



# Exempt Organizations Technical Guide

## TG 3-20 Introduction to Private Foundations & Special Rules Under IRC 508

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## I. Overview

- (1) This TG introduces private foundations and gives an overview of the applicable excise taxes. This TG also discusses the special rules of Section 508 that pertain to private foundations.

### A. Background/History

- (1) The Tax Reform Act of 1969 amended the Internal Revenue Code (IRC) by adding provisions classifying Section 501(c)(3) organizations either as private foundations or public charities. It added a wide array of restrictions, requirements, taxes and penalties affecting organizations classified as a private foundation and certain individuals associated with them. Later, the Pension Protection Act of 2006, P.L. 109-280 (PPA 2006) and the Bipartisan Budget Act of 2018, P.L. 115-123 (2018) changed several Chapter 42 provisions pertaining to private foundations.

**Note:** These law changes impacted other entities as well as private foundations. This introduction gives you a brief overview of the IRC sections that are generally applicable for private foundations.

- (2) Every organization that qualifies for tax exemption as an organization under Section 501(c)(3) is a private foundation unless it is described under one of the categories in Section 509(a). Also, certain nonexempt charitable trusts are subject to some private foundation rules. Organizations in Section 509(a) classified as public charities include:
  - a. Institutions described in Section 170(b)(1)(A) (other than in clauses (vii) and (viii)) such as hospitals or universities,
  - b. Those that have broad public support, or
  - c. Those that actively function in a supporting relationship to these organizations.
- (3) Once an organization becomes a private foundation, it retains that status, even if it no longer is described in Section 501(c)(3), until its private foundation status terminates under Section 507. See Section 509(b).
- (4) The main IRC sections affecting private foundations are in Sections 507 – 509 and 4940 – 4946 inclusive. See other Technical Guides for detailed discussions of these provisions listed below:
  - a. Section 507 – Termination of private foundation status.
  - b. Section 508(a) - (e) – Special rules (notice requirements, presumption that organizations are private foundations, disallowance of charitable deductions, governing instrument requirements as pertaining to private foundations).

- c. Section 509 – Private foundation defined.
- d. Section 4940 – Excise tax based on investment income.
- e. Section 4941 – Taxes on self-dealing.
- f. Section 4942 – Taxes on failure to distribute income.
- g. Section 4943 – Taxes on excess business holdings.
- h. Section 4944 – Taxes on investments which jeopardize charitable purpose.
- i. Section 4945 – Taxes on taxable expenditures.
- j. Section 4946 – Definitions and special rules (disqualified persons).
- k. Section 4947 – Application of taxes to certain non-exempt trusts.
- l. Section 4948 – Application of taxes and denial of exemption with respect to certain foreign organizations.
- m. Section 4960 – Tax on excess tax-exempt organization executive compensation.

## **B. Relevant Terms**

- (1) Private Foundations: Organizations that are exempt from taxation under Section 501(c)(3) 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.
- (2) Chapter 42: Refers to 26 U.S. Code Chapter 42, Private Foundations and Certain Other Tax-Exempt Organizations. Code sections that apply excise taxes on certain private foundations and provide definitions within Chapter 42 are: 4940 through 4948.

## **C. Law/Authority**

- (1) There are different types of private foundations depending on how they are structured and how they operate. Such organizations can be private non-operating foundations (namely grant making private foundations), private operating foundations and exempt operating foundations. It is important to determine which type of private foundation you are reviewing because not all Chapter 42 requirements apply to private operating foundations and exempt operating foundations.
- (2) An organization described in Section 501(c)(3) is a private foundation unless it falls into one of the categories specifically excluded from the definition of that term (referred to in Section 509(a)). In addition, certain nonexempt charitable trusts are also treated as private foundations.
- (3) A private operating foundation, as defined in Section 4942(j)(3), is any private foundation that spends at least 85% of its adjusted net income or its minimum investment return, whichever is less, directly for the active conduct of its exempt

activities (the income test). In addition, the foundation must meet one of the following tests:

- a. The assets test,
  - b. The endowment test, or
  - c. The support test.
- (4) To qualify as an exempt operating foundation, as defined in Section 4940(d)(2), for a tax year, a private foundation must meet all the following requirements:
- a. It is a private operating foundation,
  - b. It has been publicly supported for at least ten tax years or was a private operating foundation on January 1, 1983,
  - c. Its governing body, at all times during the tax year, consists of individuals fewer than 25% of whom are disqualified individuals, and is broadly representative of the general public, and
  - d. It has no officer who is a disqualified individual at any time during the tax year.

## **II. Exemption / Filing Requirements**

- (1) During its existence, a private foundation has numerous interactions with the IRS - from filing an application for recognition of tax-exempt status, to filing required annual information returns, to making changes in its mission and purpose.

### **A. Exemption**

- (1) To be tax-exempt under Section 501(a) as an organization described in Section 501(c)(3), an organization must be organized and operated exclusively for exempt purposes set forth in Section 501(c)(3).
- (2) Organizations described in Section 501(c)(3) are commonly referred to as charitable organizations. Organizations described in Section 501(c)(3), other than testing for public safety organizations, are eligible to receive tax-deductible contributions in accordance with Section 170.
- (3) The organization must not be organized or operated for the benefit of private interests, and no part of a Section 501(c)(3) organization's net earnings may inure to the benefit of any private shareholder or individual.
- (4) Section 501(c)(3) organizations are prohibited from engaging in political activities for or against any candidate for public office and, as a general rule, may only engage in an insubstantial amount of legislative (lobbying) activities. (Note that private foundations are generally subject to an excise tax on amounts paid or incurred for lobbying, subject to certain exceptions.)

### **B. Exemption Application**

- (1) To apply for exemption, a foundation should complete and submit Form 1023, Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code, or Form 1023-EZ, Streamlined Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code, along with the required user fee. If a foundation is represented by an attorney or other representative, it must also submit a power of attorney.
- (2) Private operating foundations and certain other organizations cannot file a Form 1023-EZ. See Revenue Procedure (Rev. Proc.) 2021-5 (updated annually) for additional information.

### **C. Annual Return Requirements**

- (1) All private foundations, including taxable private foundations and nonexemptcharitable trusts described in Section 4947(a)(1) that are treated as private foundations, are required to file an annual return on Form 990-PF, Return ofPrivate Foundation.
- (2) Form 990-PF must be filed by the 15th day of the 5th month following the close of the organization's accounting period.
- (3) If the foundation is on a calendar year, or if it has no established accounting period, the return will be due May 15, each year.

- (4) For a complete liquidation, dissolution or termination, the return must be filed by the 15th day of the 5th month following complete liquidation, dissolution or termination.
- (5) If an organization fails to file Form 990-PF by the due date (taking into account any extensions granted), it will have to pay \$20 for each day the return is late (\$105 a day for large organizations), not to exceed the lesser of \$10,500 (\$53,000 for large organizations) or 5% of the organization's gross receipts for the year, unless it can show that the failure was due to reasonable cause. The IRS may make written demand that the delinquent return be filed within a reasonable time after the date of mailing the demand. If the organization does not file by the date specified in the demand, the person or persons responsible for the failure to file will be subject to a penalty of \$10 a day for each day after the date specified in the notice that the return is not filed unless it is shown that the failure to file is due to reasonable cause. The total amount imposed on all persons responsible for the failure to file is limited to \$5,000. The penalty is also applicable to a failure to provide information required by the return, or a failure to file correct information.

**Note:** The \$20 daily penalty under Section 6652(c)(1)(a) and the \$100 daily penalty under Section 6652(c)(2)(C) are annually adjusted for inflation per Section 6652(c)(7). Consult the annual revenue procedures on forms and instructions and the Form 990-PF Instructions for the applicable adjustments for each year.

- (6) Even though a private foundation is recognized as tax exempt, it still may be liable for tax on its unrelated business income. Unrelated business income is income from a trade or business, regularly carried on, that is not substantially related to the charitable, educational or other purpose that is the basis of the organization's exemption. An exempt organization that has \$1,000 or more of gross income from an unrelated business must file Form 990-T. An organization must pay estimated tax if it expects its tax for the year to be \$500 or more. The obligation to file Form 990-T is in addition to the obligation to file the annual information return, Form 990-PF.

**Note:** With a few exceptions, most tax-exempt organizations that file Forms 990, 990-EZ, 990-PF, 990-T or 1120-POL must file electronically.

### III. Other Considerations

- (1) There are other considerations that need to be reviewed when looking at a Section 501(c)(3) organization that is classified as a private foundation. Private foundations raise complex and interrelated issues regarding the application of Chapter 42.

#### A. Differences Between Private Foundation and Public Charity

- (1) Private foundations must meet stricter requirements and are subject to more regulation than public charities.
- (2) A private foundation cannot be tax exempt, nor will contributions to it be deductible as charitable contributions unless its governing instrument contains special provisions in addition to those that apply to all organizations described in Section 501(c)(3).
- (3) There are additional restrictions and requirements for private foundations, including:
  - a. Restrictions on self-dealing with substantial contributors and other disqualified persons,
  - b. Requirements that the private foundation annually distribute income for charitable purposes,
  - c. Limits on their holdings in private businesses,
  - d. Provisions that investments must not jeopardize the carrying out of exempt purposes, and
  - e. Provisions to assure that expenditures further exempt purposes.

#### B. Brief Overview of the Excise Taxes for Private Foundations

- (1) Section 4940(a) imposes on each private foundation which is exempt from taxation under Section 501(a) for the taxable year, with respect to the carrying on of its activities, a tax equal to 1.39% of the net investment income of such foundation for the taxable year.

**Note:** 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 15% special rate that applied if the private foundation met certain distribution requirements. The changes are effective for taxable years beginning after December 20, 2019.

- (2) Section 4941 imposes an excise tax on any direct or indirect act of self-dealing between a private foundation and a disqualified person. There is an initial 10% excise tax imposed on a disqualified person, who is the self-dealer, on the amount involved in the act of self-dealing for each year or partial year in the



taxable period. An initial excise tax of 5% of the amount involved is imposed on a foundation manager who knowingly participates in an act of self-dealing, unless participation is not willful and is due to reasonable cause, for each year or part of a year in the taxable period.

- (3) Section 4942 imposes an excise tax on the undistributed income of a private foundation for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year (if such first day falls within the taxable period); the amount of the initial tax is equal to 30% of the amount of such income remaining undistributed at the beginning of such second (or succeeding) taxable year.
- (4) Section 4943 imposes an excise tax on the excess business holdings of any private foundation in a business enterprise during any taxable year which ends during the taxable period; the amount of the initial tax is equal to 10% of the value of such holdings.
- (5) Section 4944 imposes an excise tax if a private foundation invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes; the amount of the initial tax is equal to 10% of the amount so invested for each year (or part thereof) in the taxable period. An initial excise tax of 10% of the amount invested is imposed on a foundation manager who knowingly participates in making the jeopardizing investment, unless participation is not willful and is due to reasonable cause, for each year or part of a year in the taxable period.
- (6) Section 4945 imposes an excise tax on each taxable expenditure; the amount of the initial tax is equal to 20% of the amount thereof. An initial excise tax of 5% of the expenditure amount is imposed on a foundation manager who knowingly participates in making a taxable expenditure unless participation is not willful and is due to reasonable cause.
- (7) Sections 4941 – 4945 also impose an additional second tier excise tax for the violations if correction is not made. See the Sections 4941 – 4945 Technical Guides for detailed analysis regarding these provisions.
- (8) Section 4946 defines disqualified persons with respect to a private foundation.

## **C. Special Rules for Private Foundations**

- (1) Section 508 has several rules affecting private foundations:
  - a. Section 508(a) requires organizations to notify the IRS that they are applying for recognition of Section 501(c)(3) status.
  - b. Section 508(b) presumes that a Section 501(c)(3) organization is a private foundation unless it notifies the IRS to the contrary.
  - c. Section 508(e) requires a private foundation's governing instrument to contain provisions addressing the rules of Sections 4941, 4942, 4943, 4944 and 4945.

- d. Section 508(d) disallows charitable deductions for contributions to private foundations under certain circumstances.
- (2) No gift or bequest made to an organization upon which the tax provided by Section 507(c) has been imposed shall be allowed as a deduction under Section 170, 545(b)(2), 642(c), 2055, 2106(a)(2) or 2522, if such gift or bequest is made:
- a. By any person after notification is made under Section 507(a), or
  - b. By a substantial contributor (as defined in Section 507(d)(2)) in his taxable year which includes the first day on which action is taken by such organization which culminates in the imposition of tax under Section 507(c) and any subsequent taxable year.
- (3) No gift or bequest made to an organization shall be allowed as a deduction under Section 170, 545(b)(2), 642(c), 2055, 2106(a)(2) or 2522, if such gift or bequest is made:
- a. To a private foundation or a trust described in Section 4947 in a taxable year for which it fails to meet the requirements of Section 508(e) (determined without regard to Section 508(e)(2)), or
  - b. To any organization in a period for which it is not treated as an organization described in Section 501(c)(3) by reason of Section 508(a).

**Exception:** Paragraph (1) of Section 508(d) shall not apply if the entire amount of the unpaid portion of the tax imposed by Section 507(c) is abated by the Secretary under Section 507(g).

#### **D. Section 508(b) Presumption of Foundation Status and Required Notice**

- (1) Generally, a Section 501(c)(3) organization is presumed to be a private foundation unless it files a timely notice to the contrary with the IRS (Section 508(b)). An organization ordinarily files its notice by filing a properly completed Form 1023 or Form 1023-EZ application. Form 1023 includes questions for determining whether the organization is a private foundation or a private operating foundation. See Treasury Regulations (Treas. Reg.) 1.508-1(a)(2)(iv).
- (2) The regulations allow for a 15-month filing deadline to file the notice with the IRS, like that for Section 508(a). See Treas. Reg. 1.508-1(b)(2)(i). Organizations receive an automatic 12-month extension if they file an application for exemption with the IRS within 12 months of the original 15-month deadline. See Treas. Reg. 301.9100-2. However, the presumption of private foundation status is rebuttable. Even if the organization doesn't meet the deadline, the organization may subsequently submit information establishing its status as a public charity. See Revenue Ruling (Rev. Rul.) 73-504, 1973-2 C.B. 190. Most organizations exempt from the Section 508(a) notice requirement are

also exempt from the Section 508(b) notice requirement (including Section 4947(a)(1) trusts). See Treas. Reg. 1.508-1(b)(7).

- (3) Usually, an organization cannot be a private foundation unless it is exempt under Section 501(c)(3).
- (4) Private foundation status begins with recognition of exemption; so, if an organization required under Section 508(a) to file a Form 1023 or Form 1023-EZ application, fails to do so by the deadline, and is recognized as exempt only from the filing date (postmark date) of the application, then it will be a private foundation (or a public charity) from the filing date (postmark date).
- (5) Certain nonexempt trusts in Section 4947 are treated as private foundations for certain purposes even if they have not met the Section 508(a) notice requirement.
- (6) Private foundations that lose their exempt status remain private foundations until their private foundation status is terminated under Section 507.
- (7) An organization, its contributors, or others can only rely on a determination letter from the IRS to prove that it is not a private foundation. They may not rely on the timely filing of a notice under Section 508(b). See Treas. Reg. 1.508-1(b)(3)(i), (5)(ii), and (6), Treas. Reg. 1.509(a)-7, and Rev. Proc. 2018-32, 2018-23 I.R.B. 739.

**Exception:** An exception applies for certain community trusts. See Rev. Proc. 77-20, 1977-1 C.B. 585.

## E. Section 508(e) Governing Instrument Requirements

- (1) In general, a private foundation is not exempt under Section 501(a) for the year, and contributors may not deduct contributions to the private foundation made in the year, unless the private foundation's governing instrument requires it to conduct itself to avoid tax liability (both for itself and its disqualified persons) under Sections 4941, 4942, 4943, 4944 and 4945. See Sections 508(e)(1) and (d)(2)(A).
- (2) The governing instrument is the articles of organization under Treas. Reg. 1.501(c)(3)-1(b)(2). Bylaws do not qualify. See Treas. Reg. 1.508-3(c).
- (3) The governing instrument is deemed to meet the Section 508(e)(1) requirements if state law requires the foundation to act or refrain from acting so as not to subject the foundation to the taxes imposed by Sections 4941-4945, or, equivalently, treats the governing instrument as requiring this conduct. See Treas. Reg. 1.508-3(d)(1).
- (4) As a practical matter, most domestic private foundations do not need Section 508(e) provisions in their governing instruments, since laws in all states except New Mexico and U.S. Territories satisfy the requirements. See Rev. Rul. 75-38, 1975-1 C.B. 161. The laws of many states do not apply to satisfy Section 508(e) if their coverage is specifically disclaimed in one of the following documents:

- a. The governing instrument, or
  - b. Court decrees.
- (5) State law does not satisfy Section 508(e) if it does not apply to a clause in the governing instrument that conflicts with Section 508(e)(1). See Treas. Reg. 1.508-3(d)(5).

**Example 1:** A clause prohibiting distribution of corpus conflicts with Section 508(e)(1). See Treas. Reg. 1.508-3(b)(2).

**Example 2:** A clause empowering the trustee to make investments without being limited to investments authorized by law does not conflict. See Treas. Reg. 1.508-3(d)(3).

**Example 3:** In *Trust Under Will of Bella Mabury v. Commissioner*, 80 T.C. 718 (1983), the court held that a California law requiring private foundations to meet the requirements of Section 4942 did not automatically supersede a conflicting provision in a pre-1969 testamentary trust that required accumulation of income, but allowed for the trustee to bring a judicial proceeding to reform the trust in compliance with Section 4942.

- (6) If a private foundation intends to rely on state law to satisfy Section 508(e) and the state law by its terms does not apply to a governing instrument with a mandatory conflicting direction or allows private foundations to elect out of the law, then the private foundation must indicate on its annual return that it has not taken actions that would prevent the application of the state law. See Treas. Reg. 1.508-3(d)(3) and (4).
- (7) In general, where state law does not satisfy Section 508(e), the governing instrument must specifically refer to each of Sections 4941, 4942, 4943, 4944 and 4945. See Treas. Reg. 1.508-3(b)(1). For examples of language that satisfies the requirements, see Rev. Rul. 70-270, 1970-1 C.B. 135 and Rev. Rul. 74-368, 1974-2 C.B. 390 (for Section 4947(a)(2) trusts).
- (8) The governing instrument cannot expressly prohibit the distribution of capital/principal/corpus. See Treas. Reg. 1.508-3(b)(2).
- (9) Language that satisfies the organizational test under Treas. Reg. 1.501(c)(3)-1(b) does not necessarily meet Section 508(e). See Treas. Reg. 1.508-3(b)(1). Conversely, language sufficient for Section 508(e)(1) purposes does not necessarily satisfy the Section 501(c)(3) organizational test. See Rev. Rul. 85-160, 1985-2 C.B. 162.

**Note:** A private foundation cannot be tax exempt nor will contributions to it be deductible as charitable contributions unless its governing instrument contains special provisions in addition to those that apply to all organizations described in Section 501(c)(3). See Publication 557, *Tax-Exempt Status for Your Organization*, for examples of these provisions. In most cases, this requirement

may be satisfied by reference to state law. The IRS has published a list of states with this type of law. See Rev. Rul. 75-38, 1975-1 C.B. 161.

**Note:** Arizona is not listed in the revenue ruling but now has the requisite state law. With the exception of New Mexico, all other states and the District of Columbia have enacted statutory provisions that satisfy Section 508(e). Organizations in United States territories are generally required to have the required clauses in their governing instruments.

- (10) In New Mexico and U.S. Territories where the law does not satisfy Section 508(e), governing instruments generally meet the Section 508(e)(1) requirements for a tax year only if they meet the requirements by the end of the year. See Treas. Reg. 1.508-3(a). Several exceptions apply:
- a. In certain situations where a court declares a state law meeting the requirements of Section 508(e)(1) invalid for a class of private foundations, a private foundation has one year to amend its governing instrument. See Treas. Reg. 1.508-3(d)(2)(ii)-(iv).
  - b. If an organization originally is classified as a public charity and later classified as a private foundation, then it has one year from the date of receiving the final private foundation ruling to amend its governing instrument. See Treas. Reg. 1.508-3(b)(5).
  - c. If an organization must institute a judicial proceeding to amend its governing instrument, then the Section 508(e)(1) requirements are deemed satisfied within the one-year period if the organization institutes the proceeding within the period, and within a reasonable time, the organization in fact meets the Section 508(e) requirements. See Treas. Reg. 1.508-3(b)(6).
  - d. If the organization was organized before January 1, 1970, and institutes a necessary judicial proceeding within the year, then Section 508(e)(1) does not apply after the judicial proceeding if the court does not allow the reformation. See Treas. Reg. 1.508-3(b)(6).
- (11) Charitable trusts described in Section 4947(a)(1) that are subject to the private foundation rules must comply with Section 508(e). Split-interest trusts under Section 4947(a)(2) are also subject to the Section 508(e) requirements if Chapter 42 provisions apply to them. See Treas. Reg. 1.508-3(e).
- (12) Trusts described in Section 4947 must comply with Section 508(e) to avoid disallowed deductions under Section 508(d)(2)(A) for contributions to them. For additional details, see Treas. Reg. 1.508-3(e)(2) and (3).

## **E.1. Exceptions to Section 508(e) Requirements**

- (1) There are multiple exceptions to the Section 508(e) requirements regarding the foundation's governing instrument.

- (2) If an organization whose governing instrument was executed before January 1, 1970, instituted a necessary judicial proceeding in a court of proper jurisdiction by December 31, 1971, to reform its governing instrument to comply with Section 508(e), then Section 508(e)(1) does not apply to the organization before, during and (if the court did not allow the organization to reform its governing instrument to comply with Section 508(e)(1)) after the judicial proceeding. See Section 508(e)(2).
- (3) The court in *Trust Under Will of Bella Mabury v. Commissioner*, cited above, applied a similar rule under Section 4942 to excuse the trust from complying with Sections 508(e) and 4942 where it filed a timely judicial proceeding and the state court did not allow reformation. This transitional rule under Section 4942 allowed certain pre-existing trusts to accumulate income where courts were determining the validity of an accumulation provision.
- (4) A similar exception applies to organizations for tax years beginning before a certain transitional date. The exception also applies to any periods after the transitional date during the pendency of a judicial proceeding begun before the transitional date which is necessary to reform, or to excuse such foundation from compliance with, its governing instrument or any other instrument in order to meet the requirements of Section 508(e)(1) (and thereafter if the court did not allow reformation of the governing instrument). See Treas. Reg. 1.508-3(g), as originally published (T.D. 7232, 1973-1 C.B. 252), and as amended.
- (5) The transitional date is the earlier of:
  - a. February 10, 1977 (for community trusts), May 21, 1976 (for medical research organizations), or
  - b. The date 91 days after the organization received a final ruling or determination letter that it is a private foundation.
- (6) Foreign private foundations that have received substantially all their support (other than gross investment income) from sources outside the United States are exempt from Section 508(e). See Section 4948(b) and Treas. Reg. 1.508-1(a)(2)(vi).
- (7) Certain transitional/savings/grandfather provisions in the Tax Reform Act of 1969 override Section 508(e). See Treas. Reg. 1.508-3(b)(3).

## **F. Section 508(d) Disallowance of Charitable Deductions**

- (1) Section 508(d) disallows charitable deductions under the IRC's income, estate and gift tax provisions for contributions to private foundations (and trusts in Sections 4947(a)(1) and (2)) under certain circumstances.
- (2) Section 508(d)(1) disallows deductions for certain contributions made to a private foundation or Section 4947 trust upon which the tax under Section 507(c) has been imposed.

- (3) Section 508(d)(2)(A) disallows deductions for certain contributions made in a taxable year for which the private foundation or Section 4947 trust does not meet the Section 508(e)(1) requirements.
- (4) The charitable deduction IRC sections' provisions are equivalent to or cross-reference Section 508(d). See Section 170(f)(1) and Treas. Reg. 1.170A-1(j)(2), Section 681(b) and Treas. Reg. 1.681(b)-1, Section 2055(e)(1) and Treas. Reg. 20.2055-5, and Section 2522(c)(1) and Treas. Reg. 25.2522(c)-2.
- (5) Section 508(d)(2)(B) has a similar rule disallowing a deduction for a contribution made to an organization during a period the organization is not exempt under Section 501(c)(3) because of Section 508(a).

### **F.1. Section 508(d)(1) Disallowance**

- (1) Under Section 508(d)(1) and Treas. Reg. 1.508-2(a), charitable deductions for contributions to an organization are disallowed if a contribution is made:
  - a. By any person after the organization or the IRS has provided notification under Section 507(a) that the organization's private foundation status has been terminated, or
  - b. By a substantial contributor in his tax year which includes the first day on which the organization takes action which ends in the Section 507(c) tax (and any subsequent tax year). See Section 508(d)(1)(B).
- (2) Section 508(d)(3) allows a deduction under Section 508(d)(1) if the entire amount of the unpaid portion of the Section 507(c) tax is abated under Section 507(g). See Treas. Reg. 1.508-2(a)(2).

### **F.2. Section 508(d)(2)(A) Disallowance**

- (1) Section 508(d)(2)(A) disallows deductions for certain contributions made in a taxable year for which the private foundation or Section 4947 trust does not meet the Section 508(e)(1) requirements.
- (2) The "taxable year" referred to in Section 508(d)(2)(A) is the donee organization's year. If it meets the Section 508(e)(1) requirements by the end of the taxable year in which the gift is made, the donor's charitable deduction will not be disallowed under Section 508(d)(2)(A). See Treas. Reg. 1.508-2(b)(1)(ii) and (iii).
- (3) For a bequest to an organization that does not exist on the date of the testator's death (but created by the testator's will), the "taxable year" is the organization's first taxable year. See Treas. Reg. 1.508-2(b)(1)(ii).
- (4) In general, the exceptions that apply under Section 508(e) (to both private foundations and Section 4947 trusts) also apply for Section 508(d)(2)(A). So, if an organization is exempt from (or is considered to meet) the Section 508(e) requirements for its tax year in which a contribution is made, then the deduction is not disallowed under Section 508(d)(2)(A) to the contributor; conversely, if



Section 508(e) is not satisfied for the year, then the deduction is disallowed. However, there are some special rules for Section 508(d)(2)(A) purposes:

- a. A contribution to a Section 4947(a)(2) trust, whose governing instrument is executed after March 22, 1973, and that (by its terms) will become an Section 4947(a)(1) trust, is disallowed unless the governing instrument states that the trust must comply with all the Chapter 42 provisions when it becomes a Section 4947(a)(1) trust. See Treas. Reg. 1.508-2(b)(1)(vii).
- b. Where a state law meeting the Section 508(e) requirements applies retroactively, it does not apply to contributions made more than two years before the enactment of the state law. See Treas. Reg. 1.508-3(d)(6).
- c. Treas. Reg. 1.508-3(g) applies only to contributions made before the transitional date.