



Exempt Organizations Technical Guide

TG 3-22 Termination of Private Foundation Status IRC 507

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I. Overview

- (1) A private foundation is any domestic or foreign organization described in Section 501(c)(3) except for an organization referred to in Sections 509(a)(1), (a)(2), (a)(3), or (a)(4). The definition divides Section 501(c)(3) organizations into two classes: private foundations and public charities. Private foundations are subject to the provisions of Chapter 42. Once an organization is classified as a private foundation, it can only terminate that status by complying with the requirements of Section 507, either through transfer of its assets to a Section 509(a)(1) charity, by operation as a Section 509(a)(1), (a)(2) or (a)(3) charity, or by payment of the Section 507 tax. Section 507 only terminates the private foundation status with the IRS, it does not terminate the organization's legal existence under state law.

A. Background/History

- (1) Every organization that qualifies for tax exemption as an organization described in Section 501(c)(3) is a private foundation unless it falls into one of the categories specifically excluded from the definition of that term, referred to in Section 509(a). In addition, certain nonexempt charitable trusts are also treated as private foundations. Even if an organization falls within one of the categories excluded from the definition of private foundation, it will be presumed to be a private foundation, with some exceptions, unless it gives timely notice to the IRS that it is not a private foundation. If an organization is required to file the notice, it generally must do so within 27 months from the end of the month in which it was organized. Generally, organizations use Form 1023, Application for Recognition of Exemption, for this purpose.
- (2) Section 508(b) provides that an organization described in Section 501(c)(3) must notify the IRS as provided by regulations that it is not a private foundation, or it will be presumed to be a private foundation. It does not specify a timeframe for notification. Revenue Ruling (Rev. Rul.) 73-504, 1973-2 C.B. 190 discusses an organization which failed to notify the IRS within the deadline in the Income Tax Regulations but was permitted to establish a public charity status.
- (3) If a public charity no longer qualifies as a public charity under Section 509(a)(1), (a)(2), (a)(3), or (a)(4), then it becomes a private foundation. An organization which is a private foundation on October 9, 1969, or becomes one on any subsequent date, can terminate that status only by one of the methods described in Section 507.
- (4) If the private foundation status was erroneously determined, then the organization can make a correction. An organization that erroneously determined that it was a private foundation (for example, by erroneously classifying an item or items in its calculation of public support) and wishes to correct the error can request a determination letter classifying it as a public charity by showing that it continuously met the public support tests during the relevant periods. See Revenue Procedure (Rev. Proc.) 2021-5, 2021-1 I.R.B. 250 (updated annually).

B. Relevant Terms

- (1) **Disqualified Persons:** Defined in Section 4946 as all substantial contributors to the foundation, all foundation managers of the foundation, an owner of more than 20% of the total combined voting power of a corporation, the profits interests of a partnership or the beneficial interest of a trust or unincorporated enterprise which is a substantial contributor to the foundation, family members of disqualified persons, a corporation of which more than 35% of the total combined voting power is owned by disqualified persons, a partnership of which more than 35% of the profits interest is owned by disqualified persons, a trust, estate or unincorporated enterprise of which more than 35% of the beneficial interest is owned by disqualified persons, family members of disqualified persons. See Treas. Reg 53.4946-1(a)(1).
- (2) **Substantial Contributor:** Defined in Section 507(d)(2) as any person (within the meaning of Section 7701(a)(1)), whether or not exempt from taxation under Section 501(a), who contributed or bequeathed an aggregate amount of more than \$5,000 to the private foundation, if such amount is more than 2% of the total contributions and bequests received by the private foundation before the close of the taxable year of the private foundation in which a contribution or bequest is received by the foundation from such person. In the case of a trust, the term substantial contributor also means the creator of the trust. Such term does not include a governmental unit described in Section 170(c)(1). See Section 4946(a)(1)(A) and Treas. Reg 1.507-6(a)(1).
- (3) **Related Person:** With respect to any person, the term “related person” means any other person who would be a disqualified person (within the meaning of Section 4946) by reason of his relationship to such person. In the case of a contributor which is a corporation, the term also includes any officer or director of such corporation. See Section 507(d)(2)(C)(ii).
- (4) **Value of Assets:** The value of the net assets shall be determined at whichever time such value is higher: (1) the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation, or (2) the date on which it ceases to be a private foundation. See Section 507(e).
- (5) **Willful and Flagrant Act (or Failure to Act):** An act which is voluntarily, consciously, and knowingly committed in violation of any provision of Chapter 42 (other than Section 4940 or 4948(a)) and which would appear to be a gross violation to a reasonable person. See Treasury Regulation (Treas. Reg.) 1.507-1(c)(2).
- (6) **Willful Repeated Acts (or Failures to Act):** At least two acts or failures to act both of which are voluntary, conscious, and intentional. See Treas. Reg. 1.507-1(c)(1).
- (7) **Knowing:** Does not mean “having reason to know” an act or failure to act constitutes a Chapter 42 violation. However, evidence showing that a foundation manager has reason to know of a particular fact or particular rule is relevant in determining whether he had actual knowledge of such fact or rule.

Thus, for example, evidence showing that a foundation manager has reason to know of sufficient facts so that, based solely upon such facts, an expenditure would be a taxable expenditure is relevant in determining whether he has actual knowledge of such facts. See Treas. Reg. 53.4945-1(a)(2)(iii).

C. Law/Authority

- (1) The status of an organization as a private foundation will be terminated only if:
 - a. The organization notifies the IRS of its intent to accomplish such termination, or
 - b. With respect to the organization there have been either willful repeated acts (or failures to act), or a willful or flagrant act (or failure to act), giving rise to tax liability under Chapter 42; and the IRS notifies the organization that it is therefore liable for Section 507(c) taxes. See Treas. Reg. 1.507-1(a).
- (2) Private foundation status exists independent of exempt status. Private foundation status may exist where an organization described in Section 501(c)(3):
 - a. Has not yet applied for exemption,
 - b. Has had its exempt status revoked (taxable private foundation), or
 - c. Where it has applied for exemption under sections other than Section 501(c)(3).
- (3) An organization cannot avoid private foundation status because its activities are such that the organization could qualify under a section of the Internal Revenue Code (IRC) other than Section 501(c)(3), where it no longer qualifies under Section 501(c)(3). Additionally, if an organization, which is a private foundation, ceases to be described in Section 501(c)(3), it will not lose its private foundation status. It will become a taxable private foundation. A taxable private foundation is still subject to Chapter 42 and must meet the requirements of Section 507 if it wishes to terminate its private foundation status. See Section 509(b), Treas. Reg. 1.509(b)-1.
- (4) Rev. Proc. 2021-5, 2021-1 I.R.B. 250 (updated annually) discusses the process an organization should use when terminating its private foundation status under Section 507(b)(1)(B). This includes both the advance and final ruling requests.

II. Requirements

- (1) Section 507 provides the necessary requirements for organizations that terminate their private foundation status – whether voluntarily or involuntarily.

A. Termination of Private Foundation Status

- (1) Section 507 covers three areas that result in termination of private foundation status, and one area in which private foundation status is not terminated:
 - a. Section 507(a) Termination.
 - b. Section 507(b)(1) Termination.
 - c. Section 507(b)(2) Termination.

B. Section 507(a) Terminations

- (1) Under this Section, a private foundation may be involuntarily terminated for repeated or flagrant violations of Chapter 42 provisions. Private foundation status can also be voluntarily terminated under this Section. The common result is the tax imposed under Section 507(c). See Treas. Reg. 1.507-1(a).
- (2) The status of an organization as a private foundation will be terminated only if:
 - a. The organization notifies the IRS of its intent to accomplish such termination, or
 - b. With respect to the organization there have been either willful repeated acts (or failures to act), or a willful or flagrant act (or failure to act), giving rise to tax liability under Chapter 42; and the IRS notifies the organization that it is therefore liable for Section 507(c) taxes.
 - c. If tax liability is incurred, the organization either pays the Section 507(c) tax, less any amount abated under Section 507(g), if any, or has the entire amount abated under Section 507(g).
- (3) Rev. Rul. 2008-41, 2008-302 IRB 170, includes a discussion of the termination of trusts under Section 507(a)(1) which are subject to the private foundation provisions of Section 4947(a)(2) and possible imposition of an excise tax under Section 507(c). The ruling found the trust has not terminated its private foundation status under Section 507(a)(1) as a result of the division of the trust into two or more separate trusts because no notice of termination was filed or was required to be filed. Accordingly, the excise tax imposed under Section 507(c) does not apply. See Treas. Reg. 1.507-1(b)(6).

B.1. Voluntary Section 507(a)(1) Terminations

- (1) In order to terminate its private foundation status an organization must submit a statement to the IRS of its intent to terminate its private foundation status under Section 507(a)(1). A statement of intent to voluntarily terminate private foundation status must set forth in detail the computation and amount of tax

imposed under Section 507(c) – unless the organization requests abatement of such tax pursuant to Section 507(g):

- a. Full payment of the tax must be made when the statement is filed, less any amount that is the subject of an abatement request.
 - b. If a request for abatement is denied, the tax due must be paid in full upon notification of the denial. See Treas. Reg. 1.507-1(b)(1).
- (2) A Section 507(a)(1) termination does not relieve a private foundation, or any disqualified person, of tax liability under Chapter 42 for acts or failures to act prior to termination or for any additional taxes imposed for failures to correct such acts or failures to act. See Treas. Reg. 1.507-1(b)(2).
 - (3) After a Section 507(a)(1) termination, an organization wishing to be treated as described in 501(c)(3) must apply for recognition of exemption under Section 501(c)(3) in accordance with Section 508(a). See Treas. Reg. 1.507-1(b)(3).
 - (4) For purposes of the disallowance of charitable deductions under Section 508(d), the IRS will give public notice that it has received from a private foundation a notice of intent to terminate its status under Section 507(a)(1). See Treas. Reg. 1.507-1(b)(5).
 - (5) A transfer of assets described in Section 507(b)(2) to one or more other private foundations (or one or more other private foundations and one or more Sections 509(a)(1), (a)(2), (a)(3), or (a)(4) organizations), will not be a voluntary termination under Section 507(a)(1) unless such private foundation voluntarily gives notice pursuant to Section 507(a)(1). See Treas. Regs. 1.507-1(b)(6) and 1.507-3(c).
 - (6) Neither a transfer of all of the assets of a private foundation, nor a significant disposition of its assets, will be deemed to result in a termination of the transferor's private foundation status under Section 507(a)(1) unless the transferor elects to terminate pursuant to Section 507(a)(1), or unless Section 507(a)(2) is applicable. See Treas. Reg. 1.507-1(b)(7).
 - (7) If a transfer of all the assets of a private foundation or a significant disposition of its assets (Treas. Reg. 1.507-3(c)(2)) results in Chapter 42 tax liability, or Chapter 42 tax liability was incurred prior to the transfer by the transferor, transferee liability may be applied against the transferee organization for payment of such liability. Any Chapter 42 tax liability incurred for failure to correct a past Chapter 42 tax liability will be deemed incurred on the date on which the act or failure to act giving rise to the initial tax liability occurred. See Treas. Reg. 1.507-1(b)(8).
 - (8) A private foundation which transfers all of its net assets must file the annual information return required by Section 6033, the Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation, and the foundation managers are required to file the annual report of a private foundation required by Section 6056, Health Insurance Coverage Form, for the taxable year in which the transfer occurs.

However, neither return is required for any taxable year following the taxable year in which the last of any such transfers occurred, if the organization has neither legal nor equitable title to any assets or engages in no activity during the subsequent years. See Treas. Reg. 1.507-1(b)(9).

B.2. Involuntary Section 507(a)(2) Terminations

- (1) For purposes of involuntary terminations under Section 507(a)(2):
 - a. A “willful and flagrant act (or failure to act)” is one which is voluntarily, consciously, and knowingly committed in violation of any provision of Chapter 42 (other than Section 4940 or 4948(a)) and which would appear to be a gross violation to a reasonable person. See Treas. Reg. 1.507-1(c)(2).
 - b. The term “willful repeated acts (or failures to act)” means at least two acts or failures to act both of which are voluntary, conscious, and intentional. See Treas. Reg. 1.507-1(c)(1).
 - c. An act (or failure to act) may be treated as an act by the private foundation for purposes of Section 507(a)(2) even though tax is imposed upon one or more foundation managers and not upon the foundation. See Treas. Reg. 1.507-1(c)(3).
 - d. A failure to correct an act or acts (or failure or failures to act) which gave rise to Chapter 42 tax liability by the close of the correction period may be a willful and flagrant act (or failure to act). See Treas. Reg. 1.507-1(c)(4).
 - e. For an act (or failure to act) to be willful, a motive to avoid the restrictions of the law or the incurrence of any tax is not necessary. However, there must be knowledge on behalf of the foundation or a manager that an act (or failure to act) is one of self-dealing, a taxable expenditure, or other act (or failure to act) to which Chapter 42 applies. See Treas. Reg. 1.507-1(c)(5) and 53.4945-1(a)(2)(iii).

C. Section 507(b)(1) Termination

- (1) There are two kinds of termination of private foundation status described in Section 507(b):
 - a. Distribution of net assets to certain public charities. See Treas. Reg. 1.507-2(a).
 - b. Operation as a public charity. See Treas. Reg. 1.507-2(b).
- (2) Private foundations terminating private foundation status under Section 507(b) are not subject to Section 507(c) tax. See Treas. Reg. 1.507-2(a)(1) and 1.507-2(b)(2).

C.1. Section 507(b)(1)(A) Terminations – Distributions of Net Assets to Public Charities

- (1) A foundation may terminate its private foundation status if it distributes its net assets to one or more public charities. To accomplish the termination in this manner:
 - a. There must not have been either willful, repeated acts (or failures to act) or a willful and flagrant act (or failure to act) giving rise to liability for tax under Chapter 42.
 - b. It must distribute all its right, title, and interest in and to all its net assets.
 - c. The organization(s) to which it distributes must be public charities as described in Section 170(b)(1)(A)(i) - (vi) and (ix).
 - d. The public charities must have been in existence and so described for a continuous period of at least 60 months. See Treas. Reg. 1.507-2(a).

Note: Section 170(b)(1)(A)(ix) was added by Consolidated Appropriations Act 2016, Public Law 114-113, 129 Stat. 2241 (2015) and Treas. Reg 1.507-2(a) was not amended to reflect this new Section.
- (2) The Section 507(c) termination tax is not imposed on organizations terminating under Section 507(b)(1)(A); therefore, no abatement of such tax under Section 507(g) is required. See Treas. Reg. 1.507-2(a)(1).
- (3) To terminate its private foundation status by distributing all its net assets in compliance with the requirements of Section 507(b)(1)(A), the organization is not required to file the notification described under Section 507(a)(1). The private foundation may, therefore, carry out the distributions without giving advance notice to the IRS of its intent to terminate. See Treas. Reg. 1.507-2(a)(1).
- (4) To effectuate a transfer of "all of its rights, title, and interest in and to all of its net assets" within the meaning of Section 507(b)(1)(A), a transferor private foundation may not impose any material restriction or condition that prevents the transferee organization (the public charity) from freely and effectively employing the transferred assets, or derived income, in furtherance of its exempt purposes. Whether a condition or restriction imposed upon a transfer is "material " must be determined from all the facts and circumstances of the transfer. See Treas. Reg. 1.507-2(a)(7).
- (5) If a private foundation transfers all its assets to one or more persons, but less than all its net assets to one or more 60-month Section 509(a)(1) organizations, the foundation will not have terminated its private foundation status. If such a foundation subsequently receives a grant, the grant will be considered to have been made to a private foundation. See Treas. Reg. 1.507-1(b)(7).
- (6) Neither Section 507(b)(1)(A) nor the regulations establish a fixed time period within which the distribution of all the organization's net assets must be

completed. Nevertheless, the distributing organization will be treated as a private foundation for all purposes until the distribution is completed. See Treas. Reg. 1.507-2(a)(4).

- (7) An organization that remains in existence after terminating its private foundation status under Section 507(b)(1)(A) must, unless specifically excepted by Section 508(c), file Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, to be treated as an organization described in Section 501(c)(3). See Rev. Rul. 74-490, 1974-2 C.B. 171.

C.2. Transfers Made During Section 507(b)(1)(B) Terminations

- (1) A transfer from a private foundation to one or more other private foundations, during a Section 507(b)(1)(B) termination, will constitute a transfer described in Section 507(b)(2) and Treas. Reg. 1.507-3. Even though the transferor satisfies the requirements of Section 507(b)(1)(B) thereafter, thereby successfully terminating its private foundation status, Treas. Reg. 1.507-2(e) will not apply, and such transfer will still be treated as a Section 507(b)(2) and Treas. Reg. 1.507-3 transfer, rather than as a transfer from an organization described in Sections 509(a)(1), (2), or (3).

C.3. Section 507(b)(1)(B) Terminations – Operation as a Public Charity

- (1) The basic requirements for terminating private foundation status under Section 507(b)(1)(B) are:
 - a. The organization has not been involved in willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) giving rise to liability for tax under Chapter 42.
 - b. The organization meets the requirements of Section 509(a)(1), (a)(2), or (a)(3) for a continuous period of 60 calendar months (the 12-month transition period referred to in the IRC has ended).
 - c. The organization notifies the IRS, before the start of the 60-month period, that it's terminating its private foundation status.
 - d. The organization, within 90 days after the end of the 60-month period, furnishes the IRS sufficient information to allow a determination that the organization met the requirements of Section 509(a)(1), (a)(2), or (a)(3). See Treas. Reg. 1.507-2(b)(4).
- (2) Generally, a private foundation is required to notify the IRS of its intention to terminate before the beginning of the 60-month period that it is terminating its private foundation status. See Treas. Reg. 1.507-2(b)(1)(ii).
- (3) To request an advance ruling that an organization can be expected to meet the requirements of Section 507(b)(1)(B)(i), the organization would submit Form 8940, Request for Miscellaneous Determination, along with the required information and user fee to the address indicated in the Form 8940 instructions. See Rev. Proc. 2021-5, 2021-1 I.R.B. 250, (updated annually).

- (4) Such notification should contain the following information:
- a. Name and address of the private foundation;
 - b. Its intention to terminate its private foundation status;
 - c. Whether the 60-month period applies;
 - d. IRC Section under which it seeks classification (Section 509(a)(1), (a)(2), or (a)(3));
 - e. If Section 509(a)(1) is applicable, the clause of Section 170(b)(1)(A) involved;
 - f. Date its regular taxable year begins; and
 - g. Date of commencement of the 60-month period.
- (5) If not requesting an advance ruling, the organization would send the required information to Internal Revenue Service, Exempt Organizations Determinations, P.O. Box 2508, Cincinnati, OH 45201.
- (6) In order to accomplish a Section 507(b)(1)(B) termination of its private foundation status, an organization must change its organizational structure, its operations, the sources of its support, or any combination of the foregoing, to the extent necessary to meet the requirements of Section 509(a)(1), (a)(2), or (a)(3) for a continuous period of 60 calendar months beginning with the first day of any taxable year which begins after December 31, 1969.
- (7) To establish a successful termination an organization must, within 90 days after the expiration of the 60-month period, file such information with the IRS as is necessary to make a determination as to the organization's status as an organization described under Section 509(a)(1), (a)(2), or (a)(3).

Note: The regulations do not address what happens if an organization doesn't provide the information within the 90 days.

- a. Failure to supply all the information required to make such a determination, within the time required, will not alone constitute a failure to satisfy the requirements of Section 507(b)(1)(B).
 - b. When timely filed information is incomplete, and additional information as requested by the IRS is filed within the allowed time period, the original submission will be considered timely. See Treas. Reg. 1.507-2(b)(5).
- (8) If a private foundation successfully accomplishes a valid Section 507(b)(1)(B) termination of its private foundation status, the termination is retroactive to the beginning of the 60-month period. Thus, the terminating organization will be treated for the entire 60-month period in the same manner as an organization described in Sections 509(a)(1), (a)(2), or (a)(3). See Treas. Reg. 1.507-2(e)(1).
- (9) If a private foundation fails to accomplish a Section 507(b)(1)(B) termination during the 60-month period, it will be subject to Sections 507, 508, 509, and

Chapter 42 for the 60-month period during which it does not satisfy the requirements of Sections 509(a)(1), (a)(2), or (a)(3). However, it will be treated as an organization described in Sections 509(a)(1), (a)(2), or (a)(3) for any taxable year or years in which it does satisfy those requirements; in such year(s), Sections 507, 508, 509, and Chapter 42 will not apply. Grants and contributions made for any particular year will be treated according to its foundation status during that year. In determining whether an organization satisfies the requirements of Sections 509(a)(1), (a)(2) or (a)(3) for any taxable year in the 60-month period, the organization will be treated as if it were a new organization with its first taxable year beginning on the date of the commencement of the 60-month period. See Treas. Reg. 1.507-2(e)(2)(i) and (ii).

- (10) The organization's aggregate tax benefit will continue to be computed from the date from which such computation would have been made, but for the notice filed under Section 507(b)(1)(B)(ii), except that any taxable year within such 60-month period for which such organization meets the requirements of Sections 509(a)(1), (a)(2), or (a)(3) will be excluded from such computations. See Treas. Reg. 1.507-2(e)(2)(iii).

D. Section 507(b)(2) Transfers

- (1) A transferor private foundation may transfer all its assets to one or more private foundations who will, subject to the appropriate requirements in the regulations, inherit the attributes and characteristics of the transferor private foundation. The transferee foundation shall not be treated as a newly created organization. See Treas. Reg. 1.507-3(a).
- (2) A transfer of assets is described in Section 507(b)(2) if it is made by a private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. A transfer of assets shall also include any organization or reorganization described in subchapter C of Chapter 1 of the IRC. See Treas. Reg. 1.507-3(c)(1).
- (3) The meaning of the terms liquidation, merger, reorganization, redemption, and recapitalization is determined by the law of the state in which the private foundation was incorporated or otherwise created. Most states have nonprofit or not-for-profit corporation statutes that are expressly applicable to charitable corporations. Among other things, the statutes usually deal with mergers or consolidations, dissolutions, and sales or other dispositions of assets of charitable corporations. If the private foundation is a trust, the charitable trust law of the state applies in determining the meaning of the terms.
- (4) The terms other adjustment, organization, or reorganization shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

- (5) The term "significant disposition of assets to one or more private foundations" includes:
 - a. The dispositions to one or more private foundations for the taxable year, and
 - b. Where any disposition to one or more private foundations for the taxable year is part of a series of related dispositions made during prior taxable years, the total of the related dispositions made during such prior taxable years, is 25% or more of the fair market value of the net assets of the foundation at the beginning of the taxable year or at the beginning of the first taxable year in which any of the series of related dispositions was made. See Treas. Reg. 1.507-3(c)(2).
- (6) A significant disposition of assets may occur in a single taxable year or over the course of two or more taxable years. A disposition not otherwise significant in relation to the fair market value of the foundation's net assets may be a "significant disposition" when aggregated with other dispositions to private foundations in the same year and with "related" distributions in prior taxable years. The determination whether a "significant disposition" has occurred through a series of "related distributions" will be made based on "all the facts and circumstances of the particular case." See Treas. Reg. 1.507-3(c)(2).
- (7) A transfer of assets described in Section 507(b)(2) does not constitute a termination of the transferor's private foundation status under Section 507(a)(1) unless the transferor voluntarily gives notice pursuant to Section 507(a)(1). See Rev. Rul. 2002-28, 2002-1 C.B. 941.

D.1. Transferor and Transferee Treatment Following a Transfer to Another Private Foundation

- (1) The broad purpose of the rules contained in the regulations is to preserve the applicable restrictions contained in Chapter 42 in the case of assets that are transferred from one private foundation to another. The regulations thus provide that such transfers result in a carryover of certain tax attributes and characteristics of the transferor organization to the transferee foundation. See Treas. Reg. 1.507-3(a)(1).
- (2) A transferee private foundation succeeds to that part of the transferor's "aggregate tax benefit" (defined in Treas. Reg. 1.507-5) that is attributable to the assets transferred, based on the transferor's assets held just before the transfer. However, fair market value of assets held and transferred is determined at the time of the transfer. Furthermore, a transferee foundation not effectively controlled, directly or indirectly, by the same person or persons who effectively control the transferor organization cannot succeed to an aggregate tax benefit greater than the fair market value of the assets transferred, as determined at the time of the transfer. See Treas. Reg. 1.507-3(a)(2).

- (3) In the event of a transfer of assets described in Section 507(b)(2), any person who is a substantial contributor (within the meaning of Section 507(d)(2)) with respect to the transferor foundation shall be treated as a substantial contributor with respect to the transferee foundation, regardless of whether such person meets the \$5,000-2% test with respect to the transferee organization at any time. If a private foundation makes a Section 507(b)(2) transfer to two or more transferee private foundations, any person who is a substantial contributor with respect to the transferor foundation prior to such transfer shall be considered a substantial contributor with respect to each transferee private foundation. This prevents a transferor foundation from avoiding the prohibitions of Chapter 42 relating to substantial contributors by transferring its assets to another private foundation having different substantial contributors. Thus, a transferee foundation that has acquired "substantial contributors" by reason of an Section 507(b)(2) transfer will be affected by the rules under Section 4941 (self-dealing), Section 4942 (income distributions), and Section 4963 (excess business holdings) that relate to a private foundation and its "disqualified persons." See Treas. Reg. 1.507-3(a)(3).
- (4) A transferor foundation cannot prevent the use of its assets for the payment of Chapter 42 tax liabilities by transferring such assets to another private foundation. In such a case the assets are subject to, in the hands of the transferee, any liability incurred by the transferor either prior to or as a result of the transfer, to the extent that the transferor foundation does not satisfy the liability. See Treas. Reg. 1.507-3(a)(4).
- (5) A Section 507(b)(2) transfer will be counted toward the satisfaction of the transferor's Section 4942 distribution requirements to the extent the assets transferred meet the requirements of Section 4942(g). However, the recordkeeping requirements of Section 4942(g)(3)(B) are inapplicable during any period in which the transferor has no assets. See Treas. Reg. 1.507-3(a)(5).
- (6) After a Section 507(b)(2) transfer, the applicable time period described in Sections 4943(c)(4), (c)(5), or (c)(6) shall include the period during which the transferor foundation held the assets transferred, and the period during which the transferee foundation holds such assets. See Treas. Reg. 1.507-3(a)(6).
- (7) When the transferor foundation disposes of all of its assets, during any period in which it has no assets, Sections 4945(d)(4) and (h) shall not apply to the transferee or the transferor with respect to any "expenditure responsibility" grants made by the transferor. However, any information reporting requirements imposed by Section 4945 would still apply for any year in which any such transfer is made. See Treas. Reg. 1.507-3(a)(7).
- (8) In a Section 507(b)(2) transfer, the following provisions shall apply to the transferee foundation with respect to the assets transferred to the same extent they would apply to the transferor foundation had the transfer not been affected:
 - a. Section 4940(c)(4)(B) as to basis of property,

- b. Section 4942(f)(4) as to distributions of income,
 - c. Section 101(l)(2) of the Tax Reform Act of 1969 (TRA '69) with respect to the provisions of Section 4941,
 - d. Section 101(l)(3)(A) of TRA '69 as to Section 4942, if the transferor qualified for the application of such section just before the transfer, and at least 85% of the fair market value of the net assets of the transferee immediately after the transfer were received pursuant to the transfer,
 - e. Section 101(l)(3)(B) through (E) of TRA '69 as to Section 4942,
 - f. Section 101(l)(5) of TRA '69 as to Section 4945, and
 - g. Section 101(l)(6) of TRA '69 as to Section 508(e). See Treas. Reg. 1.507-3(a)(8)(ii).
- (9) In a Section 507(b)(2) transfer, if the transferee foundation(s) is effectively controlled (as stated in Treas. Reg. 1.482-1(a)(3)), directly or indirectly, by the same person or persons which effectively controlled the transferor foundation, for purposes of Chapter 42 and Sections 507 through 509 such a transferee shall be treated as if it were the transferor. When the net assets are transferred to two or more foundations, then, when appropriate, each transferee shall be treated as if it were the transferor on a proportional basis, according to the fair market value of assets received and the fair market value of the net assets held by the transferor just before the transfer. See Treas. Reg. 1.507-3(a)(9).

D.2. Transfers to Sections 509(a)(1), (a)(2), or (a)(3) Organizations

- (1) The assets transferred by a private foundation to a Section 509(a)(1), (a)(2), or (a)(3) organization are no longer subject to Chapter 42, unless the transferee subsequently becomes a private foundation within three years of the transfer, in which case the transfer will be treated as if it were an Section 507(b)(2) transfer at the time it was made. See Treas. Reg. 1.507-3(e).
- (2) Rev. Rul. 2003-13, 2003-1 C.B. 305, discusses the responsibilities of private foundations that distribute all their net assets to one or more public charities described in Section 509(a)(1), (a)(2), or (a)(3). If the private foundation does not provide notice and does not terminate, the private foundation is not subject to tax under Section 507(c). If the private foundation chooses to provide notice, and therefore terminates, it is subject to the tax under Section 507(c) on the date notice is given; however, if the private foundation has no net assets on the day it provides notice (for example, it provides notice at least one day after it distributes all its net assets), the tax imposed by Section 507(c) will be zero.

III. Other Considerations

- (1) There are other considerations that should be analyzed when examining an organization that terminates its private foundation status.

A. Organizations Qualifying as Distributees

- (1) A foundation may terminate its private foundation status if it distributes its net assets to one or more public charities. The distribution of net assets must be to one or more organizations described in Section 170(b)(1)(A)(i) - (vi) and (ix), in effect Section 509(a)(1) organizations. Section 509(a)(1) excludes these organizations from the definition of private foundations. Briefly, the types of organizations that generally qualify as distributees are:
 - a. Churches or conventions or associations of churches (Section 170(b)(1)(A)(i)).
 - b. Schools (Section 170(b)(1)(A)(ii)).
 - c. Hospitals (Section 170(b)(1)(A)(iii)).
 - d. Medical research organizations operated in conjunction with a hospital (Section 170(b)(1)(A)(iii)).
 - e. Organizations receiving substantial public support or governmental support (exclusive of income received from the exercise or performance of their exempt function) and operated for the benefit of a college or university owned or operated by a governmental unit (Section 170(b)(1)(A)(iv)).
 - f. Governmental units described in Section 170(c)(1) (Section 170(b)(1)(A)(v)).
 - g. Organizations that normally receive a substantial part of their support (exclusive of income received from the exercise or performance of their exempt function) from the public or the government (Section 170(b)(1)(A)(vi)).
 - h. An agricultural research organization directly engaged in the continuous active conduct of agricultural research (as defined in Section 1404 of the National Agricultural Research, Extension, and Teaching Policy Act of 1977) in conjunction with a land-grant college or university or a non-land grant college of agriculture, and during the calendar year in which the contribution is made such organization is committed to spend such contribution for such research before January 1 of the fifth calendar year which begins after the date such contribution is made (Section 170(b)(1)(A)(ix)).

Note: Section 170(b)(1)(A)(ix) was added by Consolidated Appropriations Act 2016, Public Law 114-113, 129 Stat. 2241 (2015).

- (2) In addition, a distributee organization must have been in existence and must have been so described for a continuous period of at least 60 calendar months immediately preceding the distribution. See Treas. Reg. 1.507-2(a)(1).
- (3) A distributee organization in existence less than 60 months prior to receiving distribution will qualify as a proper distributee where it was formed from the consolidation of two public charities each of which would have been in existence for 60 months at the time of distribution had they not been consolidated. See Rev. Rul. 75-289, 1975-2 C.B. 215.
- (4) An organization that qualifies under Section 170(b)(1)(A)(i) - (vi) is not precluded from being a qualified distributee merely because it also appears to meet the description of a Section 170(b)(1)(A)(vii), or (viii) organization. See Treas. Reg. 1.507-2(a)(3).
- (5) If within a period of three years from the date of transfer, the transferee organization becomes a private foundation, the transfer may be considered a transfer under Section 507(b)(2). See Treas. Reg. 1.507-3(e).

B. Reliance on Distributee's Ruling Letter

- (1) Under Treas. Reg. 1.507-2(a)(2), an organization seeking to terminate its private foundation status under Section 507(b)(1)(A) may rely on a final ruling or determination letter issued to a potential distributee organization that such distributee is described in Section 170(b)(1)(A)(i) - (vi) and (ix) until public notice is given of revocation of the distributee's classification or public notice is given that grantors may be affected pending verification of the continued foundation status classification of the distributee except where the distributor or grantor:
 - a. Had knowledge that the distributee's foundation classification letter was revoked, or
 - b. Was in part responsible for, or was aware of, the act, the failure to act, or the substantial and material change on the part of the organization which gave rise to the revocation of the distributee's determination letter. See Rev. Proc. 2021-5 (updated annually).

C. Trusts Treated as Private Foundations

- (1) A charitable trust described in Section 4947(a)(1) is a trust that is not tax exempt, all of the unexpired interests of which are devoted to one or more charitable purposes, and for which a charitable contribution deduction was allowed under a specific section of the IRC. A charitable trust is treated as a private foundation unless it meets the requirements for one of the exclusions that classifies it as a public charity. Therefore, it will be subject to the private foundation excise tax provisions including Chapter 42 and Section 507.
- (2) Section 4947(a)(2) split interest trusts are not subject to all the Chapter 42 restrictions on private foundations. Sections 4941 and 4945, self-dealing and taxable expenditures, apply in all cases, as do Sections 507 and 508(e). Sections 4943 and 4944 apply except in two situations:

- (a) If the remainder interests are entirely charitable, and the income interests entirely non-charitable; and
- (b) If all the income interests are entirely charitable, the charitable interests comprise less than 60% of the value of all the assets of the trust, and there are no charitable remainder interests.

Congress determined that, in these situations, since the charitable interests were comparatively small or remote in time, the restrictions of the annuity or unitrust form offer enough protection under the circumstances.

D. Filing Requirements During Termination Period

- (1) The terminating private foundation must continue to file Form 990-PF either in the year it distributes its assets and dissolves, or during the 60-month termination period. The applicable box for the particular type of terminating private foundation on the top of Form 990-PF should be checked. See Section 6043(b), Treas. Regs. 1.6043-3, and 1.507-2(b)(6).
- (2) If a terminating private foundation submits the required information within 90 days from the end of its termination period which shows the termination was effective, then in the last year of a 60-month termination period, an organization files Form 990.
- (3) An organization which makes a Section 507(b)(1)(A) termination is not required to comply with the public inspection of private foundation annual reports requirements of Section 6104(d). See Treas. Reg. 1.507-2(a)(5)(ii).

E. Transfers to Organizations not Described in Sections 501(c)(3) or 4947(a)(1)

- (1) In general, a transfer of assets by a private foundation to an organization not described in Section 501(c)(3) or treated as described in Section 501(c)(3) under Section 4947(a)(1) constitutes a taxable expenditure under Section 4945(d)(5). If such a transfer is made and, in order to correct the taxable expenditure, later is transferred to a private foundation, Section 507(b)(2) and Treas. Reg. 1.507-3(a) would be applicable as though the transfer had been made directly to the private foundation.

F. Taxable Transfers

- (1) Unless a private foundation gives notice under Section 507(a)(1) to terminate its status, a transfer of assets described in Section 507(b)(2) will not constitute a termination of the transferor's private foundation status. However, such transfer must satisfy the requirements of all pertinent provisions of Chapter 42 of the IRC. See Treas. Reg. 1.507-3(d).

Note: For example, if the transfer constitutes a taxable expenditure as defined in Section 4945, the transferor is liable for the Chapter 42 tax that is incurred.

- (2) If a transfer described in Section 507(b)(2) constitutes a willful and flagrant violation of Chapter 42, as described in Section 507(a)(2)(A), then the provisions of Section 507(a)(2) dealing with involuntary terminations are applicable, rather than the provisions of Section 507(b)(2). In that event, the transferor foundation would be subject to Section 507(c) tax. See Treas. Regs. 1.507-3(d) and 1.507-4(b).

G. Extension of Time to Assess Deficiencies for Section 507(b)(1)(B) Terminations

- (1) When a private foundation files a notification of its intent to begin a 60-month termination pursuant to Section 507(b)(1)(B) and does not request an advance ruling, it may also elect to extend the period of limitation within which it may be assessed Section 4940 tax for any taxable year within the 60-month termination period by filing Form 872-B, Consent to Extend the Time to Assess Miscellaneous Excise Taxes. See Treas. Reg. 1.507-2(b)(7).
- (2) The filing of the Form 872-B is optional for an organization not requesting an advance ruling. If an organization chooses not to submit the form it must pay taxes on its Section 4940 taxable income during the period. When the organization successfully accomplishes a 60-month Section 507(b)(1)(B) termination then it can file a claim for refund of the tax paid during the 60-month period. However, if a consent which would prevent the period of limitations for all years in the 60-month period from expiring is not in effect, in order to be able to file a claim for refund for a specific year in which the period of limitation would have expired, the foundation must agree to extend the period of limitation for all taxes imposed under Chapter 42. See Treas. Reg. 1.507-2(b)(7) and Treas. Reg. 1.507-2(e)(3).

H. Certain Transfer of Assets

- (1) Private foundations attempting to accomplish a Section 507(b)(1) and (2) termination might dispose of certain assets by making transfers to one or more private foundations or to other types of organizations.
- (2) A transfer to a private foundation during the termination period is a transfer described in Section 507(b)(2), even though the transferor foundation thereafter successfully terminates under Section 507(b)(1)(B).

IV. Examination Techniques

- (1) This section focuses on how to assert the Section 507(c) termination tax once you have determined that taxes are applicable.

A. Imposition of Section 507(c) Tax

- (1) Section 507(c) imposes on a private foundation whose status as such has been terminated either voluntarily or involuntarily under Section 507(a) a tax equal to the lower of the:
- Aggregate tax benefit defined in Section 507(d) resulting from the Section 501(c)(3) status of the organization, or
 - Value of its net assets. See Treas. Reg. 1.507-4(a).
- (2) Section 507(c) tax does not apply to Sections 507(b)(1)(A) or 507(b)(2) transfers unless Section 507(a) becomes applicable. See Treas. Reg. 1.507-4(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.

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

The Termination Tax is the Smaller of:	
A) The aggregate tax benefit - the sum of:	
1.	The increase in income, estate, and gift taxes** on substantial contributors that would result from the disallowance of their contributions. The taxes are computed from the later of the foundation inception date or March 1, 1913. See Section 507(d)(1)(A)
2.	The income taxes of the foundation, had the foundation filed Forms 1120, U.S. Corporation Income Tax Return, or Forms 1041, U.S. Income Tax Return for Estates and Trusts, in lieu of Forms 990-PF. The taxes are computed from the later of the foundation inception date or January 1, 1913.* See Section 507(d)(1)(B)
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.	

3.	The aggregate tax benefit received from other private foundations in Section 507(b)(2) transfers. See Treas. Regs. 1.507-5(a)(3) and 1.507-3(a)(2)	
4.	The accumulated interest on the above amounts as computed via Report Generation System NT (RGS NT) or Integrated Data Retrieval System (IDRS) command code INTST. See 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>		

- (4) 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 any available information via IDRS, return requests, and Online Statistics of Income EO Image Net (SEIN). Establish Audit Information Management System (AIMS) controls via the Reporting Compliance and Case Management System (RCCMS) using source code 45 to retrieve the returns of the substantial contributors.
- (5) See IRM 4.75.31 for guidance on converting the Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation, to Forms 1120, U.S. Corporation Income Tax Return, or 1041, U.S. Income Tax Return for Estates and Trusts. Use RGS NT to determine the increase in income tax from the disallowance of charitable contributions deductions.
- (6) Propose the tax using Forms 4883, Exempt Organizations Excise Tax Audit Change, and 4621, Report of Examination – Exempt Organizations. Use Form 990-PF to assess the tax in lieu of Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the IRC.
- (7) 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).
- (8) 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)
- (9) 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).

B. Aggregate Tax Benefit Defined

- (1) For purposes of Section 507(c)(1), the aggregate tax benefit resulting from the Section 501(c)(3) status of a private foundation is the sum of:
- a. The aggregate increases in tax under Chapters 1, 11, and 12 (or the corresponding provisions of prior law) that all substantial contributors to the foundation would have incurred if their contributions had not been deductible after February 28, 1913.
 - b. The aggregate increases in tax under Chapter 1 (or the corresponding provisions of prior law) that the private foundation would have incurred for taxable years beginning after December 31, 1912, had it not been exempt from tax under Section 501(a) (or the corresponding provisions of prior law); and, in the case of a trust, if deductions under Section 642(c) (or the corresponding provision of prior law) had been limited to 20% of the taxable income of the trust (computed without benefit of Section 642(c) but with the benefit of Section 170(b)(1)(A)).
 - c. The amount succeeded to from transferors under Treas. Reg. 1.507-3(a) and Section 507(b)(2).
 - d. Interest on the increases in tax determined in (a), (b), and (c) above from the first day on which each such increase would have been due and payable to the date on which the organization ceases to be a private foundation. See Treas. Reg. 1.507-5(a).
- (2) In computing the amount of the aggregate increases in tax, all deduction benefits attributable to a particular contribution shall be included. See Treas. Reg. 1.507-5(b).

C. Valuation of Assets

- (1) For purposes of Section 507(c), the value of the net assets of a private foundation shall be determined at whichever time such value is higher:
- a. The first day on which action is taken by the organization which culminates in its ceasing to be a private foundation.
 - b. The date on which it ceases to be a private foundation. See Treas. Reg. 1.507-7(a).

- (2) For terminations under Section 507(a)(1), the date on which the private foundation gives notification of a voluntary termination is the day referred to in Treas. Reg. 1.507-7(a)(1). See Treas. Reg. 1.507-7(b)(1).
- (3) For terminations under Section 507(a)(2), the date referred to in Treas. Reg. 1.507-7(a)(1) is the date of occurrence of the willful and flagrant act (or failure to act) or the first of the series of willful repeated acts (or failures to act) giving rise to liability for tax under Chapter 42 and the imposition of tax under Section 507(a)(2). See Treas. Reg. 1.507-7(b)(2).
- (4) Fair market value of the net assets shall be determined pursuant to the provisions of Treas. Reg. 53.4942(a)-2(c)(4). See Treas. Reg. 1.507-7(c).
- (5) The term "net assets" means the gross assets of a private foundation reduced by all liabilities of the foundation, including appropriate estimated and contingent liabilities (such as liability for tax imposed under Chapter 42). See Treas. Reg. 1.507-7(d).

D. Tax Liability on Transferred Assets

- (1) In determining Section 507(c) tax liability in the case of assets transferred by a private foundation, the tax will be deemed to have been imposed on the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation. See Treas. Reg. 1.507-8.
- (2) If private foundation status is terminated under Section 507(a)(2), the first day on which action is taken which culminates in its ceasing to be a private foundation shall be the date of occurrence of the willful and flagrant act (or failure to act) or the first of the series of willful repeated acts (or failures to act) giving rise to liability for Chapter 42 tax and Section 507(a)(2) tax. See Treas. Reg. 1.507-8.
- (3) If private foundation status is terminated under Section 507(a)(1), the first day on which action is taken which culminates in its ceasing to be a private foundation shall be the date on which the terminating foundation gives the notification described in Section 507(a)(1). See Treas. Reg. 1.507-8.

E. Transfer of All Rights Title and Interest

- (1) To effectuate a transfer of "all of its rights, title, and interest in and to all of its net assets" within the meaning of Treas. Reg. 1.507-2(a)(6), a transferor private foundation may not impose any material restriction or condition that prevents the transferee organization (the public charity) from freely and effectively employing the transferred assets for its exempt purposes. Whether a condition or restriction imposed upon a transfer is "material " must be determined from all the facts and circumstances of the transfer.
- (2) Treas. Reg. 1.507-2(a)(7)(i) provides significant facts and circumstances to consider regarding the transfer of rights, title, and interest of assets include whether the:
 - a. Transferee is the owner in fee of the transferred assets.

- b. Transferred assets will be held and administered in a manner consistent with its exempt purposes.
 - c. Governing body of the transferee has ultimate authority and control over the transferred assets and income derived from them.
 - d. Governing body of the public charity is organized and operated independently from the transferor. Relevant considerations in determining the independence of the transferee's governing body include: whether the transferor or disqualified persons select members of the governing body of the transferee; whether the members of the governing body of the transferee are disqualified persons with respect to the transferor; whether the members of the governing body of the transferee are selected by public officials acting in their capacities as such; and, the length of time each member of the governing body may serve as such.
- (3) Treas. Reg. 1.507-2(a)(7)(iii) provides that the following factors will not be considered "material" restrictions or conditions:
- a. The fund is given the transferor's name or similar designation or a name that memorializes the creator of the foundation or his family.
 - b. The income or assets of the fund are to be used for a designated purpose or a particular Section 509(a)(1), (2), or (3) organization and the use is consistent with the transferee's exempt purpose.
 - c. The transferred assets are administered in a separate or identifiable fund, some or all of the principal of which is not to be distributed for a specified period as, for example, a fund to endow a chair at a university. The transferee must be the legal and equitable owner of the fund and the governing body must exercise ultimate and direct authority and control over the fund.
 - d. The transferor requires that the transferred property be retained by the transferee if the retention is important to the achievement of exempt purposes because of peculiar features of the property, as, for example, the transfer of a woodland preserve to be maintained as an arboretum for the benefit of the community.
- (4) Treas. Reg. 1.507-2(a)(7)(iv) sets out certain factors that will be considered "material" restrictions or conditions.
- a. The transferor, a disqualified person with respect to it or a person or committee designated by such a person, reserves the right to name the persons to which the transferee must distribute or to direct the timing of such distributions (unless the transferred assets will be held and administered in a manner consistent with its exempt purposes), as, for example, by power of appointment. See Treas. Reg. 1.507-2(a)(7)(iv)(A)(2) - (3) for a listing of some specific factors that indicate whether the reservation of such a right exists.

- b. The terms of the transfer agreement require the public charity to take or withhold action with respect to the transferred assets which furthers none of the transferee's exempt purposes and would, if performed by the transferor, subject it to tax under Chapter 42 of the Code.
- c. The transferee assumes or takes assets subject to leases, contractual agreements or other liabilities of the transferor for purposes inconsistent with the purposes or best interests of the transferee, other than the payment of the transferor's Chapter 42 taxes incurred prior to the transfer to the extent of the value of the assets transferred.
- d. The transferee is required by any express or implied agreement or restriction to retain investment assets transferred to it by the transferor.
- e. An agreement is entered into giving the transferor or a disqualified person with respect to it the right of first refusal with respect to transferred property unless acquired by the transferor subject to a right of first refusal prior to October 9, 1969.
- f. An agreement is entered into between the transferee and the transferor establishing an irrevocable relationship with respect to maintenance or management of the assets transferred such as with banks or brokerage firms.

F. Abatement of Taxes

- (1) The IRS may at its discretion abate the unpaid portion of Section 507(c) tax imposed, if:
 - a. The private foundation distributes its net assets to one or more organizations described in Section 170(b)(1)(A) (other than in clauses (vii) or (viii)), each of which has been in existence and so described for a continuous period of at least 60 calendar months, or
 - b. Effective assurance is given to the IRS that the assets of the organization which are dedicated to charitable purposes will, in fact, be used for charitable purposes. See Treas. Reg. 1.507-9.

G. Filing Requirements

- (1) A private foundation is required to file an information return on Form 990-PF regarding any liquidation, dissolution, Section 507(b)(1)(A) termination, partial liquidation, or "substantial contraction." This requirement applies whether the private foundation is a corporation, association, or trust. See Section 6043(b) and Treas. Reg. 1.6043-3.
- (2) A private foundation which fails to meet the requirements of Section 507(b)(1)(A) may be required to file a return under Section 6043(b) because of a transfer of assets to one or more sections 509(a) (1), (2), or (3) organizations. However, such filing does not necessarily mean that a Section 507(b)(2) transfer has occurred. See Treas. Reg. 1.507-3(c)(3).

- (3) A private foundation which has terminated its private foundation status under Section 507(b)(1)(B) (regarding operating as a public charity) is not required to file Form 990-PF with respect to a liquidation, dissolution, termination, or substantial contraction which is in connection with the termination under Section 507(b)(1)(B). See Treas. Reg. 1.507-2(b)(6).

V. Issue Indicators and Examination Tips

- (1) This section provides for possible issue indicators and tips when examining a private foundation, particularly when the Section 507(c) tax may be at issue.

A. Issue Indicators

- (1) A foundation status discrepancy exists based on internal records and filed Form 990-PF.
- (2) A foundation has indicated to the IRS its intent to terminate but has not completed the termination timely or as indicated.
- (3) A foundation has been assessed multiple Chapter 42 excise taxes (other than Section 4940). Further review may be necessary to determine whether the taxes resulted from willful acts or failures to act.

B. Examination Tips

- (1) Review IDRS prints INOLES and BMFOLO to verify the organization's information. The prints include, among other things, the organization's filing requirements, fiscal year end, exemption subsection, foundation status code, determination ruling date, status code, prior status code, and status code date. Review the information to determine whether the organization foundation status (from private foundation to a non-private foundation), tax-exempt status (terminated its tax-exempt status to operate as a taxable organization) or operating status has changed (has terminated or ceased operating).
- (2) Determine whether the organization's termination was voluntary or involuntary.
- (3) Tour the organization's facility, if applicable. Perform initial interview with someone that is knowledgeable of the organization's exempt activity.
- (4) Review the organization's intent to terminate submitted to the IRS to determine how the foundation proposed to terminate.
- (5) Verify the organization followed the submitted termination plan.
- (6) If the organization terminates by distributing its assets to a public charity, substantiate that the recipient is a qualified public charity and in existence and so described for a continuous period of at least 60 months. Review the recipient's determination letter and internal tax-exempt status information via IDRS.
- (7) If the organization terminates by distributing its assets to another private foundation:
 - a. Substantiate that transferring foundation voluntarily gave notice of its intent to terminate pursuant to Section 507(a)(1).
 - b. If the terminating foundation's transfer will be counted toward the satisfaction of its Section 4942 distribution requirements, verify adequate records are

maintained to substantiate the assets transferred meet the requirements of Section 4942(g)(3).

- c. Inspect the receiving foundation's Form 990-PF for any Chapter 42 violations involving any substantial contributor from the transferring foundation (any person who is a substantial contributor regarding the transferor foundation shall be treated as a substantial contributor regarding the transferee foundation, regardless of whether such person meets the \$5,000-2% test with respect to the transferee organization at any time).
- (8) If the organization terminates by operating as a public charity, perform typical examination techniques to substantiate that the organizational and operational requirements are met.

VI. Example Worksheets / Exhibits

- (1) This section provides worksheets as well as exhibits focusing on practical applications when asserting tax under Section 507(c).

A. Section 507 Termination Tax Example

- (1) Because of a Form 5666 filed during a previous examination, Agent Smith is inspecting the records of Private Foundation Echo. The trustees, Sierra, Tango, and Uniform were previously assessed Section 4941 taxes for transactions in 200512, 200612, and 200712.
- (2) According to the Form 5666, on the day after inception in 2005, PF Echo loaned 75% of its cash to Victor, a corporation wholly owned by Sierra, Tango, and Uniform. There was no loan instrument on file. The corporation later corrected the transaction, paying the money back on December 1, 2008, with additional interest computed at prime rate. The previous agent pro-rated the tax assessments on the trustees based on their shares of ownership. The agent also assessed Section 4945 taxes on the foundation for taxable expenditures not serving a Section 170(c)(2)(B) purpose.
- (3) During the examination of 201012 through 201112, Agent Smith finds that PF Echo has since paid 80% of its cash to the trustees reported as notes receivable on Forms 990-PF. Each trustee took turns signing the notes receivable, as shown below:

Date	Amount	Signed for PF Echo	Signed as Recipient
12/2/2008	\$575,000	DP Tango	DP Sierra
12/2/2008	\$498,000	DP Uniform	DP Tango
12/2/2008	\$452,000	DP Sierra	DP Uniform

- (4) All the notes have 30-year terms, with payment in full upon maturity. The notes fail to specify any amount of interest or any interim payments.
- (5) After consulting with IRS Area Counsel, Agent Smith proposes revocation and involuntary termination. Using Online SEIN, Agent Smith retrieves the Forms 990-PF from 2005 to present. Agent Smith also pulls the IMFOLR prints for each trustee's Forms 1040 from 2005 to present. The following tables show the amounts donated by each trustee (Form 990-PF Schedule B), adjusted gross income, contribution amount deducted, and individual income marginal tax bracket for each year from 2005 through 2011. None of the trustees made any contributions in 2011.

Note: The tables below don't include computations of alternative minimum tax (AMT), which would be included in an actual computation of the aggregate tax benefit.

DP Sierra - Income Tax Benefit						
Year	Donation	AGI	Deduction	Tax Bracket	Tax	Interest
2005	\$360,000	\$1,310,860	\$360,000	35%	\$126,000	\$50,103
2006	\$270,000	\$885,491	\$265,647	35%	\$92,976	\$27,232
2007	\$290,000	\$978,140	\$293,442	35%	\$102,705	\$20,260
2008	\$160,000	\$543,394	\$160,911	35%	\$56,319	\$7,560
2009	\$75,000	\$381,309	\$75,000	35%	\$26,250	\$2,356
2010	\$190,000	\$641,164	\$190,000	35%	\$66,500	\$3,300
Total					\$470,750	\$110,811

DP Tango - Income Tax Benefit						
Year	Donation	AGI	Deduction	Tax Bracket	Tax	Interest
2005	\$250,000	\$830,138	\$249,041	35%	\$87,164	\$34,660
2006	\$260,000	\$891,221	\$260,959	35%	\$91,336	\$26,751
2007	\$230,000	\$794,359	\$230,000	35%	\$80,500	\$15,880
2008	\$195,000	\$662,571	\$195,000	35%	\$68,250	\$9,162
2009	\$300,000	\$949,045	\$248,714	35%	\$87,050	\$7,814
2010	\$190,000	\$642,991	\$192,897	35%	\$67,154	\$3,332
Total					\$481,454	\$97,599

DP Uniform - Income Tax Benefit						
Year	Donation	AGI	Deduction	Tax Bracket	Tax	Interest
2005	\$110,000	\$443,763	\$110,000	35%	\$38,500	\$15,309
2006	\$190,000	\$623,977	\$187,193	35%	\$65,518	\$19,189
2007	\$240,000	\$806,943	\$242,082	35%	\$84,729	\$16,714
2008	\$310,000	\$1,047,661	\$310,724	35%	\$108,753	\$14,599
2009	\$370,000	\$1,217,879	\$365,364	35%	\$127,877	\$11,479
2010	\$440,000	\$1,492,553	\$444,636	35%	\$155,623	\$7,722
Total					\$581,000	\$85,012

- (6) The tables below show the calculation of the gift taxes on DP Sierra, DP Tango, and DP Uniform, that would be assessed if PF Echo were a taxable entity. The tables assume that each DP had a \$1 million “applicable exclusion

amount” available to apply to lifetime gifts in 2005, and made no other taxable gifts between 2005 and 2010. The tables list the year, donation, exclusion, the gift tax on the net taxable amount, and interest.

DP Sierra - Gift Tax Benefit				
Year	Donation	Exclusion Amount Used	Gift Tax	Interest
2005	\$360,000	\$360,000	\$0	\$0
2006	\$270,000	\$270,000	\$0	\$0
2007	\$290,000	\$290,000	\$0	\$0
2008	\$160,000	\$80,000	\$18,200	\$2,443
2009	\$75,000	\$0	\$16,900	\$1,517
2010	\$190,000	\$0	\$51,600	\$2,560
Total		\$1,000,000	\$86,700	\$6,520

DP Tango - Gift Tax Benefit				
Year	Donation	Exclusion Amount Used	Gift Tax	Interest
2005	\$250,000	\$250,000	\$0	\$0
2006	\$260,000	\$260,000	\$0	\$0
2007	\$230,000	\$230,000	\$0	\$0
2008	\$195,000	\$195,000	\$0	\$0
2009	\$300,000	\$65,000	\$66,000	\$5,924
2010	\$190,000	\$0	\$51,600	\$2,560
Total		\$1,000,000	\$117,600	\$8,484

DP Uniform - Gift Tax Benefit				
Year	Donation	Exclusion Amount Used	Gift Tax	Interest
2005	\$110,000	\$110,000	\$0	\$0
2006	\$190,000	\$190,000	\$0	\$0
2007	\$240,000	\$240,000	\$0	\$0
2008	\$310,000	\$310,000	\$0	\$0
2009	\$370,000	\$150,000	\$61,200	\$5,494
2010	\$440,000	\$0	\$135,400	\$6,719
Total		\$1,000,000	\$196,600	\$12,213

- (7) Had PF Echo been a taxable entity, all contributions by the trustees would be regarded as capital contributions. Based on amounts reported on Forms 990-PF, PF Echo would have incurred the following income tax liabilities since inception had it been a taxable entity:

PF Echo - Income Tax Benefit			
Tax Year	Taxable Income	Tax (at Trust Tax Rates)	Interest
2005	\$11,600	\$3,167	\$1,259
2006	\$107,000	\$36,529	\$10,699
2007	\$218,000	\$75,343	\$14,862
2008	\$283,000	\$98,069	\$13,164
2009	\$269,000	\$93,137	\$8,360
2010	\$363,000	\$126,036	\$6,254
Total		\$432,281	\$54,598

- (8) There are no estate taxes to compute, and no amounts were received from other foundations in Section 507(b)(2) transfers. The net assets per PF Echo's financial records on November 30, 2008 (closest available date using bank records and brokerage statements) were \$2,932,270. The net assets as of September 30, 2012 were \$4,640,806. Interest on the tax liabilities, using RGSNT, computed to September 30, 2012 is shown below:

Aggregate Tax Benefit				
Taxpayer	Year	Tax Increase	Interest	Aggregate Tax Benefit
DP Sierra Income Tax	2005 - 2010	\$470,750	\$110,811	\$581,561
DP Tango Income Tax	2005 - 2010	\$481,454	\$97,599	\$579,053
DP Uniform Income Tax	2005 - 2010	\$581,000	\$85,012	\$666,012
DP Sierra Gift Tax	2005 - 2010	\$86,700	\$6,520	\$93,220
DP Tango Gift Tax	2005 - 2010	\$117,600	\$8,484	\$126,084
DP Uniform Gift Tax	2005 - 2010	\$196,600	\$12,213	\$208,813
PF Echo Income Tax	2005 - 2010	\$432,281	\$54,598	\$486,879
Aggregate Tax Benefit		\$2,366,385	\$375,237	\$2,741,622

- (9) The termination tax is the lesser of either the aggregate tax benefit of \$2,741,622 or the net value of the assets (greater of \$2,932,270 or \$4,640,806). The tax is \$2,741,622.

Exempt Organizations Excise Tax Audit Changes

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

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

		Taxable Years Ended		
		12/31/2012		
Internal Revenue Code Section for Proposed Adjustment		507(c)		
1. Adjustments				
2.	Total Adjustments	0.00		
3.	Amount reported on return or as Previously adjusted	0.00		
4.	Total amount as corrected	0.00		
5.	Applicable tax rate %	0.00		
6.	Initial tax liability as corrected (line 4 x Line 5)	2,741,622.00		
7.	Initial tax liability reported	0.00		
8.	Increase (or decrease) in tax	2,741,622.00		
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

Explanation of Adjustments
See attached Explanation of Items for computation of tax liability

Exempt Organizations – Report of Examination

(Proposed Tax Changes)

1. Form No. 990-PF	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 Echo [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)
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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
	12/31/2012		

10. Reporter Preparer's Name [Insert your name]	11. Agreement Secured (Check one.) Yes <input type="checkbox"/> No <input type="checkbox"/>
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12. Findings Discussed with (Name and Title) [Insert name of a foundation manager or representative]	13. Agreement Date [Leave blank]
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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)
507(c)	12/31/2012	2,741,622.00			

15. Remarks
See attached Explanation of Items

16. Attachments