



# Exempt Organizations Technical Guide

## TG 60: Taxes on Excess Business Holdings – IRC Section 4943

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## I. Overview

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

### A. Background / History

- (1) Under Chapter 42, Section 4943 excise taxes are imposed on a private foundation which has excess business holdings. The taxes imposed under Section 4943 apply to:
  - a. Private foundations
  - b. Certain charitable trusts described in Section 4947(a)(1), and
  - c. Certain split-interest trusts described in Section 4947(a)(2).
- (2) The excess business holdings rules were enacted by Congress in the Tax Reform Act of 1969, Public Law 91-172 ("TRA '69"), to limit individuals' ability to retain control of a business enterprise by setting up a private foundation and transferring substantial ownership of that business enterprise to the foundation.
- (3) As a practical matter, the law prior to 1969 didn't preserve private foundations' integrity. The 1969 Act generally limits a private foundation's ability to own a business, one that is not conducted as an exempt function asset, by the excess business holding rules contained in Section 4943.
- (4) The Pension Protection Act of 2006, Public Law 109-280 ("PPA 2006"), expanded Section 4943 to apply to donor advised funds and certain Section 509(a)(3) supporting organizations as well as private foundations. Donor advised funds are subject to the excess business holding rules pursuant to Section 4943(e). Certain Section 509(a)(3) supporting organizations, are subject to Section 4943 excise taxes on excess business holdings under Section 4943(f). The provisions are effective for tax years beginning after August 17, 2006.
- (5) The PPA 2006, Section 1212, also amended the Code for Chapter 42 excise taxes. Most of the first tier excise tax rates, as well as the limits on foundation manager taxes were doubled. The amendments apply to excise taxes imposed by Section 4943.
- (6) Regarding the filing requirements for private foundations, for tax years beginning on or after July 2, 2019, Section 3101 of Public Law 116-25 requires that returns by exempt organizations be filed electronically. If an organization is filing Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation, for a tax year beginning on or after July 2, 2019, the organization must file the return electronically. Limited exceptions apply.

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

## B. Relevant Terms

- (1) **Business Enterprise:** In general, includes the active conduct of a trade or business including any activity that is regularly carried on for the production of income from the sale of goods or the performance of services and that constitutes an unrelated trade or business under Section 513. The term does not include a functionally related business, a trade or business that obtains at least 95% of its gross income from passive sources, or program-related investments. See Section 4943(d)(3).
- (2) **Excess Business Holdings:** Defined in Section 4943(c)(1), with respect to the holdings of any private foundation in any business enterprise, as the amount of stock or other interest in the enterprise which the private foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.
- (3) **Functionally Related Business:** Defined by reference to Section 4942(j)(4) as:
  - a. A trade or business the conduct of which is substantially related (aside from the mere provision of funds for the exempt purpose) to the exercise or performance by the private foundation of its charitable, educational or other purpose or function constituting the basis for its exemption,



- b. A trade or business in which substantially all the work is performed for the foundation without compensation,
  - c. A business carried on by the foundation primarily for the convenience of its members, students, patients, officers or employees (such as a cafeteria operated by a museum for the convenience of its members, employees and visitors),
  - d. A business that consists of the selling of merchandise, substantially all of which has been received by the foundation as gifts or contributions, or
  - e. An activity carried on within a larger combination of similar activities or within a larger complex of other endeavors that is related to the exempt purposes of the foundation (other than the need to simply provide funds for these purposes).
- (4) **Permitted Holdings:** Defined, in general, as 20% of the voting stock reduced by 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% of the voting stock of an incorporated business enterprise, nonvoting stock held by the private foundation shall also be treated as permitted holdings. See Section 4943(c)(2)(A).

## C. Law / Authority

- (1) Section 4943 provides two levels of tax on the excess business holdings of a private foundation in a business enterprise:
- a. Initial tax - There is 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% of the value of such holdings. See Section 4943(a).
  - b. Additional tax - In any case in which an initial tax is imposed 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% of such excess business holdings. See Section 4943(b).

## II. Requirements

- (1) Taxes on excess business holdings. Private foundations, donor advised funds, and certain Section 509(a)(3) organizations are subject to excise tax under Section 4943 for excess business holdings in business enterprises.

### A. Excess Business Holdings

- (1) Excess business holdings are the amount of stock, or other interest, in a business enterprise that a private foundation would have to dispose of, to a person other than a disqualified person, as defined in Section 4946, so that the remaining holdings of the foundation are permitted holdings. See Section 4943(c).

### B. Permitted Holdings

- (1) A foundation and its disqualified persons together may hold up to 20% of the voting stock of a corporation conducting a business that isn't substantially related to the exempt purpose of the foundation. See Section 4943(c)(3)(A). If it can be established to the satisfaction of the IRS that effective control of the corporation is in one or more persons who are not disqualified persons with respect to the foundation, the 20% limit is raised to 35%. See Section 4943(c)(2)(B).
- (2) If disqualified persons together hold more than 20% of the voting stock, or 35% where a non-disqualified person has control, a foundation must also dispose of its nonvoting stock. See Section 4943(c)(2)(B).

### C. 2% De Minimis Rule

- (1) Even if the 20% or 35% limit is exceeded, a foundation won't have excess business holdings in any corporation in which it, together with all other effectively controlled private foundations if it doesn't own, actually or constructively, more than 2% of the voting stock and more than 2% of the value of all outstanding shares of all classes of stock. See Section 4943(c)(2)(C).
- (2) If a private foundation, together with all other private foundations, actually or constructively owns more than 2% of either the voting stock or the value of the outstanding shares of all classes of stock (including stock treated as held by a disqualified person under Section 4943(c)(4)(B), Section 4943(c)(5), or Section 4943(c)(6)) in any business enterprise, the 2% rule doesn't apply, and all the stock in such business enterprise classified as excess business holdings is treated as excess business holdings.

### D. Exception for 100% Owned Voting Stock

- (1) Section 4943(g) was added by the Bipartisan Budget Act of 2018, Public Law 115-123 ("BBA"), and provides an exception for certain limited holdings to independently operated philanthropic business. In general, the excess business holdings provisions of Section 4943(a) shall not apply with respect to the holdings

of a private foundation in any business enterprise which meets all the requirements of Sections 4943(g)(2), (3), and (4).

- (2) The requirements of Section 4943(g)(2) are met if:
  - a. 100% of the voting stock in the business enterprise is held by the private foundation at all times during the taxable year, and
  - b. All the private foundation's ownership interests were acquired by means other than by purchase (such as a gift or bequest).
- (3) The requirements of Section 4943(g)(3) are met if:
  - a. The business enterprise, not later than 120 days after the close of the taxable year, distributes an amount equal to its net operating income for such taxable year to the private foundation.
  - b. For purposes of Section 4943(g)(3), the net operating income of any business enterprise for any taxable year is an amount equal to the gross income of the business enterprise for the taxable year, reduced by the sum of (i) the deductions allowed by chapter 1 for the taxable year which are directly connected with the production of such income, (ii) the tax imposed by chapter 1 on the business enterprise for the taxable year, and (iii) an amount for a reasonable reserve for working capital and other business needs of the business enterprise.
- (4) The requirements of Section 4943(g)(4) are met if, at all times during the taxable year:
  - a. No substantial contributor to the private foundation or family member of such a contributor is a director, officer, trustee, manager, employee, or contractor of the business enterprise,
  - b. At least a majority of the board of directors of the private foundation are persons who are not (i) directors or officers of the business enterprise, or (ii) family members of a substantial contributor to the private foundation, and
  - c. There is no loan outstanding from the business enterprise to a substantial contributor to the private foundation or to any family member of such a contributor.
- (5) Generally, this new provision doesn't apply to any donor advised fund, a trust described in Section 4947(a)(1), or a trust described in Section 4947(a)(2). Section 4943(g) applies to taxable years beginning after December 31, 2017.

## **E. Business Enterprise**

- (1) A private foundation isn't subject to the excess business holdings tax unless it has an equity interest in a business enterprise.

### **E.1. Business Enterprise Defined**

- (1) The term "business enterprise" includes the active conduct of a trade or business, including any activity regularly carried on to produce income from the sale of goods or the performance of services and that constitutes an unrelated trade or business under Section 513. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business is excluded from the classification of a business enterprise merely because it does not result in a profit. See Treasury Regulation (Treas. Reg.) 53.4943-10(a)(1). See also Private Letter Ruling (PLR) 200532058 concerning excess business holdings rules under Section 4943, wherein the IRS determined that income from the development of an ice arena does not constitute unrelated business taxable income because such revenues will be derived from a trade or business that is substantially related to foundation's exempt purposes. The ruling held that such income won't constitute debt financed income within the meaning of Section 514, and, accordingly, won't be subject to tax under Section 511. In addition, the foundation's development of the ice arena is a functionally related business under Section 4942(j)(4). As such, it is not a business enterprise pursuant to Section 4943(d)(3)(A), as described in Treas. Reg. 53.4943-10(a) and (b).

## **E.2. Exclusions**

- (1) A business enterprise doesn't include debt, a functionally related business, or a passive holding company.

## **E.3. Debt**

- (1) A bond or other evidence of indebtedness isn't a holding in a business enterprise unless it's an equitable interest in the enterprise. A leasehold interest in real property isn't an interest in a business enterprise, even though rent payable under the lease depends on the income or profits derived by another from that property, unless the leasehold interest is an interest in the income or profits of an unrelated trade or business under Section 513. See Treas. Reg. 53.4943-10(a)(2).

## **E.4. Functionally Related Business**

- (1) A business enterprise doesn't include a functionally related business as defined in Section 4942(j)(4). A functionally related business includes a business that's related for purposes of the tax on unrelated business income. It also includes a business, which although unrelated to the direct activities of the private foundation, is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors that is related to the exempt purposes of the organization.

## **E.5. Passive Holding Company**

- (1) A business enterprise does not include a trade or business of which at least 95% of its gross income is from passive sources. See Section 4943(d)(3)(B).

- (2) If less than 95% of the income of a trade or business is from passive sources, the foundation may substitute for the passive source gross income the average gross income from passive sources for the 10 tax years immediately preceding the tax year in question (or for any shorter period the entity has been in existence). See Treas. Reg. 53.4943-10(c)(1).
- (3) Stock in a passive holding company is not a holding in a business enterprise even if the company is controlled by the foundation. Instead, the foundation is treated as owning its proportionate share of any interests in a business enterprise held by the company. See Treas. Reg. 53.4943-10(c)(1).

## **E.6. Exception Under Section 4943(g)**

- (1) The BBA created an exception from the excise tax on excess business holdings, called Section 4943(g), for certain independently operated enterprises whose voting stock is wholly owned by a private foundation and all the private foundation's ownership interests in the business enterprise were acquired by means other than by purchase.

## **F. Taxes Imposed**

- (1) Section 4943(a)(1) imposes an initial tax on a private foundation with excess business holdings.
- (2) Section 4943(b) imposes an additional tax on a private foundation that fails to timely dispose of such excess business holdings.

### **F.1. Initial Taxes**

- (1) There is 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% of the value of such holdings. This is also referred to as a first tier tax. See Section 4943(a)(1).
- (2) Special rules: The tax imposed by paragraph (1)
  - a. Shall be imposed on the last day of the taxable year, but
  - 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.
- (3) The amount of such tax is imposed on 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 Treas. Reg. 20.2031-1 through 20.2031-3 of the Estate Tax Regulations Chapter shall apply. See Treas. Reg. 53.4943-2(a)(1).

- (4) For purposes of the taxes under Section 4943, certain donor advised funds and supporting organizations are treated as private foundations. See Sections 4943(e) and 4943(f).

## **F.2. Additional Taxes**

- (1) In any case in which an initial tax is imposed under Section 4943(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% of such excess business holdings. See Section 4943(b). This is also referred to as a second tier tax. The additional tax won't be assessed, or if assessed will be abated, if the excess business holdings are reduced to zero during the correction period.

### III. Other Considerations

- (1) Excess business holdings are the amount of stock or other interest in a business enterprise that the foundation or a disqualified person would have to dispose of to a person who isn't a disqualified person so that the remaining holdings of the foundation in the enterprise are permitted holdings. See Treas. Reg. 53.4943-3(a)(1).

#### A. Permitted Holdings in an Incorporated Business Enterprise

- (1) Under Section 4943(c)(2)(A), the permitted holdings of any private foundation in the voting stock of an incorporated business enterprise are:
  - a. 20% of the voting stock in the enterprise reduced (but not below zero) by,
  - b. The percentage of voting stock in the enterprise actually or constructively owned by all disqualified persons.
- (2) The percentage of voting stock held by any person in a corporation is normally determined by reference to the power of stock to vote for the election of directors. Treasury stock and stock that is authorized but unissued is disregarded.
- (3) The fact that extraordinary corporate action (for example charter or bylaw amendments) by a corporation may require the favorable vote of more than a majority of the directors, or of the outstanding voting stock of the corporation, shall not alter the determination of voting power of stock in the corporation. See Treas. Reg. 53.4943-3(b)(1)(ii).

#### A.1. Nonvoting Stock

- (1) In any case in which all disqualified persons hold, actually or constructively, 20% or less (35% or less when third persons have effective control) of the voting stock of an incorporated business enterprise, any shares of nonvoting stock are permitted holdings of any private foundation in the nonvoting stock of an incorporated business enterprise. All equity interests that don't have voting power attributable to them will be classified as nonvoting stock.
- (2) Evidences of indebtedness (including convertible indebtedness), warrants, and other options or rights to acquire stock shall not be considered equity interests. See Treas. Reg. 53.4943-3(b)(2)(i).

#### A.2. Stock with Contingent Voting Rights

- (1) Stock carrying voting rights that will vest only when indeterminate conditions have been met will be treated as nonvoting stock until the conditions have occurred that cause the voting rights to vest.

**Example:** Preferred stock that gains voting rights only if no dividends are paid on it. When the rights vest, the stock will be treated as voting stock that was acquired other than by purchase under Section 4943(c)(6), but only if the private

foundation or disqualified persons had no control over whether those conditions would occur. See Treas. Reg. 53.4943-3(b)(2)(ii).

### **A.3. Convertible Nonvoting Stock**

- (1) Nonvoting stock that may be converted into voting stock will not be treated as voting stock until the conversion occurs. See Treas. Reg. 53.4943-3(b)(2)(ii).

### **B. 35% Rule**

- (1) The 20% rules for permitted holdings in an incorporated business enterprise regarding voting stock and nonvoting stock will be increased to 35% if:
  - a. The private foundation and all disqualified persons together do not hold, actually or constructively, more than 35% of the voting stock in the business enterprise, and
  - b. The foundation establishes that effective control of the business enterprise is in one or more persons (other than the foundation itself) who aren't disqualified persons. See Treas. Reg. 53.4943-3(b)(3)(i).

#### **B.1. Effective Control**

- (1) 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 that is decisive and not its form or the means by which it is exercisable. See Treas. Reg. 53.4943-3(b)(3)(ii).

### **C. Permitted Holdings in Unincorporated Business Enterprise**

- (1) The permitted holdings of a private foundation in any business enterprise which is not incorporated shall be determined under the same principles that are applicable to holdings in an incorporated business enterprise. See Treas. Reg. 53.4943-3(c)(1).

#### **C.1. Partnership or Joint Venture**

- (1) For a general partnership, a limited partnership, or joint venture, the terms "profit interest" and "capital interest" are substituted for "voting stock" and "nonvoting stock", respectively. See General Counsel Memorandum (GCM) 39195 (March 15, 1984) which noted that a private foundation's holdings as a limited partner under state law aren't, for purposes of Section 4943, equivalent to nonvoting stock.
- (2) The interest in profits of a foundation (or disqualified person) is 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.

- (3) In the absence of a provision in the partnership agreement, the capital interest of a foundation (or disqualified person) in a partnership is determined based on its interest in the assets of the partnership that would be distributable to the foundation (or disqualified person) upon its withdrawal from the partnership, or upon liquidation of the partnership, whichever is greater. See Treas. Reg. 53.4943-3(c)(2).

## **C.2. Sole Proprietorship**

- (1) A private foundation may have no permitted holdings in a sole proprietorship. See Treas. Reg. 53.4943-3(c)(3).

## **C.3. Trusts and Other Unincorporated Business Enterprises**

- (1) For any other unincorporated business enterprise that is not described above, the term "beneficial interest" is to be substituted for "voting stock." All references to nonvoting stock won't apply to any unincorporated business enterprise described below as "trusts" and "other unincorporated business." See Treas. Reg. 53.4943-3(c)(4)(i).

## **C.4. Trusts**

- (1) The beneficial interest of a private foundation or any disqualified person in a trust shall be the beneficial remainder interest of the foundation or person as provided in Treas. Reg. 53.4943-8(b). See Treas. Reg. 53.4943-3(c)(4)(ii).

## **C.5. Other Unincorporated Business Enterprises**

- (1) The beneficial interest of a private foundation or any disqualified person in an unincorporated business enterprise (other than a trust, a partnership, joint venture, or a sole proprietorship), includes any right to receive a portion of distributions of profits of the 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 upon liquidation of the enterprise, except as a creditor or employee. See Treas. Reg. 53.4943-3(c)(4)(iii).
- (2) A right to receive distributions of profits includes a right to receive any amount from the profits (other than as a creditor or employee), whether as a certain sum or as a portion of profits realized by the enterprise.
- (3) If there is no agreement fixing the rights of the participants in the enterprise, the interest of the foundation (or disqualified person) in the enterprise will 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 the foundation (or 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. See Treas. Reg. 53.4943-3(c)(4)(iii).

## D. Five-Year Disposition Period

- (1) If there is a change in the holdings in a business enterprise of a private foundation or its disqualified persons that causes the private foundation to have excess business holdings, the private foundation has a five-year disposition period to reduce its holdings to a permitted level.
- (2) The five-year disposition period doesn't apply if the change in holdings is a result of a purchase by the private foundation or a disqualified person. See Section 4943(c)(6); Treas. Reg. 53.4943-6(a)(1).

### D.1. Private Foundation Has No Excess Business Holdings Prior to Change in Holdings

- (1) If a private foundation has no excess business holdings (determined without regard to the five-year disposition period) in a business enterprise immediately prior to a change in holdings in such enterprise to which the five-year disposition period applies, the entire interest of the foundation in the enterprise (immediately after such change) shall (while held by the foundation) be treated as held by a disqualified person during the five-year period beginning on the date of such change. See Section 4943(c)(6)(A); Treas. Reg. 53.4943-6(a)(1)(ii).

### D.2. Private Foundation Has Excess Business Holdings Prior to Change in Holdings

- (1) If a private foundation has excess business holdings (determined without regard to the five-year disposition period) in a business enterprise immediately prior to a change in holdings in such enterprise to which Section 4943(c)(6) applies, the entire interest of the foundation in the enterprise (immediately after such change) shall (while held by the foundation) be treated as held by a disqualified person during the five-year period beginning on the date of such change. See Section 4943(c)(6)(B); Treas. Reg. 53.4943-6(a)(1)(iii).
- (2) Treas. Reg. 53.4943-6(c)(2) further explains this provision by stating that Section 4943(c)(6) shall not apply to an increase in the holdings of a foundation in a business enterprise that is part of a plan whereby disqualified persons will purchase additional holdings in the same enterprise during the five-year period beginning on the date of such change (for example: to maintain control of such enterprise, since such increase shall be treated as caused in part by the purchase of such additional holdings).

**Note:** If and as soon as any holdings in such enterprise become excess business holdings (determined as if the Section 4943(c)(6) change hadn't occurred) during the five-year period, such excess holdings shall no longer be treated as held by a

disqualified person under Section 4943(c)(6) but shall constitute excess business holdings. See Treas. Reg. 53.4943-6(a)(1)(iii).

### **D.3. Acquisitions by Will or Trust**

- (1) For holdings in a business enterprise acquired by a private foundation under the terms of a will or trust, the five-year disposition period shall not commence until the date of distribution of holdings from the estate or trust to the foundation. An interest to which the five-year disposition period applies that is constructively held by a foundation prior to the date of distribution is treated as held by a disqualified person prior to such date. See Treas. Reg. 53.4943-6(b)(1).

### **D.4. Transfers from One Private Foundation to Another**

- (1) The five-year disposition period shall not apply to any transfer of holdings in a business enterprise by one private foundation to another private foundation that is related to the first foundation under Section 4946(a)(1)(H). See Treas. Reg. 53.4943-6(c)(1).

### **D.5. Certain Transfers That are Part of a Plan**

- (1) The five-year disposition period shall not apply to an increase in the holdings of a private foundation in a business enterprise that is part of a plan whereby disqualified persons will purchase additional holdings in the same enterprise during the five-year period beginning on the date of the change, for example, to maintain control of the enterprise, since the increase will be treated as caused in part by the purchase of the additional holdings. See Treas. Reg. 53.4943-6(c)(2).

### **D.6. Constructive Ownership**

- (1) The purchase of holdings by an entity whose holdings are treated as constructively owned by a foundation or disqualified persons, or both, under Section 4943(d)(1) will be treated as purchased by the disqualified persons if the foundation, disqualified persons or both have effective control of the entity or otherwise can control the purchase. See Treas. Reg. 53.4943-6(c)(3).

## **E. Five-Year Extension of Initial Five-Year Disposition Period**

- (1) The IRS is authorized to allow an additional five-year period for the disposition of an unusually large gift or bequest of either diverse or complex business holdings. Once an application for a five-year extension has been received, the IRS will determine whether the plan can reasonably be expected to be carried out within the additional five-year period. Any extension is discretionary with the IRS, and all relevant facts and circumstances will be considered.
- (2) To qualify for the additional five-year period, a foundation must:
  - a. Establish that diligent efforts to dispose of the excess holdings have been made in the initial five-year period,

- b. Establish that because of the size and complexity of the holdings, disposition within the initial five-year period has not been possible except at a price substantially below fair market value,
- c. Before the close of the initial five-year period, submit a plan to the IRS for disposing of the excess holdings in question, and
- d. Before the close of the initial five-year period, submit the plan to the State Attorney General (or other appropriate official), and submit any response from this official to the IRS. See Section 4943(c)(7).

**Note:** The request for extension of the period for disposition, as well as the copy of any response received from state officials, should be submitted as a private letter ruling request.

## F. Constructive Ownership Rules

- (1) In computing the holdings in a business enterprise of a private foundation or disqualified person, any stock or other interest owned, directly or indirectly, by or for a corporation, partnership, estate, or trust is considered as being owned proportionately by or for its shareholders, partners, or beneficiaries.
- (2) Any interest in a business enterprise actually or constructively owned by a shareholder of a corporation, a partner of a partnership, or a beneficiary of an estate or trust shall not be considered as constructively held by the corporation, partnership, trust or estate. See Treas. Reg. 53.4943-8(a)(1).

### F.1. Warrants or Other Options

- (1) Any corporation, partnership, estate or trust that has a warrant or other option to acquire an interest in a business enterprise, such interest is not deemed to be constructively owned by the entity until the option is exercised. See Treas. Reg. 53.4943-8(a)(1).

### F.2. Powers of Appointment

- (1) Any interest in a business enterprise over which a foundation or a disqualified person has a power of appointment exercisable in favor of the foundation or a disqualified person shall be considered owned by the foundation or disqualified person holding such power of appointment. See Treas. Reg. 53.4943-8(a)(2).

### F.3. Exception for Estates and Trusts

- (1) Any interest actually or constructively owned by an estate or trust is deemed constructively owned, in the case of an estate, by its beneficiaries or, in the case of a trust, by its remainder beneficiaries, except in the case of split-interest trusts, employee benefit trusts and revocable trusts. These exceptions are discussed below. The following is an example of the general rule.

**Example:** If a trust owns 100% of the stock of Corporation, and if, on an actuarial basis, W's life interest in the trust is 15%, Y's life interest is 25%, and Z's remainder interest is 60%, then Z will be the owner of 100% of the stock.

- (2) No portion of an interest in a business enterprise which was transferred to a Section 4947(a)(2) trust for the benefit of a private foundation shall be considered as owned by the foundation if the foundation holds only an income interest in the trust; or if the foundation holds only a remainder interest in the trust (unless the foundation can exercise primary investment discretion with respect to such interest) until such trust ceases to be so described. See Treas. Reg. 53.4943-8(b)(2).
- (3) An interest in a business enterprise owned by a trust described in Section 401(a), shall not be considered as owned by its beneficiaries, unless disqualified persons control the investment of the trust assets. See Treas. Reg. 53.4943-8(b)(3).
- (4) An interest in a business enterprise owned by a revocable trust shall be treated as owned by the grantor of such trust. See Treas. Reg. 53.4943-8(b)(1).

#### **F.4. Estates**

- (1) Under Section 4943(d)(1) and Treas. Reg. 53.4943-8(b)(5), a beneficiary includes any person (including a private foundation) entitled to receive property of a decedent pursuant to a will or pursuant to laws of descent and distribution.
- (2) A person shall no longer be considered a beneficiary of an estate when:
  - a. All the property to which the person is entitled has been received by this person,
  - b. This person no longer has a claim against the estate, and
  - c. There is only a remote possibility that it will be necessary for the estate to seek the return of property or to seek payment from this person by contribution or otherwise to satisfy claims against the estate or expenses of administration.
- (3) When a person (including a private foundation) ceases to be a beneficiary, then stock or another interest in a business enterprise owned by the estate shall not thereafter be considered owned by such person.
- (4) If any person is the constructive owner of an interest in a business enterprise held by an estate, the date of death of the testator or decedent intestate shall be the first day on which such person shall be considered a constructive owner of such interest. See Treas. Reg. 53.4943-8(b)(5).

#### **G. Imposition of Initial Tax on Excess Business Holdings**

- (1) As noted above, there is imposed an initial excise tax on the excess business holdings of a private foundation for each taxable year of the foundation that ends during the taxable period. The amount of such tax is equal to 10% of the total

value of all the private foundation's excess business holdings in each of its business enterprises. See Section 4943(a)(1); Treas. Reg. 53.4943-2(a)(1).

**Exception:** If the foundation establishes that the violation was due to reasonable cause and not due to willful neglect, and corrects the violation, the IRS has discretionary authority to abate the first tier excise tax. See Section 4962.

- (2) The initial tax is imposed on the last day of the private foundation's taxable year.

### **G.1. Date of Valuation of Excess Business Holdings**

- (1) The value of the excess business holdings subject to the initial tax is determined regarding a foundation's holdings in a business enterprise as of the day during the foundation's taxable year when the foundation's excess holdings in such enterprise are the greatest. If the foundation's greatest excess holdings are maintained for two or more days during any taxable year, the value of such excess holdings subject to the initial tax is the greatest value attained by such excess holdings as of any day on which they are maintained. See Section 4943(a)(2); Treas. Reg. 53.4943-2(a)(2).

### **G.2. Additional Tax**

- (1) In any case in which the initial tax is imposed on 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, an additional tax is imposed equal to 200% of the value of such excess holdings. See Section 4943(b); Treas. Reg. 53.4943-2(b).

### **G.3. Exception – 90 Day Period**

- (1) A private foundation isn't subject to the Section 4943 excise tax on excess business holdings resulting from 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 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, and its purchase would not have created excess holdings but for such prior acquisitions by disqualified persons. See Treas. Reg. 53.4943-2(a)(1)(ii).

### **G.4. Determination of Whether Foundation Disposed of Excess Holdings During 90-Day Period**

- (1) In determining whether the foundation has disposed of its excess business holdings during the 90-day period, any disposition of holdings by a disqualified person during the 90-day period is disregarded.
- (2) Foundation Knowledge of Acquisitions Made by Disqualified Persons - Facts and Circumstances Test. Whether a private foundation will be treated as knowing, or

having reason to know, of the acquisition of holdings by a disqualified person depends on the facts and circumstances of each case.

- (3) To make this determination, these factors should be considered:
  - a. The fact that the foundation didn't discover acquisitions made by disqualified persons using a plan of action reasonably calculated to discover such holdings.
  - b. The diversity of foundation holdings.
  - c. The existence of large numbers of disqualified persons who have little or no contact with the foundation or its managers. See Treas. Reg. 53.4943-2(a)(1)(ii) and (v).

### **G.5. Extension of 90-Day Period**

- (1) The 90-day period shall be extended to include the period during which the foundation is prevented by federal or state securities laws from disposing of such excess business holdings. See Treas. Reg. 53.4943-2(a)(1)(iii).

### **H. Effect of Disposition of Holdings Subject to Material Restrictions**

- (1) If a private foundation disposes of an interest in a business enterprise but imposes any material restrictions or conditions that prevent the transferee from freely and effectively using or disposing of the transferred interest, then the transferor foundation will be treated as owning such interest until all such restrictions or conditions are eliminated (regardless of whether the transferee is treated for other purposes of the Code as owning such interest from the date of the transfer).
- (2) A restriction or condition imposed in compliance with federal or state securities laws, or in accordance with the terms or conditions of the gift or bequest through which such interest was acquired by the foundation, shall not be considered a material restriction or condition imposed by a private foundation. See Treas. Reg. 53.4943-2(a)(1)(iv).

### **I. Present Holdings**

- (1) Section 4943(c)(4) and the regulations set forth a complex set of grandfather rules pertaining to holdings of a foundation on May 26, 1969 ("present holdings") that would otherwise be excess business holdings.
- (2) These rules generally require some reduction of the foundation's present holdings during two phases, and thereafter allow for higher-than-normal levels of permitted holdings of such present holdings in some circumstances. The rules place limits, however, on the percentage of ownership measured by value as well as voting power.
- (3) Under the downward ratchet rule, however, decreases in present holdings "ratchet down" the maximum permitted holdings (but not below 20%).

- (4) Similar rules apply under Section 4943(c)(5) to holdings acquired by trust or will in effect on May 26, 1969.
- (5) Similar present holdings rules apply to the holdings on August 17, 2006, of donor advised funds and supporting organizations subject to Section 4943.
- (6) The rules are set forth in greater detail below.

## I.1. Exceptions

- (1) Under Section 4943(c)(4)(A)(i), with respect to the holdings of any private foundation in a business enterprise, if such foundation and all disqualified persons together have holdings in such enterprise more than 20% of the voting stock on May 26, 1969, the percentage of such holdings is substituted for the normal 20% or 35% permitted holdings level, but not more than 50%. This level is known as the substituted level.
- (2) The substituted permitted holdings levels apply separately to both the percentage of voting stock and the percentage of value of all outstanding shares of all classes of stock. See Section 4943(c)(4)(A)(iii). In the case of a corporation that has more than one class of stock outstanding, if the percentage of value held by the private foundation, its disqualified persons, or both, increases over a period of time solely due to changes in the relative value of different classes of stock, then the substituted level is also increased. See Treas. Reg. 53.4943-4(d)(10).
- (3) Under Section 4943(c)(4)(B), all the foundation's present holdings in a business enterprise on May 26, 1969, are treated as held by a disqualified person during the first phase. Thus, the foundation has until the end of the first phase to reduce the combined present holdings of itself and disqualified persons to 50% (for both voting and value) if the holdings are above 50%. Any new purchases by the foundation, however, would result in excess business holdings. If disqualified persons hold more than 2% voting power, then the foundation should reduce its voting power to 25% by the end of the first phase, to avoid excess business holdings at the start of the second phase. See Section 4943(c)(4)(D)(i).
- (4) The first phase is 20 years (beginning May 26, 1969) if the percentage of voting stock, profits interest, or beneficial interest of the foundation and disqualified persons exceeds 95%. See Section 4943(c)(4)(B)(i) and Treas. Reg. 53.4943-4(c)(1)(i).
- (5) The first phase is 15 years if the 20-year period doesn't apply and the combined percentage interest of the foundation and disqualified persons of any of the following interests exceeds 75% (See Section 4943(c)(4)(B)(ii) and Treas. Reg. 53.4943-4(c)(1)(ii)):
  - a. Voting stock or value of all outstanding shares of all classes of stock of a corporation,
  - b. Profits or capital interests in a partnership or joint venture, or
  - c. Beneficial interest in any other unincorporated enterprise.



**Note:** A substantial contributor or family member of a substantial contributor who held more than a 15% interest in the voting stock on May 26, 1969, can elect to have the first phase be 10 years in these circumstances rather than 15. See Section 4943(c)(4)(E).

- (6) The first phase is 10 years in all other cases. See Section 4943(c)(4)(B)(iii) and Treas. Reg. 4943-4(c)(1)(iii).
- (7) During the first phase, a foundation may acquire additional interests other than by purchase that are treated as held by a disqualified person for varying periods under Section 4943(c)(5) or Section 4943(c)(6). In such case, holdings that a foundation disposes are charged first against those holdings it must dispose of in the shortest period. See Treas. Reg. 53.4943-4(a)(2).
- (8) A present holding doesn't lose such status merely because it is converted from a constructive holding to a direct holding (or vice versa), or from one business form to another, such as incorporation of a sole proprietorship. See Treas. Reg. 53.4943-4(b)(1) and (c)(2).
- (9) The first phase is suspended during a judicial proceeding necessary to reform or excuse the foundation from compliance with its governing instrument or other instrument in effect on May 26, 1969, to allow disposition of present holdings. See Section 4943(c)(4)(C).

## I.2. Present Holdings – Downward Ratchet Rule

- (1) Section 4943(c)(4)(A)(ii) sets forth the “downward ratchet rule”: If the percentage of the holdings of a foundation in a business enterprise subject to the present holdings rules (or the percentage of the combined holdings of a foundation together with all disqualified persons) decreases for any reason, the decreased percentage is substituted as the maximum permitted holdings (but not below 20%). The downward ratchet rule thus decreases the substituted level of permitted present holdings in certain situations. It's designed to prevent the foundation from purchasing additional holdings in the business enterprise. See Treas. Reg. 53.4943-4(d)(4)(i)(A).
- (2) The rule is applied both to percentage of voting stock and to percentage of value. See Treas. Reg. 53.4943-4(d)(4)(i)(B).
- (3) The rule is applied in all three phases. See Treas. Reg. 53.4943-4(d)(5) and (6).
- (4) Under a de minimis rule, a decrease in percentage holdings attributable to issuances of stock (or issuances coupled with redemptions) is disregarded so long as the net percentage decrease does not exceed 2%, and so long as the number of shares held by the foundation is unaffected. See Section 4943(c)(4)(A)(ii).
- (5) See Treas. Reg. 53.4943-4(d)(4) for other special rules regarding transfers of holdings involving disqualified persons, change of foundation managers, and termination of private foundation status under Section 507.

### **I.3. Present Holdings – Second and Third Phases**

- (1) Under Section 4943(c)(4)(D)(iii), the second phase is 15 years. The third phase is the period beginning after the second phase and runs indefinitely. Treas. Reg. 53.4943-4(d)(6).
- (2) If at any time during the second phase disqualified persons have holdings more than 2% voting power (including profits interest in partnership or beneficial interest in other unincorporated enterprise), the foundation's own holdings cannot exceed 25% voting power or value, and the combined holdings of the foundation and disqualified persons cannot exceed 50%. These percentages continue as the maximum permitted holdings in the third phase, subject to the downward ratchet rule. See Treas. Reg. 53.4943-4(d)(5).
- (3) If disqualified persons don't have holdings more than 2% voting power at any time during the second phase, then the foundation must reduce the combined holdings of itself and disqualified persons to 35% voting power and value by the end of the second phase. See Section 4943(c)(4)(D)(ii).
- (4) In determining whether disqualified persons have holdings of more than 2% voting power, holdings treated as held by disqualified persons under Section 4943(c)(5) and Section 4943(c)(6) are disregarded. See Treas. Reg. 53.4943-4(d)(5)(ii).
- (5) These percentages continue as the maximum permitted holdings into the third phase, subject to the downward ratchet rule, except that if at any time in the third phase disqualified persons have holdings more than 2% voting power, the foundation must reduce its holdings to 25% voting power and value. See Section 4943(c)(4)(D)(ii) and Treas. Reg. 53.4943-4(d)(6).
- (6) If an acquisition of holdings by a disqualified person results in disqualified person holdings more than 2% voting power, then the acquisition is treated as subject to the five-year period under Section 4943(c)(6) – the foundation has five years to reduce its holdings to permissible levels. See Section 4943(c)(6).
- (7) Section 4943(c)(4)(D) may limit a private foundation's permitted holdings in a business enterprise to 25% of the value of all outstanding shares of all classes of stock during the second phase of the present holdings rules described in Section 4943(c)(4). See Rev. Rul. 81-22, 1981-1 C.B. 510.

### **J. Present Holdings Acquired by Trust or Will**

- (1) Section 4943(c)(5) sets forth rules similar to the present holdings rules for an interest in a business enterprise which a foundation acquires under the terms of a trust that was irrevocable on May 26, 1969, or under a will in effect on such date.
- (2) The first phase begins not on May 26, 1969, but on the date of distribution under the trust or will. For example, if a will is executed in 1968, the testator dies in 1990 with the 1968 will in effect, and on June 30, 1991 the estate distributes property to a foundation under the will that would be an excess business holding

of the foundation on May 26, 1969 (if the property had been held by the foundation on such date), then the first phase (10 or 15 years) begins June 30, 1991. Distribution is deemed to occur if an estate or trust is terminated for federal tax purposes. See Treas. Reg. 53.4943-5(b)(1).

- (3) The 20-year period for the first phase doesn't apply; a 15-year period is used instead. In applying the 75% thresholds to determine whether the 15-year period applies, interest held by the foundation on May 26, 1969, are deemed to include an interest to which Section 4943(c)(5) applies that has been acquired from a person who wasn't a disqualified person on May 26, 1969. See Treas. Reg. 53.4943-5(b)(1).
- (4) Section 4943(c)(5) shall not apply to a business holding acquired after May 26, 1969, by an estate or trust, other than because of the death of the decedent. For example, if a foundation is a residual beneficiary under a will in effect May 26, 1969, and the residue of the estate is cash, then the estate's purchase of stock with the cash for distribution to the foundation will not be treated as an interest acquired under the terms of a will in effect on May 26, 1969. See Treas. Reg. 53.4943-5(a)(2).
- (5) If a holding passes to a foundation under a trust in effect on May 26, 1969, that was revocable but never revoked, and the holding otherwise would have passed to the foundation under a will in effect on May 26, 1969, then the holding is treated as passing under the will and Section 4943(c)(5) applies. See Treas. Reg. 53.4943-5(a)(3).
- (6) Treas. Reg. 53.4943-5(a)(4) provides that a post-May 26, 1969, amendment of a will in effect on May 26, 1969, is disregarded if the amendment is made solely because of:
  - a. A reduction in the holding that the foundation was to receive under the will, or
  - b. Any other change that doesn't affect the rights of the foundation with respect to the holding.

**Example:** An interest in a business enterprise was bequeathed to a private foundation under the residuary clause of a will executed before May 26, 1969. After May 26, 1969, a second will expressly revoked the first will and increased the amounts of the specific bequests without changing the residuary clause. The interest in the business enterprise acquired by the foundation on the death of the testator comes within the special transitional rules under Section 4943(c)(4) and Section 4943(c)(5). Rev. Rul. 81-119, 1981-1 C.B. 512.

- (7) If there is an increase in holdings due to a post-May 26, 1969, amendment of the will, then the incremental increase is not treated as a present holding, but Section 4943(c)(6) would apply. The interest which would have been acquired before such increase shall remain present holdings. See Treas. Reg. 53.4943-5(a)(4).
- (8) In some cases, an interest to which Section 4943(c)(5) applies is also constructively held by the foundation under Treas. Reg. 53.4943-8 prior to

distribution to the foundation. To the extent of such overlap, the interest is treated as held by a disqualified person prior to distribution, because of Section 4943(c)(5). In some cases, both Section 4943(c)(4) and Section 4943(c)(5) may apply to a holding, again due to the constructive ownership rules; in such case, the first phase ends with whichever period under Section 4943(c)(4) or Section 4943(c)(5) ends later. See Treas. Reg. 53.4943-5(b)(2).

- (9) The phases for each interest to which Section 4943(c)(5) applies start independently from those phases for any other interest of the foundation in the same business enterprise to which Section 4943(c)(4) or Section 4943(c)(5) applies. See Treas. Reg. 53.4943-5(c)(2).

## **IV. Other Definitions**

- (1) Other definitions are provided on terms related to excess business holdings.

### **A. Constructive Ownership**

- (1) Where a foundation has excess business holdings which are constructively held for it by another entity, correction is made when either that entity, the foundation, or a disqualified person disposes of a sufficient interest in the enterprise so that no interest held by the foundation is an excess business holding. See Treas. Reg. 53.4943-9(c).

### **B. Donor Advised Funds**

- (1) Under Section 4943(e), donor advised funds are treated as private foundations for Section 4943 purposes, for tax years beginning after August 17, 2006.
- (2) A disqualified person with respect to a donor advised fund includes a donor, a donor advisor, a family member of a donor or donor advisor, or a 35% controlled entity of such persons. See Section 4943(e)(2).
- (3) Rules such as the present holdings provisions under Section 4943(c)(4), Section 4943(c)(5), and Section 4943(c)(6) apply to donor advised funds for their holdings beginning after August 17, 2006.

### **C. Gross Income**

- (1) Gross income from passive sources includes items that are excluded by Section 512 from unrelated business income, such as dividends, interest, and annuities, royalties, rent, and gains or losses from the disposition of certain property.
- (2) Any income classified as passive under this paragraph doesn't lose its character merely because Section 512(b)(4) or Section 514 (relating to unrelated debt-financed income) applies to such income.
- (3) Income from passive sources includes income from the sale of goods if the seller does not manufacture, produce, physically receive or deliver, negotiate sales of, or maintain inventories in such goods. See Treas. Reg. 53.4943-10(c)(2).

### **D. Sole Proprietorships**

- (1) A sole proprietorship means any business enterprise:
  - a. Actually and directly owned by a private foundation,
  - b. In which the foundation has a 100% equity interest, and
  - c. Which isn't held by a corporation, trust, or other business entity for the foundation.
- (2) A foundation may be considered to own a sole proprietorship even though the foundation is itself a corporation or a trust. However, a sole proprietorship owned

by a foundation won't be treated as a sole proprietorship when the foundation owns less than 100% of the equity of the business enterprise. See Treas. Reg. 53.4943-10(e).

## E. Supporting Organizations

- (1) Under Section 4943(f), the following types of Section 509(a)(3) supporting organizations are treated as private foundations for Section 4943 purposes, for tax years beginning after August 17, 2006:
  - a. A non-functionally integrated Type III supporting organization.
  - b. A Type II supporting organization that accepts a gift from a person (other than an Section 509(a)(1), Section 509(a)(2), or Section 509(a)(4) organization) that directly or indirectly controls a supported organization of the supporting organization, from a family member, or from a 35% controlled entity of such persons. Indirect control includes effective control, as where a person, their family member, and their attorney are a majority of the board. See the Joint Committee on Taxation's Technical Explanation of the Pension Protection Act of 2006, p. 361.
- (2) A disqualified person with respect to a supporting organization includes the following:
  - a. A person who, within the last five years, could exercise substantial influence, a family member, or a 35% controlled entity of such persons.
  - b. A substantial contributor, a family member, or a 35% controlled entity of such persons.
  - c. An organization effectively controlled (directly or indirectly) by the same persons who control the Section 509(a)(3) organization.
  - d. An organization substantially all the contributions to which were made by the supporting organization's officers, directors, trustees, key employees, substantial contributors, greater-than-20% owners of substantial contributors, and/or their family members.
- (3) Rules such as the present holdings provisions under Section 4943(c)(4), Section 4943(c)(5), and Section 4943(c)(6) apply to supporting organizations for their holdings on August 17, 2006.
- (4) The excess business holdings of a supporting organization are exempt from Section 4943 if the IRS determines that such holdings are consistent with the organization's exempt purpose. Favorable factors include a reasoned determination by the state attorney general that disposition of the holdings would have a severe detrimental impact on the community, and a supporting organization's binding commitment to pay 5% of its assets each year to its supported organizations. See the Joint Committee on Taxation's Technical Explanation of the Pension Protection Act of 2006, p. 361.

- (5) Excess business holdings shall not include holdings of a Type III supporting organization permanently held as of November 18, 2005, for the benefit of the community under the direction of a state attorney general. See Section 4943(f)(6).

## F. Readjustments

- (1) Special rules apply to readjustments and prohibited transactions involving business holdings, designed in part to prevent readjustments from becoming a device for foundations to increase business holdings.

- (2) A “readjustment” includes but is not limited to:

- a. Merger or consolidation,
- b. Recapitalization,
- c. Acquisition of stock or assets,
- d. Transfer of assets,
- e. Change in identity, form, or place of organization, however effected,
- f. Redemption, and
- g. Distribution of assets or stock.

**Note:** A corporation is treated as involved in a readjustment if, as part of the readjustment, any of its stock is issued or redeemed, or any of its stock or assets are transferred. See Treas. Reg. 53.4943-7(d)(1) and (3).

- (3) A “prohibited transaction” is one of the following types of transactions involving a business enterprise in which the foundation has a holding:

- a. The business enterprise acquires stock or other ownership or assets of another business enterprise, or redeems its own interest, using either cash or property transferred to the acquiring business (such as a capital contribution) by, or proceeds of a loan made to, or guaranteed by, the private foundation, disqualified persons, or both.
- b. The business enterprise acquires at least 40% of the voting power or value or assets of another business enterprise, if the acquiring business enterprise’s net assets used in its trade or business aren’t more than 15% of the net assets acquired.
- c. The business enterprise is used as a device to acquire or expand excess business holdings, which depends on the facts and circumstances. Such use is presumed if the business enterprise acquires 40% or more of the voting power, value, or assets of a business enterprise if the consideration for the acquisition consists primarily of nonvoting stock (or similar interest in unincorporated entity) of the acquiring business enterprise. See Treas. Reg. 53.4943-7(d)(2).

- (4) Readjustments and Section 4943(c)(6). An increase in business holdings resulting from a readjustment is generally treated as acquired other than by

purchase for purposes of Section 4943(c)(6). Exceptions apply in the following instances:

- a. Readjustments involving holdings treated as held by a disqualified person prior to the readjustment do not extend the period treated as held by a disqualified person.
  - b. An increase to the extent attributable to excess business holdings prior to the readjustment is treated as occurring by purchase by a disqualified person.
  - c. An increase involving a prohibited transaction is treated as occurring by purchase by a disqualified person, unless the foundation establishes to the satisfaction of the IRS that effective control of all parties to the transaction was in persons other than the foundation and disqualified persons. See Treas. Reg. 53.4943-6(d)(1) and (2).
- (5) A redemption by a corporation that is a disqualified person doesn't result in an acquisition by purchase by a disqualified person based solely on the corporation's disqualified person status. See Treas. Reg. 53.4943-6(d)(4).
- (6) Under a de minimis rule, increases in holdings because of redemptions are aggregated as of the end of the tax year to determine excess business holdings, unless the aggregate is 1% or more of voting power or value of stock. See Treas. Reg. 53.4943-6(d)(5).
- (7) Readjustments and Section 4943(c)(4) and Section 4943(c)(5):
- a. In general, if a foundation or disqualified person has holdings to which Section 4943(c)(4) or Section 4943(c)(5) applies, stock of a corporation received by the foundation or disqualified person in a readjustment in exchange for such holdings is treated as such holdings surrendered in the exchange. See Treas. Reg. 53.4943-7(a)(1).
  - b. Even if no exchange occurs, the holdings held before the readjustment of any business enterprise involved are treated as exchanged for the holdings held after the readjustment. See Treas. Reg. 53.4943-7(a)(2).
  - c. Holdings received in a readjustment won't be treated as the holdings surrendered to the extent that the holdings received represent a greater percentage ownership than the highest percentage ownership (as measured by holdings surrendered in the readjustment) in any business enterprise held prior to the readjustment. See Treas. Reg. 53.4943-7(b)(1) - (3).
- (8) The percentage limits are applied separately to voting power and value and are also applied separately to foundation holdings and combined holdings of the foundation and disqualified persons.
- (9) In general, the excess holdings are treated as an interest acquired other than by purchase, to which Section 4943(c)(6) applies. But if a readjustment includes a prohibited transaction, then the lowest (rather than the highest) percentage of voting power or value in any business enterprise involved in the readjustment is



used. See Treas. Reg. 53.4943-7(b)(4). See Treas. Reg. 53.4943-7 for other special provisions.

## **G. Taxable Period**

- (1) The taxable period is the period beginning on the first day on which there are excess holdings and ending on the earlier of:
  - a. The date of mailing of a notice of deficiency under Section 6212 with respect to the excise tax on excess business holdings;
  - b. The date on which the excess is eliminated; or
  - c. The date on which the excise tax on excess business holdings with respect to such holdings is assessed. See Section 4943(d)(2); Treas. Reg. 53.4943-9(a)(1).
- (2) If a notice of deficiency 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. Treas. Reg. 53.4943-9(a)(2).

## V. Examination Techniques

- (1) This section focuses on how to calculate and assert the excise tax once it has been determined that there are excess business holdings as defined in Section 4943. It also contains information relevant to examinations of private foundations in general.

### A. Introduction

- (1) Section 4943 taxes are imposed on the excess business holdings of a private foundation for each taxable year of the foundation which ends during the taxable period. The initial tax is imposed on the last day of the taxable year, but the holdings shall be determined as of the day during the taxable year when the holdings were the greatest.
- (2) The amount of tax may vary from year to year as the excess holdings vary.

### B. Permitted Holdings Summary

- (1) The foundation may hold an ownership interest in a business enterprise. The foundation is permitted to hold up to:
  - a. 2% regardless of disqualified person ownership percentages (de minimis rule).
  - b. 35% (ownership of foundation and disqualified persons combined), if the enterprise is effectively controlled by third persons. See Rev. Rul. 81-111, 1981-1 C.B. 509.
  - c. 20% (ownership of foundation and disqualified persons combined), in all other cases.

**Note:** Pay particular attention to the source of the income in the business enterprise. If 95% or more of the gross income is from passive sources, then the above rules don't apply, as a passive holding company is not considered a business enterprise. Passive sources include but aren't limited to interest, dividends, payments with respect to securities loans, royalties, and rent from real property. See Sections 4943(d)(3)(B), 512(b)(1), 512(b)(2), and 512(b)(3).

- (2) In many instances a foundation has a grace period to divest itself of the excess ownership interest, which varies depending on the circumstances. In general, the foundation has five years in which to dispose of excess holdings acquired other than by purchase (such as by bequest or gift) without incurring any tax. Section 4943(c)(6). There are exceptions to the rule. See Treas. Reg. 53.4943-6(c) for a listing of such exceptions.
- (3) When examining a private foundation, verify the amount of ownership in any business enterprise. Perform third party contacts with the disqualified persons as needed to determine their ownership percentages. Issue summonses as needed

if the disqualified persons are uncooperative. Please review IRM 4.11.57, Third-Party Contacts, to ensure compliance with the procedures for third party contacts.

**Note:** Be aware that some business enterprise holdings may also constitute jeopardizing investments under Section 4944.

- (4) For purposes of the tax calculation, determine the highest value of the holdings within the tax year. If the ownership interest is in a privately held company or partnership, determine whether to make a Specialist Referral System referral for a Large Business and International (LB&I) economist or engineer. The tax is on the fair market value of the excess portion of the business holdings for the tax year. Assert the tax for each year for which the foundation has/had excess holdings (but only for tax years that end within the taxable period).
- (5) Consider expanding the examination to additional years for which the statute is open, and for which the foundation still had excess holdings as of the start of the tax year. The tax amount may vary per year, depending on the increase/decrease in excess holdings that occurred in the years under examination.
- (6) Complete Forms 4883, 4621, 886-A and 870-E. See Section VII of this Technical Guide for examples of how to determine and compute the tax.

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

- (7) Refer to the Correction section below for a discussion of acceptable correction.
- (8) The tax is reported on Form 4720 and assessed against the private foundation. See IRM 4.70.13, Executing the Examination, to set up a substitute for return if no return was filed or to secure a delinquent return.

## C. Chapter 42 First Tier Excise Taxes Table

- (1) The table below identifies the parties subject to the Chapter 42 excise taxes, (initial/first tier taxes generally applicable to private foundations under subchapter A), the applicable tax rates before and after the implementation of PPA 2006, and what limit, if any, applies to the tax, and if so, how much.
- (2) The Taxpayer Certainty and Disaster Tax Relief Act (TCA) passed on December 20, 2019 included legislation that reduced the 2% excise tax on net investment income of private foundations to 1.39%. At the same time, the legislation repealed the 1% special rate that applied if the private foundation met certain distribution requirements (former Section 4940(e)). The changes are effective for taxable years beginning after December 20, 2019.

Code Section	Liable party	Tax Rate (PPA 2006*)		Limit (PPA 2006*)		TCA
		Before	After	Before	After	After
4940(a)	PF	up to 2%	up to 2%	None	None	1.39%**
4941(a)(1)	Self-dealer	5%	10%	None	None	No change
4941(a)(2)	FM	2.5%	5%	\$10,000 per act	\$20,000 per act	No change
4942(a)	PF	15%	30%	None	None	No change
4943(a)(1)	PF	5%	10%	None	None	No change
4944(a)(1)	PF	5%	10%	None	None	No change
4944(a)(2)	FM	5%	10%	\$5,000 per act	\$10,000 per act	No change
4945(a)(1)	PF	10%	20%	None	None	No change
4945(a)(2)	FM	2.5%	5%	\$5,000 per act	\$10,000 per act	No change

\*The tax rate changes are effective for full tax years that begin after August 17, 2006.  
\*\*The tax rate changes are effective for full tax years after December 20, 2019.

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

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

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

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

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

- (6) Under Section 4945, there is only one first tier tax in the taxable period (unlike Sections 4941 - 4944).
- (7) Use the tax year of the disqualified person for Section 4941 (Rev. Rul. 75-391, 1975-2 C.B. 446). Similarly, use the tax year of the private foundation for tax paid by the private foundation under Section 4940 or Sections 4942-4945, and the tax year of the foundation manager for foundation manager taxes under Sections 4941, 4944 and 4945.
- (8) Except for Section 4940, excise taxes are reported on Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code. Previously, for years prior to 2020, if the taxpayer was a self-dealer, disqualified person, organization or foundation manager, donor or donor adviser, or related person, the taxpayer completed Part II of the Form 4720 to report the tax. When Part II was processed, the Form 4720 was designated as Form 4720-A. Alternatively, such taxpayer (described above) had the option to report liability for excise tax on the return filed by the organization, assuming that both had the same taxable year. For tax years beginning in 2020, each taxpayer must file a separate Form 4720. Form 4720 has been revised to identify whether the filer is the organization or another taxpayer subject to the Chapter 42 excise taxes. Accordingly, for tax years after 2019, an agent preparing the Form 4720 under substitute for return (SFR) procedures to report a taxpayer's excise tax liability during an examination will no longer convert the Form 4720 to "Form 4720-A." The revenue agent will, instead, complete a Form 4720 identifying the filer as described in the instructions for Form 4720. Please see the instructions for Form 4720 and Notice 2021-01, 2021-2 I.R.B. 315, for further information.  
**Note:** Electronic filing of the Form 4720 is required for private foundations for Form 4720 returns due on or after July 15, 2021. A limited exception applies for 2020 Form 4720 returns with a due date on or after July 15, 2021, that are submitted on paper and bear a postmark date on or before June 16, 2021. Organizations other than private foundations are encouraged, but not required, to file Form 4720 electronically.
- (9) To calculate Section 4940 and Section 4942 taxes, complete the Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation. Reclassify expenditures as necessary to determine the qualifying distributions.
- (10) The applicable report forms are:
  - a. Form 4621, Exempt Organizations - Report of Examination
  - b. Form 4883, Exempt Organizations Excise Tax Audit Changes

- c. Form 886-A, Explanation of Items
- d. Form 870-E, Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment

## D. One Act/Failure to Act, Multiple Violations

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

**Example 1:** The foundation engages in self-dealing expenditures. The foundation reported these amounts in Part I Column d as charitable disbursements. The IRS later disallows these amounts and the Part XII Line 1a amount is reduced. This in turn reduces the qualifying distributions. When the qualifying distributions for the year are less than: the sum of 1% of the net investment income and the product

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

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

**Note:** Part V of the Form 990-PF won't be used for taxable years beginning after December 20, 2019, because the Taxpayer Certainty and Disaster Tax Relief Act passed on December 20, 2019, included legislation that reduced the 2% excise tax on the net investment income of a private foundation to 1.39%. This legislation also repealed the 1% special rate that applied if the private foundation met certain distribution requirements.

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

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

Form 990-PF line adjustment	Increase or decrease
Part I Line 27(b)	Increase
Part VI Line 5	Increase
Part XI Line 2(a)	Increase
Part XI Line 7	Decrease
Part XIII Line 1	Decrease

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

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

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

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

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

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

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

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

**Example:** A foundation purchases stock of a disqualified person's wholly owned corporation directly from the disqualified person. The purchase of the stock constitutes a self-dealing transaction. If the foundation owns more than 2% of the total stock of the corporation, the purchase may trigger Section 4943. A donation



of the stock won't constitute a self-dealing transaction but may trigger Section 4943.

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

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

## E. Information Regarding Correction

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

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

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

- (3) The correction amount isn't necessarily the same as the amount involved in a particular transaction. Compute the correction amount and the taxable amount involved separately.

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

- (4) When correction is made, obtain verification. See the following list (not all-inclusive) for acceptable proof of correction. Discuss with the manager and Area Counsel as to appropriate methods of correction and proof, if desired:
- a. Copies of cancelled check(s) to the foundation and bank statement(s) showing the deposit(s).
  - b. New title documents for returned real property.
  - c. Copies of cancelled check(s) and bank statement(s) showing appropriate distributions.
  - d. Brokerage/financial institution statement(s) showing that a foundation no longer owns an asset or stock.

- e. Copies of reports secured concerning the uses of grants made.
- (5) Be alert for attempts to circumvent the correction requirement. At a minimum, ensure that the parties don't:
- a. Deposit the correction amount and then issue a new check back to the party making correction.
  - b. Obtain new title documents for returned property and then change title back to the party that returned the property.
  - c. Redeposit amounts distributed to satisfy Section 4942 (such as voided checks, circular transactions).
  - d. Transfer assets or stocks to other financial institutions or to disqualified parties for which statements aren't provided.
  - e. Engage in an act of self-dealing when attempting to make correction.
- (6) If revoking or involuntarily terminating the foundation, request and verify that correction is made to a governmental agency or other Section 501(c)(3) organization that isn't itself at risk of revocation.
- (7) In the event that requests to extend the correction period (Section 4963(e)(1)(B)) are received, under Delegation Order 7-4 (IRM 1.2.2.8.4), Area Managers may authorize extensions of the correction period, or delegate the authority to the group manager. Consult the group manager if considering granting an extension of time to make correction. It is recommended that the appropriate Area Counsel also be consulted per the group manager's authorization.
- (8) Extensions of the correction period aren't ordinarily granted unless these factors are present:
- a. The taxpayer is actively seeking in good faith to correct the taxable event.
  - b. Adequate correction is unavailable or can't reasonably be expected to occur during the original correction period.
  - c. The taxable event appears to be an isolated occurrence, and it appears unlikely that similar taxable events will occur in the future. See Treas. Reg. 53.4963-1(e)(3).

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

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

**Note:** If the taxpayer pays the first tier tax after IRS mails a statutory notice of deficiency and before the 90-day period of the notice has expired, the taxpayer

has 90 days from the payment date to make correction. Treas. Reg. 53.4963-1(e)(4). If the taxpayer petitions the Tax Court regarding the second tier taxes, before the correction period (including extensions) expires, the correction period runs until the decision is final. See Treas. Reg. 53.4963-1(e)(2).

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

## F. Correction Period

- (1) Under Section 4963(e), the correction period is the period beginning on the first day on which there are excess business holdings and ending 90 days after the date of mailing under Section 6212 of a notice of deficiency with respect to the additional tax, extended by:
  - a. Any period in which a deficiency can't be assessed under Section 6213(a) (determined without regard to the supplemental proceeding provided for under Section 4961(b), and
  - b. Any other period which the IRS determines is reasonable and necessary to bring about correction.

## G. Advance Approval of Proposed Correction

- (1) Taxpayers may request advance approval of a proposed correction. If granted, the advance approval provides assurance to taxpayers and organizations that IRS will view an intended remedial action favorably as correction.
- (2) Advance approval is **only** available when:
  - a. The only barrier is the reluctance to correct because the taxpayer is uncertain of final IRS approval, and
  - b. The other aspects of the issue aren't disputed.
- (3) For all other cases, treat the case as unagreed if the taxpayer is unwilling to make correction.
- (4) To grant advance approval, all the following conditions must be met:
  - a. The taxpayer indicates acceptance of initial tax liability (Sections 4941 through 4945).
  - b. Correction will be very difficult or costly, requiring the exercise of sound judgment on a broad scale.

- c. The taxpayer should be able to complete the proposed correction within 90 days from the date of approval.
  - d. The taxpayer submits a written request for advance approval, attention of the Area Manager.
- (5) The written request must:
- a. Fully describe the surrounding circumstances giving rise to the initial tax liability.
  - b. Outline in detail the nature and method of the proposed correction.
  - c. Accept an initial tax liability for the act or failure to act in question.
  - d. Include the date by which the taxpayer will complete the correction.
- (6) When such a written request is received, suspend further action on the issue, and continue all other aspects of the examination. Send a copy of the request to the Area Manager (scanned and secured e-mail if possible). Consult with Area Counsel if complex correction situations arise from the written request. Schedule and hold a conference call with the Group and Area Managers.
- (7) If the Area Manager approves the request, prepare and issue a draft correction approval letter. See Letter 5305, Private Foundation Correction Approval Letter. The letter must:
- a. Explain in detail the proposed corrective action.
  - b. Specify the due date for correction completion.
  - c. Require the taxpayer to notify the area manager upon completion.
  - d. Clarify that the taxpayer's reliance on the letter is conditioned on the taxpayer meeting the conditions specified for correction.

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

- (8) If the Area Manager denies the request, prepare and issue a draft correction rejection letter. See Letter 5306, Private Foundation Correction Rejection Letter. In the letter:
- a. Outline the taxpayer's proposal.
  - b. Explain why it doesn't constitute correction.
  - c. Clarify that other methods of correction are still available.
  - d. Suggest a correction action (or actions) that would be acceptable.
- (9) If the Area Manager accepts the request, keep the case in the group, and continue to work other issues on the case. When the Area Manager provides notification that the taxpayer corrected, secure proof. Secure the taxpayer's agreement to the first tier tax on Form 870-E. Collect the first tier tax or secure an installment agreement request (Form 9465, Installment Agreement Request).

(10) If notification or proof isn't received by the due date for correction, contact the taxpayer to confirm correction. Ask the taxpayer to send proof right away (via express mail, or fax).

(11) If proof of correction is not promptly received after contacting the taxpayer, close the case as unagreed. See IRM 4.70.14, Resolving the Examination, for closing procedures.

## H. All Chapter 42 Second Tier Excise Taxes

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

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

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

(2) Second tier taxes are:

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

(3) Indicate in the report of examination (Forms 4883, 4621, 886-A) the amount of potential second tier taxes if the taxpayer doesn't make correction. With Area

Manager approval, the closing of an agreed first tier tax case can be delayed for a reasonable period to permit correction, depending on the facts and circumstances.

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

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

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

- (5) All second tier taxes are imposed once per act/failure to act or taxable event. Refer to the specific Code section and the regulations for how to determine the amount of the second tier tax calculation. Under Sections 4942 and 4943, if the taxpayer partially corrects (reduces but doesn't eliminate undistributed income or excess business holdings), the second tier tax is on the uncorrected remaining amount.
- (6) See IRM 4.70.14, Resolving the Examination, for additional information for the necessary letters and forms to complete. For a proposed second tier tax liability, show the second tier tax on the last year which shows an adjustment for the first tier tax, noting in the examination report that the additional tax will be imposed at the end of the taxable period if the act/failure to act or taxable event isn't corrected. Before issuing a 30-day letter to a foundation manager asserting second tier excise taxes, the examiner must issue a Thorne letter requesting that the foundation manager agree to correction.
- (7) If the taxpayer doesn't agree to the tax or fails to make correction, the case is unagreed. See IRM 4.70.14, Resolving the Examination, for case closing procedures.

## I. Termination Tax

- (1) This section focuses on those situations when tax is due under Section 507 for termination of private foundation status. The termination tax acts like a third tier excise tax. The phrase "termination" has several different meanings in the context of private foundations. The term is ordinarily used when an entity dissolves or goes out of business. For a private foundation, however, termination of foundation status doesn't necessarily mean dissolution has occurred. Termination for Section 507 purposes means any of the following:
- a. The foundation notifies the IRS and pays the Section 507(c) tax (if any) (Section 507(a)(1)).
  - b. The IRS involuntarily terminates the foundation and imposes Section 507(c) tax (Section 507(a)(2)).

- c. The foundation transfers all of its net assets to certain public charities (Section 507(b)(1)(A)).
- d. The foundation becomes a public charity (Section 507(b)(1)(B)).

**Note:** Transfer under Section 507(b)(2) of all of a foundation’s net assets to one or more other foundations doesn’t, by itself, terminate private foundation status. The foundation must separately terminate, whether voluntarily (Sections 507(a)(1), 507(b)(1)(A), or 507(b)(1)(B)) or involuntarily (Section 507(a)(2)).

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

**Note:** If a private foundation’s Section 501(c)(3) status is revoked but its private foundation status isn’t terminated under Section 507, then the foundation becomes a taxable private foundation; it’s no longer tax-exempt but still subject to Chapter 42 taxes as a private foundation. See Section 509(b) and Treas. Reg. 1.509(b)-1(b).

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

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

The Termination Tax is the Smaller of:	
A) The aggregate tax benefit - the sum of:	B) The value of the net assets as of the date the foundation first committed



1.	The increase in income, estate, and gift taxes** on substantial contributors that would result from the disallowance of their contributions. The taxes are computed from the later of the foundation inception date or March 1, 1913. Section 507(d)(1)(A))	a Chapter 42 violation that culminates in its Section 507 termination, or the effective termination date, whichever amount is higher. See Section 507(e)(1). Default to this amount unless the "aggregate tax benefit" is calculated.
2.	The income taxes of the foundation, had the foundation filed Forms 1120, U.S. Corporation Income Tax Return, or Forms 1041, U.S. Income Tax Return for Estates and Trusts, in lieu of Forms 990-PF. The taxes are computed from the later of the foundation inception date or January 1, 1913.* (Section 507(d)(1)(B))	
3.	The aggregate tax benefit from other private foundations in Section 507(b)(2) transfers. (Treas. Regs. 1.507-5(a)(3) and 1.507-3(a)(2))	
4.	The accumulated interest on the above amounts as computed via Report Generation System NT (RGS NT) or Integrated Data Retrieval System (IDRS) command code INTST. (Section 507(d)(1)(C))	
*For purposes of this calculation, the charitable contribution deduction allowed a trust is deemed to have been limited to 20% of taxable income. Section 507(d)(1)(B)(ii).		
** For any year in which a gift tax would be due if a charitable deduction were not available, refer to the Instructions to Form 709, United States Gift (and Generation - Skipping Transfer) Tax Return, for that particular year for assistance in calculating the appropriate amount of deemed gift tax.		

- (6) Aggregate tax benefit is used as the amount of the termination tax only if the foundation substantiates the amount by adequate records or other corroborating evidence. See Section 507(c)(1). As the IRS retains records for a limited period, it may not be feasible to compute the tax from the date of inception. Obtain what information is available via IDRS, return requests, and Online Statistics of Income EO Image Net (SEIN). Establish Audit Information Management System (AIMS) controls via the Reporting Compliance and Case Management System (RCCMS) using source code 45 to retrieve the returns of the substantial contributors.
- (7) See IRM 4.70.14, Resolving the Examination, for guidance on converting the Form 990-PF to Forms 1120 or 1041. Use the RGS NT to determine the increase in income tax from the disallowance of charitable contributions deductions.

- (8) Propose the tax using Forms 4883 and 4621. Use Form 990-PF to assess the tax in lieu of Form 4720.
- (9) Imposition of the termination tax doesn't eliminate liability for the underlying Chapter 42 taxes that initiated the termination process. See Treas. Reg. 1.507-1(b)(2).
- (10) When you close the case as a termination, prepare Form 2363-A, Request for IDRS Input for BMF/EO Entity Change, to update the status code, indicating the effective date in YYYYMM format:
  - a. Status 23: 507(a)
  - b. Status 24: 507(b)(1)(A) (no termination tax applies)
  - c. Status 25: 507(b)(1)(B) (no termination tax applies)
- (11) Termination of private foundation status under Section 507 results in the foundation being treated as an organization created on the day after termination. See Section 509(c).

## **J. Revocation**

- (1) Propose to revoke exemption if the foundation ceases to be operated exclusively for exempt purposes but the circumstances don't warrant involuntary termination of private foundation status under Section 507(a)(2). A Section 501(c)(3) foundation must engage primarily in activities that accomplish Section 501(c)(3) purposes. If more than an insubstantial part of its activities does not further an exempt purpose, propose revocation. A private foundation is subject to the auto-revocation process of Section 6033(j). (See IRM 4.70.14, Resolving the Examination.)
- (2) Foundations are subject to similar restrictions as other Section 501(c)(3) organizations:
  - a. Absolute prohibition for political campaigning.
  - b. Limitation on lobbying (subject to Section 4945(d) which functions as a virtual ban on lobbying).
  - c. Prohibition on inurement.
  - d. Prohibition on operating for the benefit of private interests.
  - e. Limitation on UBI activities (less than primary purpose).
  - f. Limitation on commercial-type insurance (Section 501(m)).
  - g. Prohibition on illegal activities/purposes that violate public policy.
- (3) If the foundation violates any of the prohibitions and/or restrictions listed above, propose revocation. Private foundations are subject to declaratory judgement under Section 7428 when proposing revocation. An administrative record and administrative record index are required for all proposed revocations and should be prepared in accordance with IRM 4.70.14, Resolving the Examination.

Additionally, when proposing revocation, follow the information in IRM 4.70.14, Resolving the Examination. Upon revocation, the foundation becomes a taxable private foundation.

- (4) In many revocations, the foundation, disqualified persons, and foundation managers may also be subject to Chapter 42 excise taxes. If there are willful repeated acts or a single willful and flagrant act triggering Chapter 42 taxes, propose the termination tax in addition to revocation. You may include the basic report forms (Forms 4883 and 4621) with Letter 3614, 30-day letter package for Chapter 42 excise taxes. Form 870-E shows all tax deficiencies of the foundation.
- (5) In revocations of private foundations, the foundation becomes a taxable foundation and must file an income tax return as well as Form 990-PF. See Section 509(b) and Treas. Reg. 1.509(b)-1(b). Use status codes 18 (for trusts) and 19 (for corporations) in lieu of status code 22. Status codes 18 and 19 set the Form 990-PF and Form 1041 or Form 1120 filing requirements. Prepare Form 2363-A with status code change and indicate the effective date of revocation in YYYYMM format. Leave the Form 2363-A in the case file for processing following review.
- (6) All revocations are subject to Mandatory Review.

## K. Statute of Limitations

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

Code Section	Liable Party	Tax Form	Tax year
4940(a)	PF	990-PF	On the same form, same year.
4941(a)(1)	Self-dealer	*4720	If individual: Year of Form 1040, U.S. Individual Income Tax Return, in which transaction occurs.  All others: Year of Form 1041 (trust), 1065 (partnership), or 1120 (corporation) in which transaction falls. *
4941(a)(2)	FM	*4720	Form 1040 year in which transaction occurs.

4942(a)	PF	4720	Same year of Form 990-PF
4943(a)(1)	PF	4720	Same year of Form 990-PF
4944(a)(1)	PF	4720	Same year of Form 990-PF
4944(a)(2)	FM	*4720	Form 1040 year in which transaction occurs.
4945(a)(1)	PF	4720	Same year of Form 990-PF
4945(a)(2)	FM	*4720	Form 1040 year in which transaction occurs.
*Contact Area Counsel if considering asserting tax on indirect self-dealing against a disqualified person partner or other owner of the disqualified person entity (in addition to asserting tax on self-dealing against the entity).			

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

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

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

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

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

**Note:** A statute extension for the foundation’s return doesn’t extend the statute for a disqualified person or foundation manager. Separate statute extensions must be secured for all parties. Refer to IRM 25.6.22, Extension of Assessment Statute of Limitations by Consent, for further information regarding statute extensions.

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

- (5) The statutory limitations period for Chapter 42 taxes reportable on Form 4720 ordinarily begins with the filing of Form 990-PF, whether or not Form 4720 is filed. If there are multiple acts/failures to act or taxable events over a period of years, the Forms 4720 will have separate statutes for each transaction. When extending the statute for the Form 4720, extend the statute for all the transactions.

**Example:** A private foundation, a calendar year taxpayer, first has excess business holdings on February 1, 2012. There hasn’t been a correction. No Form 4720 was filed. The Form 990-PF for 201212 was timely filed on May 15, 2013. Assume the foundation disclosed the excess business holdings on its 201212 Form 990-PF return. The three-year statute for both the Form 990-PF and the Form 4720 begins on May 15, 2013.

**Note:** The filing of Form 990-PF for the year of the initial taxable act ordinarily starts the limitations period (or periods, if multiple acts during the tax year) for second tier tax as well as first tier tax, even though second tier tax does not arise until the end of the taxable period. See the example in Treas. Reg. 301.6501(n)-1(c) regarding an act of self-dealing. Similarly, the second tier tax payable by a

foundation manager is essentially on refusal to agree to correct, which doesn't arise until after a Thorne letter is sent.

- (6) For discrete acts, if the statute expired for the year the act occurred, no assessment can be made for any subsequent year. However, for continuing transactions under Section 4941, even if the statute expired for the year in which the original transaction occurred, tax for each open year may be asserted (because a new act is deemed to occur every year within the taxable period). Similarly, an excess business holding acquired in a closed year of the foundation that is still held by the foundation in one or more open years is subject to Section 4943 tax for an open year, assuming the holding is still an excess business holding.
- (7) When preparing the extensions, reference the specific Code section in the type of tax. Use "excise (Section 494X)". If extending multiple excise tax code sections, state "excise (Sections 494X and 494Y)". If extending both income and excise taxes, state "income and/or excise (Section 494X)". It's recommended a consent for both income and excise tax be used only when a private foundation may be liable for both excise tax under Section 4940 on its investment income and income tax (such as unrelated business income tax). This is because a regular Form 872 is used to extend the statute for these taxes, based on the foundation's taxable year and not taxable periods arising from taxable events (which require using a modified Form 872).
- (8) Extensions for Section 4941 through Section 4945 taxes require a modification of the Form 872. Replace the phrase "on any returns made by or for the above taxpayer(s) for the period(s) ended" with "from the above taxpayer(s) for the years that are fully or partially within the taxable period(s) that began". Use the date of the first act or failure to act (or taxable event) for the start of the taxable period.
- (9) If there are multiple acts in a single tax year that trigger Chapter 42 taxes, you may list them on the modified Form 872.
- (10) For each year in which acts or failures to act occur which give rise to Chapter 42 taxes, including for deemed or continuing transactions (such as loan transactions in which each year the loan is outstanding, a new or separate transaction is created), secure a modified Form 872. Separate consents for each year in which new or continuing transactions occurred should be obtained.
- (11) As the Section 4940 tax is assessed on the Form 990-PF, prepare any statute extensions for Section 4940 taxes using the regular Form 872. Associate the statute extension with the appropriate Form 990-PF.

## **L. Applicable Penalties**

- (1) For a complete overview of the penalties that apply to private foundations, see IRM 20.1.8, Employee Plans and Exempt Organizations Miscellaneous Civil Penalties.

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

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

- (3) Foundations can also be subject to the criminal penalties of Section 7203, Section 7206, and Section 7207, as well as the civil fraud penalty of Section 6663. See IRM 9.1.3, Criminal Statutory Provisions and Common Law, and IRM 20.1.5, Return Related Penalties.
- (4) Foundations, individuals, and taxable entities who file (or are required to file but do not file) Form 4720 may be subject to failure to file, failure to pay, estimated tax, negligence, and civil fraud penalties.
- (5) Any entity or individual previously liable for a Chapter 42 tax may be subject to a 100% penalty. See Section 6684. This penalty may also be imposed where the act or failure to act is both willful and flagrant. In both circumstances, the act or failure to act must not be due to reasonable cause. Under Section 6684 if a person becomes liable for tax under any section of Chapter 42 and meets the criteria, then such person is liable for a penalty equal to the amount of such tax. Thus, this penalty can be imposed with respect to both first tier and second tier taxes. The penalty, which is an assessable penalty (assessed in the same manner as taxes) is not imposed with respect to Section 4940 and 4948(a) taxes. See IRM 20.1.8, Employee Plans and Exempt Organizations Miscellaneous Civil Penalties.
- Note:** The IRS bears the burden of proof on whether an act or failure to act was willful and flagrant. See *Thorne v. Commissioner*, 99 T.C. 67 (1992); *Moody v. Commissioner*, 69 T.C.M. (CCH) 2517 (1995).
- (6) Foundations that file Form 990-T, Exempt Organization Business Income Tax Return, may be subject to failure to file, failure to pay, estimated tax, accuracy and civil fraud penalties.
- (7) The officers, directors, trustees, and employees of a foundation may be subject to the public inspection compliance penalty of Section 6685 on the responsible

party. See IRM 20.1.8, Employee Plans and Exempt Organizations Miscellaneous Civil Penalties.

- (8) When computing penalties under Section 6651(a)(1) and (2), 6651(f), 6662, or 6663, use the first tier tax amounts for the computations. Because the second tier taxes aren't taxes reported (or required to be reported) on any tax return, they're not subject to those penalties. Imposition of the penalties under Sections 6662 and 6663 requires that the taxpayer file a return. If the taxpayer didn't file a return, those penalties don't apply. An SFR doesn't constitute a return for the purpose of applying penalties under Section 6662 and 6663.

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

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

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

## M. Domestic Taxable Private Foundations

- (1) Taxable private foundations are former tax-exempt private foundations whose exemptions were revoked. Unless terminated under Section 507, they remain



private foundations, and under TE/GE jurisdiction. See Section 509(b) and Treas. Reg. 1.509(b)-1(b).

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

## N. Abatement of Excise Taxes

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

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

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

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

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

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

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

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

- (7) If the taxpayer requests abatement during the examination, verify correction first. If the facts don't warrant abatement, document the willful neglect and failure to establish reasonable cause. If the facts warrant abatement, don't propose the tax. Address the issue in an advisory closing letter. See IRM 4.70.14, Resolving the Examination.

- (8) See the lists below for examples of abatement/non-abatement of the first tier tax.

- (9) Possible abatement:

**Example:** The foundation incurred a Section 4942(a) liability when it incorrectly valued its assets in a manner which was not willful and was due to reasonable cause. As a result of the incorrect valuation of assets, the foundation didn't properly distribute all of its required distributable amount. A notice of deficiency with respect to the excise taxes imposed by Section 4942(a) and (b) is mailed to the foundation under Section 6212(a). Subsequently, the foundation makes the appropriate qualifying distribution (within the allowable distribution period). In addition, the foundation submitted a written document to requesting abatement of the excise taxes due to reasonable cause. The examining agent concurred that the foundation's

written request for abatement has met the threshold for reasonable cause. Based upon these facts, the initial excise tax under Section 4942(a) can be abated since all the requirements of such subparagraph have been satisfied.

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

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

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

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

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

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

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

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

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

## O. Pre-Examination Considerations

- (1) If a copy of the determination file isn't already in the file, follow the requirements in IRM 4.70.12, Planning the Examinations, to request and review a copy. You may receive a copy on disk, via secure e-mail, or via Teams. For private foundations, focus additional attention on:
  - a. Who are the founders, initial substantial contributors, and foundation managers?
  - b. What is the purpose of the foundation (actively operating, grant-making, and so forth)?

- c. Did the organization request advance approval of individual grant-making under 4945(g)?
  - d. If grant-making, what criteria were provided, and what constitutes the applicant pool?
  - e. What assets were donated to form the corpus of the foundation?
  - f. Who contributed the assets?
- (2) Make note of whether the articles of incorporation, association, or trust document contains the Section 508 language. See Publication (Pub.) 557. Note that most states now incorporate the language into state law, thus eliminating the requirement to have the language in the document. See Treas. Reg. 1.508-3(d). If the language is present, note all who signed the document.

**Note:** When encountering a Chapter 42 violation, be sure to incorporate this information into the report of examination, if relevant to the party committing the transaction (self-dealers, foundation managers). This helps establish that at a minimum the founders acknowledged these restrictions in the governing instruments at the time the foundation was formed.

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

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

after July 15, 2021, that are submitted on paper and bear a postmark date on or before June 16, 2021.

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

- (5) Obtain IDRS transcripts for the foundation and the disqualified persons. Perform Accurant research on the disqualified persons. Review the completed research for possible compliance issues (such as missing returns, prior Chapter 42 liabilities, same disqualified person and foundation addresses, foundation vehicles registered under disqualified persons, payments to disqualified person businesses listed on the Form 990-PF).
- (6) Review the Form 990-PF for the period(s) under examination in the following sequence:

<b>Review Form 990-PF:</b>	
<b>Verify the Statute of Limitations</b>	
1	Find the date stamped received.
2	Determine the date mailed, if possible.
3	Apply the rules of Section 7502 (timely mailing treated as timely filing).
<b>Analyze the first page, Letters A through J (in the top third of the page)</b>	
1	Note the accounting method.
2	Note whether this is an initial, amended, or final return.
3	Determine whether there has been a name or address change.
4	Check whether a foreign foundation and percentage of foreign support (for purposes of Section 4948(b)).
5	Check for unusual events: prospective exemption, 507(b)(1)(A) termination, 507(b)(1)(B) conversion.
6	Note the type of entity.
<b>Review Parts VII-A and VII-B, Statements Regarding Activities</b>	
1	Verify the presence of all required schedules. Note any missing documents.
2	Check for an FBAR, if indicated.

3	Determine the liability for Form 4720.
4	Note any private benefit disclosures.
<b>Review Part VIII, Information About Officers, Directors, Trustees, Foundation Managers, Highly Paid Employees, and Contractors</b>	
1	Match the amounts reported to the Forms W-2. (Use command code IRPTRR to retrieve the Forms W-2.)
2	Note the top paid individuals and contractors. Match to the list of founders, substantial contributors, and foundation managers reported in the determination application and in Part XV. (May be subject to Section 4941.)
<b>Review XVII, Information Regarding Transfers to and Transactions and Relationships With Noncharitable Exempt Organizations</b>	
1	Identify any large, unusual, or questionable items.
2	Verify the non-charitable entities exemptions on IDRS.
3	Print the INOLES/BMFOLO information for each non-charitable entity.
4	Use Online SEIN to obtain copies of the Forms 990 or 990-EZ for each entity.
5	Check EO Select Check for electronic postcard information.
6	See if there are any related parties on the board of each entity.
<b>Review Part XV, Supplementary Information</b>	
1	Identify any large, unusual, or questionable items.
2	Compare any entries to information from the determination application.
<b>Review Part IV, Capital Gains and Losses for Tax on Investment Income</b>	
1	Verify the math. Note any errors.
2	Identify any large, unusual, or questionable items.
3	Note the type of asset(s) for future reference in the interview and IDR.
<b>Review Part I, Analysis of Revenue and Expenses</b>	
1	Verify the math. Note any errors.
2	Identify any large, unusual, or questionable items.
<b>Review Part XVI-A, Analysis of Income-Producing Activities and Part XVI-B, Relationship of Activities to the Accomplishment of Exempt Purposes</b>	
1	Verify the math. Note any errors.

2	Identify any large, unusual, or questionable items.
3	Compare to Part I. Note any differences.
4	Compare to any filed Forms 990-T. Note any differences.
<b>Review Part II, Balance Sheets **</b>	
1	Verify the math. Note any errors.
2	Identify any large, unusual, or questionable items.
3	Check for any attached schedules. Note any missing schedules.
4	Compare any amounts on the attached schedules to Part II. Note any differences.
**There are new reporting standards for net assets, and Part II of Form 990-PF was updated to reflect the Financial Accounting Standards Board's (FASB's) reclassification of net assets into two classes, net assets without donor restrictions and net assets with donor restrictions.	
<b>Review Part III, Analysis of Changes in Net Assets or Fund Balances</b>	
1	Verify the math. Note any errors.
2	Note any increases or decreases not included in Part I, Line 27a. Determine whether such amounts should be included in Part I.
<b>Review Part IX, Summary of Direct Charitable Activities, Summary of Program-Related Investments</b>	
1	Identify any large, unusual, or questionable items.
2	Compare the expenses reported to the amounts listed in Part I.
3	If applicable, compare the investment amounts to the amounts listed in Part II.
<b>Review Part X, Minimum Investment Return</b>	
1	Verify the math. Note any errors.
2	Note the existence of any acquisition indebtedness for Section 514 purposes.
<b>Review Part XI, Distributable Amount</b>	
1	Verify the math. Note any errors.
2	Note whether there was any income tax. Check the amount against Form 990-T (or Form 1120/Form 1041 if a taxable foundation).
3	Note any recoveries of qualifying distributions for inclusion in the IDR.
<b>Review Part XII, Qualifying Distributions</b>	

1	Verify the math. Note any errors.
2	For set asides, note whether claiming prior IRS approval or look for an attached schedule. If prior approval, or schedule is missing, note for inclusion in the IDR.
<b>Review Part XIII, Undistributed Income</b>	
1	Verify the math. Note any errors.
2	Note any excess distributions. Compare the amounts reported to the prior years' Forms 990-PF.
3	For entries indicating election required, check for the attached statement. If none present, include in the IDR a request of the election.
4	Verify that the foundation has not elected to treat a qualifying distribution as made out of corpus in an attempt to "refresh" an expiring excess distribution "carryover."
<b>Review Part V, Qualification Under Section 4940(e) for Reduced Tax on Net Investment Income (for taxable years beginning on or before December 20, 2019)</b>	
1	Verify the math. Note any errors.
2	Compare the entries in Line 1 to the prior years' Forms 990-PF Parts X through XII. Note any differences.
<b>Review Part VI, Excise Tax Based on Investment Income</b>	
1	Verify the math. Note any errors.
2	Note the tax rate used. Verify whether the correct rate was used.
3	Note any additional taxes reported. Verify whether properly entered. (If tax-exempt, UBTI is not included and deductions taken into account in determining UBTI are not taken into account in determining Section 4940 tax either. If taxable, UBIT and regular income tax are included.)
<b>Review Part XIV, Private Operating Foundations</b>	
1	Verify the math.
2	Note which operating foundation status was claimed. (Section 4942(j)(3) vs. Section 4942(j)(5)). If Section 4942(j)(5), compare the charitable activities to the Code and regulation requirements. See the instructions to the Form 990-PF.
3	Note the letter date. Request a copy via the initial IDR.

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

- (7) Review any information in the case file from Classification. Prepare to start an administrative record if there are indicators of potential exemption issues. See IRM 4.70.14, Resolving the Examination.



- (8) Modify the initial interview/questionnaire to incorporate any items identified during the review of the application and tax returns. Additional questions to ask:
- a. Please describe the relationship, if any, between the foundation manager(s), founder(s), and any substantial contributor(s). (If all the same person, don't ask.)
  - b. Please explain your understanding of the Chapter 42 provisions/prohibitions.

- (9) Incorporate the items noted from analyzing the application and the tax returns. When asking for financial information, you can ask for the supporting source documents, such as bank statements and cancelled checks, for up to five years back. For private operating foundations, Form 990-PF Part XIV supports the request of records for the three prior years.

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

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

- (10) Consider requesting these additional items in the IDR:

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

- k. Leases, partnership agreements, and all contracts between the foundation and disqualified persons.
- l. Credit card statements of the foundation as well as credit card statements of the disqualified persons, if applicable.
- m. Travel expenses incurred by the foundation on behalf of disqualified persons.

**P. Field/Office Correspondence Exam Information**

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

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

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

<b>Financial Statement and Financial Record Analysis:</b>	
1	Compute the average fair market value of the securities using the twelve monthly ending values.
2	Do the same for the bank statements.
3	Compare the amounts to Form 990-PF Part X Line 1.
4	Identify the program related investments, if reported on Form 990-PF Part IX-B, and determine whether they qualify as such.
5	Determine if there is any overlap between program related investments and non-charitable use investments.
6	Identify any assets purchased in the year(s) under examination.
7	Compare the asset purchase amounts to the amount reported in Part XII Line 2.
8	Determine any differences, verify whether any amounts are for non-charitable use.
9	Identify any amounts listed as set aside.
10	Verify that the set aside was appropriate.
11	Identify any acquisition indebtedness.
12	Determine whether Section 514 applies. If so, verify that a Form 990-T was filed and that it included the debt financed income.
13	Determine whether the acquisition indebtedness triggers Section 4941 as a loan with a disqualified person (or as a deemed sale or

	exchange with a disqualified person because the foundation received property subject to a mortgage or similar lien as described in Section 4941(d)(2)(A)).
14	Determine whether any of the asset purchases trigger Section 4941 as a sale with a disqualified person.
15	Review the other assets of the organization.
16	Look at the title documents. Review for any questionable elements involving disqualified persons.
17	Inquire and verify whether the assets are being used by any disqualified persons.
18	Review the cancelled checks and check registers. Request explanations for questionable expenditures.
19	Inspect any receipts provided for the questionable expenditures.
20	Identify all payments that are grants or scholarships to disqualified persons.
21	Determine whether the payments meet the exceptions to Section 4941 and Section 4945.
22	Compare the Forms W-2/1099 to the amounts reported on Form 990-PF Part VIII and to the amounts reported in the register.
23	Determine whether there are any missing or incorrectly reported Forms W-2/1099.

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

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

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

- a. Engaged in any self-dealing transactions.
  - b. Failed to make qualifying distributions.
  - c. Held or acquired excess business holdings.
  - d. Made jeopardizing investments.
  - e. Made taxable expenditures.
- (8) If there are any acts/failures to act giving rise to Chapter 42 taxes, ensure that the statute of limitations is protected. Request extensions from the foundation and from each disqualified person party to an act/failure to act. Open AIMS controls on BMF for the foundation and any business entities and on NMF for any individuals.

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

- (9) For any Chapter 42 taxes, prepare a report of examination for each liable party. Ensure there are no disclosure violations. See IRM 4.70.14, Resolving the Examination, for the report letter and attachments. All excise tax reports include Forms 4621, 4883, 886-A and 870-E.
- (10) If an act requires correction, verify that correction is made before closing an agreed case. See IRM 4.70.14, Resolving the Examination for the initial report, formal report, protest to Appeals, and rebuttal information.
- (11) See IRM 4.70.14, Resolving the Examination, for information on the necessary letters and forms to complete. However, before issuing a 30-day letter to a foundation manager proposing the second tier tax, you must first issue a Thorne letter. For help in drafting a Thorne letter, with your manager's authorization, contact Area Counsel. A sample Thorne letter can be found in other Technical Guides, such as those for Sections 4941 and 4945.
- (12) For egregious cases, consider involuntary termination and revocation. Discuss these possibilities with your group manager and Area Counsel before pursuing these actions. See IRM 4.70.14, Resolving the Examination, for information on preparing an administrative record.

## Q. Exam Case Closing Information

- (1) Resolve the following types of related cases:

- a. Employment tax cases such as worker reclassification, fringe benefit treatment, and unreported amounts.
  - b. Income tax cases (Forms 990-T for tax-exempt foundations, Forms 1120 or 1041 for taxable foundations).
  - c. Excise tax cases (gaming and/or Chapter 42 taxes).
- (2) Discuss with your group manager whether to close the related cases separately from the Form 990-PF.
- (3) Close Form 990-PF as a no change/no change with advisory if there is no modification to the Section 4940 tax, foundation status, or exempt status. See IRM 4.70.14, Resolving the Examination, for case file assembly and other common closing information.
- (4) For agreed cases involving employment, income, or gaming excise taxes:
- a. Issue report of examination.  
**Note:** Remember that if a disqualified person is involved, there will be a separate case file and report for that taxpayer, and disclosure rules will be applicable.
  - b. Secure the agreement.
  - c. Collect payment or complete a request for an installment agreement. See IRM 4.70.14, Resolving the Examination.
  - d. Prepare the appropriate closing letter. See IRM 4.70.14, Resolving the Examination.
  - e. Close the case to your manager, who in turn closes it to the EO Closing Unit.
- (5) For agreed cases involving Chapter 42 taxes:
- a. Request correction.  
**Note:** No correction for Section 4940 adjustments
  - b. Obtain verification of correction.
  - c. Correction made: Issue report of examination.
  - d. Correction not made: Treat as unagreed.
  - e. Secure the agreement on Form 870-E.
  - f. Collect payment and/or complete the installment agreement request.
  - g. Prepare the appropriate closing letter.
  - h. Close the case to your manager, who in turn closes it to the EO Closing Unit.  
**Note:** Before asserting excise taxes on the foundation manager(s), issue a Thorne letter, before issuing the 30-day letter. Consult your manager and Area Counsel for pre-issuance review of the Thorne letter.
- (6) For cases requiring correction, follow the information below:

- a. If correction is acceptable, issue the acceptance letter. See Letter 5305.
- b. If correction is inadequate or unacceptable, issue the rejection letter. See Letter 5306.
- c. If uncorrected, determine whether additional time is needed for correction.
- d. Grant an extension of time with managerial approval for the correction to be made.
- e. If uncorrected as of the end of the extension date, **close as unagreed**, even if the taxpayer previously signed an agreement to the first tier tax on Form 870-E.

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

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

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

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

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

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

**Note:** If applicable, consider offering a Fast Track Settlement before issuing the formal report of examination. Both agent and manager must approve a

request to enter into fast track negotiations. See IRM 4.70.14, Resolving the Examination, for Fast Track Settlement information.

(9) A valid protest contains the following elements:

- a. The taxpayer's name, address, Employer Identification Number (EIN) and a daytime phone number.
- b. A statement that the taxpayer wants to protest the proposed determination.
- c. A copy of the 30-day letter showing the findings that the taxpayer disagrees with (or the date and IRS office symbols from the letter).

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

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

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

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

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

## **VI. Issue Indicators and Examination Tips**

- (1) This section provides for possible issue indicators and tips when examining a private foundation, particularly with respect to excess business holdings subject to tax under Section 4943.

### **A. Issue Indicators**

- (1) Review the Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation, for reporting of excess business holdings.
- (2) Review stock ownership of both the private foundation and the disqualified persons on the Form 990-PF.
- (3) Review prior year(s) returns for consistent reporting and disposal of assets that may be under-reported to avoid Section 4943 issues.
- (4) Verify whether asset disposals were made to disqualified persons (possible acts of self-dealing).
- (5) Review Form 990-PF for reporting of excess business holdings; the five-year disposition period starts the date the business interest or stock is contributed.
- (6) Extensions of time to dispose of assets should be substantiated by proof of IRS approval.
- (7) If a foundation fails to establish that an extension was approved, seek to impose the Section 4943 excise taxes.

### **B. Examination Tips**

- (1) The five-year clock for the disposition period for the excess business holdings starts ticking when the business interest or stock is contributed. If the proposed sale falls through, there may be a problem.
- (2) If the private foundation claims it has excess business holdings but has an additional five years to dispose of such assets, obtain the documentation the private foundation received from the IRS that it requested from the IRS the extension and that the IRS has approved such extension. Also verify that the appropriate State Attorney General has approved as well.
- (3) If the private foundation has 35% holdings in a business enterprise, it must be shown to the IRS that effective control of the business enterprise is with an independent third party and not with the foundation or any of its disqualified persons. See Section 4943(c)(2)(B) and Treas. Reg. 53.4943-3(b)(3)(ii) for more information on what constitutes effective control.
- (4) A business that is a disqualified person with respect to the private foundation cannot redeem shares from the foundation since that would be a self-dealing transaction under Section 4941 unless an incorporated business offers to redeem from all the owners on the same terms and meets the self-dealing exception under Section 4941(d)(2)(F) and Treas. Reg. 53.4941(d)-3(d).



- (5) Also look at the ownership of that business enterprise from all related disqualified persons as that term is defined in Section 4946, which includes attribution from related entities.
- (6) The permitted holdings pertain to the voting stock, so schedule out who owns how much of the voting stock, including all disqualified persons and the private foundation to ensure the limitations on permitted holdings are not exceeded.
- (7) If the foundation is claiming any exceptions to the permitted holdings, verify the accuracy of such exceptions.
- (8) Also, absent a cash contribution, loan, or the private foundation's receipt of dividends from the business, the private foundation may have no cash with which to make the annual distribution for charitable purposes of 5% of the value of the private foundation's net investment assets required under Section 4942.

## VII. Example Worksheets / Exhibits

- (1) This section provides worksheets as well as exhibits focusing on practical applications when asserting Section 4943 excise taxes in those situations in which a private foundation has excess business holdings. The examples also show how the Section 6663 penalty is asserted. Also provided are examples of statute extensions, including a modified Form 872 extending the time for assessing Section 4943 tax.

### A. Section 4943 First Tier Tax Example

- (1) Private Foundation Kilo owns 15% of the common stock in a privately held corporation. Disqualified person Delta owns 25% of the stock in the same corporation. Oscar, DP Delta's fiancé, owns 55% of the stock in the corporation. Oscar's parents jointly own the remaining 5% of the stock. DP Delta donated the stock to the foundation in 2003, when DP Delta formed the foundation and became the foundation manager. DP Delta is still the foundation manager.

Entity	Stock Ownership
Private Foundation Kilo	15% Common Stock
Delta – DP	25% Common Stock
Oscar – DP	55% Common Stock
Oscar's Parent	5% Common Stock

- (2) Agent Brown is examining the 200912 Form 990-PF for the foundation. The highest value of the stock for the year is listed as \$3,000, per the foundation's records. Agent Brown obtains an LB&I engineer via an SRS referral to perform a valuation. The engineer appraises the stock's highest value for 2009 at \$2,895,000, using the information reported on the Form 1120 and other valuation sources. After conferring with the Fraud Technical Specialist and presenting the information in a conference with Criminal Investigation (CI), Agent Brown is informed that CI will pass on the case.
- (3) Agent Brown expands the examination to the 201012 and 201112 tax years. In 2010, Oscar gifts DP Delta with 2% of the stock, and in 2011, Oscar further gifts DP Delta with another 2% of the stock. In 2012 Oscar breaks the engagement. The Form 990-PF lists the value of PF Kilo's stock at \$5,000 for 2010, and \$4,000 for 2011. The engineer subsequently determines the highest value for the stock in 2010 to be \$4,256,000, and in 2011 to be \$3,748,000. Based on the fact pattern, Agent Brown decides to assert the civil fraud penalty under Section 6663 (75%). Agent Brown obtains written supervisory approval for penalty assessment in order to comply with Section 6751(b)(1) and includes all pertinent documentation in the case file.

(4) A fiancé isn't a disqualified person under Section 4946(d), as a fiancé is not a spouse. As Oscar holds the controlling interest in the corporation, the excess amount held by the foundation and the disqualified person is 5% (15% + 25% - 35%) for 2009, 7% for 2010 (15% + 27% - 35%), and 9% for 2011 (15% + 29% - 35%). The table below shows the value of the excess stock for each year and the amount of tax.

Tax year	Total value	Excess %	Excess value	Section 4943(a) Tax rate	Section 4943(a) Tax	Section 6663 penalty
200912	2,895,000.00	5%	144,750.00	10%	14,475.00	10,856.25
201012	4,256,000.00	7%	297,920.00	10%	29,792.00	22,344.00
201112	3,748,000.00	9%	337,320.00	10%	33,732.00	25,299.00

(5) Agent Brown determines that abatement under Section 4962 doesn't apply in this case. She issues a report December 1, 2012. Note that Section 4943(a) taxes are not imposed until the end of each year in the taxable period, unlike excise taxes under Sections 4941(a), 4942(a), and 4944(a). Therefore, Agent Brown doesn't assert tax for the tax year 201212. Agent Brown would issue the following initial report when soliciting correction, or as part of the formal report of examination after the foundation has made full correction.

**Note:** See Rev. Rul. 2013-17, 2013-38 I.R.B. 201, addressing what constitutes a marriage, such as common law marriage for purposes of determining who is a spouse for Section 4946 disqualified person status.

**Exempt Organizations Excise Tax Audit Changes**

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

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

		Taxable Years Ended		
		12/31/2009	12/31/2010	12/31/2011
Internal Revenue Code Section for Proposed Adjustment		4943(a)	4943(a)	4943(a)
1. Adjustments	Excess Business Holdings in PHC	144,750.00	297,920.00	337,320.00
2.	Total Adjustments	144,750.00	297,920.00	337,320.00
3.	Amount reported on return or as Previously adjusted	0	0	0
4.	Total amount as corrected	144,750.00	297,920.00	337,320.00
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x Line 5)	14,475.00	29,792.00	33,732.00
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	14,475.00	29,792.00	33,732.00
9.	Additional tax (minimum)	0	0	0
10.	Penalties (Code section 6663)	10,856.25	22,344.00	25,299.00

Explanation of Adjustments  
See attached Explanation of Items

**Exempt Organizations – Report of Examination**

(Proposed Tax Changes)

1. Form No. 4720	2. Area Office [Insert name of your area]	3. Date of Report [Insert date]
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4. Name and Address of Taxpayer  Private Foundation Kilo [Insert street address] [Insert city, state, and zip code]	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
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6. Social Security Number or Employer Identification Number  [Insert EIN]	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)	9. Tax Period(s) Ended	
	12/31/2009	12/31/2010			
	12/31/2011				

10. Reporter Preparer's Name  [Insert your name]	11. Agreement Secured (Check one.) Yes <input type="checkbox"/> No <input type="checkbox"/>
--	--

12. Findings Discussed with (Name and Title) [Insert name of a foundation manager or representative]	13. Agreement Date [Leave blank]
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14a. Summary of Proposed Adjustments				14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)	Internal Revenue Code Section (1)	Amount (2)
4943(a)	12/31/2009	14,475.00		6663	10,856.25
4943(a)	12/31/2010	29,792.00		6663	22,344.00
4943(a)	12/31/2011	33,732.00		6663	25,299.00

15. Remarks See attached Explanation of Items
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16. Attachments
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## B. Section 4943: Second Tier Tax Example

- (1) See the following Form 4883 for how to propose the second tier tax. Note that under Section 4943(b), the second tier tax is on the amount of the excess business holdings at the end of the taxable period. This tax is imposed once upon the amount of uncorrected excess business holdings. Report the second tier tax on the last year in which an adjustment has been made showing initial tier tax liability.

**Note:** The penalty under Section 6663 is asserted only on the first tier tax amounts because the second tier tax isn't subject to that penalty.

Section 4943(a) and Section 6663 Penalty Computation						
Tax year	Total value	Excess %	Excess value	Tax rate	Tax	6663 Penalty
200912	2,895,000.00	5%	144,750.00	10%	14,475.00	10,856.25
201012	4,256,000.00	7%	297,920.00	10%	29,792.00	22,344.00
201112	3,748,000.00	9%	337,320.00	10%	33,732.00	25,299.00

Section 4943(b) Computation			
Tax year	Excess value	Tax rate	Tax
201112	337,320.00	200%	674,640.00

- (2) Without correction, Agent Brown would issue the following formal report of examination that includes the second tier tax with a 30-day letter (Letter 3614).

**Exempt Organizations Excise Tax Audit Changes**

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

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

		Taxable Years Ended		
		12/31/2009	12/31/2010	12/31/2011
Internal Revenue Code Section for Proposed Adjustment		4943(a)	4943(a)	4943(a)
1. Adjustments	Excess Business Holdings in PHC	144,750.00	297,920.00	337,320.00
2.	Total Adjustments	144,750.00	297,920.00	337,320.00
3.	Amount reported on return or as Previously adjusted	0	0	0
4.	Total amount as corrected	144,750.00	297,920.00	337,320.00
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x Line 5)*	14,475.00	29,792.00	33,732.00
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	14,475.00	29,792.00	33,732.00
9.	Additional tax (minimum) at 200% 4943(b)	0	0	674,640.00
10.	Penalties (Code section 6663)	10,856.25	22,344.00	25,299.00

Explanation of Adjustments  
See attached Explanation of Items

**Exempt Organizations – Report of Examination**

(Proposed Tax Changes)

1. Form No. 4720	2. Area Office [Insert name of your area]	3. Date of Report [Insert date]
---------------------	--	------------------------------------

4. Name and Address of Taxpayer  Private Foundation Kilo [Insert street address] [Insert city, state, and zip code]	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
---	---

6. Social Security Number or Employer Identification Number  [Insert EIN]	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)	9. Tax Period(s) Ended	
	12/31/2009	12/31/2010			
	12/31/2011				

10. Reporter Preparer's Name  [Insert your name]	11. Agreement Secured (Check one.) Yes <input type="checkbox"/> No <input type="checkbox"/>
--	--

12. Findings Discussed with (Name and Title) [Insert name of a foundation manager or representative]	13. Agreement Date [Leave blank]
---	-------------------------------------

14a. Summary of Proposed Adjustments				14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)	Internal Revenue Code Section (1)	Amount (2)
4943(a)	12/31/2009	14,475.00		6663	10,856.25
4943(a)	12/31/2010	29,792.00		6663	22,344.00
4943(a)	12/31/2011	33,732.00	674,640.00	6663	25,299.00

15. Remarks See attached Explanation of Items
--

16. Attachments
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### **C. Statute Extension Example**

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

[Insert Name of Taxpayer]

[Insert Continuation of Name, If Necessary]

*(Name(s))*

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

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

*(Address)*

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

(1) The amount of any Federal \_\_\_\_\_ [Excise (Section 4940 and/or income)] \_\_\_\_\_  
*(Kind of tax)*

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

[Insert Tax Year(s)]

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

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

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

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

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

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

### Your Rights as a Taxpayer

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

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

## D. Statute Extension Example – Modified

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

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

- (2) Consult with Area Counsel when preparing Form 872 for excise taxes, particularly in situations where a private foundation may be liable for several different types of excise taxes arising in a particular year or years.
- (3) The example shown can be used when extending the statute of limitations for assessing excise taxes under Section 4943.

[Insert Name of Taxpayer]

[Insert Continuation of Name, If Necessary]

*(Name(s))*

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

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

*(Address)*

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

(1) The amount of any Federal \_\_\_\_\_ [Excise (Section 4943)] \_\_\_\_\_  
*(Kind of tax)*

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

[Insert the date in the year in which the foundation first held excess business holdings] OR if the statute for that year is

closed but the foundation still has the excess business holdings, then [Insert beginning date of first open taxable year in

which foundation had excess business holdings]

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

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

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

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

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

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

**Your Rights as a Taxpayer**

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

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

**E. Section 4943 Excise Taxes on Excess Business Holdings Lead Sheet**

**Taxpayer Name:**  
**TIN:**  
**Tax Form:**

**Examiner:**  
**Date:**  
**Tax Year:**

<b>IRC 4943 Taxes on Excess Business Holdings Lead Sheet</b>				
<b>Tax Period</b>	<b>Per Return</b>	<b>Per Exam</b>	<b>Adjustment</b>	<b>Reference</b>
<b>Conclusion:</b> <i>(Reflects the final determination on the issue.)</i>				
<i>The following techniques are not intended to be all-inclusive nor are they mandatory steps to be followed. Judgment should be used in selecting the techniques that apply to each taxpayer.</i>				
<b>Audit Steps:</b> <i>(Document audit steps taken or to be taken.)</i>				<b>Workpaper Reference</b>
1. Identify disqualified persons as defined in IRC 4946. Determine if the private foundation is liable to for filing Form 4720, and review if filed.				
2. Identify businesses in any form, including corporations, partnerships, limited liability companies, etc. held by the private foundation and its disqualified persons.				
3. Determine if the business is a business enterprise. If it is a passive income business or a functionally related business it may not be a business enterprise for purposes of IRC 4943.				
4. Calculate percentage holdings of the private foundation and its disqualified persons with respect to business enterprises.				
5. Verify, for permitted holdings, if the total amount of holdings exceed 20 percent. If they do, determine if the 35 percent limitation is applicable.				
6. Identify holdings that exceed the percentage limitations. Determine how the holdings were obtained, such as by purchase or by bequest, and if the holdings are or will be disposed of within the appropriate time periods.				
7. Calculate the excise taxes on any excess business holdings. IRC 4943(a)(1) provides the initial excise tax is imposed on a foundation in an instance of excess holdings in a business enterprise for each tax year that ends during the taxable period.				
8. Decide whether after the initial excise tax is imposed if the foundation disposed of the excess business holdings. If not, determine if an additional excise tax is applicable. Treas. Reg. 53.4943-2(b).				
9. Determine if the foundation applied for abatement of excise taxes; see IRC 4962.				
<b>Facts:</b> <i>(Document the relevant facts.)</i>				

**Taxpayer Name:**

**TIN:**

**Tax Form:**

**Examiner:**

**Date:**

**Tax Year:**

<b>Law:</b> <i>(Tax Law, Regulations, court cases, and other authorities.)</i>
IRC Sections: 4943, 4946; Treas. Regs. 53.4943-1, 53.4946-1
Specific citations:
<b>Taxpayer Position:</b> <i>(If applicable)</i>