



Exempt Organizations Technical Guide

TG 61 Excise Taxes on Investments which Jeopardize Charitable Purposes IRC 4944

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I. Overview

- (1) Organizations that are exempt from taxation under Section 501(c)(3) of the Internal Revenue Code and don't 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) Under Chapter 42, excise taxes are imposed on a private foundation pursuant to Section 4944 if a private foundation invests any amount in a way that jeopardizes the carrying out of its exempt purposes. Foundation managers who participate in the making of the investment, knowing that it jeopardizes the carrying out of the foundation's exempt purpose, are also subject to excise taxes.
- (3) There is an exception under Section 4944(c) for program-related investments. For purposes of Section 4944, investments, the primary purposes of which are to accomplish one or more of the purposes described in Section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes.

A. Background / History

- (1) Congress enacted the Tax Reform Act of 1969 (P.L. 91-172) ("TRA '69") in an effort "to put an end, as far as it reasonably could, to the abuses and potential abuses connected with private foundations." *Thorne v. Commissioner*, 99 T.C. 67, 83 (1992) (citing *Mannheimer Charitable Trust v. Commissioner*, 93 T.C. 35, 39 (1989)). These perceived abuses related to investments included investing in:
 - a. Warrants,
 - b. Futures,
 - c. Options,
 - d. Securities, and
 - e. Engaging in speculative practices that jeopardized a private foundation's assets as cited in Treasury Regulation (Treas. Reg.) 53.4944-1(a)(2).
- (2) Under Section 504 as then enacted, an organization described in Section 501(c)(3) would lose its exemption if it invested its accumulated income in a manner that jeopardized the carrying out of its exempt purposes. No similar limitations applied to an organization's principal. Congress concluded that Section 504 wasn't sufficiently effective to deter an organization described in Section 501(c)(3) from engaging in the abuses.
- (3) The House of Representatives' TRA '69 bill proposed the following changes to the Internal Revenue Code:
 - a. Repeal Section 504 and add Section 4944,

- b. Extend the prohibition on jeopardy investment to include all assets of a foundation,
 - c. Tax the amount held to be a jeopardizing investment, rather than revoke the organization's exemption, and
 - d. Tax a foundation manager who knowingly participated in the making of a jeopardizing investment on the amount so invested.
- (4) The Senate modified the House's Tax Reform bill, adopted by Congress as part of the TRA '69, which contained the present Section 4944. See background and general explanation of Section 4944 in S. Rep. No. 91-552, 91st Cong., 1st Session 45, 46 (1969), 1969-3 C.B. 453, 454. The 1969 Tax Reform Act took effect on January 1, 1970.
 - (5) The Pension Protection Act of 2006, P.L. 109-280 ("PPA 2006"), Section 1212, 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 4944.
 - (6) Regarding the filing requirements for private foundations, for tax years beginning on or after July 2, 2019, Section 3101 of P. L. 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.
 - (7) Electronic filing requirements haven't 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 will apply for tax years beginning in 2020 and later.
 - (8) 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.
 - (9) 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.
 - (10) The Bipartisan Budget Act of 2018 created an exception from the excise tax on excess business holdings, called Section 4943(g), for certain independently operated enterprises whose voting stock is wholly owned by a private foundation. Section 4943(g) shall apply to taxable years beginning after December 31, 2017.
 - (11) 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. 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. Please see the instructions to the Form 4720 for further information.

B. Relevant Terms

- (1) **Advice of Counsel:** If certain requirements are met, a foundation manager isn't subject to the Section 4944(a)(2) excise tax if the manager relies on the advice of legal or qualified investment counsel in making an investment that later becomes a jeopardizing investment. For a foundation manager to demonstrate reliance upon the advice of legal counsel, the manager must fully disclose the factual situation to legal counsel (including in-house counsel). Advice received from legal counsel must be communicated in a reasoned written legal opinion that an investment would not jeopardize the carrying out of the foundation's exempt purposes (because, as a matter of law, the investment is excepted from such classification). A written legal opinion is considered "reasoned" even if it reaches a conclusion that is subsequently determined to be incorrect, if it addressed relevant facts and applicable law. If a written legal opinion merely recites the facts and expresses a conclusion, it isn't considered "reasoned". See Treas. Reg. 53.4944-1(b)(2)(v). To demonstrate reliance upon the advice of qualified investment counsel, the foundation manager must have:
- a. Fully disclosed the factual situation to qualified investment counsel,
 - b. Relied on advice of such counsel, such advice being derived in a manner consistent with generally accepted practices of persons who are qualified investment counsels, and
 - c. Communicated in writing that an investment will provide for the long- and short-term financial needs of the foundation. See Treas. Reg. 53.4944-1(b)(2)(v).

If a foundation manager shows the described requirements to satisfy reliance on advice of legal counsel or qualified investment counsel are met, the manager's participation in making a jeopardizing investment is not considered "knowing" or "willful" and will ordinarily be considered "due to reasonable cause." Absence of advice of legal counsel or qualified investment counsel for the investment won't, by itself, give rise to any inference that a foundation manager's participation was knowing, willful, or without reasonable cause. See Treas. Reg. 53.4944-1(b)(2)(v).

- (2) **Excess Business Holdings:** Defined in Section 4943(c)(1), with respect to the holdings of any private foundation in any business enterprise, as the amount of stock or other interest in the enterprise which the private foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

- (3) **Burden of Proof:** The burden of proof is on the government to show that a foundation manager has knowingly participated in the making of a jeopardizing investment. See Section 7454(b); Treas. Reg. 53.4944-1(b)(2)(vi).
- (4) **Knowingly:** Under Treas. Reg. 53.4944-1(b)(2)(i), a foundation manager is considered to have knowingly participated in the making of a jeopardizing investment only if the foundation manager:
- Has actual knowledge of sufficient facts, so that, based solely upon such facts, such investment would be a jeopardizing investment,
 - Is aware that such an investment under these circumstances may violate the provisions of Section 4944, and
 - Negligently fails to make reasonable attempts to ascertain whether the investment is a jeopardizing investment or is in fact aware that it was such an investment for purposes of Section 4944 and Chapter 42.

The definition of knowing doesn't include "having reason to know." However, evidence showing that a foundation manager has reason to know of a fact or rule is relevant in determining whether the manager had actual knowledge of such fact or rule.

- (5) **Participation:** A foundation manager must have participated in the making of the jeopardizing investment to be held liable for the first tier tax. Treas. Reg. 53.4944-1(b)(2)(iv) defines participation as any manifestation of approval of the investment by that foundation manager in the making of the investment.
- (6) **Reasonable Cause:** If a foundation manager participates in the making of a jeopardizing investment, but such participation is due to reasonable cause, the manager isn't subject to the 10% tax. A foundation manager's actions are due to reasonable cause if the manager has exercised responsibility on behalf of the foundation with ordinary business care and prudence. Treas. Reg. 53.4944-1(b)(2)(iii). See *United States v. Boyle*, 469 U.S. 241 (1985) which discusses "reasonable cause."
- (7) **Taxable Period:** The first tier taxes of Sections 4944(a)(1) and (2) are imposed on private foundations and foundation managers for each year (or portion thereof) in the taxable period. The taxable period, with respect to any investment which jeopardizes the carrying out of exempt purposes, is the period beginning with the date on which the amount is so invested and ending on the earliest of the date:
- Of mailing of a notice of deficiency under Section 6212 with respect to the tax imposed by Section 4944(a)(1),
 - On which the tax imposed by Section 4944(a)(1) is assessed, or
 - On which the amount so invested is removed from jeopardy. See Section 4944(e)(1); Treas. Reg. 53.4944-5(a)(1).

If the notice of deficiency isn't mailed because of a waiver of the restrictions on assessment and collection of a deficiency, or because the deficiency is paid, the

date of filing of the waiver or the date of such payment, respectively, will be treated as the end of the taxable period. See Treas. Reg. 53.4944-5(a)(2).

- (8) **Willful:** A foundation manager's participation in making a jeopardizing investment not only must be knowing, but also must be willful. Treas. Reg. 53.4944-1(b)(2)(ii) provides that participation is willful if it is voluntary, conscious and intentional. Motive is not a necessary requirement to show willfulness. However, if a foundation manager doesn't know that the investment is a jeopardizing investment (as defined in Section 4944(a)(1) and Treas. Reg. 53.4944-1(a)(2)), then the manager's participation isn't considered willful, as cited in Treas. Reg. 53.4944-1(b)(2)(ii).

C. Law / Authority

- (1) Section 4944 was enacted to tax those private foundations making investments that jeopardize the carrying out of their exempt purposes. The deterrence is an excise tax imposed on private foundations and the foundation managers for making investments that fall within the definition of jeopardizing investments. However, "program-related" investments (such as low-interest or interest-free loans to needy students, high risk investments in low-income housing) don't fall within this definition.
- (2) If a private foundation makes an investment that is determined to be a jeopardizing investment, Section 4944(a)(1) imposes an excise tax that is to be paid by the private foundation. When the private foundation is subject to the Section 4944(a)(1) tax, its managers may be subject to the excise tax under Section 4944(a)(2) if the managers knowingly and willfully participated in the making of that jeopardizing investment. The taxes described in Section 4944(a)(1) and (a)(2) are known as "first tier" taxes.
- (3) An additional excise tax of much greater severity is imposed under Section 4944(b)(1) on the private foundation when it fails to correct the jeopardizing investment within the taxable period. Section 4944(b)(2) also imposes a tax on managers if the managers refuse to act to correct the situation. The taxes described in Section 4944(b)(1) and (b)(2) are known as "second tier" taxes.
- (4) If the private foundation repeatedly or flagrantly violates Section 4944, the IRS may terminate its status. This action will make that private foundation liable for the termination tax under Section 507(c). See Treas. Reg. 1.507-1(a)(2).

II. Requirements

- (1) Section 4944 imposes an excise tax on investments that jeopardize the foundation's ability to carry out its exempt purpose.

A. Jeopardizing Investments Defined

- (1) Treas. Reg. 53.4944-1(a)(2)(i) states that an investment is a jeopardizing investment if it's determined that the foundation managers, in making the investment, have failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the long- and short-term financial needs of the foundation to carry out its exempt purposes.
- (2) These criteria reflect a "prudent trustee" approach to determine whether an investment jeopardizes the carrying out of a private foundation's charitable purposes. See the General Explanation of the Tax Reform Act of 1969, prepared by the staff of the Joint Committee on Internal Revenue Taxation, December 3, 1970, page 46.

A.1. Ordinary Business Care and Prudence

- (1) In exercising the requisite standard of ordinary business care and prudence, private foundation managers may consider the:
 - a. Expected return (including both income and appreciation of capital),
 - b. Risks of rising and falling price levels, and
 - c. Need for diversification within the investment portfolio (such as with respect to type of security, type of industry, maturity of company, degree of risk, and potential for return).
- (2) Treas. Reg. 53.4944-1(a)(2)(i) specifically provides that the determination should be made on an investment-by-investment basis, in each case considering the foundation's portfolio.

A.2. Time of Making Investment

- (1) The determination whether the investment of any amount jeopardizes the carrying out of a foundation's exempt purposes is to be made under the facts and circumstances that exist when the foundation makes the investment. A review based on hindsight (whether the investment was an actual success or failure) is not relevant to this determination.

A.3. Close Scrutiny of Certain Investments

- (1) No category of investments is treated as a per se violation of Section 4944. Thus, there aren't specific investments treated as jeopardizing investments. There are, however, examples of types or methods of investments which require scrutiny to

determine whether foundation managers have met the requisite standard of ordinary business care and prudence. See Treas. Reg. 53.4944-1(a)(2)(i).

- (2) Examples of types or methods of transactions in Treas. Reg. 53.4944-1(a)(2)(i) which require scrutiny are:
 - a. Trading in securities on margin,
 - b. Trading in commodity futures,
 - c. Investments in working interests in oil and gas wells,
 - d. Purchase of “puts”, “calls” and “straddles,”
 - e. Purchase of warrants, and
 - f. Selling short.
- (3) Using the assets of a private foundation to guarantee or serve as collateral for transactions of another organization, is viewed as lending of money or extending credit and, thus, are forms of investment activity. These investments also deserve scrutiny. See *Janpol v. Commissioner*, 101 T.C. 518 (1993).

B. Examples of Jeopardizing and Non-Jeopardizing Investments

- (1) The examples below from Treas. Reg. 53.4944-1(c)(1)-(5) illustrate types of investments that may or may not be jeopardizing investments.

B.1. Example 1

- (1) A is a foundation manager of B, a private foundation with assets of \$100,000. After considering B’s portfolio as a whole, A approves the following three investments:
 - a. \$5,000 in the common stock of corporation X,
 - b. \$10,000 in the common stock of corporation Y, and
 - c. \$8,000 in the common stock of corporation Z.
- (2) Corporation X has been in business a considerable time, its record of earnings is good, and there is no reason to anticipate a diminution of its earnings.
- (3) Corporation Y has a promising product, has had earnings in some years and substantial losses in others, has never paid a dividend, and is widely reported in investment advisory services as seriously undercapitalized.
- (4) Corporation Z has been in business a short period of time and manufactures a product that is new, isn’t sold by others, and must compete with a well-established alternative product that serves the same purpose. Z’s stock is classified as a high-risk investment by most investment advisory services with the possibility of substantial long-term appreciation but with little prospect of a current return.

- (5) A has studied the records of the three corporations and knows the foregoing facts. In each case the price per share of common stock purchased by B is favorable to B.
- (6) Under the standards of Treas. Reg. 53.4944-1(a)(2)(i), the investment of \$10,000 in the common stock of Y and the investment of \$8,000 in the common stock of Z may be classified as jeopardizing investments, while the investment of \$5,000 in the common stock of X will not be so classified.

B.2. Example 2

- (1) Assume the facts of Example 1 above, except that in the case of:
 - a. Corporation Y, B's investment will be made for new stock to be issued by Y and there is reason to anticipate that B's investment, together with investments required by B to be made concurrently with its own, will satisfy the capital needs of corporation Y and will thereby overcome the difficulties that have resulted in Y's uneven earnings record; and
 - b. Corporation Z, the management has a demonstrated capacity for getting new businesses started successfully and Z has received substantial orders for its new product.
- (2) Under the standards of Treas. Reg. 53.4944-1(a)(2)(i), neither the investment in Y nor the investment in Z will be classified as a jeopardizing investment.

B.3. Example 3

- (1) E is a private foundation with assets of \$200,000. After a careful review of D's training, experience and record in the field of investment management, as well as advice that D was well qualified to provide professional investment advice in the management of investment assets, D was hired by E as a foundation manager to oversee E's investments. D, after careful research into how best to diversify E's investments, to provide for E's long-term financial needs, and to protect E against the effects of long-term inflation, decided to allocate a portion of E's investment assets to unimproved real estate in selected areas of the country where population patterns and economic factors strongly indicate continuing growth at a rapid rate. D determines that the short-term financial needs of E can be met through E's other investments.
- (2) Under the standards of Treas. Reg. 53.4944-1(a)(2)(i), the investment of a portion of E's investment assets in unimproved real estate will not be classified as a jeopardizing investment, as cited in Treas. Reg. 53.4944-1(c).

B.4. Example 4

- (1) A private foundation received a donation of a whole-life insurance policy. At the time of the donation, the policy was subject to a policy loan that the insurer had made to the donor. The policy provided that, upon the death of the insured, the foundation would receive insurance proceeds in an amount equal to the face

value of the policy reduced by the sum of the outstanding principal of the loans and any unpaid interest thereon.

- (2) At the time the policy was donated, the life expectancy of the insured-donor was 10 years. Instead of immediately surrendering the policy to the insurer for its cash surrender value, the foundation kept the policy as an investment and annually pays the premiums and interest due on the policy and the policy loan, respectively. The combined premium and interest payments are of such an amount that, by the end of eight years, the foundation will have invested a greater amount in premiums and interest than it could receive as a return on this investment, namely, in the form of insurance proceeds upon the death of the insured. So, the insurance policy will produce a financial loss to the foundation at the end of eight years.
- (3) Under the facts and circumstances, the foundation managers, by investing at the projected rate of return prevailing at the time of the investment, failed to exercise ordinary business care and prudence in providing for the long-term and short-term financial needs of the foundation in carrying out its exempt purposes. Thus, each payment made by the private foundation for a premium on the insurance policy and the interest on the policy loan is a jeopardizing investment. See Rev. Rul. 80-133, 1980-1 C.B. 258.

B.5. Example 5

- (1) The manager of a private foundation invested the entire corpus of the foundation in a foreign bank without inquiring into the integrity of the bank. The manager didn't know the bank's license to do business and its charter had been revoked. Interest payments received by the foundation were irregular. The Tax Court agreed with the IRS that the investment was a jeopardizing investment, as cited in *Thorne v. Commissioner*.

C. Investments Received as Gifts or Acquired through Corporate Reorganization

- (1) Investments originally made by any party who later gratuitously transferred them to a private foundation aren't subject to the provisions of Section 4944. However, if the foundation gives any consideration to that party upon the transfer, the foundation will be treated as having made an investment (within the meaning of Section 4944(a)(1)) in the amount of the consideration. See Treas. Reg. 53.4944-1(a)(2)(ii)(a).
- (2) Investments that are acquired by a private foundation solely because of a corporate reorganization within the meaning of Section 368(a) are not subject to the provisions of Section 4944. See Treas. Reg. 53.4944-1(a)(2)(ii)(b).

D. Program-Related Investments

- (1) Section 4944(c) states that program-related investments don't fall within the definition of jeopardizing investment.

- (2) A program-related investment is an investment which has the following characteristics:
- a. The primary purpose is to accomplish one or more of the purposes described in Section 170(c)(2)(B),
 - b. No significant purpose of which is the production of income or the appreciation of property, and
 - c. No purpose of which is to accomplish one or more purposes described in Section 170(c)(2)(D), relating to legislative or political activities. See Treas. Reg. 53.4944-3(a).

D.1. Primary Purpose

- (1) An investment is a program-related investment if the primary purpose is to accomplish a Section 170(c)(2)(B) purpose, and such investment would not have been made except for the relationship between the investment and the accomplishment of these exempt purposes. See Section 4944(c); Treas. Reg. 53.4944-3(a)(2)(i).
- (2) These Section 170(c)(2)(B) purposes include the following:
- a. Religious,
 - b. Charitable,
 - c. Scientific,
 - d. Literary,
 - e. Educational,
 - f. Prevention of cruelty to children or animals, and
 - g. Fostering national or international amateur sports competition without providing athletic facilities or equipment.
- (3) In addition, for purposes of Section 4944, investments described in Section 4942(j)(4)(B) and the regulations thereunder (relating to functionally related businesses) are considered as being made primarily to accomplish Section 170(c)(2)(B) purposes. See Treas. Reg. 53.4944-3(a)(2)(ii).
- (4) Section 170(c)(2)(B) purposes may be carried out by organizations not described in Section 170(c) or exempt under Section 501(a). See Treas. Reg. 53.4944-3(a)(2)(i).

D.2. Prohibited Purposes

- (1) A program-related investment must not have a significant purpose of production of income or the appreciation of property. However, an investment that produces significant income or capital appreciation isn't conclusive evidence of a significant purpose of production of income or the appreciation of property. Consideration is given regarding whether a profit-motivated investor would be likely to make the

investment on the same terms as those made by the foundation. See Treas. Reg. 53.4944-3(a)(2)(iii).

- (2) An investment isn't a program-related investment if it accomplishes any of those purposes described in Section 170(c)(2)(D). See Treas. Reg. 53.4944-3(a)(1)(iii). Section 170(c)(2)(D) purposes include:
 - a. Attempting to influence legislation, and
 - b. Participating in or intervening in (including the publishing or distributing of statements) any political campaign on behalf of, or in opposition to any candidate for public office.
- (3) However, for an investment whose recipient appears before or communicates with a legislative body on legislation or proposed legislation of direct interest to that recipient and if the expenses thereof qualify as business expenses deductible under Section 162, that investment is not considered to have been made to accomplish Section 170(c)(2)(D) purposes. See Treas. Reg. 53.4944-3(a)(2)(iv).

D.3. Changes in Program-Related Investments

- (1) Once it has been determined that an investment is "program-related" it shall not cease to qualify as a "program-related investment" if changes (if any) in the form or terms of the investment are made primarily for exempt purposes and not for any significant purpose involving the production of income or the appreciation of property.
- (2) A change made in the form or terms of a program-related investment for the prudent protection of the foundation's investment shall not ordinarily cause the investment to cease to qualify as program-related.
- (3) However, under certain conditions, a program-related investment may cease to be a program-related investment because of critical changes in circumstances such as serving illegal or private purposes. In such an event, the private foundation will become subject to the tax imposed by Section 4944(a)(1) no earlier than the 30th day after the date on which the foundation (or any of its managers) have actual knowledge of such critical changes in circumstances. See Treas. Reg. 53.4944-3(a)(3)(i).

D.4. Examples of Program-Related and Non-Program-Related Investments

- (1) X is a small business enterprise located in a deteriorated urban area and owned by members of an economically disadvantaged minority group. Conventional sources of funds are unwilling or unable to provide funds to X on terms it considers economically feasible. Y, a private foundation, makes a loan to X bearing interest below the market rate for commercial loans of comparable risk. Y's primary purpose for making the loan is to encourage the economic development of such minority group. The loan has no significant purpose involving the production of income or the appreciation of property. The loan

significantly furthers the accomplishment of Y's exempt activities and wouldn't have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment even though Y may earn income from the investment in an amount comparable to or higher than earnings from conventional portfolio investments. See Treas. Reg. 53.4944-3(b), Example 1.

- (2) Assume the facts as stated in (1) above, except that after the date of execution of the loan, Y extends the due date of the loan. The extension is granted to permit X to achieve greater financial stability before it is required to repay the loan. Since the change in the terms of the loan is made primarily for exempt purposes and not for any significant purpose involving the production of income or the appreciation of property, the loan continues to qualify as a program-related investment. See Treas. Reg. 53.4944-3(b), Example 2.
- (3) X is a small business enterprise located in a deteriorated urban area and owned by members of an economically disadvantaged minority group. Conventional sources of funds are unwilling to provide funds to X at reasonable interest rates unless it increases the amount of its equity capital. Consequently, Y, a private foundation, purchases shares of X's common stock. Y's primary purpose in purchasing the stock is to encourage the economic development of such minority group, and no significant purpose involves the production of income or the appreciation of property. The investment significantly furthers the accomplishment of Y's exempt activities and wouldn't have been made but for such relationship between the investment and Y's exempt activities. Accordingly, the purchase of the common stock is a program-related investment, even though Y may realize a profit if X is successful and the common stock appreciates in value. See Treas. Reg. 53.4944-3(b), Example 3.
- (4) X is a business enterprise which isn't owned by low-income persons or minority group members, but the continued operation of X is important to the economic well-being of a deteriorated urban area because X employs a substantial number of low-income persons from such area. Conventional sources of funds are unwilling or unable to provide funds to X at reasonable interest rates. Y, a private foundation, makes a loan to X at an interest rate below the market rate for commercial loans of comparable risk. The loan is made under a program run by Y to help low-income persons by offering increased economic opportunities and to prevent community deterioration. No significant purpose of the loan involves the production of income or the appreciation of property. The investment significantly furthers the accomplishment of Y's exempt activities and wouldn't have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment. See Treas. Reg. 53.4944-3(b), Example 4.
- (5) X is a business enterprise which is financially secure and the stock of which is listed and traded on a national exchange. Y, a private foundation, makes a loan to X at an interest rate below the market rate to induce X to establish a new plant in a deteriorated urban area which, because of the high risks involved, X would be

unwilling to establish absent such inducement. The loan is made under a program run by Y to enhance the economic development of the area by, for example, providing employment opportunities for low-income persons at the new plant, and no significant purpose involves the production of income or the appreciation of property. The loan significantly furthers the accomplishment of Y's exempt activities and wouldn't have been made but for such relationship between the loan and Y's exempt activities. Accordingly, even though X is large and established, the investment is program-related. See Treas. Reg. 53.4944-3(b), Example 5.

- (6) X is a business enterprise owned by a nonprofit community development corporation. When fully operational, X will market agricultural products, thereby providing a marketing outlet for low-income farmers in a depressed rural area. Y, a private foundation, makes a loan to X bearing interest at a rate less than the rate charged by financial institutions which have agreed to lend funds to X if Y makes the loan. The loan is made under a program run by X to encourage economic redevelopment of depressed areas, and no significant purpose involves the production of income or the appreciation of property. The loan significantly furthers the accomplishment of Y's exempt activities and wouldn't have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment. See Treas. Reg. 53.4944-3(b), Example 6.
- (7) X, a private foundation, invests \$100,000 in the common stock of corporation M. The dividends received from such investment are later applied by X in furtherance of its exempt purposes. Although there is a relationship between the return on the investment and the accomplishment of X's exempt activities, there is no relationship between the investment per se and such accomplishment. Therefore, the investment cannot be considered as made primarily to accomplish one or more of the purposes described in Section 170(c)(2)(B) and cannot qualify as program-related. See Treas. Reg. 53.4944-3(b), Example 7.
- (8) S, a private foundation, makes an investment in T, a business corporation, which qualifies as a program-related investment under Section 4944(c) at the time that it is made. All of T's voting stock is owned by S. T experiences financial and management problems which, in the judgment of the foundation, require changes in management, in financial structure or in the form of the investment. The following three methods of resolving the problems appear feasible to S, but each of the three methods would result in reduction of the exempt purposes for which the program-related investment was initially made:
 - a. Sale of stock or assets – The foundation sells its stock to an unrelated person. Payment is made in part at the time of sale; the balance is payable over an extended term of years with interest on the amount outstanding. The foundation receives a purchase-money mortgage.
 - b. Lease – The corporation leases its assets for a term of years to an unrelated person, with an option in the lease to buy the assets. If the option is

exercised, the terms of payment are to be like those described in the sale of stock or assets example above.

- c. Management contract – The corporation enters into a management contract which gives broad operating authority to one or more unrelated persons for a term of years. The foundation and the unrelated persons are obligated to contribute toward working capital requirements. The unrelated persons will be compensated by a fixed fee or a share of profits, and they will receive an option to buy the stock held by S or the assets of the corporation. If the option is exercised, the terms of payment are to be like those described in the sale of stock or assets example above.

Each of the three methods involves a change in the form or terms of a program-related investment for the prudent protection of the foundation's investment. Thus, under Treas. Reg. 53.4944-3(a)(3)(i), none of the three transactions (nor any debt instruments or other obligations held by S because of engaging in one of these transactions) would cause the investment to cease to qualify as program-related. See Treas. Reg. 53.4944-3(b), Example 8.

- (9) X is a socially and economically disadvantaged individual. Y, a private foundation, makes an interest-free loan to X for the primary purpose of enabling X to attend college. The loan has no significant purpose involving the production of income or the appreciation of property. The loan significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment. See Treas. Reg. 53.4944-3(b), Example 9.
- (10) Y, a private foundation, makes a high-risk investment in low-income housing, the indebtedness with respect to which is insured by the Federal Housing Administration. Y's primary purpose in making the investment is to finance the purchase, rehabilitation, and construction of housing for low-income persons. The investment has no significant purpose involving the production of income or the appreciation of property. The investment significantly furthers the accomplishment of Y's exempt activities and wouldn't have been made but for such relationship between the investment and Y's exempt activities. Accordingly, the investment is program-related. See Treas. Reg. 53.4944-3(b), Example 10.

D.5. Treasury Regulation 53.4944-3(b); Additional Examples (Treasury Decision 9762 (4/21/16))

- (1) On April 21, 2016, the Treasury Department issued final regulations for program-related investments (T.D. 9762) which became effective on April 25, 2016. These regulations provide additional examples at Treas. Reg. 53.4944-3(b), Examples 11 – 19. The examples stand for the following principles:
 - a. An activity conducted in a foreign country furthers an exempt purpose if the same activity would further an exempt purpose if conducted in the United States,

- b. The exempt purposes served by a program-related investment are not limited to situations involving economically disadvantaged individuals and deteriorated urban areas,
- c. The recipients of program-related investments aren't required to be within a charitable class so long as they are the instruments for furthering an exempt purpose,
- d. A potentially high rate of return doesn't automatically prevent an investment from qualifying as a program-related investment,
- e. Exempt purposes can be achieved through a variety of investments, including loans to individuals, tax-exempt organizations, for-profit organizations, and equity investments in for-profit organizations,
- f. A credit enhancement arrangement may qualify as a program-related investment, and
- g. A private foundation's acceptance of an equity position in conjunction with making a loan does not necessarily prevent the investment from qualifying as a program-related investment.

(2) The new examples indicate that foundations may use program-related investments to:

- a. Invest in for-profit entities, either through a purchase of common stock or through a below market interest rate loan, if these investments further the foundation's exempt purpose, and
- b. Guarantee the commercial loans of another nonprofit corporation, if there is a reimbursement agreement between the private foundation and nonprofit corporation.

(3) The original 10 examples in Treas. Reg. 53.4944-3(b), focused on investment for the relief of the poor; however, the nine new examples – 11 through 19 in the regulations, stand for the position that a foundation may make program-related investments to for-profits, nonprofits, or individuals so long as the investment furthers the foundation's exempt purpose and a significant purpose for making the investment isn't to make a profit. These new examples are:

- a. Example 11. X is a business enterprise that researches and develops new drugs. X's research demonstrates a vaccine can be developed within ten years to prevent a disease that predominantly affects poor individuals in developing countries. However, neither X nor other commercial enterprises like X will devote their resources to develop the vaccine because the potential return on investment is significantly less than required by X or other commercial enterprises to undertake a project to develop new drugs. Y, a private foundation, enters into an investment agreement with X in order to induce X to develop the vaccine. Pursuant to the investment agreement, Y purchases shares of the common stock of S, a subsidiary corporation that X establishes to research and develop the vaccine. The agreement requires S to distribute the vaccine to poor individuals in developing countries at a price

that is affordable to the affected population, although, the agreement doesn't preclude S from selling the vaccine to other individuals at a market rate. The agreement also requires S to publish the research results, disclosing substantially all information about the results that would be useful to the interested public. S agrees the publication of its research results will be made as promptly after the completion of the research as is reasonably possible, without jeopardizing S's right to secure patents necessary to protect its ownership or control of the results of the research. The expected rate of return on Y's investment in S is less than the expected market rate of return for an investment of similar risk. Y's primary purpose in making the investment is to fund scientific research in the public interest. No significant purpose of the investment involves the production of income or the appreciation of property. The investment significantly furthers the accomplishment of Y's exempt activities and wouldn't have been made but for such relationship between the investment and Y's exempt activities. Accordingly, Y's purchase of the common stock of S is a program-related investment.

- b. Example 12. Q, a developing country, produces a substantial amount of recyclable solid waste materials that are currently disposed of in landfills and by incineration, contributing significantly to environmental deterioration in Q. X is a new business enterprise located in Q. X's only activity will be collecting recyclable solid waste materials in Q and delivering those materials to recycling centers that are inaccessible to a majority of the population. If successful, the recycling collection business would prevent pollution in Q caused by the usual disposition of solid waste materials. X has obtained funding from only a few commercial investors who are concerned about the environmental impact of solid waste disposal. Although X made substantial efforts to procure additional funding, X hasn't been able to obtain sufficient funding because the expected rate of return is significantly less than the acceptable rate of return on an investment of this type. Because X has been unable to attract additional investors on the same terms as the initial investors, Y, a private foundation, enters into an investment agreement with X to purchase shares of X's common stock on the same terms as X's initial investors. Although there is a high risk associated with the investment in X, there is also the potential for a high rate of return if X is successful in the recycling business in Q. Y's primary purpose in making the investment is to combat environmental deterioration. No significant purpose of the investment involves the production of income or the appreciation of property. The investment significantly furthers the accomplishment of Y's exempt activities and wouldn't have been made but for such relationship between the investment and Y's exempt activities. Accordingly, Y's purchase of the X common stock is a program-related investment.
- c. Example 13. Assume the facts as stated in Example 12, except that X offers Y shares of X's common stock in order to induce Y to make a below-market rate loan to X. X previously made the same offer to a number of commercial

investors. These investors were unwilling to provide loans to X on such terms because the expected return on the combined package of stock and debt was below the expected market return for such a package based on the level of risk involved, and they were also unwilling to provide loans on other terms X considers economically feasible. Y accepts the stock and makes the loan on the same terms that X offered to the commercial investors. Y's primary purpose in making the investment is to combat environmental deterioration. No significant purpose of the investment involves the production of income or the appreciation of property. The investment significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the investment and Y's exempt activities. Accordingly, the loan accompanied by the acceptance of common stock is a program-related investment.

- d. Example 14. X is a business enterprise located in V, a rural area in State Z. X employs a large number of poor individuals in V. A natural disaster occurs in V, causing significant damage to the area. The business operations of X are harmed because of damage to X's equipment and buildings. X has insufficient funds to continue its business operations and conventional sources of funds are unwilling or unable to provide loans to X on terms it considers economically feasible. In order to enable X to continue its business operations, Y, a private foundation, makes a loan to X bearing interest below the market rate for commercial loans of comparable risk. Y's primary purpose in making the loan is to provide relief to the poor and distressed. No significant purpose of the loan involves the production of income or the appreciation of property. The loan significantly furthers the accomplishment of Y's exempt activities and wouldn't have been made, but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment.
- e. Example 15. Y, a private foundation, makes loans bearing interest below the market rate for commercial loans of comparable risk to poor individuals who live in W, a developing country, to enable them to start small businesses such as a roadside fruit stand. Conventional sources of funds were unwilling or unable to provide such loans on terms they consider economically feasible. Y's primary purpose in making the loans is to provide relief to the poor and distressed. No significant purpose of the loans involves the production of income or the appreciation of property. The loans significantly further the accomplishment of Y's exempt activities and wouldn't have been made but for such relationship between the loans and Y's exempt activities. Accordingly, the loans to the poor individuals who live in W are program-related investments.
- f. Example 16. X is a limited liability company treated as a partnership for federal income tax purposes. X purchases coffee from poor farmers residing in a developing country, either directly or through farmer-owned cooperatives. To fund the provision of efficient water management, crop cultivation, pest management, and farm management training to the poor farmers by X, Y, a

private foundation, makes a loan to X bearing interest below the market rate for commercial loans of comparable risk. The loan agreement requires X to use the proceeds from the loan to provide the training to the poor farmers. X would not provide such training to the poor farmers absent the loan. Y's primary purpose in making the loan is to educate poor farmers about advanced agricultural methods. No significant purpose of the loan involves the production of income or the appreciation of property. The loan significantly furthers the accomplishment of Y's exempt activities and wouldn't have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment.

- g. Example 17. X is a social welfare organization that is recognized as an organization described in Section 501(c)(4). X was formed to develop and encourage interest in painting, sculpture, and other art forms by, among other things, conducting weekly community art exhibits. X needs to purchase a large exhibition space to accommodate the demand for exhibition space within the community. Conventional sources of funds are unwilling or unable to provide funds to X on terms it considers economically feasible. Y, a private foundation, makes a loan to X at an interest rate below the market rate for commercial loans of comparable risk to fund the purchase of the new space. Y's primary purpose in making the loan is to promote the arts. No significant purpose of the loan involves the production of income or the appreciation of property. The loan significantly furthers the accomplishment of Y's exempt activities and wouldn't have been made but for such relationship between the loan and Y's exempt activities. Accordingly, the loan is a program-related investment.
- h. Example 18. X is a non-profit corporation that provides childcare services in a low-income neighborhood, enabling many residents of the neighborhood to be gainfully employed. X meets the requirements of Section 501(k) and is recognized as an organization described in Section 501(c)(3). X's current childcare facility has reached capacity and has a long waiting list. X has determined that the demand for its services warrants the construction of a new childcare facility in the same neighborhood. X is unable to obtain a loan from conventional sources of funds including B, a commercial bank because of X's credit record. Pursuant to a deposit agreement, Y, a private foundation, deposits \$h in B, and B lends an identical amount to X to construct the new childcare facility. The deposit agreement requires Y to keep \$h on deposit with B during the term of X's loan and provides that if X defaults on the loan, B may deduct the amount of the default from the deposit. To facilitate B's access to the funds in the event of default, the agreement requires that the funds be invested in instruments that allow B to access them readily. The deposit agreement also provides that Y will earn interest at a rate of t% on the deposit. The t% rate is substantially less than Y could otherwise earn on this sum of money, if Y invested it elsewhere. The loan agreement between B and X requires X to use the proceeds from the loan to construct the new childcare facility. Y's primary purpose in making the deposit is to further its educational

purposes by enabling X to provide childcare services within the meaning of Section 501(k). No significant purpose of the deposit involves the production of income or the appreciation of property. The deposit significantly furthers the accomplishment of Y's exempt activities and would not have been made but for such relationship between the deposit and Y's exempt activities. Accordingly, the deposit is a program-related investment.

- i. Example 19. Assume the same facts as stated in Example 18, except that instead of making a deposit of \$h into B, Y enters into a guarantee agreement with B. The guarantee agreement provides that if X defaults on the loan, Y will repay the balance due on the loan to B. B was unwilling to make the loan to X in the absence of Y's guarantee. X must use the proceeds from the loan to construct the new childcare facility. At the same time, X and Y enter into a reimbursement agreement whereby X agrees to reimburse Y for any and all amounts paid to B under the guarantee agreement. The signed guarantee and reimbursement agreements together constitute a "guarantee and reimbursement arrangement." Y's primary purpose in entering into the guarantee and reimbursement arrangement is to further Y's educational purposes. No significant purpose of the guarantee and reimbursement arrangement involves the production of income or the appreciation of property. The guarantee and reimbursement arrangement significantly further the accomplishment of Y's exempt activities and would not have been made but for such relationship between the guarantee and reimbursement arrangement and Y's exempt activities. Accordingly, the guarantee and reimbursement arrangement is a program-related investment.

E. Removal from Jeopardy

- (1) Section 4944(e)(2) provides that a private foundation has removed a jeopardizing investment from jeopardy when:
 - a. It sells or otherwise disposes of the investment, and
 - b. The proceeds of such sale or other disposition are not themselves investments which jeopardize the carrying out of exempt purposes.
- (2) Treas. Reg. 53.4944-5(b) states that if a private foundation changes the form or terms of a jeopardizing investment, such a change constitutes a removal of the investment from jeopardy if, after such change, the investment no longer jeopardizes the carrying out of such private foundation's exempt purposes.
- (3) If, after making a jeopardizing investment, a foundation subsequently exchanges that investment for another jeopardizing investment, it will be treated as only one jeopardizing investment for purposes of Section 4944. See Treas. Reg. 53.4944-5(b).

E.1. Transfer to Another Private Foundation

- (1) A jeopardizing investment can't be removed from jeopardy by the transfer thereof to another private foundation if the recipient is related to the transferor foundation within the meaning of Section 4946(a)(1)(H)(i) or (ii).
- (2) The exception is where the jeopardizing investment would be a program-related investment in the hands of the transferee private foundation. See Treas. Reg. 53.4944-5(b).

E.2. Examples of Removal from Jeopardy

- (1) Assume that both C and D are investments which jeopardize exempt purposes. X, a private foundation, purchases C in 1971 and later exchanges C for D. Such exchange doesn't constitute a removal of C from jeopardy. In addition, no new taxable period will arise with respect to D, since, for purposes of Section 4944, only one jeopardizing investment has been made. See Treas. Reg. 53.4944-5(c), Example 2.
- (2) Assume the facts as stated in paragraph (1) above, except that X sells C for cash and later reinvests such cash in D. Two separate investments jeopardizing exempt purposes have resulted. Since the cash received in the interim is not of a jeopardizing nature, the amount invested in C has been removed from jeopardy and, thus, the taxable period with respect to C has been terminated. The subsequent reinvestment of such cash in D gives rise to a new taxable period with respect to D. See Treas. Reg. 53.4944-5(c), Example 3.
- (3) X, a private foundation on a calendar-year basis, makes a \$1,000 jeopardizing investment on January 1, 1970. X thereafter sells the investment for \$1,000 on January 3, 1971. The taxable period is from January 1, 1970, to January 3, 1971. X will be liable for an initial tax of \$100, that is, a tax of 5% of the amount of the investment for each year (or part thereof) in the taxable period. See 53.4944-5(c), Example 1. See also Treas. Reg. 53.4944-5(a) for a detailed discussion of taxable period.

Note: The regulation example hasn't been updated to reflect the current tax rate of 10% on the amount of the investment, increased as a result of PPA 2006.

F. Section 4944 Sanctions

- (1) Section 4944 imposes a multi-level tax designed to deter private foundations from making jeopardizing investments.
- (2) A first tier tax is imposed on a private foundation that has made a jeopardizing investment and may also be imposed on managers for each year or part thereof.
- (3) A second tier tax could be imposed on the foundation and the managers for failure to remove that investment from jeopardy within the "correction period." If correction has been made, the second tier tax won't be imposed.

F.1. First Tier Tax

- (1) A private foundation that made a jeopardizing investment, whether from income or corpus, is subject to a tax equal to 10% of the amount of the jeopardizing investment for each year (or part thereof) in the taxable period. The foundation pays the tax. See Section 4944(a)(1).

F.2. First Tier Tax on Foundation Managers

- (1) The managers of a private foundation are subject to a tax equal to 10% of the amount of the jeopardizing investment for each year (or part thereof) in the taxable period if the foundation managers knowingly participated in making the jeopardizing investment, unless their participation is not willful and is due to reasonable cause. See Section 4944(a)(2).
- (2) If more than one foundation manager is liable for the first tier tax imposed under Section 4944(a)(2), all foundation managers are jointly and severally liable for the tax imposed with respect to any one jeopardizing investment. See Section 4944(d)(1) and Treas. Reg. 53.4944-4(a).
- (3) The maximum aggregate amount of tax for which all participating foundation managers are liable with respect to any one jeopardizing investment under the first tier tax of Section 4944(a)(2) may not exceed \$10,000. See Section 4944(d)(2).
- (4) To be held liable for first tier tax under Section 4944(a)(2), a foundation manager must have knowingly participated in making the jeopardizing investment. Participation must have been willful and not due to reasonable cause.

F.3. Examples of First Tier Tax

- (1) A is a foundation manager of B, a private foundation with assets of \$100,000. A approves the following three investments by B after considering with respect to each of them B's portfolio as a whole:
 - a. An investment of \$5,000 in the common stock of corporation X,
 - b. An investment of \$10,000 in the common stock of corporation Y, and
 - c. An investment of \$8,000 in the common stock of corporation Z.

Corporation X has been in business a considerable time, its record of earnings if good, and there is no reason to anticipate a diminution of its earnings.

Corporation Y has a promising product, has had earnings in some years and substantial losses in others, has never paid a dividend, and is widely reported in investment advisory services as seriously undercapitalized.

Corporation Z has been in business a short period of time and manufactures a product that is new, is not sold by others, and must compete with a well-established alternative product that serves the same purpose. Z's stock is classified as high-risk investment by most investment advisory services with the possibility of substantial long-term appreciation but with little prospect of a current return. A has studied the records of the three corporations and knows the

foregoing facts. In each case the price per share of common stock purchased by B is favorable to B.

Under the standards of Treas. Reg. 53.4944-1(a)(2)(i), the investment of \$10,000 in the common stock of Y and the investment of \$8,000 in the common stock of Z may be classified as jeopardizing investments, while the investment of \$5,000 in the common stock of X won't be so classified.

B would then be liable for a first tier tax of \$1,000 (10% of \$10,000) for each year (or part thereof) in the taxable period for the investment in Y, and a first tier tax of \$800 (10% of \$8,000) for each year (or part thereof) in the taxable period for the investment in Z. Further, since A had actual knowledge that the investments in the common stock of Y and Z were jeopardizing investments, A would then be liable for the same amount of first tier taxes as B.

- (2) Assume the facts in paragraph (1) above, except that:
- a. In the case of corporation Y, B's investment will be made for new stock to be issued by Y and there is reason to anticipate that B's investment, together with investments required by B to be made concurrently with its own, will satisfy the capital needs of corporation Y and will thereby overcome the difficulties that have resulted in Y's uneven earnings record; and
 - b. In the case of corporation Z, the management has a demonstrated capacity for getting new businesses started successfully and Z has received substantial orders for its new product.

Under the standards of Treas. Reg. 53.4944-1(a)(2)(i), neither the investment in Y nor the investment in Z will be classified as a jeopardizing investment, and neither A nor B will be liable for a first tier tax on either of such investments.

- (3) D is a foundation manager of E, a private foundation with assets of \$200,000. After a careful review of D's training, experience and record in the field of investment management, as well as advice that D was well qualified to provide professional investment advice in the management of investment assets, D was hired by E to manage E's investments. D, after careful research into how best to diversify E's investments, to provide for E's long-term financial needs, and to protect E against the effects of long-term inflation, decided to allocate a portion of E's investment assets to unimproved real estate in selected areas of the country where population patterns and economic factors strongly indicate continuing growth at a rapid rate. D determines that the short-term financial needs of E can be met through E's other investments.

Under the standards of Treas. Reg. 53.4944-1(a)(2)(i), the investment assets in unimproved real estate won't be classified as a jeopardizing investment, and neither D nor E will be liable for a first tier tax on such investment, as cited in Treas. Reg. 53.4944-1(c).

F.4. Second Tier Tax

- (1) The second tier tax of Section 4944(b)(1) is imposed on a private foundation if both:
 - a. A first tier tax has been imposed on that private foundation for making a jeopardizing investment, and
 - b. The investment isn't removed from jeopardy within the taxable period.
- (2) The rate of the second tier tax for the private foundation is 25% of the amount of the jeopardizing investment.
- (3) A private foundation may avoid the second tier tax if it removes the jeopardizing investment from jeopardy within the taxable period.

F.5. Second Tier Tax on Foundation Managers

- (1) Section 4944(b)(2) imposes a tax upon any foundation manager if two conditions exist:
 - a. The second tier tax has been imposed on the foundation pursuant to Section 4944(b)(1), and
 - b. That foundation manager refuses to agree to the removal of all or a part of the jeopardizing investment from jeopardy.
- (2) Imposition of the Section 4944(a)(2) first tier tax on foundation managers is not a prerequisite for the imposition of the second tier tax. The only conditions needed to trigger the imposition of the second tier tax are the two above requirements.
- (3) A foundation manager must refuse a request to remove the investment from jeopardy to trigger imposition of the second tier tax of Section 4944(b)(2). Either a fellow foundation manager or the IRS can make this request, as cited in *Thorne v. Commissioner*. According to *Thorne v. Commissioner*, the IRS must make a formal written request to the foundation manager to remove the investment from jeopardy. Otherwise, the foundation manager can't be considered as having refused an IRS request to make the correction. The written request for correction must be made within a reasonable period prior to the issuance of a statutory notice of deficiency for the second tier tax of Section 4944(b).

Note: 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. See IRM 4.75.15.

- (4) The rate of second tier tax for a foundation manager is 5% of the amount of the jeopardizing investment, Section 4944(b)(2). The foundation manager pays the tax due.
- (5) If more than one foundation manager is liable for the second tier tax under Section 4944(b)(2), all foundation managers are jointly and severally liable for the

tax imposed with respect to any one jeopardizing investment. See Section 4944(d)(1) and Treas. Reg. 53.4944-4(a).

- (6) The maximum aggregate amount of tax for which all participating foundation managers are liable with respect to any one jeopardizing investment under the second tier tax of Section 4944(b)(2) may not exceed \$20,000.

F.6. Examples of Second Tier Taxes

- (1) X is foundation manager of Y, a private foundation. On the advice of X, Y invests \$5,000 in the common stock of corporation M. Assume that both X and Y are liable for the taxes imposed by Section 4944(a) on the making of the investment. Assume further that no part of the investment is removed from jeopardy within the taxable period and that X refused to agree to such removal. Y will be liable for an additional tax of \$1,250 ($\$5,000 \times 25\%$). X will be liable for an additional tax of \$250 ($\$5,000 \times 5\%$).
- (2) Assume the facts as stated in paragraph (1), except that X isn't liable for the tax imposed by Section 4944(a)(2) because his participation was not willful and was due to reasonable cause. X will nonetheless be liable for the tax of \$250 imposed by Section 4944(b)(2) since an additional tax has been imposed upon Y and X refused to agree to the removal of the investment from jeopardy.
- (3) Assume the facts as stated in paragraph (1), except that Y removes \$2,000 of the investment from jeopardy within the taxable period, with X refusing to agree to the removal from jeopardy of the remaining \$3,000 of such investment. Y will be liable for an additional tax of \$750, imposed upon the portion of the investment which has not been removed from jeopardy within the taxable period ($\$3,000 \times 25\%$). Further, X will be liable for an additional tax of \$150, also imposed upon the same portion of the investment ($\$3,000 \times 5\%$). See Treas. Reg. 53.4944-2(c).

G. Abatement of First Tier Tax

- (1) Section 4962 grants the IRS discretionary authority to abate certain Chapter 42 first tier taxes including taxes under Section 4944(a) for taxable events occurring after December 31, 1984, as cited in Sections 4962(a) and (b). In certain circumstances, this provision gives a private foundation and its managers a chance to avoid having the first tier tax imposed under Section 4944(a).
- (2) Abatement is available to a foundation or its managers only if it is established to the IRS's satisfaction that the making of a jeopardizing investment:
 - a. Was due to reasonable cause,
 - b. Was not due to willful neglect, and
 - c. Has been corrected within the correction period.

G.1. Correction Period

- (1) The correction period begins with the date on which the taxable expenditure was made and ends 90 days after the mailing under Section 6212 of a notice of deficiency with respect to the second tier tax. See Section 4963(e)(1) and Treas. Reg. 53.4963-1(e).
- (2) The IRS can extend the correction period if certain requirements are met. See Section 4963(e)(1)(A) and (B) and Treas. Reg. 53.4963-1(e)(3).

G.2. Authority to Abate

- (1) Under Delegation Order 7-11 (Rev. 1) dated July 2, 2018, the authority to abate substantial qualified first tier excise tax amounts imposed by Chapter 42 of the Internal Revenue Code as described in Section 4962(b) remains with the Director, Exempt Organizations.
- (2) A substantial qualified first tier excise tax amount, for purposes of this delegation order, is a sum exceeding \$200,000 for all such tax payments or deficiencies (exclusive of interest, other taxes, and penalties) involving all related parties and transactions arising from Chapter 42 taxable events within the statute of limitations as determined by the area office involved. Amounts for which several parties are jointly and severally liable are counted only once in this summation. This authority may not be redelegated.
- (3) Authority to abate other than substantial qualified first tier excise tax amounts (less than \$200,000) imposed by Chapter 42 of the Internal Revenue Code as described in Section 4962(b) is delegated to: Manager, EO FSL/ET; Area Managers, EO Examinations; and Manager, Compliance, Planning & Classification (CP&C) Classification & Case Assignment. This authority may not be redelegated.
- (4) Authority to abate other than substantial qualified first tier excise tax amounts of \$10,000 or less imposed by Chapter 42 of the Internal Revenue Code, as described in Section 4962(b) is delegated to: Department Manager, W&I Accounts Management. This authority may be redelegated but not lower than Group Managers, W&I Accounts Management.
- (5) Sources of Authority - Section 4962; Treasury Order 150-10. To the extent that the authority previously exercised consistent with this order may require ratification; it is hereby affirmed and ratified. This order supersedes Delegation Order No. 7-11, dated November 8, 2011.
- (6) See IRM 1.2.2, Servicewide Delegations of Authority, for further information.

H. Abatement of Second Tier Tax

- (1) Section 4961(a) provides that if a jeopardizing investment is removed from jeopardy during the correction period, the second tier tax imposed won't be assessed, and if assessed, it'll be abated, and if collected, it'll be credited or refunded as an overpayment.

- (2) A second tier tax imposed and assessed under Section 4944(b) can be abated if a jeopardizing investment is removed from jeopardy during the correction period.

I. Section 507 Terminations and Other Sanctions

- (1) If a private foundation willfully and repeatedly or willfully and flagrantly violates Section 4944 (or any other Chapter 42 provisions), the status of that organization as a private foundation may be terminated by the IRS per Section 507(a)(2). Also, such private foundation may be subject to the termination tax imposed by Section 507(c).
- (2) Under Section 6684, if a foundation manager is liable for the tax under Section 4944, such manager may be liable for a penalty equal to that amount if the act or failure to act that causes the Section 4944 tax liability is not due to reasonable cause, and either:
 - a. Such person has theretofore been liable for the Section 4944 tax, or
 - b. The act or failure to act was both willful and flagrant. See Treas. Reg. 301.6684-1.

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 4944.

A. Subsequent Losses

- (1) Once it has been determined that an investment isn't one that jeopardizes the exempt purposes of the foundation, subsequent losses that may result from the investment won't be considered to jeopardize the carrying out of such purposes. See Treas. Reg. 53.4944-1(a)(2)(i).

B. Determinations

- (1) Considering the requirements that the determination of whether an investment is a jeopardizing investment is to be made on an investment by investment basis, and is to be made as of the time of the investment, the IRS can't issue a ruling that proposed investment procedures governing investments by a private foundation will preclude imposition of a tax under Section 4944 on the private foundation. See Rev. Rul. 74-316, 1974-2 C.B. 389.
- (2) Investments made by private foundations prior to January 1, 1970, won't be subject to the provisions of Section 4944, unless, on or after such date, the form or terms of the investment have been changed or the investment has been exchanged. See Treas. Reg. 53.4944-6.

C. Program-Related Investments / Other Code Section Considerations

- (1) A determination that an investment is program-related will exclude the investment from consideration as a business enterprise under Section 4943 and Treas. Reg. 53.4943-10 or as a taxable expenditure under Section 4945 so long as expenditure responsibility requirements are met. See Treas. Reg. 53.4945-5(b)(4) and Treas. Reg. 53.4945-6(b)(1)(vi).
- (2) Program-related investments are also treated as qualifying distributions under Section 4942 in many circumstances. See Treas. Reg. 53.4942(a)-3(a)(2)(i).
- (3) Repeated willful or flagrant violations of Section 4944 by a private foundation may result in the termination of its private foundation status as well as the imposition of tax per Section 507. Foundation managers may be subject to a penalty under Section 6684.
- (4) Section 4944 won't exempt or relieve any party from compliance with any State or Federal law imposing any obligation, duty or responsibility, or other standard of conduct regarding the operation and administration of an organization or trust to which Section 4944 applies. Conversely, no state law can exempt or relieve any person from any obligation, duty, responsibility, or other standard of conduct under Section 4944 and as cited in Treas. Reg. 53.4944-1(a)(2).

IV. Examination Techniques

- (1) This subsection focuses on how to calculate and assert the excise tax under Section 4944 once it has been determined that the foundation has made a jeopardizing investment. It also contains information relevant to examinations of private foundations in general.

A. Introduction

- (1) Investment in a Ponzi scheme may potentially trigger Section 4944, depending on the facts and circumstances. If the foundation has invested in a Ponzi scheme, consult with Area Counsel.
- (2) Look for investments that show a lack of reasonable business care and prudence in providing for the foundation's long- and short-term financial needs for it to carry out its exempt function. No single factor determines a jeopardizing investment.
- (3) No specific category of investments is treated as a violation. However, apply careful scrutiny to:
 - a. Trading in securities on margin,
 - b. Trading in commodity futures,
 - c. Investing in working interests in oil and gas wells,
 - d. Buying puts, calls and straddles,
 - e. Buying warrants, and
 - f. Selling short.
- (4) If the investment decision was sound at the time the investment was made, it is not a jeopardizing investment, even if it later results in a loss.
- (5) Keep in mind that the tax doesn't apply to investments:
 - a. Originally made by a donor who gifted them to the foundation. If the person receives any consideration from the foundation on the transfer, the foundation is treated as having made an investment equal to the consideration.
 - b. Acquired by the foundation as a result of a corporate reorganization.
 - c. Made before 1970.
- (6) If the form or terms of the investment(s) are later changed, or they are exchanged for other investments, then the investments may be subject to the tax.
- (7) Compute the tax using the value of the amount invested on the day the investment was made. Assess the tax for each year or partial year in the taxable period. The tax amount is the same for each year, similar to discrete acts of self-dealing and taxes imposed by Sections 4942 and 4943.
- (8) To ensure that correction has been met, determine if the foundation has removed the investment from jeopardy by either selling it or disposing of it (other than

exchanging it for another jeopardizing investment). See Treas. Reg. 53.4944-5(b) for guidance.

- (9) When correction is made, obtain verification. See the following list (not all-inclusive) for acceptable proof of correction. Discuss with your manager and Area Counsel as to appropriate methods of correction and proof. Correction can be verified through:
- 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, and
 - c. Brokerage/financial institution statement(s) showing that a foundation no longer owns an asset or stock.
- (10) Be alert for attempts to circumvent the correction requirement. At a minimum, ensure that the parties don't:
- a. Obtain new title documents for returned property and then change title back to the party that returned the property.
 - b. Transfer assets or stocks to other financial institutions or to disqualified parties for which statements aren't provided.
- (11) Complete Forms 4883, 4621, 886-A and 870-E. See Example Worksheet/Exhibits in 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 and IRM 4.75.15. 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.
- (12) The Section 4944(a)(1) tax is reported on Form 4720 and assessed against the private foundation. See IRM 4.75.22, EO Delinquent, Amended and Substitute for Return Procedures, to set up a substitute for return if no return was filed or to secure a delinquent return.
- (13) The foundation manager tax is reported on Form 4720 and assessed against the responsible individual(s).

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 (former Section 4940(e)). 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:
- 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).
- (3) For taxable years beginning before December 21, 2019, 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 impose 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 December 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 December 20, 2019, the excise tax is 1.39% of net investment income, and there is no reduced 1% tax rate.

Example 1: The foundation engages in self-dealing expenditures. 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 distribution 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 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 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 occur 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 below 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 grantmaking 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.

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.

- (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.
- (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), 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 Area 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:
- a. 90 days after paying the first tier tax, or
 - b. 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. 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. 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 there are excess business holdings 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:
 - a. 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
 - b. Any other period which the IRS determines is reasonable and necessary to bring about correction.

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:
 - a. The only barrier is the reluctance to correct because they are uncertain of final approval by the IRS, and
 - b. 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:
 - a. The taxpayer indicates acceptance of initial tax liability (Sections 4941 through 4945).
 - b. Correction will be very difficult or costly, requiring the exercise of sound judgment on a broad scale.

- c. The taxpayer should be able to complete the proposed correction within 90 days from the date of approval.
 - d. The taxpayer submits a written request for advance approval, attention of the Area Manager.
- (5) The written request must:
- a. Fully describe the surrounding circumstances giving rise to the initial tax liability.
 - b. Outline in detail the nature and method of the proposed correction.
 - c. Accept an initial tax liability for the act or failure to act in question.
 - d. 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:
- a. Explain in detail the proposed corrective action.
 - b. Specify the due date for correction completion.
 - c. Require the taxpayer to notify the Area Manager upon completion.
 - d. 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 particular 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 isn't 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 isn't promptly received after contacting the taxpayer, close the case as unagreed. See IRM 4.75.16, Case Closing Procedures, 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, and
- 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) See IRM 4.75.15, Closing Letters and Examination Reports, 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 isn't 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.
- (7) If the taxpayer doesn't agree to the tax or fails to make correction, the case is unagreed. See IRM 4.75.16 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 a foundation’s net assets to one or more other foundations does not, by itself, terminate private foundation status. The foundation must separately terminate, whether voluntarily (507(a)(1)) or involuntarily (507(a)(2)).

(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:	
<p>A) The aggregate tax benefit - the sum of:</p>	<p>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.</p>
<p>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))</p>	

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 RGS NT or IDRS command code INTST. (Section 507(d)(1)(C))
<p>*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).</p> <p>** 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.</p>	

- (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 SEIN. Establish 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 4.75.31 for guidance on converting the Form 990-PF to Forms 1120 or 1041. Use the Report Generation System NT (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 you close the case 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 doesn't further an exempt purpose, propose revocation. A private foundation is subject to the auto-revocation process of Section 6033(j). See IRM 4.75.16.
- (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 commercial-type insurance (Section 501(m)).
 - f. 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 4.75.32. Additionally, when proposing revocation, follow the information in IRM 4.75.31, Conversion of Returns.
- (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 triggering Chapter 42 taxes, propose the termination tax in addition to revocation. You may include the basic report forms (Forms 4883 and 4621) with Letter 3614, 30-day letter package for Chapter 42 excise taxes. Form 870-E shows all tax deficiencies of 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
3 years	Form 990-PF filed disclosing the transaction (must adequately identify existence and nature of transaction). See Cline v. Commissioner, 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) Failure to set aside deficiency	+2 years to statute date	6501(l)(3)
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- (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 doesn’t 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: You may use Form 872-A, Special Consent to Extend the Time to Assess Tax, 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.

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 doesn’t arise until after a Thorne letter is sent.

- (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 IRC 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’s 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(g)(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) 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 and 20.1.5.
- (4) Foundations, individuals, and taxable entities who file (or are required to file but don't file) Form 4720 may be subject to failure to file, failure to pay, estimated tax, negligence, and civil fraud penalties.
- (5) 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) isn't imposed with respect to Section 4940 and 4948(a) taxes. See IRM 20.1.8.

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).

- (6) 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.
- (7) 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.
- (8) 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 aren't taxes that are reported (or required to be reported) on any tax return, they aren't subject to those penalties. Imposition of the penalties under Sections 6662 and 6663 requires that the taxpayer file a return. If the taxpayer didn't file a return, those penalties don't apply. An SFR doesn't 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 4.75.22), 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%.

- (9) 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 4.75.22. 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.
- (10) 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 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. and 20.1.11.
- (11) 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.
- (7) If you find acts/failures to act that give 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. Was not due to willful neglect, and
 - c. Was corrected within the correction period.
- (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 (see Section 4963 and 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. See 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 isn't 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 4.75.15, Closing Letters and Examination Reports.
- (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 4942(a) liability when it incorrectly valued its assets in a manner which wasn't willful and was due to reasonable cause. As a result of the incorrect valuation of assets, the foundation didn't properly distribute all of its required distributable amount. A notice of deficiency with respect to the excise taxes imposed by Section 4942(a) and (b) is mailed to the foundation under Section 6212(a). Subsequently, the foundation makes the appropriate qualifying distribution (within the allowable distribution period). In addition, the foundation submitted a written document to requesting abatement of the excise taxes due to reasonable cause. The examining agent concurred that the foundation's written request for abatement has met the threshold for reasonable cause. Based upon these facts, the initial excise tax under Section 4942(a) can be abated since all the requirements of such subparagraph have been satisfied.

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 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 4.75.37, Claims, Requests for Abatement and Examination Reconsiderations, 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 4.75.10, Exempt Organizations Pre-contact Procedures, to request and review a copy. You may receive a copy on disk, via secure e-mail, or via Skype. 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, etc.)?
- 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 Publication (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 Accurint 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. (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 IRM 7.27.16.4.2 and the Instructions to the Form 990-PF.
3	Note the letter date. Request a copy via the initial IDR.

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 4.75.32, Declaratory Judgment Cases and The Administrative Record.
- (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:

- 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.
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?

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 you determine that amounts reported in Part I Column d are not charitable expenditures, remove the amounts in your 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 4.75.15 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 4.75.15 for the initial report, formal report, protest to Appeals, and rebuttal information.
- (11) See IRM 4.75.15 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. A sample Thorne letter can be found below and in other Technical Guides, such as those for Sections 4941 and 4945.
- (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 4.75.32, Declaratory Judgment Cases and the Administrative Record, 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 4.75.16 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.
 - b. Secure the agreement.
 - c. Collect payment or complete a request for an installment agreement. See IRM 4.75.16.
 - d. Prepare the appropriate closing letter. See IRM 4.75.15.
 - 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.
- (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, 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 4.75.15 for Fast Track Settlement information.

(9) A valid protest contains the following elements:

a. The taxpayer's name, address, Employer Identification Number (EIN) 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.

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 doesn't 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 4.75.32, Declaratory Judgment Cases and The Administrative Record.

V. Issue Indicators and Examination Tips

- (1) This section provides possible issue indicators and tips when examining a private foundation, particularly with respect to jeopardizing investments subject to tax under Section 4944.

A. Issue Indicators

- (1) A program-related investment may cease to be a program-related investment because of critical changes in circumstances, such as serving illegal or private purposes. In such an event, the PF will become subject to the tax imposed by Section 4944(a)(1) no earlier than the 30th day after the date on which the PF (or any of its managers) has actual knowledge of such critical changes in circumstances. See Treas. Reg. 53.4944-3(a)(3)(i). In addition, consider how the former program-related investment must be treated for Section 4942 purposes, including computation of the distributable amount, as well as compliance with the other provisions of chapter 42, Section 4941 self-dealing, Section 4943 excess business holdings and Section 4945 taxable expenditures.
- (2) The investment should be examined under the facts and circumstances existing at the time the PF made the investment. Facts and circumstances only apparent in hindsight, such as whether the investment was an actual success or failure, are relevant.
- (3) Once it has been determined that a particular investment is not one that jeopardizes the exempt purposes of the foundation, subsequent losses that may result from the investment will not be considered jeopardy investments for purposes of Section 4944. See Treas. Reg. 53.4944-1(a)(2)(i).
- (4) A determination that an investment qualifies as a program-related investment, does not rule out the applicability of other Chapter 42 provisions such as Section 4941 self-dealing.
- (5) No single factor determines a jeopardizing investment. Look for investments that demonstrate a lack of reasonable business care and prudence in providing for the foundation's long- and short-term financial needs for it to carry out its exempt function.
- (6) Other investment strategies that deserve scrutiny are:
 - a. Investment in "junk" bonds,
 - b. Risk arbitrage,
 - c. Hedge funds,
 - d. Derivatives,
 - e. Distressed real estate,
 - f. International equities in developing countries, and
 - g. Digital currencies.

B. Examination Tips

- (1) Review the PF's Articles of Incorporation or Certificate of Incorporation, along with any other restrictions that may have been placed on the PF's assets to determine whether a program-related investment is consistent with the PF's purposes.
- (2) A business that is a disqualified person with respect to the foundation cannot redeem shares from the foundation because it would constitute a self-dealing transaction under Section 4941 unless an incorporated business offers to redeem from all the owners on the same terms and meets the self-dealing exception under Section 4941(d)(2)(F) and Treas. Reg. Section 53.4941(d)-3(d).
- (3) If applicable, review contracts or other materials with or from the organization's financial brokers regarding investment policies and risks.
- (4) Review and inspect balance sheet items and identify the foundation's types of investments (margin accounts, futures market, securities which are not publicly traded, investing in companies owned by related parties).
- (5) Review contracts and agreements surrounding program-related investments. Were any disqualified persons involved in the transactions in a personal capacity that could result in act(s) of self-dealing?
- (6) Does the foundation receive regular reports regarding a program-related investment? If so, review. If not, why not?
- (7) Review any files maintained by the foundation regarding its due diligence prior to making an investment. Research the investment to learn of any public information, including but not limited to related parties, misuse and fraud.

VI. Example Worksheets / Exhibits

- (1) This section provides worksheets as well as exhibits focusing on practical applications when asserting Section 4944 excise taxes for jeopardizing investments made by a private foundation. The examples in the exhibits 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 4944 tax.

A. Section 4944: First Tier Tax Example

- (1) On July 1, 2010, Foundation Manager Papa makes an investment in an international hedge fund, using funds from Private Foundation Quebec. The foundation has a portfolio valued at \$25,575,000, which consists of cash, common stocks of companies on the Dow Jones Industrial Index, mutual fund investments, and Build America Bonds issued by a very large metropolitan city. At the time of the investment, the foundation had \$15,000 in cash. FM Papa is the newest foundation manager for PF Quebec, having been on the job six months. FM Papa previously worked at a larger private foundation for two years.
- (2) FM Papa acquires a loan from a bank using the bonds as collateral. The loan is for \$16,500,000, which FM Papa invests in the hedge fund. The expected return from the hedge fund is 10% per year, which should generate sufficient revenue to repay the loan, which has an APR of 4%.
- (3) FM Papa made the investment on advice obtained from a friend, who received advice from another friend, who in turn received it from a local celebrity. The celebrity is more known for appearing and succeeding on a national syndicated reality competition show than for financial acumen. FM Papa has performed a few discrete searches on the web, finding a website for the fund, and a few mentions in the foreign press. FM Papa printed the web pages for PF Quebec's records.
- (4) The hedge fund's business address is located in the Philippines, and the fund manager operates out of Hong Kong. The hedge fund manager is not affiliated with any domestic or international brokerage or investment firms. There is little information available about the fund manager.
- (5) Upon inspection, Agent Jones determines that after receipt of an initial series of four \$5,000 dividend payments no further funds were received. The foundation manager kept the investment on the Form 990-PF for 2010 but was unable to contact the hedge manager to inquire about the investment. The foundation has taken no actions with respect to the investment.
- (6) Agent Jones determines that PF Quebec is subject to Section 4944 and develops the case for asserting the foundation manager tax on FM Papa. FM Papa is a calendar year taxpayer. See the table below for the tax computations.

Tax Year	Investment	Foundation Tax Rate	Tax	Foundation Manager Tax Rate	Foundation Manager Tax
201009	\$16,500,000.00	10%	\$1,650,000.00	10%	\$10,000.00
201109	\$16,500,000.00	10%	\$1,650,000.00	10%	0.00
201209	\$16,500,000.00	10%	\$1,650,000.00	10%	0.00
Reminder: The tax for any one investment caps at \$10,000 for foundation managers under 4944(a)(2) per 4944(d)(2).					

- (7) Agent Jones determines that abatement under Section 4962 does not apply in this case. She issues her reports May 1, 2012, soliciting correction. The following initial reports would be issued when soliciting correction, or as part of the formal reports of examination after there is full correction.

Note: An initial report isn't mandatory per the IRM. If an initial report is sent before the formal report, which includes the 30-day letter and accompanying forms, it should solicit correction.

Exempt Organizations Excise Tax Audit Changes

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

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

		Taxable Years Ended		
		9/30/2010	9/30/2011	9/30/2012
Internal Revenue Code Section for Proposed Adjustment		4944(a)(1)	4944(a)(1)	4944(a)(1)
1. Adjustments	Jeopardizing Investment – Hedge Fund	16,500,000.00	16,500,000.00	16,500,000.00
2.	Total Adjustments	16,500,000.00	16,500,000.00	16,500,000.00
3.	Amount reported on return or as Previously adjusted	0	0	0
4.	Total amount as corrected	16,500,000.00	16,500,000.00	16,500,000.00
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x Line 5)	1,650,000.00	1,650,000.00	1,650,000.00
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	1,650,000.00	1,650,000.00	1,650,000.00
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

Explanation of Adjustments
See attached Explanation of Items

Form 4883 (Rev. 1-2004)

Catalog Number 42083F

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

Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer Foundation Manager Papa		Employer ID No. [Insert SSN]	Schedule or Exhibit 1	
Name of Exempt Organization (if different from Taxpayer) Private Foundation Quebec				
		Taxable Years Ended		
		12/31/2010		
Internal Revenue Code Section for Proposed Adjustment		4944(a)(2)		
1. Adjustments	Jeopardizing Investment – Hedge Fund	16,500,000.00		
2.	Total Adjustments	16,500,000.00		
3.	Amount reported on return or as Previously adjusted	0		
4.	Total amount as corrected	16,500,000.00		
5.	Applicable tax rate %	10%		
6.	Initial tax liability as corrected (line 4 x Line 5) *	10,000.00		
7.	Initial tax liability reported	0		
8.	Increase (or decrease) in tax	10,000.00		
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

Explanation of Adjustments

* Subject to \$10,000 limit on tax

See attached Explanation of Items

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]
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4. Name and Address of Taxpayer Private Foundation Quebec [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)	9. Tax Period(s) Ended	
	9/30/2010	9/30/2011			
	9/30/2012				

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)	Internal Revenue Code Section (1)	Amount (2)
4944(a)(1)	9/30/2010	1,650,000.00			
4944(a)(1)	9/30/2011	1,650,000.00			
4944(a)(1)	9/30/2012	1,650,000.00			

15. Remarks See attached Explanation of Items
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16. Attachments

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 Papa [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 Quebec [Insert street address] [Insert city, state, and zip code]
---	---

6. Social Security Number or Employer Identification Number [Insert SSN]	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)	9. Tax Period(s) Ended	
	12/31/2010			9/30/2010	

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)	Internal Revenue Code Section (1)	Amount (2)
4944(a)(2)	12/31/2010	10,000.00			

15. Remarks See attached Explanation of Items
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16. Attachments

B. Section 4944: Second Tier Tax and Penalties Example

- (1) Taking the example above a step further, Agent Jones determines that PF Quebec and FM Papa are subject to the failure to file and failure to pay penalties under Section 6651(a). She establishes Substitute for Returns for the Forms 4720 on IDRS. The failure to file penalty, normally 5% per month for up to five months, is limited to 4.5% per month when the failure to pay penalty is also imposed, at the 0.5% rate for each month or part of a month the tax isn't paid. The foundation's return due dates for the years ending 201009 and 201109 were February 15, 2011, and February 15, 2012. (The due date for the 201209 return is February 15, 2013, thus no failure to file or failure to pay penalties apply to the proposed assessment for the 201209 return.) The Form 4720 return due date for FM Papa's tax year ending December 31, 2010, is May 15, 2011.
- (2) Agent Jones first issues a Thorne letter to FM Papa requesting correction. (See the Thorne Letter section below for sample language used in a Thorne letter for a theoretical Section 4945 scenario.) Agent Jones doesn't receive a response to the certified letter.
- (3) Agent Jones issues a report of examination via a 30-day letter to the foundation on September 1, 2012. The report explains the failure to file and pay penalties and why they apply. The penalties for the foundation are computed as follows:

Tax Year	Tax Amount	Section 6651(a) Penalty Rate	Months Late	Penalty
201009	\$1,650,000.00	4.5%	5	\$371,250.00
201009	\$1,650,000.00	0.5%	19	\$156,750.00
201109	\$1,650,000.00	4.5%	5	\$371,250.00
201109	\$1,650,000.00	0.5%	7	\$57,750.00
Total Penalty				\$957,000.00

Note: Under Section 4944(b), the second tier tax is on the amount of the investment, provided that the investment is not corrected by the end of the taxable period. This tax is assessed once per uncorrected jeopardizing investment. Report the second tier tax on the last year under examination showing an adjustment for initial tier tax liability. The second tier tax on management is 5% of the investment, not to exceed \$20,000.

- (4) Agent Jones has also learned from a call from SB/SE Collection that FM Papa is being sought for a Section 4941 tax assessment from 200412. Using the W-2 information from PF Quebec, SB/SE found the -L freeze on PF Quebec's Form 990-PF and pulled an AMDISA print to find Agent Jones' group. Because FM Papa was previously liable for a Chapter 42 tax, Agent Jones decides to propose

the Section 6684 penalty on FM Papa after conferring with Area Counsel. This 100% penalty is imposed on the amount of tax for which it is determined that the person is liable and includes both the first and second tier tax amounts.

- (5) Because a penalty under Section 6684 is being proposed, Agent Jones obtains written supervisory approval for penalty assessment in order to comply with Section 6751(b)(1) and includes all pertinent documentation in the case file. She issues a report of examination via the 30-day letter to FM Papa on September 1, 2012 explaining the penalties asserted against FM Papa.
- (6) The penalties for FM Papa are:

Tax Year	Tax Amount	Code Section	Penalty Rate	Months Late	Penalty
201012	\$10,000.00	6651(a)(1)	4.5%	5	\$2,250.00
201012	\$20,000.00	6651(a)(2)	0.5%	16	\$800.00
201012	\$10,000.00	6684	100%	N/A	\$10,000.00
201012	\$20,000.00	6684	100%	N/A	\$20,000.00
Total Penalty					\$33,050.00

- (7) Without correction, Agent Jones would issue the following formal reports of examination 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 Quebec	Employer ID No. [Insert EIN]	Schedule or Exhibit 1
---	---------------------------------	--------------------------

Name of Exempt Organization (if different from Taxpayer)

		Taxable Years Ended		
		9/30/2010	9/30/2011	9/30/2012
Internal Revenue Code Section for Proposed Adjustment		4944(a)	4944(a)	4944(a)
1. Adjustments	Jeopardizing Investment	16,500,000.00	16,500,000.00	16,500,000.00
2.	Total Adjustments	16,500,000.00	16,500,000.00	16,500,000.00
3.	Amount reported on return or as Previously adjusted	0	0	0
4.	Total amount as corrected	16,500,000.00	16,500,000.00	16,500,000.00
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x Line 5)*	1,650,000.00	1,650,000.00	1,650,000.00
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	1,650,000.00	1,650,000.00	1,650,000.00
9.	Additional tax (minimum) at 25% (4944(b)(1))	0	0	4,125,000.00
10.	Penalties (Code Section 6651(a))	528,000.00	429,000.00	

Explanation of Adjustments

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%.

See attached Explanation of Items

Form 4883 (Rev. 1-2004)

Catalog Number 42083F

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

Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer Foundation Manager Papa		Employer ID No. [Insert SSN]	Schedule or Exhibit 1	
Name of Exempt Organization (if different from Taxpayer) Private Foundation Quebec				
		Taxable Years Ended		
		12/31/2010		
Internal Revenue Code Section for Proposed Adjustment		4944(a)(2)		
1. Adjustments	Jeopardizing Investment	16,500,000.00		
2.	Total Adjustments	16,500,000.00		
3.	Amount reported on return or as Previously adjusted	0		
4.	Total amount as corrected	16,500,000.00		
5.	Applicable tax rate %	10%		
6.	Initial tax liability as corrected (line 4 x Line 5) *	10,000.00		
7.	Initial tax liability reported	0		
8.	Increase (or decrease) in tax	10,000.00		
9.	Additional tax (minimum) at 5% (4944(b)(2))	20,000.00		
10.	Penalties (Code Section 6651(a), 6684)	33,050.00		

Explanation of Adjustments

* Subject to \$10,000 limit on tax under 4944(b)(1), \$20,000 limit on tax under 4944(b)(2). 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%.

See attached Explanation of Items

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 Quebec [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	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)	9. Tax Period(s) Ended	
	9/30/2010	9/30/2011			
	9/30/2012				

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)	Internal Revenue Code Section (1)	Amount (2)
4944(a)(1)	9/30/2010	1,650,000.00		6651(a)(1)	371,250.00
				6651(a)(2)	156,750.00
4944(a)(1)	9/30/2011	1,650,000.00		6651(a)(1)	371,250.00
				6651(a)(2)	57,750.00
4944(a)(1)	9/30/2012	1,650,000.00	4,125,000.00		

15. Remarks
See attached Explanation of Items

16. Attachments

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 Papa [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 Quebec [Insert street address] [Insert city, state, and zip code]
---	---

6. Social Security Number or Employer Identification Number [Insert SSN]	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)	9. Tax Period(s) Ended	
	12/31/2010			9/30/2010	

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)	Internal Revenue Code Section (1)	Amount (2)
4944(a)(2)	12/31/2010	10,000.00	20,000.00	6651(a)(1)	2,250.00
	12/31/2010			6652(a)(2)	800.00
	12/31/2010			6684	30,000.00

15. Remarks See attached Explanation of Items
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16. Attachments

C. Thorne Letter

- (1) This exhibit contains sample language for a theoretical situation involving Section 4945. Consult 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

Date:
Taxpayer ID number:
Form:
Tax periods ended:
Person to contact:
Name:
ID number:
Telephone:
Fax:
Manager's contact information:
Name:
ID number:
Telephone:

TAXPAYER NAME
TAXPAYER ADDRESS
TAXPAYER ADDRESS

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

[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)] _____
(Kind of tax)

tax due on any return(s) made by or for the above taxpayer(s) for the period(s) ended
 _____ [Insert Tax Years] _____

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)

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]
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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 4944)]
(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 jeopardizing investment occurred]

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

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 4944 Excise Taxes on Jeopardizing Investments Lead Sheet

Taxpayer Name:
TIN:
Tax Form:

Examiner:
Date:
Tax Year:

IRC 4944 Taxes on Jeopardizing Investments Lead Sheet				
Tax Period	Per Return	Per Exam	Adjustment	Reference
Conclusion: <i>(Reflects the final determination on the issue.)</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.				
Audit Steps: <i>(Document audit steps taken or to be taken.)</i>				Workpaper Reference
1. Identify disqualified persons as defined in IRC 4946. Review Articles of Incorporation or other organizing documents to determine the foundation's exempt charitable purpose. Determine if the private foundation is liable to for filing Form 4720, and review if filed.				
2. Identify investments of the private foundation, both principal and income. Examine each individual investment and evaluate whether the particular investment jeopardizes the foundation's exempt purpose, taking into account the foundation's entire portfolio.				
3. Determine if any of the assets are donated or acquired as a result of a corporate reorganization. Treas. Reg. 53.4944-1(a)(2)(ii).				
4. Determine if any of the investments are program-related investments. Treas. Reg. 53.4944-3(a)(1).				
5. Determine whether the foundation manager, in making such investment, failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the long and short term financial needs of the foundation. Treas. Reg. 53.4944-1(a)(2). Consider if the foundation used the services of an independent investment advisor.				
6. Calculate the initial excise tax. IRC 4944(a) imposes the tax on the foundation equal to 10% of the amount invested each year in the taxable period. A 10% tax is also imposed on any foundation manager knowing the investment jeopardizes the carrying out of the PF's exempt purposes.				
7. Verify that an investment which jeopardizes the carrying out of exempt purposes has been removed from jeopardy, and determine the taxable period. IRC 4944(e).				
8. Determine whether the private foundation and/or its managers requested an abatement of the initial tax by timely removing the investment from				

Taxpayer Name:

TIN:

Tax Form:

Examiner:

Date:

Tax Year:

jeopardy within the correction period. IRC 4963(e)(1) and Treas. Reg. 53.4963-1(d).	
9. Calculate the additional excise tax. IRC 4944(b) imposes the tax on the foundation equal to 25% of the amount not removed from jeopardy during the taxable period. A 5% tax is also imposed on any foundation manager that refused to remove the investment from jeopardy. All such managers are jointly and severally liable for the tax imposed with respect to such investments. Treas. Reg. 53.4944-4(a).	
10. 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 Sections: 4944, 4962, 4963; Treas. Regs. 53.4944-1, 53.4944-4, 53.4963-1	
Specific citations:	
Taxpayer Position: <i>(If applicable)</i>	