944(c) program-related investment, then it is for a purpose described in Section 170(c)(2)(B) and, hence, not a taxable expenditure. Treas. Reg. 53.4945-6(c)(1)(i); and
 - b. The grantor private foundation is reasonably assured that the grant will be used exclusively for purposes described in Section 170(c)(2)(B). Reasonable assurance means the grantee organization agrees to comply with the requirements of Section 4945(d) and the expenditure responsibility requirements of Section 4945(h) and Treas. Reg. 53.4945-5; and to maintain the grant funds in a separate fund described in Section 170(c)(2)(B). In appropriate cases, the grantor may instead make an equivalency determination that a foreign grantee is described in Section 501(c)(3) and is a qualifying public charity. See Treas. Reg. 53.4945-6(c)(2).

III. Other Considerations

- (1) There are other considerations that need to be taken into account when examining a transaction that may fall within the definition of Section 4945.

A. Sanctions Under Section 4945

- (1) Section 4945 imposes a multi-level tax designed to deter private foundations from making certain expenditures.
 - a. On making a taxable expenditure, a first tier tax is imposed on the private foundation and perhaps the managers.
 - b. A severe second tier tax is imposed on the private foundation and the managers for refusing to correct a taxable expenditure.
- (2) In addition, repeated willful or flagrant violations of Section 4945 by a private foundation may result in the termination of its private foundation status as well as the imposition of tax thereunder pursuant to Section 507. Also, the private foundation and foundation managers may be subject to a penalty under Section 6684.

A.1. First Tier Tax on Private Foundation

- (1) A private foundation that made a taxable expenditure described in Section 4945(d) is subject to an excise tax equal to 20% of the amount of the taxable expenditure. See Section 4945(a)(1) (as amended by the PPA 2006 Pub. L. No. 109-280) and Treas. Reg. 53.4945-1(a).

A.2. First Tier Tax on Foundation Managers

- (1) If a private foundation has made a taxable expenditure, a manager of a private foundation is subject to a 5% tax:
 - a. If the manager agrees to make such expenditure; and
 - b. If the manager knows that such expenditure is a taxable expenditure;
 - c. Provided such agreement is willful and is not due to reasonable cause. See Section 4945(a)(2) (as amended by the PPA 2006 Pub. L. No. 109-280) and Treas. Reg. 53.4945-1(a)(2).
- (2) With respect to any one taxable expenditure, the maximum amount of the tax imposed by Section 4945(a)(2) shall not exceed \$10,000. See Section 4945(c)(2).
- (3) The first tier tax applies only to those foundation managers who are authorized to approve, or to recommend approval of, the making of expenditures by the private foundation. It also applies to those foundation managers who are members of a group, such as its board of directors or trustees, that are authorized to make such expenditures. See Treas. Reg. 53.4945-1(a)(2). For the definition of "foundation manager," see Section 4946(b). Courts have held foundation managers liable for

the tax in *Thorne v. Commissioner*, 99 T.C. 67 (1992), *Madden v. Commissioner*, T.C. Memo 1997-395, and *Parks v. Commissioner*, 145 T.C. 278 (2015), *aff'd sub nom.*, *Parks Foundation v. Commissioner*, 717 F. App'x 712 (9th Cir. 2017).

A.3. Definition of Agreement

- (1) The 5% tax, as stated above, is imposed on the agreement of a foundation manager to make a taxable expenditure. Agreement is defined to mean approval, which is sufficient to constitute an exercise of the foundation manager's authority to approve, or to exercise discretion in recommending approval of, the making of the expenditure by the foundation, whether or not such manifestation of approval is the final or decisive approval on behalf of the foundation.

Example: A member of the board of directors who votes in favor of making a taxable expenditure would be considered to have approved of or agreed to the expenditure. See Treas. Reg. 53.4945-1(a)(2)(ii).

A.4. Definition of Knowing

- (1) To be liable for the first tier tax, a foundation manager must have "known" that the expenditure to which he/she agreed was a taxable expenditure. Knowing is defined as the following:
 - a. A foundation manager has actual knowledge of sufficient facts so that, based solely upon such facts, such expenditure would be a taxable expenditure;
 - b. He/she is aware that such an expenditure under these circumstances may violate the provisions of federal tax law governing taxable expenditures; and
 - c. He/she negligently fails to make reasonable attempts to ascertain whether the expenditure is a taxable expenditure, or he/she is in fact aware that it is such an expenditure. See Treas. Reg. 53.4945-1(a)(2)(iii).
- (2) "Knowing" does not mean "having reason to know," but rather actual knowledge in determining whether a foundation manager is liable for tax. For example, a foundation manager would have "knowledge" if he/she has sufficient understanding of the facts and law involved that the expenditure would be a taxable expenditure. However, evidence tending to show that a foundation manager has reason to know of a particular fact or particular rule is relevant in determining whether he had actual knowledge of such fact or rule. For example, evidence tending to show that a foundation manager has reason to know of sufficient facts so that, based solely upon such facts, an expenditure would be a taxable expenditure is relevant in determining whether he has actual knowledge of such facts. See Treas. Reg. 53.4945-1(a)(2)(iii).
- (3) The burden of proof is upon the IRS to show knowledge. See Section 7454(b) and Treas. Reg. 53.4945-1(a)(2)(viii).

A.5. Definition of Willful

- (1) The foundation manager's agreement to a taxable expenditure must also be "willful" in order for him/her to be liable for the first tier tax under Section 4945(a)(2). Willful is defined as voluntary, conscious, and intentional. See Treas. Reg. 53.4945-1(a)(2)(iv).
- (2) Motive to avoid the restrictions of the law or tax liability is not required to show that an agreement is willful. However, a foundation manager's agreement to a taxable expenditure is not willful if he does not know that it is a taxable expenditure.

A.6. Due to Reasonable Cause

- (1) A foundation manager is not liable for the 5% first tier tax if his/her agreement to make the taxable expenditure is due to reasonable cause. Reasonable cause means the foundation manager exercises ordinary business care and prudence on behalf of the private foundation. See Treas. Reg. 53.4945-1(a)(2)(v).
- (2) An example of "reasonable cause" is where a foundation manager made a taxable expenditure based on the advice of counsel. See below for discussion of advice of counsel; see also *United States v. Boyle*, 469 U.S. 241 (1985) for a general discussion on "reasonable cause."

A.7. Advice of Counsel

- (1) The advice of counsel defense must have the following requirements:
 - a. A foundation manager must make a full disclosure of the factual situation to legal counsel (including house counsel);
 - b. He/she relies on the advice of such counsel that an expenditure is not a taxable expenditure under Section 4945;
 - c. The advice of legal counsel must be expressed in a reasoned written legal opinion. A reasoned opinion addresses the facts, the applicable law, and, based upon the aforementioned, concludes the expenditure is not a taxable expenditure, even if this conclusion is subsequently determined to be incorrect. However, a written legal opinion is not "reasoned" if it does nothing more than recite the facts and express a conclusion. See Treas. Reg. 53.4945-1(a)(2)(vi).
- (2) If these requirements are satisfied, even though such expenditure is subsequently held to be a taxable expenditure, the foundation manager's agreement to make such expenditure will not be considered "knowing" or "willful" and will be considered "due to reasonable cause" within the meaning of Section 4945(a)(2). See Treas. Reg. 53.4945-1(a)(2)(vi). See also *Burruss Land and Lumber Co., Inc. v. United States*, 349 F. Supp. 188 (W.D. Va. 1972), which held that reliance upon advice of legal counsel or accountant constituted reasonable cause for failure to file federal excise tax return.
- (3) Absence of advice of counsel with respect to an expenditure will not, by itself, give rise to any inference that a foundation manager's agreement to making a

taxable expenditure is knowing, willful, or without reasonable cause. See Treas. Reg. 53.4945-1(a)(2)(vi).

- (4) *Parks v. Commissioner*, 145 T.C. 278 (2015), *aff'd sub nom., Parks Foundation v. Commissioner*, 717 F. App'x 712 (9th Cir. 2017), held that a foundation manager did not reasonably rely on advice of counsel in publishing certain radio messages in certain instances where counsel's opinions did not address the facts and applicable law and merely expressed legal conclusions and thus were not reasoned.

B. Second Tier Taxes

- (1) The second tier taxes imposed by Section 4945(b) are designed to induce private foundations and their managers to promptly correct any improper expenditures. If a private foundation fails to correct a taxable expenditure within the taxable period, both the foundation and those managers who fail to agree to the corrective action will be liable for these taxes.

B.1. Second Tier Taxes on Private Foundations

- (1) Section 4945(b)(1) imposes on a private foundation an additional excise tax equal to 100% of the amount of the taxable expenditure if it failed to correct the taxable expenditure within the taxable period (subject to abatement if there is subsequent correction within the correction period). The private foundation must pay the second tier excise tax.
- (2) Both first tier and second tier taxes are properly asserted at the same time when issuing a notice of deficiency. See *Allan H. Applestein Foundation Trust v. Commissioner*, T.C. Memo. 1981-650, and *Howell v. Commissioner*, 77 T.C. 916 (1981). The second tier tax is then abated if there is subsequent correction within the correction period.

B.2. Second Tier Taxes on Foundation Managers

- (1) Section 4945(b)(2) imposes on any foundation manager an additional excise tax equal to 50% of the amount of the taxable expenditure if two conditions exist:
 - a. The second tier tax is imposed on the foundation pursuant to Section 4945(b)(1); and
 - b. That foundation manager refuses to agree to correct all or part of the expenditure.
- (2) With respect to any one taxable expenditure, the maximum amount of the tax imposed by Section 4945(b)(2) shall not exceed \$20,000. See Section 4945(c)(2).
- (3) This tax on foundation managers is imposed on the failure to agree to correct an expenditure rather than the failure to correct. Hence, only those foundation managers who refused to correct the expenditure are subject to the tax. Also, the foundation managers must pay the second tier excise tax.

- (4) The imposition of the Section 4945(a)(2) first tier tax on foundation managers is not a prerequisite for the imposition of the second tier tax on foundation managers. The only conditions needed to trigger the imposition of the second tier tax are the two requirements described above.
- (5) A request for correction can be made by a fellow foundation manager or the IRS.
 - a. If it is the latter, according to *Thorne v. Commissioner*, 99 T.C. 67 (1992), the IRS must make a formal written request to the foundation manager to make the correction.
 - b. Otherwise, according to *Thorne*, the foundation manager cannot be considered as having refused to make the correction because the IRS never specifically requested that he take such action.
- (6) The written request for correction should be made within a reasonable period of time (to allow opportunity to respond) prior to the issuance of a 30-day letter proposing a statutory notice of deficiency for the second tier tax of Section 4945(b).

Note: Internal Revenue Manual (IRM) 4.70.14, Resolving the Examination, states that the *Thorne* letter should be sent out to the foundation manager prior to issuance of a 30-day letter asserting the first tier and second tier taxes, as applicable; if the foundation manager does not agree to correction, then the 30-day letter with the reports should assert the second tier foundation manager taxes.

B.3. Correction of Taxable Expenditures and Second Tier Taxes

- (1) The purpose of correction is to permit a private foundation and its managers to take all reasonable steps to return the foundation to the position it was in before it made the taxable expenditure. It also permits the private foundation and its managers to avoid the imposition of the severe second tier taxes of Section 4945(b).
- (2) To correct a taxable expenditure, a private foundation must recover funds and, when funds cannot be fully recovered, must take additional corrective action to prevent future violations. In cases where the grantee or grantor has failed to satisfy the reporting requirements, correction will ordinarily involve obtaining or making the required reports.

B.4. Definition and Method of Correction

- (1) Section 4945(b)(1), as stated above, provides that if a private foundation corrects a taxable expenditure during the taxable period, it and its managers will not be liable for the second tier tax. However, the private foundation is not required to attempt to recover the taxable expenditure by legal action if in all probability a judgment would not be satisfied. See Treas. Reg. 53.4945-1(d)(1).
- (2) Under Section 4945(i) and Treas. Reg. 53.4945-1(d)(1), correcting a taxable expenditure is accomplished by recovering the amount of the expenditure to the

extent recovery is possible. If all the funds constituting the taxable expenditure are recovered, the foundation will have corrected the transaction and need not take any further steps to avoid liability for the additional tax.

- (3) If recovery of the full amount of the expenditure is not possible, the IRS may require the private foundation, under the facts and circumstances, to take some or all the following corrective actions:
 - a. Withholding any unpaid funds due to the grantee;
 - b. Making no further grants to the particular grantee;
 - c. Submitting, in addition to other reports that are required, periodic reports (for example, quarterly) with respect to all its expenditures (such reports shall be equivalent in detail to the reports required by Section 4945(h)(3) and Treas. Reg. 53.4945-5(d));
 - d. Improving methods of exercising expenditure responsibility;
 - e. Improving methods of selecting recipients of individual grants; and
 - f. Implementing other measures as the IRS may prescribe in a particular case.
- (4) If the expenditure is taxable only because of inadequate reporting (in violation of Section 4945(h)(2) or Section 4945(h)(3)), correction may be accomplished by obtaining the required report. In addition, if the expenditure is taxable only because of a failure to obtain a full and complete report from the grantee on how the funds were spent (Section 4945(h)(2)) and an investigation indicates that no grant funds have been diverted to any use not in furtherance of a purpose specified in the grant, correction may be accomplished by exerting all reasonable efforts to obtain the report in question and reporting the failure to the IRS, even though the report is not finally obtained. See Treas. Reg. 53.4945-1(d)(2).
- (5) Where a grant is a taxable expenditure under Section 4945(d)(3) only because of a failure to obtain advance approval of procedures under Section 4945(g), correction may be accomplished by obtaining approval of the grant making procedures and establishing to the satisfaction of the IRS that:
 - a. No grant funds have been diverted for use not in furtherance of a purpose not specified in the grant;
 - b. The grant making procedures instituted would have been approved if advance approval of such procedures had been properly requested; and
 - c. Where advance approval of grant making procedures is subsequently required, such approval will be properly requested. See Treas. Reg. 53.4945-1(d)(3).

B.5. Definition of Taxable Period

- (1) The taxable period, for purposes of correcting a taxable expenditure, begins with the date of the making of the taxable expenditure and ends on the earlier of:

- a. The date of a mailing of a notice of deficiency with respect to the first tier tax; or
- b. The date on which the first tier tax is assessed. See Section 4945(i)(2) and Treas. Reg. 53.4945-1(e).

B.6. Joint and Several Liability, and Limits on Liability of Foundation Managers

- (1) If more than one foundation manager is liable for the first tier tax imposed under Section 4945(a)(2) or the second tier tax under Section 4944(b)(2), all foundation managers are jointly and severally liable for the tax imposed under each provision with respect to any one taxable expenditure. See Section 4945(c)(1) and Treas. Reg. 53.4945-1(c)(1).
- (2) The maximum aggregate amount of tax all participating foundation managers are liable for with respect to any one taxable expenditure is \$10,000 under the first tier tax of Section 4945(a)(2) and \$20,000 under the second tier tax of Section 4945(b)(2). See Section 4945(c)(2).

B.7. Abatement of First Tier and Second Tier Taxes

- (1) Section 4962 grants the IRS discretionary authority to abate certain Chapter 42 first tier taxes including taxes under Section 4945(a) for taxable events (making taxable expenditures) occurring after December 31, 1984. See Sections 4962(a) and (b). In effect, this provision gives a private foundation and its managers a chance to avoid the imposition of the first tier taxes under Section 4945(a).
- (2) A private foundation or its managers may abate the first tier taxes only if they can establish to the satisfaction of the IRS that the making of a taxable expenditure:
 - a. Was due to reasonable cause;
 - b. Was not due to willful neglect; and
 - c. Has been corrected within the correction period.
- (3) The correction period begins with the date on which the taxable expenditure was made and ends 90 days after the mailing of a notice of deficiency with respect to the second tier tax. See Section 4963(e)(1) and Treas. Reg. 53.4963-1(e).
- (4) The correction period can be extended by the IRS if certain requirements are met. See Section 4963(e)(1)(A) and (B) and Treas. Reg. 53.4963-1(e).
- (5) Section 4961(a) permits the abatement of certain Chapter 42 second tier taxes, including taxes under Section 4945(b). Specifically, this provision provides that if a taxable expenditure is corrected during the "correction period," the second tier tax imposed is not to be assessed, and if assessed, the assessment is to be abated, and if collected shall be credited or refunded as an overpayment. See Section 4961(a).

C. Section 507 Termination and Other Sanctions

- (1) If a private foundation willfully and repeatedly or willfully and flagrantly violates Section 4945 (or any of the other provisions of Chapter 42), the IRS may terminate its private foundation status pursuant to Section 507(a)(2).
- (2) Hence, such private foundation may be subject to the termination tax imposed by Section 507(c).
- (3) In addition, a private foundation or foundation manager may be liable for the tax under Section 6684 in the amount equal to the tax under Section 4945. See, for example, *Thorne v. Commissioner*, 99 T.C. 67 (1992); cf. *Larchmont Foundation, Inc. v. Commissioner*, 72 T.C. 131 (1979), vacated and remanded, 659 F.2d 1085 (7th Cir. 1981).

IV. Examination Techniques

- (1) This section focuses on how to calculate and assert the excise tax under Section 4945 once it's been determined that the foundation made taxable expenditures. It also contains information relevant to examinations of private foundations in general.

A. Introduction

- (1) Section 4945(d) lists five categories of taxable expenditures. These include amounts:
 - a. Spent to carry on propaganda or attempt to influence legislation. See Section 4945(d)(1).
 - b. Expended to influence any specific public election outcome, or to carry on a partisan voter registration drive (directly or indirectly). See Section 4945(d)(2).
 - c. Paid as a grant to an individual for travel, study, or other similar purposes, unless the grant satisfies Section 4945(g). See Section 4945(d)(3).
 - d. Disbursed as a grant to an organization, unless the organization is a public charity (other than certain supporting organizations) or the PF exercises expenditure responsibility per Section 4945(h). See Section 4945(d)(4)(A)(ii) or exempt operating foundation. See Section 4945(d)(4).
 - e. Paid or incurred for any purpose other than one in Section 170(c)(2)(B). See Section 4945(d)(5).
- (2) An expenditure may fall into several categories of taxable expenditures. Regardless of the number of categories violated, the tax is assessed only once.

Example: A foundation manager issues a series of payments to two individuals to travel throughout several counties in a state during an election year. The recipients act as paid signature gatherers for a number of ballot initiatives to modify current laws. They also go door to door to sign up eligible voters, based on a list of potential voters provided by a state political party. They provide pamphlets to the voters promoting specific party candidates. The individuals submit travel vouchers for reimbursement to the foundation, along with the signature pages, lists of voter registrations, and paid invoices for the printing of the pamphlets.

Note: In the above example, the foundation has violated Sections 4945(d)(1), (d)(2), and (d)(5). The foundation is liable only once for the tax on the reimbursements to the individuals, and the tax is imposed only once in the taxable period.

- (3) When examining the foundation, review all the expenditures. Determine which expenditures constitute grants. For grants to individuals for travel, studies, or similar purposes, verify that the organization has obtained a Section 4945(g) advance ruling letter. The organization may request the letter during the initial application process or in a subsequent ruling request. If the foundation doesn't

have a ruling letter, determine whether it meets an exception under Section 4945(d)(3) or Section 4945(g). Assert the tax if the foundation doesn't meet the exceptions.

Note: The foundation may submit Form 8940, Request for Miscellaneous Determination, and pay a user fee to request a Section 4945(g) advance ruling letter. The ruling is prospective from the date of the letter and is not retroactive, though it may be required as part of correction.

- (4) Unless a grant was made to a public charity (other than certain supporting organizations - see Section 4945(d)(4)(A)(ii)) or an exempt operating foundation, determine whether the foundation exercised expenditure responsibility.
- (5) For those grants that failed the expenditure responsibility requirement, propose the first tier tax and request correction. Refer to the Correction section for a discussion of acceptable correction.
- (6) Be aware that there are permitted expenditures, such as:
 - a. Expenditures to acquire investments that generate income to be used to further the purposes of the organization.
 - b. Reasonable expenses related to acquiring these investments.
 - c. Payment of taxes.
 - d. Expenses that qualify as allowable deductions in figuring unrelated business income tax (UBIT).
 - e. Any payment that is a Section 4942 qualifying distribution.
 - f. Any deduction allowed in arriving at taxable net investment income (Section 4940).
 - g. Reasonable expenditures to evaluate, acquire, modify, and dispose of program-related investments.
 - h. Business expenses of the recipient of a program-related investment.
- (7) Payment of unreasonable administrative expenses, including wages, consultant fees, and other fees for services performed, are taxable expenditures unless they were:
 - a. Made in the good faith belief that the amounts were reasonable.
 - b. Consistent with ordinary business care and prudence.
- (8) Request documentation that supports the reasonableness determination for any expenditure that appears unreasonable. Expenditures may be taxable if the trustees, officers, or foundation managers didn't try to determine whether the expenditures were reasonable. If needed, submit a Specialist Referral System request for an LB&I engineer to evaluate the expenditure. Determine the excess expenditure and propose the tax for the excess amount.

(9) Compute the tax using the expenditure amount, or excess amount if deemed unreasonable. Propose the tax for the year in which the expenditure was made.

(10) In addition to the Section 4945(a)(1) tax imposed on foundations, Section 4945(a)(2) imposes a tax on a foundation manager who knowingly and willfully agrees to the expenditure.

(11) Refer to the Correction section for a discussion of acceptable correction.

(12) Complete Form 4883, Exempt Organizations Excise Tax Audit Changes, Form 4621, Report of Examination - Exempt Organization, Form 886-A, Explanation of Items, and Form 870-E, Waiver of Restriction on Assessments and Collection of Deficiency and Acceptance of Overassessment. See Section VI of this Technical Guide for examples of how to determine and compute the tax.

Note: Form 870-E is used with respect to taxes that a taxpayer agrees to pay in full, suspends interest from continuing to accrue, and facilitates closure. See IRM 8.6.4, Reaching Settlement and Securing an Appeals Agreement Form and IRM 4.70.14, Resolving the Examination. List separately the tax for each taxable event (and for each year within the taxable period), and when applicable, prepare a separate Form 870-E for each taxpayer.

(13) The Section 4945(a)(1) tax is reported on Form 4720 and assessed against the private foundation. See IRM 4.70.13, Executing the Examination, to set up a substitute for return if no return was filed or to secure a delinquent return.

(14) The foundation manager tax is reported on Form 4720 and assessed against the responsible individual(s). See also IRM 4.70.14, Resolving the Examination, for the situations described above.

Note: A manager, self-dealer, disqualified person, donor, donor adviser or related person who owes tax under Chapter 41 or 42 (including an organization manager under Section 4965), may no longer report the tax on the Form 4720 filed by the organization. Each taxpayer must file a separate Form 4720. See Notice 2021-01, 2021-2 I.R.B. 315.

B. Chapter 42 First Tier Excise Taxes Table

(1) The table below identifies the parties subject to the Chapter 42 excise taxes, (initial/first tier taxes generally applicable to private foundations under subchapter A), the applicable tax rates before and after the implementation of PPA 2006, and what limit, if any, applies to the tax, and if so, how much.

(2) The Taxpayer Certainty and Disaster Tax Relief Act (TCA) passed on December 20, 2019, included legislation that reduced the 2% excise tax on net investment income of private foundations to 1.39%. At the same time, the legislation repealed the 1% special rate that applied if the private foundation met certain distribution requirements. The changes are effective for taxable years beginning after December 20, 2019.

Code Section	Liable party	Tax Rate (PPA 2006*)		Limit (PPA 2006*)		TCA
		Before	After	Before	After	After
4940(a)	PF	up to 2%	up to 2%	None	None	1.39%**
4941(a)(1)	Self-dealer	5%	10%	None	None	No change
4941(a)(2)	FM	2.5%	5%	\$10,000 per act	\$20,000 per act	No change
4942(a)	PF	15%	30%	None	None	No change
4943(a)(1)	PF	5%	10%	None	None	No change
4944(a)(1)	PF	5%	10%	None	None	No change
4944(a)(2)	FM	5%	10%	\$5,000 per act	\$10,000 per act	No change
4945(a)(1)	PF	10%	20%	None	None	No change
4945(a)(2)	FM	2.5%	5%	\$5,000 per act	\$10,000 per act	No change
*The tax rate changes are effective for full tax years that begin after August 17, 2006.						
**The tax rate changes are effective for full tax years after December 20, 2019.						

- (3) If an organization or individual incurs an excise tax under Section 4941, 4942, 4943, or 4944 in a given year, then the first tier tax is imposed that year and each subsequent tax year or partial year in the taxable period (but under Section 4943, only for tax years that end within the taxable period).

Note: If a foundation has undistributed income under Section 4942 for its first taxable year that remains undistributed as of the end of its second taxable year, then the Form 4720 instructions treat the Section 4942 tax on the undistributed income as imposed as of the end of its second taxable year, reportable on Form 4720 for its second taxable year (normally due May 15 of its third taxable year for a calendar year filer).

- (4) For Sections 4941, 4943, and 4944, the taxable period doesn't end until the earliest of:
- a. Full correction (in the case of Section 4943 when the excess business holding is eliminated, or in the case of Section 4944, when the amount invested is removed from jeopardy),
 - b. Assessment, or
 - c. Issuance of a notice of deficiency.
- (5) For Sections 4942 and 4945, the taxable period ends on the earliest of:

- a. Issuance of a notice of deficiency, or
- b. Assessment.

Note: The notice of deficiency should reflect taxes owed for all years and partial years up to the date of notice, as a second notice of deficiency might not be allowed for taxes on the same act or failure to act. See Section 6212(c).

- (6) Under Section 4945, there is only one first tier tax in the taxable period (unlike Sections 4941 - 4944).
- (7) Use the tax year of the disqualified person for Section 4941 (Rev. Rul. 75-391, 1975-2 C.B. 446). Similarly, use the tax year of the private foundation for tax paid by the private foundation under Section 4940 or Sections 4942-4945, and the tax year of the foundation manager for foundation manager taxes under Sections 4941, 4944 and 4945.
- (8) Except for Section 4940, excise taxes are reported on Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code. Previously, for years prior to 2020, if the taxpayer was a self-dealer, disqualified person, organization or foundation manager, donor or donor adviser, or related person, the taxpayer completed Part II of the Form 4720 to report the tax. When Part II was processed, the Form 4720 was designated as Form 4720-A. Alternatively, such taxpayer (described above) had the option to report liability for excise tax on the return filed by the organization, assuming that both had the same taxable year. For tax years beginning in 2020, each taxpayer must file a separate Form 4720. Form 4720 has been revised to identify whether the filer is the organization or another taxpayer subject to the Chapter 42 excise taxes. Accordingly, for tax years after 2019, an agent preparing the Form 4720 under substitute for return (SFR) procedures to report a taxpayer's excise tax liability during an examination will no longer convert the Form 4720 to "Form 4720-A." The revenue agent will, instead, complete a Form 4720 identifying the filer as described in the instructions for Form 4720. Please see the instructions for Form 4720 and Notice 2021-01, 2021-2 IRB 315, for further information.

Note: Electronic filing of the Form 4720 is required for private foundations for Form 4720 returns due on or after July 15, 2021. A limited exception applies for 2020 Form 4720 returns with a due date on or after July 15, 2021, that are submitted on paper and bear a postmark date on or before June 16, 2021. Organizations other than private foundations are encouraged, but not required, to file Form 4720 electronically.
- (9) To calculate Section 4940 and Section 4942 taxes, complete the Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation. Reclassify expenditures as necessary to determine the qualifying distributions.
- (10) The applicable report forms are:
 - a. Form 4621, Exempt Organizations - Report of Examination

- b. Form 4883, Exempt Organizations Excise Tax Audit Changes
- c. Form 886-A, Explanation of Items
- d. Form 870-E, Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment

C. One Act/Failure to Act, Multiple Violations

- (1) The structure of Chapter 42 permits the assessment of excise taxes under different statutes for the same transaction. For instance, a self-dealing transaction (Section 4941) is frequently also a taxable expenditure (Section 4945), that may also affect the net investment income (Section 4940) and the qualifying distributions (Section 4942). See Treas. Reg. 53.4944-1(a)(2)(iv); Rev. Rul. 77-161, 1977-1 C.B. 358; *Kermit Fisher Foundation v. Commissioner*, T.C. Memo. 1990-300.
- (2) Section 4940 and Section 4942 are closely related. Expenses must be allocated between Section 4940 (investment activities) and Section 4942 (charitable activities). See Treas. Reg. 53.4940-1(e)(1); Rev. Rul. 75-410, 1975-2 C.B. 446; *Julia R. & Estelle L. Foundation, Inc. Commissioner*, 598 F.2d 755 (2d Cir. 1979); *Kermit Fisher Foundation v. Commissioner*, above. Also, a deduction for expenses paid or incurred in any taxable year for the production of gross investment income earned as an incident to a charitable function may not be greater than the income earned from such charitable function which is includible in gross investment income for such year. See Treas. Reg. 53.4940-1(e)(2)(iv). However, deductions with respect to property used for an exempt purpose in excess of the income derived from the property may be treated as a qualifying distribution. See Treas. Reg. 53.4942(a)-2(d)(4)(i).
- (3) For taxable years beginning before December 21, 2019, (prior to the effective date of the TCA which repealed Section 4940(e)) Section 4940(e) and Section 4942 were especially inseparable. Adjustments to the net value of non-charitable use assets impacts the investment tax calculations (under former Section 4940(e)) and the minimum investment return (Section 4942). Both taxes rely on determining qualifying distributions; Section 4942 applies them against undistributed income to compute the tax liability. The following examples illustrate several outcomes when changes are made to the first page of the Form 990-PF.
- (4) Note that the examples below regarding Section 4940, which imposes an excise tax on the net investment income of most domestic tax-exempt private foundations, including private operating foundations, are for tax years beginning on or before Dec. 20, 2019. For those years, the excise tax is 2% of net investment income, but is reduced to 1% in certain cases. For tax years beginning after Dec. 20, 2019, the excise tax is 1.39% of net investment income, and there is no reduced 1% tax rate.

Example 1: The foundation has expenditures which constitute actions of self-dealing. The foundation reported these amounts in Part I Column d as charitable disbursements. The IRS later disallows these amounts and the Part XII Line 1a

amount is reduced. This in turn reduces the qualifying distributions. When the qualifying distributions for the year are less than: the sum of 1% of the net investment income and the product of 1) the 5-year average percentage payout ratio and 2) the net value of the non-charitable use assets, the foundation can't use the Section 4940(e) 1% tax rate. For Section 4942 purposes, undistributed income is offset by qualifying distributions. When the qualifying distributions are reduced or disallowed, the potential for tax on undistributed income arises. This flow of actions is demonstrated as follows:

Form 990-PF line adjustment	Increase or decrease
Part I Line 26 Column (d)	Decrease
Part XII Line 1(a)	Decrease
Part XII Line 4	Decrease
Part V Line 8	Decrease
Part XIII Line 4	Decrease

Note: Part V of the Form 990-PF will no longer be used for taxable years beginning after December 20, 2019, because the Taxpayer Certainty and Disaster Tax Relief Act passed on December 20, 2019, included legislation that reduced the 2% excise tax on the net investment income of a private foundation to 1.39%. This legislation also repealed the 1% special rate that applied if the private foundation met certain distribution requirements.

If Part V Line 8 is less than Part V Line 7, use the 2% tax rate for 4940. A decrease in qualifying distributions results in Section 4942 tax if Part XIII Line 6(e) is greater than zero.

Example 2: The foundation understates the net investment income (either understating investment revenues or over-allocating/overstating investment expenses or both). This directly increases the Section 4940 tax. Also, this decreases the distributable amount (Part XI). This decreases the amount of undistributed income to be offset by qualifying distributions in Part XIII. This flow of actions is demonstrated as follows:

Form 990-PF line adjustment	Increase or decrease
Part I Line 27(b)	Increase
Part VI Line 5	Increase
Part XI Line 2(a)	Increase

Part XI Line 7	Decrease
Part XIII Line 1	Decrease

If the amount on Part XIII Line 1 is greater than the sum of Part XIII Lines 4(d) and 5, there will be an amount in Part XIII Line 6f. This amount is then reported on the subsequent year's Form 990-PF Part XIII Line 2a.

Example 3: The foundation overstates the net investment income. The Section 4940 tax is reduced, and the distributable amount in turn is increased, increasing any possible Section 4942 tax.

Example 4: The foundation understates the non-charitable use assets. (This frequently occurs when the return preparer averages the beginning and end of year bank/brokerage balances in lieu of the month end balances.) The non-charitable use assets net value and the minimum investment return (Part X Lines 5 and 6) increases. In addition to affecting the subsequent year's distribution ratio, it raises the threshold for meeting the Section 4940(e) reduced tax rate. For Section 4942 purposes, the distributable amount increases, thus increasing the chance for tax two years down the road.

Example 5: The foundation overstates the non-charitable use assets. The net value of non-charitable use assets decreases, as do the minimum investment return and distributable amount. This lowers the Section 4940(e) threshold, and the chance for a possible Section 4942 tax is reduced.

- (5) Section 4941 and Section 4945 excise tax liability can commonly arise for the same transaction. Many self-dealing transactions aren't considered to be for Section 170(c)(2)(B) purposes, thus becoming taxable expenditures. On the other hand, a taxable expenditure isn't necessarily a self-dealing transaction and vice-versa. See Rev. Rul. 77-161, 1977-1 C.B. 358. Remember to apply the appropriate Code section and Regulations when analyzing each transaction.

Example 1: A foundation manager uses foundation funds to go on a vacation in the Bahamas. This transaction is both a self-dealing transaction and a taxable expenditure.

Example 2: The same foundation manager is a member of Church X congregation. The manager uses the funds to pay for a "recuperation retreat" for the church's pastor and the pastor's family in the Bahamas. The manager isn't related to the pastor by blood or marriage, and the pastor and family aren't otherwise disqualified persons with respect to the foundation. The foundation doesn't have advance approval under Section 4945(g) to make grants to individuals. Due to lack of advance approval of the grant procedures under Section 4945(g), the transaction constitutes a taxable expenditure but not a self-dealing expenditure.

- (6) An act subject to Section 4943 may also trigger other taxes in certain situations.

Example: A foundation purchases stock of a disqualified person's wholly owned corporation directly from the disqualified person. The purchase of the stock constitutes a self-dealing transaction. If the foundation owns more than 2% of the total stock of the corporation, the purchase may trigger Section 4943. A donation of the stock won't constitute a self-dealing transaction but may trigger Section 4943.

- (7) As with Section 4943, an act subject to Section 4944 may also trigger other taxes in certain situations.

Example: The foundation bought stock of a disqualified person's wholly owned corporation from the disqualified person. The corporation is a corporate sole entity used to shelter the disqualified person's income and assets. The disqualified person isn't a minister of a church and thus the entity constitutes a sham corporation. The purchase constitutes a jeopardizing investment and a self-dealing transaction. As with the previous example, if the foundation owns more than 2% of the total stock of the corporation, the transaction may also trigger Section 4943.

D. Information Regarding Correction

- (1) Each Chapter 42 excise tax, except for Section 4940, requires correction of the taxable event that triggers the excise tax. (Sections 4942, 4943, and 4944 generally don't refer to "correction" but effectively require correcting the violation to avoid multiple taxes and second tier taxes.) Failure to make correction can result in the imposition of second tier taxes. When one transaction triggers multiple excise taxes, the correction for one tax may possibly also satisfy correction for the other taxes. Refer to the specific Technical Guides and Regulations for directions on the appropriate correction methods for each Code subsection.
- (2) The immediately following table identifies the Code subsection requiring correction and the actions required to make it. There is no correction for Section 4940, as it has no second tier excise tax. Section 4940 is an excise tax that is computed like an income tax, except that certain deductions aren't allowed, such as the net operating loss deduction under Section 172. See Treas. Reg. 53.4940-1(e).

Code Section	Correction
4941(e)(3)	Undo the transaction to the extent possible. Restore the foundation to the same or better financial position than it would have been had the transaction not occurred. See Treas. Reg. 53.4941(e)-1(c)

4942(h)(2) and 4963(d)(2)	Reduce the amount of undistributed income to zero. Can elect to treat qualifying distributions as made from a prior year's undistributed income. Treas. Reg. 53.4942(a)-3(b)(6), relating to failure to distribute minimum amounts under the cash distribution test for set-asides, allows for correction (by distribution of cash or cash equivalent only) within the correction period if the failure to distribute was not willful and was due to reasonable cause.
4943(c)	Depending on when and how the business holding was received, the organization may have a transition period in which to dispose of the excess holding. Correction is made when no excess holdings remain. Treas. Reg. 53.4943-9(c)
4944(e)(2)	Remove the investment from jeopardy by either selling it or disposing of it (other than exchanging it for another jeopardizing investment). Treas. Reg. 53.4944-5(b)
4945(i)(1)	Recover as much of the expenditure as possible, and any other correction the IRS may prescribe if unable to recover the whole expenditure. In certain situations, obtain or make a report on the use of a grant, or obtain approval of grant-making procedures. Treas. Reg. 53.4945-1(d)

- (3) The correction amount isn't necessarily the same as the amount involved in a particular transaction. Compute the correction amount and the taxable amount involved separately. Refer to the specific technical guides and regulations for directions on the appropriate correction methods.

Note: When two or more excise taxes are involved, verify that correction has been made for each tax code section under which liability arises. What may constitute correction for one section may not be sufficient correction under another code section.

Example: A foundation issues a below-market "loan" to a disqualified person, who in turn uses the money to purchase a vacation property for personal use. The transaction is both self-dealing and a taxable expenditure. To correct the taxable expenditure, the disqualified person needs to repay the loan. To correct the self-dealing transaction, the disqualified person needs to not only repay the loan, but also pay interest.

- (4) When correction is made, obtain verification. See the following list (not all-inclusive) for acceptable proof of correction. Discuss with the manager and Area Counsel as to appropriate methods of correction and proof, if desired:

- a. Copies of cancelled check(s) to the foundation and bank statement(s) showing the deposit(s).
 - b. New title documents for returned real property.
 - c. Copies of cancelled check(s) and bank statement(s) showing appropriate distributions.
 - d. Brokerage/financial institution statement(s) showing that a foundation no longer owns an asset or stock.
 - e. Copies of reports secured concerning the uses of grants made.
- (5) Be alert for attempts to circumvent the correction requirement. At a minimum, ensure that the parties don't:
- a. Deposit the correction amount and then issue a new check back to the party making correction.
 - b. Obtain new title documents for returned property and then change title back to the party that returned the property.
 - c. Redeposit amounts distributed to satisfy Section 4942 (such as voided checks, circular transactions).
 - d. Transfer assets or stocks to other financial institutions or to disqualified parties for which statements aren't provided.
 - e. Engage in an act of self-dealing when attempting to make correction.
- (6) If revoking or involuntarily terminating the foundation, request and verify that correction is made to a governmental agency or other Section 501(c)(3) organization that isn't itself at risk of revocation.
- (7) In the event that requests to extend the correction period (Section 4963(e)(1)(B)) are received, under Delegation Order 7-4 (IRM 1.2.2.8.4), Area Managers may authorize extensions of the correction period, or delegate the authority to the group manager. Consult the group manager if considering granting an extension of time to make correction. It is recommended that the appropriate TE/GE Division Counsel also be consulted per the group manager's authorization.
- (8) Extensions of the correction period aren't ordinarily granted unless these factors are present:
- a. The taxpayer is actively seeking in good faith to correct the taxable event.
 - b. Adequate correction is unavailable or can't reasonably be expected to occur during the original correction period.
 - c. The taxable event appears to be an isolated occurrence, and it appears unlikely that similar taxable events will occur in the future. See Treas. Reg. 53.4963-1(e)(3).

Note: An extension of the correction period also extends the period in which the taxpayer may petition the Tax Court for the deficiency. Treas. Reg. 301.6213-1(e).

- (9) A taxpayer paying the full amount of the first tier tax during the original correction period extends the correction period to the later of:
- 90 days after paying the first tier tax, or
 - The last day of the original correction period.

Note: If the taxpayer pays the first tier tax after the IRS mails a statutory notice of deficiency and before the 90-day period of the notice has expired, the taxpayer has 90 days from the payment date to make correction. See Treas. Reg. 53.4963-1(e)(4). If the taxpayer petitions the Tax Court regarding the second tier taxes, before the correction period (including extensions) expires, the correction period runs until the decision is final. See Treas. Reg. 53.4963-1(e)(2).

- (10) See Treas. Reg. 53.4963-1(e)(5) for extensions of the correction period where a claim for refund is filed with respect to payment of the full amount of the first tier tax imposed with respect to the taxable event or when a suit or proceeding with respect to the claim is filed.
- (11) If there has been a waiver of the restrictions on assessment and collection of the deficiency or if the deficiency is paid, and therefore no notice of deficiency is mailed, the correction period will end with the end of the collection prohibition period described in Treas. Reg. 53.4961-2(e)(5). See Treas. Reg. 53.4963-1(e)(6).

E. Correction Period

- (1) Under Section 4963(e), the correction period is the period beginning on the first day on which the taxable event occurs and ending 90 days after the date of mailing under Section 6212 of a notice of deficiency with respect to the additional tax, extended by:
- Any period in which a deficiency cannot be assessed under Section 6213(a) (determined without regard to the supplemental proceeding provided for under Section 4961(b), and
 - Any other period which the IRS determines is reasonable and necessary to bring about correction.
- (2) See Section 4963(e)(2) which sets forth special rules for when the taxable event occurs.

F. Advance Approval of Proposed Correction

- (1) Taxpayers may request advance approval of a proposed correction. If granted, the advance approval provides assurance to taxpayers and organizations that the IRS will view an intended remedial action favorably as correction.

- (2) Advance approval is **only** available when:
- The only barrier is the reluctance to correct because they are uncertain of final IRS approval, and
 - The other aspects of the issue aren't disputed.
- (3) For all other cases, treat the case as unagreed if the taxpayer is unwilling to make correction.
- (4) To grant advance approval, all the following conditions must be met:
- The taxpayer indicates acceptance of initial tax liability (Sections 4941 through 4945).
 - Correction will be very difficult or costly, requiring the exercise of sound judgment on a broad scale.
 - The taxpayer should be able to complete the proposed correction within 90 days from the date of approval.
 - The taxpayer submits a written request for advance approval, attention of the Area Manager.
- (5) The written request must:
- Fully describe the surrounding circumstances giving rise to the initial tax liability.
 - Outline in detail the nature and method of the proposed correction.
 - Accept an initial tax liability for the act or failure to act in question.
 - Include the date by which the taxpayer will complete the correction.
- (6) When such a written request is received, suspend further action on the issue, and continue all other aspects of the examination. Send a copy of the request to the Area Manager (scanned and secured e-mail if possible). Consult with Area Counsel if complex correction situations arise from the written request. Schedule and hold a conference call with the Group and Area Managers.
- (7) If the Area Manager approves the request, prepare and issue a draft correction approval letter. See Letter 5305, Private Foundation Correction Approval Letter. The letter must:
- Explain in detail the proposed corrective action.
 - Specify the due date for correction completion.
 - Require the taxpayer to notify the Area Manager upon completion.
 - Clarify that the taxpayer's reliance on the letter is conditioned on it meeting the conditions specified for correction.

Reminder: Monitor the time remaining on the statute of limitations. Consider requesting a statute extension as needed.

- (8) If the Area Manager denies the request, prepare and issue a draft correction rejection letter. See Letter 5306, Private Foundation Correction Rejection Letter. In the letter:
 - a. Outline the taxpayer's proposal.
 - b. Explain why it doesn't constitute correction.
 - c. Clarify that other methods of correction are still available.
 - d. Suggest a correction action (or actions) that would be acceptable.
- (9) If the Area Manager accepts the request, keep the case in the group, and continue to work other issues on the case. When the Area Manager provides notification that the taxpayer corrected, secure proof. Secure the taxpayer's agreement to the first tier tax on Form 870-E. Collect the first tier tax or secure an installment agreement request (Form 9465, Installment Agreement Request).
- (10) If notification or proof is not received by the due date for correction, contact the taxpayer to confirm correction. Ask the taxpayer to send proof right away (via express mail, or fax).
- (11) If proof of correction is not promptly received after contacting the taxpayer, close the case as unagreed. See IRM 4.70.14, Resolving the Examination, for closing procedures.

G. All Chapter 42 Second Tier Excise Taxes

- (1) See the following table for the additional/second tier taxes generally applicable to private foundations under subchapter A for each Code section.

Code Section	Liable party	Tax Rate	Limit? (PPA 2006*)	
			Before	After
4941(b)(1)	Self-dealer	200%	None	None
4941(b)(2)	FM	50%	\$10,000 per act	\$20,000 per act
4942(b)	PF	100%	None	None
4943(b)	PF	200%	None	None
4944(b)(1)	PF	25%	None	None
4944(b)(2)	FM	5%	\$10,000 per act	\$20,000 per act
4945(b)(1)	PF	100%	None	None
4945(b)(2)	FM	50%	\$10,000 per act	\$20,000 per act

*The limit changes are effective for the first full tax years that begin after August 17, 2006.

(2) Second tier taxes are:

- a. Triggered by the failure to make correction,
- b. Imposed at the same time as first tier taxes for assessment or when a notice of deficiency is issued, and
- c. Abated if correction is made within the correction period.

(3) Indicate in the report of examination (Forms 4883, 4621, 886-A) the amount of potential second tier taxes if the taxpayer doesn't make correction. With Area Manager approval, the closing of an agreed first tier tax case can be delayed for a reasonable period to permit correction, depending on the facts and circumstances.

(4) Before granting the above extension, ensure that the taxpayer has:

- a. Signed the Form 870-E.
- b. Paid the first tier tax.
- c. Granted a statute extension, if necessary.

Note: Obtain the Area Manager's approval due to the additional case cycle time.

(5) All second tier taxes are imposed once per act/failure to act or taxable event.

Refer to the specific Code section and the regulations for how to determine the amount of the second tier tax calculation. Under Sections 4942 and 4943, if the taxpayer partially corrects (reduces but does not eliminate undistributed income or excess business holdings), the second tier tax is on the uncorrected remaining amount.

(6) Under Section 4945(b)(1), the second tier tax is imposed on the foundation and is at the rate of 100% of the amount of each taxable expenditure. For foundation managers, who have refused to agree to part or all of the correction of the taxable expenditure, the tax under Section 4945(b)(2) is at the rate of 50% of the amount of the taxable expenditure (subject to the limitations in Section 4945(c)(2)).

(7) See IRM 4.70.14, Resolving the Examination, for additional information for the necessary letters and forms to complete. For a proposed second tier tax liability, show the second tier tax on the last year which shows an adjustment for the first tier tax, noting in the examination report that the additional tax will be imposed at the end of the taxable period if the act/failure to act or taxable event is not corrected. Before issuing a 30-day letter to a foundation manager asserting second tier excise taxes, the examiner must issue a Thorne letter requesting that the foundation manager agree to correction. See *Thorne v. Commissioner*, 99 T.C. 67 (1992). For help drafting a Thorne letter, contact Area Counsel. See

Example Worksheets/Exhibits for sample language used in a Thorne letter for a theoretical Section 4945 scenario.

- (8) If the taxpayer doesn't agree to the tax or fails to make correction, the case is unagreed. See IRM 4.70.14, Resolving the Examination, for case closing procedures.

H. Termination Tax

- (1) This section focuses on those situations when tax is due under Section 507 for termination of private foundation status. The termination tax acts like a third tier excise tax. The phrase "termination" has several different meanings in the context of private foundations. The term is ordinarily used when an entity dissolves or goes out of business. For a private foundation, however, termination of foundation status doesn't necessarily mean dissolution has occurred. Termination for Section 507 purposes means any of the following:

- a. The foundation notifies the IRS and pays the Section 507(c) tax (if any). (Section 507(a)(1)).
- b. The IRS involuntarily terminates the foundation and imposes Section 507(c) tax. (Section 507(a)(2)).
- c. The foundation transfers all of its net assets to certain public charities. (Section 507(b)(1)(A)).
- d. The foundation becomes a public charity. (Section 507(b)(1)(B)).

Note: Transfer under Section 507(b)(2) of all of a foundation's net assets to one or more other foundations does not, by itself, terminate private foundation status.

- (2) If the foundation hasn't engaged in repeated willful acts or one flagrant, willful act triggering Chapter 42 taxes, the foundation may opt for termination under Section 507(b)(1)(A) or (b)(1)(B). If terminated under Section 507(b)(1), the foundation pays \$0 in termination taxes.
- (3) If the foundation voluntarily terminates under Section 507(a)(1), the foundation submits its final Form 990-PF and pays a termination tax (\$0 tax if the foundation distributes all of its net assets before providing notice of termination). The foundation follows the instructions to the Form 990-PF as to the method of notification.
- (4) Consider a Section 507(a)(2) involuntary termination (resulting in Section 507(c) tax) when there have been multiple willful repeated acts committed under Chapter 42. Also consider Section 507(a)(2) if there has been one willful flagrant act (or failure to act) committed triggering Chapter 42 treatment. If proposing involuntary termination, revocation may be proposed at the same time.

Note: If a private foundation's Section 501(c)(3) status is revoked but its private foundation status is not terminated under Section 507, then the foundation becomes a taxable private foundation; it is no longer tax-exempt but still subject

to Chapter 42 taxes as a private foundation. See Section 509(b) and Treas. Reg. 1.509(b)-1(b).

Note: As a practical matter, termination tax assessments are more likely to occur during a subsequent examination. Once Chapter 42 taxes have been assessed, any new violations identified in a later examination will provide proof of willfulness.

- (5) Computing the termination tax requires multiple smaller computations normally provided by the foundation:

The Termination Tax is the Smaller of:	
A) The aggregate tax benefit - the sum of:	
1.	The increase in income, estate, and gift taxes** on substantial contributors that would result from the disallowance of their contributions. The taxes are computed from the later of the foundation inception date or March 1, 1913. Section 507(d)(1)(A))
2.	The income taxes of the foundation, had the foundation filed Forms 1120, U.S. Corporation Income Tax Return, or Forms 1041, U.S. Income Tax Return for Estates and Trusts, in lieu of Forms 990-PF. The taxes are computed from the later of the foundation inception date or January 1, 1913.* (Section 507(d)(1)(B))
3.	The aggregate tax benefit from other private foundations in Section 507(b)(2) transfers. (Treas. Regs. 1.507-5(a)(3) and 1.507-3(a)(2))
4.	The accumulated interest on the above amounts as computed via Report Generation System NT (RGS NT) or Integrated Data Retrieval System (IDRS) command code INTST. (Section 507(d)(1)(C))
B) The value of the net assets as of the date the foundation first committed a Chapter 42 violation that culminates in its Section 507 termination, or the effective termination date, whichever amount is higher. See Section 507(e)(1). Default to this amount unless the "aggregate tax benefit" is calculated.	

*For purposes of this calculation, the charitable contribution deduction allowed a trust is deemed to have been limited to 20% of taxable income. Section 507(d)(1)(B)(ii).

** For any year in which a gift tax would be due if a charitable deduction were not available, refer to the Instructions to Form 709, United States Gift (and Generation - Skipping Transfer) Tax Return, for that particular year for assistance in calculating the appropriate amount of deemed gift tax.

- (6) Aggregate tax benefit is used as the amount of the termination tax only if the foundation substantiates the amount by adequate records or other corroborating evidence. See Section 507(c)(1). As the IRS retains records for a limited period, it may not be feasible to compute the tax from the date of inception. Obtain what information is available via IDRS, return requests, and Online Statistics of Income EO Image Net (SEIN). Establish Audit Inventory Management System (AIMS) controls via the Reporting Compliance and Case Management System (RCCMS) using source code 45 to retrieve the returns of the substantial contributors.
- (7) See IRM 4.70.14, Resolving the Examination, for guidance on converting the Form 990-PF to Forms 1120 or 1041. Use the RGS NT to determine the increase in income tax from the disallowance of charitable contributions deductions.
- (8) Propose the tax using Forms 4883 and 4621. Use Form 990-PF to assess the tax in lieu of Form 4720.
- (9) Imposition of the termination tax doesn't eliminate liability for the underlying Chapter 42 taxes that initiated the termination process. See Treas. Reg. 1.507-1(b)(2).
- (10) When the case is closed as a termination, prepare Form 2363-A, Request for IDRS Input for BMF/EO Entity Change, to update the status code, indicating the effective date in YYYYMM format:
 - a. Status 23: 507(a)
 - b. Status 24: 507(b)(1)(A) (no termination tax applies)
 - c. Status 25: 507(b)(1)(B) (no termination tax applies)
- (11) Termination of private foundation status under Section 507 results in the foundation being treated as an organization created on the day after termination. See Section 509(c).

I. Revocation

- (1) Propose to revoke exemption if the foundation ceases to be operated exclusively for exempt purposes but the circumstances don't warrant involuntary termination of private foundation status under Section 507(a)(2). A Section 501(c)(3) foundation must engage primarily in activities that accomplish Section 501(c)(3) purposes. If more than an insubstantial part of its activities does not further an

exempt purpose, propose revocation. A private foundation is subject to the auto revocation process of Section 6033(j). (See IRM 4.70.14, Resolving the Examination.)

- (2) Foundations are subject to similar restrictions as other Section 501(c)(3) organizations:
 - a. Absolute prohibition for political campaigning.
 - b. Limitation on lobbying (subject to Section 4945(d) which functions as a virtual ban on lobbying).
 - c. Prohibition on inurement.
 - d. Prohibition on operating for the benefit of private interests.
 - e. Limitation on UBI activities (less than primary purpose).
 - f. Limitation on commercial-type insurance (Section 501(m)).
 - g. Prohibition on illegal activities/purposes that violate public policy.
- (3) If the foundation violates any of the prohibitions and/or restrictions listed above, propose revocation. Private foundations are subject to declaratory judgement under Section 7428 when proposing revocation. An administrative record and administrative record index are required for all proposed revocations and should be prepared in accordance with IRM 4.70.14, Resolving the Examination. Additionally, when proposing revocation, follow the information in IRM 4.70.14, Resolving the Examination. Upon revocation, the foundation becomes a taxable private foundation.
- (4) In many revocations, the foundation, disqualified persons, and foundation managers may also be subject to Chapter 42 excise taxes. If there are willful repeated acts or a single willful and flagrant act (or failure to act) triggering Chapter 42 taxes, propose the termination tax in addition to revocation. The basic report forms (Forms 4883 and 4621) shown in Section VI of this Technical Guide can be included with Letter 3614, 30-day letter package for Chapter 42 excise taxes. Form 870-E (Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment) is used to show all tax deficiencies determined for the foundation.
- (5) In revocations of private foundations, the foundation becomes a taxable foundation and must file an income tax return as well as Form 990-PF. See Section 509(b) and Treas. Reg. 1.509(b)-1(b). Use status codes 18 (for trusts) and 19 (for corporations) in lieu of status code 22. Status codes 18 and 19 set the Form 990-PF and Form 1041 or Form 1120 filing requirements. Prepare Form 2363-A with status code change and indicate the effective date of revocation in YYYYMM format. Leave the Form 2363-A in the case file for processing following review.
- (6) All revocations are subject to Mandatory Review.

J. Statute of Limitations

- (1) The Form 990-PF initially controls all statutory limitations periods for assessment and collection of taxes (or “statutes”) with respect to the excise taxes. (See Section 6501(l)(1) and Treas. Reg. 301.6501(n)-1(a).) The following table identifies the Code section, the taxable party, the return used to report the tax, and the year in which the tax is imposed.

Code Section	Liable Party	Tax Form	Tax year
4940(a)	PF	990-PF	On the same form, same year.
4941(a)(1)	Self-dealer	*4720	If individual: Year of Form 1040, U.S. Individual Income Tax Return, in which transaction occurs. All others: Year of Form 1041 (trust), 1065 (partnership), or 1120 (corporation) in which transaction falls. *
4941(a)(2)	FM	*4720	Form 1040 year in which transaction occurs.
4942(a)	PF	4720	Same year of Form 990-PF
4943(a)(1)	PF	4720	Same year of Form 990-PF
4944(a)(1)	PF	4720	Same year of Form 990-PF
4944(a)(2)	FM	*4720	Form 1040 year in which transaction occurs.
4945(a)(1)	PF	4720	Same year of Form 990-PF
4945(a)(2)	FM	*4720	Form 1040 year in which transaction occurs.
*Contact Area Counsel if considering asserting tax on indirect self-dealing against a disqualified person partner or other owner of the disqualified person entity (in addition to asserting tax on self-dealing against the entity).			

- (2) The rules for the length of statutory period for assessing Chapter 42 taxes are:

Length of statute	Requirements	Code Section
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3 years	Form 990-PF filed disclosing the transaction (must adequately identify existence and nature of transaction). See <i>Cline v. Commissioner</i> , T.C. Memo. 1988-144.	6501(a) and (e)(3)
6 years	Section 4940, 4948: Exceeds 25% of amount reported on return. Section 4941 - 4945: Transaction not disclosed on the return. Requires Area Counsel memo.	6501(e)(3)
Open ended	False or fraudulent return with intent to evade tax. Form 990-PF not filed (SFR). Requires Area Counsel memo for false or fraudulent returns.	6501(c)(1) and (c)(3), 6020(b)

(3) See table below for Section 4942 statute modifications:

4942 Subsection	Additional Time	Code Section Reference
4942(g)(3) Failure to distribute deficiency	+1 year to statute date	6501(l)(2)
4942(g)(2)(B)(ii) Cash distribution test set aside deficiency	+2 years to statute date	6501(l)(3)

(4) Prepare and obtain statute extensions for all parties to an excise tax. This entails extensions on the foundation, disqualified persons, and foundation managers, if applicable. Use Form 872, Consent to Extend the Time to Assess Tax, to secure the extension.

Note: A statute extension for the foundation's return does not extend the statute for a disqualified person or foundation manager. Separate statute extensions

must be secured for all parties. Refer to IRM 25.6.22 for further information regarding statute extensions.

Caution: Form 872-A, Special Consent to Extend the Time to Assess Tax, may be used as an alternative to allow an open-ended extension, until terminated by the submission of Form 872-T, Notice of Termination of Special Consent to Extend the Time to Assess Tax. Use Form 872-A only for cases with valid formal protests to Appeals.

- (5) The statutory limitations period for Chapter 42 taxes reportable on Form 4720 ordinarily begins with the filing of Form 990-PF, whether or not Form 4720 is filed. If there are multiple acts/failures to act or taxable events over a period of years, the Forms 4720 will have separate statutes for each transaction. When extending the statute for the Form 4720, extend the statute for all the transactions. The example below, although illustrating statute dates with respect to self-dealing acts or transactions, is also useful for illustrating statute dates when a foundation makes a taxable expenditure. Note, however, that a taxable expenditure made by a foundation is one specific act and is not considered a continuing transaction.

Example: A private foundation with a fiscal year ending in August makes a series of self-dealing transactions in 2008, 2009, 2010, and 2011. Transactions occurred on November 1, 2008, June 1, 2009, September 1, 2009, October 1, 2009, March 15, 2010, September 15, 2010, and May 20, 2011. All the transactions are discrete transactions, except for the transaction on September 1, 2009, which is a continuing transaction (a loan). There has been no correction. The self-dealer's fiscal year ends in December. The Forms 990-PF for 200908 through 201108 were filed February 20, 2010, March 10, 2011, and February 15, 2012, respectively. No Form 4720 is filed. Assume that the acts/transactions were disclosed on the Forms 990-PF filed. The table below shows how the statutes work for the Forms 990-PF and 4720, as of an extension request date of September 1, 2012:

Transaction	Form 990PF	Statute Begins	Form 4720	Statute Begins
11/1/2008	200908	2/20/2010	200812	2/20/2010
6/1/2009	200908	2/20/2010	200912	2/20/2010
9/1/2009 (loan)	201008	3/10/2011	200912	3/10/2011
10/1/2009	201008	3/10/2011	200912	3/10/2011

1/1/2010 (continuing loan transaction)	201008	3/10/2011	201012	3/10/2011
3/15/2010	201008	3/10/2011	201012	3/10/2011
9/15/2010	201108	2/15/2012	201012	2/15/2012
1/1/2011 (continuing loan transaction)	201108	2/15/2012	201112	2/15/2012
5/20/2011	201108	2/15/2012	201112	2/15/2012
1/1/2012 (continuing loan transaction)	201208	TBD	201212	TBD

Note: The filing of Form 990-PF for the year of the initial taxable act ordinarily starts the limitations period (or periods, if multiple acts during the tax year) for second tier tax as well as first tier tax, even though second tier tax does not arise until the end of the taxable period. See the example in Treas. Reg. 301.6501(n)-1(c) regarding an act of self-dealing. Similarly, the second tier tax payable by a foundation manager is essentially on refusal to agree to correct, which does not arise until after a Thorne letter is sent, but again the limitations period begins with the return for the first tier tax.

- (6) For discrete acts, if the statute expired for the year the act occurred, no assessment can be made for any subsequent year. However, for continuing transactions under Section 4941, even if the statute expired for the year in which the original transaction occurred, tax for each open year may be asserted (because a new act is deemed to occur every year within the taxable period). Similarly, an excess business holding acquired in a closed year of the foundation that is still held by the foundation in one or more open years is subject to Section 4943 tax for an open year, assuming the holding is still an excess business holding.
- (7) When preparing the extensions, reference the specific Code section in the type of tax. Use "excise (Section 494X)". If extending multiple excise tax code sections, state "excise (Sections 494X and 494Y)". If extending both income and excise taxes, state "income and/or excise (Section 494X)". It is recommended that a consent for both income and excise tax be used only when a private foundation may be liable for both excise tax under Section 4940 on its investment income and income tax (such as unrelated business income tax). This is because a regular Form 872 is used to extend the statute for these taxes, based on the

foundation's taxable year and not taxable periods arising from taxable events (which require using a modified Form 872).

- (8) Extensions for Section 4941 through Section 4945 taxes require a modification of the Form 872. Replace the phrase "on any returns made by or for the above taxpayer(s) for the period(s) ended" with "from the above taxpayer(s) for the years that are fully or partially within the taxable period(s) that began". Use the date of the first act or failure to act (or taxable event) for the start of the taxable period.
- (9) If there are multiple acts in a single tax year that trigger Chapter 42 taxes, you may list them on the modified Form 872.
- (10) For each year in which acts or failures to act occur which give rise to Chapter 42 taxes, including for deemed or continuing transactions (such as loan transactions in which each year the loan is outstanding, a new or separate transaction is created), secure a modified Form 872. Separate consents for each year in which new or continuing transactions occurred should be obtained.
- (11) As the Section 4940 tax is assessed on the Form 990-PF, prepare any statute extensions for Section 4940 taxes using the regular Form 872. Associate the statute extension with the appropriate Form 990-PF.

K. Applicable Penalties

- (1) For a complete overview of the penalties that apply to private foundations, see IRM 20.1.8, Employee Plans and Exempt Organizations Miscellaneous Civil Penalties.
- (2) As the Form 990-PF is both an information return and an excise tax return for purposes of Section 4940, foundations are subject to several sets of penalties:
 - a. Section 6652(c) - daily delinquencies (Section 6652(c)(1)(A) - failure to file return or show correct information), public inspections (Section 6652(c)(1)(C) and (D)) and prohibited tax shelters (Section 6652(c)(3)).
 - b. Section 6651(a), Section 6655, and Section 6662(c) - failure to file, failure to pay, estimated tax (Section 6655(b)(3)(B)), and accuracy-related due to negligence penalties. See IRM 20.1.2, Failure To File/Failure To Pay Penalties, IRM 20.1.3, Estimated Tax Penalties and IRM 20.1.5, Return Related Penalties.

Note: The daily delinquency penalty of Section 6652(c)(1)(A) is computed on the number of days late. The failure to file penalty of Section 6651(a) is computed as a percentage of the Section 4940 tax due. A late filed Form 990-PF can be subject to both penalties. Both are normally automatically computed and assessed when the return is posted to BMF.

- (3) Regarding the filing requirements for private foundations, for tax years beginning on or after July 2, 2019, section 3101 of P.L. 116-25 (Taxpayer First Act of 2019) requires that returns by exempt organizations be filed electronically. See Section 6033(n). If an organization is filing Form 990-PF, Return of Private Foundation or

Section 4947(a)(1) Trust treated as Private Foundation, for a tax year beginning on or after July 2, 2019, the organization must file the return electronically. Limited exceptions apply. Electronic filing requirements have not changed for Form 990-PF filers with tax years beginning before July 1, 2019 (which includes calendar year 2019 Forms 990-PF). Required electronic filing for calendar year filers will apply for tax years beginning in 2020 or later. In addition, private foundations must file Form 4720 electronically for returns due on or after July 15, 2021. A limited exception applies for 2020 Form 4720 returns due on or after July 15, 2021, that are submitted on paper and bear a postmark date on or before June 16, 2021.

- (4) Foundations can also be subject to the criminal penalties of Section 7203, Section 7206, and Section 7207, as well as the civil fraud penalty of Section 6663. See IRM 9.1.3, Criminal Statutory Provisions and Common Law and 20.1.5, Related Return Penalties.
- (5) Foundations, individuals, and taxable entities who file (or are required to file but do not file) Form 4720 may be subject to failure to file, failure to pay, estimated tax, negligence, and civil fraud penalties.
- (6) Any entity or individual previously liable for a Chapter 42 tax may be subject to a 100% penalty. See Section 6684. This penalty may also be imposed where the act or failure to act is both willful and flagrant. In both circumstances, the act or failure to act must not be due to reasonable cause. Under Section 6684 if a person becomes liable for tax under any section of Chapter 42 and meets the criteria, then such person is liable for a penalty equal to the amount of such tax. Thus, this penalty can be imposed with respect to both first tier and second tier taxes. The penalty, which is an assessable penalty (assessed in the same manner as taxes) is not imposed with respect to Section 4940 and 4948(a) taxes. See IRM 20.1.8, Employee Plans and Exempt Organizations Miscellaneous Civil Penalties.

Note: The IRS bears the burden of proof on whether an act or failure to act was willful and flagrant. See *Thorne v. Commissioner*, 99 T.C. 67 (1992); *Moody v. Commissioner*, 69 T.C.M. (CCH) 2517 (1995).

- (7) Foundations that file Form 990-T, Exempt Organization Business Income Tax Return, may be subject to failure to file, failure to pay, estimated tax, accuracy and civil fraud penalties.
- (8) The officers, directors, trustees, and employees of a foundation may be subject to the public inspection compliance penalty of Section 6685 on the responsible party. See IRM 20.1.8, Employee Plans and Exempt Organizations Miscellaneous Civil Penalties.
- (9) When computing penalties under Section 6651(a)(1) and (2), 6651(f), 6662, or 6663, use the first tier tax amounts for the computations. Because the second tier taxes are not taxes that are reported (or required to be reported) on any tax return, they are not subject to those penalties. Imposition of the penalties under Sections 6662 and 6663 requires that the taxpayer file a return. If the taxpayer did

not file a return, those penalties do not apply. An SFR does not constitute a return for the purpose of applying penalties under Section 6662 and 6663.

Example: In a report of examination issued to a disqualified person for self-dealing transactions, the agent proposes \$15,000 in tax on a \$150,000 payment. The agent prepared a substitute for return package (IRM 4.70.13, Executing the Examination), because the taxpayer didn't file the late Form 4720. The agent proposes the failure to file and pay penalties. The 201312 return was due on May 15, 2014. The agent issued the report October 15, 2016. The failure to file penalty is at a 22.5% rate (4.5% x 5 months), for \$3,375. The failure to pay penalty rate is at 14.5% (.5% x 29 months late), for \$2,175. See Section 6651(a)(1), (a)(2), and (c)(1) (which reduces the penalty amount under Section 6651(a)(1) when both the failure to file and failure to pay penalties apply).

Note: The examination report should explain that the failure to pay computation is merely an estimate because the penalty will continue to accrue, until the initial tax is fully paid, up to a maximum rate of 25%.

- (10) If proposing or recommending a failure to pay penalty for a non-filer under a substitute for return package, the failure to pay determination must be included in the examination report. See IRM 4.70.13, Executing the Examination. In addition, the failure to pay penalty may only be asserted on a certified substitute for return. Examiners should follow the instructions on Form 13496, IRC Section 6020(b) Certification.
- (11) Be aware that with some exceptions, Section 6751(b)(1) requires written supervisory approval for penalty assessment which must be obtained prior to issuing any written communication of penalties to a taxpayer that offers the taxpayer an opportunity to sign an agreement or consent to assessment or proposal of the penalty. See IRM 20.1.5, Return Related Penalties, which outlines the requirements for securing written supervisory approval and describes the documentation required for the case file. Section 6751(b)(2) provides exceptions to this requirement for additions to tax and penalties under 6651, 6654, 6655, or 6662 (but only with respect to an addition to tax by reason of subsection (b)(9)) and any penalties automatically calculated through electronic means. See IRM 20.1.1, Introduction and Penalty Relief and 20.1.11, Excise Tax and Estate and Gift Tax Penalties.
- (12) For examples of penalty computations, see Example Worksheet/Exhibits in Section VI of this Technical Guide.

L. Domestic Taxable Private Foundations

- (1) Taxable private foundations are former tax-exempt private foundations whose exemptions were revoked. Unless terminated under Section 507, they remain private foundations, and under TE/GE jurisdiction. See Section 509(b) and Treas. Reg. 1.509(b)-1(b).
- (2) Taxable private foundations are required to file Form 990-PF in addition to either the Form 1120 or Form 1041.

- (3) Taxable foundations remain subject to Chapter 42 taxes.
- (4) A taxable foundation owes Section 4940 tax to the extent that this tax (plus unrelated business income tax, computed as if it were still exempt), exceeds its income tax liability. See Section 4940(b). The foundation isn't subject to the Form 990-T filing requirement, but may attach the Form 990-T, Exempt Organization Business Income Tax Return, to the Form 990-PF to show the computations.
- (5) When computing the Section 4940 tax:
 - a. Compute the 1.39% tax via Form 990-PF.
 - b. Add the tax computed via Form 990-T.
 - c. Subtract the tax determined via Form 1120 or Form 1041.
- (6) Taxable foundations are subject to the penalty of Section 6710 for not making required disclosures under Section 6113 of non-deductibility of contributions for the first five years after revocation. See IRM 20.1.8, Employee Plans and Exempt Organizations Miscellaneous Civil Penalties.
- (7) If there are willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act) giving rise to Chapter 42 taxes, consider proposing involuntary termination under Section 507(a)(2).

M. Abatement of Excise Taxes

- (1) Under Sections 4961 and 4962, abatement is available for the following taxes:

Code Section	First Tier	Second Tier
4941	No	Yes
4942	Yes	Yes
4943	Yes	Yes
4944	Yes	Yes
4945	Yes	Yes

- (2) To qualify for abatement of second tier tax, the taxable event must be corrected within the correction period. See Section 4961(a). The taxpayer qualifies for abatement of first tier tax if the taxpayer establishes to the IRS' satisfaction that the taxable event:
 - a. Was due to reasonable cause.
 - b. Wasn't due to willful neglect.
 - c. Was corrected within the correction period. Section 4962(a).

- (3) The correction period begins on the date the event occurs and ends 90 days after the mailing date of a notice of deficiency in connection with the second tier tax imposed on that taxable event (Section 4963, Section 6212). That time is extended by:
- a. Any period in which a petition to the Tax Court for redetermination of the deficiency is pending. (Section 6213(a)).
 - b. Any other period the IRS determines is reasonable and necessary to correct the taxable event.

- (4) If correction hasn't occurred or doesn't occur, **abatement is unavailable**. If correction is made, consider whether abatement is applicable for the first tier tax (other than Section 4941 tax, for which abatement is not available). Correction within the correction period requires abatement of the second tier tax.

Note: In practice, assessment of the tax is on hold until after the 90-day period (plus any court time) has elapsed. If correction is made, Mandatory Review and the EO Closing Unit adjust the assessment amount to reflect only the first tier tax.

- (5) If correction is made before a statutory notice of deficiency is issued, don't propose the second tier tax. Any subsequent statutory notice will exclude consideration of the second tier tax.
- (6) If correction is made after the correction period has expired, abatement isn't available under Section 4962.

Note: If you receive a request for abatement or claim for refund, verify whether the second tier tax was assessed via an examination. If needed, request a copy of a previous examination report via RCCMS using source code 45.

- (7) If the taxpayer requests abatement during the examination, verify correction first. If the facts don't warrant abatement, document the willful neglect and failure to establish reasonable cause. If the facts warrant abatement, don't propose the tax. Address the issue in an advisory closing letter. See IRM 4.70.14, Resolving the Examination.
- (8) See the lists below for examples of abatement/non-abatement of the first tier tax.
- (9) Possible abatement:

Example: The foundation incurred a Section 4943(a) liability when an unrelated third party exercised its property rights on an ownership interest in a jointly owned business enterprise. This was done at a time, and in a manner that made it difficult for the foundation to identify its risk in a timely manner despite prudent precautions.

Example: The foundation incurred a Section 4945(a) liability when it gave scholarships for the first time without obtaining advance approval of its scholarship procedures. Upon review of its procedures, an EO specialist determined that the procedures met the criteria for advance approval at the time the scholarships were originally given.

Example: The foundation relied, in good faith, on the written, reasoned advice of an attorney or accountant (dated before the transaction) that the transaction wasn't subject to Chapter 42.

(10) Likely non-abatement (though pertinent facts must be considered):

Example: The foundation's officers, directors, and representatives state they were ignorant of the provisions of the law.

Example: The Form 990-PF return for the tax period was prepared by a compensated attorney, accountant, or enrolled agent. The return gave no notice that a specifically identified questionable transaction had occurred.

Example: The foundation, a related foundation, or a predecessor foundation had a previous Chapter 42 tax amount abated under Section 4962 for the same type of taxable event.

Example: The taxable transaction wasn't identified as a potential violation of Chapter 42 by any party until an examination began.

(11) See IRM 4.70.17, Claims and Abatements, for information to work abatement requests.

N. Pre-Examination Considerations

(1) If a copy of the determination file isn't already in the file, follow the requirements in IRM 4.70.12, Planning the Examinations. A copy may be obtained on disk, via secure e-mail, or via Teams. See IRM 4.70.12, Planning the Examinations, for determination file reviews. For private foundations, focus additional attention on:

- a. Who are the founders, initial substantial contributors, and foundation managers?
- b. What is the purpose of the foundation (actively operating, grant making)?
- c. Did the organization request advance approval of individual grant making under 4945(g)?
- d. If grant making, what criteria were provided, and what constitutes the applicant pool?
- e. What assets were donated to form the corpus of the foundation?
- f. Who contributed the assets?

(2) Make note of whether the articles of incorporation, association, or trust document contains the Section 508 language. See Pub. 557. Note that most states now incorporate the language into state law, thus eliminating the requirement to have the language in the document. See Treas. Reg. 1.508-3(d) and Rev. Rul. 75-38, 1975-1 C.B. 161 (which is not an up-to-date listing of the pertinent state laws). If the language is present, note all who signed the document.

Note: When encountering a Chapter 42 violation, be sure to incorporate this information into the report of examination, if relevant to the party committing the

transaction (self-dealers, foundation managers). This helps establish that at a minimum the founders acknowledged these restrictions in the governing instruments at the time the foundation was formed.

- (3) If the application and/or tax return list a website address for the foundation, visit the website and determine whether the information matches the information in the application. Note any changes from the application materials. Compare contact information provided to the tax return and the application.
- (4) Obtain copies of prior and subsequent Forms 990-PF and Forms 990-T via Online SEIN.
 - a. Review the Forms 990-T to determine the sources of income reported.
 - b. Using the Forms 990-T as a guide, add to the initial Information Document Request (IDR) any items on the Form 990-T that merit review.
 - c. Match the income and expenses reported on the Form 990-PF to the Form 990-T. Note any differences. Note whether there may be allocation issues.
 - d. Perform the standard risk analysis, identifying the large, unusual, and questionable items for inclusion on the IDR.

Note: Regarding the filing requirements for private foundations, for tax years beginning on or after July 2, 2019, Section 3101 of P.L. 116-25 (Taxpayer First Act of 2019) requires that returns by exempt organizations be filed electronically. See Section 6033(n). If an organization is filing Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation, for a tax year beginning on or after July 2, 2019, the organization must file the return electronically. Limited exceptions apply. Electronic filing requirements have not changed for Form 990-PF filers with tax years beginning before July 1, 2019 (which includes calendar year 2019 Forms 990-PF). Required electronic filing for calendar year filers will apply for tax years beginning in 2020 or later. In addition, private foundations must file Form 4720 electronically for returns due on or after July 15, 2021. A limited exception applies for 2020 Form 4720 returns due on or after July 15, 2021, that are submitted on paper and bear a postmark date on or before June 16, 2021.

Reminder: Private foundations can be subject to the Form 990-T filing requirement for the same reasons as a public charity. The foundation is permitted to generate income within the limitations set by Chapter 42. An unrelated business directly conducted by a foundation, however, may constitute an excess business holding as a “sole proprietorship” business enterprise. See Section 4943(c)(3)(B) and Treas. Reg. 53.4943-10(e). Exceptions apply to a proprietorship described in Section 4943(d)(3).

- (5) Obtain IDRS transcripts for the foundation and the disqualified persons. Perform Accurant research on the disqualified persons. Review the completed research for possible compliance issues (such as missing returns, prior Chapter 42 liabilities, same disqualified person and foundation addresses, foundation vehicles

registered under disqualified persons, payments to disqualified person businesses listed on the Form 990-PF).

- (6) Review the Form 990-PF for the period(s) under examination in the following sequence:

Review Form 990-PF:	
Verify the Statute of Limitations	
1	Find the date stamped received.
2	Determine the date mailed, if possible.
3	Apply the rules of Section 7502 (timely mailing treated as timely filing).
Analyze the first page, Letters A through J (in the top third of the page)	
1	Note the accounting method.
2	Note whether this is an initial, amended, or final return.
3	Determine whether there has been a name or address change.
4	Check whether a foreign foundation and percentage of foreign support (for purposes of Section 4948(b).
5	Check for unusual events: prospective exemption, 507(b)(1)(A) termination, 507(b)(1)(B) conversion.
6	Note the type of entity.
Review Parts VII-A and VII-B, Statements Regarding Activities	
1	Verify the presence of all required schedules. Note any missing documents.
2	Check for an FBAR, if indicated.
3	Determine the liability for Form 4720.
4	Note any private benefit disclosures.
Review Part VIII, Information About Officers, Directors, Trustees, Foundation Managers, Highly Paid Employees, and Contractors	
1	Match the amounts reported to the Forms W-2, Wage and Tax Statement. (Use command code IRPTRR to retrieve the Forms W-2.)
2	Note the top paid individuals and contractors. Match to the list of founders, substantial contributors, and foundation managers reported in the determination application and in Part XV. (May be subject to Section 4941.)
Review XVII, Information Regarding Transfers to and Transactions and Relationships With Noncharitable Exempt Organizations	

1	Identify any large, unusual, or questionable items.
2	Verify the non-charitable entities exemptions on IDRS.
3	Print the INOLES/BMFOLO information for each non-charitable entity.
4	Use Online SEIN to obtain copies of the Forms 990 or 990-EZ for each entity.
5	Check EO Select Check for electronic postcard information.
6	See if there are any related parties on the board of each entity.
Review Part XV, Supplementary Information	
1	Identify any large, unusual, or questionable items.
2	Compare any entries to information from the determination application.
Review Part IV, Capital Gains and Losses for Tax on Investment Income	
1	Verify the math. Note any errors.
2	Identify any large, unusual, or questionable items.
3	Note the type of asset(s) for future reference in the interview and IDR.
Review Part I, Analysis of Revenue and Expenses	
1	Verify the math. Note any errors.
2	Identify any large, unusual, or questionable items.
Review Part XVI-A, Analysis of Income-Producing Activities and Part XVI-B, Relationship of Activities to the Accomplishment of Exempt Purposes	
1	Verify the math. Note any errors.
2	Identify any large, unusual, or questionable items.
3	Compare to Part I. Note any differences.
4	Compare to any filed Forms 990-T. Note any differences.
Review Part II, Balance Sheets **	
1	Verify the math. Note any errors.
2	Identify any large, unusual, or questionable items.
3	Check for any attached schedules. Note any missing schedules.
4	Compare any amounts on the attached schedules to Part II. Note any differences.
**There are new reporting standards for net assets, and Part II of Form 990-PF was updated to reflect the Financial Accounting Standards Board's	

(FASB's) reclassification of net assets into two classes, net assets without donor restrictions and net assets with donor restrictions.	
Review Part III, Analysis of Changes in Net Assets or Fund Balances	
1	Verify the math. Note any errors.
2	Note any increases or decreases not included in Part I, Line 27a. Determine whether such amounts should be included in Part I.
Review Part IX, Summary of Direct Charitable Activities, Summary of Program-Related Investments	
1	Identify any large, unusual, or questionable items.
2	Compare the expenses reported to the amounts listed in Part I.
3	If applicable, compare the investment amounts to the amounts listed in Part II.
Review Part X, Minimum Investment Return	
1	Verify the math. Note any errors.
2	Note the existence of any acquisition indebtedness for Section 514 purposes.
Review Part XI, Distributable Amount	
1	Verify the math. Note any errors.
2	Note whether there was any income tax. Check the amount against Form 990-T (or Form 1120/Form 1041 if a taxable foundation).
3	Note any recoveries of qualifying distributions for inclusion in the IDR.
Review Part XII, Qualifying Distributions	
1	Verify the math. Note any errors.
2	For set asides, note whether claiming prior IRS approval or look for an attached schedule. If prior approval, or schedule is missing, note for inclusion in the IDR.
Review Part XIII, Undistributed Income	
1	Verify the math. Note any errors.
2	Note any excess distributions. Compare the amounts reported to the prior years' Forms 990-PF.
3	For entries indicating election required, check for the attached statement. If none present, include in the IDR a request of the election.
4	Verify that the foundation has not elected to treat a qualifying distribution as made out of corpus in an attempt to "refresh" an expiring excess distribution "carryover."

Review Part V, Qualification Under Section 4940(e) for Reduced Tax on Net Investment Income (for taxable years beginning on or before December 20, 2019)	
1	Verify the math. Note any errors.
2	Compare the entries in Line 1 to the prior years' Forms 990-PF Parts X through XII. Note any differences.
Review Part VI, Excise Tax Based on Investment Income	
1	Verify the math. Note any errors.
2	Note the tax rate used. Verify whether the correct rate was used.
3	Note any additional taxes reported. Verify whether properly entered. (If tax-exempt, UBTI is not included and deductions taken into account in determining UBTI are not taken into account in determining Section 4940 tax either. If taxable, UBIT and regular income tax are included.)
Review Part XIV, Private Operating Foundations	
1	Verify the math.
2	Note which operating foundation status was claimed. (Section 4942(j)(3) vs. Section 4942(j)(5)). If Section 4942(j)(5), compare the charitable activities to the Code and regulation requirements. See the Instructions to the Form 990-PF.
3	Note the letter date. Request a copy via the initial IDR.

******There are new reporting standards for net assets, and Part II of Form 990-PF was updated to reflect the Financial Accounting Standards Board's (FASB's) reclassification of net assets into two classes, net assets without donor restrictions and net assets with donor restrictions.

Note: The above method of reviewing the Form 990-PF is based on the sequencing chart for completing the Form 990-PF (Instructions for Form 990-PF).

- (7) Review any information in the case file from Classification. Prepare to start an administrative record if there are indicators of potential exemption issues. See IRM 4.70.14, Resolving the Examination.
- (8) Modify the initial interview/questionnaire to incorporate any items identified during the review of the application and tax returns. Additional questions to ask:
 - a. Please describe the relationship, if any, between the foundation manager(s), founder(s), and any substantial contributor(s). (If all the same person, don't ask.)
 - b. Please explain your understanding of the Chapter 42 provisions/prohibitions.
- (9) Incorporate the items noted from analyzing the application and the tax returns. When asking for financial information, you can ask for the supporting source documents, such as bank statements and cancelled checks, for up to five years

back. For private operating foundations, Form 990-PF Part XIV supports the request of records for the three prior years.

Note: When asking for the records, indicate the basis for the request. (For example, “Please provide the bank statements and cancelled checks for the years XXXX through YYYY to support the amounts reported on the Form 990-PF.”)

Caution: If you identify any self-dealing transactions or taxable expenditures in prior years, ensure that the statute is still open before pursuing the issue. Discuss with your manager regarding requesting a Counsel memo on a six-year statute, if applicable.

(10) Consider requesting these additional items in the IDR with respect to the items under exam:

- a. A list of all disqualified persons with respect to the foundation, including government officials with which the foundation had any interactions, and a brief explanation of why each is a disqualified person (for example “daughter of substantial contributor (Mr. X)”).
- b. A list of all business enterprises owned in whole or in part by the foundation and percentage of ownership for the foundation and disqualified persons. See Form 990-PF.
- c. The list of all scholarship and grant recipients who were awarded a grant or received a payment.
- d. Relationship information of the scholarship/grant recipients to the founder(s), substantial contributor(s), foundation manager(s) and any other disqualified persons.
- e. Copies of the scholarship/grant criteria and any application forms.
- f. Copies of any such applications and other grant request forms received.
- g. Title documents to any foundation owned real property.
- h. Compensation contracts for the foundation manager(s).
- i. Notes and other loan documents involving disqualified persons.
- j. Review of the general ledger and bank statements for transactions with disqualified persons.
- k. Leases, partnership agreements, and all contracts between the foundation and disqualified persons.
- l. Credit card statements of the foundation as well as credit card statements of the disqualified persons, if applicable.
- m. Travel expenses incurred by the foundation on behalf of disqualified persons.

O. Field/Office Correspondence Exam Information

- (1) Review any revised organizing documents. Verify that any Section 508 language is included, if not covered by state law. Determine whether any changes have modified the exempt purpose or jeopardize the exemption.
- (2) Perform the foundation status test. Verify whether the entity continues to fail to qualify under Section 509(a) as a public charity.

Note: If the foundation satisfies the test for public charity status, inform the organization of the possibility of a Section 507(b)(1)(B) termination. To apply for an advance ruling the foundation must file Form 8940 with EO Determinations.

- (3) Examine the financial statements and financial records. At a minimum, do the following:

Financial Statement and Financial Record Analysis:	
1	Compute the average fair market value of the securities using the twelve monthly ending values.
2	Do the same for the bank statements.
3	Compare the amounts to Form 990-PF Part X Line 1.
4	Identify the program-related investments, if reported on Form 990-PF Part IX-B, and determine whether they qualify as such.
5	Determine if there is any overlap between program-related investments and non-charitable use investments.
6	Identify any assets purchased in the year(s) under examination.
7	Compare the asset purchase amounts to the amount reported in Part XII Line 2.
8	Determine any differences, verify whether any amounts are for non-charitable use.
9	Identify any amounts listed as set aside.
10	Verify that the set aside was appropriate.
11	Identify any acquisition indebtedness.
12	Determine whether Section 514 applies. If so, verify that a Form 990-T was filed and that it included the debt financed income.
13	Determine whether the acquisition indebtedness triggers Section 4941 as a loan with a disqualified person (or as a deemed sale or exchange with a disqualified person because the foundation received property subject to a mortgage or similar lien as described in Section 4941(d)(2)(A)).
14	Determine whether any of the asset purchases trigger Section 4941 as a sale with a disqualified person.
15	Review the other assets of the organization.
16	Look at the title documents. Review for any questionable elements involving disqualified persons.

17	Inquire and verify whether the assets are being used by any disqualified persons.
18	Review the cancelled checks and check registers. Request explanations for questionable expenditures.
19	Inspect any receipts provided for the questionable expenditures.
20	Identify all payments that are grants or scholarships to disqualified persons (self-dealing under Section 4941(d)(1)(E)).
21	Determine whether the payments meet the exceptions to Section 4941 and Section 4945.
22	Compare the Forms W-2/1099 to the amounts reported on Form 990-PF Part VIII and to the amounts reported in the register.
23	Determine whether there are any missing or incorrectly reported Forms W-2/1099.

- (4) Determine how assets were used. Verify the relationship of the asset to the exempt purposes of the foundation. Tour all foundation facilities. If the foundation has real estate investment property tour those properties as well. Be aware of potential self-dealing acts such as DP's having offices in the building or using the land. Does the foundation have artwork? Where is it located? In the DP's home?

Note: Keep in mind that at times, potential self-dealing transactions may not show up in the books of the organization. For instance, the foundation may own property for investment purposes, such as ranch land. Do the disqualified persons use the land for recreation such as fishing or hunting?

- (5) Using a blank Form 990-PF, revise the amounts reported according to the exam findings. Changes to the return impact the Section 4940 tax and may trigger the Section 4942 tax. If you have reviewed the financial records from prior years, revise the prior year Forms 990-PF as needed. Use the modified information from the prior years to revise Parts V (as pertinent to years ending prior to December 20, 2019) and XIII of the exam year Form 990-PF.
- (6) If amounts reported in Part I Column d are not charitable expenditures, remove the amounts in the revised Form 990-PF. Self-dealing transactions and taxable expenditures generally should be removed from Part I Column d if previously reported as such. This in turn modifies Part XII, directly impacting the computations in Part XIII.
- (7) Determine whether the foundation has:
- Engaged in any self-dealing transactions.
 - Failed to make qualifying distributions.
 - Held or acquired excess business holdings.
 - Made jeopardizing investments.
 - Made taxable expenditures.

- (8) If there are any acts/failures to act giving rise to Chapter 42 taxes, ensure that the statute of limitations is protected. Request extensions from the foundation and from each disqualified person party to an act/failure to act. Open AIMS controls on BMF for the foundation and any business entities and on NMF for any individuals.

Note: For tax years beginning in 2020, an individual liable for a Chapter 42 excise tax will not have the option to file jointly with the organization with respect to which the excise tax relates. Beginning with tax year 2020, Form 4720 has been revised to identify whether the filer is the organization or an individual. Therefore, for tax years after 2019, an agent preparing Form 4720 to report individual excise tax liability during an examination will no longer convert Form 4720 to “Form 4720-A.” The revenue agent will, instead, complete Form 4720 identifying the filer as an individual as described in the instructions for Form 4720. See the instructions to the Form 4720 for further information.

- (9) For any Chapter 42 taxes, prepare a report of examination for each liable party. Ensure that there are no disclosure violations. See IRM 4.70.14, Resolving the Examination, for the report letter and attachments. All excise tax reports include Forms 4621, 4883, 886-A, and 870-E.
- (10) If an act requires correction, verify that correction is made before closing an agreed case. See IRM 4.70.14, Resolving the Examination, for the initial report, formal report, protest to Appeals, and rebuttal information.
- (11) See IRM 4.70.14, Resolving the Examination, for information on the necessary letters and forms to complete. However, before issuing a 30-day letter to a foundation manager proposing the second tier tax, you must first issue a Thorne letter. For help in drafting a Thorne letter, with your manager’s authorization, contact Area Counsel.
- (12) For egregious cases, consider involuntary termination and revocation. Discuss these possibilities with your group manager and Area Counsel before pursuing these actions. See IRM 4.70.14, Resolving the Examination, for information on preparing an administrative record.

P. Exam Case Closing Information

- (1) Resolve the following types of related cases:
- a. Employment tax cases such as worker reclassification, fringe benefit treatment, and unreported amounts.
 - b. Income tax cases (Forms 990-T for tax-exempt foundations, Forms 1120 or 1041 for taxable foundations).
 - c. Excise tax cases (gaming and/or Chapter 42 taxes).
- (2) Discuss with your group manager whether to close the related cases separately from the Form 990-PF.

- (3) Close Form 990-PF as a no change/no change with advisory if there is no modification to the Section 4940 tax, foundation status, or exempt status. See IRM 4.70.14, Resolving the Examination, for case file assembly and other common closing information.
- (4) For agreed cases involving employment, income, or gaming excise taxes:
- a. Issue report of examination.
Note: Remember that if a disqualified person is involved, there will be a separate case file and report for that taxpayer, and disclosure rules will be applicable.
 - b. Secure the agreement.
 - c. Collect payment or complete a request for an installment agreement. See IRM 4.70.14, Resolving the Examination.
 - d. Prepare the appropriate closing letter. See IRM 4.70.14, Resolving the Examination.
 - e. Close the case to your manager, who in turn closes it to the EO Closing Unit.
- (5) For agreed cases involving Chapter 42 taxes:
- a. Request correction.
Note: No correction for Section 4940 adjustments
 - b. Obtain verification of correction.
 - c. Correction made: Issue report of examination.
 - d. Correction not made: Treat as unagreed.
 - e. Secure the agreement on Form 870-E.
 - f. Collect payment and/or complete the installment agreement request.
 - g. Prepare the appropriate closing letter.
 - h. Close the case to your manager, who in turn closes it to the EO Closing Unit.
Note: Before asserting excise taxes on the foundation manager(s), issue a Thorne letter, before issuing the 30-day letter. Consult your manager and Area Counsel for pre-issuance review of the Thorne letter. See Example Worksheets/Exhibits for sample language used in a Thorne letter.
- (6) For cases requiring correction, follow the information below:
- a. If correction is acceptable, issue the acceptance letter. See Letter 5305.
 - b. If correction is inadequate or unacceptable, issue the rejection letter. See Letter 5306.
 - c. If uncorrected, determine whether additional time is needed for correction.
 - d. Grant an extension of time with managerial approval for the correction to be made.

- e. If uncorrected as of the end of the extension date, **close as unagreed**, even if the taxpayer previously signed an agreement to the first tier tax on Form 870-E.

(7) For agreed cases involving revocation or foundation status modification:

- a. Secure Form 6018, Consent to Proposed Action.
- b. Obtain a statute extension, if less than 270 days remaining on the statute of limitations.
- c. Prepare a Form 3198-A, TEGE Special Handling Notice, completing the Mandatory Review/Operations, Planning & Review section.
- d. Close the case to your manager, who closes the case to Mandatory Review.

(8) For unagreed cases, regardless of the type of tax or action (revocation, termination, foundation status modification):

- a. Issue a Thorne letter before issuing the 30-day letter if proposing excise taxes on the foundation manager(s).
- b. Obtain a full copy of the tax form under protest showing the date received, if not already in the file or on RCCMS. Use Online SEIN if obtaining a Form 990-PF or a filed Form 4720.
- c. Issue a formal report of examination with the appropriate waiver/agreement form(s).
- d. Ensure that there are 425 days remaining on the statute of limitations when closed from the group.

Note: All cases received in Appeals require 365 days remaining on the assessment statute of limitations.

- e. Prepare a Form 3198-A, completing the applicable sections.
- f. Verify that a formal protest to Appeals is valid. If invalid, secure a valid protest.
- g. Prepare and issue a full rebuttal to any protests.
- h. Close the case to your manager as unagreed (with or without protest).

Note: If applicable, consider offering a Fast Track Settlement before issuing the formal report of examination. Both agent and manager must approve a request to enter into fast track negotiations. See IRM 4.70.14 for Resolving the Examination.

(9) A valid protest contains the following elements:

- a. The taxpayer's name, address, Employer Identification Number (EIN) if the taxpayer is an organization and a daytime phone number.
- b. A statement that the taxpayer wants to protest the proposed determination.

- c. A copy of the 30-day letter showing the findings that the taxpayer disagrees with (or the date and IRS office symbols from the letter).

Note: If a copy of the 30-day letter is the only item missing from a protest, the case can be closed using the copy in the file without returning the protest to the taxpayer to perfect. See IRM 4.10.8, Report Writing.

- d. An explanation of the taxpayer's reasons for disagreeing, including any supporting documents.
- e. The law or authority, if any, on which the taxpayer is relying.

(10)The protest must also contain a valid jurat statement: "Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts, and such facts are true, correct and complete."

(11)Representatives submitting the protest must also include a substitute declaration stating that the representative prepared the protest and any accompanying documents, and personally knows (or does not know) that the statement of facts in the protest and any accompanying documents are true and correct. Organization officers or representatives may sign the protest. (See Pub. 892, How to Appeal an IRS Decision on Tax Exempt Status.)

(12)For cases subject to Section 7428 declaratory judgment, prepare an administrative record. See IRM 4.70.14, Resolving the Examination.

V. Issue Indicators and Examination Tips

- (1) This section provides for possible issue indicators and examination tips when examining a private foundation, particularly with respect to taxable expenditures subject to tax under Section 4945.

A. Issue Indicators

- (1) The foundation has incurred taxable expenditures, but no Form 4720 has been filed.
- (2) Amounts spent to carry on propaganda or attempt to influence legislation.
- (3) Expenditures to influence any specific public election outcome, or to carry on a partisan voter registration drive (directly or indirectly).
- (4) Amounts paid as a grant to an individual for travel, study, or other similar purposes, unless the grant satisfies Section 4945(g).
- (5) Amounts disbursed as a grant to an organization, unless the organization is a public charity (other than certain supporting organizations) or the private foundation exercises expenditure responsibility per Section 4945(h).
- (6) Expenditures paid or incurred for any purpose other than one in Section 170(c)(2)(B).

B. Examination Tips

- (1) When examining the foundation, review all the expenditures and determine which expenditures constitute grants to organizations. If any of the grantee organizations are not organizations listed in Section 4945(d)(4)(A), then the grants are subject to expenditure responsibility in accordance with Section 4945(h). These grants must be reviewed in further detail to determine if all three conditions of expenditure responsibility are met.
- (2) Examine to see if the foundation, if it makes grants to individuals for travel, study, or other similar purposes, submitted the Form 8940 to request approval of its grant-making procedures. Requests for advance approval may be made either as part of an exemption application or by separate ruling request.
- (3) Determine if the person or group of persons who select recipients of the grant can derive a private benefit, either directly or indirectly, if certain potential grantees are selected over others.
- (4) Determine if the four requirements of grants to individuals were followed:
 - a. The grant is awarded on an objective and nondiscriminatory basis,
 - b. The grant is made pursuant to a procedure approved in advance by the IRS, and
 - c. The grant constitutes a scholarship or fellowship grant which would be subject to the provisions of Section 117(a) and is to be used for study at an

educational organization described in Section 170(b)(1)(A)(ii) (see Section 4945(g)(1)); or

- d. The purpose of the grant is to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee. See Section 4945(g)(3).

- (5) Determine if the foundation's approved grant-making procedures were followed.
- (6) Determine if the grant recipients are related to any foundation disqualified persons.
- (7) Review (sample) the files of grant recipients and those denied grants to ensure the grants were made in a non-discriminatory basis, and the grant process was adhered to.
- (8) Determine if the foundation has monitoring procedures to ensure the grant proceeds are being used in furtherance of the purposes for which it was originally granted.
- (9) If the grantor is unable to provide documentation to show it meets expenditure responsibility for applicable grants, propose the first tier tax and request correction.
- (10) Part XV of Form 990-PF should list the name, address and foundation status of all grant recipients. Review the grantees for any that may have foreign addresses. The tax-exempt status of an organization can be verified by using EO Select Check (Pub. 17).
- (11) If the foreign organization does not have a determination letter, then ask the private foundation if it has an equivalency determination for the foreign organization. If provided, verify that a qualified tax practitioner prepared the equivalency determination, that it contains current information, and that it appears reasonable.
- (12) If the private foundation was required to exercise expenditure responsibility, Treas. Reg. 53.4945-5(d) requires the private foundation to include certain reports with the Form 990-PF. Form(s) 990-PF for the tax period(s) under examination should be reviewed for compliance.
- (13) If a private foundation fails to establish that grants are qualifying distributions, consider whether it has distributed sufficient amounts as qualifying distributions. If not, examine whether Section 4942 excise taxes should be imposed for failure to distribute income.
- (14) Check the TE/GE issue snapshots for pertinent snapshots.

VI. Example Worksheets / Exhibits

- (1) This section provides worksheets as well as exhibits focusing on practical applications when asserting Section 4945 excise taxes for taxable expenditures made by a private foundation. The examples in the exhibits also show how additional taxes and penalties are asserted. Also provided are examples of statute extensions, including a modified Form 872 extending the time for assessing Section 4945 tax.

A. Section 4945 – First Tier Tax Example

- (1) Be aware that some transactions may trigger multiple excise taxes. It's common for a transaction to be both a self-dealing transaction and a taxable expenditure transaction.
- (2) The following facts below are taken from Part VII, Item A in TG: 58 Excise Taxes on Self-Dealing – IRC Section 4941. The expenditure doesn't meet any exception listed in Section 4945. The transaction is a taxable expenditure. The table below shows how the tax is computed for the foundation and the foundation manager.
- (3) Disqualified Person Charlie establishes Private Foundation Bravo on June 1, 2005, depositing \$500,000 into PF Bravo's savings account. PF Bravo's fiscal year ends June 30. DP Charlie is the sole foundation manager of PF Bravo. DP Charlie applies for and receives exemption for PF Bravo under Section 501(c)(3) as a private foundation. The determination letter is dated August 22, 2007. PF Bravo's Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, states that the foundation will make grants only to public charities. The determination letter states, "We have not considered whether grants made under your procedures are excludable from the gross income of recipients under Section 117(a) of the Code." DP Charlie is a CPA, and partner of a small accounting firm. DP Charlie has 20 years of experience, with 10 years spent as the controller of a large public charity.
- (4) On October 10, 2009, PF Bravo issues a check to Mike, DP Charlie's child. DP Mike is 10 years old. The check is for \$25,000. The memo field on the check states "Happy Birthday". DP Mike has not rendered any services to the foundation.
- (5) During an examination of the Form 990-PF for 201006, Agent Davis notifies PF Bravo that the transaction constitutes a taxable expenditure subject to tax under Section 4945. For the report of examination, Agent Davis proposes the foundation manager excise tax under Section 4945(a)(2) on DP Charlie. The amount of the taxable expenditure, \$25,000, is the amount that is subject to tax. The amount of correction is also \$25,000.
- (6) DP Charlie filed the 201006 Form 990-PF on November 15, 2010. The statute of limitations on the taxable expenditure transaction is November 15, 2013, if the return provided adequate notice of the transaction. Because DP Charlie made

correction in 2011, no second tier taxes are proposed. Note that when there is a taxable expenditure, tax is imposed only once in the taxable period.

Description	Amount
10/10/2009 Transaction	25,000.00
Foundation Tax at 20%	5,000.00
Foundation Manager Tax at 5% (Cap at \$10K)	1,250.00

- (7) Expanding upon the example, assume that Private Foundation Bravo subsequently files a late Form 4720. The Form 4720 is filed 10 days after Agent Davis issued the initial examination appointment letter on July 2, 2012. The foundation reports only \$5,000 as a taxable expenditure. Upon further inquiry, Agent Davis finds that the \$20,000 not reported was placed into a Section 529 tuition plan. No foundation manager taxes were reported. Agent Davis' resulting adjustment is computed below.

Description	Amount
10/10/2009 Transaction	25,000.00
Amount Reported	5,000.00
Adjusted Transaction Amount	20,000.00
Foundation Tax at 20%	4,000.00
Foundation Manager Tax at 5% (Cap at \$10K)	1,250.00

- (8) Due to PF Bravo's filing of the late Form 4720, the failure to file or failure to pay penalties are not proposed. (See IRM 4.8.9, Statutory Notices of Deficiency, for information on failure to file and failure to pay penalties). For Foundation Manager (FM) Charlie, Agent Davis establishes the substitute for return on IDRS and proposes the failure to file and failure to pay penalties. For FM Charlie (a calendar year taxpayer), the Form 4720 return for the taxable expenditure transaction occurring in 2009, was due May 15, 2010. Agent Davis determines that abatement under Section 4962 does not apply in this case. Agent Davis issues the report on December 3, 2012, and solicits correction. See below for penalty computations:

Taxpayer	Tax	Penalty Rate	Months Late	Penalty
FM Charlie	\$1,250.00	4.5%	5	\$281.25
FM Charlie	\$1,250.00	0.5%	31	\$193.75

Exempt Organizations Excise Tax Audit Changes

(Chapter 41, Chapter 42, and Section 170(f)(10)(F) Excise Taxes)

Name of Taxpayer Private Foundation Bravo	Employer ID No. [Insert EIN]	Schedule or Exhibit 1
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Name of Exempt Organization (*if different from*
Taxpayer)

		Taxable Years Ended		
		06/30/2010		
Internal Revenue Code Section for Proposed Adjustment		4945(a)(1)		
1. Adjustments	Taxable expenditure (birthday gift)	20,000.00		
2.	Total Adjustments	20,000.00		
3.	Amount reported on return or as Previously adjusted	5,000.00		
4.	Total amount as corrected	25,000.00		
5.	Applicable tax rate %	20%		
6.	Initial tax liability as corrected (line 4 x Line 5)	5,000.00		
7.	Initial tax liability reported	1,000.00		
8.	Increase (or decrease) in tax	4,000.00		
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

Explanation of Adjustments
See attached Explanation of Items

Form 4883 (Rev. 1-2004)

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Exempt Organizations Excise Tax Audit Changes

(Chapter 41, Chapter 42, and Section 170(f)(10)(F) Excise Taxes)

Name of Taxpayer Foundation Manager Charlie		Employer ID No. [Insert EIN]	Schedule or Exhibit 1	
Name of Exempt Organization (<i>if different from</i> Taxpayer) Private Foundation Bravo				
		Taxable Years Ended		
		12/31/2009		
Internal Revenue Code Section for Proposed Adjustment		4945(a)(2)		
1. Adjustments	Taxable expenditure (birthday gift)	25,000.00		
2.	Total Adjustments	25,000.00		
3.	Amount reported on return or as Previously adjusted	0.00		
4.	Total amount as corrected	25,000.00		
5.	Applicable tax rate %	5%		
6.	Initial tax liability as corrected (line 4 x Line 5)*	1,250.00		
7.	Initial tax liability reported	0.00		
8.	Increase (or decrease) in tax	1,250.00		
9.	Additional tax (minimum)			
10.	Penalties (Code section 6651(a)(1), 6651(a)(2))	475.00		

Explanation of Adjustments

See attached Explanation of Items

* Tax on foundation managers is capped at \$10,000. The failure to pay penalty per 6651(a)(2) will continue to accrue until the tax deficiency is fully paid, up to a maximum rate of 25%.

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Exempt Organizations – Report of Examination

(Proposed Tax Changes)

1. Form No. 4720	2. Area Office [Insert name of your area]	3. Date of Report [Insert date]	
4. Name and Address of Taxpayer Private Foundation Bravo [Insert street address] [Insert city, state, and zip code]		5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)	
6. Social Security Number or Employer Identification Number [Insert EIN]	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)
	6/30/2010		
9. Tax Period(s) Ended			
10. Reporter Preparer's Name [Insert your name]		11. Agreement Secured (Check one.) Yes <input type="checkbox"/> No <input type="checkbox"/>	
12. Findings Discussed with (Name and Title) [Insert name of a foundation manager or representative]		13. Agreement Date [Leave blank]	
14a. Summary of Proposed Adjustments			
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)
4945(a)(1)	6/30/2010	4,000.00	
15. Remarks See attached Explanation of Items			
16. Attachments			
Form 4621 Rev (1-2004)		Catalog Number 41830Q	
		Department of the Treasury Internal Revenue Service www.irs.gov	

Exempt Organizations – Report of Examination

(Proposed Tax Changes)

1. Form No. 4720	2. Area Office [Insert name of your area]	3. Date of Report [Insert date]	
4. Name and Address of Taxpayer Foundation Manager Charlie [Insert street address] [Insert city, state, and zip code]		5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4) Private Foundation Bravo [Insert street address] [Insert city, state, and zip code]	
6. Social Security Number or Employer Identification Number [Insert EIN]	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)
	12/31/2009		
9. Tax Period(s) Ended		10. Reporter Preparer's Name [Insert your name]	
6/30/2010		11. Agreement Secured (Check one.) Yes <input type="checkbox"/> No <input type="checkbox"/>	
12. Findings Discussed with (Name and Title) [Insert name of a foundation manager or representative]		13. Agreement Date [Leave blank]	
14a. Summary of Proposed Adjustments		14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)
4945(a)(2)	12/31/2009	1,250.00	6651(a)(1)
	12/31/2009		6651(a)(2)
15. Remarks See attached Explanation of Items			
16. Attachments			
Form 4621 Rev (1-2004)		Catalog Number 41830Q	
		Department of the Treasury Internal Revenue Service www.irs.gov	

B. Section 4945 – Second Tier Tax and Penalties Example

- (1) Continuing with the example above, Agent Davis, prior to issuing a 30-day letter with the enclosed reports, issues a Thorne letter to Foundation Manager Charlie, who refuses to make correction. DP Charlie disputes that he is liable under Section 4945(a)(2) and plans to file a formal protest to Appeals upon receipt of Agent Davis' report, issued on January 2, 2013. See the Thorne Letter example below for sample language used in a Thorne letter for a theoretical Section 4945 scenario.
- (2) In the example above, Charlie was found to be a CPA who worked for a decade for a large public charity. After consulting Area Counsel, Agent Davis determines that Charlie is further liable for the Section 6684 penalty for a willful and flagrant violation. The computations for Charlie's liability are shown below:

Tax Year	Tax Amount	Code Section	Penalty Rate	Months Late	Penalty
200912	\$1,250.00	6651(a)(1)	4.5%	5	\$281.25
200912	\$1,250.00	6651(a)(2)	0.5%	32	\$200.00
200912	\$10,000.00	6684	100%	N/A	\$1,250.00
200912	\$20,000.00	6684	100%	N/A	\$12,500.00
Total Penalty					\$14,231.25

- (3) Because a penalty under Section 6684 is being proposed, Agent Davis obtains written supervisory approval for penalty assessment to comply with Section 6751(b)(1) and includes all pertinent documentation in the case file.
- (4) As the transaction is not corrected, Private Foundation Bravo is subject to the second tier tax on the entire amount of the transaction. Without correction, Agent Davis would issue the following formal reports of examination to Private Foundation Bravo and Foundation Manager Charlie that include the second tier tax with a 30-day letter (Letter 3614):

Exempt Organizations Excise Tax Audit Changes

(Chapter 41, Chapter 42, and Section 170(f)(10)(F) Excise Taxes)

Name of Taxpayer Private Foundation Bravo	Employer ID No. [Insert EIN]	Schedule or Exhibit 1
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Name of Exempt Organization (*if different from*
Taxpayer)

		Taxable Years Ended		
		06/30/2010	06/30/2010	
Internal Revenue Code Section for Proposed Adjustment		4945(a)(1)	4945(b)(1)	
1. Adjustments	Taxable expenditure (birthday gift)	20,000.00	25,000.00	
2.	Total Adjustments	20,000.00		
3.	Amount reported on return or as Previously adjusted	5,000.00		
4.	Total amount as corrected	25,000.00		
5.	Applicable tax rate %	20%		
6.	Initial tax liability as corrected (line 4 x Line 5)*	5,000.00		
7.	Initial tax liability reported	1,000.00		
8.	Increase (or decrease) in tax	4,000.00		
9.	Additional tax (minimum) at 100% (IRC 4945(b)(1))		25,000.00	
10.	Penalties (Code section)			

Explanation of Adjustments
See attached Explanation of Items

Form 4883 (Rev. 1-2004)

Catalog Number 42083F

Department of the Treasury
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Exempt Organizations Excise Tax Audit Changes

(Chapter 41, Chapter 42, and Section 170(f)(10)(F) Excise Taxes)

Name of Taxpayer Foundation Manager Charlie		Employer ID No. [Insert EIN]	Schedule or Exhibit 1	
Name of Exempt Organization (<i>if different from</i> Taxpayer) Private Foundation Bravo				
		Taxable Years Ended		
		12/31/2009		
Internal Revenue Code Section for Proposed Adjustment		4945(a)(2)		
1. Adjustments	Taxable expenditure (birthday gift)	25,000.00		
2.	Total Adjustments	25,000.00		
3.	Amount reported on return or as Previously adjusted	0.00		
4.	Total amount as corrected	25,000.00		
5.	Applicable tax rate %	5%		
6.	Initial tax liability as corrected (line 4 x Line 5)*	1,250.00		
7.	Initial tax liability reported	0.00		
8.	Increase (or decrease) in tax	1,250.00		
9.	Additional tax (minimum) at 50% (IRC 4945(b)(2))	12,500.00		
10.	Penalties (IRC 6651(a)(1), 6651(a)(2), 6684)	14,231.25		

Explanation of Adjustments

See attached Explanation of Items

* The tax is capped at \$10,000 for Section 4945(a)(2) and \$20,000 for Section 4945(b)(2).

The failure to pay penalty per Section 6651(a)(2) will continue to accrue until the tax deficiency is fully paid, up to a maximum rate of 25%.

Form 4883 (Rev. 1-2004)

Catalog Number 42083F

Department of the Treasury
Internal Revenue Service
www.irs.gov

Exempt Organizations – Report of Examination

(Proposed Tax Changes)

1. Form No. 4720	2. Area Office [Insert name of your area]	3. Date of Report [Insert date]	
4. Name and Address of Taxpayer Private Foundation Bravo [Insert street address] [Insert city, state, and zip code]		5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)	
6. Social Security Number or Employer Identification Number [Insert EIN]	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)
	6/30/2010		
9. Tax Period(s) Ended			
10. Reporter Preparer's Name [Insert your name]		11. Agreement Secured (Check one.) Yes <input type="checkbox"/> No <input type="checkbox"/>	
12. Findings Discussed with (Name and Title) [Insert name of a foundation manager or representative]		13. Agreement Date [Leave blank]	
14a. Summary of Proposed Adjustments			
14b. Penalty			
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)
4945(a)(1)	6/30/2010	4,000.00	25,000.00
15. Remarks See attached Explanation of Items			
16. Attachments			
Form 4621 Rev (1-2004)		Catalog Number 41830Q	
Department of the Treasury Internal Revenue Service www.irs.gov			

Exempt Organizations – Report of Examination

(Proposed Tax Changes)

1. Form No. 4720	2. Area Office [Insert name of your area]	3. Date of Report [Insert date]	
4. Name and Address of Taxpayer Foundation Manager Charlie [Insert street address] [Insert city, state, and zip code]		5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4) Private Foundation Bravo [Insert street address] [Insert city, state, and zip code]	
6. Social Security Number or Employer Identification Number [Insert EIN]	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)
	12/31/2009		
9. Tax Period(s) Ended			
10. Reporter Preparer's Name [Insert your name]		11. Agreement Secured (Check one.) Yes <input type="checkbox"/> No <input type="checkbox"/>	
12. Findings Discussed with (Name and Title) [Insert name of a foundation manager or representative]		13. Agreement Date [Leave blank]	
14a. Summary of Proposed Adjustments			
14b. Penalty			
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)
4945(a)(2)	12/31/2009	1,250.00	12,500.00
	12/31/2009		
	12/31/2009		
15. Remarks See attached Explanation of Items			
16. Attachments			
Form 4621 Rev (1-2004)		Catalog Number 41830Q	
Department of the Treasury Internal Revenue Service www.irs.gov			

C. Thorne Letter

- (1) This exhibit contains sample language for a theoretical situation involving Section 4945. Consult with Area Counsel when drafting a Thorne letter. Counsel approves the issuance of all Thorne letters and helps to individually design each letter specific to the fact pattern presented.



Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities
RETURN ADDRESS
RETURN ADDRESS

TAXPAYER NAME
TAXPAYER ADDRESS
TAXPAYER ADDRESS

Date:
Taxpayer ID number:
Form:

Tax periods ended:

Person to contact:

Name:
ID number:
Telephone:
Fax:

Manager's contact information:

Name:
ID number:
Telephone:

Certified Mail

Dear [INSERT TAXPAYER NAME]:

I am nearing the conclusion of the examination of the [INSERT FOUNDATION NAME]'s Form 990-PF for [INSERT FISCAL YEAR(S)]. These information returns reported that the Foundation made numerous expenditures for [INSERT REASON]. The Foundation identified these expenditures as being for [INSERT TYPE OF PURPOSE] purposes. My examination has revealed that these expenditures were in fact for purposes other than [INSERT TYPE OF PURPOSE] purposes.

I have concluded that these expenditures were "taxable expenditures" within the meaning of Section 4945(d) of the Internal Revenue Code (IRC). I have concluded that the expenditures are either described in IRC Section 4945(d)(1) (amounts paid to carry on propaganda or otherwise attempt to influence legislation) or IRC Section 4945(d)(5) (amounts paid for any purpose other than one specified in IRC Section 170(c)(2)(B)).

The purpose of this letter is to advise you that I intend to propose liabilities under IRC Section 4945(a)(1) on the Foundation, and IRC Section 4945(a)(2) on you as the foundation manager. My understanding is that you do not concur with my proposals and that the Foundation has made no correction of these taxable expenditures as defined in IRC Section 4945(b)(1) on the Foundation. In addition, and as explained in more detail below, I also intend to propose IRC Section 4945(b)(2) liabilities on you as foundation manager.

[Only use one of the next 2 paragraphs. Select the 1st paragraph for short statute cases (<270 days on statute remaining). Select the 2nd paragraph for cases in which sufficient time remains on the statute.]

While I intend to propose the liabilities described in the preceding paragraphs, please do not construe this letter as a 30-day letter. Following the conclusion of my preparation of a report on the proposed liabilities, I will send out the report of examination. Around the same time frame, statutory notices of deficiency will be issued, giving you and the Foundation 90 days to file a petition with the appropriate court.

While I intend to propose the liabilities described in the preceding paragraphs, please do not construe this letter as a 30-day letter. Following the conclusion of my preparation of a report on the proposed liabilities, I will send out the report of examination via a 30-day letter to you. This letter will advise you of your administrative appeal rights. Generally, you will have thirty days from the receipt of that letter to submit an administrative protest.

Please be advised that I intend to propose to define correction under the facts and circumstances of this examination to be that you reimburse the Foundation for the taxable expenditures of the Foundation. I intend to propose the following amounts of taxable expenditures in the following years:

Year	Taxable Expenditure
XXXX	\$ABCDE.00
YYYY	\$FGHI.00
ZZZZ	\$JKLMNO.00
Total	\$PQRSTU.00

The liability of the Foundation under IRC Section 4945(b)(1) would be eliminated if you make the above enumerated reimbursement to the Foundation. In addition, your liability under IRC Section 4945(b)(2) would be eliminated if you agree to the correction.

Pursuant to *Thorne v. Commissioner*, 99 T.C. 67 (1992), I am hereby formally requesting that you make the correction as cited above. Please advise me in writing by [INSERT DATE in MM DD, YYYY format] whether you will agree or refuse to make the requested correction.

Thank you for your prompt attention to this matter.

Sincerely,

[INSERT NAME]

D. Statute Extension Example

- (1) This example can be used when extending the statute of limitations for assessing excise tax under Section 4940 and/or income tax against a private foundation.

Form 872 (September 2020)	Department of the Treasury-Internal Revenue Service Consent to Extend the Time to Assess Tax	In reply refer to: SE:T:EO:E:XX:79XX TIN [Insert TIN]
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[Insert Name of Taxpayer]

[Insert Continuation of Name, If Necessary]

(Name(s))

taxpayer(s) of [Insert Street Address, P.O. Box, or APO/FPO]

[Insert City, State, Zip Code, (and foreign country, if applicable)]

(Address)

and the Commissioner of Internal Revenue consent and agree to the following:

(1) The amount of any Federal [Excise (section 4940 and/or income)]

(Kind of tax)

tax due on any return(s) made by or for the above taxpayer(s) for the period(s) ended

[Insert Tax Year(s)]

may be assessed at any time on or before [Insert Expiration Date]

(Expiration date)

of the Internal Revenue Code suspends the running of the period of limitations to assess such tax, then, when, under the Internal Revenue Code, the running of the period resumes, the extended period to assess will include the number of days remaining in the extended period immediately before the suspension began.

(2) The taxpayer(s) may file a claim for credit or refund and the Service may credit or refund the tax within 6 months after this agreement ends, except with respect to the items in paragraph (4).

(3) Paragraph (4) applies only to any taxpayer who holds an interest, **either directly or indirectly**, in any partnership subject to subchapter C of chapter 63 of the Internal Revenue Code, as in effect for partnership taxable years beginning before January 1, 2018.

(4) Without otherwise limiting the applicability of this agreement, this agreement also extends the period of limitations for assessing any tax (including penalties, additions to tax and interest) attributable to any partnership items (see section 6231 (a)(3)), affected items (see section 6231(a)(5)), computational adjustments (see section 6231(a)(6)), and partnership items converted to nonpartnership items (see section 6231(b)). Additionally, this agreement extends the period of limitations for assessing any tax (including penalties, additions to tax, and interest) relating to any amounts carried over from the taxable year specified in paragraph (1) to any other taxable year(s). This agreement extends the period for filing a petition for adjustment under section 6228(b) but only if a timely request for administrative adjustment is filed under section 6227. For partnership items which have converted to nonpartnership items, this agreement extends the period for filing a suit for refund or credit under section 6532, but only if a timely claim for refund is filed for such items.

(5) This Form contains the entire terms of the Consent to Extend the Time to Assess Tax. There are no representations, promises, or agreements between the parties except those found or referenced on this Form.

Your Rights as a Taxpayer

You have the right to refuse to extend the period of limitations or limit this extension to a mutually agreed-upon issue(s) or mutually agreed-upon period of time. **Publication 1035, Extending the Tax Assessment Period**, provides a more detailed explanation of your rights and the consequences of the choices you may make. If you have not already received a Publication 1035, the publication can be obtained, free of charge, from the IRS official who requested that you sign this consent or from the IRS' web site at www.irs.gov or by calling toll free at 1-800-TAX-FORM (1-800-829-3676). Signing this consent will not deprive you of any appeal rights to which you would otherwise be entitled.

(Space for signature is on the back of this form and signature instructions are attached)

E. Statute Extension Example – Modified

- (1) Extensions for Sections 4941 through 4945 taxes require modification of the Form 872. The example shown is not an official Form, but a modified Form 872. The modified Form replaces the phrase “on any returns made by or for the above taxpayer(s) for the period(s) ended with” with “from the above taxpayer(s) for the years that are fully or partially within the taxable period(s) that began”. As a general rule for extending statutes for assessment of Chapter 42 excise taxes, use the date of the first act or failure to act (or taxable event) for the start of the taxable period.

Note: The statute must be protected for an act or acts in each separate year (including continuing acts), preferably by separate consents noting the date(s) of the act and year.

- (2) Consult with Area Counsel when preparing Form 872 for excise taxes, particularly in situations where a private foundation may be liable for several different types of excise taxes arising in a particular year or years.

Form 872 (September 2020)	Department of the Treasury-Internal Revenue Service Consent to Extend the Time to Assess Tax	In reply refer to: SE:T:EO:E:XX:79XX TIN [Insert TIN]
-------------------------------------	--	--

[Insert Name of Taxpayer]

[Insert Continuation of Name, If Necessary]

(Name(s))

taxpayer(s) of [Insert Street Address, P.O. Box, or APO/FPO]

[Insert City, State, Zip Code, (and foreign country, if applicable)]

(Address)

and the Commissioner of Internal Revenue consent and agree to the following:

(1) The amount of any Federal [Excise (section 4945)]

(Kind of tax)

tax due from the above taxpayer(s) for the years that are fully or partially within the taxable period(s) that began

[Insert the Date(s) on which the Taxable Expenditure(s) Occurred]

may be assessed at any time on or before [Insert Expiration Date]. If a provision
 (Expiration date)

of the Internal Revenue Code suspends the running of the period of limitations to assess such tax, then, when, under the Internal Revenue Code, the running of the period resumes, the extended period to assess will include the number of days remaining in the extended period immediately before the suspension began.

(2) The taxpayer(s) may file a claim for credit or refund and the Service may credit or refund the tax within 6 months after this agreement ends, except with respect to the items in paragraph (4).

(3) Paragraph (4) applies only to any taxpayer who holds an interest, **either directly or indirectly**, in any partnership subject to subchapter C of chapter 63 of the Internal Revenue Code, as in effect for partnership taxable years beginning before January 1, 2018.

(4) Without otherwise limiting the applicability of this agreement, this agreement also extends the period of limitations for assessing any tax (including penalties, additions to tax and interest) attributable to any partnership items (see section 6231 (a)(3)), affected items (see section 6231(a)(5)), computational adjustments (see section 6231(a)(6)), and partnership items converted to nonpartnership items (see section 6231(b)). Additionally, this agreement extends the period of limitations for assessing any tax (including penalties, additions to tax, and interest) relating to any amounts carried over from the taxable year specified in paragraph (1) to any other taxable year(s). This agreement extends the period for filing a petition for adjustment under section 6228(b) but only if a timely request for administrative adjustment is filed under section 6227. For partnership items which have converted to nonpartnership items, this agreement extends the period for filing a suit for refund or credit under section 6532, but only if a timely claim for refund is filed for such items.

(5) This Form contains the entire terms of the Consent to Extend the Time to Assess Tax. There are no representations, promises, or agreements between the parties except those found or referenced on this Form.

Your Rights as a Taxpayer

You have the right to refuse to extend the period of limitations or limit this extension to a mutually agreed-upon issue(s) or mutually agreed-upon period of time. **Publication 1035, Extending the Tax Assessment Period**, provides a more detailed explanation of your rights and the consequences of the choices you may make. If you have not already received a Publication 1035, the publication can be obtained, free of charge, from the IRS official who requested that you sign this consent or from the IRS' web site at www.irs.gov or by calling toll free at 1-800-TAX-FORM (1-800-829-3676). Signing this consent will not deprive you of any appeal rights to which you would otherwise be entitled.

(Space for signature is on the back of this form and signature instructions are attached)

F. Section 4945 Taxes on Taxable Expenditures Lead Sheet

Taxpayer Name:
TIN:
Tax Form:

Examiner:
Date:
Tax Year:

IRC 4945 Taxes on Taxable Expenditures Lead Sheet				
Tax Period	Per Return	Per Exam	Adjustment	Reference
Conclusion: <i>(Reflects the final determination on the issue.)</i>				
<p><i>The following techniques are not intended to be all-inclusive nor are they mandatory steps to be followed. Judgment should be used in selecting the techniques that apply to each taxpayer. Reference: Technical Resource Guide 62: Taxable Expenditures of Private Foundations</i></p>				
Audit Steps: <i>(Document audit steps taken or to be taken.)</i>				Workpaper Reference
1. Identify disqualified persons as defined in IRC 4946. Determine if the private foundation is liable to for filing Form 4720, and review if filed.				
2. Identify amounts incurred by the private foundation that meet the definition of taxable expenditures under IRC 4945(d).				
3. Determine the nature of the transaction and if it meets any of the following categories: <ul style="list-style-type: none"> • Propaganda or other attempt to influence legislation. IRC 4945(d)(1) and 4945(e) • Influence the outcome of any specific public election. IRC 4945(d)(2) and 4945(f) • Grant to an individual for travel, study, or other similar purpose. IRC 4945(d)(3) and 4945(g) • Grant to an organization unless. IRC 4945(d)(4) and 4945(h) • Any purpose other than one specified in IRC 170(c)(2)(B). IRC 4945(d)(5) 				
4. Calculate the initial excise tax. IRC 4945(a) imposes a 20% tax on the private foundation for each taxable expenditure. A 5% tax is imposed on any foundation manager knowing it is a taxable expenditure. Treas. Reg. 53.4945-1(a)(1).				
5. Determine if the taxable expenditure(s) is corrected within the taxable period. IRC 4945(i).				

Taxpayer Name:

TIN:

Tax Form:

Examiner:

Date:

Tax Year:

6. Determine if the private foundation requested abatement of the initial tax due to reasonable cause and not due to willful neglect, and that the violation was timely corrected. IRC 4962.	
7. Calculate the additional tax. IRC 4945(b) imposes a 100% tax on the private foundation for each taxable expenditure not corrected within the taxable period. A 50% tax is imposed on any foundation manager who refused to agree to part or all of the correction. The manager(s) are jointly and severally liable for the tax in which an initial tax is imposed on a foundation because of a taxable expenditure and the transaction is not timely corrected. Treas. Reg. 53.4945-1(b)(2).	
8. Determine if there has been correction of the taxable expenditure and if appropriate whether the termination taxes are imposed pursuant to IRC 507.	
9. Determine whether appropriate steps have been taken to remedy the circumstances that caused the excise tax to be imposed.	
Facts: <i>(Document the relevant facts.)</i>	
Law: <i>(Tax Law, Regulations, court cases, and other authorities.)</i>	
IRC Section: 4945, 4946, 4962; Treas. Regs. 53.4945-1 – 5	
Specific citations:	
Taxpayer Position: <i>(If applicable)</i>	