



# Exempt Organizations Technical Guide

## TG 58: Excise Taxes on Self-Dealing - IRC Section 4941

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## I. Overview

- (1) Organizations that are exempt from taxation under Section 501(c)(3) of the Internal Revenue Code and do not fall into any of the public charity statuses 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, excise taxes are imposed on acts of self-dealing under Section 4941. The taxes imposed under Section 4941 apply to certain acts involving:
  - a. Private foundations,
  - b. Certain charitable trusts described in Section 4947(a)(1), and
  - c. Split-interest trusts described in Section 4947(a)(2).
- (2) Prior to enactment of Section 4941, the Revenue Act of 1950 specified several prohibited types of self-dealing transactions applicable to certain categories of exempt organizations and to certain nonexempt charitable trusts. The prohibited transaction rules of 1950 imposed arm's-length standards for certain specified types of transactions between an organization and its creators or substantial donors and their families and controlled corporations. The sanctions for violating the standards included loss of exemption and denial of charitable contribution deductions.
- (3) Under the Tax Reform Act of 1969, the laws regarding the prohibited transaction rules were revised. Section 4941 was added to the Code to impose, in lieu of the former prohibited transactions rules, excise taxes on self-dealing transactions between "disqualified persons," defined in Section 4946, and private foundations. The tax is also imposed on the participation of any foundation manager in an act of self-dealing between a disqualified person and a private foundation, knowing that it is such an act.

**Note:** The Section 4941 self-dealing rules also apply to trusts described in Section 4947(a)(1) that are treated as private foundations, trusts described in Section 4947(a)(2), and taxable private foundations (see Treasury Regulation (Treas. Reg.) 1.509(b)-1(b)).

- (4) The general reasons for the changes are set forth in General Explanation of the Tax Reform Act of 1969 (December 3, 1970), JCS-16-70 at 30, prepared by the Staff of the Joint Committee on Internal Revenue Taxation ("Explanation"). Paraphrasing the Explanation, arm's-length standards require disproportionately greater enforcement efforts, resulting in sporadic and uncertain effectiveness. These sanctions were sometimes ineffective and tended to discourage enforcement efforts. Conversely, in many cases the sanctions were so great compared to the offense that they caused reluctance in enforcement, especially in view of the element of subjectivity in applying arm's-

length standards. Where the IRS did seek to apply sanctions in such circumstances, the same factors encouraged extensive litigation and a noticeable reluctance by the courts to uphold severe sanctions. Consequently, as a practical matter, prior law didn't preserve private foundations' integrity.

- (5) The 1969 Act generally prohibits self-dealing transactions and offers a variety and progression of sanctions to:
  - a. Minimize the need to apply subjective arm's-length standards,
  - b. Avoid the temptation to misuse private foundations for noncharitable purposes,
  - c. Provide a more rational relationship between sanctions and improper acts, and
  - d. Make it more practical to properly enforce the law. JCS-16-70 at 30-31.
- (6) The changes made in the 1969 Act were based on Congress' belief that the highest fiduciary standards require nearly complete elimination of all self-dealing rather than relying on arm's-length standards. Accordingly, Congress set forth a regime to discourage self-dealing acts by imposing first and second tier excise taxes on disqualified persons and foundation managers.
- (7) The Pension Protection Act of 2006, P.L. 109-280 (PPA 2006), Section 1212, doubled the rates of most first tier Chapter 42 excise taxes as well as the limits on foundation manager taxes. This includes excise taxes imposed by Section 4941. For Section 4941, the first tier tax is currently 10% of the amount involved (with joint and several liability), and the foundation manager tax is currently 5% of the amount involved (with joint and several liability, and a \$20,000 maximum).
- (8) 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.
- (9) Electronic filing requirements have not 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.
- (10) 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.
- (11) The Taxpayer Certainty and Disaster Tax Relief Act passed on December 20, 2019, included legislation that reduced the 2% excise tax on net investment income of private foundations to 1.39%. At the same time, the legislation

repealed the 1% special rate that applied if the private foundation met certain distribution requirements. The changes are effective for taxable years beginning after December 20, 2019.

- (12) For tax years beginning in 2020, an individual liable for a Chapter 42 excise tax will not have the option to file jointly with the organization with respect to which the excise tax relates. Beginning with tax year 2020, Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the IRC, has been revised to identify whether the filer is the organization or an individual. Accordingly, for tax years after 2019, an agent preparing Form 4720 to report individual excise tax liability during an audit will no longer convert Form 4720 to "Form 4720-A." The revenue agent will, instead, complete Form 4720 identifying the filer as an individual as described in the instructions for Form 4720. Please see the instructions to the Form 4720 for further information.

## B. Relevant Terms

- (1) **Disqualified Person:** Defined in Section 4946 (and in greater detail in TG 63: Disqualified Persons – IRC Section 4946), as basically an individual or organization related to a private foundation as a substantial contributor (or 20% owner of a substantial contributor), a foundation manager, a member of their families, or certain entities 35% owned by the foregoing. For purposes of Section 4941 only, certain government officials are also disqualified persons.
- (2) **Self-Dealing:** Defined in Section 4941 as generally prohibiting all direct and indirect transactions between a private foundation and its disqualified persons. See Section 4941(d)(1).
- (3) **Indirect Self-Dealing:** Defined in Section 4941 as generally a transaction (but is not limited to) between an organization controlled by a private foundation and a disqualified person.

## C. Law / Authority

- (1) Section 4941 imposes an excise tax on any direct or indirect act of self-dealing between a private foundation and a disqualified person. Self-dealing transactions described under Section 4941(d) are:
- The sale, exchange, or leasing of property between a foundation and a disqualified person,
  - The lending of money or other extension of credit between a foundation and a disqualified person,
  - The furnishing of goods, services, or facilities between a foundation and a disqualified person,
  - The payment of compensation or expenses (or reimbursement) by a foundation to a disqualified person,

- e. The transfer or use of the foundation's income or assets by or for the benefit of a disqualified person, and
- f. Certain payments to government officials by a foundation.

The self-dealing transactions listed above are qualified by many special rules and exceptions described throughout this Technical Guide.

- (2) The excise taxes imposed by Section 4941 for engaging in one or more of the enumerated acts of self-dealing are assessed against the self-dealer and, in appropriate cases, the foundation managers.
- (3) The same act or transaction can give rise to liability for more than one Chapter 42 tax. For example, an act of self-dealing might also be an expenditure for a non-charitable purpose taxable under Section 4945. See *Kermit Fischer Foundation v. Commissioner*, T.C. Memo. 1990-300, 59 T.C.M. (CCH) 898 (1990) (Tax Court imposed excise tax on disqualified person under Section 4941 and on private foundation under Section 4945 for the same acts); Treas. Reg. 53.4941(d)-1(a); and Revenue Ruling (Rev. Rul.) 77-161, 1977-1 C.B. 358 (stating that a given set of facts can give rise to taxes under more than one provision of chapter 42 of the Code, but the fact that the loan in the ruling constituted an act of self-dealing did not automatically mean that it is also a taxable expenditure).



## II. Requirements

- (1) Section 4941 imposes an excise tax on certain direct and indirect financial transactions between a private foundation and its disqualified persons.

### A. Definition of Self-Dealing

- (1) Self-dealing means any direct or indirect transaction described in Section 4941(d)(1) and not otherwise excepted. It is immaterial whether the transaction benefits or is detrimental to the foundation. See Treas. Reg. 53.4941(d)-1(a).
- (2) Generally, a disqualified person who participates in an act of self-dealing is liable for the tax even though that person had no knowledge at the time of the act that the act constituted self-dealing. See Treas. Reg. 53.4941(a)-1(a)(1). An exception applies to certain government officials. Another exception applies to certain sales of securities between a foundation and disqualified person over an exchange if:
  - a. The transaction takes place through a stockbroker where normal trading procedures on a stock exchange or recognized over-the-counter market are followed;
  - b. Neither the buyer nor the seller knows the identity of the other party; and
  - c. The sale is made in the ordinary course of business and does not involve a block of securities larger than the average daily trading volume of that stock over the previous four weeks. See Treas. Reg. 53.4941(a)-1(a)(1).
- (3) The securities exchange exception discussed above does not apply if the disqualified person is a dealer in securities acting as a principal in the transaction; nor does it apply to the lending of money or other extension of credit.
- (4) Self-dealing does not include a transaction between a private foundation and a disqualified person where the disqualified person status arises only because of such transaction. See Treas. Reg. 53.4941(d)-1(a). This is often referred to as the “first bite” rule. For example, the bargain sale of property to a private foundation is not an act of self-dealing if the seller becomes a disqualified person only because the bargain element of the sale caused the seller to become a substantial contributor. However, the first bite rule doesn’t apply after disqualified person status is established, such as in the case of a continuing act of self-dealing. See Private Letter Ruling (PLR) 9530032 (1995), which isn’t precedential guidance, but illustrates this point.

### B. Specific Acts of Self-Dealing

- (1) Section 4941(d)(1) provides for six specific self-dealing acts between a private foundation and its disqualified persons.

#### B.1. Sale or Exchange or Leasing of Property (Section 4941(d)(1)(A))

- (1) Generally, any sale or exchange of property between a private foundation and a disqualified person is an act of self-dealing. See Section 4941(d)(1)(A) and Treas. Reg. 53.4941(d)-2(a). Consider the following situations:
- a. A disqualified person's sale of incidental supplies to a private foundation is an act of self-dealing regardless of the amount the foundation pays for the incidental supplies. See Treas. Reg. 53.4941(d)-2(a)(1).
  - b. Similarly, a disqualified person's sale of stock or other securities to a private foundation in a bargain sale is an act of self-dealing regardless of the amount the foundation pays for that stock or other securities (subject to the "first bite" rule). See Treas. Reg. 53.4941(d)-2(a)(1).
  - c. An installment sale may be an act of self-dealing both as a sale and as an extension of credit. See Treas. Reg. 53.4941(d)-2(a)(1).
  - d. A private foundation's sale of art objects to a disqualified person at a public auction conducted by an auction gallery to which the items were consigned for sale constitutes an act of self-dealing. See Rev. Rul. 76-18, 1976-1 C.B. 355. The limited exception that applies to certain anonymous sales of securities over an exchange (which is a kind of auction) did not apply.
  - e. A transfer of a private foundation's stock to repay an interest free loan that a disqualified person made and used exclusively for exempt purposes, is the same as a sale or exchange of property between the private foundation and the disqualified person and is an act of self-dealing. Whereas the loan was not an act of self-dealing because it was interest-free and because the proceeds were used exclusively for purposes specified in Section 501(c)(3), the transfer of shares in satisfaction of the debt was an act of self-dealing. See Rev. Rul. 77-379, 1977-2 C.B. 387.
  - f. An act of self-dealing will not result from the exchange of securities between a private foundation and a corporation that was previously a disqualified person because of the ownership of more than 35% of its total combined voting power by the former foundation manager, who resigned five years before the exchange, and didn't participate in planning the exchange offer during the period of disqualification. See Rev. Rul. 76-448, 1976-2 C.B. 368.
- (2) Under certain conditions, a sale or exchange (or other transaction involving securities) between a private foundation and a corporation which is a disqualified person is not considered self-dealing if the transaction takes place pursuant to a liquidation, merger, redemption, recapitalization, or other corporate adjustment, organization, or reorganization. See Section 4941(d)(2)(F) and Treas. Reg. 53.4941(d)-3(d). The foundation must be afforded equal treatment with the other holders of securities of the same class in the corporation and receive at least fair market value for the transaction not to be considered self-dealing. Compensating the foundation with property, such as debentures, for its stock when other holders of identical stock receive cash is not considered treating the foundation on a uniform basis.

- (3) The purchase or sale of securities by a private foundation is not self-dealing under Treas. Reg. 53.4941(a)-1(a)(1) if:
- a. The transaction takes place through a stockbroker where normal trading procedures on a stock exchange or recognized over-the-counter market are followed,
  - b. Neither the buyer nor the seller nor the agent of either knows the identity of the other party, and
  - c. The sale is made in the ordinary course of business and does not involve a block of securities larger than the average daily trading volume of that stock over the previous four weeks.
- (4) The exceptions for the purchase or sale of securities in (3) above do not apply to transactions involving dealers in securities who are disqualified persons acting as principals, or to securities transactions involving the lending of money or other extensions of credit between private foundations and disqualified persons. See Section 4941(d)(1)(B).
- (5) One case in which a redemption was approved by the court was *Deluxe Corp. v. United States*, 885 F.2d 848 (Fed. Cir. 1989). The corporation conducted a redemption of the common stock. Some of the stock was owned by a private foundation. The corporation excluded its officers and directors from the redemption. The Court concluded that the redemption met the exception in Section 4941(d)(2)(F) because Treas. Reg. 53.4941(d)-3(d)(1) did not require the shareholders who are officers or directors to be included in the redemption program (in light of potential conflicts with securities laws), and the redemptions were no less than fair market value.
- (6) A disqualified person's transfer of real or personal property to a private foundation is treated as a sale or exchange if the foundation:
- a. Assumes a mortgage or similar lien which was placed on the property before the transfer, or
  - b. Takes the property, subject to a mortgage or similar lien placed on it by the disqualified person, within the 10-year period ending on the date of transfer. See Section 4941(d)(2)(A).
- Note:** The term "similar lien" includes, but is not limited to, deeds of trust and vendor's liens, but doesn't include any lien which is insignificant in relation to the fair market value of the property transferred. See Treas. Reg. 53.4941(d)-2(a)(2).
- (7) In *Gershman Family Foundation v. Commissioner*, 83 T.C. 217 (1984) acq. 1985-2 C.B. viii, the court held that a disqualified person's transfer of a promissory note, secured by an all-inclusive trust deed on property that is subject to senior notes, to a private foundation was an act of self-dealing. The court concluded that the statutory language "subject to a mortgage or similar lien" should be broadly construed to apply to transfers in which an individual

may improperly benefit from a transaction even though there's no clear and immediate detriment to or relinquishment by the foundation. See also Rev. Rul. 78-395, 1978-2 C.B. 270 (a disqualified person's transfer to a private foundation of real property that is subject to a lien placed on the property by the disqualified person within the 10-year period ending on the transfer date is an act of self-dealing, even though the lien was created merely as part of a multiphase financing plan begun more than 10 years earlier); Rev. Rul. 80-132, 1980-1 C.B. 255 (a disqualified person's donation to a private foundation of a life insurance policy subject to an outstanding loan made to the donor within the 10-year period ending on the date of the donation that was not insignificant in relation to the value of the policy was an act of self-dealing).

- (8) Leasing property between a disqualified person and a private foundation is considered self-dealing except when a disqualified person leases property to a foundation without charge. A lease is considered to be without charge even though the foundation pays for reasonable janitorial services, utilities or other maintenance costs it incurs for the use of the property, so long as the payment is not made directly or indirectly to a disqualified person. See Treas. Reg. 53.4941(d)-2(b)(2).
- (9) Certain binding leases of office space in effect on Oct. 9, 1969 (or renewals) to a foundation are excluded from self-dealing. See Section 4941(d)(2)(H) and Treas. Reg. 53.4941(d)-2(b)(3).
- (10) See also the exception for furnishing of facilities under Section 4941(d)(2)(D), discussed in section II in this Guide.

## **B.2. Lending of Money or Other Extension of Credit (Sections 4941(d)(1)(B) and 4941(d)(2)(B))**

- (1) The lending of money or other extension of credit between a private foundation and a disqualified person generally constitutes self-dealing.
- (2) An act of self-dealing may occur if a private foundation and a disqualified person enter into a debtor-creditor (or creditor-debtor) relationship, either directly or indirectly. For example, an act of self-dealing occurs where a third-party purchases property and assumes a mortgage, the mortgagee of which is a private foundation, and subsequently the third party transfers the property to a disqualified person who either assumes liability under the mortgage or takes the property subject to the mortgage. Similarly, an act of self-dealing generally occurs where a note, the obligor of which is a disqualified person, is transferred by a third party to a private foundation which becomes the creditor under the note. See Treas. Reg. 53.4941(d)-2(c)(1).
- (3) The exceptions to the general rule are:
  - a. Loans or other extensions of credit by a disqualified person to a private foundation without interest or other charge and if the proceeds of the loan

are used exclusively for purposes specified in Section 501(c)(3). See Section 4941(d)(2)(B) and Treas. Reg. 53.4941(d)-2(c)(2).

- b. The making of a promise, pledge or similar arrangement to a private foundation by a disqualified person, whether evidenced by an oral or written agreement, a promissory note, or other instrument of indebtedness, to the extent motivated by charitable intent and unsupported by consideration, is not considered an extension of credit before the date of maturity. See Treas. Reg. 53.4941(d)-2(c)(3).
- c. A foundation's receipt and holding of a note owed by a disqualified person pursuant to a transaction described in Treas. Reg. 53.4941(d)-1(b)(3) (the estate administration exception) is excepted and does not constitute self-dealing.
- d. A foundation's receipt and holding of a debenture owed by a disqualified person pursuant to a transaction described in Section 4941(d)(2)(F) and Treas. Reg. 53.4941(d)-3(d) (the corporate redemption exception). If the debenture remains outstanding after the end of the obligor's tax year, however, the debenture is treated as a new act of self-dealing no longer subject to the exception. See Example 2 of Treas. Reg. 53.4941(d)-3(d)(2), and Example 3 of Treas. Reg. 53.4941(e)-1(e)(1)(ii).
- e. Certain accounts receivable owed by disqualified persons to private foundations arising from sales excepted from self-dealing under Section 4941(d)(2)(D) are not treated as extensions of credit. See Treas. Reg. 53.4941(d)-3(b)(2).
- f. General banking services discussed immediately below.

#### (4) General banking services

- a. The performance of certain general banking services, trust functions, and safekeeping activities (including the maintenance of checking and savings accounts and safe deposit boxes (but not certificates of deposit)) for a private foundation by a bank or trust company which is a disqualified person. The banking services must be reasonable and necessary to carrying out the private foundation's exempt purposes, and the compensation paid, taking into account the fair interest rate for using the foundation's funds, to the bank or trust company must not be excessive considering the fair interest rate for using the foundation's funds. See Treas. Reg. 53.4941(d)-2(c)(4).
- b. This exception permitting the performance of general banking services is based on the personal services exception (discussed in section II.B.4 in this Guide). See Example 3 of Treas. Reg. 53.4941(d)-3(c)(2).
- c. The foundation must not be charged any interest on overdrafts of checking accounts. Treas. Reg. 53.4941(d)-2(c)(4)(i). However, imposing a service charge for the actual cost of processing an overdraft is permissible. See Rev. Rul. 73-546, 1973-2 C.B. 384.

- d. Also, the foundation must be able to withdraw its funds from a savings account on no more than 30 days' notice without being subject to a loss of interest on its money when the money was on deposit. Treas. Reg. 53.4941(d)-2(c)(4)(ii). For applications of this rule, see Rev. Rul. 73-595, 1973-2 C.B. 384 (no payment of interest), and Rev. Rul. 77-288, 1977-2 C.B. 388 (1-year CD did not qualify for the banking services exception).
- e. See also Rev. Rul. 77-259, 1977-2 C.B. 387, holding that purchase of a mortgage by a foundation from a disqualified person bank was an act of self-dealing not excepted as a general banking service.

### **B.3. Furnishing of Goods, Services, or Facilities (Sections 4941(d)(1)(C), 4941(d)(2)(C), and 4941(d)(2)(D))**

- (1) The furnishing of goods, services, or facilities between a private foundation and disqualified person is generally considered an act of self-dealing. See Section 4941(d)(1)(C).
  - a. This includes the furnishing of goods, services, or facilities such as office space, automobiles, auditoriums, secretarial help, meals, libraries, publications, laboratories, or parking lots. Treas. Reg. 53.4941(d)-2(d)(1).
  - b. Similarly, the rental of aircraft by a disqualified person to a private foundation constitutes self-dealing. See Rev. Rul. 73-363, 1973-2 C.B. 383.
- (2) An exception applies to a disqualified person's furnishing of goods, services, or facilities to a private foundation without charge. Section 4941(d)(2)(C). The furnishing of goods is considered "without charge" even though the foundation pays for reasonable transportation, insurance, or maintenance costs it incurs in obtaining or using the property, so long as the payment is not made directly or indirectly to the disqualified person. See Treas. Reg. 53.4941(d)-2(d)(3).
- (3) Another exception applies to the furnishing of goods, services, or facilities by a private foundation to a disqualified person if the furnishing is made on a basis no more favorable than that on which made available to the public. Section 4941(d)(2)(D). For the exception to apply, the furnishing of goods, services or facilities by the foundation must be functionally related to the exercise or performance of the private foundation's exempt purposes, and there must be a substantial number of persons other than disqualified persons using the goods, services, or facilities. See Treas. Reg. 53.4941(d)-3(b). The exception was applied in these rulings:
  - a. Rev. Rul. 76-459, 1976-2 C.B. 369 (disqualified person corporation's use of a private foundation museum's private road for access to the adjacent headquarters and manufacturing plant of the corporation during the same hours the road is used by the public as a thoroughfare connecting two public streets held not self-dealing).
  - b. Rev. Rul. 76-10, 1976-1 C.B. 355 (use by government official of foundation's library meeting room, which is functionally related to the

foundation's exempt purpose and made available at no charge to the community-at-large, held not self-dealing).

- c. In contrast, see Rev. Rul. 79-374, 1979-2 C.B. 387, which held self-dealing under Section 4941(d)(1)(C) an exempt private foundation's rental of office space to disqualified persons. The foundation conducted agricultural economics research and experimentation in part of an office building it owned and rented the remaining spaces to disqualified persons who are engaged in agricultural business activities. The foundation did not use these businesses in its research. The IRS found the rentals not functionally related to the foundation's exempt purpose.
- (4) A foundation's furnishing of goods, services, or facilities to a disqualified person (other than a foundation manager or employee) without charge is an act of self-dealing. See Treas. Reg. 53.4941(d)-2(d)(1). Furnishing to a disqualified person foundation manager or employee, however, is excepted from self-dealing under the following two conditions:
- a. The furnishing must be reasonable and necessary to such person's performance of tasks in carrying out the foundation's exempt purposes (whether or not includible as compensation in gross income).
  - b. The value of such furnishing, taken in conjunction with any other payment of compensation or payment or reimbursement of expenses to such person by the foundation, is not excessive for services such person performed in the capacity as foundation manager or employee.

See Treas. Reg. 53.4941(d)-2(d)(2). For example, a foundation manager provided meals and lodging as caretaker of a historical site operated by a foundation might qualify for the exception.

#### **B.4. Payment of Compensation (or Payment or Reimbursement of Expenses) (Section 4941(d)(1)(D), 4941(d)(2)(E))**

- (1) A foundation's payment of compensation or payment or reimbursement of expenses to a disqualified person is generally self-dealing. See Section 4941(d)(1)(D). However, an exception to this rule is made for the payment of compensation by a foundation to or reimbursement of expenses of a disqualified party (other than a government official) for the performance of personal services which are reasonable and necessary to carrying out the exempt purposes of the foundation, providing the payment is not excessive. See Section 4941(d)(2)(E) and Treas. Reg. 53.4941(d)-3(c)(1).
- (2) Payment of expenses includes reasonable advances for expenses anticipated in the immediate future by the foundation. Payment of a cash advance to a foundation manager or employee for expenses on behalf of the foundation is not an act of self-dealing so long as the amount of the advance is reasonable in relation to duties and expense requirements. Such advances shall not ordinarily

exceed \$500. See Treas. Reg. 53.4941(d)-3(c)(1), which sets forth the requirements for such cash advances.

**Example:** If a private foundation makes an advance to a foundation manager to cover anticipated out-of-pocket current expenses for a reasonable period (such as a month) and the manager accounts to the private foundation under a periodic reimbursement program for actual expenses incurred, the private foundation will not be regarded as having engaged in an act of self-dealing:

- a. When it makes the advance,
  - b. When it replenishes the funds upon receipt of supporting vouchers from the foundation manager, or
  - c. If it temporarily adds to the advance to cover extraordinary expenses anticipated to be incurred in fulfillment of a special assignment (such as long-distance travel).
- (3) Rev. Rul. 73-613, 1973-2 C.B. 385 held the payment of legal fees on behalf of a director-manager of a private foundation relating to the filing of a lawsuit arising out of his duties as a director did not constitute an act of self-dealing by reason of the exception provided by Section 4941(d)(2)(E).
- (4) The disqualified person providing the personal services need not be an individual, so “personal services” refers instead to the nature of the services. The term “personal services” includes the services of a broker serving as an agent for the private foundation, but not the services of a dealer who buys from the private foundation as principal and resells to third parties. See Treas. Reg. 53.4941(d)-3(c)(1).
- (5) Treas. Reg. 53.4941(d)-3(c)(2) provides the following four examples of payment of compensation for certain personal services.
- a. M, a partnership, is a law firm. A and B are partners of M and serve as trustees to the private foundation and therefore are disqualified persons. Also, A and B own more than 35% of the profits interest in M, thereby making M a disqualified person. M performs various legal services for the private foundation. The payment of compensation by the private foundation to M shall not constitute an act of self-dealing if the services performed are reasonable and necessary for carrying out of the private foundation’s exempt purposes and the amount paid by the private foundation for such services is not excessive.
  - b. Manager of a private foundation owns an investment counseling business. Acting in his capacity as an investment counselor Manager manages foundation’s investment portfolio for which he receives an amount which is determined to be not excessive. The payment of such compensation to Manager shall not constitute an act of self-dealing.
  - c. A commercial bank serves as trustee for private foundation. In addition to bank’s duties as trustee, bank maintains foundation’s checking and savings



accounts and rents a safety deposit box to foundation. The use of the funds by bank and the payment of compensation by the private foundation to bank for such general banking services shall be treated as the payment of compensation for the performance of personal services which are reasonable and necessary to carry out the exempt purposes of private foundation if such compensation is not excessive.

- d. D, a substantial contributor to a private foundation, owns a factory which manufactures microscopes. D contracts with foundation to manufacture 100 microscopes. Any payment to D under the contract shall constitute an act of self-dealing since the payment does not constitute the payment of compensation for the performance of personal services.
- (6) Rev. Rul. 74-591, 1974-2 C.B. 385, held that the payment of a pension for past personal services to one of the directors of a private foundation was not an act of self-dealing since the total compensation paid to the director, including the pension, was for personal services and not excessive. The pension was for past services as the foundation's sole employee, including general administration, bookkeeping, investment counseling, disbursing, and managing real estate. (See also Rev. Rul. 73-126, 1973-1 C.B. 220.)
  - (7) *Madden v. Commissioner*, 74 T.C.M. (1997), reasoned that it was Congress's intent that any exceptions to the self-dealing transaction rules should be construed narrowly and that treating all services as personal services would erode the prohibition against "furnishing of services" under Sections 4941(d)(1)(C) and (d)(2)(C). The court concluded that general maintenance, janitorial, and custodial services were different in nature from the professional and managerial services found in the examples in the regulations and, therefore, did not meet the definition of personal services.
  - (8) There is no guidance in Chapter 42 to determine reasonable compensation. However, we can look to other areas for help. Reasonable compensation is defined in the Income Tax Regulations, specifically Treas. Reg. 1.162-7(b)(3), as the amount like organizations would ordinarily pay for like services in like circumstances. This standard is also adopted in the excess benefit transactions regulations under Section 4958. The excess benefit transaction regulations under Treas. Reg. 53.4958-6 states that payments under a compensation arrangement are presumed to be reasonable, and a transfer of property, or the right to use property, is presumed to be at fair market value, if it meets three requirements: (1) advanced approval by an authorized body of the organization; (2) that the authorized body looked at comparable data for making the particular compensation; and (3) that the process is adequately documented ("rebuttable presumption" that a transaction is not an excess benefit transaction). Not meeting the three requirements, however, does not automatically mean the compensation is not reasonable.
  - (9) In *Kermit Fischer Foundation v. Commissioner*, T.C. Memo. 1990-300, 59 T.C.M. (CCH) 898 (1990), a private foundation's sole trustee received

compensation from the private foundation irregularly, and the amounts appeared to be related more to his need for funds than to his duties and responsibilities. The IRS offered uncontradicted expert testimony regarding the normal compensation paid for trusts of the foundation's size. The expert suggested that a normal salary for a comparable trust would have been \$1,450 to \$2,000 per year, rather than the approximately \$40,000 per year the trustee received during the years at issue. Moreover, the annual compensation the manager received was disproportionately large compared to the foundation's total assets. The court held that the disqualified person, the trustee of the foundation, was liable for tax under Section 4941(a) for receipt of excessive compensation.

- (10) De minimis fringe benefits under Section 132(a)(4) may be disregarded in determining reasonable compensation. See Treas. Reg. 53.4941(d)-2(f)(8).
- (11) Under Rev. Rul. 73-613, 1973-2 C.B. 385, the payment of legal fees on behalf of a director-manager of a private foundation relating to the filing of a lawsuit arising out of his duties as a director did not constitute an act of self-dealing by the exception provided by Section 4941(d)(2)(E).

#### **B.5. Transfer or Use of the Foundation's Income or Assets by or for the Benefit of a Disqualified Person (Section 4941(d)(1)(E))**

- (1) If a foundation's income or assets are transferred to, or used by or for the benefit of, a disqualified person, it is an act of self-dealing. Section 4941(d)(1)(E); Treas. Reg. 53.4941(d)-2(f)(1). An exception applies if the benefit to a disqualified person from the foundation's use of its income or assets is only incidental or tenuous. Treas. Reg. 53.4941(d)-2(f)(2). Another exception applies to a disqualified person's use of property in which the disqualified person and private foundation have a joint or common interest, if the interests of both were acquired before October 9, 1969. See Treas. Reg. 53.4941(d)-4(e).
- (2) Examples of self-dealing acts under Section 4941(d)(1)(E):
  - a. Private foundation's payment of any Chapter 42 tax imposed on a disqualified person;
  - b. Private foundation's payment of the premiums on an insurance policy for liability insurance for a foundation manager for Chapter 42 taxes (unless this payment is treated as compensation);
  - c. The purchase or sale of stock or other securities to manipulate the price to the advantage of a disqualified person;
  - d. Making a scholarship grant to the descendant of a bank employee with fiduciary responsibilities over the foundation;
  - e. Private foundation's guarantee of a bank loan to a disqualified person;
  - f. A private foundation's payment of a disqualified person's church membership dues (Rev. Rul. 77-160, 1977-1 C.B. 351);

- g. Placing paintings owned by a private foundation in the residence of a substantial contributor, a disqualified person. This is an act of self-dealing under Section 4941(d)(1)(E) since the disqualified person has the direct use and benefit of an asset of the private foundation. See Rev. Rul. 74-600, 1974-2 C.B. 385; and
- h. A private foundation's making of a grant which satisfies a disqualified person's legal obligation.

**Note:** There is an exception for certain grants or payments, enforceable by local law, to satisfy pledges made to a Section 501(c)(3) organization on or before April 16, 1973, and the disqualified person obtains no substantial benefit, other than the satisfaction of an obligation. See Treas. Reg. 53.4941(d)-2(f)(1).

- (3) See also Notice 99-36, 1999-1 C.B. 1284, which provides that certain charitable split-dollar insurance transactions that purport to give rise to charitable contribution deductions may result in a use of foundation assets for the benefit of a disqualified person.
- (4) Treas. Reg. 53.4941(d)-2(f)(2) states that the fact that a disqualified person receives an incidental or tenuous benefit from the use by a private foundation of its income or assets will not, by itself, make such use an act of self-dealing. Rev. Rul. 77-331, 1977-2 C.B. 388, reasoned that an incidental or tenuous benefit occurs when the general reputation or prestige of a disqualified person is enhanced by public acknowledgement of some specific donation by such person, when a disqualified person receives some other relatively minor benefit of an indirect nature, or when such a person merely participates to a wholly incidental degree in the fruits of some charitable program that is of broad public interest to the community.
- (5) Examples of incidental or tenuous benefit:
  - a. A foundation's grant to a public charity will not be an act of self-dealing merely because the charity is located in the same area as a substantial contributor corporation. See Example 1 of Treas. Reg 53.4941(d)-2(f)(9).
  - b. A scholarship or a fellowship grant to a person other than a disqualified person, which is paid or incurred by a private foundation in accordance with a program which is consistent with the requirements of the foundation's exempt status under Section 501(c)(3), the requirements for the allowance of deductions under Section 170 for contributions made to the foundation, and the requirements of Section 4945(g)(1) will not be an act of self-dealing under Section 4941(d)(1) merely because a disqualified person indirectly receives an incidental benefit from such grant. Thus, a scholarship or a fellowship grant made by a private foundation in accordance with a program to award scholarships or fellowship grants to the children of employees of a substantial contributor shall not constitute an act of self-dealing if the requirements of the preceding sentence are satisfied. See Example 2 of Treas. Reg. 53.4941(d)-2(f)(9) and Rev. Rul. 80-310, 1980-2 C.B. 319.

- c. A foundation's provision of proxy voting rights, for voting at the annual shareholder meeting, to the corporation in which the foundation owns stock and whose management includes disqualified persons, is not an act of self-dealing. See Example 3 of Treas. Reg. 53.4941(d)-2(f)(9).
- d. A foundation's naming of a recreation center after a substantial contributor is considered an incidental benefit. See Example 4 of Treas. Reg. 53.4941(d)-2(f)(9). See also Rev. Rul. 73-407, 1973-2 C.B. 383 (a contribution by a private foundation to a public charity made on the condition that the public charity change its name to that of a substantial contributor to the foundation and agree not to change the name again for 100 years does not constitute an act of self-dealing).
- e. A foundation's grant to a public charity, one of whose officers, directors or trustees is also a manager or substantial contributor with respect to the foundation is considered an incidental benefit. See Rev. Rul. 75-42, 1975-1 C.B. 359, clarified by Rev. Rul. 82-136, 1982-2 C.B. 300 (a grant by a private foundation to a second private foundation does not constitute an act of self-dealing even though a banking institution serves as sole trustee of both foundations as any benefit received by the disqualified person (the banking institution) is merely incidental); Rev. Rul. 78-77, 1978-1 C.B. 378 (foundation purchase of property from a testamentary trust, where a bank was the trustee of both the foundation and the trust, was not an act of self-dealing).
- f. A foundation's loan to a public charity, which is paid to contractors who have ordinary banking relationships with a bank that is a disqualified person, is not an act of self-dealing. See Rev. Rul. 85-162, 1985-2 C.B. 275.
- g. A grant by a private foundation to a Section 509(a)(1), (2), or (3) organization will not be an act of self-dealing merely because the organization is in the same area as a corporation which is a substantial contributor to the foundation, or one of the Section 509(a)(1), (2) or (3) organization's officers, directors or trustees is also a manager of or a substantial contributor to the private foundation. See Treas. Reg. 53.4941(d)-2(f)(2).
- h. Under Rev. Rul. 77-6, 1977-1 C.B. 350, a hospital proposed to finance an expansion program by using bonds. To reduce the cost of the bonds, a private foundation agreed to guarantee the payment of both the principal and the interest on the bonds. A disqualified person with respect to the foundation, who was also an officer of the hospital, planned to purchase a portion of the bond issue. However, the private foundation's guarantee did not and would never apply to any bonds purchased by the disqualified person. The arrangement did not result in any use of the foundation's assets for the economic benefit of the disqualified person, and any benefit derived by the disqualified person by virtue of that person's position as an

officer of the hospital was considered incidental or tenuous, so there was no act of self-dealing.

(6) Employer-related scholarship programs:

- a. While a foundation's making of a scholarship grant, loan, or loan guarantee to a disqualified person is an act of self-dealing under Section 4941(d)(1)(E) (see Treas. Reg. 53.4941(d)-2(f)(2) and Rev. Rul. 77-331, 1977-2 C.B. 388), scholarships to the employees (or family members of employees) of a corporation disqualified person with respect to the foundation are not considered self-dealing in appropriate circumstances.
- b. A scholarship or a fellowship grant to a person other than a disqualified person, which is paid or incurred by a private foundation in accordance with a program which is consistent with: (i) the requirements of the foundation's exempt status under Section 501(c)(3), (ii) the requirements for the allowance of deductions under Section 170 for contributions made to the foundation, and (iii) the requirements of Section 4945(g)(1), will not be an act of self-dealing under Section 4941(d)(1) merely because a disqualified person indirectly receives an incidental benefit from such grant. See Treas. Reg. 53.4941(d)-2(f)(2).
- c. For examples of the kind of scholarship program with an employment nexus that meet the above requirements, see Example 1 of Treas. Reg. 53.4945-4(b)(5); Treas. Reg. 53.4941(d)-2(f)(2); Example 2 of Treas. Reg. 53.4941(d)-2(f)(9). See also Rev. Rul. 80-310, 1980-2 C.B. 319 (foundation grant to a university to establish an educational program in manufacturing engineering was not an act of self-dealing because any benefit to a corporation disqualified person that intended to hire graduates of the new program and encourage its employees to enroll in the program, where the corporation would not receive preferential treatment in recruiting graduates or enrolling its employees, was incidental and tenuous).

(7) General Counsel Memorandum (GCM) 39107 (1983) discusses the history of the incidental and tenuous benefits standard under Treas. Reg. 53.4941(d)-2(f)(2) and concludes that strict limits to the scope of the exception of incidental and tenuous benefits have been established. It states that the factors leading to that conclusion include congressional reasoning on the enactment of the self-dealing prohibition in Section 4941, stating the committee's decision, generally in accord with the House bill, are based on the belief that the highest fiduciary standards require that self-dealing not be engaged in, rather than that arm's-length standards be observed. See S. Rep. No. 91-552, 91st Cong., 1st Sess. 28-29 (1969), 1969-3 CB 442-443. The GCM noted that we believe that "the highest fiduciary standards" do not allow for the intermingling of the assets of a PF with the property of disqualified persons.

(8) An act of self-dealing is committed when a foundation makes a loan to an individual who has substantial dealings with the foundation manager in his capacity as the individual's attorney. See GCM 39632 (1987).

- (9) Indemnification and insurance for foundation manager. A foundation's indemnification of a foundation manager for defense in a civil proceeding (judicial or administrative) arising from the manager's personal services on behalf of the foundation may or may not constitute self-dealing. See Treas. Reg. 53.4941(d)-2(f)(3). The term "indemnification" includes both the foundation's reimbursement of the manager for such expenses and direct payment of such expenses as they arise. See Treas. Reg. 53.4941(d)-2(f)(6). Thus, the rules differ depending on whether the foundation's payment for indemnification or insurance is considered compensation to the foundation manager. See Treas. Reg. 53.4941(d)-2(f)(3) through -2(f)(8).
- (10) A foundation's indemnification against all expenses (other than taxes such as Chapter 42 taxes, penalties, or expenses of correction), including attorneys' fees, judgments, and settlement expenditures, is not self-dealing if such expenses are reasonably incurred by the manager in connection with such proceeding, and the manager has not acted willfully and without reasonable cause with respect to the act or failure to act which led to such proceeding or to liability for tax under Chapter 42. Such indemnification is not treated as compensation for purposes of determining reasonable compensation under Chapter 42. See Treas. Reg. 53.4941(d)-2(f)(3). The conditions are that the expenses be reasonably incurred relating to the contest proceedings, and that the foundation manager be successful in the defense or the proceedings be terminated by settlement.

**Example:** A foundation manager might successfully contest the liability for Chapter 42 tax based on the expiration of the statute of limitations, but if, in fact, the manager acted willfully and without reasonable cause, the indemnification for expenses would be an act of self-dealing.

- (11) A foundation's indemnification of a foundation manager for defense in a civil proceeding arising from the manager's personal services on behalf of the foundation, to the extent not permitted above, is considered as compensation to the foundation manager and is permitted if added to the other compensation paid to the manager, and the manager's total compensation is reasonable. See Treas. Reg. 53.4941(d)-2(f)(4).
- (12) Generally, payments by a private foundation of the premiums for an insurance policy providing liability insurance to a disqualified person for Chapter 42 taxes shall be an act of self-dealing under the provisions of Section 4941(d)(1)(E) unless such premiums are treated as part of the compensation paid to such disqualified person and the foundation manager's total compensation, including the compensatory insurance premiums, is reasonable. See Treas. Reg. 53.4941(d)-2(f)(4); see also Rev. Rul. 74-405, 1974-2 C.B. 384 and Rev. Rul. 82-223, 1982-2 C.B. 301.
- (13) A foundation may allocate its liability insurance between compensatory and non-compensatory coverage if it includes the premiums for the compensatory

coverage in the foundation manager's compensation. See Treas. Reg. 53.4941(d)-2(f)(5).

- (14) Charitable remainder unitrusts, as split-interest trusts described in Section 4947(a)(2), are subject to Section 4941. Notice 94-78, 1994-2 C.B. 555, described a type of accelerated charitable remainder trust used to avoid income tax. These trusts are characterized by a very high noncharitable payout amount (for example 75% annually), a short term (for example a two-year trust), and the realization of substantial capital gain income. Notice 94-78 stated that depending on the facts of each case, the IRS will challenge trusts of this type based on one or more legal doctrines including self-dealing under Section 4941(d)(1)(E).
- (15) Notice 94-78 has limited relevance after the amendment of Section 664(d)(2)(A) (enacted with the Taxpayer Relief Act of 1997) and the promulgation of Treas. Reg. 1.664-3(a)(1)(i)(g). The former limits the fixed percentage payout of a qualifying charitable remainder unitrust to no more than 50%, while the latter provides a conditional safe harbor from the tax under Section 4941 for payment of the unitrust amount after the close of the taxable year. However, a Trust containing, for example, a 49% noncharitable payout amount and having the other characteristics of an accelerated charitable remainder unitrust (described above) may be examined to determine if the payment falls outside the safe harbor in Treas. Reg. 1.664-3(a)(1)(i)(g) so that tax under Section 4941 should be imposed, as provided by Notice 94-78. Note that a charitable remainder annuity trust that makes an annuity payment after the close of the taxable year may also be examined to determine if the payment falls outside the safe harbor in Treas. Reg. 1.664-2(a)(1)(i)(a).
- (16) A tax planning technique not uncommon to some charitable remainder unitrusts having a net income with makeup provision described in Section 664(d)(3) is to defer the amount of income to the noncharitable income recipient for some period beyond the initiation of the trust. In TAM 9825001(1997), with respect to the deferral of income from the trust by the purchase of a deferred annuity, the IRS concluded that the deferral of income did not constitute an act of self-dealing under Section 4941(d)(1)(E), at least where there is an absence of any unreasonable effect on the charitable remainder interest.

## **B.6. Payments to a Government Official (Sections 4941(d)(1)(F) and 4941(d)(2)(G))**

- (1) With exceptions, an act of self-dealing occurs if a private foundation makes any payment of money or other property to a governmental official. See Treas. Reg. 53.4941(d)-2(g).
- (2) Section 4946(c) provides that for purposes of Section 4941, the term "government official" means, with respect to an act of self-dealing, an individual who, at the time of such act, holds any of the following offices or positions

(other than as a “special Government employee”, as defined in Section 202(a) of title 18, United States Code):

- a. An elective public office in the executive or legislative branch of the Government of the United States,
  - b. An office in the executive or judicial branch of the Government of the United States, appointment to which was made by the President,
  - c. A position in the executive, legislative, or judicial branch of the Government of the United States which is listed in schedule C of rule VI of the Civil Service Rules, or the compensation for which is equal to or greater than the lowest rate of basic pay for the Senior Executive Service under section 5382 of title 5, United States Code,
  - d. A position under the House of Representatives or the Senate of the United States held by an individual receiving gross compensation at an annual rate of \$15,000 or more,
  - e. An elective or appointive public office in the executive, legislative, or judicial branch of the government of a State, possession of the United States, or political subdivision or other area of any of the foregoing, or of the District of Columbia, held by an individual receiving gross compensation at an annual rate of \$20,000 or more,
  - f. A position as personal or executive assistant or secretary to any of the foregoing, or
  - g. A member of the Internal Revenue Service Oversight Board.
- (3) An individual who is otherwise described in Section 4946(c) is treated as a government official while on leave of absence from the government without pay.
- (4) While the tax is imposed on the agreement to pay, the amount involved is based on payment (Treas. Reg. 53.4941(e)-1(b)(1)), so a mere agreement to pay without actual payment results in no tax.
- (5) The tax under Section 4941(a)(1) is imposed on an act of self-dealing with a government official only if the government official participates knowing that it is such an act. See Treas. Regs. 53.4941(a)-1(a)(2) and 53.4941(a)-1(b)(3). This provision limits significantly the number of taxable acts of self-dealing with government officials. In addition, the personal services exception under Section 4941(d)(2)(E) does not apply to a government official.
- (6) Any agreement to employ or make a grant to a government official for any period after the termination of government employment does not constitute self-dealing if the agreement is entered into within 90 days prior to such termination is not an act of self-dealing. See Section 4941(d)(1)(F).
- (7) Under Section 4941(d)(2)(G), the following types of payments made by a private foundation to a government official are not considered acts of self-dealing:



- a. Prize or award. A foundation's grant of a prize or award to a government official, if the recipient is selected from the general public without any action on his or her part and is not required to render substantial future services. See Section 4941(d)(2)(G)(i) (which cross-references Section 74(b)(1) and (2)) and Treas. Reg. 53.4941(d)-3(e)(1).
- b. Scholarship or fellowship. A foundation's grant of a scholarship or fellowship to a government official, if the grant is to be used for study at a Section 170(b)(1)(A)(ii) educational organization (including, for this purpose, a for-profit school) and would be excluded from the recipient's income under pre-1986 Section 117(a) (which excluded grants covering room, board, laundry, travel, research, and clerical help incidental to the scholarship or fellowship, in addition to tuition and fees and course-required books, supplies, and equipment). See Section 4941(d)(2)(G)(ii); Treas. Reg. 53.4941(d)-3(e)(2) (the regulation is not current with the statute); and Treas. Reg. 1.117-1 through 1.117-4.
- c. Certain retirement plan payments. An annuity or other payment (forming part of a stock-bonus, pension, or profit-sharing plan) by a trust which is a qualified trust under Section 401, or under a plan meeting the requirements of Section 404(a)(2). See Section 4941(d)(2)(G)(iii) and (iv) and Treas. Reg. 53.4941(d)-3(e)(3) and (4). This exception would apply if a government official had previously earned the right to such payment as an employee or fiduciary of the foundation.
- d. Certain de minimis gifts. A foundation's contribution or gift of property (other than money), or services or facilities made available, to or for the benefit of a government official, not exceeding \$25.00 in aggregate value for any calendar year. See Section 4941(d)(2)(G)(v) and Treas. Reg. 53.4941(d)-2(g)(5).
- e. Certain government employees' training programs. A foundation's payment made under 5 U.S.C. chapter 41 (relating to government employees' training programs). Section 4941(d)(2)(G)(vi) and Treas. Reg. 53.4941(d)-2(g)(6).
- f. Certain travel expenses within the United States. A foundation's payment to or reimbursement of a government official for travel expenses (including meals and lodging) for travel solely from one point in the U.S. to another for governmental or charitable purposes (described in Section 170(c)(1) or Section 170(c)(2)(B)), provided such payment or reimbursement is not greater than the actual cost of transportation plus an amount not more than 125% of the maximum amount of per diem payable to a U.S. Government employee for like travel. See Section 4941(d)(2)(G)(vii) and Treas. Reg. 53.4941(d)-2(g)(7). The permissible points of travel are strictly construed. Rev. Rul. 74-601, 1974-2 C.B. 385, held that reimbursement by a private foundation for travel, meals, and lodging expenses incurred by U.S. Congressmen it chose to participate in a conference co-sponsored in a

foreign country was not excepted from self-dealing under Section 4941(d)(2)(G)(vii). Similarly, Rev. Rul. 76-159, 1976-1 C.B. 356, held that the payment or reimbursement of travel expense of a government official from Puerto Rico for roundtrip travel from Puerto Rico to U.S. to attend board of trustee meetings of a private foundation was not excepted from self-dealing under Section 4941(d)(2)(G)(vii), applying the definition of U.S. under Section 7701(a)(9).

- (8) Although PLRs are not considered guidance, they illustrate how the IRS applied a certain set of facts to the law. In PLR 200225042 (2002) the IRS noted that certain government officials' attendance or participation at conferences for bringing together world leaders to promote world peace and reconciliation and to facilitate international agreement is not an act of self-dealing under Section 4941(d)(1).

### C. Disqualified Person

- (1) Since Section 4941 imposes an excise tax on any direct or indirect act of self-dealing between a private foundation and a disqualified person, it's critical to understand the term disqualified person. See Treas. Reg. 53.4946-1. "Disqualified person" as defined in Section 4946 for purposes of Section 4941 means:
  - a. A substantial contributor to the foundation (as defined in Section 507(d)(2)),
  - b. A foundation manager,
  - c. An owner of more than 20% of the voting power of a corporation, or of the profits interest of a partnership or unincorporated enterprise, which is a substantial contributor to the foundation,
  - d. Certain members of the family of any individual described in a., b., or c. above,
  - e. A corporation in which persons described in a., b., c., or d. above own more than 35% of the voting power,
  - f. A partnership in which persons described in a., b., c., or d. above own more than 35% of the profits interest,
  - g. A trust or estate in which persons described in a., b., c., or d. above hold more than 35% of the beneficial interest, and
  - h. Certain government officials (Section 4946(c)).

**Note:** See TG 63: Disqualified Persons – IRC Section 4946 for more information.

### D. Taxes Imposed

- (1) Section 4941 imposes four separate and distinct taxes on each act of self-dealing:

- a. An initial (or first tier) tax on self-dealing by Section 4941(a)(1), payable by the self-dealing disqualified person,
  - b. An initial (or first tier) tax on the foundation manager's participation by Section 4941(a)(2), payable by the foundation manager,
  - c. An additional (or second tier) tax imposed by Section 4941(b)(1) on failure to correct within the taxable period, payable by the disqualified person, and
  - d. An additional (or second tier) tax imposed by Section 4941(b)(2) on refusing to agree to part or all of a correction, payable by a foundation manager.
- (2) Section 507(a)(2) states that private foundation status shall be terminated if:
- a. The foundation commits either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under Chapter 42,
  - b. The Secretary notifies such organization that, by reason of Section 507(a)(2)(A), such organization is liable for the termination tax imposed by Section 507(c), and
  - c. The foundation pays the tax (unless abated).
- (3) Section 4941(c)(1) provides special rules for joint and several liabilities. If more than one person is liable with respect to any one act of self-dealing, all such persons shall be jointly and severally liable under such paragraph with respect to such act. For example, if two or more foundation managers knowingly participate as foundation managers in an act of self-dealing, there is only one tax on them (the lesser of 10% of the amount involved or \$20,000), and they are jointly and severally liable for the amount (meaning that the IRS can collect the tax from any of them). See Treas. Reg. 53.4941(c)-1(b)(2).
- (4) By contrast, if two or more disqualified persons jointly participate as disqualified persons in an act of self-dealing, then there is generally a separate act of self-dealing with respect to each of them for purposes of Section 4941 (but not Section 507 or, in the case of a foundation manager, Section 6684). If the jointly participating disqualified persons are related as family members, however, they are treated as one person and there is a single act of self-dealing for which they are jointly and severally liable. See Treas. Reg. 53.4941(e)-1(e)(2).
- (5) Section 4941(c)(2) provides that with respect to any one act of self-dealing, the maximum amount of the initial tax and/or the additional tax imposed on the foundation manager shall not exceed \$20,000.

## **D.1. Taxes on Self-Dealer**

- (1) A Section 4941(a) excise tax is imposed on a disqualified person, who is the self-dealer, for each act of self-dealing with a private foundation. The tax imposed on the self-dealer is 10% of the amount involved in the act of self-dealing for each year or partial year in the taxable period. A disqualified person who engages in an act of self-dealing with a private foundation computes the

initial tax on self-dealing based on the disqualified person's own tax year if it is different from the foundation's tax year. See Rev. Rul. 75-391, 1975-2 C.B. 446.

- (2) Except for government officials, the initial tax is imposed on a disqualified person who participates in an act of self-dealing even though that person may not have been aware that the act constituted self-dealing. See Treas. Reg. 53.4941(a)-1.
  - a. A disqualified person is considered to have participated in an act of self-dealing if that person engages or takes part in the transaction alone or with others or directs any person to do so. See Treas. Reg. 53.4941(a)-1(a)(3).

## **D.2. Taxes on Foundation Manager**

- (1) When an initial tax is imposed on an act of self-dealing, an initial tax is also imposed on the participation by a foundation manager, if the manager participated knowing the act constitutes self-dealing, and the participation is willful and not due to reasonable cause. See *Madden v. Commissioner*, 74 T.C.M. (1997). See below for the definitions of key terms such as "knowing," "willful," and "due to reasonable cause."
- (2) The initial tax on a foundation manager is 5% of the amount involved for each year or partial year in the taxable period, subject to the limitation of Section 4941(c)(2). Section 4941(c)(2) provides that, with respect to any one act of self-dealing, the maximum amount of the initial tax or the additional tax payable by the foundation manager shall not exceed \$20,000 (if both taxes apply, the maximum amount is \$40,000).
- (3) A foundation manager participating in a self-dealing transaction may be liable for tax as a self-dealer (Section 4941(a)(1)) as well as for tax as a participating foundation manager (Section 4941(a)(2)). See Rev. Rul. 78-76, 1978-1 C.B. 377.
- (4) Participation by the foundation manager includes silence or inaction on the manager's part where there is a duty to speak or act, as well as any affirmative action by such manager. However, a foundation manager will not be considered to have participated in an act of self-dealing where that person has opposed the act in a manner consistent with the fulfillment of responsibilities to the foundation. See Treas. Reg. 53.4941(a)-1(b)(2).
- (5) Advice of counsel. If a foundation manager, after fully disclosing the facts of a transaction to legal counsel (including house counsel), relies on the counsel's advice expressed in a "reasoned written legal opinion" that the transaction is not an act of self-dealing, the foundation manager will not ordinarily be liable for the tax imposed by Section 4941(a)(2) even though the transaction is subsequently determined to be an act of self-dealing. The rationale for this provision is that reliance on such advice will not ordinarily result in "knowing" or "willful" participation in an act of self-dealing and such participation will ordinarily be considered "due to reasonable cause." To be safely relied upon as "reasoned," the written legal opinion must contain a rationale and conclusion based on the

facts and the applicable law. An opinion that does nothing more than recite the facts and express a conclusion will not be considered "reasoned" and may not be relied upon to prevent the imposition of tax on the foundation manager. See *Thorne v. Commissioner*, 99 T.C. 67 (1992) for a case where the tax under Section 4945(a)(2) was imposed on the foundation manager for failure to exercise expenditure responsibility with respect to certain grant recipients despite the assertion of reliance on the advice of counsel by the foundation manager.

- (6) The absence of advice of counsel with respect to an act shall not, by itself, give rise to any inference that a person participated in such act knowingly, willfully or without reasonable cause. See Treas. Reg. 53.4941(a)-1(b)(6).
- (7) The IRS has the burden of proof on the issue whether a foundation manager or a government official has knowingly participated in an act of self-dealing. See Section 7454(b).
- (8) A foundation manager participating in a self-dealing transaction may be liable for tax as a self-dealer (Section 4941(a)(1)) as well as for tax as a participating foundation manager (Section 4941(a)(2)). See Rev. Rul. 78-76, 1978-1 C.B. 377.
- (9) Foundation manager taxes were also upheld in *Madden v. Commissioner*, T.C. Memo. 1997-397, 74 T.C.M. (CCH) 440 (1997).

### **D.3. Additional Taxes**

- (1) If an act of self-dealing is not corrected within the taxable period, Section 4941(b) imposes additional taxes on self-dealers' failure to correct and on participating foundation managers' refusal to agree to correction.
- (2) A tax of 200% of the amount involved is paid by the self-dealer (or self-dealers if jointly and severally liable).
- (3) Likewise, a tax of 50% of the amount involved is paid by any foundation manager (or managers if jointly and severally liable) who has refused to agree to part or all of the correction of the self-dealing act, subject to a \$20,000 limitation.
- (4) In accordance with the opinion of the Tax Court in *Thorne v. Commissioner*, cited above, it is necessary that the IRS make a formal request in writing to the foundation manager that the correction be made. Otherwise, the foundation manager cannot be considered as having refused to make the correction. The written request for correction, known as a "Thorne letter," must be made within a reasonable period prior to the issuance of a statutory notice of deficiency asserting the second-tier tax. See IRM 4.70.14, Resolving the Examination, for procedural information regarding the issuance of the Thorne letter.
- (5) A foundation manager may be liable for the Section 4941(b)(2) tax without such manager (or any other manager) being liable for the Section 4941(a)(2) tax.

## E. Enforcement of the Two-Tier Tax Scheme

- (1) Under the 1969 excise tax scheme, Section 4941(a) imposed an initial (first tier) tax of 5% of the amount involved for each act of self-dealing for each taxable year that ends during the "taxable period." If the act of self-dealing remains uncorrected during the statutory "correction period," Section 4941(b) imposed an additional (second tier) tax on the self-dealer's failure to correct. The definition of "correction period" in the 1969 statutory language created a peculiar timing problem that the Tax Court found barred judicial review of the Section 4941(b) second tier tax and made the scheme unworkable. See *Adams v. Commissioner*, 72 T.C. 81 (1979).
- (2) Public Law 96-596 (December 24, 1980) was enacted to correct the statutory defect and permit the IRS to enforce the two-tier tax scheme under Section 4941 and other Chapter 42 provisions that have the Adams issue.
- (3) The second tier taxes are "imposed" at the end of the taxable period (for the initial or first tier tax), rather than after the correction period. See Section 4941(b).
- (4) The term "taxable period" as redefined in Section 4941(e)(1) and Treas. Reg 53.4941(e)-1(a), for any act of self-dealing, means the period beginning with the date on which the act of self-dealing occurs and ending on the earliest of these:
  - a. The date the IRS mails a notice of deficiency for tax imposed by subsection (a)(1) under Section 6212,
  - b. The date on which the tax imposed by Section 4941(a)(1) is assessed, or
  - c. The date on which correction of the act of self-dealing is "completed."
- (5) These changes allow the IRS to determine a deficiency for the second tier tax at the end of the taxable period, giving rise to a deficiency for the second tier taxes over which the Tax Court can assume jurisdiction under Section 6214. While ruling on a second tier tax deficiency, the Tax Court may also determine whether the taxable event has been corrected. Section 6214(c) has been amended to give the court this jurisdiction.
- (6) Public Law 96-596 also added Section 4961(a) to Chapter 42 to provide that any liability for the second tier tax deficiency determined by the IRS will be abated if timely correction occurs (by the end of the correction period, as defined in Section 4963(e)).
- (7) Section 4961(b) gives the Tax Court jurisdiction to conduct a supplemental proceeding (if the taxpayer seeks one within 90 days after the end of the correction period) to determine whether the taxable event was timely corrected.
- (8) Section 4961(c) suspends the period of limitations on collection of second tier taxes if an action for refund of the first tier tax is commenced not later than 90 days after the day on which the second tier tax is assessed.

- (9) Section 4963 sets out definitions of the crucial terms in the revised two-tier tax scheme.
- (10) Section 6684 imposes a penalty upon a person who becomes liable for a tax under Section 4941 for any act not due to reasonable cause, if the person has previously been liable for tax under Chapter 42, or the act is willful and flagrant. The penalty equals the tax imposed under Section 4941. See *Moody v. Commissioner*, 69 T.C.M. 2517 (1995).
- (11) Section 4962 provides for abatement of certain first tier taxes, but Section 4941(a) taxes are not included. See Section 4962(b).

### III. Other Considerations

- (1) There are other considerations that need to be reviewed when looking at a transaction that may fall within the definition of Section 4941.

#### A. Indirect Self-Dealing

- (1) The various enumerated acts of self-dealing may be engaged in directly between a disqualified party and a private foundation or indirectly through a third party.
- (2) Neither the Code nor the Regulations comprehensively define indirect self-dealing. Section 4941(d) prohibits indirect as well as direct acts of self-dealing. One form of indirect self-dealing is a transaction between a disqualified person and an organization controlled by a private foundation. The definition of control for this purpose is found in Treas. Reg. 53.4941(d)-1(b)(5).
- (3) For situations involving indirect acts of self-dealing, see *Adams v. Commissioner*, 70 T.C. 373 (1978) (the court noted that it is the use of the assets or income of a foundation and the actual or constructive benefit derived by the disqualified person which are the relevant considerations in its finding of indirect self-dealing transactions (a sale and a loan) between a disqualified person and an organization controlled by a foundation); and *Moody v. Commissioner*, supra (the court noted that failure of an organization to come within the "control" tests is not determinative of a lack of indirect self-dealing and held that portions of some of the foundation's grants to intermediary charities not controlled by the foundation were used for the benefit of disqualified persons and resulted in indirect self-dealing).
- (4) Certain transactions involving third parties are excepted from the self-dealing provisions. These exclusions are explained below. See Treas. Reg. 53.4941(d)-1(b).

##### A.1. Control

- (1) An organization is controlled by a private foundation if the foundation, its managers, or disqualified persons are able, by aggregating their voting power or positions of authority with that of the foundation, to require the organization to act or refrain from acting in a manner which would constitute self-dealing.
- (2) An organization will be considered to be controlled by a private foundation, or by a private foundation and disqualified persons, if such persons are able, in fact, to control the organization (even if their aggregate voting power is less than 50% of the total voting power of the organization's governing body) or if one or more of such persons has the right to exercise veto power over the actions of such organization relevant to any potential acts of self-dealing. A private foundation shall not be regarded as having control over an organization merely because it exercises expenditure responsibility (as defined in Section 4945(h)) with respect to grants to such organization.



- (3) A controlled organization may be any type of exempt or nonexempt organization including a school, hospital, operating foundation or social welfare organization. See Treas. Reg. 53.4941(d)-1(b)(5).
- (4) Rev. Rul. 76-158, 1976-1 C.B. 354, holds that a foundation does not control a corporation for purposes of Section 4941 where the foundation owns 35% of the voting stock and its foundation manager personally owns the remaining 65% but does not hold a position of authority in the corporation by virtue of being a foundation manager. See also *Moody v. Commissioner*, supra, which held that a disqualified person's transactions with a hotel were not indirect self-dealing, due to findings that the foundation did not control the hotel company and that the transactions did not otherwise amount to indirect self-dealing.

## **A.2. Certain Business Transactions**

- (1) Indirect self-dealing does not include any transaction described in Section 4941(d)(1) between a disqualified person and an organization controlled by a private foundation if:
  - a. The transaction results from a business relationship which was established prior to the effective date of Section 4941,
  - b. The transaction was at least as favorable to the organization controlled by the foundation as an arm's length transaction with an unrelated person, and
  - c. Either the organization controlled by the foundation would have suffered severe economic hardship by engaging in the transaction with an unrelated party, or the controlled organization provided a unique product or service unavailable elsewhere. See Treas. Reg. 53.4941(d)-1(b)(1).

## **A.3. Grants to Intermediaries**

- (1) Indirect self-dealing does not include a transaction between a government official and an intermediary organization that received a grant from a private foundation and which is not controlled by the foundation (Treas. Regs. 53.4941(d)-1(b)(2) and 53.4941(d)-1(b)(5)) provided that the private foundation:
  - a. Does not earmark the grant for a named government official, and
  - b. Does not exercise any control over the selection process. A member of the foundation cannot participate in the government official's selection procedure. See also PLR 9421039 (1994). (PLR's are not precedential guidance.)
- (2) A grant by a private foundation shall not constitute an indirect act of self-dealing even though such foundation had reason to believe that certain government officials would derive benefits from such grant so long as the intermediary organization exercises control over the selection process and makes the selection completely independently of the private foundation.

## **A.4. Estate Administration Exclusion**

- (1) Indirect self-dealing does not include the sale to a disqualified person of property held by an estate (or revocable trust, including a trust which has become irrevocable on a grantor's death) of which a private foundation is a beneficiary if:
  - a. The administrator, executor or trustee can sell, is required to sell, or can reallocate the property to another beneficiary,
  - b. The transaction is approved by the probate court having jurisdiction over the estate (or by another court having jurisdiction over the estate (or trust) or over the private foundation),
  - c. The transaction occurs before the estate is terminated for Federal income tax purposes (or, in the case of a revocable trust, before it is considered subject to Section 4947),
  - d. The estate (or trust) receives an amount at least equal to the fair market value of the foundation's interest or expectancy in the property at the time of the transaction, and
  - e. With respect to transactions occurring after April 16, 1973, the transaction:
    - (i) results in the foundation receiving an interest or expectancy at least as liquid as the one it gave up, (ii) results in the foundation receiving an asset related to the active carrying out of its exempt purposes, or (iii) is required under the terms of any option which is binding on the estate (or trust). See Treas. Reg. 53.4941(d)1(b)(3).
- (2) The constitutionality of this regulation was upheld in *Estate of Reis v. Commissioner*, 87 T.C. 1016 (1986), and *Rockefeller v. United States*, 572 F. Supp. 9 (E.D. Ark. 1982), *aff'd* 718 F.2d 290 (8th Cir. 1983), *cert. den.* 466 U.S. 962 (1984).
- (3) Revenue Procedure (Rev. Proc.) 2023-3, 2023-1 I.R.B. 144, sets forth a no-rule position regarding whether transactions during the administration of an estate or trust meet the requirements of the exception to Section 4941 set forth in Treas. Reg. 53.4941(d)-1(b)(3) in cases in which a disqualified person issues a promissory note in exchange for property of an estate or trust.

## **A.5. Transactions with Certain Organizations**

- (1) Transactions between a private foundation and an organization that is not controlled by the foundation and is not a disqualified person with respect to the foundation are not to be considered indirect self-dealing acts between the private foundation and disqualified persons that are owners of the organization solely because of their less than 35% ownership interest (though the transactions may be indirect self-dealing due in part to other reasons). See Treas. Reg. 53.4941(d)-1(b)(4).

## **A.6. Transactions with Limited Amounts**

- (1) Indirect self-dealing does not include any transaction between a disqualified person and an organization controlled by a private foundation or between two disqualified persons where the transaction may affect the foundation's assets if:
  - a. The transaction arises in the normal and customary course of a retail business engaged in with the public,
  - b. In the case of a transaction between a disqualified person and a controlled organization, the transaction is at least as favorable to the controlled organization as an arm's-length transaction with an unrelated person, and
  - c. The total of the amounts involved in transactions with any one disqualified person does not exceed \$5,000 in any one taxable year. See Treas. Reg. 53.4941(d)-(1)(b)(6).

## A.7. Statutory Exceptions

- (1) The statutory exceptions to self-dealing found in Section 4941(d)(2) also apply to transactions involving one or more disqualified persons (but not the private foundation) where due to Section 4941(d)(2), the foundation could engage in the transaction. See Treas. Reg. 53.4941(d)-1(b)(7).

**Example:** A corporation controlled by a private foundation could pay reasonable compensation for personal services to a disqualified person (except a government official).

## IV. Other Definitions

- (1) Other definitions are provided on terms relative to self-dealing.

### A. Number of Acts of Self-Dealing

- (1) Most types of self-dealing transactions involve only a single, discrete act of self-dealing. If, however, such transaction relates to the leasing of property, the lending of money or other extension of credit, other use of money or property, or payment of compensation, the transaction will generally be treated as giving rise to an act of self-dealing on the day the transaction occurs plus an act of self-dealing on the first day of each taxable year or portion of a taxable year which is within the taxable period and which begins after the taxable year in which the transaction occurs (commonly known as a continuing act of self-dealing). See Treas. Reg. 53.4941(e)-1(e)(1)(i).

- (2) The regulation cited above provides numerous examples.

**Example:** On August 31, 1970, private foundation sells a building to a disqualified person. Private foundation is on the calendar year basis. Under these circumstances, the transaction between the private foundation and the disqualified person is one act of self-dealing, which is treated for purposes of Section 4941 as occurring on August 31, 1970.

**Example:** Assume the facts as stated above except that, instead of selling the building to private foundation, disqualified person leases the building to the foundation for a term of four years beginning July 31, 1970, at an annual rental of \$12,000. The fair rental value of the building is also \$12,000 per annum as of July 31, 1970, and throughout the next 4 years. This transaction is corrected on September 30, 1973. Under these circumstances, the transaction between the disqualified person and the private foundation constitutes four separate acts of self-dealing, which are treated for purposes of Section 4941 as occurring on July 31, 1970, January 1, 1971, January 1, 1972, and January 1, 1973.

- (3) The first tier tax for an act of self-dealing (whether discrete or continuing) is imposed annually for each taxable year (or part thereof) during the taxable period, not only in the taxable year in which the self-dealing took place. See Treas. Reg. 53.4941(b)-1(a)(1) and GCM 39066 (1983), as modified by GCM 39451 (1985).
- (4) The 1981 CPE Statute of Limitations for Exempt Organization's Returns, though older and not updated, provides an example that is illustrative of the subsequent acts.

**Example:** A hypothetical assessment situation illustrates application of the period of limitations to continuous acts of self-dealing. The situation involves a loan made in 1974 by a private foundation to a disqualified person under circumstances not covered by any exception or transitional rule to Section 4941. The loan was made in 1974 and was corrected in 1975. The appropriate tax on the self-dealing act is \$100. Both the foundation and the disqualified

person are calendar year taxpayers. For the taxable periods involved, the foundation timely filed all required returns and indicated "no" or "not applicable" to all questions concerning Chapter 42 transactions. The disqualified person did not file Form 4720. The only indication of the self-dealing event was the listing of the loan note among the foundation's assets on Form 990-PF, without any description of the relationship or identity of the note's maker. In this hypothetical situation, the foundation's return for 1974, which was timely filed and thus deemed filed on the due date of May 15, 1975, starts the six-year period running for all taxes resulting from the 1974 act of self-dealing for each year or part thereof in the taxable period. The taxes due for each year or part year in the taxable period, which ended when the act of self-dealing was corrected in 1975, are \$100 for 1974, and \$100 in 1975.

The period of limitations for the act of self-dealing that occurred on the first day of 1975 (because the initial act was a continuing transaction) expires on May 15, 1982, six years after the foundation's return for 1975 was deemed filed. With respect to this second act, no taxes other than the initial tax of \$100 are due because the act of self-dealing was corrected in 1975, thus ending the taxable period. The total taxes due for both acts of self-dealing were \$300.

- (5) Rev. Rul. 2002-43, 2002-2 C.B. 85, shows how private foundation self-dealing taxes are calculated in an instance of a private foundation to a disqualified person that spans more than one year and thus constitutes multiple acts of self-dealing.
- (6) Also, in PLR 9530032 (1995) the private foundation made a multi-year loan to a disqualified person, and it stated that there would be an act of self-dealing with respect to each year there was an outstanding principal balance on the loan.

## B. Amount Involved

- (1) The taxes imposed by Section 4941 are on the "amount involved" in the act of self-dealing. In general, this is the greater of the amount of money and the fair market value of other property given, or the amount of money and the fair market value of other property received. See Section 4941(e)(2) and Treas. Reg. 53.4941(e)-1(b)(1).

**Example:** A foundation pays a personal obligation, such as a Chapter 42 tax liability, of a disqualified person, the "amount involved" is the total amount paid by the foundation.

- (2) In the case of compensation paid for personal services (to other than government officials), the "amount involved" is the amount paid over the fair value of the services. See Treas. Reg. 53.4941(e)-1(b)(2).
- (3) Regarding the use of money or other property (including loans to a disqualified person), the "amount involved" is the greater of the amount paid for such use or the fair market value of the use. See Treas. Reg. 53.4941(e)-1(b)(2). For a continuing act of self-dealing, such as a loan or rental of property, a new amount involved must be determined for each deemed act of self-dealing.

Special considerations apply to a deemed act of self-dealing involving a lending of money or other extension of credit (a deemed loan):

- a. The fair market interest rate for each deemed loan within the taxable period is the fair market interest rate on the date the deemed loan occurs (which may be higher or lower than the fair market rate on the date of the initial loan).
- b. To determine the fair market value of the deemed loan, it is necessary to determine the amount of the deemed loan. The amount of the deemed loan includes not only the unpaid/outstanding principal but also any unpaid interest from the prior taxable year or years—there has been an extension of credit with respect to this unpaid interest as well as the unpaid principal. The amount of the deemed loan is multiplied by the fair market interest rate to determine the amount involved for the deemed loan (unless the amount of interest actually paid during the taxable year is greater).

**Example:** The IRS released Chief Counsel Advisory (CCA) 202243008, wherein advice was sought, for purposes of the Section 4941(a)(1) excise tax on a self-dealing loan, whether, interest that accrues on the loan during years for which the Section 6501 period of limitation has closed (a "closed year") is included in the loan balance to compute the amount involved for the deemed acts of self-dealing that occur in years for which the period of limitations is still open (an "open year"). Per the facts of the CCA, a private foundation makes a loan to a disqualified person which constitutes an act of self-dealing under Section 4941(d)(1)(B). The unpaid interest is to be added to the loan balance each year. The disqualified person did not make any payments of interest or principal. By the time the loan is addressed during an examination, the period of limitations has expired for the initial act of self-dealing that occurred on the date the loan was made and for several of the earliest deemed acts of self-dealing within the taxable period. The IRS concluded that interest that accrues during closed years is included in the loan balance to compute the amount involved for the deemed acts of self-dealing in open years. Although Section 6501 generally prohibits the assessment of amounts of tax more than three years after the filing of a return, the loan balance, including accrued but unpaid interest, is not an amount of tax. Therefore, even though the IRS may not assess the Section 4941 excise tax for acts of self-dealing that occurred in closed years, any accrued interest and principal payments from closed years affect the loan balance going forward and must be accounted for to determine the amount involved for deemed acts of self-dealing that occur in open years. Note: the CCA is not precedential guidance, but it illustrates the point.

- (4) For the first tier tax, fair market value of property or use of property is determined on the date that the act of self-dealing occurs. For the second tier tax, the amount involved is the highest fair market value during the taxable period (defined below). See Treas. Reg. 53.4941(e)-1(b)(3).

- (5) In transactions which are treated as acts of self-dealing solely because the foundation failed to receive fair market value for property it transferred, the “amount involved” is the excess of the fair market value over the amount received by the foundation if the parties made a good faith effort to determine fair market value. A "good faith effort " is ordinarily made where:
- The person making the valuation is not a disqualified person, is competent to make the valuation, and is not able to derive an economic benefit from the value utilized, and
  - The valuation method is a generally accepted one for valuing comparable property for purposes of arm’s-length business transactions. See Treas. Reg. 53.4941(e)-1(b)(2)(iii).
- (6) Treas. Reg. 53.4941(e)-1(b)(4) provides examples of the amount involved.

**Example:** John Doe, a disqualified person with respect to private foundation M, uses an airplane owned by M on June 15 and June 16, 1970, for a two-day trip to New York City on personal business and pays M \$500 for the use of such airplane. The fair rental value for the use of the airplane for those two days is \$3,000. For purposes of Section 4941(a), the amount involved with respect to the act of self-dealing is \$3,000.

**Example:** A private foundation sells a condominium to its founder. The condo’s fair market value is \$250,000. The founder pays \$25,000. The amount involved under the general rule is the greater of \$250,000 or \$25,000. In this case, the amount involved is \$250,000. This amount is subject to the self-dealing tax.

**Example:** On July 1, 2014, a child of a substantial contributor moves into a foundation owned apartment complex to attend a nearby college. The child lives rent-free in the apartment for six months of 2014, all of 2015, and all of 2016 until correction is made December 31, 2016. The next-door neighbors, who are not disqualified persons, in an identical apartment pay \$700 per month in rent in 2014, \$750 in rent in 2015, and \$800 in rent in 2016. The child is a calendar-year taxpayer. The act triggers separate deemed acts on January 1, 2015, and January 1, 2016. The amount involved in each year is as follows:

Date	Rent Amount	Time in Months	Amount Involved
7/1/2014	\$700	x6	4,200.00
1/1/2015	\$750	x12	9,000.00
1/1/2016	\$800	x12	9,600.00

- (7) See Example Worksheets/Exhibits below for examples of how to compute the tax and complete the Form 4883, Exempt Organizations Excise Tax Audit Changes, and Form 4621, Report of Examination - Exempt Organization, and

how to prepare Form 870-E, Waiver of Restriction on Assessments and Collection of Deficiency and Acceptance of Overassessment. The tax is reported on Form 4720, assessed against the self-dealer(s), and if applicable, the foundation manager(s).

### C. Taxable Period

- (1) The "taxable period" is the period beginning with the date on which the act of self-dealing occurs and ending on the earliest of:
  - a. The date of mailing a notice of deficiency with respect to the tax imposed by Section 4941(a)(1) under Section 6212,
  - b. The date on which the tax imposed by Section 4941(a)(1) is assessed, or
  - c. The date on which correction of the act of self-dealing is completed. See Section 4941(e)(1) and Treas. Reg. 53.4941(e)-1(a).

**Example:** On July 16, 1970, F, a manager of private foundation X acting on behalf of the foundation, knowing his act to be one of self-dealing, willfully and without reasonable cause engaged in an act of self-dealing by selling certain real estate to A, a disqualified person. On March 25, 1973, the IRS mailed a notice of deficiency to A with respect to the tax imposed on the sale under Section 4941(a)(1). The taxable period with respect to the act of self-dealing for both A and F is July 16, 1970, through March 25, 1973. See Example 1 of Treas. Reg. 53.4941(e)-1(a)(4).

- (2) An act of self-dealing occurs on the date on which all the terms and conditions of the transaction and the liabilities of the parties have been fixed.
- (3) Where 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 payment of the deficiency is treated as the end of the taxable period. See Treas. Reg. 53.4941(e)-1(a)(3).

### D. Correction

- (1) Generally, correction is accomplished by undoing the act of self-dealing to the extent possible. If the act of self-dealing cannot be undone, then the private foundation should be restored to a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards. See Section 4941(e)(3) and Treas. Reg. 53.4941(e)-1(c)(1).

**Example:** A disqualified person sells property to a private foundation for cash. Correction may be accomplished by the disqualified person returning the cash to the foundation and transforming the transaction into a gift.

- (2) Correction in accordance with Treas. Reg. 53.4941(e)-1(c) is not an act of self-dealing. Taxpayers must exercise care, however, in making correction to



ensure that the acts of correction themselves do not constitute additional acts of self-dealing. For example, in *DuPont v. Commissioner*, 74 T.C. 498 (1980), the taxpayer's intended acts of correction constituted additional acts of self-dealing. See also Rev. Rul. 81-40, 1981-1 C.B. 508 (a disqualified person's attempt to correct a loan by transferring real estate of equivalent value to the foundation was a second act of self-dealing).

- (3) The principles in the following paragraphs illustrate the minimum standards of correction in certain cases. See Treas. Reg. 53.4941(e)-1(c) for specific examples.
- (4) Sale by foundation to disqualified person. In the case of a sale of property by a private foundation to a disqualified person for cash, undoing the transaction includes, but is not limited to, rescinding the sale. The amount returned to the disqualified person must not exceed the lesser of the cash received by the foundation or the fair market value of the property received by the disqualified person. The fair market value to be returned is the lesser of the fair market value on the date the act of self-dealing occurred or at the time of rescission of the sale. In addition to rescission, the disqualified person must also pay to the foundation any net income derived from the use of the property to the extent that it exceeds any income derived by the foundation during the correction period from its use of the cash received from the original sale. See Treas. Reg. 53.4941(e)-1(c)(2).
- (5) If, prior to the end of the correction period, the disqualified person resells the property (originally purchased from a private foundation) in an arm's-length transaction to a bona fide purchaser other than the foundation or another disqualified person, rescission of the original sale is not required. The disqualified person must pay over to the foundation the excess (if any) of the greater of the fair market value of the property on the date of correction (the date on which the money is paid over to the foundation), or the amount realized by the disqualified party from the arm's-length sale over the amount which would have been returned to the disqualified person under paragraph (4) above. In addition, the disqualified party must pay over to the foundation any net profit realized using the property during the correction period.
- (6) Sale by disqualified person to foundation. As with sales by a foundation, undoing the transaction includes, but is not limited to, rescinding the sale. Correction can be accomplished by returning the purchase price to the foundation and transforming the transaction into a gift. The sale may also be rescinded by returning the property to the disqualified person in exchange for an amount of money equal to the greatest of the cash paid on the original sale, the fair market value of the property at the time of the original sale, or the fair market value at the time of rescission. In addition, the disqualified person must pay to the foundation any income realized from the use of the proceeds of the sale to the extent that the income exceeds any income earned by the foundation from the use of the property. See Treas. Reg. 53.4941(e)-1(c)(3).

- (7) If, prior to the end of the correction period, the foundation resells property (originally purchased from a disqualified person) in an arm's-length transaction to other than a disqualified person, the foundation must be paid by the disqualified person, the excess (if any) of the amount which would have been paid if rescission of the sale was required over the amount realized from the resale of the property. The disqualified person must also pay over any net income realized as provided above.
- (8) Use of property by a disqualified person. If a disqualified person uses the property of a private foundation, correction includes, but is not limited to, termination of such use. In addition, the disqualified person must pay to the foundation:
- The excess (if any) of the fair market value (greater of the value at time of the act of self-dealing or at the time of correction) for the use of the property over the amount paid for the use until termination, plus
  - The excess (if any) of the amount that would have been paid by the disqualified party for the period after termination (if such termination had not occurred) that the disqualified person would have used the property (disregarding further extensions or renewals) over the fair market value (at the time of correction) of the use for such period.
- Example:** Foundation loans \$10,000 to a disqualified person, DP, for one year on January 1, 2021, at 2% interest per year, which the disqualified person repays in full on December 31, 2021. The fair market interest rate was 5.25% on January 1, 2021, was 5.25% but dropped 5% on December 31, 2021. In order to correct this act of self-dealing on December 31, 2021, DP must terminate use of the loan, which DP has done by repaying the loan. In addition, DP must pay to Foundation \$325, the excess of \$525 (the fair market interest for one year;  $\$10,000 \times 5.25\%$ ) over \$200 (the amount paid to Foundation from January 1, 2021 to December 31, 2021;  $\$10,000 \times 2\%$ ). The fair market interest rate on the date of the loan is used in this case because it is higher than the rate on the date of correction.
- (9) In the case of a disqualified person's continued use of money or other property spanning multiple years, the fair market value for the use for each year is determined separately—use the greater of fair market value at the time of the act of self-dealing (first day of the tax year for continuing acts) or fair market value at the time of correction. See Example 2 of Treas. Reg. 53.4941(e)-1(c)(4)(ii).
- (10) Use of disqualified person's property by a private foundation. If a private foundation uses the property of a disqualified person, correction includes, but is not limited to, termination of such use. In addition, the disqualified person must pay to the foundation:
- The excess (if any) of the amount they received from the foundation over the fair market value (lesser of the value at the time of the act of self-

dealing or at the time of correction) for the use of the property until the time of termination, plus

- b. The excess (if any) of the fair market value of the use of the property for the period the foundation would have used the property if termination had not occurred, over the amount that would have been paid by the foundation after termination for use in such period. See Treas. Reg. 53.4941(e)-1(c)(5).

(11) Excessive Compensation. If a private foundation pays compensation to a disqualified person for the performance of personal services reasonable and necessary to carry out the exempt purposes of the foundation, correction requires paying back to the foundation any amount considered excessive under Treas. Reg. 1.162-7. Termination of the employment is not necessary. See Treas. Reg. 53.4941(e)-1(c)(6).

(12) Valuation Errors. In the case where a transaction is considered self-dealing solely because the foundation did not receive fair market value, correction will ordinarily occur if the foundation is paid an amount equal to the "amount involved" plus any additional amounts necessary to compensate it for the loss of the use of the money or other property during the period from the date of the act of self-dealing to the date of correction. See Treas. Reg. 53.4941(e)-1(c)(7).

## E. Fair Market Value

(1) Wherever the term "fair market value" appears in Section 4941 and applicable regulations, refer to Treas. Reg. 53.4942(a)-2(c)(4). See Treas. Reg. 53.4941(e)-1(f).

(2) In the case of a loan, or other use of money, the fair market interest rate is used to determine the fair market value of the use of money. See Example 2 of Treas. Reg. 53.4941(e)-1(b)(4). The prime rate plus 2% is a useful starting point or benchmark in determining an appropriate fair market interest rate. A lower or higher interest rate may be appropriate under the facts and circumstances of a particular case.

## F. Knowing

(1) A person (including a government official or a foundation manager) "knows" that an act constitutes self-dealing if that person:

- a. Has actual knowledge of sufficient facts so that, based solely upon such facts, the transaction would be an act of self-dealing,
- b. Is aware that this act under these circumstances may violate the provisions of federal law governing self-dealing, and
- c. Negligently fails to make reasonable attempts to determine whether the transaction is an act of self-dealing or is in fact aware that it is such an act.

- (2) "Knowing" does not mean "having reason to know." However, evidence that a person has reason to know of a fact or rule is relevant in determining whether they had actual knowledge of such fact or rule. See Treas. Reg. 53.4941(a)-1(b)(3).

## **G. Willful**

- (1) Participation in an act of self-dealing by a foundation manager is willful if it is voluntary, conscious, and intentional. There is no need that there be an intention to avoid the restrictions of the law or the liability for tax. However, participation will not be considered willful if the foundation manager does not know that the act constitutes self-dealing. See Treas. Reg. 53.4941(a)-1(b)(4).

## **H. Reasonable Cause**

- (1) A foundation manager's participation in an act of self-dealing is due to reasonable cause if the manager has exercised his responsibility on behalf of the foundation with ordinary business care and prudence. See Treas. Reg. 53.4941(a)-1(b)(5).
- (2) If a manager relies on the advice of counsel (expressed in a reasoned written legal opinion based upon full disclosure of the factual situation) that an act is not self-dealing and that act is later held to be an act of self-dealing, the manager's participation in the act will ordinarily not be considered "knowing" or "willful" and will ordinarily be considered "due to reasonable cause." See Treas. Reg. 53.4941(a)-1(b)(6).
- (3) For abatements under Chapter 42 in general see Tax Exempt/Government Entities (TE/GE) Exempt Organizations (EO) Issue Snapshot, Abatement of Chapter 42 First Tier Taxes Due to Reasonable Cause.

## V. Examination Techniques

- (1) This section focuses on how to calculate and assert the excise tax once it's been determined that a self-dealing transaction has occurred. It also contains information relevant to examinations of private foundations in general.

### A. Introduction

- (1) Section 4941 taxes are imposed for every year or partial year within a taxable period. The taxable period starts with the self-dealing act and ends with the earlier of:
  - a. Correction,
  - b. Issuance of a statutory notice of deficiency, or
  - c. Assessment of the excise tax.

### B. Discrete and Continuing Transactions

- (1) Section 4941 self-dealing transactions are classified as discrete (one-time) or continuing. A discrete transaction (such as a sale or exchange) only occurs once, but the self-dealing tax on the discrete transaction is imposed each year/partial year in the taxable period. A continuing transaction (such as a loan, a lease, or compensation for services) is an ongoing transaction across taxable years of the taxpayer. In such case, there is deemed a new act of self-dealing on the first day of each taxable year within the taxable period of the initial act. Each deemed new act of self-dealing has its own taxable period, and self-dealing tax is imposed on each deemed new act for each whole or partial year in its taxable period. See Treas. Reg. 53.4941(e)-1(e)(1).
- (2) Continuing transactions “pyramid” the tax liabilities but generally have a lesser “amount involved” than discrete acts. The table below lists the transactions that are generally considered to be discrete or continuing, respectively.

Type of Transaction	Discrete or Continuing
Sale of property to/from a DP	Discrete
Exchange of property with a DP	Discrete
Leasing of property to/from a DP	Continuing
Lending of money to/from a DP	Continuing
Other extension of credit to/from a DP	Continuing
Furnishing of goods	Discrete

Furnishing of services	Discrete
Furnishing of facilities	Discrete (unless leasing of property)
Payment of compensation	Continuing
Transfer of PF asset to a DP	Discrete
Use of a PF asset by a DP	Continuing
Use of a PF assets for the benefit of a DP	Continuing
Agreement to make payment to government official	Discrete

**Note:** See Treas. Reg. 53.4941(e)-1(e)(1)(i) for the list of acts that are generally treated as “continuing”.

### B.1. Examples of Discrete and Continuing Transactions

- (1) Discrete Transaction Example: A substantial contributor to a foundation buys back a piece of artwork originally donated to the foundation. The payment is made on December 30, 2015. The foundation and contributor are calendar year taxpayers. No correction was made, or tax assessed or notice of deficiency mailed until January 1, 2017. The contributor will owe tax on the transaction in 2015, again in 2016, and again in 2017. The table below illustrates the discrete concept (self-dealing tax is owed for each of the three years in the taxable period):

Date	2016	2017	2018
12/30/2015	X	X	X

- (2) Continuing Transaction Example: A substantial contributor donates a painting to the foundation on January 17, 2015. The contributor then hangs the painting in his or her study in their home on the same day. No correction was made, or tax assessed or notice of deficiency mailed prior to January 1, 2017. The foundation and contributor are calendar year taxpayers. The contributor will owe tax on the use of the painting in 2015, 2016, and 2017. In addition, the contributor is deemed to have a new transaction on January 1, 2016, and again on January 1, 2017. The table below illustrates the continuing (“pyramiding”) concept:

Date	2015	2016	2017
1/17/2015	X	X	X
1/1/2016		X	X
1/1/2017			X

- (3) Due to the nature of a transaction, the amount involved in a transaction is determined differently based on the type of transaction. The general rule is that the amount involved is the greater of:
  - a. The fair market value of the property given, or
  - b. The fair market value of the property received.
- (4) This rule is modified for the period for which money or property is used, where the amount involved is the greater of:
  - a. The amounts paid for such use, or
  - b. The fair market value of such use.
- (5) Other modifications may also apply. See Amount Involved, Treas. Reg. 53.4941(e)-1(b). Refer to the Amount Involved section in this guide for further information.
- (6) Refer to the Correction section in this guide for a discussion of acceptable correction.
- (7) Complete Form 4883, Form 4621, Form 886-A, Explanation of Items, and Form 870-E. See Example Worksheets/Exhibits below 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.

- (8) The excise tax is reported on Form 4720, and assessed against the self-dealer(s), and if applicable, the foundation manager(s). See IRM 4.70.13, Executing the Examination, to set up a substitute for return (SFR) if no Form 4720 is filed, or to secure a delinquent return.
- (9) The foundation manager tax is reported on Form 4720 and assessed against the responsible individual(s). See also IRM 4.70.13, Executing the Examination, for the situations described above.

**Note:** A manager, self-dealer, disqualified person, donor, donor adviser or related person who owes tax under Chapter 41 or 42 (including an organization manager under Section 4965), may no longer report the tax on the Form 4720 filed by the organization. Each taxpayer must file a separate Form 4720. See Notice 2021-01, 2021-2 I.R.B. 315.

### C. Chapter 42 First Tier Excise Taxes Table

- (1) The table below identifies the parties subject to the Chapter 42 excise taxes, (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. 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:
- a. Full correction (in the case of Section 4943 when the excess business holding is eliminated, or in the case of Section 4944, when the amount invested is removed from jeopardy),
  - b. Assessment, or
  - c. Issuance of a notice of deficiency.

- (5) For Sections 4942 and 4945, the taxable period ends on the earliest of:
- a. Issuance of a notice of deficiency, or
  - b. Assessment.

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

- (6) Under Section 4945, there is only one first tier tax in the taxable period (unlike Sections 4941 - 4944).
- (7) Use the tax year of the disqualified person for Section 4941 (Rev. Rul. 75-391, 1975-2 C.B. 446). Similarly, use the tax year of the private foundation for tax paid by the private foundation under Section 4940 or Sections 4942-4945, and the tax year of the foundation manager for foundation manager taxes under Sections 4941, 4944 and 4945.
- (8) Except for Section 4940, excise taxes are reported on Form 4720. 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 SFR procedures to report a taxpayer's excise tax liability during an examination

will no longer convert the Form 4720 to “Form 4720-A.” The revenue agent will, instead, complete a Form 4720 identifying the filer as described in the instructions for Form 4720. Please see the instructions for Form 4720 and Notice 2021-01, 2021-2 IRB 315, for further information.

**Note:** Electronic filing of the Form 4720 is required for private foundations for Form 4720 returns due on or after July 15, 2021. A limited exception applies for 2020 Form 4720 returns with a due date on or after July 15, 2021, that are submitted on paper and bear a postmark date on or before June 16, 2021. Organizations other than private foundations are encouraged, but not required, to file Form 4720 electronically.

- (9) To calculate Section 4940 and Section 4942 taxes, complete the Form 990-PF. Reclassify expenditures as necessary to determine the qualifying distributions.
- (10) The applicable report forms are:
  - a. Form 4621
  - b. Form 4883
  - c. Form 886-A, Explanation of Items
  - d. Form 870-E

#### **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)(i).
- (3) For taxable years beginning before December 21, 2019, (prior to the effective date of the TCA which repealed Section 4940(e)) 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.

**Note:** The examples below regarding Section 4940, which imposes 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 has expenditures which constitute acts of self-dealing. 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 percentage payout ratio and 2) the net value of the non-charitable use assets, the foundation can't use the Section 4940(e) 1% tax rate. For Section 4942 purposes, undistributed income is offset by qualifying distributions. When the qualifying distributions are reduced or disallowed, the potential for tax on undistributed income arises. This flow of actions is demonstrated as follows:

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

**Note:** Part V of the Form 990-PF will no longer be used for taxable years beginning after December 20, 2019, because the Taxpayer Certainty and Disaster Tax Relief Act passed on December 20, 2019, included legislation that reduced the 2% excise tax on the net investment income of a private foundation to 1.39%. This legislation also repealed the 1% special rate that applied if the private foundation met certain distribution requirements.

If Part V Line 8 is less than Part V Line 7, use the 2% tax rate for 4940. If Part XIII Line 2 Column (c) is greater than Part XIII Line 4 Column C, the amount in Part XIII Line 6(e) is subject to 4942.

**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.

- (4) Section 4941 and Section 4945 excise tax liability can commonly arise 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.

- (5) 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.

- (6) 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. This and other facts and circumstances result in the entity being 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 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 grant-making 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. Refer to the specific technical guides and regulations for directions on the appropriate correction methods.

**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.

**Example:** A foundation issues a below-market "loan" to a disqualified person, who in turn uses the money to purchase a vacation property for personal use. The transaction is both self-dealing and a taxable expenditure. To correct the taxable expenditure, the disqualified person needs to repay the loan. To correct the self-dealing transaction, the disqualified person needs to not only repay the loan, but also pay interest.

- (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) Rev. Rul. 81-40, 1981-1 C.B. 508 dealt with the issue of correction. A private foundation loaned money to a disqualified person with respect to the foundation. When both parties realized that the loan was an act of self-dealing under Section 4941(d)(1)(B), the disqualified person proposed to correct the act of self-dealing by transferring to the private foundation a parcel of real estate with a fair market value purportedly equal to the amount of the debt.

- a. The ruling held that an attempted correction of an initial act of self-dealing described in Section 4941(d)(1)(B) by the transfer of real estate purportedly equal in fair market value to the amount of the initial act of self-dealing constituted a second act of self-dealing.
  - b. The proposed transfer of real property would not be proper correction of the act of self-dealing because the minimum standards of Treas. Reg. 53.4941(e)-1(c)(4) would not be met. Even if the property is equal in value to the amount of the loan, it will be generally less advantageous to the foundation to receive the property than to have the loan repaid since it may be both difficult and costly for the foundation to convert the property to cash and thus restore its position.
  - c. Also, if the property were transferred in return for cancellation of the self-dealer's indebtedness to the foundation, the transaction would be considered a sale of property by the disqualified person to the private foundation and would itself be an act of self-dealing under Section 4941(d)(1)(A). The rule of Treas. Reg. 53.4941(e)-1(c) that any correction pursuant to that paragraph and Section 4941 shall not be an act of self-dealing is not applicable as the proposed transfer of real property would not constitute proper correction of the original act of self-dealing.
  - d. Under certain circumstances, a transfer of property could be acceptable correction of a loan transaction that is an act of self-dealing. For example, if a disqualified person purchased property with money borrowed from a private foundation and the property increased substantially in value, transfer of the property to the foundation would be an acceptable substitute for repayment of the loan if it could be shown that the property could be converted readily into an amount of money in excess of the amount borrowed. The transfer would not only exceed the minimum standards of Treas. Reg. 53.4941(e)-1(c)(4), but would be required by the rule of Treas. Reg. 53.4941(e)-1(c)(1) that the foundation must be restored to a position no worse than if the disqualified person were dealing under the highest fiduciary standards.
- (7) 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.
  - (8) 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 TE/GE Division Counsel also be consulted per the group manager's authorization.
  - (9) Extensions of the correction period aren't ordinarily granted unless these factors are present:



- a. The taxpayer is actively seeking in good faith to correct the taxable event.
- b. Adequate correction is unavailable or can't reasonably be expected to occur during the original correction period.
- c. The taxable event appears to be an isolated occurrence, and it appears unlikely that similar taxable events will occur in the future. See Treas. Reg. 53.4963-1(e)(3).

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

(10) 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
- b. The last day of the original correction period

**Note:** If the taxpayer pays the first tier tax after the IRS mails a statutory notice of deficiency and before the 90-day period of the notice has expired, the taxpayer has 90 days from the payment date to make correction. See 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).

(11) 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.

(12) 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) Section 4963(e), enacted as a part of Public Law 96-596 to remedy the Adams problem in assessing second tier taxes discussed above, defines "correction period." In general, it is the period beginning on the date the taxable event occurs and ending 90 days after the date of mailing under Section 6212 of a notice of deficiency with respect to the second tier tax imposed on such taxable event, extended by:

- a. Any period in which a deficiency can't be assessed under Section 6213(a) (determined without regard to the last sentence of Section 4961(b)), and

- b. Any other period which the IRS determines is reasonable and necessary to bring about correction of the taxable event.
- (2) The correction period ordinarily will not be extended above unless the following factors are present:
    - a. The foundation or an appropriate State officer (as defined in Section 6104(c)(2)) is actively seeking in good faith to correct the act of self-dealing,
    - b. Adequate corrective action can't reasonably be expected to result during the un-extended correction period, and
    - c. The act of self-dealing appears to have been an isolated occurrence and it appears unlikely that similar acts of self-dealing will occur in the future. See Treas. Reg. 53.4963-1(e)(3).
  - (3) If the first level tax is paid within the un-extended, or normal correction period, the normal correction period is automatically extended to end the later of:
    - a. 90 days after payment of the tax, or
    - b. The last day of the correction period determined without regard to this provision. See Treas. Reg. 53.4963-1(e)(4).
  - (4) If a claim for refund is filed with respect to a tax imposed under Section 4941(a)(1) or (2) within the un-extended correction period, the correction period is extended while the claim is pending plus an additional 90 days. If a suit or proceeding referred to in Section 7422(g) is filed, the correction period will be extended until the determination in the suit for refund (determined without regard to a supplemental proceeding under section 4861(b)) is final, determined under Treas. Reg. 301.7422-2(a). See Treas. Reg. 53.4963-1(e)(5).
  - (5) Section 4962 does not provide for abatement of first tier Section 4941 taxes.

## **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 the IRS will view an intended remedial action favorably as correction.
- (2) Advance approval is only available when:
  - a. The only barrier is the reluctance to correct because they are uncertain of final 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. Since these issues can be complex, it is recommended that the Area Manager consult with the appropriate TE/GE Division Counsel.
- (7) If the Area Manager approves the request, prepare and issue a draft correction approval letter. See Letter 5305, Private Foundation Correction Approval Letter. The letter must:
- a. Explain in detail the proposed corrective action.
  - b. Specify the due date for correction completion.
  - c. Require the taxpayer to notify the Area Manager upon completion.
  - d. Clarify that the taxpayer's reliance on the letter is conditioned on it meeting the conditions specified for correction.
- Reminder:** Monitor the time remaining on the statute of limitations. Consider requesting a statute extension as needed.
- (8) If the Area Manager denies the request, prepare and issue a draft correction rejection letter. See Letter 5306, Private Foundation Correction Rejection Letter. In the letter:
- a. Outline the taxpayer's proposal.
  - b. Explain why it doesn't constitute correction.
  - c. Clarify that other methods of correction are still available.
  - d. Suggest a 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 is not 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, and
  - c. Granted a statute extension, if necessary.

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

- (5) All second tier taxes are imposed once per act/failure to act or taxable event. Refer to the specific Code section and the regulations for how to determine the amount of the second tier tax calculation. Under Sections 4942 and 4943, if the taxpayer partially corrects (reduces but does not eliminate undistributed income or excess business holdings), the second tier tax is on the uncorrected remaining amount.
- (6) To determine the amount involved for the second-tier tax under Section 4941, use the highest fair market value during the taxable period. See Section 4941(e)(2)(B) and Treas. Reg. 53.4941(e)-1(b)(3).

**Example 1:** Section 4941(b)(1) discrete act: In 2016, a substantial contributor purchases back a piece of artwork previously donated to the foundation. The contributor pays \$2,000 for the artwork that has a fair market value of \$250,000. Assuming that the fair market value does not increase during the taxable period, the amount involved is \$250,000 (Treas. Reg. 53.4941(e)-1(b)). For the taxable period, the second tier tax is  $\$250,000 \times 200\% = \$500,000$ .

**Note:** For purposes of Section 4941(b), where an act of self-dealing involves a loan or lease in which a new act of self-dealing arises under the pyramiding rule, the amount involved is separately determined for each act, including deemed acts.

**Example 2:** Section 4941(b)(1) continuing act: On July 1, 2015, a child of a substantial contributor moves into a foundation owned apartment complex to attend a nearby college. The child lives rent free in their apartment for six months of 2015, all of 2016, and all of 2017, while the next-door neighbors in an identical apartment pay \$700 per month in rent in 2015, \$750 in 2016, and \$800 in 2017. The foundation and the child are calendar year taxpayers. The act also triggers separate deemed acts on January 1, 2016, and January 1, 2017. For purposes of the second-tier tax, the amount involved with respect to each act for each year in the taxable period is as follows:

Date	Rent Amount	Time in Months	Amount Involved for 2 <sup>nd</sup> Tier Tax
7/1/2015	800.00	x 6 =	4,800.00
1/1/2016	800.00	x 12 =	9,600.00
1/1/2017	800.00	x 12 =	9,600.00
		Total	24,000.00 x 200%
		Tax	48,000.00

- (7) 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 is not 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. See *Thorne v. Commissioner*, 99 T.C. 67 (1992). For help drafting a Thorne letter, contact Area Counsel. See Example Worksheets/Exhibits for sample language used in a Thorne letter for a theoretical Section 4945 scenario.

**Note:** Self-dealers are separate taxpayers from the foundation. Do not hold a combined conference with the private foundation and the self-dealer. Section 4941 tax is not payable by the foundation even if the foundation was involved in the discussions surrounding the transaction. However, the foundation may be subject to other Chapter 42 excise taxes. Please also ensure that any Forms 2848, Power of Attorney and Declaration of Representative, are specific regarding the Code sections involved if there are any substantive discussions.

- (8) 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 does not, by itself, terminate private foundation status.

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

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

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

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

The Termination Tax is the Smaller of:	
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 (RGS NT) or Integrated Data Retrieval System (IDRS) command code INTST. (Section 507(d)(1)(C))	
<p>*For purposes of this calculation, the charitable contribution deduction allowed a trust is deemed to have been limited to 20% of taxable income. Section 507(d)(1)(B)(ii).</p> <p>** For any year in which a gift tax would be due if a charitable deduction were not available, refer to the Instructions to Form 709, United States Gift (and Generation - Skipping Transfer) Tax Return, for that particular year for assistance in calculating the appropriate amount of deemed gift tax.</p>		

- (6) Aggregate tax benefit is used as the amount of the termination tax only if the foundation substantiates the amount by adequate records or other corroborating evidence. See Section 507(c)(1). As the IRS retains records for a limited period, it may not be feasible to compute the tax from the date of inception. Obtain what information is available via IDRS, return requests, and Online Statistics of Income EO Image Net (SEIN). Establish Audit Inventory 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 the case is closed 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 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 (or failure to act) triggering Chapter 42 taxes, propose the termination tax in addition to revocation. The basic report forms (Forms 4883 and 4621) can be included with Letter 3614, 30-day letter package for Chapter 42 excise taxes. Form 870-E is used to show all tax deficiencies determined for 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 private foundation, the self-dealer, or a foundation manager), 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)  Cash distribution test 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 does not 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:** Form 872-A, Special Consent to Extend the Time to Assess Tax, may be used 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. The example below, although illustrating statute dates with respect to self-dealing acts or transactions, is also useful for illustrating statute dates when a foundation makes a taxable expenditure. Note, however, that a taxable expenditure made by a foundation is one specific act and is not considered a continuing transaction.

**Example:** A private foundation with a fiscal year ending in August makes a series of self-dealing transactions in 2008, 2009, 2010, and 2011. Transactions occurred on November 1, 2008, June 1, 2009, September 1, 2009, October 1, 2009, March 15, 2010, September 15, 2010, and May 20, 2011. All the transactions are discrete transactions, except for the transaction on September 1, 2009, which is a continuing transaction (a loan). There has been no correction. The self-dealer's fiscal year ends in December. The Forms 990-PF for 200908 through 201108 were filed February 20, 2010, March 10, 2011, and February 15, 2012, respectively. No Form 4720 is filed. Assume that the acts/transactions were disclosed on the Forms 990-PF filed. The table below shows how the statutes work for the Forms 990-PF and 4720, as of an extension request date of September 1, 2012:

Transaction	Form 990PF	Statute Begins	Form 4720	Statute Begins
11/1/2008	200908	2/20/2010	200812	2/20/2010
6/1/2009	200908	2/20/2010	200912	2/20/2010
9/1/2009 (loan)	201008	3/10/2011	200912	3/10/2011
10/1/2009	201008	3/10/2011	200912	3/10/2011
1/1/2010 (continuing loan transaction)	201008	3/10/2011	201012	3/10/2011
3/15/2010	201008	3/10/2011	201012	3/10/2011

9/15/2010	201108	2/15/2012	201012	2/15/2012
1/1/2011 (continuing loan transaction)	201108	2/15/2012	201112	2/15/2012
5/20/2011	201108	2/15/2012	201112	2/15/2012
1/1/2012 (continuing loan transaction)	201208	TBD	201212	TBD

**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 does not arise until after a Thorne letter is sent, but again the limitations period begins with the return for the first tier tax.

- (6) 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 is recommended that a consent for both income and excise tax be used only when a private foundation may be liable for both excise tax under Section 4940 on its investment income and income tax (such as unrelated business income tax). This is because a regular Form 872 is used to extend the statute for these taxes, based on the foundation’s taxable year and not taxable periods arising from taxable events (which require using a modified Form 872).
- (7) 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.
- (8) If there are multiple acts in a single tax year that trigger Chapter 42 taxes, you may list them on the modified Form 872.
- (9) 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.

- (10) 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.
- (11) 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.
- (12) Under rules for applying the statute of limitations, expiration of the limitations period prevents the assessment of tax for any act or deemed act of self-dealing that occurred in a closed year when a self-dealing loan extends over both closed and open years. Because the amount involved in a deemed act of self-dealing is determined based on the interest rate and the loan balance (including accumulated unpaid interest) on the date the deemed act of self-dealing occurred, expiration of the limitations period for an earlier act of self-dealing in the taxable period has no effect on the amount involved for a later deemed act (the value of which is determined as of the date on which it occurred). See CCA 202243008, discussed above. Application of the statute of limitations to a continuing transaction is illustrated in the following example.

**Example:** On January 1, 2016, a private foundation (Foundation) makes a \$10,000 loan to a disqualified person. The loan carries a stated rate of interest of 2%. No payments of principal or interest are made by the disqualified person. Both the private foundation and the disqualified person are calendar year taxpayers and the private foundation adequately discloses the transaction such that the three-year statute of limitations applies. The private foundation timely files all returns on May 15<sup>th</sup> each year. The disqualified person corrects the transaction on December 31, 2021. Because no facts and circumstances are present in the case indicating that a lower or higher rate of interest would be applicable, the prime rate plus 2% is an appropriate rate to calculate the amount involved and excise tax. The table below shows changes in the prime rate during the taxable period.

Date	Prime Rate	Fair Market Rate (Prime + 2%)
1/1/2016	3.50%	5.50%
1/1/2017	3.75%	5.75%
1/1/2018	4.50%	6.50%

1/1/2019	5.50%	7.50%
1/1/2020	4.75%	6.75%
1/1/2021	3.25%	5.25%

Section 4941(a)(1) imposes tax on each act of self-dealing at a rate of 10% for each year or partial year in the taxable period. On the first day of each taxable year of the disqualified person, a new act of self-dealing is deemed to occur. Unpaid interest at the end of one year is added to the principal amount at the beginning of the next year. The table below shows the amount involved and tax on each act of self-dealing that occurs within the taxable period between January 1, 2016 and December 31, 2021.

Year	Principal	Interest Rate (Prime + 2%)	FMV Interest	Amount Involved	4941(a)(1) Tax Due
2016	\$10,000	5.50%	\$550.00	\$550.00	\$55.00
2017	\$10,550	5.75%	\$606.63	\$606.63	\$60.66
2018	\$11,157	6.50%	\$725.18	\$725.18	\$72.52
2019	\$11,882	7.50%	\$891.14	\$891.14	\$89.11
2020	\$12,773	6.75%	\$862.17	\$862.17	\$86.22
2021	\$13,635	5.25%	\$715.84	\$715.84	\$71.58

The limitations period for each act begins when the private foundation files its Form 990-PF for the year in which the act of self-dealing occurred. When the limitations period for an act has expired, assessment cannot be made on any of the tax attributable to that act. See GCM 39066 (1983). By the time the loan is corrected on December 31, 2021, the limitations period has run for the acts of self-dealing that occurred on January 1, 2016, and January 1, 2017. Due to the running of the limitations period, no tax may be assessed with respect to the 2016 and 2017 acts of self-dealing. The effect of the statute of limitations is shown in the table below.

Year of Self-Dealing Act	Statute Date	2016 Tax Due	2017 Tax Due	2018 Tax Due	2019 Tax Due	2020 Tax Due	2021 Tax Due
2016*	5/15/2020	\$55.00	\$55.00	\$55.00	\$55.00	\$55.00	\$55.00
2017*	5/17/2021		\$60.66	\$60.66	\$60.66	\$60.66	\$60.66



2018	5/16/2022			\$72.52	\$72.52	\$72.52	\$72.52
2019	5/15/2023				\$89.11	\$89.11	\$89.11
2020	5/17/2024					\$86.22	\$86.22
2021	5/16/2025						\$71.58
Total Tax Assessable in Open Years		\$0	\$0	\$72.52	\$161.63	\$247.85	\$319.43
* The expired statute for the 2016 and 2017 tax years prohibits the assessment of the excise taxes for any years in the taxable period.							

## 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(g)(3)(B)), and accuracy-related due to negligence penalties. See IRM 20.1.2, Failure To File/Failure To Pay Penalties, IRM 20.1.3, Estimated Tax Penalties and IRM 20.1.5, Return Related Penalties.

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

(3) 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 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.

- (4) 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 20.1.5, Return Related Penalties.
- (5) 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.
- (6) 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 (unlike some penalties discussed below that are assessed only with respect to first-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).

- (7) 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.
- (8) 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.
- (9) 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 are not taxes that are reported (or required to be reported) on any tax return, they are not subject to those penalties. Imposition of the penalties under Sections 6662 and 6663 requires that the taxpayer file a return. If the taxpayer did not file a return, those penalties do not apply. An SFR does not 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%.

- (10) 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, IRC Section 6020(b) Certification.
- (11) 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.
- (12) For examples of penalty computations, see Example Worksheet/Exhibits of this Technical Guide.

## 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 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 there are willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act) giving 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. Section 4962(a).
- (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 (Section 4963, 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. (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 is not 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 a request for abatement or claim for refund is received, 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 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)?
  - c. Did the organization request advance approval of individual grant making under Section 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 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 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, Wage and Tax Statement. (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 any self-dealing transactions or taxable expenditures are identified in prior years, ensure that the statute is still open before pursuing the issue. Request a Counsel memo on a six-year statute, if applicable.

- (10) Consider requesting these additional items in the IDR with respect to each of the years under examination:
- 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 (including business activities directly carried on 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, Request for Miscellaneous Determination, 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 (self-dealing under Section 4941(d)(1)(E)).
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 DPs having offices in the building or using the land. Does the foundation have artwork? Where is it located? In the DP's home?

**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 the financial records from prior years have been reviewed, 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 amounts reported in Part I Column d do not qualify as charitable expenditures, remove the amounts in the revised Form 990-PF. Self-dealing transactions and taxable expenditures generally should be removed from Part I Column d if previously reported as such. This in turn modifies Part XII, directly impacting the computations in Part XIII.
- (7) Determine whether the foundation has:
- Engaged in any self-dealing transactions.
  - Failed to make qualifying distributions.
  - Held or acquired excess business holdings.
  - Made jeopardizing investments.

- 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 Non-Master File (NMF) for any individuals.

**Note:** For tax years beginning in 2020, an individual liable for a Chapter 42 excise tax will not have the option to file jointly with the organization with respect to which the excise tax relates. Beginning with tax year 2020, Form 4720 has been revised to identify whether the filer is the organization or an individual. Therefore, for tax years after 2019, an agent preparing Form 4720 to report individual excise tax liability during an examination will no longer convert Form 4720 to “Form 4720-A.” The revenue agent will, instead, complete Form 4720 identifying the filer as an individual as described in the instructions for Form 4720. See the instructions to the Form 4720 for further information.
- (9) For any Chapter 42 taxes, prepare a report of examination for each liable party. Ensure that there are no disclosure violations. See IRM 4.70.14, 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 manager’s authorization, contact Area Counsel.
- (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 990PF.

- (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, a separate case file and report is required 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 second tier excise taxes against 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. See Example Worksheets/Exhibits for sample language used in a Thorne letter.
- (6) For cases requiring correction, follow the information below:
- a. If correction is acceptable, issue Letter 5305, Private Foundation Correction Approval.



- b. If correction is inadequate or unacceptable, issue Letter 5306, Private Foundation Correction Rejection.
  - 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, TEGE Special Handling Notice, 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 second tier excise taxes on the foundation manager(s).
  - b. Obtain a full copy of the tax form under protest showing the date received, if not already in the file or on RCCMS. Use Online SEIN if obtaining a Form 990-PF or a filed Form 4720.
  - c. Issue a formal report of examination with the appropriate waiver/agreement form(s).
  - d. Ensure that there are 425 days remaining on the statute of limitations when closed from the group.  
**Note:** All cases received in Appeals require 365 days remaining on the assessment statute of limitations.
  - e. Prepare a Form 3198-A, completing the applicable sections.
  - f. Verify that a formal protest to Appeals is valid (see below). 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 Audit Tips

- (1) This section provides possible issue indicators and examination tips when examining a private foundation, particularly with respect to acts of self-dealing subject to tax under Section 4941.

### A. Issue Indicators

- (1) Self-dealing transaction occurred but no Form 4720 filed.
- (2) Evidence of loans from the foundation to disqualified persons.
- (3) Use of foundation's property by disqualified persons.
- (4) Review the Form 990-PF to determine if any lease payments were made to the foundation from a disqualified person.
- (5) Review the Form 990-PF and see if any property has been sold by the foundation and identify the purchaser to ensure it is not a disqualified person.
- (6) Look to other Chapter 42 Code sections as well. 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 under Section 4945, that may also affect the net investment income (Section 4940), and the qualifying distributions (Section 4942). Section 4941 and Section 4945 can commonly occur for the same transaction. Many self-dealing transactions are not considered to be for Section 170(c)(2)(B) purposes, thus becoming taxable expenditures. But a taxable expenditure isn't necessarily a self-dealing transaction, and vice versa. See Rev. Rul. 77-161, 1977-1 C.B. 358.

### B. Audit Tips

- (1) Examiners will need to investigate to identify the disqualified persons with respect to the private foundation and review if any transactions have been entered between the disqualified persons and the foundation that might warrant further review. Evidence can be obtained from contracts, meeting minutes, interviews, and personnel and payroll records.
- (2) Review balance sheet listing of assets, including depreciation schedules.
- (3) Establish location of all assets, even fully depreciated ones, and identify who is using them. For instance:
  - a. Real property acreage owned by the PF might be used by the DPs for hunting or other personal uses.
  - b. A fully depreciated vehicle may be driven by a DP.
  - c. Artwork owned by the PF may be listed in the books as in "storage" but really hanging in a DPs residence or business.

- (4) How were fully depreciated assets (which still may have value) disposed of? Were they just given to a DP?
- (5) Tour the property leased or owned by the foundation and note any other assets. Be aware that even though a building is not generating rental income, someone, such as a DP, may be using it.
- (6) Review rental agreements, sales contracts, agreements, side deals.
- (7) Review 990-PF Part VIII regarding compensation of officers and directors.
- (8) Review the type of service when a personal service exception is claimed.
- (9) Review organizing documents such as by-laws, minutes of the meetings of the board and committees to determine if:
  - a. The compensation was approved and authorized;
  - b. The nature of services to be rendered satisfy the personal services exception and relate to the organization's exempt purpose;
  - c. The rate of payment for services is reasonable.
- (10) Review books and records such as general ledger and payroll records to determine if services were rendered.
- (11) Review expenditure journals for any payments to disqualified persons.
- (12) Examine the income stream of the foundation to ensure the income is not being derived from any activity involving a disqualified person. If so, determine whether the activity falls within one of the exceptions to self-dealing pursuant to Section 4941.
- (13) Review if there is a mortgage or lien on a non-cash gift such as property. If there is, it may be considered a sale from a disqualified person.
- (14) Review balance sheet items on Part II of Form 990-PF which may indicate sale, exchange or leasing of property with disqualified persons. Check if there are additions or reductions in asset balances on Line 14 for land, buildings, and equipment.
- (15) Ensure the self-dealing transaction was reported on the Form 4720. Determine whether the excise tax was paid and whether the self-dealing transaction was corrected. Failure to make correction can result in the imposition of second tier taxes.
- (16) Review and verify balance sheet items on Part II of Form 990-PF, which may indicate loans to and from disqualified persons for receivables due from officers, directors, trustees and other disqualified persons and information for loans from officers, directors, trustees, and other disqualified persons.
- (17) Ensure the self-dealer and, if applicable, foundation manager, not only reported the self-dealing transaction on the Form 4720, but that the tax was paid, and correction has occurred. Remember each Chapter 42 excise tax relating to private foundations (other than under Section 4940 and 4948(a)) requires

correction of the act or failure to act that triggers the excise tax. Failure to make correction can result in the imposition of second tier taxes.

(18) Check the TEGE issue snapshots list for pertinent snapshots.

## VII. Example Worksheets / Exhibits

- (1) This section provides worksheets as well as exhibits focusing on practical applications when asserting excise taxes under Section 4941. The examples do not discuss additional taxes and penalties.

### A. Section 4941 First Tier Example: PF Payment to DP (No Services Rendered)

- (1) Disqualified Person Charlie establishes Private Foundation Bravo on June 1, 2005, depositing \$500,000 into PF Bravo's savings account. PF Bravo's fiscal year ends June 30th. DP Charlie is the sole foundation manager of PF Bravo. DP Charlie applies for and receives exemption for PF Bravo under Section 501(c)(3) as a private foundation. The determination letter is dated August 22, 2007. PF Bravo's Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, states that the foundation will make grants only to public charities. The determination letter states, "We have not considered whether grants made under your procedures are excludable from the gross income of recipients under Section 117(a) of the Code." DP Charlie is a CPA, and partner of a small accounting firm. DP Charlie has 20 years of experience, with 10 years spent as the controller of a large public charity.
- (2) On October 10, 2009, PF Bravo issues a check to Mike, DP Charlie's child. DP Mike is 10 years old. The check is for \$25,000. The memo field on the check states "Happy Birthday." DP Mike has not rendered any services to the foundation. During 2011, DP Charlie makes correction by returning the \$25,000, plus interest he earned on that amount, to PF Bravo.
- (3) During an audit of the Form 990-PF for 201006, Agent Davis notifies PF Bravo that the transaction constitutes a self-dealing transaction. For the report of examination, Agent Davis proposes excise taxes on DP Charlie as the self-dealer under Section 4941(d)(1)(E) as a transfer of PF assets for the benefit of DP Charlie (the transfer to Charlie's minor child benefitted Charlie). The amount involved is the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the other property received, or \$25,000. See Treas. Reg. 53.4941(e)-1(b)(1). The amount of correction is also \$25,000 plus any income derived from the use of the \$25,000. Based on DP Charlie's work history, Agent Davis also recommends imposing the foundation manager excise tax under Section 4941(a)(2).
- (4) DP Charlie filed the 201006 Form 990-PF on November 15, 2010. The statute of limitations on the self-dealing transaction is November 15, 2013, if the return provided adequate notice of the transaction. Because DP Charlie made correction in 2011, no second tier taxes are proposed. Note that while there is a single, discrete act of self-dealing, the tax is imposed in each year or partial

year in the taxable period. Section 4945 taxable expenditure excise taxes are also applicable.

**Exempt Organizations Excise Tax Audit Changes**

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

Name of Taxpayer Disqualified Person Charlie	Employer ID No. [Insert EIN]	Schedule or Exhibit 1
---	---------------------------------	--------------------------

Name of Exempt Organization ( <i>if different from Taxpayer</i> ) Private Foundation Bravo
---

		Taxable Years Ended		
		12/31/2009	12/31/2010	12/31/2011
Internal Revenue Code Section for Proposed Adjustment		4941(a)(1)	4941(a)(1)	4941(a)(1)
1. Adjustments	Check to Charlie's child 10/10/2019	\$25,000	\$25,000	\$25,000
2.	Total Adjustments	\$25,000	\$25,000	\$25,000
3.	Amount reported on return or as Previously adjusted	0	0	0
4.	Total amount as corrected	\$25,000	\$25,000	\$25,000
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x Line 5)*	\$2,500	\$2,500	\$2,500
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	\$2,500	\$2,500	\$2,500
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

Explanation of Adjustments  
See attached Explanation of Items



**Exempt Organizations Excise Tax Audit Changes**

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

Name of Taxpayer Disqualified Person Charlie	Employer ID No. [Insert EIN]	Schedule or Exhibit 1
---	---------------------------------	--------------------------

Name of Exempt Organization ( <i>if different from Taxpayer</i> ) Private Foundation Bravo
---

		Taxable Years Ended		
		12/31/2009	12/31/2010	12/31/2011
Internal Revenue Code Section for Proposed Adjustment		4941(a)(2)	4941(a)(2)	4941(a)(2)
1. Adjustments	Check to Charlie's child 10/10/2019	\$25,000	\$25,000	\$25,000
2.	Total Adjustments	\$25,000	\$25,000	\$25,000
3.	Amount reported on return or as Previously adjusted	0	0	0
4.	Total amount as corrected	\$25,000	\$25,000	\$25,000
5.	Applicable tax rate %	5%	5%	5%
6.	Initial tax liability as corrected (line 4 x Line 5)	\$1,250	\$1,250	\$1,250
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	\$1,250	\$1,250	\$1,250
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

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  Disqualified Person Charlie [Insert street address] [Insert city, state, and zip code]		5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)  Private Foundation Bravo [Insert street address] [Insert city, state, and zip code]			
6. Social Security Number or Employer Identification Number	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)	9. Tax Period(s) Ended	
	12/31/2009	12/31/2010		6/30/2010	
	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)
4941(a)(1)	12/31/2009	\$2,500			
4941(a)(2)	12/31/2009	\$1,250			
4941(a)(1)	12/31/2010	\$2,500			
4941(a)(2)	12/31/2010	\$1,250			
4941(a)(1)	12/31/2011	\$2,500			
4941(a)(2)	12/31/2011	\$1,250			
15. Remarks See attached Explanation of Items					
16. Attachments					

## B. Section 4941 First Tier Tax Example: Sale of Property to PF

- (1) Disqualified Person Victor creates Foundation Foxtrot on August 15, 2007. DP Victor initially deposits \$50,000 into PF Foxtrot to fund the foundation. DP Victor files the application for exemption on November 10, 2009, and receives a favorable determination letter dated August 21, 2010. Upon receipt of the determination letter on August 30, 2010, DP Victor donates three business properties to the foundation. These properties consist of a seven-story apartment complex, a four-story retail complex/mall, and a 54-story office tower. PF Foxtrot is a calendar year taxpayer.
- (2) As of the date of donation, DP Victor has a \$365,000 construction loan outstanding on the apartment complex property. The property tax valuation for the property for 2010 is \$1,825,000.
- (3) DP Victor obtained a loan for \$2,760,000 to purchase the mall. As of the date of donation, DP Victor still has \$1,504,000 remaining on the loan. The property tax valuation for the property for 2010 is \$3,486,000.
- (4) DP Victor obtained a construction loan of \$58,500,000 for the office tower in July 2001. As of the date of donation, DP Victor still owed \$48,716,700 on the loan. The property tax valuation for the property for 2010 is \$84,325,000. The loans are all nonrecourse with the properties as collateral, and DP Victor obtained them within 10 years of transferring the properties to PF Foxtrot.
- (5) The following table briefly summarizes the values of the properties:

Building	Outstanding Mortgage	Property Tax Valuation
Apartment complex	\$365,000	\$1,825,000
Retail mall	\$1,504,000	\$3,486,000
Office tower	\$48,716,700	\$84,325,000

- (6) In accepting the three donated properties (each subject to a mortgage which a disqualified person placed on the property within the 10-year period ending on the date of the transfer), PF Foxtrot has engaged in three self-dealing transactions. See Treas. Reg. 53.4941(d)-2(a)(2). The amount involved is the greater of the amount of money and the fair market value of the other property given, or the amount of money and the fair market value of the other property received. See Treas. Reg. 53.4941(e)-1(b)(1). In the case of a gift of mortgaged property to a foundation, the outstanding mortgage debt is the “amount given” by the foundation in determining the amount involved. In this case, the three amounts involved are the amounts received for each (\$1,825,000, \$3,486,000, and \$84,325,000), as the value of each property exceeds the mortgage debt that DP Victor was relieved from paying. To achieve correction, the donations

must be rescinded, and (consistent with the highest fiduciary standards) the foundation must be reimbursed for (1) the excess of the value of the property over the outstanding loan, as of the date of the donation (or if greater, as of the date of rescission), and (2) any amounts expended on the loans or properties in excess of the income received from the properties. See Treas. Reg. 53.4941(e)-1(c)(3).

- (7) During the audit of the 201012 Form 990-PF, Agent Davis informs DP Victor that the donations constitute self-dealing transactions. Agent Davis issues the report of examination on July 10, 2012. (The statute of limitations on the timely filed Form 990-PF is May 15, 2014.) The taxes for the first three years in the taxable period are determined as follows:

**Exempt Organizations Excise Tax Audit Changes**

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

Name of Taxpayer Disqualified Person Victor	Employer ID No. [Insert EIN]	Schedule or Exhibit 1
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Name of Exempt Organization ( <i>if different from Taxpayer</i> ) Private Foundation Foxtrot
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		Taxable Years Ended		
		12/31/2010	12/31/2011	12/31/2012
Internal Revenue Code Section for Proposed Adjustment		4941(a)(1)	4941(a)(1)	4941(a)(1)
1. Adjustments	Mortgaged property donation (8/30/2010) - apartment	\$1,825,000	\$1,825,000	\$1,825,000
	Mortgaged property donation (8/30/2010) – retail mall	\$3,486,000	\$3,486,000	\$3,486,000
	Mortgaged property donation (8/30/2010) – office tower	\$84,325,000	\$84,325,000	\$84,325,000
2.	Total Adjustments	\$89,636,000	\$89,636,000	\$89,636,000
3.	Amount reported on return or as Previously adjusted	0	0	0
4.	Total amount as corrected	\$89,636,000	\$89,636,000	\$89,636,000
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x Line 5)*	\$8,963,600	\$8,963,600	\$8,963,600
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	\$8,963,600	\$8,963,600	\$8,963,600
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

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

6. Social Security Number or Employer Identification Number  [Insert SSN]	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)	9. Tax Period(s) Ended	
	12/31/2010	12/31/2011		12/31/2010	
	12/31/2012				

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

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

14a. Summary of Proposed Adjustments				14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)	Internal Revenue Code Section (1)	Amount (2)
4941(a)(1)	12/31/2010	\$8,963,600			
4941(a)(1)	12/31/2011	\$8,963,600			
4941(a)(1)	12/31/2012	\$8,963,600			

15. Remarks  
See attached Explanation of Items

16. Attachments

### C. Section 4941 First Tier Tax Example: DP Use of PF Property

- (1) On January 1, 2011, Disqualified Person Victor (the same individual in B. above) leased space in the office tower donated to Private Foundation Foxtrot. DP Victor entered into the lease with PF Foxtrot, paying \$350 a month in rent for a 3,500-square foot office (\$0.10 per square foot per month), located on the 54th floor. DP Victor's lease requires incremental increases in rent of \$50 per month on January 1st of each succeeding year, with the lease renewable after 5 years. PF Foxtrot currently charges other tenants in the building \$1.85 per square foot per month, with offices ranging from 2,000 square feet to entire floors at 14,000 square feet. In 2011, PF Foxtrot charged \$1.825 per square foot, and \$1.85 in 2012 and 2013.
- (2) Agent Davis expands the audit to the 201112 Form 990-PF, and informs DP Victor on May 10, 2013, during the initial interview, that the lease constitutes a self-dealing transaction. DP Victor then terminates the lease on May 31, 2013.
- (3) The leasing of property from the foundation constitutes a continuing self-dealing transaction. See Treas. Regs. 53.4941(d)-2(b)(1), 53.4941(e)-1(e)(1). The amount of correction equals the excess of the fair market value of the leased property (at the time of the act of self-dealing or time of correction, whichever is higher) over the amount paid for the length of the lease until terminated. If the rents exceeded fair market value, correction would also require payment to the foundation of the additional rents (to the extent above fair market value) that would have been paid for the remainder of the lease, without considering unexercised extensions or renewals. See Treas. Reg. 53.4941(e)-1(c)(4). The correction amount is computed below.

Calendar Year	FMV Amount	Lease Payments	Difference
2011	$\$1.825 \times 3500 \times 12 =$ \$76,650	$\$350.00 \times 12 =$ \$4,200	\$72,450
2012	$\$1.85 \times 3500 \times 12 =$ \$77,700	$\$400.00 \times 12 =$ \$4,800	\$72,900
2013	$\$1.85 \times 3500 \times 5 =$ \$32,375	$\$450.00 \times 5 =$ \$2,250	\$30,125
Total Correction Amount			\$175,475

- (4) The amount involved is the greater of the amount paid for the use or the fair market value of such use for the period for which the money or other property is used. See Treas. Reg. 53.4941(e)-1(b)(2)(ii). For 2011, the amount involved is \$76,650 ( $\$1.825/\text{sq. ft./month} \times 3500 \text{ sq. ft.} \times 12 \text{ months}$ ). For 2012, the amount

involved is \$77,700 ( $\$1.85/\text{sq. ft./month} \times 3500 \text{ sq. ft.} \times 12 \text{ months}$ ). For 2013, the amount involved is \$32,375 ( $\$1.85/\text{sq. ft./month} \times 3500 \text{ sq. ft.} \times 5 \text{ months}$ ).



**Exempt Organizations Excise Tax Audit Changes**

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

Name of Taxpayer Private Foundation Victor		Employer ID No. [Insert EIN]	Schedule or Exhibit 1	
Name of Exempt Organization ( <i>if different from Taxpayer</i> ) Private Foundation Foxtrot				
		<b>Taxable Years Ended</b>		
		12/31/2011	12/31/2012	12/31/2013
Internal Revenue Code Section for Proposed Adjustment		4941(a)(1)	4941(a)(1)	4941(a)(1)
1. Adjustments	Lease of office space 1/1/2011	\$76,650	\$76,650	\$76,650
	Lease of office space 1/1/2012		\$77,700	\$77,700
	Lease of office space 1/1/2013			\$32,375
2.	Total Adjustments	\$76,650	\$154,350	\$186,725
3.	Amount reported on return or as Previously adjusted	0	0	0
4.	Total amount as corrected	\$76,650	\$154,350	\$186,725
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x Line 5)*	\$7,665	\$15,435	\$18,673
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	\$7,665	\$15,435	\$18,673
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

Explanation of Adjustments  
See attached Explanation of Items

Form 4883 (Rev. 1-2004)

Catalog Number 42083F

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

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

6. Social Security Number or Employer Identification Number	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)	9. Tax Period(s) Ended	
	12/31/2011	12/31/2012		12/31/2011	
	12/31/2013				

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)
4941(a)(1)	12/31/2011	\$7,665			
4941(a)(1)	12/31/2012	\$15,435			
4941(a)(1)	12/31/2013	\$18,673			

15. Remarks See attached Explanation of Items
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16. Attachments
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## D. Section 4941 Second Tier Tax Example

- (1) Assume the same facts as in B. and C. above, except that the disqualified person didn't correct any of the acts of self-dealing before the examiner issued the report of examination on December 1, 2012. See table below for additional property values for 2011 and 2012.
- (2) To determine the amount involved for the second tier tax, use the highest fair market value of the property during the taxable period. See Section 4941(e)(2)(B). Note that the second tier tax is proposed for any uncorrected act of self-dealing. Where an act of self-dealing involves a loan or a lease in which a new act of self-dealing arises under the pyramiding rule, the same principles apply for the new act, but the amount involved is separately determined for each new act, including deemed acts.

Transaction	Date*	Fair Market Value	4941(b) Tax at 200%
Apartment complex	08/30/2010	\$1,825,000	\$3,782,860
	04/01/2011	\$1,834,226	
	04/01/2012	\$1,891,430	
Retail mall	08/30/2010	\$3,486,000	\$6,972,000
	04/01/2011	\$3,204,269	
	04/01/2012	\$3,388,821	
Office tower	08/30/2010	\$84,325,000	\$176,865,296
	04/01/2011	\$88,432,648	
	04/01/2012	\$87,773,023	
Building lease 1/1/2011 act	01/01/2011	\$76,650	\$155,400
	01/01/2012	\$77,700	
Building lease 1/1/2012 act	01/01/2012	\$77,700	\$155,400
Total second tier taxes			\$187,930,956
* The county in which the buildings are located issues the property tax bill annually on April 1st of each year.			

- (3) Report the second tier tax on the final tax year in which adjustments have been made showing first tier tax liability. The second tier tax is imposed when the notice of deficiency is mailed. The following Form 4883 illustrates how the second tier tax is proposed after combining the above examples.

## Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer Disqualified Person Victor	Employer ID No. [Insert EIN]	Schedule or Exhibit 1
--	---------------------------------	--------------------------

Name of Exempt Organization ( <i>if different from Taxpayer</i> ) Private Foundation Foxtrot
---

		Taxable Years Ended		
		12/31/2010	12/31/2011	12/31/2012
Internal Revenue Code Section for Proposed Adjustment		4941(a)(1)	4941(a)(1)	4941(a)(1)
1. Adjustments	Mortgaged property donation (8/30/2010) – apartment	\$1,825,000	\$1,825,000	\$1,825,000
	Mortgaged property donation (8/30/2010) – retail mall	\$3,486,000	\$3,486,000	\$3,486,000
	Mortgaged property donation (8/30/2010) – office tower	\$84,325,000	\$84,325,000	\$84,325,000
	Lease of office space 1/1/2011		\$76,650	\$76,650
	Lease of office space 1/1/2012			\$77,700
2.	Total Adjustments	\$89,636,000	\$89,712,650	\$89,790,350
3.	Amount reported on return or as Previously adjusted	0	0	0
4.	Total amount as corrected	\$89,636,000	\$89,712,650	\$89,790,350
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x Line 5)*	\$8,963,600	\$8,971,265	\$8,979,035
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	\$8,963,600	\$8,971,265	\$8,979,035
9.	Additional tax (minimum) – 200% (Section 4941(b)(1))			\$187,930,956
10.	Penalties (Code section)			

Explanation of Adjustments  
See attached Explanation of Items

Form 4883 (Rev. 1-2004)

Catalog Number 42083F

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

**Exempt Organizations – 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  Disqualified Person Victor [Insert street address] [Insert city, state, and zip code]	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)  Private Foundation Foxtrot [Insert street address] [Insert city, state, and zip code]
--	--

6. Social Security Number or Employer Identification Number	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)	9. Tax Period(s) Ended	
	12/31/2010	12/31/2011		12/31/2010	12/31/2011
	12/31/2012			12/31/2012	

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

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

14a. Summary of Proposed Adjustments				14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)	Internal Revenue Code Section (1)	Amount (2)
4941(a)(1)	12/31/2010	\$8,963,600			
4941(a)(1)	12/31/2011	\$8,971,265			
4941(a)(1)	12/31/2012	\$8,979,035			
4941(b)(1)*			\$187,930,956		

15. Remarks  
See attached Explanation of Items  
\*Additional tax will be imposed at the end of the taxable period defined in Section 4941(e)(1) if the acts are not corrected.

16. Attachments

## E. Section 4941 First Tier Tax Example: PF Loans Money to DP

- (1) On July 1, 2010, Private Foundation Golf lends Hotel Corporation \$150,000. Under the terms of the note, Hotel will pay PF Golf \$1,000 a month (\$750 in principal, \$250 in interest) on the first of each month for 15 years, with a final balloon payment of \$15,000 (all principal, no interest). Hotel Corporation makes the first payment on August 1, 2010. PF Golf and Hotel Corporation have fiscal tax years ending September 30th.
- (2) Hotel Corporation has three shareholders, Romeo, Juliet, and India. Romeo and Juliet are trustees of PF Golf. India is the child of Romeo and Juliet. As Romeo and Juliet are disqualified persons under Section 4946(a)(1)(B), India is also a disqualified person under Section 4946(a)(1)(D). Hotel Corporation is a disqualified person under Section 4946(a)(1)(E). The loan constitutes a self-dealing transaction. As this transaction constitutes a continuing transaction, the examiner must separately compute the amount involved for each new act deemed to occur on the first day of each succeeding tax year of the Hotel Corporation as well as a separate (one time) correction amount. The two amounts are not necessarily identical.
- (3) The correction amount is the amount that would place the foundation in a position no worse than it would have been if PF Golf had been dealing with Hotel Corporation under the highest fiduciary standards. For correction, the Hotel Corporation must pay to the foundation the loan principal outstanding, plus the excess (if any) of fair market interest (using the rate at the time of the act of self-dealing or the time of correction, whichever is higher) over the interest paid by Hotel Corporation until termination of the use of the funds. If the interest that was to be paid by Hotel Corporation for the remainder of the loan term (without regard to extensions or renewals) would have exceeded fair market interest at the time of correction for that period, then that excess must also be paid to the foundation. If the agreed-upon rate is treated as the fair market interest rate at the time of the loan, this rate may be higher than the fair market interest rate at the time of correction if interest rates have dropped. Consistent with Treas. Reg. 53.4941(e)-1(c)(4)(ii), Example (2), fair interest rate is determined separately for each taxable year in which the loan is outstanding until correction.
- (4) After analyzing the facts and circumstances of the case, Agent Davis determines that the prime interest rate plus 2% is an appropriate rate to calculate the amount involved and excise tax. On July 1, 2010, the prime rate was 3.25% and remained 3.25% for all years involved. The amount of correction is the principal and additional interest owed. Unpaid interest from a previous year is added to the principal amount for the subsequent year. The table below computes the interest owed on correction as of the date of the examination on December 10, 2012:

Date	Principal Amount*	Annual Interest Rate**	Number of Payments	FMV Interest Received	Interest Payments	Interest Amounts Owed
7/1/2010	\$150,000	x .0525	x 2/12	= \$1,313	- \$500	= \$813
10/1/2010	\$149,312.50 (150,000 - 1,500 + 812.50)	x .0525	x 12/12	= \$7,839	- \$3,000	= \$4,839
10/1/2011	\$145,151.41 (149,312.50 - 9,000 + 4,838.91)	x .0525	x 12/12	= \$7,620	- \$3,000	= \$4,620
10/1/2012	\$140,771.86 (145,151.41 - 9,000 + 4,620.45)	x .0525	x 4/12	= \$2,464	- \$1,000	= \$1,464
Total Additional Interest Owed						\$11,736
*Includes any unpaid FMV interest added to principal						
**At the time of the loan (or deemed new act of self-dealing) or the time of correction, whichever is higher						

- (5) The report of examination accounts for the January 1, 2013, payment, because it falls within the 30-day period for the report. A correction of \$139,236 (\$127,500 remaining principal + \$11,736 unpaid fair market interest) is immediately made on December 10, 2012. Because DP Hotel Corporation made correction, no second tier taxes will be proposed in the report of examination. The report of examination is dated December 15, 2012.
- (6) When the use of money or other property is involved, the amount involved is the greater of the amount paid for such use or the fair market value of such use for the period for which the money or other property is used. See Treas. Reg. 53.4941(e)-1(b)(2)(ii).

Date of Act	Principal Amount*	Annual Interest Rate**	Number of Payments	FMV Interest	Payments Received	Amount Involved
7/1/2010	\$150,000	x .0525	x 2/12	= \$1,313	\$500	\$1,313
10/1/2010	\$149,312.50	x .0525	x 12/12	= \$7,839	\$3,000	\$7,839
10/1/2011	\$145,151.41	x .0525	x 12/12	= \$7,620	\$3,000	\$7,620
10/1/2012	\$140,771.86	x .0525	x 4/12	= \$2,464	\$1,000	\$2,464
*Includes any unpaid FMV interest added to principal						
**At the time of the loan (or deemed new act of self-dealing)						

- (7) As the 201309 Form 4720 is not due until February 15, 2014, the report of examination will only propose taxes for the periods ended September 30, 2010, September 30, 2011, and September 30, 2012. If desired, Hotel Corporation could file the Form 4720 early and pay the tax in 2013.

**Note:** The examiner could set up the tax on a year that has not yet closed and could add that period 201309 to the report.

**Reminder:** The amount involved is usually less if there is a loan transaction under Section 4941(d)(1)(B) versus a mere transfer of assets under Section 4941(d)(1)(E), such as an outright payment to a disqualified person without consideration. Since whether a transfer of funds between a disqualified person and a foundation constitutes a loan or an outright payment is dependent on various facts and circumstances, the examiner should consult with Area Counsel when analyzing transactions involving transfers of funds between a foundation and a disqualified person.



**Exempt Organizations Excise Tax Audit Changes**

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

Name of Taxpayer Hotel Corporation		Employer ID No. [Insert EIN]	Schedule or Exhibit 1	
Name of Exempt Organization ( <i>if different from Taxpayer</i> ) Private Foundation Golf				
		<b>Taxable Years Ended</b>		
		9/30/2010	9/30/2011	9/30/2012
Internal Revenue Code Section for Proposed Adjustment		4941(a)(1)	4941(a)(1)	4941(a)(1)
1. Adjustments	Loan from PF to Hotel Corporation on 7/1/2010	\$1,313	\$1,313	\$1,313
	Continuing loan on 10/1/2010		\$7,839	\$7,839
	Continuing loan on 10/1/2011			\$7,620
2.	Total Adjustments	\$1,313	\$9,152	\$16,772
3.	Amount reported on return or as Previously adjusted	0	0	0
4.	Total amount as corrected	\$1,313	\$9,152	\$16,772
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x Line 5)*	\$131	\$915	\$1,677
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	\$131	\$915	\$1,677
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

Explanation of Adjustments  
See attached Explanation of Items

Form 4883 (Rev. 1-2004)

Catalog Number 42083F

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

**Exempt Organizations Excise Tax Audit Changes**

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

Name of Taxpayer Hotel Corporation	Employer ID No. [Insert EIN]	Schedule or Exhibit 1
---------------------------------------	---------------------------------	--------------------------

Name of Exempt Organization ( <i>if different from Taxpayer</i> ) Private Foundation Golf
--

		Taxable Years Ended		
		9/30/2013		
Internal Revenue Code Section for Proposed Adjustment		4941(a)(1)		
1. Adjustments	Loan from PF to Hotel Corporation on 7/1/2010	\$1,313		
	Continuing loan on 10/1/2010	\$7,839		
	Continuing loan on 10/1/2011	\$7,620		
	Continuing loan on 10/1/2012	\$2,464		
2.	Total Adjustments	\$19,236		
3.	Amount reported on return or as Previously adjusted	0		
4.	Total amount as corrected	\$19,236		
5.	Applicable tax rate %	10%		
6.	Initial tax liability as corrected (line 4 x Line 5)*	\$1,924		
7.	Initial tax liability reported	0		
8.	Increase (or decrease) in tax	\$1,924		
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

Explanation of Adjustments  
See attached Explanation of Items

Form 4883 (Rev. 1-2004)

Catalog Number 42083F

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

**Exempt Organizations – 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  Hotel Corporation [Insert street address] [Insert city, state, and zip code]	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)  Private Foundation Golf [Insert street address] [Insert city, state, and zip code]
---	---

6. Social Security Number or Employer Identification Number	7. Tax Period(s) Ended		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)	9. Tax Period(s) Ended	
	9/30/2010	9/30/2011		9/30/2010	9/30/2011
	9/30/2012	9/30/2013		9/30/2012	9/30/2013

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)
4941(a)(1)	9/30/2010	\$131			
4941(a)(1)	9/30/2011	\$915			
4941(a)(1)	9/30/2012	\$1,677			
4941(a)(1)	9/30/2013	\$1,924			

15. Remarks  
See attached Explanation of Items

16. Attachments

## **F. Thorne Letter**

- (1) This exhibit contains sample language for a theoretical situation involving Section 4945. Consult Counsel when drafting a Thorne letter. Counsel approves the issuance of all Thorne letters, and helps to individually design each letter specific to the fact pattern presented.



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

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

TAXPAYER NAME  
 TAXPAYER ADDRESS  
 TAXPAYER ADDRESS

**Certified Mail**

Dear [INSERT TAXPAYER NAME]:

I am nearing the conclusion of the audit of the [INSERT FOUNDATION NAME]'s Form 990-PF for [INSERT CALENDAR OR FISCAL YEAR(S)]. These information returns reported that the Foundation made numerous expenditures for [INSERT REASON]. The Foundation identified these expenditures as being for [INSERT TYPE OF PURPOSE] purposes. My audit has revealed that these expenditures were in fact for purposes other than [INSERT TYPE OF PURPOSE] purposes.

I have concluded that these expenditures were "taxable expenditures" within the meaning of Section 4945(d) of the Internal Revenue Code (IRC). I have concluded that the expenditures are either described in IRC Section 4945(d)(1) (amounts paid to carry on propaganda or otherwise attempt to influence legislation) or IRC Section 4945(d)(5) (amounts paid for any purpose other than one specified in IRC Section 170(c)(2)(B)).

The purpose of this letter is to advise you that I intend to propose liabilities under IRC Section 4945(a)(1) on the Foundation, and IRC Section 4945(a)(2) on you as the foundation manager. My understanding is that you do not concur with my proposals and that the Foundation has made no correction of these taxable expenditures as defined in IRC Section 4945(b)(1) on the Foundation. In addition, and as explained in more detail below, I also intend to propose IRC Section 4945(b)(2) liabilities on you as foundation manager.

**[Only use one of the next 2 paragraphs. Select the 1<sup>st</sup> paragraph for short statute cases (<270 days on statute remaining). Select the 2<sup>nd</sup> paragraph for cases in which sufficient time remains on the statute.]**

While I intend to propose the liabilities described in the preceding paragraphs, please do not construe this letter as a 30-day letter. Following the conclusion of my preparation of a report on the proposed liabilities, I will send out the report of examination. Around the same time frame, statutory notices of deficiency will be issued, giving you and the Foundation 90 days to file a petition with the appropriate court.

While I intend to propose the liabilities described in the preceding paragraphs, please do not construe this letter as a 30-day letter. Following the conclusion of my preparation of a report on the proposed liabilities, I will send out the report of examination via a 30-day letter to you. This letter will advise you of your administrative appeal rights. Generally, you will have thirty days from the receipt of that letter to submit an administrative protest.

Please be advised that I intend to propose to define correction under the facts and circumstances of this audit to be that you reimburse the Foundation for the taxable expenditures of the Foundation. I intend to propose the following amounts of taxable expenditures in the following years:

Year	Taxable Expenditure
XXXX	\$ABCDE.00
YYYY	\$FGHI.00
ZZZZ	\$JKLMNO.00
Total	\$PQRSTU.00

The liability of the Foundation under Section 4945(b)(1) would be eliminated if you make the above enumerated reimbursement to the Foundation. In addition, your liability under Section 4945(b)(2) would be eliminated if you agree to the correction.

Pursuant to *Thorne v. Commissioner*, 99 T.C. 67 (1992), I am hereby formally requesting that you make the correction as cited above. Please advise me in writing by [INSERT DATE in MM DD, YYYY format] whether you will agree or refuse to make the requested correction.

Thank you for your prompt attention to this matter.

Sincerely,

[INSERT NAME]

## **G. 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.

Form <b>872</b> (September 2020)	Department of the Treasury-Internal Revenue Service <b>Consent to Extend the Time to Assess Tax</b>	In reply refer to: <b>SE:T:EO:E:XX:79XX</b> TIN [Insert TIN]
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[Insert Name of Taxpayer]

[Insert Continuation of Name, If Necessary]

*(Name(s))*

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

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

*(Address)*

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

(1) The amount of any Federal \_\_\_\_\_ [Excise (section 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 Years(s)]

may be assessed at any time on or before \_\_\_\_\_ [Insert Expiration Date]

*(Expiration date)*

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

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

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

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

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

### Your Rights as a Taxpayer

You have the right to refuse to extend the period of limitations or limit this extension to a mutually agreed-upon issue(s) or mutually agreed-upon period of time. **Publication 1035, Extending the Tax Assessment Period**, provides a more detailed explanation of your rights and the consequences of the choices you may make. If you have not already received a Publication 1035, the publication can be obtained, free of charge, from the IRS official who requested that you sign this consent or from the IRS' web site at [www.irs.gov](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)*



## H. Statute Extension Examples – 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”. This language extends the limitations period for the tax on the taxable act for each year in the taxable period (and extends second tier taxes payable by the taxpayer). In general, use the date of the first act or failure to act 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 modified Form 872 example below should be used if specifying the date(s) of acts of self-dealing.

Form <b>872</b> (September 2020)	Department of the Treasury-Internal Revenue Service  <b>Consent to Extend the Time to Assess Tax</b>	In reply refer to: <b>SE:T:EO:E:XX:79XX</b>  TIN [Insert TIN]
-------------------------------------	--	---

[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 4941)]  
 (Kind of tax)

tax due from the above taxpayer(s) for the taxable years that are fully or partially within the taxable period(s) that began  
 [Insert Date(s) of Act(s) of Self-Dealing Within Open Year]

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

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

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

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

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

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

**Your Rights as a Taxpayer**

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

- (4) The modified Form 872 example below should be used if there are too many dates of self-dealing acts to specify (or concerned about undiscovered acts).

Form <b>872</b> (September 2020)	Department of the Treasury-Internal Revenue Service <b>Consent to Extend the Time to Assess Tax</b>	In reply refer to: <b>SE:T:EO:E:XX:79XX</b> TIN [Insert TIN]
-------------------------------------	--	---

[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 4941)]

(Kind of tax)

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

[Insert Date of Open Year]

may be assessed at any time on or before \_\_\_\_\_ [Insert Expiration Date]

(Expiration date)

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

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

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

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

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

### Your Rights as a Taxpayer

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

## **I. Section 4941 Taxes on Self-Dealing Lead Sheet**

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

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

IRC 4941 Taxes on Self-Dealing Lead Sheet				
Tax Period	Per Return	Per Exam	Adjustment	Reference
<b>Conclusion:</b> <i>(Reflects the final determination on the issue.)</i>				
<p><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></p>				
<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.				
2. Identify transactions between the foundation and disqualified persons, or an organization controlled by a private foundation (for indirect self-dealing).				
3. Determine the nature of the transaction.				
4. Determine whether the transaction is a self-dealing transaction; IRC 4941(d).				
5. If self-dealing occurred, verify whether the self-dealing transaction was corrected, an excise tax return filed (Form 4720), and tax due paid.				
6. Calculate the 'amount involved'; IRC 4941(e).				
7. Determine if there are subsequent acts of self-dealing arising from the initial transaction; Treas. Reg. 53.4941(e)-1(e)(1)(i).				
8. Calculate the first tier tax, IRC 4941(a)(1) paid by the self-dealer, and the IRC 4941(a)(2) tax paid by the participating managers.				
9. Calculate the second tier tax, IRC 4941(b)(1) paid by the self-dealer, and the IRC 4941(b)(2) tax paid by the participating manager, if the first tier tax imposed and the self-dealing transaction is not timely corrected.				
10. Determine if the IRC 507 termination tax is applicable.				
<b>Facts:</b> <i>(Document the relevant facts.)</i>				
<b>Law:</b> <i>(Tax Law, Regulations, court cases, and other authorities.)</i>				
IRC Section: 4941, 4946, 507, 53.4941(e)-1				

**Taxpayer Name:**

**TIN:**

**Tax Form:**

**Examiner:**

**Date:**

**Tax Year:**

Specific citations:
<b>Taxpayer Position:</b> <i>(If applicable)</i>