

Internal Revenue Service
Appeals Office

Department of the Treasury

Employer Identification Number:

Release Number: **201451043**
Release Date: 12/19/2014
Date: September 23, 2014

Person to Contact:

Employee ID Number:
Tel:
Fax:

UIL: 501.03-00

Certified Mail

Dear :

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code effective January 1, 2008.

Our revocation was made for the following reason(s):

You are not operated exclusively for charitable purposes because you serve private rather than public interests. In addition, your earnings inure to the benefit of private individuals.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on Forms 1120. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

If you were a private foundation as of the effective date of the adverse determination, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,

Acting Appeals Team Manager

Enclosure: Publication 892 and/or 556



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

Date: *march 26, 2013*

Taxpayer Identification Number:

Form:

Tax year(s) ended:

Person to contact / ID number:

Contact numbers:

Phone Number:

Fax Number:

Manager's name / ID number:

Manager's contact number:

Phone Number:

Response due date:

Certified Mail - Return Receipt Requested

Dear

Why you are receiving this letter

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

What you need to do if you agree

If you agree with our proposal, please sign the enclosed Form 6018, *Consent to Proposed Action – Section 7428*, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

If we don't hear from you

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

Effect of revocation status

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

What you need to do if you disagree with the proposed revocation

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the

IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

Contacting the Taxpayer Advocate Office is a taxpayer right

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate assistance. If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service
Office of the Taxpayer Advocate
300 N. Los Angeles St, Room 5109
Los Angeles, CA 90012

Phone Number: 213-576-3140

For additional information

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Director, EO Examinations

Enclosures:
Report of Examination
Form 6018
Publication 892
Publication 3498

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

LEGEND

ORG - Organization name XX - Date Address - address City - city State - state County - county President - President
Treasurer - Treasurer Secretary - Secretary Foundation - Foundation
Hotel-1 through 2 - Hotel-1 through 2 Unit-1 through Unit-4

Issue

1. Is the ORG ("ORG") operated exclusively for exempt purposes under IRC Section 501(c)(3)? Has the income and assets inured to the benefit the ORG's officers?
2. Is the ORG liable for excise tax on Taxable Expenditures under IRC § 4945?
3. Is the ORG liable for excise tax on Failure to Distribute Income under IRC §4942?
4. Is the ORG liable for excise tax on Excess Business Holdings under IRC §4943?

Facts

Articles of Incorporation

The organization was incorporated in the State of State, on August 31, 19XX. The Articles of Incorporation state that the ORG is organized exclusively for charitable and educational purposes within the meaning of § 501(c)(3) of the Internal Revenue Code, and it is not organized for the private gain of any person.

The Articles contain a dissolution clause stating that the assets, property, profits and net income of this organization are irrevocably dedicated to charitable and educational purposes within the meaning of § 501(c)(3). The Article's also contain a clause prohibiting inurement which states that no part of the net earnings shall inure to the benefit of any incorporator, director, officer or member of the corporation, and provide that the ORG will not engage in transactions that would subject it to excise tax under Chapter 42 of the Code (including tax on undistributed income, acts of self-dealing, excess business holdings, or making taxable expenditures which would adversely affect its exempt status).

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

Form 1023 and Determination Letter

The ORG received its exemption letter on March 19, 19XX under § 501(c)(3), classified as private ORG. According to IRS records, the ORG is classified as a non-operating private foundation.

The Form 1023 stated the ORG was formed for the purpose of distributing contributions received from President (and his family and associates) to other exempt organizations which support environmental concerns and seek to educate the general public (about the relationship between mankind and the environmental). A portion of the funds was to be distributed current, with the remainder to be accumulated as an endowment base for future support of conservation oriented activities. The ORG's initial activity purportedly consisted of screening requests for contributions from exempt organizations and making necessary investment decisions.

The Form 1023 listed its officers and directors as follows:

President – President / Director
Treasurer – Treasurer / Director
Secretary – Secretary / Director

Additionally, the Form 1023 acknowledged that the officers above were also members of the board of directors of the Foundation.

Disqualified Persons

The disqualified persons with respect to the ORG and Foundation are:

President Officer/Director
Treasurer Officer/Director
Secretary Officer/Director

The ORG provides the majority of the Foundation (FDN)'s support.

Organization and Activities

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

In, 20XX, the ORG provided grants totaling \$0 to the Foundation, a related non-operating private foundation. It also provided \$0 in grants to various other charities. The ORG did not engage in any direct charitable or educational activities during 20XX.

In 20XX and 20XX, the ORG provided grants totaling \$0 and \$0, respectively, to the FDN. It also provided grants totaling approximately \$0 and \$0 to various other charities in 20XX and 20XX, respectively. The ORG did not engage in any direct charitable or educational activities during 20XX and 20XX.

The FDN's activities include construction of an educational center in State, and the operation of a botanical garden and related open space land in City, State. The physical address of the City property is Address, City, State Zip code. The property was donated by the President Corporation in the early 19XX's. It includes two parcels, and consists of approximately 255 and 9 acres, respectively. The disqualified persons retain the right to use the property for personal use in perpetuity.

The FDN's botanical garden and property is immediately enclosed by the President & Treasurer / President Corporation's 40 acre property (situs address), and the Secretary & Husband / President Corporation's 33 acre property (situs address).

The President & Treasurer's and Secretary & Husband's retain control over the FDN's property in City, State. They converted structures on FDN's property into vacation rentals which are used by Secretary in her for-profit, the Inn. Additionally, the disqualified persons control public access to the FDN's property. The County of County revoked the Organization's Conditional Use Permit (CUP), prohibiting it from advertising or being opened to the public in 20XX. The CUP, similar to a business license, permitted the organization to operate its facilities to the general public.

The FDN stated that it has hundreds of visitors annually. The FDN does not advertise its property and it is hidden from the public view. Note that similar botanical gardens in the Southern State region have between 59,000 – 500,000 visitors annually.

City Hotel

In 20XX, the President & Treasurer's purchased property located at Address, City, State, (711) that consisted of an existing for-profit hotel named Hotel-1. Simultaneously, the FDN purchased Address, City, State (719) for \$0¹. 711 consists of

* * * *

¹ On April 24, 20XX

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX
		December 31, 20XX
		December 31, 20XX

six units, and 719 consists of four units. On February 6, 20XX², the FDN transferred the 719 property to the ORG. Both 711 and 719 properties are used to operate Hotel-2 (Hotel-2), a for-profit owned by the President & Treasurer.

On August 8, 20XX, the President & Treasurer's prepared an Application for Business Tax Identification Number. They obtained a business license doing business as (DBA) Hotel-2. The provided business description was an 'Inn' - accommodation, food services, and drinking, etc. The business started around September 9, 20XX. The application listed the principal business addresses at 711 and Address, and owners as Treasurer / CFO Owner & President, President.

The FDN renovated the 719 property and transferred Hotel-2's business license to the ORG during the property donation. The ORG currently holds the business license. The ORG stated that there are no rental agreements, lease agreements, or ownership percentages or arrangements between the President & Treasurer and the ORG.

Hotel-2 is advertised on www.Hotel-2.com³. Currently, ten units are available to reserve on-line. Address consists of four units, Unit-1, Unit-2, Unit-3 and Unit-4. Treasurer owns the remaining six units. The website advertises the hotel's physical address as Address and mailing address as Address. Hotel-2 is a commercial enterprise operated similar to an ordinary hotel. The President & Treasurer have effective control over this business through their 60% ownership percentage and as controlling managers the ORG.

Reservations for 711 and 719 are made on the website. Transactions are processed through a reservation management system which is subscribed under Treasurer's name. All room revenues are deposited in Treasurer's / Hotel-2 (711) account. She subsequently issues checks from this account to the ORG for its portion of room revenue. In 20XX, the ORG received \$ in room revenue.

Hotel expenditures included house keeping/ cleaning, laundry, advertising, Comcast, utilities, property tax, commercial liability insurance, etc., totaling approximately \$0 in 20XX and \$0 in 20XX

* * * *

² Per FDN's 20XX Form 990-PF

³ 1st capture of the website on archive.org is dated May 5, 20XX; blog: <http://blog.Hotel-2.com> 1st entry was dated December 18, 20XX.

⁴ 1st capture of the website on archive.org is dated May 5, 20XX; blog: <http://blog.Hotel-2.com> 1st entry was dated December 18, 20XX.

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

Form 990-PF

Year	20XX	20XX	20XX
1. Contributions Gifts Grants ⁴	0	0	0
3. Interest on Savings and Temp cash Investments	0	0	0
4. Dividends & Interest from Securities	0	0	0
5. Gross Rents	0	0	0
6a. Net Gain (loss) from sale of assets (securities, stocks, etc)	0	0	0
6b. Gross sales price	0	0	0
12. Total Revenue	0	0	0
14. Other employees salaries & wages	0	0	0
16. Legal Fees	0	0	0
Accounting	0	0	0
Other prof fees	0	0	0
17. Interest		0	0
18. Taxes	0	0	0
19. Depreciation	0	0	0
20. Occupancy	0	0	0
21. Travel conferences and meetings			
23. Other Expenses	0	0	0
24. Total operating and admin	0	0	0
25. Contribution, gifts & grants paid	0	0	0
26. Total expenses and disbursements	0	0	0
27. Excess of revenue over expenses	0	-0	-0

The ORG expenditures included administrative, hotel and expenses incurred to maintain the investment properties.

* * * *

⁵ From Trust

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

Grants totaled:

	20XX	20XX	20XX
FDN/ Related	\$0	\$0	\$0 ⁵
Other	\$0	\$0	\$0
	0	0	0
	96%	96%	94%

Assets

The ORG's assets include:

	20XX	20XX	20XX
Average Monthly Cash Balances:			
State Bank	0	0	0
Rabo Investment	0 ⁶	0	0 ⁷
County Commerce	0	0	0
Bank of State	0	0	0 ⁸
Loan	0	0	0
Schwab	0	0	0
Building	0	0	0
Address	0	0	0
Address	0	0	0
Lot	0	0	0
Address	0	0	0

Notes Receivable

Ramos	0	0	0
Doyle	0	0	0

* * * *

⁶ \$0 ICEC

⁷ EOY balance

⁸ EOY balance

⁹ EOY balance

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

Rivera	0	0	0
<u>Dexter</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

The Forms 990-PF did not reveal the City hotel activity. The Forms 990-PF did not reveal the relationship between the ORG and the FDN.

Part X, Minimum Investment Return, Part XI, Distributable Amount, and Part Xii, Qualifying Distributions were incomplete and incorrect for THE 20XX AND 20XX years.

The ORG provided negative responses by stating "No" to questions on Part VII-B, Statements regarding Activities for Which Form 4720 may be required.

Lines 1a (1), (2), (3), (4), (5), asked "during the year did the ORG pay or incur any amount to":

- (1) Engage in the sale or exchange, or leasing of property with a disqualified person?
- (2) Borrow money from, lend money to, or otherwise extend credit to (or accept it from) a disqualified person?
- (3) Furnish goods, services, or facilities to (or accept them from) a disqualified person?
- (4) Pay compensation to, or pay or reimburse the expenses of, a disqualified person? [Note: Answered "yes" in 20XX]
- (5) Transfer any income or assets to a disqualified person (or make any of either available for the benefit or use of a disqualified person

Item 5a (4) & (5):

5a (4) "During the year did the ORG pay or incur any amount to an organization other than a charitable, etc., organization described in section 509(a)(1), (2), or (3), or section 4940(d)(2)?"

Line 5a (5) "During the year did the ORG pay or incur any amount to provide for any purpose other than religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals?"

The organization checked "No" to questions 5a (4) & (5) above in 20XX, 20XX, and 20XX. The response for each of the years was "No." The correct answer was "Yes,"

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

since FDN received grants from the ORG. The FDN is not a section 509(a)(1), (2), or (3) organization. As a result of the incorrect answer to item 5(a)(4), the related questions in 5(c) were marked "N/A." 5(c) asked, "If the answer is yes to 5(a)(4), does the ORG claim exemption from the tax because it maintained expenditure responsibility for the grant? If yes, attach a statement required by Regulations section 53.4945-5(D). The correct answer to 5(a)(4) was "Yes" rather than "N/A," and a "Yes" answer to 5(a)(4) would have called for the attachment of the "statement required." No such statement was attached in any of the three returns.

Part IX-A, Summary of Direct Charitable Activities, asked to list the ORG's four largest direct charitable activities during the tax year. The ORG responded in an attached statement "The ORG primarily supports one ORG, the Foundation. This organization has two environmental education centers; one of which is an educational and scientific institution that has a botanic garden specializing in Mediterranean regions of the world.

Part XV, Supplementary Information, regarding ORG managers, asked, "(b) List any managers of the ORG who own 10% or more of the stock of a corporation (or an equally large portion of the ownership of a partnership or other entity) of which the ORG has a 10% or greater interest." The ORG stated "none" for 20XX, 20XX, & 20XX.

Law

I.R.C. § 501(c)(3) provides for the exemption from federal income tax of organizations that are organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that an organization must be both organized and operated exclusively for one or more of the purposes specified in section 501(c)(3) of the Code in order to be exempt as an organization described in such section.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it is engaged primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

Treas. Reg. § 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) states that an organization is not organized or operated for one or more exempt purposes unless it serves a public rather than a private interest. Accordingly, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator, shareholders, or persons controlled, directly or indirectly, by such private interests.

Treas. Reg. § 1.501(a)-1(c) defines a private shareholder or individual as those persons having a personal and private interest in the activities of an organization. In general, a private shareholder or individual is considered an "insider" with respect to the exempt organization.

Cases

Better Business Bureau v. United States, 316 U.S. 279 (1945), holds that the existence of a single non-exempt purpose, if substantial in nature, will destroy the exemption under section 501(c)(3). An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such purposes.

Manning Association v. Commissioner, 93 T.C. 596 (1989); 93 T.C. No. 50, holds that Manning Association, Inc., is not exempt from tax under sec. 501(c)(3) of the Code as an organization operated "exclusively for educational purposes." Notwithstanding the existence of truly educational purposes based largely upon a historic Manning homestead and historic artifacts, the association's operations were also conducted for the benefit of members of the Manning family, a nonexempt purpose that is found to be "substantial in nature." *Better Business Bureau v. United States*, 326 U.S. 279, 283 (1945). There is no 10-percent "safe harbor" of nonexempt activities within which an organization may conduct its affairs without running afoul of the disqualifying test of *Better Business Bureau*. Contrary to petitioner's position, no such safe harbor rule was established by *World Family Corp. v. Commissioner*, 81 T.C. 958 (1983), and in any event the record fails to establish that the Manning Association's activities in fact came within any such arbitrary percentage limitation.

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

Benedict Ginsberg and Adele W. Ginsberg v. Commissioner, 46 T.C. 47 (1966), holds that petitioners contributed money to a corporation organized to conduct the dredging of certain waterways. The corporation was organized and operated primarily for the benefit of those persons owning property adjacent to the waterways dredged rather than for public or charitable purposes, so that contributions to it are not deductible under *section 170, I.R.C. 1954*.

American Campaign Academy, Petitioner v. Commissioner, 92 T.C 1053, 1065-1066 (1989), Petitioner taxpayer academy sought a declaratory judgment under 26 U.S.C.S. § 7428(a) that it was exempt from federal income taxation under 26 U.S.C.S. § 501(a) as an organization meeting the requirements of 26 U.S.C.S. § 501(c)(3). The court found in favor of respondent Commissioner of Internal Revenue, holding that petitioner was nonexempt under 26 U.S.C.S. § 501(c)(3). The court found that petitioner cited no compelling authority in support of its contention that nonincidental benefits must be controllable by the organization. Moreover, the court found that the administrative record supported respondent's contention that petitioner was formed with a substantial purpose to train campaign professionals for service in Republican entities and campaigns. The court held that petitioner failed to persuade the court that this was not the case. The court found that secondary benefits that advanced a substantial purpose could not be construed as incidental to petitioner's exempt educational purpose.

The case further states that, when an organization operates for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests, the organization by definition does not operate exclusively for exempt purposes. Prohibited private benefits may include an "advantage; profit, fruit; privilege; gain; [or] interest." Occasional economic benefits flowing to persons as an incidental consequence of an organization pursuing exempt charitable purposes will not generally constitute prohibited private benefits. Thus, should * * * [the organization] be shown to benefit private interests, it will be deemed to further a nonexempt purpose under section 1.501(c)(3)-1(d)(1)(ii), Income Tax Regs. This nonexempt purpose will prevent [the organization] from operating primarily for exempt purposes absent a showing that no more than an insubstantial part of its activities further the private interests or any other nonexempt purposes.

John E. Thorne v. Commissioner, 99 t.c. 67, the court found that the taxpayer made numerous grants to organizations that were not tax-exempt, that he did not exercise expenditure responsibility under § 4945(h) over grants made, and that he made grants to friends and relatives for personal purposes, such as travel, the payment of medical bills, or to avoid eviction. Consequently, these were taxable expenditures for which

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

deficiencies and penalties could be assessed. The court further found that the violations were both knowing and willful.

Hans S. Mannheimer Charitable Trust v. Commissioner 93 TC 35 (1989). Petitioner, a private foundation, made grants to two other private foundations, all three of which had been established by the same person to promote his interest and concern about animals and nonhuman primates. Some of the same officers and trustees held similar positions in all three foundations. Held, on the facts of this case, petitioner is subject to the excise tax on "taxable expenditures" imposed by sec. 4945(a)(1) of the Internal Revenue Code, since its contributions to the other two foundations during 1981-1983 were "taxable expenditures" within sec. 4945(d)(4), by reason of its failure to exercise "expenditure responsibility" with respect to such contributions within any one of the three requirements of sec. 4945(h), as implemented particularly by sec. 53.4945-5(b), (c), and (d), Private Foundation Excise Tax Regs.

Rev. Rul. 75-286 states that a nonprofit organization with membership limited to the residents and business operators within a city block and formed to preserve and beautify the public areas in the block, thereby benefiting the community as a whole as well as enhancing the members' property rights, will not qualify for exemption under section 501(c)(3).

Rev. Rul. 67-5, 1967-1 C.B. 123 held that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation. It was further held that the foundation did not operate a charitable program commensurate in scope with its financial resources, rather the foundation was only able to carry out minimal charitable activities. The ruling stated that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the foundation was not entitled to exemption from Federal income tax under I.R.C. § 501(c)(3).

Rev. Rul. 70-186, 1970-1, distinguished, states that a nonprofit organization formed to preserve and improve a lake used extensively as a public recreational facility qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 78-85, 1978-1, distinguished, states that a nonprofit organization with membership open to the general public that was formed by residents of a city to help preserve, beautify, and maintain a public park located in the city and whose support is derived from membership dues and contributions from the general

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

public is operated exclusively for charitable purposes and qualifies for exemption under section 501(c)(3) of the Code; Rev. Rul. 75-286 distinguished.

In determining the effective date of revocation, an organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Treas. Reg. §1.501(a)-1(a)(2); Rev. Proc. 2003-4, §14.01 (cross-referencing §13.01 et seq.), 2003-1 C.B. 123. An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Rev. Proc. 2007-52, 20078-30, IRB 222.

The Commissioner may revoke a favorable determination letter for good cause. Treas. Reg. § 1.501(a)-1(a)(2). Revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Rev. Proc. 2007-52, 2007-30 IRB 222.

IRC § 4946

Section 4946(a)(1) of the Code defines the term "disqualified persons" with respect to a private foundation as including a substantial contributor to the foundation, a foundation manager, and an owner of more than 20 percent of the total combined voting power of a corporation which is a substantial contributor to the foundation. It also includes a member of the family of any individual described above. The definition includes a corporation of which the persons described ante own more than 35 percent of the total combined voting power. In addition it includes a trust or estate in which persons described above hold more than 35 percent of the beneficial interest.

Section 4946(b) of the Code defines the term foundation manager as including an officer, director, or trustee of a foundation or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation. Section 4946(d) of the Code states that the term "a member" of the family of a disqualified person includes the spouse, children of and grandchildren of a disqualified person.

Treas. Reg. § 53.4941(d)-1. Definition of self-dealing

(a) In general - For purposes of section 4941, the term "self-dealing" means any direct or indirect transaction described in §53.4941(d)-2. For purposes of this section it is

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

immaterial whether the transaction results in a benefit or a detriment to the private foundation.

IRC § 4941(d) Self-Dealing. —

4941(d)(1) In general . —For purposes of this section, the term “self-dealing” means any direct or indirect —

4941(d)(1)(C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;

4941(d)(1)(E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation;

IRC § 4942 –

4942(a) Initial Tax. —There is hereby imposed on the undistributed income of a private foundation for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year (if such first day falls within the taxable period), a tax equal to 30 percent of the amount of such income remaining undistributed at the beginning of such second (or succeeding) taxable year.

Treas. Reg. §53.4942(a)-3. Qualifying distributions defined

(a) In general

(1) *Distributions generally.* —For purposes of section 4942 and the regulations thereunder, the amount of a qualifying distribution of property (as defined in subparagraph(2) of this paragraph) is the fair market value of such property as of the date such qualifying distribution is made. The amount of an organization's qualifying distributions will be determined solely on the cash receipts and disbursements method of accounting described in section 466(c)(1).

(2) *Definition.* —The term “qualifying distribution” means —

(i) Any amount (including program-related investments, as defined in section 4944(c), and reasonable and necessary administrative expenses) paid to accomplish one or

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

more purposes described in section 170(c)(1) or (2)(B), other than any contribution to

(a) A private foundation which is not an operating foundation (as defined in section 4942(j)(3)), except as provided in paragraph (c) of this section, or

(b) An organization controlled (directly or indirectly) by the contributing private foundation or one or more disqualified persons with respect to such foundation, except as provided in paragraph (c) of this section;

(3) *Control.* —For purposes of subparagraph (2)(i)(b) of this paragraph, an organization is “controlled” by a foundation or one or more disqualified persons with respect to the foundation if any of such persons may, by aggregating their votes or positions of authority, require the donee organization to make an expenditure, or prevent the donee organization from making an expenditure, regardless of the method by which the control is exercised or exercisable. “Control” of a donee organization is determined without regard to any conditions imposed upon the donee as part of the distribution or any other restrictions accompanying the distribution as to the manner in which the distribution is to be used, unless such conditions or restrictions are described in paragraph (a)(8) of §1.507-2 of this chapter (Income Tax Regulations). In general, it is the donee, not the distribution, which must be “controlled” by the distributing private foundation for the provisions of subparagraph (2)(i)(b) of this paragraph to apply. Thus, the furnishing of support to an organization and the consequent imposition of budgetary procedures upon that organization with respect to such support shall not in itself be treated as subjecting that organization to the distributing foundation’s control within the meaning of this subparagraph. Such “budgetary procedures” include expenditure responsibility requirements under section 4945(d)(4). The “controlled” organization need not be a private foundation; it may be any type of exempt or nonexempt organization including a school, hospital, operating foundation, or social welfare organization.

4943(a) Initial Tax. —

4943(a)(1) Imposition. —There is hereby imposed on the excess business holdings of any private foundation in a business enterprise during any taxable year which ends during the taxable period a tax equal to 10 percent of the value of such holdings.

4943(a)(2) Special rules. —The tax imposed by paragraph (1) —

4943(a)(2)(A) shall be imposed on the last day of the taxable year, but

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

4943(a)(2)(B) with respect to the private foundation's holdings in any business enterprise, shall be determined as of that day during the taxable year when the foundation's excess holdings in such enterprise were the greatest.

4943(b) Additional Tax. —In any case in which an initial tax is imposed under subsection (a) with respect to the holdings of a private foundation in any business enterprise, if, at the close of the taxable period with respect to such holdings, the foundation still has excess business holdings in such enterprise, there is hereby imposed a tax equal to 200 percent of such excess business holdings.

4943(c) Excess Business Holdings. —For purposes of this section —

4943(c)(1) In general. —The term “excess business holdings” means, with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the enterprise which the 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.

4943(c)(2) Permitted holdings in a corporation. —

4943(c)(2)(A) In general. —The permitted holdings of any private foundation in an incorporated business enterprise are —

4943(c)(2)(A)(i) 20 percent of the voting stock, reduced by

4943(c)(2)(A)(ii) the percentage of the voting stock owned by all disqualified persons.

In any case in which all disqualified persons together do not own more than 20 percent of the voting stock of an incorporated business enterprise, nonvoting stock held by the private foundaion shall also be treated as permitted holdings.

4943(c)(3) Permitted holdings in partnerships, etc. —The permitted holdings of a private foundation in any business enterprise which is not incorporated shall be determined under regulations prescribed by the Secretary. Such regulations shall be consistent in principle with paragraphs (2) and (4), except that —

4943(c)(3)(A) in the case of a partnership or joint venture, “profits interest” shall be substituted for “voting stock”, and “capital interest” shall be substituted for “nonvoting stock”,

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

4943(c)(3)(B) in the case of a proprietorship, there shall be no permitted holdings, and

4943(c)(3)(C) in any other case, "beneficial interest" shall be substituted for "voting stock".

4943(c)(6) 5- year period to dispose of gifts, bequests, etc. —Except as provided in paragraph (5), if, after May 26, 1969, there is a change in the holdings in a business enterprise (other than by purchase by the private foundation or by a disqualified person) which causes the private foundation to have —

4943(c)(6)(A) excess business holdings in such enterprise, the interest of the foundation in such enterprise (immediately after such change) shall (while held by the foundation) be treated as held by a disqualified person (rather than by the foundation) during the 5-year period beginning on the date of such change in holdings; or

4943(c)(6)(B) an increase in excess business holdings in such enterprise (determined without regard to subparagraph (A)), subparagraph (A) shall apply, except that the excess holdings immediately preceding the increase therein shall not be treated, solely because of such increase, as held by a disqualified person (rather than by the foundation).

Treas. Reg. §53.4943-2. Imposition of tax on excess business holdings of private foundations

(a) Imposition of initial tax

(1) In general

(i) Initial tax. —Section 4943(a)(1) imposes an initial excise tax (the "initial tax") on the excess business holdings of a private foundation for each taxable year of the foundation which ends during the taxable period defined in section 4943(d)(2). The amount of such tax is equal to 5 percent of the total value of all the private foundation's excess business holdings in each of its business enterprises. In determining the value of the excess business holdings of the foundation subject to tax under section 4943, the rules set forth in §§20.2031-1 through 20.2031-3 of this chapter (Estate Tax Regulations) shall apply.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

(ii) *Disposition of certain excess business holdings within ninety days.* —In any case in which a private foundation acquires excess business holdings, other than as a result of a purchase by the foundation, the foundation shall not be subject to the taxes imposed by section 4943, but only if it disposes of an amount of its holdings so that it no longer has such excess business holdings within 90 days from the date on which it knows, or has reason to know, of the event which caused it to have such excess business holdings. Similarly, a private foundation shall not be subject to the taxes imposed by section 4943 because of its purchase of holdings where it did not know, or have reason to know of prior acquisitions by disqualified persons, but only if the foundation disposes of its excess holdings within the 90-day period described previously, and its purchase would not have created excess business holding but for such prior acquisitions by disqualified persons. In determining whether for purposes of this (ii) the foundation has disposed of such excess business holdings during such 90-day period, any disposition of holdings by a disqualified person during such period shall be disregarded.

§53.4943-2(a)

(v) *Foundation knowledge of acquisitions made by disqualified persons*

(A) For purposes of paragraph (a)(1)(ii) of this section, whether a private foundation will be treated as knowing, or having reason to know, of the acquisition of holdings by a disqualified person will depend on the facts and circumstances of each case. Factors which will be considered relevant to a determination that a private foundation did not know or had no reason to know of an acquisition are: the fact that it did not discover acquisitions made by disqualified persons through the use of procedures reasonably calculated to discover such holdings; the diversity of foundation holdings; and the existence of large numbers of disqualified persons who have little or no contact with the foundation or its managers.

§53.4943-3. Determination of excess business holdings

(c) *Permitted holdings in an unincorporated business enterprise*

(1) *In general.* —The permitted holdings of a private foundation in any business enterprise which is not incorporated shall, subject to the provisions of subparagraphs (2), (3), and (4) of this paragraph, be determined under the principles of paragraph (b) of this section.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

(2) *Partnership or joint venture.* —In the case of a partnership (including a limited partnership) or joint venture, the terms “profits interest” and “capital interest” shall be substituted for “voting stock” and “nonvoting stock,” respectively, wherever those terms appear in paragraph (b) of this section. The interest in profits of such foundation (or such disqualified person) shall be determined in the same manner as its distributive share of partnership taxable income. See section 704(b) (relating to the determination of the distributive share by the income or loss ratio) and the regulations thereunder. In the absence of a provision in the partnership agreement, the capital interest of such foundation (or such disqualified person) in a partnership shall be determined on the basis of its interest in the assets of the partnership which would be distributable to such foundation (or such disqualified person) upon its withdrawal from the partnership, or upon liquidation of the partnership, whichever is the greater.

(3) *Sole proprietorship.* —For purposes of section 4943, a private foundation shall have no permitted holdings in a sole proprietorship. In the case of a transfer by a private foundation of a portion of a sole proprietorship, see paragraph (c)(2) of this section (relating to permitted holdings in partners)

§53.4943-3(c)

(4) *Trusts and other unincorporated business enterprises*

(i) *In general.* —In the case of any unincorporated business enterprise which is not described in paragraph (c)(2) or (3) of this section, the term “beneficial interest” shall be substituted for “voting stock” wherever the term appears in paragraph (b) of this section. Any and all references to nonvoting stock in paragraph (b) of this section shall be inapplicable with respect to any unincorporated business enterprise described in this subparagraph.

(ii) *Trusts.* —For purposes of section 4943, the beneficial interest of a private foundation or any disqualified person in a trust shall be the beneficial remainder interest of such foundation or person determined as provided in paragraph (b) of § 53.4943-8.

(iii) *Other unincorporated business enterprises.* —For purposes of section 4943, the beneficial interest of a private foundation or any disqualified person in an unincorporated business enterprise (other than a trust or an enterprise described in paragraph (c)(2) or (3) of this section) includes any right to receive a portion of distributions of profits of such enterprise, and, if the portion of distributions is not fixed by an agreement among the participants, any right to receive a portion of the assets (if

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

any) upon liquidation of the enterprise, except as a creditor or employee. For purposes of this subparagraph, a right to receive distributions of profits includes a right to receive any amount from such profits (other than as a creditor or employee), whether as a sum certain or as a portion of profits realized by the enterprise. Where there is no agreement fixing the rights of the participants in such enterprise, the interest of such foundation (or such disqualified person) in such enterprise shall be determined by dividing the amount of all equity investments or contributions to the capital of the enterprise made or obligated to be made by such foundation (or such disqualified person) by the amount of all equity investments or contributions to capital made or obligated to be made by all participants in the enterprise.

§53.4943-3(d) examples

Example (2). F, a private foundation, is a partner in P partnership. In addition, A and B, the only disqualified persons with respect to F, are partners in P. The partnership agreement of P contains no provisions regarding the sharing of profits by, and the respective capital interests of, the partners.

(i) Assume that, under section 704(b), F's distributive share of P taxable income is determined to be 20 percent. In addition, assume that under such section, A and B are determined to have a 4-percent distributive share each of P taxable income. Accordingly, F holds a 20-percent profits interest in P, and A and B hold an 8-percent profits interest in P. Assuming that the provisions of section 4943(c)(2)(B) do not apply, the permitted holdings of F in P are 12 percent of the profits interest in P, determined by subtracting the percentage of the profits interest held by A and B in P (i.e., 8 percent) from 20 percent. (20 percent - 8 percent = 12 percent.) F, therefore, holds a percentage of the profits interest in P in excess of the percentage permitted by §53.4943-3(b)(1). The excess business holdings of F in P are a percentage of the profits interest in P equivalent to such excess percentage, or 8 percent of the profits interest in P, determined by subtracting the permitted holdings of F in P (i.e., 12 percent) from the percentage of the profits interest held by F in P (i.e., 20 percent) (20 percent - 12 percent = 8 percent).

§53.4943-10 - Business enterprise; definition

(a) *In general*

(1) Except as provided in paragraph (b) or (c) of this section, under section 4943(d)(4) the term "business enterprise" includes the active conduct of a trade or business, including any activity which is regularly carried on for the production of income from the sale of goods or the performance of services and which

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

constitutes an unrelated trade or business under section 513. For purposes of the preceding sentence, where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from the classification of a business enterprise merely because it does not result in a profit.

§20.2031-3. Valuation of interests in businesses

The fair market value of any interest of a decedent in a business, whether a partnership or a proprietorship, is the net amount which a willing purchaser, whether an individual or a corporation, would pay for the interest to a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The net value is determined on the basis of all relevant factors including —

- (a) A fair appraisal as of the applicable valuation date of all the assets of the business, tangible and intangible, including good will;
- (b) The demonstrated earning capacity of the business; and
- (c) The other factors set forth in paragraphs (f) and (h) of §20.2031-2 relating to the valuation of corporate stock, to the extent applicable.

Special attention should be given to determining an adequate value of the good will of the business in all cases in which the decedent has not agreed, for an adequate and full consideration in money or money's worth, that his interest passes at his death to, for example, his surviving partner or partners. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of examinations of the business made by accountants, engineers, or any technical experts as of or near the applicable valuation date. See section 2701 and the regulations at §25.2701 of this chapter for special rules for valuing the transfer of an interest in a partnership and for the treatment of unpaid qualified payments at the death of the transferor or an applicable family member. See section 2703 and the regulations at §25.2703 of this chapter for special rules involving options and agreements (including contracts to purchase) entered into (or substantially modified after) October 8, 1990. See section 2704(b) and the regulations at §25.2704-2 of this chapter for special valuation rules involving certain restrictions on liquidation rights created after October 8, 1990. [Reg. §20.2031-3.]

[T.D. 6296, 6-23-58. Amended by T.D. 8395, 1-28-92.]

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

§53.4943-3(b)(3). Determination of excess business holdings

(ii) *“Effective control” defined.* —For purposes of this subparagraph, the term “effective control” means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a business enterprise, whether through the ownership of voting stock, the use of voting trusts, or contractual arrangements, or otherwise. It is the reality of control which is decisive and not its form or the means by which it is exercisable. Thus, where a minority interest held by individuals who are not disqualified persons has historically elected the majority of a corporation's directors, effective control is in the hands of those individuals.

§53.4943-6(a). Five-year period to dispose of gifts, bequests, etc

(2) *Acquisitions that are not purchases.* —Section 4943(c)(6) does not apply if a change in holdings in a business enterprise is the result of a purchase by the private foundation or a disqualified person. For purposes of subparagraph (a) of this paragraph, the term “purchase” shall not include any acquisition by gift, devise, bequest, legacy, or intestate succession. Paragraph (d) of this section provides rules for the treatment of increases in holdings received in a readjustment (as defined in §53.4943-7(d)(1)).

§53.4943-6.

(c) *Exceptions*

(1) Section 4943(c)(6) and this section shall not apply to any transfer of holdings in a business enterprise by one private foundation to another private foundation which is related to the first foundation within the meaning of section 4946(a)(1)(H).

SEC. 4946. DEFINITIONS AND SPECIAL RULES.

4946(a)(1)(H) only for purposes of section 4943, a private foundation —

4946(a)(1)(H)(i) which is effectively controlled (directly or indirectly) by the same person or persons who control the private foundation in question, or

4946(a)(1)(H)(ii) substantially all of the contributions to which were made (directly or indirectly) by the same person or persons described in subparagraph (A), (B), or (C), or members of their families (within the meaning of subsection (d)), who made (directly or indirectly) substantially all of the contributions to the private foundation in question.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

§53.4943-9. Business holdings; certain periods

(a) *Taxable period*

(1) *In general.* —For purposes of section 4943, the term “taxable period” means, with respect to any excess business holdings of a private foundation in a business enterprise, the period beginning with the first day on which there are such excess business holdings and ending on the earliest of:

- (i) The date of mailing of a notice of deficiency under section 6212 with respect to the tax imposed on the holdings by section 4943(a);
- (ii) The date on which the excess is eliminated; or
- (iii) The date on which the tax imposed by section 4943(a) is assessed.

For example, *M*, a private foundation, first has excess business holdings in *X*, a corporation, on February 5, 1972. A notice of deficiency is mailed under section 6212 to *M* on June 1, 1974. With respect to *M*'s excess business holdings in *X*, the taxable period begins on February 5, 1972, and ends on June 1, 1974.

(2) *Special rule.* —Where a notice of deficiency referred to in subparagraph (1)(i) of this paragraph is not mailed because there is 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, shall be treated as the end of the taxable period.

(3) *Suspension of taxable period for 90 days.* —In any case in which a private foundation has excess business holdings solely because of the acquisition of an interest in a business enterprise to which paragraph (a)(1)(ii) or (iii) of §Link 53.4943-2 applies, the taxable period described in paragraph (a) of this section shall be suspended for the 90-day period (as extended) starting with the date on which the foundation knows or has reason to know of the acquisition, provided that at the end of such period the foundation has disposed of such excess holdings.

(b) *Cross reference.* —For rules relating to taxable events that are corrected within the correction period, defined in section 4963(e), see section 4961(a) and the regulations thereunder.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

(c) *Correction.* —For purposes of section 4943, correction shall be considered as made when no interest in the enterprise held by the foundation is classified as an excess business holding under section 4943(c)(1). In any case where the private foundation has excess business holdings which are constructively held for it under section 4943(c)(1), correction shall be considered made when either a corporation, partnership, estate, or trust in which holdings in such enterprise are constructively held for the foundation or a disqualified person, the foundation itself, or a disqualified person disposes of a sufficient interest in the enterprise so that no interest in the enterprise held by the foundation is classified as excess business holdings under section 4943(c)(1). [Reg. §53.4943-9.]

[T.D. 7496, 7-5-77. Amended by T.D. 8084, 5-1-86.]

IRC § 4945 –

§ 4945(a)(1) - There is hereby imposed on each taxable expenditure (as defined in subsection (d)) a tax equal to 20 percent of the amount thereof. The tax imposed by this paragraph shall be paid by the private foundation.

Additional Taxes —

§ 4945(b)(1) On the foundation. In any case in which an initial tax is imposed by subsection (a)(1) on a taxable expenditure and such expenditure is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount of the expenditure. The tax imposed by this paragraph shall be paid by the private foundation.

§ 4945(d) Taxable Expenditure. - For purposes of this section, the term “taxable expenditure” means any amount paid or incurred by a private foundation —

§ 4945(d)(4) as a grant to an organization unless —

4945(d)(4)(A) such organization —

4945(d)(4)(A)(i) is described in paragraph (1) or (2) of section 509(a),

4945(d)(4)(A)(ii) is an organization described in section 509(a)(3) (other than an organization described in clause (i) or (ii) of section 4942(g)(4)(A)), or

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

4945(d)(4)(A)(iii) is an exempt operating foundation (as defined in section 4940(d)(2)), or

4945(d)(4)(B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h)

§ 4945(d)(5) for any purpose other than one specified in section 170(c)(2)(B).

§ 170(c) Charitable Contribution Defined. — For purposes of this section, the term “charitable contribution” means a contribution or gift to or for the use of

§ 170(c)(2) A corporation, trust, or community chest, fund, or foundation —

§170(c)(2)(B) – organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;

§ 170(c)(2)(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

§ 4945(h) Expenditure Responsibility —The expenditure responsibility referred to in subsection (d)(4) means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures —

4945(h)(1) to see that the grant is spent solely for the purpose for which made,

4945(h)(2) to obtain full and complete reports from the grantee on how the funds are spent, and

4945(h)(3) to make full and detailed reports with respect to such expenditures to the Secretary.

§ 4945(i) Other Definitions . —For purposes of this section —

§ 4945(i)(1) Correction . —The terms “correction” and “correct” mean, with respect to any taxable expenditure, (A) recovering part or all of the expenditure to the extent recovery is possible, and where full recovery is not possible such additional corrective action as is prescribed by the Secretary by regulations, or (B) in the case of a failure to comply with subsection (h)(2) or (h)(3), obtaining or making the report in question.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

§ 4945(i)(2) Taxable period . —The term “taxable period” means, with respect to any taxable expenditure, the period beginning with the date on which the taxable expenditure occurs and ending on the earlier of —

§ 4945(i)(2)(A) the date of mailing of a notice of deficiency with respect to the tax imposed by subsection (a)(1) under Section 6212, or

§ 4945(i)(2)(B) the date on which tax imposed by subsection (a)(1) is assessed.

Treasury Regulations

Treas. Reg. § 53.4945-5. Grants to organizations

(a) Grants to nonpublic organizations

(1) In general. —Under section 4945(d)(4) the term “taxable expenditure” includes any amount paid or incurred by a private foundation as a grant to an organization (other than an organization described in section 509(a)(1), (2) or (3)), unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h). However, the granting foundation does not have to exercise expenditure responsibility with respect to amounts granted to organizations described in section 4945(f).

(2) “Grants” described. —For a description of the term “grants”, see §53.4945-4(a)(2).

(3) Section 509(a)(1), (2), and (3) organizations. —See section 508(b) and the regulations thereunder for rules relating to when a grantor may rely on a potential grantee's characterization of its status as set forth in the notice described in section 508(b).

(b) Expenditure responsibility

(1) In general. —A private foundation is not an insurer of the activity of the organization to which it makes a grant. Thus, satisfaction of the requirements of sections 4945(d)(4) and (h) and of subparagraph (3) or (4) of this paragraph, will ordinarily mean the grantor foundation will not have violated section 4945(d)(1) or (2). A private foundation will be considered to be exercising “expenditure responsibility” under section 4945(h) as long as it exerts all reasonable efforts and establishes adequate procedures —

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

- (i) To see that the grant is spent solely for the purpose for which made,
- (ii) To obtain full and complete reports from the grantee on how the funds are spent, and
- (iii) To make full and detailed reports with respect to such expenditures to the Commissioner.

In cases in which pursuant to paragraph (a)(6) of this section a grant is considered made to a secondary grantee rather than the primary grantee, the grantor foundation's obligation to obtain reports from the grantee pursuant to section 4945(h)(2) and this section will be satisfied if appropriate reports are obtained from the secondary grantee. For rules relating to expenditure responsibility with respect to transfers of assets described in section 507(b)(2), see section 507(b)(2) and the regulations thereunder.

(2) Pre-grant inquiry

(i) Before making a grant to an organization with respect to which expenditure responsibility must be exercised under this section, a private foundation should conduct a limited inquiry concerning the potential grantee. Such inquiry should be complete enough to give a reasonable man assurance that the grantee will use the grant for the proper purposes. The inquiry should concern itself with matters such as: (a) the identity, prior history and experience (if any) of the grantee organization and its managers; and (b) any knowledge which the private foundation has (based on prior experience or otherwise) of, or other information which is readily available concerning, the management, activities, and practices of the grantee organization. The scope of the inquiry might be expected to vary from case to case depending upon the size and purpose of the grant, the period over which it is to be paid, and the prior experience which the grantor has had with respect to the capacity of the grantee to use the grant for the proper purposes. For example, if the grantee has made proper use of all prior grants to it by the grantor and filed the required reports substantiating such use, no further pre-grant inquiry will ordinarily be necessary. Similarly, in the case of an organization, such as a trust described in section 4947(a)(2), which is required by the terms of its governing instrument to make payments to a specified organization exempt from taxation under section 501(a), a less extensive pre-grant inquiry is required than in the case of a private foundation possessing discretion with respect to the distribution of funds.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

(3) Terms of grants. —Except as provided in subparagraph (4) of this paragraph, in order to meet the expenditure responsibility requirements of section 4945(h), a private foundation must require that each grant to an organization, with respect to which expenditure responsibility must be exercised under this section, be made subject to a written commitment signed by an appropriate officer, director or trustee of the grantee organization. Such commitment must include an agreement by the grantee —

(i) To repay any portion of the amount granted which is not used for the purposes of the grant,

(ii) To submit full and complete annual reports on the matter in which the funds are spent and the progress made in accomplishing the purposes of the grant, except as provided in paragraph (c)(2) of this section,

(iii) To maintain records of receipts and expenditures and to make its books and records available to the grantor at reasonable times, and

(iv) Not to use any of the funds —

(a) To carry on propaganda, or otherwise to attempt, to influence legislation (within the meaning of section 4945(d)(1)),

(b) To influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive (within the meaning of section 4945(d)(2)),

(c) To make any grant which does not comply with the requirements of section 4945(d)(3) or (4), or

(d) To undertake any activity for any purpose other than one specified in section 170(c)(2)(B).

The agreement must also clearly specify the purposes of the grant. Such purposes may include contributing for capital endowment, for the purchase of capital equipment, or for general support provided that neither the grants nor the income therefrom may be used for purposes other than those described in section 170(c)(2)(B).

(4) Terms of program-related investments. —In order to meet the expenditure responsibility requirements of section 4945(h), with regard to the making of a program-related investment (as defined in section 4944 and the regulations thereunder), a private foundation must require that each such investment with respect to which

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

expenditure responsibility must be exercised under section 4945(d)(4) and (h) and this section be made subject to a written commitment signed by an appropriate officer, director or trustee of the recipient organization. Such commitment must specify the purpose of the investment and must include an agreement by the organization —

(i) To use all the funds received from the private foundation (as determined under paragraph (c)(3) of this section) only for the purposes of the investment and to repay any portion not used for such purposes, provided that, with respect to equity investments, such repayment shall be made only to the extent permitted by applicable law concerning distributions to holders of equity interests,

(ii) At least once a year during the existence of the program-related investment, to submit full and complete financial reports of the type ordinarily required by commercial investors under similar circumstances and a statement that it has complied with the terms of the investment,

(iii) To maintain books and records adequate to provide information ordinarily required by commercial investors under similar circumstances and to make such books and records available to the private foundation at reasonable times, and

(iv) Not to use any of the funds —

(a) To carry on propaganda, or otherwise to attempt, to influence legislation (within the meaning of section 4945(d)(1)),

(b) To influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive (within the meaning of section 4945(d)(2)), or

(c) With respect to any recipient which is a private foundation (as defined in section 509(a)), to make any grant which does not comply with the requirements of section 4945(d)(3) or (4).

(7) Expenditure responsibility with respect to certain transfers of assets described in section 507

(i) *Transfers of assets described in section 507(b)(2).* —For rules relating to the extent to which the expenditure responsibility rules contained in sections 4945(d)(4) and (h) and this section apply to transfers of assets described in section 507(b)(2), see §§[Link 1.507-3\(a\)\(7\)](#), [Link 1.507-3\(a\)\(8\)\(ii\)\(f\)](#), and 1.507-3(a)(9).

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

(ii) *Certain other transfers of assets.* —For rules relating to the extent to which the expenditure responsibility rules contained in sections 4945(d)(4) and (h) and this section apply to certain other transfers of assets described in §Link 1.507-3(b), see §Link 1.507-3(b) of this chapter.

(8) *Restrictions on grants (other than program-related investments) to organizations not described in section 501(c)(3).* —For other restrictions on certain grants (other than program-related investments) to organizations which are not described in section 501(c)(3), see §Link 53.4945-6(c).

(c) Reports from grantees

(1) In general. —In the case of grants described in section 4945(d)(4), except as provided in subparagraph (2) of this paragraph, the granting private foundation shall require reports on the use of the funds, compliance with the terms of the grant, and the progress made by the grantee toward achieving the purposes for which the grant was made. The grantee shall make such reports as of the end of its annual accounting period within which the grant or any portion thereof is received and all such subsequent periods until the grant funds are expended in full or the grant is otherwise terminated. Such reports shall be furnished to the grantor within a reasonable period of time after the close of the annual accounting period of the grantee for which such reports are made. Within a reasonable period of time after the close of its annual accounting period during which the use of the grant funds is completed, the grantee must make a final report with respect to all expenditures made from such funds (including salaries, travel, and supplies) and indicating the progress made toward the goals of the grant. The grantor need not conduct any independent verification of such reports unless it has reason to doubt their accuracy or reliability.

(2) Capital endowment grants to exempt private foundation s. —If a private foundation makes a grant described in section 4945(d)(4) to a private foundation which is exempt from taxation under section 501(a) for endowment, for the purchase of capital equipment, or for other capital purposes, the grantor foundation shall require reports from the grantee on the use of the principal and the income (if any) from the grant funds. The grantee shall make such reports annually for its taxable year in which the grant was made and the immediately succeeding two taxable years. Only if it is reasonably apparent to the grantor that, before the end of such second succeeding taxable year, neither the principal, the income from the grant funds, nor the equipment purchased with the grant funds has been used for any purpose which would result in

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

liability for tax under section 4945(d), the grantor may then allow such reports to be discontinued.

(3) Grantees' accounting and record-keeping procedures

(i) A private foundation grantee exempt from taxation under section 501(a) (or the recipient of a program-related investment) need not segregate grant funds physically nor separately account for such funds on its books unless the grantor requires such treatment of the grant funds. If such a grantee neither physically segregates grant funds nor establishes separate accounts on its books, grants received within a given taxable year beginning after December 31, 1969, shall be deemed, for purposes of section 4945, to be expended before grants received in a succeeding taxable year. In such case expenditures of grants received within any such taxable year shall be prorated among all such grants. In accounting for grant expenditures, private foundation s may make the necessary computations on a cumulative annual basis (or, where appropriate, as of the date for which the computations are made). The rules set forth in the preceding three sentences shall apply to the extent they are consistent with the available records of the grantee and with the grantee's treatment of qualifying distributions under section 4942(h) and the regulations thereunder. The records of expenditures, as well as copies of the reports submitted to the grantor, must be kept for at least 4 years after completion of the use of the grant funds.

(ii) For rules relating to accounting and record-keeping requirements for grantees other than those described in subdivision (i) of this subparagraph, see §§Link 53.4945-5(b)(8) and Link 53.4945-6(c).

(4) Reliance on information supplied by grantee. —A private foundation exercising expenditure responsibility with respect to its grants may rely on adequate records or other sufficient evidence supplied by the grantee organization (such as a statement by an appropriate officer, director or trustee of such grantee organization) showing, to the extent applicable, the information which the grantor must report to the Internal Revenue Service in accordance with paragraph (d)(2) of this section.

(d) Reporting to Internal Revenue Service by grantor

(1) In general. —To satisfy the report-making requirements of section 4945(h)(3), a granting foundation must provide the required information on its annual information return, required to be filed by section 6033, for each taxable year with respect to each grant made during the taxable year which is subject to the expenditure responsibility requirements of section 4945(h). Such information must also be provided on such

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

return with respect to each grant subject to such requirements upon which any amount or any report is outstanding at any time during the taxable year. However, with respect to any grant made for endowment or other capital purposes, the grantor must provide the required information only for any taxable year for which the grantor must require a report from the grantee under paragraph (c)(2) of this section. The requirements of this subparagraph with respect to any grant may be satisfied by submission with the foundation's information return of a report received from the grantee, if the information required by subparagraph (2) of this paragraph is contained in such report.

(2) Contents of report. —The report required by this paragraph shall include the following information:

- (i) The name and address of the grantee,
- (ii) The date and amount of the grant,
- (iii) The purpose of the grant,
- (iv) The amounts expended by the grantee (based upon the most recent report received from the grantee),
- (v) Whether the grantee has diverted any portion of the funds (or the income therefrom in the case of an endowment grant) from the purpose of the grant (to the knowledge of the grantor),
- (vi) The dates of any reports received from the grantee, and
- (vii) The date and results of any verification of the grantee's reports undertaken pursuant to and to the extent required under paragraph (c)(1) of this section by the grantor or by others at the direction of the grantor.

(3) Record-keeping requirements. —In addition to the information included on the information return, a granting foundation shall make available to the Internal Revenue Service at the foundation's principal office each of the following items:

- (i) A copy of the agreement covering each "expenditure responsibility" grant made during the taxable year,
- (ii) A copy of each report received during the taxable year from each grantee on any "expenditure responsibility" grant, and

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX
		December 31, 20XX
		December 31, 20XX

(iii) A copy of each report made by the grantor's personnel or independent auditors of any audits or other investigations made during the taxable year with respect to any "expenditure responsibility" grant.

(4) Reports received after the close of grantor's accounting year. —Data contained in reports required by this paragraph, which reports are received by a private foundation after the close of its accounting year but before the due date of its information return for that year need not be reported on such return, but may be reported on the grantor's information return for the year in which such reports are received from the grantee.

(e) Violations of expenditure responsibility requirements

(1) Diversions by grantee

(i) Any diversion of grant funds (including the income therefrom in the case of an endowment grant) by the grantee to any use not in furtherance of a purpose specified in the grant may result in the diverted portion of such grant being treated as a taxable expenditure of the grantor under section 4945(d)(4). However, for purposes of this section, the fact that a grantee does not use any portion of the grant funds as indicated in the original budget projection shall not be treated as a diversion if the use to which the funds are committed is consistent with the purpose of the grant as stated in the grant agreement and does not result in a violation of the terms of such agreement required to be included by paragraph (b)(3) or (b)(4) of this section.

(ii) In any event, a grantor will not be treated as having made a taxable expenditure under section 4945(d)(4) solely by reason of a diversion by the grantee, if the grantor has complied with subdivision (iii)(a) and (b) or (iv)(a) and (b) of this subparagraph, whichever is applicable.

(iii) In cases in which the grantor foundation determines that any part of a grant has been used for improper purposes and the grantee has not previously diverted grant funds, the foundation will not be treated as having made a taxable expenditure solely by reason of the diversion so long as the foundation —

(a) Is taking all reasonable and appropriate steps either to recover the grant funds or to insure the restoration of the diverted funds and the dedication (consistent with the requirements of (b)(1) and (2) of this subdivision) of the other grant funds held by the grantee to the purposes being financed by the grant, and

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

(b) Withholds any further payments to the grantee after the grantor becomes aware that a diversion may have taken place (hereinafter referred to as "further payments") until it has —

(1) Received the grantee's assurances that future diversions will not occur, and

(2) Required the grantee to take extraordinary precautions to prevent future diversions from occurring.

If a foundation is treated as having made a taxable expenditure under this subparagraph in a case to which this subdivision applies, then unless the foundation meets the requirements of (a) of this subdivision the amount of the taxable expenditure shall be the amount of the diversion (for example, the income diverted in the case of an endowment grant, or the rental value of capital equipment for the period of time for which diverted) plus the amount of any further payments to the same grantee. However, if the foundation complies with the requirements of (a) of this subdivision but not the requirements of (b) of this subdivision, the amount of the taxable expenditures shall be the amount of such further payments.

(iv) In cases where a grantee has previously diverted funds received from a grantor foundation, and the grantor foundation determines that any part of a grant has again been used for improper purposes, the foundation will not be treated as having made a taxable expenditure solely by reason of such diversion so long as the foundation —

(a) Is taking all reasonable and appropriate steps to recover the grant funds or to insure the restoration of the diverted funds and the dedication (consistent with the requirements of (b)(2) and (3) of this subdivision) of other grant funds held by the grantee to the purposes being financed by the grant, except that if, in fact, some or all of the diverted funds are not so restored or recovered, then the foundation must take all reasonable and appropriate steps to recover all of the grant funds, and

(b) Withholds further payments until —

(1) Such funds are in fact so recovered or restored,

(2) It has received the grantee's assurances that future diversions will not occur, and

(3) It requires the grantee to take extraordinary precautions to prevent future diversions from occurring.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

If a foundation is treated as having made a taxable expenditure under this subparagraph in a case to which this subdivision applies, then unless the foundation meets the requirements of (a) of this subdivision, the amount of the taxable expenditure shall be the amount of the diversion plus the amount of any further payments to the same grantee. However, if the foundation complies with the requirements of (a) of this subdivision, but fails to withhold further payments until the requirements of (b) of this subdivision are met, the amount of the taxable expenditure shall be the amount of such further payments.

(v) The phrase "all reasonable and appropriate steps" (as used in subdivisions (iii) and (iv) of this subparagraph) includes legal action where appropriate but need not include legal action if such action would in all probability not result in the satisfaction of execution on a judgment.

(2) Grantee's failure to make reports. —A failure by the grantee to make the reports required by paragraph (c) of this section (or the making of inadequate reports) shall result in the grant's being treated as a taxable expenditure by the grantor unless the grantor:

- (i) Has made the grant in accordance with paragraph (b) of this section,
- (ii) Has complied with the reporting requirements contained in paragraph (d) of this section,
- (iii) Makes a reasonable effort to obtain the required report, and
- (iv) Withholds all future payments on this grant and on any other grant to the same grantee until such report is furnished.

(3) Violations by the grantor. —In addition to the situations described in subparagraphs (1) and (2) of this paragraph, a grant which is subject to the expenditure responsibility requirements of section 4945(h) will be considered a taxable expenditure of the granting foundation if the grantor —

- (i) Fails to make a pre-grant inquiry as described in paragraph (b)(2) of this section,
- (ii) Fails to make the grant in accordance with a procedure consistent with the requirements of paragraph (b)(3) or (4) of this section, or

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

(iii) Fails to report to the Internal Revenue Service as provided in paragraph (d) of this section.

(f) Effective dates

(1) In general. —This section shall apply to all grants which are subject to the expenditure responsibility requirements of section 4945(d)(4) and (h) and which are made by private foundation s more than 90 days after October 30, 1972.

Pension Protection Act SEC. 1212. - INCREASE IN PENALTY EXCISE TAXES RELATING TO PUBLIC CHARITIES, SOCIAL WELFARE ORGANIZATIONS, AND PRIVATE FOUNDATIONS.

(1) IN GENERAL. Section 4945(a) (relating to initial taxes) is amended —

(A) in paragraph (1), by striking “10 percent” and inserting “20 percent”, and

(B) in paragraph (2), by striking “21/2 percent” and inserting “5 percent”.

(2) INCREASED LIMITATION FOR MANAGERS.—Section 4945(c)(2) is amended:

(A) by striking “\$5,000,” and inserting “\$10,000,”, and (B) by striking “\$10,000.” and inserting “\$20,000.”.

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

Analysis

A. Taxpayer’s Position

The taxpayer does not agree with the Service’s position.

B. Government’s Position

1) Is the Foundation operated exclusively for exempt purposes under IRC Section 501(c)(3)?

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

The ORG is not operated exclusively for charitable or educational purposes under section 501(c)(3) as it serves a private rather than public interest, and its earnings indirectly inure to private individuals. It fails the operational test under Treas. Reg. 1.501(c)(3)-1(c)(1) & 1(c)(2).

The ORG provides grants to the FDN, a related and controlled private foundation. The grants are used in part to maintain the 265 acre property. The property, which consists of a botanical garden (and open-space) is unlike the instances in Rev. Rul. 70-186 & 78-85, as it is not extensively used by the public. Rather, it is unadvertised and provides limited public access. Hundreds of visitors per year are stated to have visited the property, while similar botanical gardens in the Southern State region host between 50,000 – 500,000 visitors per year.

While the public benefit is limited and incidental, the President & Treasurer and Secretary & Husbands retain control FDN's property and have the right to use the property in perpetuity for personal use. The 265 acre property is inseparable and commingled with the Taft and Whitman's private property. The benefits derived from the organization flow to its founders similar to *Benedict Ginsberg and Adele W. Ginsberg v. Commissioner*, 46 T.C. 47 (1966); and Rev. Rul. 75-286, 1975-2. Similar to *American Campaign Academy, Petitioner v. Commissioner*, the benefits received by the officers advances a substantial nonexempt purpose which is not incidental. Furthermore, the officers maintain sole control over both foundations and control all financial matters. No internal controls exist to prevent inurement. The ORG's expenditures indirectly inure to the benefit of the Taft and Whitman families and therefore fails Treasury Regulations 1.501(c)(3)-1(c)(2).

The ORG's property in New Mexico is also commingled with President and Treasurer's for-profit business. The building at Address allows them to operate one for-profit hotel containing ten rooms, as opposed to six rooms. They possess the power to direct the management and policies over the hotel. City County records also confirm that President and Treasurer's own the business. The additional four units, and parking spaces that comprise Address augmented their for-profit investment (Address) providing them with a substantial benefit.

711 & 719 properties are inseparable, and it is impossible to distinguish any exempt use from this activity. Furthermore, Hotel-1 was a profit-making business that never held itself out as a charity before the President and Treasurer acquired the properties. When exempt organization's investments are dictated in part by needs of private interests, one cannot say that organization was operated exclusively for public benefit, see *Western Catholic Church v. Commissioner*, 73 T.C. 196, 214, 1979 WL 3850

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

(1979). The use of the organization's assets in such a manner constitutes inurement and acts of self dealing under IRC Sections 4941(d)(1)(C) & 4941(d)(1)(E).

The form 1023 did not disclose that the FDN would be the primary grant recipient nor did it disclose the issues surrounding the 265 acre property. In this case, the agent recommends retroactive revocation of the determination letter because the Organization operated in a manner inconsistent with its exempt status under IRC 501(c)(3). Exemption should be revoked effective January 1, 20XX.

2) Is the ORG liable for excise tax on Taxable Expenditures under IRC § 4945?

The ORG is liable for excise tax on taxable expenditures under IRC Section 4945 for failing to maintain expenditure responsibility under § 4945(h) with respect to the grants to the FDN, a controlled non-operating private ORG.

§ 4945(h) – Failure to maintain expenditure responsibility

Operating similar to Hans S. Mannheimer Charitable Trust v. Commissioner 93 TC 35 (1989), the ORG failed to comply with Regulations §§ 53.4945-5(b)(2) and 53.4945-5(b)(3) and thus failed to meet the demands of § 4945(h)(1).

Section 4945(h)(1) requires a grantor to take affirmative steps "to see that the grant is spent solely for the purposes for which [the grant was] made." § 53.4945-5(b)(2) of the regulations provide that as a first step, prior to making a grant, a private foundation should conduct a limited inquiry concerning the potential grantee and, as a second step, under § 53.4945-5(b)(3) of the Regulations, must obtain a written commitment signed by an appropriate officer, director, or trustee of the grantee organization that the funds will be used for charitable, scientific, educational, etc. purposes.

The "limited inquiry" should be complete enough to give a reasonable man assurance that the grantee will use the grant for the proper purposes and should reveal the identity, prior history, and experience of the grantee organization and its managers and any knowledge which the private foundation has concerning management, activities, and practices of the grantee organization. ORG did not conduct a pre grant inquiry to satisfy Treas. Reg. § 53.4945-1(b)(2)(i).

Furthermore, each grant was not made subject to a written agreement to satisfy Treas. Reg. § 53.4945-1(b)(3).

Those terms would require the following clauses to:

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

- Clearly specify the purpose of each grant and ensure that the grants would be used for charitable, educational, scientific, etc purposes
- Repay any portion of the amount granted which is not used for the purposes of the grant
- Submit full and complete annual reports on the matter in which the funds are spent and the progress made in accomplishing the purposes of the grant or reports from the grantee on the use of the principal and the income (if any) from the grant funds
- Maintain records of receipts and expenditures and to make its books and records available to the grantor at reasonable times
- Not to use any of the funds —

(a) To carry on propaganda, or otherwise to attempt, to influence legislation (within the meaning of section 4945(d)(1)),

(b) To influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive (within the meaning of section 4945(d)(2)),

(c) To make any grant which does not comply with the requirements of section 4945(d)(3) or (4), or

(d) To undertake any activity for any purpose other than one specified in section 170(c)(2)(B).

Because the ORG fails Treas. Reg. § 53.4945-5(b)(2) and (b)(3), it fails the requirements set fourth in IRC § 4945(h)(1).

The ORG also failed to adhere to the requirements set forth in IRC § 4945(h)(2), which requires the ORG to exert all reasonable efforts and to establish adequate procedures "to obtain full and complete reports from the grantee on how the funds are spent."

Regulation §§ 53.4945-5(c)(1), (2), (3), and (4), contain specific provisions detailing the requirements of § 4945(h)(2):

53.4945-1(c) – Reports from Grantees

The ORG did not provide annual reports detailing:

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

- The use of funds or income
- Whether the grantee complied with the grant terms⁹
- Any progress made by grantee achieving charitable purposes.

Finally, IRC § 4945(h)(3) requires the grantor "to make full and detailed reports with respect to its expenditures to the Secretary." Section 53.4945-5(d)(2) of the regulations explains in detail what the report should contain.

53.4945-1(d) - Reporting to Internal Revenue Service by grantor:

The ORG did not provide the required information on its Forms 990-PF, set forth in Treasury Regulations 53.4945-1(d).

The ORG failed to meet the demands of IRC § 4945(h)(3). Where a grantor fails to satisfy any or all of the expenditure responsibility requirements of section 4945(h), the section 4945(a)(1) excise tax is mandatory regardless of the harm or lack thereof resulting from the failure.

The following expenditures are taxable expenditures:

	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>	
Expenditure responsibility Grant to Foundation, A non-operating ORG	\$0	\$0	\$0	-

Excise Tax

<u>Year</u>	<u>Amount Involved</u>	<u>4945(a)(1)</u>	<u>Tax</u>
20XX	\$0	20%	\$0
20XX	0	20%	\$0

* * * *

⁹ no grant terms existed

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

20XX	\$0	20%	\$0
Total			<u>\$0</u>

Correction

Treas. Reg. §53.4945-1(d)(1) *In general.* —Except as provided in paragraph (d)(2) or (3) of this section, correction of a taxable expenditure shall be accomplished by recovering part or all of the expenditure to the extent recovery is possible, and, where full recovery cannot be accomplished, by any additional corrective action which the Commissioner may prescribe.

Treas. Reg. §53.4945-1(d)(2) - Correction for inadequate reporting. —If the expenditure is taxable only because of a failure to obtain a full and complete report as required by section 4945(h)(2) or because of a failure to make a full and detailed report as required by section 4945(h)(3), correction may be accomplished by obtaining or making the report in question. In addition, if the expenditure is taxable only because of a failure to obtain a full and complete report as required by section 4945(h)(2) and an investigation indicates that no grant funds have been diverted to any use not in furtherance of a purpose specified in the grant, correction may be accomplished by exerting all reasonable efforts to obtain the report in question and reporting the failure to the Internal Revenue Service, even though the report is not finally obtained.

Correction amounts under §4945(b)(1):

<u>Year</u>	<u>Amount Involved</u>	<u>4945(b)(1)</u>	<u>Tax</u>
20XX	\$0	100%	\$0
20XX	0	100%	\$0
20XX	\$0	100%	\$0
Total			<u>\$0</u>

3) Is the ORG liable for excise tax on Failure to Distribute Income under IRC §4942?

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

Section 4942(a) imposes a 30 percent excise tax on the undistributed income of a private ORG for any taxable year which has not been distributed before the first day of the succeeding taxable year. Section 4942(g)(1)(A) provides that qualifying distributions do not include grants to controlled ORGs or grants to non operating ORGs; unless those organizations re-distribute the entire amount out of corpus. The ORG would also be required to obtain adequate records or other sufficient evidence from the FDN showing that the qualifying distribution(s) has been made out of corpus. Grants to the FDN are not qualifying distributions.

Form 990		20XX	20XX	20XX
Tax Year				
Part X				
Minimum Investment Return				
1	Fair market value of assets			
a	Average monthly fair market value of securities			
b	Average of monthly cash balances	\$0	\$0	\$0
c	Fair market value of all other assets	0	0	0
d	Total	\$0	\$0	\$0
e	Reduction claimed for blockage or other factors reported on lines 1a and 1c			
2	Acquisition indebtedness applicable to line 1 assets			
3	Subtract line 2 from line 1d			
4	Cash deemed held for charitable activities. Enter 1 1/2% of line 3			
5	Net value of non charitable-use assets. Subtract line 4 from line 3. Enter here and on Part V, line 4	\$0	\$0	\$0
6	Minimum investment return. Enter 5% of line 5	\$0	\$0	\$0
Part XI				
1	Minimum investment return from Part X, line 6	\$0	\$0	\$0
2 a	Tax on investment income for 2001 from Part VI, line 5	0	0	0
b	Income tax for 2001. (This does not include the tax from Part VI.)			
c	Add lines 2a and 2b			
3	Distributable amount before adjustments. Subtract line 2c from line 1			

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer: ORG	EIN:	Year/Period Ended December 31, 20XX December 31, 20XX December 31, 20XX

4	a	Recoveries of amounts treated as qualifying distributions			
	b	Income distributions from section 4947(a)(2) trusts			
	c	Add lines 4a and 4b			
5		Add lines 3 and 4c			
6		Deduction from distributable amount			
7		Distributable amount as adjusted. Subtract line 6 from line 5.	0	0	0

Part XII					
		Amounts paid (including administrative expenses) to accomplish charitable, etc., purposes:			
1					
	a	Expenses, contributions, gifts, etc	0	0	0
	b	Program-related investments			
2		Amounts paid to acquire assets used (or held for use) directly in carrying out charitable, etc., purposes			
3		Amounts set aside for specific charitable projects that satisfy the			
	a	Suitability test (prior IRS approval required)			
	b	Cash distribution test			
4		Qualifying distributions			
5		Organizations that qualify under section 4940(e) for the reduced rate of tax on net investment income. Enter 1% of Part I, line 27b			
6		Adjusted qualifying distributions. Subtract line 5 from line 4	0	0	0

Part XIII					
1		Distributable Amount	0	0	0
2		Undistributed income in prior years			
	a	Enter amount for last year		0	0
	b	For all other prior years			0
3		Excess distribution carryover			
	a	Prior year 5			
	b	Prior year 4			
	c	Prior year 3			
	d	Prior year 2			
	e	Prior year 1			
	f	<i>Total</i>			

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

4	Qualifying Distributions			
a	Applied to last year	0	0	0
b	Applied to undistributed income of prior years (Election Req)			
c	Treated as distributions out of corpus (Election Req)			
d	Applied to current year distributable amount	0	0	0
e	Remaining amount distributed out of corpus			
5	Excess distributions carryover applied to current year (Subtract line 4b from line 1)			
6	<i>Net totals as follows</i>			
a	Corpus. Add lines 3f, 4c, and 4e. Subtract line 5			
b	Prior years' undistributed income. Subtract line 4b from line 2b			0
c	Enter the amount of prior years' undistributed income for which a notice of deficiency has been issued, or on which the section 4942(a) tax has been previously assessed			
d	Subtract line 6c from line 6b. Taxable amount			0
e	<i>Undistributed income in prior year. Subtract line 4a from line 2a. Taxable amount</i>		0	0
f	<i>Undistributed income for. Subtract lines 4d and 5 from line 1. This amount must be distributed in the subsequent year.</i>	0	0	0
7	Amounts treated as distributions out of corpus to satisfy requirements imposed by section 170(b)(1)(F) or 4942(g)(3)			
8	Excess distributions carryover from prior year 5 not applied on line 5 or line 7	0		
9	<i>Excess distribution carryover to 20XX. Subtract line 7 and 8 from line 6a.</i>	0		
10	Analysis of line 9	0		
a	Excess from prior year 4	0		
b	Excess from prior year 3	0		
c	Excess from prior year 2	0		
d	Excess from prior year 1	0		
e	Excess from current year	0		

Year	Amount Involved	Code Section	%	Total
------	-----------------	--------------	---	-------

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX
		December 31, 20XX
		December 31, 20XX

20XX \$0 4942(a)(1) 30 \$0

Correction under 4942(b)

In any case in which an initial tax is imposed under subsection (a) on the undistributed income of a private foundation for any taxable year, if any portion of such income remains undistributed at the close of the taxable period, there is hereby imposed a tax equal to 100 percent of the amount remaining undistributed at such time.

Year	Amount Involved	Code Section	%	Total
20XX	\$0	4942(b)	100	\$0

4) Is the ORG liable for excise tax on Excess Business Holdings under IRC §4943?

In 20XX and 20XX, the for-profit hotel was an unrelated business enterprise described under Regulations §53.4943-10. This activity was not a "functionally-related business," as defined in section 4942(j)(4).

The ownership was comprised of 40% ORG and 60% President and Treasurer.

The permitted holdings of any private foundation are generally 20%, which includes "profits interest" described under 4943(c)(3)(A).

The term "excess business holdings" means, with respect to the holdings of any private ORG in any business enterprise, the amount of stock or other interest in the enterprise which the ORG 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 (4943(c)(1)).

The ORG's holding in Hotel-2 constitute excess business holdings. The ORG's permitted holdings are 0%, determined by subtracting the disqualified persons percentage (60%) from 20%.

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX
		December 31, 20XX
		December 31, 20XX

In this instance, the valuation of the interest in the business shall be determined by the property's donated value.

Year	Amount Involved	Code Section	%	Total
20XX	\$0	4943(a)(1)	10	\$0
20XX	\$0	4943(a)(1)	10	\$0

Correction under §53.4943-2(b) - if at the close of the taxable period (as defined in section 4943(d)(2) and §53.4943-9) the foundation still has excess business holdings in such enterprise, there is imposed a tax under section 4943(b) equal to 200 percent of the value of such excess holdings as of the last day of the taxable period.

§53.4943-9(c) *Correction*. —For purposes of section 4943, correction shall be considered as made when no interest in the enterprise held by the foundation is classified as an excess business holding under section 4943(c)(1).

If correction is not made by the close of the taxable period then the ORG will be liable for the additional tax under 4943(b).

Amount Involved	Code Section	%	Total
\$0	4943(b)	200	\$0

Conclusion

- The ORG is not operated exclusively for charitable purposes under section 501(c)(3). Revocation of tax exempt status is proposed, effective January 1, 20XX

The ORG should be treated as a taxable private foundation that is no longer exempt under IRC section 501(a) and 501(c)(3). Though it may operate as a taxable entity, it will continue to be treated as a private foundation until that status is terminated under IRC section 507.

A taxable private foundations is liable for filing the Form 990-PF (for Chapter 4940(b) excise tax) and the related taxable return Form 1120 or 1041 (subtitle A income tax) that applies.

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Explanation of Items		
Name of Taxpayer:	EIN:	Year/Period Ended
ORG		December 31, 20XX December 31, 20XX December 31, 20XX

2. The ORG is liable for excise tax for failing to maintain expenditure responsibility under IRC 4945(h).
3. The ORG liable for excise tax for having undistributed income under IRC §4942.
4. The ORG liable for excise tax on Excess Business Holdings under IRC §4943.