Private Foundations

This guide covers the procedures for conducting audits of private foundations. For the comprehensive technical guidance on these entities, see IRM 7.26, Private Foundations Manual, and IRM 7.27, Exempt Organizations Tax Manual. Where appropriate, this guide hyperlinks to the manual section on that topic.

This guide discusses both taxable and tax-exempt domestic and foreign private foundations, as the tax treatment for each is different.

Domestic Tax-Exempt Private Foundations

1) A private foundation (PF) may be either domestic or foreign in origin. Tax exempt private foundations:
    a. are described in IRC Section 501(c)(3) and don't meet the requirements for classification under IRC Section 509(a)(1), (2), (3), or (4).
    b. typically have a single major source of funding (usually gifts from one family or corporation rather than funding from many sources). Many foundations primarily make grants to charitable organizations and to individuals, rather than directly conducting charitable programs.

2) A tax-exempt domestic private foundation is either a corporation, association, or trust created or organized in the United States or U.S. territories. See IRM 7.26.1.2.2, 508 (e) Governing Instrument Requirements and IRC Section 508(e) for required elements in the organizational document.

Code Provisions

Domestic private foundations and their disqualified persons are subject to a number of excise taxes. The table below lists the applicable code sections.

Code Section	Tax On	IRM Section
IRC 507(c)	Terminations	IRM 7.26.7, Termination of Private Foundation Status
IRC 4940	Net investment income	IRM 7.27.14, Tax on Net Investment Income of Private Foundations
IRC 4941	Self-dealing transactions	IRM 7.27.15, Taxes on Self-Dealing
IRC 4942	Failure to distribute income	IRM 7.27.16, Taxes on Foundation Failure to Distribute Income
IRC 4943	Excess business holdings	IRM 7.27.17, Taxes on Excess Business Holdings
IRC 4944	Jeopardizing investments	IRM 7.27.18, Taxes on Investments Which Jeopardize Charitable Purposes
IRC 4945	Taxable expenditures	IRM 7.27.19, Taxable Expenditures of Private Foundations
Note: IRM 7.27.14 through IRM 7.27.19 may not reflect the Pension Protection Act of 2006 (PPA 2006) rate or limit changes.		

IRC Sections 4941 through IRC 4945 require that in addition to paying an excise tax, the foundation and/or other taxpayer must correct the act or failure to act that gave rise to the excise tax liability in order to avoid second-tier taxes and any additional penalties. See Correction discussed later in this guide.

IRC Section 4946 lists definitions for purposes of Chapter 42 excise taxes. See the table below for those deemed "disqualified persons."

IRC Section 4946 definitions	IRM Section
Substantial contributor (SC)	IRM 7.27.20.2, Substantial Contributor General
Foundation manager (FM)	IRM 7.27.20.3, Foundation Manager
Owner of >20% of entity that is a SC	IRM 7.27.20.4, Owner of More Than 20 Percent Interest of an Organization that is a Substantial Contributor to a Foundation
Family member of the above individuals	IRM 7.27.20.5, Family Member Within the Meaning of IRC Section 4946(d)
Entity >35% owned by one of the above	IRM 7.27.20.6, Organizations in Which Certain Disqualified Persons Hold More Than a 35 Percent Interest
PF with in-common controlling individual(s) (For IRC Section 4943 only)	IRM 7.27.20.7, Certain Private Foundations
Government official (For IRC Section 4941 only)	IRM 7.27.20.8, Government Officials

By default, all private foundations are deemed non-operating foundations under IRC Section 4942. A private non-operating foundation is subject to the excise taxes listed above. The table below lists the exceptions to classification as a private non-operating foundation. These entities are exempt from certain excise taxes.

IRC Section	Type of entity	IRM Section
IRC 4942(j)(3)	Private operating foundation	IRM 7.26.6, Private Operating Foundations - IRC Section 4942(j)(3)
IRC 4940(d)(2)	Exempt operating foundation	IRM 7.27.14.2.2, Exempt Operating Foundation

IRC Sections 4941, 4944, and 4945 impose taxes on foundation managers for knowingly participating in taxable transactions on behalf of the foundation, and for refusing to agree to correction.

The PPA 2006, P. L. 109–280, (PPA 2006) changed the Code for Chapter 42 excise taxes. Most of the first-tier excise taxes and limits on the foundation manager taxes were doubled. The law also substantially modified IRC Section 4940, and changes were effective as of the first full tax year that began after August 17, 2006.

First-Tier Excise Taxes

The table below identifies the parties subject to the Chapter 42 excise taxes, 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.

Code Section	Liable party	Tax Rate (PPA 2006*)		Limit (PPA 2006*)	
		Before	After	Before	After
IRC 4940(a)	PF	up to 2%	up to 2%	None	None
IRC 4941(a)(1)	Self-dealer	5%	10%	None	None

IRC 4941(a)(2)	FM	2.5%	5%	$10,000 per act	$20,000 per act
IRC 4942(a)	PF	15%	30%	None	None
IRC 4943(a)(1)	PF	5%	10%	None	None
IRC 4944(a)(1)	PF	5%	10%	None	None
IRC 4944(a)(2)	FM	5%	10%	$5,000 per act	$10,000 per act
IRC 4945(a)(1)	PF	10%	20%	None	None
IRC 4945(a)(2)	FM	2.5%	5%	$5,000 per act	$10,000 per act
*The tax rate changes are effective for full tax years that begin after August 17, 2006.					

If an organization or individual incurs an excise tax under 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 (under 4943, only for tax years that end within the taxable period). The taxable period doesn't end until the earliest of:

a. full correction,
b. assessment, or
c. issuance of a notice of deficiency. 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 (IRC Section 6212(c)).

Under IRC Section 4945, there is only one first-tier tax in the taxable period (unlike IRC Sections 4941 - IRC 4944).

Use the tax year of the disqualified person for IRC Section 4941 (Rev. Rul. 75-391, 1975-2 C.B. 446).

Except for IRC Section 4940, excise taxes are reported on Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code. For taxes on individuals, convert the Form 4720 to a Form 4720-A by writing "-A" after the 4720 on the top of the form.

To compute IRC Section 4940 and IRC Section 4942 taxes, complete the Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation. Reclassify expenditures as necessary to determine the qualifying distributions. (IRM 7.27.14.2.3.4, Qualifying Distribution and IRM 7.27.16.3.2, Qualifying Distributions Defined.)

The applicable report forms are:

- Form 4621, Exempt Organizations - Report of Examination
- Form 4883, Exempt Organizations Excise Tax Audit Changes
- Form 886-A, Explanation of Items
- Form 870-E, Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment

IRC Section 4940: Net Investment Income

This subsection focuses on:

- tax law updates
- tax calculations
- tax assessments

See IRM 7.27.14 for the comprehensive technical discussion of IRC Section 4940. ***Note:*** There is no second-tier tax for IRC Section 4940.

For IRC Section 4940, PPA 2006 makes clear that for taxable years beginning after enactment, gross investment income includes income (other than unrelated business taxable income (UBTI)) from *and from sources similar to*:

- interest
- dividends
- rents
- payments with respect to securities loans (IRC Section 512(a)(5))
- royalties (including overriding royalties)

The law also changes how capital gains and losses are treated so that all capital gains and losses (other than UBTI, if applicable) are included in gross income, with a specific exception for like-kind exchanges of related-use property. The law also:

- prohibits including carrybacks or carryovers of capital losses in computing gross investment income.
- redefines capital gain net income to include property used for the production of gross investment income.

Calculate net investment income using a series of simple calculations. See the tables below for the basic formulas to compute the tax.

Term	**Equation**
Net investment income =	Gross investment income Plus capital gain net income Less allowable deductions
Capital gain net income* =	Capital gains Less capital losses**
* Capital losses can’t exceed capital gains (i.e. no net capital losses.) **Capital losses can’t be carried forward or back.	

Complete the Form 990-PF, Part I to ensure that you include all of the appropriate income and deductions.

There are several possible tax rates applicable under IRC Section 4940:

- 0 Percent
- 1 Percent
- 2 Percent

To use a 0 percent tax rate, a foundation must be a private operating foundation under IRC Section 4942(j)(3) that meets the requirements, for the tax year in question, of an exempt operating foundation under IRC Section 4940(d). See IRM 7.27.14.2.2.

To use a 1 percent reduced tax rate, a foundation must meet IRC Section 4940(e) requirements. Complete the Form 990-PF, Parts X, XI, XII, and V to determine eligibility for the reduced rate. This typically requires redoing the Form 990-PF for the prior five years. If you determine that Part V Line 8 is less than Part V Line 7, due to reclassifying expenses or disqualifying distributions, the foundation is subject to the 2 percent rate.

The tax is reported on Form 990-PF. Any adjustments to the tax are made to the Form 990-PF. Use Forms 4621 and 4883 to propose any changes in the IRC Section 4940 tax. Use Form 870-E to secure agreement. See Exhibit 1 for an example of how to compute the tax and complete the Forms 4883 and 4621.

IRC Section 4941: Self-Dealing

See IRM 7.27.15 for the comprehensive technical discussion of IRC Section 4941. This subsection focuses on how to calculate and assess the tax once you've determined that a self-dealing transaction has occurred.

IRC 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:

- correction
- issuance of a statutory notice of deficiency
- assessment of the excise tax

IRC Section 4941 self-dealing transactions are classified as discrete or continuing. Taxes for discrete transactions are imposed for each year/partial year in the taxable period. Taxes for continuing transactions are imposed for each year/partial year in the taxable period, **and** are deemed to create new transactions on the first day of each subsequent taxable year in the taxable period. (See Treas. Reg. 53.4941(e)-1(e)(1)) 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 transaction
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 a PF asset to a DP	Discrete
Use of a PF asset by a DP	Continuing
Use of a PF asset 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".

The following examples illustrate the concept of discrete and continuing transactions.

Example: Discrete: 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:

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

Example: Continuing: 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 until 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

There are exceptions to the rules for self-dealing. See IRM 7.27.15.4.2.

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:

- the fair market value of the property given
- the fair market value of the property received

This rule is **modified** for the use of money or property, where the amount involved is the greater of:

- the amount paid for such use
- the fair market value of such use

for the period for which the property is used. Other modifications may also apply. See IRM 7.27.15.7.1, Amount Involved, Reg. 53.4941(e)–1(b), and Treas. Reg. 53.4941(e)-1(b).

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 in an identical apartment pay $700 per month in rent in 2014, $750 in rent in 2015, and $800 in rent in 2016. The foundation and the child are calendar year taxpayers. 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	700.00	x 6 =	4,200.00
1/1/2015	750.00	x 12 =	9,000.00
1/1/2016	800.00	x 12 =	9,600.00

Refer to the **Correction** section for a discussion of acceptable correction.

See Exhibit 2 through Exhibit 6 for examples of how to compute the tax and complete the Forms 4883 and 4621. Prepare Form 870-E.

The tax is reported on Form 4720-A, assessed against the self-dealer(s), and if applicable, the foundation manager(s). See IRM 7.25.22, EO Delinquent, Amended and Substitute for Return Procedures, for setting up a substitute for return or securing a delinquent return.

IRC Section 4942: Failure to Distribute

See IRM 7.27.16 for the technical discussion of IRC Section 4942. This subsection focuses on how to calculate and assess the tax once you've determined that the foundation has failed to meet its distribution requirements.

IRC Section 4942 taxes don't pyramid like continuing acts of self-dealing, but a failure to distribute in a given year may give rise to tax in multiple years in the taxable period like discrete acts of self-dealing. Also, if there is a failure to distribute in one year, there may be a failure to distribute in subsequent years. IRC Section 4942 may be triggered when you disqualify an otherwise "qualifying distribution."

Qualifying distributions are made to achieve IRC Section 170(c)(2)(B) purposes. IRM 7.27.16.5 outlines the ways in which distributions are deemed to qualify.

If you determine that a distribution doesn't serve an IRC Section 170(c)(2)(B) purpose, and doesn't meet an exception in IRC Section 4942 or in Treas. Reg. 53.4942(a)-3, then redo the Form 990-PF Parts X, XI, XII, and XIII for the year(s) under audit. If operating under a six-year statute memo from Area Counsel, redo the form for each year under audit.

Note: Some transactions that constitute self-dealing transactions and/or taxable expenditures aren't qualifying distributions. Look at each transaction/expenditure on a case by case basis.

A taxpayer generally can't make any elections with respect to qualifying distributions during your audit. They must make the elections before they file the Form 990-PF. If the taxpayer properly made a pre-filing election, verify it. If there is a valid election, consider that in your revised Part XIII. (You may find the election in another part of the form.)

Refer to the **Correction** section for a discussion of acceptable correction.

Complete Forms 4883, 4621, 886-A and 870-E. See Exhibit 7 and Exhibit 8 for examples of computing and proposing the tax. Note that to incur the tax requires two years of failing to distribute; in other words, a foundation has until the end of Year 2 to make qualifying distributions of its distributable amount for Year 1. Consider opening all periods with open statutes when dealing with possible disqualified distributions.

The tax is reported on Form 4720 and assessed against the private foundation. See IRM 4.75.22, EO Delinquent, Amended and Substitute for Return Procedures, to set up a substitute for return or secure a delinquent return.

IRC Section 4943: Excess Business Holdings

For the comprehensive technical discussion of IRC Section 4943, see IRM 7.27.17. This subsection focuses on how to calculate and assess the tax once you've determined that the foundation has exceeded its permitted business holdings.

IRC Section 4943 taxes, like discrete acts of self-dealing and 4942 taxes, are imposed for the year in which the foundation has excess business holdings and each subsequent year in the taxable period. The amount of tax may vary from year to year as the excess holdings vary.

The foundation may hold an ownership interest in a business enterprise. The foundation is permitted to hold up to:

- 2%, regardless of disqualified person ownership percentages (de minimis rule)
- 35% (ownership of foundation and disqualified persons combined), if the enterprise is effectively controlled by third persons. (See Rev. Rul. 81-111, 1981-1 C.B. 509.)
- 20% (ownership of foundation and disqualified persons combined), in all other cases.

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

Foundations in many instances have a grace period to divest itself of the excess ownership interest, which varies depending on the circumstances. In general, the foundation has five years in which to dispose of excess holdings acquired other than by purchase without incurring any tax. There are exceptions to the rule, such as a 90-day time limit in certain situations. See IRM 7.27.17.5, Five-Year Disposition Period.

When examining a private foundation, verify the amount of ownership in any business enterprise. Perform third party contacts with the disqualified persons as needed to determine their ownership percentages. Issue summonses as needed if the disqualified persons are uncooperative.

Note: Be aware that some business enterprise holdings may also constitute jeopardizing investments.

If there are excess business holdings, determine for how long the foundation has had the excess holdings. Review IRM 7.27.17.5 to determine the applicable grace period for disposing of the holdings. If the foundation has exceeded the applicable period, calculate and propose the tax on the foundation.

For purposes of the tax calculation, determine the highest value of the holdings within the tax year. If the ownership interest is in a privately held company or partnership, determine whether to make a Specialist Referral System referral for a Large Business and International (LB&I) economist or engineer. The tax is on the fair market value of the excess portion of the business holdings for the tax year. Assess the tax for each year for which the foundation has/had excess holdings.

Consider expanding your audit to additional years for which the statute is open, and for which the foundation still had excess holdings as of the start of the tax year. The tax amount may vary per year, depending on the increase/decrease in excess holdings that occurred in the years under audit.

Refer to the **Correction** section for a discussion of acceptable correction.

Complete Forms 4883, 4621, 886-A and 870-E. See Exhibit 9 and Exhibit 10 for examples of how to determine and compute the tax.

The tax is reported on Form 4720 and assessed against the private foundation. See IRM 4.75.22, EO Delinquent, Amended and Substitute for Return Procedures, to set up a substitute for return or secure a delinquent return.

IRC Section 4944: Jeopardizing Investments

See IRM 7.27.18 for the technical overview of IRC Section 4944. This subsection focuses on how to identify liability for, calculate, and assess the tax once you've determined that the foundation possesses jeopardizing investments.

Investment in a Ponzi scheme may potentially trigger IRC Section 4944, depending on the facts and circumstances. If you find that the foundation invested in a Ponzi scheme, consult with Area Counsel.

Look for investments that show a lack of reasonable business care and prudence in providing for the foundation's long and short term financial needs for it to carry out its exempt function. No single factor determines a jeopardizing investment.

No specific category of investments is treated as a violation, however, apply careful scrutiny to:

- Trading in securities on margin
- Trading in commodity futures
- Investing in working interests in oil and gas wells
- Buying puts, calls, and straddles

- Buying warrants
- Selling short

If the investment decision was sound at the time the investment was made, it's not a jeopardizing expense, even if it later results in a loss.

Keep in mind that the tax doesn't apply to investments:

- Originally made by a donor who gifted them to the foundation*
- Acquired by the foundation as a result of a corporate reorganization
- Made before 1970**

Exception: * If the person receives any consideration from the foundation on the transfer, the foundation is treated as having made an investment equal to the consideration.

Exception: ** If the form or terms of the investments are later changed, or they are exchanged for other investments, then the investments can be subject to the tax.

Compute the tax using the value of the amount invested on the day the investment was made. Assess the tax for each year or partial year in the taxable period. The tax amount is the same for each year, like discrete acts of self-dealing and 4942 and 4943 taxes.

In addition to the IRC Section 4944(a)(1) tax imposed on foundations, IRC Section 4944(a)(2) provides for a tax on the foundation manager who knowingly and willfully participates in the investment. See IRM 7.27.18.6.2, First-Tier Tax on Foundation Managers, for the required criteria to propose the tax.

Refer to the **Correction** section for a discussion of acceptable correction.

Complete Forms 4883, 4621, 886-A and 870-E. See Exhibit 11 and Exhibit 12 for examples of how to determine and compute the tax.

The IRC Section 4944(a)(1) tax is reported on Form 4720 and assessed against the private foundation. See IRM 4.75.22, EO Delinquent, Amended and Substitute for Return Procedures, to set up a substitute for return or secure a delinquent return.

The foundation manager tax is reported on Form 4720-A and assessed against the responsible individual(s).

IRC Section 4945: Taxable Expenditures

See IRM 7.27.19 for the technical discussion of IRC Section 4945. This subsection focuses on how to identify liability for, calculate, and assess the tax once you've determined that the foundation made taxable expenditures.

IRC 4 Section 945(d) lists five categories of taxable expenditures. These include amounts:

1) Spent to carry on propaganda or attempt to influence legislation. IRC Section 4945(d)(1)
2) Expended to influence any specific public election outcome, or to carry on a partisan voter registration drive (directly or indirectly). IRC Section 4945(d)(2)
3) Paid as a grant to an individual for travel, study, or other similar purposes, unless satisfies Section 4945(g). IRC Section 4945(d)(3)
4) Disbursed as a grant to an organization, unless the organization is a public charity (other than certain supporting organizations) or the PF exercises expenditure responsibility per IRC Section

4945(h). See IRC Section 4945(d)(4)(A)(ii)) or exempt operating foundation. IRC Section 4945(d)(4)

5) Paid or incurred for any purpose other than one in IRC Section 170(c)(2)(B). IRC Section 4945(d)(5)

For the required elements of and **exceptions** for each category, see the following IRM sections:

- For IRC Section 4945(d)(1), see IRM 7.27.19.3, Attempting to Influence Legislation (Lobbying)
- For IRC Section 4945(d)(2), see IRM 7.27.19.4, Public Elections and Voter Registration Drives
- For IRC Section 4945(d)(3), see IRM 7.27.19.5, IRC 4945(d)(3) Grants to Individuals
- For IRC Section 4945(d)(4), see IRM 7.27.19.6, Grants to Organizations IRC Section 4945(d)(4)
- For IRC Section 4945(d)(5), see IRM 7.27.19.7, Expenditures for Noncharitable Purposes IRC Section 4945(d)(5).

An expenditure may fall into several categories of taxable expenditure. Regardless of the number of categories violated, the tax is assessed only once.

Example: A foundation manager issues a series of payments to two individuals to travel throughout several counties in a state during an election year. The recipients act as paid signature gatherers for a number of ballot initiatives to modify current laws. They also go door to door to sign up eligible voters, based on a list of potential voters provided by a state political party. They provide pamphlets to the voters promoting specific party candidates. The individuals submit travel vouchers for reimbursement to the foundation, along with the signature pages, lists of voter registrations, and paid invoices for the printing of the pamphlets.

Note: In the above example, the foundation has violated IRC Sections 4945(d)(1), (d)(2), and (d)(5). The foundation is liable only once for the tax on the reimbursements to the individuals, and the tax is imposed only once in the taxable period.

When examining the foundation, review all of the expenditures. Determine which expenditures constitute grants. For grants to individuals for travel, studies, or similar purposes, verify that the organization has obtained an IRC Section 4945(g) advance ruling letter. The organization may request the letter during the initial application process or in a subsequent ruling request. If the foundation doesn't have a ruling letter, determine whether it meets an exception under IRC Section 4945(d)(3) (IRM 7.27.19.5) or IRC Section 4945(g) (IRM 7.27.19.5.7, Advance Approval Under IRC 4945(g)). Assess the tax if the foundation doesn't meet the exceptions.

Note: The foundation may submit Form 8940, Request for Miscellaneous Determination, and pay a user fee to request an IRC Section 4945(g) advance ruling letter. The ruling is prospective from the date of the letter and is not retroactive, though it may be required as part of correction.

Unless a grant was made to a public charity (other than certain supporting organizations - see IRC Section 4945(d)(4)(A)(ii)) or an exempt operating foundation, determine whether the foundation exercised expenditure responsibility. See IRM 7.27.19.6.5, Expenditure Responsibility. Review the:

- Pre-grant inquiries (IRM 7.27.19.6.6, Pre-grant Inquiry Requirement IRC Section 4945(h)(1))
- Grant agreements (IRM 7.27.19.6.7, Terms of Grant Agreements)
- Grantee reports (IRM 7.27.19.6.10, Reporting Requirements of the Grantee Organization)
- Grantor reports (IRM 7.27.19.6.11, Reporting Requirements of the Grantor)

For those grants that failed the expenditure responsibility requirement, propose the first-tier tax and request correction. Refer to the **Correction** section for a discussion of acceptable correction.

Be aware that there are permitted expenditures, such as:

- Expenditures to acquire investments that generate income to be used to further the purposes of the organization.
- Reasonable expenses related to acquiring these investments.
- Payment of taxes.
- Expenses that qualify as allowable deductions in figuring unrelated business income tax (UBIT).
- Any payment that is an IRC Section 4942 qualifying distribution.
- Any deduction allowed in arriving at taxable net investment income (IRC Section 4940).
- Reasonable expenditures to evaluate, acquire, modify, and dispose of program-related investments.
- Business expenses of the recipient of a program related investment.

Payment of unreasonable administrative expenses, including wages, consultant fees, and other fees for services performed, are taxable expenditures unless they were:

a) Made in the good faith belief that the amounts were reasonable.
b) Consistent with ordinary business care and prudence.

Request documentation that supports the reasonableness determination for any expenditure that appears unreasonable. Expenditures may be taxable if the trustees, officers, or foundation managers didn't make an effort to determine whether the expenditures were reasonable. If needed, submit a Specialist Referral System request for an LB&I engineer to evaluate the expenditure. Determine the excess expenditure and propose the tax for the excess amount.

Compute the tax using the expenditure amount, or excess amount if deemed unreasonable. Propose the tax for the year in which the expenditure was made.

In addition to the IRC Section 4945(a)(1) tax imposed on foundations, IRC Section 4945(a)(2) imposes a tax on a foundation manager who knowingly and willfully agrees to the expenditure. See IRM 7.27.19.8 for the required criteria to propose the tax.

Refer to the **Correction** section for a discussion of acceptable correction.

Complete Forms 4883, 4621, 886-A and 870-E. See Exhibit 13 and Exhibit 14 for examples of how to determine and compute the tax.

The IRC Section 4945(a)(1) tax is reported on Form 4720 and assessed against the private foundation. See IRM 4.75.22, EO Delinquent, Amended and Substitute for Return Procedures, to set up a substitute for return or secure a delinquent return.

The foundation manager tax is reported on Form 4720-A and assessed against the responsible individual(s).

One Act/Failure to Act, Multiple Violations

The structure of Chapter 42 permits the assessment of excise taxes under different statutes for the same violation. For instance, a self-dealing transaction (IRC Section 4941) is frequently also a taxable expenditure (IRC Section 4945), that may also affect the net investment income (IRC Section 4940) and the qualifying distributions (IRC Section 4942).

IRC Section 4940 and IRC Section 4942 are inseparable. Adjustments to the net value of non-charitable use assets impact the computation of the distribution ratio (IRC Section 4940) and the minimum investment return

(IRC Section 4942). Both taxes rely on determining qualifying distributions; IRC Section 4940 uses the distribution ratio to determine eligibility for the 1 percent tax rate, and IRC 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.

Example 1: The organization engages in self-dealing expenditures. They reported these amounts in Part I Column d as charitable disbursements. 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 one percent of the net investment income and the product of 1) the 5-year average distribution ratio and 2) the net value of the non-charitable use assets, the foundation can't use the IRC Section 4940(e) one percent tax rate. For IRC 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

If Part V Line 8 is less than Part V Line 7, use the two percent 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 organization understates the net investment income (either understating investment revenues or over-allocating/overstating investment expenses or both). This directly increases the IRC 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 organization overstates the net investment income. The IRC Section 4940 tax is reduced, and the distributable amount in turn is increased, increasing any possible IRC Section 4942 tax.

Example 4: The organization 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 IRC 4940(e) reduced tax rate. For IRC Section 4942 purposes, the distributable amount increases, thus increasing the chance for tax two years down the road.

Example 5: The organization 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 IRC 4940(e) threshold, and the chance for a possible IRC Section 4942 tax is reduced.

IRC Section 4941 and IRC Section 4945 can commonly occur for the same transaction. Many self-dealing transactions aren't considered to be for IRC Section 170(c)(2)(B) purposes, thus becoming taxable expenditures. On the other hand, a taxable expenditure isn't necessarily a self-dealing transaction. Remember to apply the appropriate Code and Regulations when analyzing each transaction.

Example 1: A foundation manager uses foundation funds to go on a vacation in the Bahamas. The foundation doesn't have advance approval under IRC Section 4945(g) to make grants to individuals. 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. Due to lack of advance approval of the grant procedures under IRC Section 4945(g), the transaction constitutes a taxable expenditure but not a self-dealing expenditure.

An act subject to IRC 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 (see IRM 7.27.15.4.2.6, Securities Transactions). The purchase of the stock constitutes a self-dealing transaction. If the foundation owns more than 2 percent of the total stock of the corporation, the purchase may trigger IRC Section 4943. (A donation of the stock won't constitute a self-dealing transaction, but may trigger IRC Section 4943.)

As with IRC Section 4943, an act subject to IRC Section 4944 may also trigger other taxes in certain situations.

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

Correction

Each Chapter 42 excise tax 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. When one transaction triggers multiple excise taxes, the correction for one tax may possibly also satisfy correction for the other taxes.

The following table below identifies the code subsection requiring correction and the actions required to make it. There is no correction for IRC Section 4940, as it has no second-tier excise tax. (IRC 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 IRC Section 172). See Treas. Reg. 53.4940-1(e).

Code Section	Correction
IRC 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. IRM 7.27.15.7.2, Correction, Treas. Reg. 53.4941(e)-1(c)
IRC 4942(h)(2) and IRC 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) requires distribution of cash if failure to distribute was willful and not due to reasonable cause.) IRM 7.27.16.6.8.7, Failure to Distribute Minimum Amounts.
IRC 4943(c)	Depending on when and how the business holding was received, the organization may have a transition period in which to get rid of the excess holding. Correction is made when no excess holdings remain. IRM 7.27.17.11, Correction, Treas. Reg. 53.4943-9(c)
IRC 4944(e)(2)	Remove the investment from jeopardy by either selling it or disposing it (other than exchanging it for another jeopardizing investment). IRM 7.27.18.5, Removal from Jeopardy, Treas. Reg. 53.4944-5(b)
IRC 4945(i)(1)	Recover as much of the expenditure as possible, and any other correction we prescribe if unable to recover the whole expenditure. In certain situations, obtain or make a report on the use of a grant, or obtain approval of grantmaking procedures. IRM 7.27.19.9.3, Correction of Taxable Expenditures and Second-Tier Taxes, Treas. Reg. 53.4945-1(d)

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 manual sections and regulations for directions on the appropriate correction methods.

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

When correction is made, obtain verification. See the following (not all-inclusive) for acceptable proof of correction. Discuss with your manager and Area Counsel as to appropriate methods of correction and proof, if desired:

- Copies of cancelled check(s) to the foundation and bank statement(s) showing the deposit(s).
- New title documents for returned real property.
- Copies of cancelled check(s) and bank statement(s) showing appropriate distributions.
- Brokerage/financial institution statement(s) showing that a foundation no longer owns an asset or stock.
- Copies of reports secured concerning the uses of grants made.

Be alert for attempts to circumvent the correction requirement. At a minimum, ensure that the parties don't:

- Deposit the correction amount and then issue a new check back to the party making correction.
- Obtain new title documents for returned property and then change title back to the party that returned the property.
- Redeposit amounts distributed to satisfy IRC Section 4942 (such as voided checks, circular transactions).
- Transfer assets or stocks to other financial institutions or to disqualified parties for which statements aren't provided.

If you're revoking or involuntarily terminating the foundation, request and verify that correction is made to a governmental agency or other IRC Section 501(c)(3) organization that isn't itself at risk of revocation.

You may receive requests to extend the correction period (IRC Section 4963(e)(1)(B)). Under Delegation Order 7-4 (IRM 1.2.46.5, Delegation Order 7-4 (formerly DO-139, Rev. 7)), area managers may authorize extensions of the correction period, or delegate the authority to the group manager. Consult your group manager if you're considering granting an extension of time to make correction.

Extensions of the correction period aren't ordinarily granted unless these factors are present:

- The taxpayer is actively seeking in good faith to correct the taxable event.
- Adequate correction is unavailable or can't reasonably be expected to occur during the original correction period.
- 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).

A taxpayer paying the full amount of the first-tier tax during the original correction period extends the correction period to the later of:

- 90 days after paying the first-tier tax
- The last day of the original correction period.

Note: If the taxpayer pays the first-tier tax after IRS mails a statutory notice of deficiency and before the 90-day period of the notice has expired, the taxpayer has 90 days from the payment date to make correction. Treas. Reg. 53.4963-1(e)(4). If the taxpayer petitions the Tax Court regarding the second-tier taxes, before the correction period (including extensions) expires, the correction period runs until the decision is final. Treas. Reg. 53.4963-1(e)(2).

Advance Approval of Proposed Correction

Taxpayers may request advance approval of a proposed correction. If granted, the advance approval provides assurance to taxpayers and organizations that IRS will view an intended remedial action favorably as correction.

Advance approval is **only** available when:

- The only barrier is the reluctance to correct because they are uncertain of final IRS approval.
- The other aspects of the issue aren't disputed.

For all other cases, treat the case as unagreed if the taxpayer is unwilling to make correction.

To grant advance approval, all of the following conditions must be met:

- The taxpayer indicates acceptance of initial tax liability (IRC Sections 4941 through 4945).
- Correction will be very difficult or costly, requiring the exercise of sound judgment on a broad scale.
- The taxpayer should be able to complete the proposed correction within 90 days from the date of approval.
- The taxpayer submits a written request for advance approval, attention of the Area Manager.

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 they'll complete the correction.

When you receive a written request, 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). Schedule and hold a conference call with your group and Area Managers.

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.

If the Area Manager denies the request, prepare and issue a draft correction rejection letter. See Letter 5306, Private Foundation Correction Rejection Letter. In the letter:

a) Outline the taxpayer's proposal.

b) Explain why it doesn't constitute correction.
c) Clarify that other methods of correction are still available.
d) Suggest a particular correction action (or actions) that would be acceptable.

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 notifies you 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).

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

If you don't receive proof of correction, close the case as unagreed. See IRM 4.75.16, Case Closing Procedures, for closing procedures.

Second-Tier Excise Taxes

See the following table for the second-tier taxes for each code section.

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

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. Indicate in your 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, you may delay closing an agreed first-tier tax case for a reasonable period to permit correction, depending on the facts and circumstances.

Before granting the above extension, ensure that the taxpayer has:

- signed the Form 870-E.
- paid the first-tier tax.
- granted a statute extension, if necessary.

Note: Get your Area Manager's approval due to the additional case cycle time.

All second-tier taxes are imposed once per act/failure to act. To determine the amount involved for the second-tier tax, use the highest fair market value during the taxable period. For assessment, report the second-tier tax on the last year of the audit. If the taxpayer partially corrects, the second-tier tax is on the uncorrected remaining amount.

Example 1: IRC 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. The amount involved is $250,000 (Treas. Reg. 53.4941(e)- 1(b)). For the 2016 tax year, the second-tier tax is $250,000 x 200% =$500,000.

Note: For purposes of IRC 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: IRC 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 rent in 2016, and $800 in rent 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. The amount involved in each year is as follows:

Date	Rent Amount	Time in Months	Amount Involved
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

See IRM 4.75.15.8.6, Private Foundation Excise Taxes, for additional information for the necessary letters and forms to complete. However, before issuing a 30-day letter to a foundation manager asserting second-tier excise taxes, you must issue a Thorne letter requesting that they take specific actions. See *Thorne v. Commissioner*, 99 T.C. 67 (1992). For help drafting a Thorne letter, contact Area Counsel. See Exhibit 16 for sample language used in a Thorne letter for a theoretical IRC Section 4945 scenario. See also IRM 7.27.15.3.2, Tax on Foundation Manager.

If the taxpayer doesn't agree to the tax or fails to make correction, the case is unagreed. See IRM 4.75.16 for case closing procedures.

Termination Tax

See IRM 7.26.7 for the comprehensive technical discussion of private foundation terminations. This section focuses on those situations when tax is due. The termination tax acts like a third-tier excise tax.

The phrase “termination” has several different meanings in the context of private foundations. When a public charity terminates, the entity dissolves or goes out of business. For a private foundation, termination doesn’t necessarily mean dissolution has occurred. Termination for IRC Section 507 purposes means:

a) The foundation notifies the IRS and pays the IRC Section 507(c) tax (if any). (IRC Section 507(a)(1)).
b) The IRS involuntarily terminates the foundation and imposes IRC Section 507(c) tax. (IRC Section 507(a)(2)).
c) The foundation transfers all of its net assets to certain public charities. (IRC Section 507(b)(1)(A)).
d) The foundation becomes a public charity. (IRC Section 507(b)(1)(B)).

Note: Transfer under IRC 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. The foundation must separately terminate, whether voluntarily (507(a)(1)) or involuntarily (507(a)(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 IRC Section 507(b). If terminated under IRC Section 507(b), the foundation pays $0 in termination taxes.

If the foundation voluntarily terminates under IRC 507(a)(1), they submit their final Form 990-PF and pay a termination tax. The foundation follows the instructions to the Form 990-PF as to the method of notification.

Consider imposing an IRC Section 507(a)(2) involuntary termination when the foundation has committed multiple willful repeated acts under Chapter 42. You can also consider IRC 507(a)(2) if the foundation committed one willful flagrant act triggering Chapter 42 treatment. If proposing involuntary termination, you can propose revocation at the same time. See IRM 7.26.7.3.2, Involuntary IRC 507(a)(2) Terminations.

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

Computing the termination tax requires multiple smaller computations normally provided by the foundation:

<table>
<tr><th colspan="3">The termination tax is the smaller of:</th></tr>
<tr><td colspan="2">A) The aggregate tax benefit - the sum of:</td><td rowspan="5">B) The value of the net assets as of the date the foundation first committed a Chapter 42 violation, or the effective termination date, whichever amount is higher. See IRC Section 507(e)(1). Default to this amount unless the “aggregate tax benefit” is calculated.</td></tr>
<tr><td>1.</td><td>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. (IRC Section 507(d)(1)(A))</td></tr>
<tr><td>2.</td><td>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.* (IRC Section 507(d)(1)(B))</td></tr>
<tr><td>3.</td><td>Amounts received from private foundations to which IRC Section 507(b)(2) transferee liability applies. (Treas. Reg. 1.507-3)</td></tr>
<tr><td>4.</td><td>The accumulated interest on the above amounts as computed via RGS NT or IDRS command code INTST. (IRC Section 507(d)(1)(C))</td></tr>
<tr><td colspan="3">*For purposes of this calculation, the charitable contribution deduction allowed a trust is deemed to have been limited to 20% of taxable income. IRC Section 507(d)(1)(B)(ii).

** For any year in which a gift tax would be due if a charitable deduction were not available, refer to the Instructions to Form 709, United States Gift (and Generation - Skipping Transfer) Tax Return, for that particular year for assistance in calculating the appropriate amount of deemed gift tax.</td></tr>
</table>

As we retain records for a limited period, you may not be able to compute the tax from the date of inception. Obtain what information you can via IDRS, return requests, and Online SEIN. Establish AIMS controls via the

Reporting Compliance and Case Management System (RCCMS) using source code 45 to retrieve the returns of the substantial contributors.

See IRM 4.75.31 for guidance on converting the Form 990-PF to Forms 1120 or 1041. Use the Report Generation System NT (RGS NT) to determine the increase in income tax from the disallowance of charitable contributions deductions.

Propose the tax using Forms 4883 and 4621. Use Form 990-PF to assess the tax in lieu of Form 4720. See Exhibit 15 for an example.

Imposition of the termination tax doesn't eliminate liability for the underlying Chapter 42 taxes that initiated the termination process.

When you close the case as a termination, prepare Form 2363-A, Request for IDRS Input for BMF/EO Entity Change, to update the status code, indicating the effective date in YYYYMM format:

- Status 23: 507(a)
- Status 24: 507(b)(1)(A) (No termination tax applies)
- Status 25: 507(b)(1)(B) (No termination tax applies)

Termination of private foundation status under IRC Section 507 results in the foundation being treated as an organization created on the day after termination. IRC Section 509(c).

Revocation

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 IRC Section 507(a)(2). An IRC 501(c)(3) foundation must engage primarily in activities that accomplish IRC Section 501(c)(3) purposes. If more than an insubstantial part of its activities doesn't further an exempt purpose, propose revocation. A private foundation is subject to the auto revocation process of IRC Section 6033(i) and IRC Section 6033(j). (See IRM 4.75.16.)

Foundations are subject to similar restrictions as other IRC Section 501(c)(3) organizations:

- Absolute prohibition for political campaigning
- Limitation on lobbying (subject to IRC Section 4945(d))
- Prohibition on inurement
- Prohibition on operating for benefit of private interests
- Limitation on UBI activities (less than primary purpose)
- Limitation on commercial-type insurance (IRC Section 501(m))
- Prohibition on illegal activities/purposes that violate public policy

If the foundation violates any of the prohibitions and/or restrictions listed above, propose revocation. When proposing revocation, follow the procedures in IRM 4.75.31, Conversion of Returns . Upon revocation, the foundation becomes a taxable private foundation.

In many revocations, the foundation, disqualified persons, and foundation managers may also be subject to Chapter 42 excise taxes. If there are multiple repeated acts or a single flagrant act triggering Chapter 42 taxes, propose the termination tax in addition to revocation. You may include the basic report forms in Exhibit 15 with Letter 3614, 30-day letter package for Chapter 42 excise taxes. Form 870-E shows all tax deficiencies of the foundation.

In revocations of private foundations, the foundation becomes a taxable foundation and must file an income tax return as well as [Form 990-PF](). 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.

All revocations are subject to Mandatory Review. Leave the Form 2363-A in the case file.

Statute of Limitations

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

Code Section	Liable party	Tax form	Tax year
IRC 4940(a)	PF	990-PF	On the same form, same year.
IRC 4941(a)(1)	Self-dealer	4720-A	If individual: Year of Form 1040, *U.S. Individual Income Tax Return*, in which transaction occurs. All others: Year of Form 1041, 1065, *U.S. Return of Partnership Income*, or 1120 in which transaction falls. If a partnership, flows through to the respective partners. *
IRC 4941(a)(2)	FM	4720-A	Form 1040 year in which transaction occurs.
IRC 4942(a)	PF	4720	Same year of Form 990-PF
IRC 4943(a)(1)	PF	4720	Same year of Form 990-PF
IRC 4944(a)(1)	PF	4720	Same year of Form 990-PF
IRC 4944(a)(2)	FM	4720-A	Form 1040 year in which transaction occurs.
IRC 4945(a)(1)	PF	4720	Same year of Form 990-PF
IRC 4945(a)(2)	FM	4720-A	Form 1040 year in which transaction occurs.

* If assessing a Chapter 42 tax on a partnership, also assess tax on the partners. Pro-rate the amount of tax per partner based on their percentage of control of the partnership.

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)	IRC 6501(a)
6 years	IRC 4940, 4948: Exceeds 25% of amount reported on return. IRC 4941 - IRC 4945: Transaction not disclosed on the return. Requires Area Counsel memo.	IRC 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.	IRC 6501(c)(1), IRC 6020(b)

See table below for IRC Section 4942 statute modifications:

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

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.

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

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 over a period of years, the Forms 4720/4720-A will have separate statutes for each transaction. When extending the statute for the Form 4720/4720-A, extend the statute for all of the transactions.

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, with the exception of the transaction on September 1, 2009, which is a continuing transaction. 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. 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 990-PF	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 (continuing transaction)	201008	3/10/2011	200912	3/10/2011
10/1/2009	201008	3/10/2011	200912	3/10/2011
1/1/2010 (continuing 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 transaction)	201108	2/15/2012	201112	2/15/2012
5/20/2011	201108	2/15/2012	201112	2/15/2012

1/1/2012 (continuing transaction)	201208	TBD	201212	TBD

When preparing the extensions, reference the specific code section in the type of tax. Use “excise (Section 494X)” or “excise (section 494X)”. If extending both income and excise taxes, state “income and/or excise (Section 494X)”. If extending multiple excise tax code sections, state “excise (Sections 494X and 494Y)”.

Extensions for IRC Section 4941 through IRC 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 for the start of the taxable period. See Exhibit 17 for an example.

If there are multiple acts in a single tax year that trigger Chapter 42 taxes, you may list them on the modified Form 872. See Exhibit 18 for an example.

As the IRC Section 4940 tax is assessed on the Form 990-PF, prepare any statute extensions for IRC Section 4940 taxes using the regular Form 872. Associate the statute extension with the appropriate Form 990-PF.

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, even if the statute expired for the year in which the original transaction occurred, you may assess tax for each open tax year, because it is deemed a new act every year until correction.

Applicable Penalties

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.

As the Form 990-PF is both an information return and an excise tax return, foundations are subject to several sets of penalties:

IRC Section 6652(c) - daily delinquencies, public inspections, and prohibited tax shelters.

IRC Section 6651(a), IRC Section 6655, and IRC Section 6662(c) - failure to file, failure to pay, estimated tax, and negligence penalties. See IRM 20.1.2, Failure To File/Failure To Pay Penalties, IRM 20.1.3, Estimated Tax Penalties and IRM 20.1.5.7, IRC Section 6662(c), Negligence or Disregard of Rules or Regulations.

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

Foundations can also be subject to the criminal penalties of IRC Section 7203, IRC Section 7206, and IRC Section 7207, as well as the civil fraud penalty of IRC 6663. (See IRM 9.1.3, Criminal Statutory Provisions and Common Law and IRM 20.1.5.14.1, IRC 6663, Civil Fraud Penalty.)

Foundations, individuals, and taxable entities who file Form 4720 may be subject to failure to file, failure to pay, estimated tax, negligence, and civil fraud penalties. Any entity that has previously owed a Chapter 42 tax reported on Form 4720 may be subject to the 100% penalty. (IRC Section 6684, IRM 20.1.8.2.2, Failure to Act Due to Reasonable Cause for Private Foundations and Certain Other Tax-exempt Organizations.)

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.

The officers, directors, trustees, and employees of a foundation may be subject to the public inspection compliance penalty of IRC Section 6685 on the responsible party. (IRM 20.1.8.2.3, IRC Section 6685 - Failure to Comply with the Public Inspection Requirements for Certain Tax Exempt Organizations.)

When computing penalties on Chapter 42 tax liabilities that are based on a percentage of the tax, prepare two computations. The first computation uses the first-tier tax. The second computation uses the second-tier taxes.

Example: In an *initial* report of examination issued to a disqualified person for self-dealing transactions, the agent proposes $15,000 in tax on a $150,000 payment. The agent prepared a substitute for return package (IRM 4.75.22.7.1), 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 the maximum 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.

Example: The taxpayer disagrees with the initial report. In the *formal* report of examination, the agent proposes the second-tier tax in the Form 886-A, Explanation of Items. The agent then recomputes the failure to file and failure to pay penalties and issues the report on November 15, 2016. The failure to pay penalty is now $70,875 ($15,000 first-tier tax + $300,000 second-tier tax multiplied by 22.5%). The failure to pay penalty is $47,250 ($315,000 in taxes multiplied by 15%). The failure to pay penalty rate increased by an additional .5% as another month had passed without full payment. These penalties would be adjusted if the second-tier tax is abated.

For examples of penalty computations, see Exhibits 9, 10, and 12 through 14.

Domestic Taxable Private Foundations

Taxable private foundations are former tax-exempt private foundations whose exemptions were revoked. Unless terminated under IRC Section 507, they remain private foundations, and under TE/GE jurisdiction.

Taxable private foundations are required to file Form 990-PF in addition to either the Form 1120 or Form 1041.

Taxable foundations remain subject to Chapter 42 taxes.

A taxable foundation owes IRC 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. The foundation isn't subject to the Form 990-T filing requirement, but may attach the Form 990-T, Exempt Organization Business Income Tax Return, to the Form 990-PF to show the computations.

When computing the IRC Section 4940 tax:

a) Compute the 1 percent or 2 percent tax via Form 990-PF Part V.
b) Add the tax computed via Form 990-T.
c) Subtract the tax determined via Form 1120 or Form 1041.

Note: Taxable private foundations can't qualify as IRC Section 4940(d)(2) exempt operating foundations.

Taxable foundations are subject to the penalty of IRC Section 6710 for not making required disclosures under IRC Section 6113 of nondeductibility of contributions for the first five years after revocation. (IRM 20.1.8.2.4, IRC Section 6710 - Failure to Disclose that Contributions are Nondeductible.)

If you find acts/failures to act that give rise to Chapter 42 taxes, consider proposing involuntary termination.

Foreign Private Foundations

Foreign organizations are those **not** created in or under the laws of the U.S. or U.S. territories, which include:

- American Samoa
- Guam
- Northern Mariana Islands
- Puerto Rico
- U.S. Virgin Islands

The inception of a corporation or trust in a foreign country doesn't preclude exemption under IRC Section 501(c)(3). Generally (subject to applicable treaties), charitable contributions to these entities aren't deductible under IRC Section 170(c)(1), (2), (3), or (4).

The primary benefit of IRC Section 501(c)(3) exemption is to reduce the income tax liability on U.S. sourced investment income. Foreign private foundations are taxed at a 4 percent rate on their U.S. sourced gross investment income (instead of a statutory 30 percent rate for foreign entities). Some foundations are exempted from the tax due to tax treaties that change the tax treatment of the income. For IRC Section 4948, gross investment income is defined per IRC Section 4940(c)(2) and doesn't include capital gains and losses.

Note: Amounts reported as income on Form 990-T are excepted from the IRC Section 4948(a) tax computation.

When examining foreign foundations, verify that the foundation is foreign. Some entities initially incorporate in a foreign country and then file for domestic incorporation before filing an application for exemption. Consult Area Counsel if you encounter these types of entities.

Know the filing requirements for foreign foundations. They aren't required to:

a. Complete some parts of the Form 990-PF.
b. Submit a copy to a state official.
c. Comply with the public inspection requirements.

Note: Foreign foundations aren't required to file Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR). Foreign foundations aren't considered United States persons, as they aren't created or organized in the U.S. or under U.S. laws.

Foreign Tax Exempt Foundations

Tax exempt foreign private foundations are treated differently depending on the source of their income, per IRC Section 4948(b).

Type of income source	Subject to	Exempt from
Category 1) 85% or more foreign	Prohibited transactions (IRC 4948(c)), IRC 511 through IRC 514, IRC 4948(a)	Tax under IRC 4940 through IRC 4945, IRC 507, IRC 508
Category 2) More than 15% domestic	IRC 507, IRC 508, IRC 511 through IRC 514, IRC 4941 through IRC 4945, 4948(a)	IRC 4940
For the income test above, disregard gross investment income.		

For a discussion of prohibited transactions, see IRM 7.27.27.4.1, Meaning of Prohibited Transaction. Engaging in prohibited transactions will result in revocation.

Note: Except for willful and flagrant violations, chapter 42 transactions (excluding IRC Section 4942) constitute prohibited transactions only after the IRS issues notice to the foundation that subsequent transactions are deemed prohibited transactions. In effect, if you find a Chapter 42 transaction (other than IRC Section 4942), you generally can't propose revocation based on prohibited transactions unless the foundation has already been placed on notice. If you find an initial act/failure to act, place the foundation on notice. Contact Area Counsel for help to prepare and issue the notice.

Remember that foreign foundations can qualify as both IRC Section 4942(j)(3) private operating foundations and IRC Section 4940(d) exempt operating foundations. Classification as an exempt operating foundation is a moot issue for IRC Section 4940 as foreign foundations aren't subject to IRC Section 4940, though it may matter for IRC Section 4945(d)(4). Foreign foundations can apply for reclassification as a public charity by filing Form 8940. If they are claiming to be an operating foundation, they're required to complete Part X of the Form 990-PF.

Foundations in Category 1 aren't required to complete Parts X, XI, XIII, and XIV of the Form 990-PF. They are required to attach a computation of the 85 percent test to the Form 990-PF.

When examining these entities, verify that the foundation properly computed the IRC Section 4948 tax. Look at all of the sources of the income and determine the percentage of non-investment income from domestic sources. Identify the foundation category. Then look at the transactions to determine liability under Chapter 42.

Foreign Taxable Foundations

A taxable foreign private foundation is one that has been revoked. These foundations can reapply for exemption. See IRM 7.27.27.6, Reestablishment of Exempt Status.

Unless a termination tax is imposed, the foundation retains its assets upon revocation. Foundations in Category 1, aren't subject to the termination tax, but are subject to the 30 percent withholding rate of IRC Section 1441, IRC Section 1442, and IRC Section 1443 on U.S. sourced income.

Foundations in Category 2 may be subject to the termination tax. The entity that remains after an IRC Section 507(a)(2) termination is either a corporation or a trust. Regardless of the type of entity, the 30 percent tax rate applies, as the entity is considered a foreign person.

IRC Section 511 through IRC Section 514 no longer apply to a foreign taxable foundation. Regular corporate or trust tax rules apply instead.

Foreign taxable foundations file either Form 1040-NR, U.S. Nonresident Alien Income Tax Return, or Form 1120-F, U.S. Income Tax Return of a Foreign Corporation in addition to Form 990-PF.

Abatement of Excise Taxes

Under IRC 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

To qualify for abatement of second-tier tax, the taxable event must be corrected within the correction period. The taxpayer qualifies for abatement of first-tier tax if the taxable event:

- Was due to reasonable cause.
- Wasn't due to willful neglect.
- Was corrected within the correction period.

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 (IRC Section 4963, IRC Section 6212). That time is extended by:

- Any period in which a petition to the Tax Court for redetermination of the deficiency is pending. (IRC Section 6213(a)).
- Any other period we determine is reasonable and necessary to correct the taxable event.

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. 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.

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.

If correction is made after the correction period has expired, abatement isn't available under IRC Section 4962.

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

If the taxpayer requests abatement during your audit, verify correction first. If you determine that the facts don't warrant abatement, document the willful neglect and failure to establish reasonable cause. If the facts warrant abatement, don't propose the tax. Address the issue in an advisory closing letter. See IRM 4.75.15, Closing Letters and Audit Reports.

See the lists below for examples of abatement/non-abatement scenarios.

Possible abatement:

- The foundation incurred an IRC 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 in spite of prudent precautions.
- The foundation incurred an IRC 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.
- 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.

Likely non-abatement:

- The foundation's officers, directors, and representatives state they were ignorant of the provisions of the law.
- 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.
- The foundation, a related foundation, or a predecessor foundation had a previous Chapter 42 tax amount abated under IRC Section 4962 for the same type of taxable event.
- The taxable transaction wasn't identified as a potential violation of Chapter 42 by any party until an audit began.

See IRM 4.75.37.8, Requests for Abatement Under IRC Section 4962, for procedures to work abatement requests.

Pre-Examination Procedures

If a copy of the determination file isn't already in the file, follow the procedures in IRM 4.75.10.6.2, Request the Determination Administrative File. You may receive a copy on disk, via secure e-mail, or via Office Communicator (OCS). See IRM 4.75.10, Exempt Organizations Pre-Audit Procedures for determination file reviews. For private foundations, focus additional attention on:

- Who are the founders, initial substantial contributors, and foundation managers?
- What is the purpose of the foundation (actively operating, grant making, etc.)?
- Did the organization request advance approval of individual grant making under IRC 4945(g)?
- If grant making, what criteria were provided, and what constitutes the applicant pool?
- What assets were donated to form the corpus of the foundation?
- Who contributed the assets?

Make note of whether the articles of incorporation, association, or trust document contains the IRC Section 508 language. See IRM 7.26.1.2.2 or 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 Rev. Rul. 75-38, 1975-1 C.B. 161. If the language is present, note all who signed the document.

Note: If you encounter a Chapter 42 violation, be sure to incorporate this information into your 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 at the time the foundation was formed.

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.

Obtain copies of prior and subsequent Forms 990-PF and Forms 990-T via Online SEIN.

- Review the Forms 990-T to determine the sources of income reported.
- Using the Forms 990-T as a guide, add to your initial Information Document Request (IDR) any items on the Form 990-T that merit review.
- 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.
- Perform the standard risk analysis, identifying the large, unusual, and questionable items for inclusion on the IDR.

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.

Obtain IDRS transcripts for the foundation and the disqualified persons. Perform Accurint research on the disqualified persons. Review the completed research for possible compliance issues (such as missing returns, prior Chapter 42 liabilities, same disqualified person and foundation addresses, foundation vehicles registered under disqualified persons, payments to disqualified person businesses listed on the Form 990-PF.)

Review the Form 990-PF for the period(s) under audit in the following sequence:

Review Form 990-PF:	
Verify the statute of limitations	
1	Find the date stamped received.
2	Determine the date mailed, if possible.
3	Apply the rules of IRC Section 7502 (timely mailing treated as timely filing).
Analyze the first page, Letters A through J (in the top third of the page)	
1	Note the accounting method
2	Note whether this is an initial, amended, or final return.
3	Determine whether there has been a name or address change.

Review Form 990-PF:	
4	Check whether a foreign foundation and percentage of foreign support.
5	Check for unusual events: prospective exemption, 507(b)(1)(A) termination, 507(b)(1)(B) conversion.
6	Note the type of entity.
Review Parts VII-A and VII-B, Statements Regarding Activities	
1	Verify the presence of all required schedules. Note any missing documents.
2	Check for an FBAR, if indicated.
3	Determine the liability for Form 4720.
4	Note any private benefit disclosures.
Review Part VIII, Information About Officers, Directors, Trustees, Foundation Managers, Highly Paid Employees, and Contractors	
1	Match the amounts reported to the Forms W-2. (Use command code IRPTRR to retrieve the Forms W-2.)
2	Note the top paid individuals and contractors. Match to the list of founders, substantial contributors, and foundation managers reported in the determination application and in Part XV. (May be subject to IRC Section 4941.)
Review XVII, Information Regarding Transfers To and Transactions and Relationships With Noncharitable Exempt Organizations	
1	Identify any large, unusual, or questionable items.
2	Verify the non-charitable entities exemptions on IDRS.
3	Print the INOLES/BMFOLO information for each non-charitable entity.
4	Use Online SEIN to obtain copies of the Forms 990 or 990-EZ for each entity.
5	Check EO Select Check for electronic postcard information.
6	See if there are any related parties on the board of each entity.
Review Part XV, Supplementary Information	
1	Identify any large, unusual, or questionable items.
2	Compare any entries to information from the determination application.
Review Part IV, Capital Gains and Losses for Tax on Investment	
1	Verify the math. Note any errors.
2	Identify any large, unusual, or questionable items.
3	Note the type of asset(s) for future reference in the interview and IDR.
Review Part I, Analysis of Revenue and Expenses	

Review Form 990-PF:	
1	Verify the math. Note any errors.
2	Identify any large, unusual, or questionable items.
Review Part XVI-A, Analysis of Income-Producing Activities and Part XVI-B, Relationship of Activities to the Accomplishment of Exempt Purposes	
1	Verify the math. Note any errors.
2	Identify any large, unusual, or questionable items.
3	Compare to Part I. Note any differences.
4	Compare to any filed Forms 990-T. Note any differences.
Review Part II, Balance Sheets	
1	Verify the math. Note any errors.
2	Identify any large, unusual, or questionable items.
3	Check for any attached schedules. Note any missing schedules.
4	Compare any amounts on the attached schedules to Part II. Note any differences.
Review Part III, Analysis of Changes in Net Assets or Fund Balances	
1	Verify the math. Note any errors.
2	Note any increases or decreases not included in Part I, Line 27a. Determine whether such amounts should be included in Part I.
Review Part IX, Summary of Direct Charitable Activities, Summary of Program-Related Investments	
1	Identify any large, unusual, or questionable items.
2	Compare the expenses reported to the amounts listed in Part I.
3	If applicable, compare the investment amounts to the amounts listed in Part II.
Review Part X, Minimum Investment Return	
1	Verify the math. Note any errors.
2	Note the existence of any acquisition indebtedness for IRC Section 514 purposes.
Review Part XI, Distributable Amount	
1	Verify the math. Note any errors.
2	Note whether there was any income tax. Check the amount against Form 990-T (or Form 1120/Form 1041 if a taxable foundation.)
3	Note any recoveries of qualifying distributions for inclusion in the IDR.
Review Part XII, Qualifying Distributions	
1	Verify the math. Note any errors.

Review Form 990-PF:	
2	For set asides, note whether claiming prior IRS approval or look for an attached schedule. If prior approval, or schedule is missing, note for inclusion in the IDR.
Review Part XIII, Undistributed Income	
1	Verify the math. Note any errors.
2	Note any excess distributions. Compare the amounts reported to the prior years' Forms 990-PF.
3	For entries indicating election required, check for the attached statement. If none present, include in the IDR a request of the election.
Review Part V, Qualification Under Section 4940(e) for Reduced Tax on Net Investment Income	
1	Verify the math. Note any errors.
2	Compare the entries in Line 1 to the prior years' Forms 990-PF Parts X through XII. Note any differences.
Review Part VI, Excise Tax Based on Investment Income	
1	Verify the math. Note any errors.
2	Note the tax rate used. Verify whether the correct rate was used.
3	Note any additional taxes reported. Verify whether properly entered. (If tax-exempt, UBIT is not included. If taxable, UBIT and regular income tax are included.)
Review Part XIV, Private Operating Foundations	
1	Verify the math.
2	Note which operating foundation status was claimed. (IRC Section 4942(j)(3) vs. IRC Section 4942(j)(5)). If IRC Section 4942(j)(5), compare the charitable activities to the code and regulation requirements. See IRM 7.27.16.4.2 and the Instructions to the Form 990-PF.
3	Note the letter date. Request a copy via the initial IDR.

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

Review any information in the case file from Classification. Prepare to start an administrative record if there are indicators of potential exemption issues. See IRM 4.75.32, Declaratory Judgment Cases And The Administrative Record.

Modify your initial interview/questionnaire to incorporate any items identified during the review of the application and tax returns. Additional questions to ask:

- 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.)
- Please explain your understanding of the Chapter 42 provisions/prohibitions.

Incorporate the items you noted in analyzing the application and the tax returns. When you ask for financial information, you can ask for the supporting source documents for up to five years back, due to Part V and Part XIII. This means that for the qualifying distributions and minimum investment income, you can ask for the bank statements and cancelled checks for the five prior years. (For private operating foundations, Part XIV permits you to obtain records for the three prior years.)

Note: When asking for the records, make sure that you indicate the basis for your request, (for example, “Please provide the bank statements and cancelled checks for the years XXXX through YYYY to support the amounts reported on Parts V and XIII of the Form 990-PF.”)

Caution: If you identify any self-dealing transactions or taxable expenditures in prior years, ensure that the statute is still open before you pursue the issue. Request a Counsel memo on a six-year statute, if applicable.

Consider requesting these additional items in the IDR:

- A list of all business enterprises and percentage of ownership for the foundation and disqualified persons. See Part XV of the Form 990-PF.
- The list of all scholarship and grant recipients.
- Relationship information of the scholarship/grant recipients to the founder(s), substantial contributor(s), and foundation manager(s).
- Copies of the scholarship/grant criteria and any applications.
- Copies of any applications received for the year(s) under exam.
- Title documents to any foundation owned real property.
- Compensation contracts for the foundation manager(s).
- Notes and other loan documents involving disqualified persons.
- Review of the general ledger and bank statements for transactions with disqualified persons.
- Leases, partnership agreements, and all contracts between the foundation and disqualified persons.
- Credit card statements of the foundation as well as credit card statements of the disqualified persons, if applicable.
- Travel expenses incurred by the foundation on behalf of disqualified persons.

Field/Office Correspondence Exam Procedures

Review any revised organizing documents. Verify that any IRC Section 508 language is included, if not covered by state law. (IRM 7.26.1.2.2) Determine whether any changes have modified the exempt purpose or jeopardize the exemption.

Perform the foundation status test. Verify whether the entity continues to fail to qualify under IRC Section 509(a)(1) and IRC Section 509(a)(2).

Note: If the foundation satisfies the test for either Section 509(a)(1) or 509(a)(2), inform the organization of the possibility of an IRC Section 507(b)(1)(B) termination. To apply for an advance ruling the organization must file Form 8940 with EO Determinations. Examine the financial statements and financial records. At a minimum, do the following:

Financial statement and financial record analysis:	
1	Compute the average fair market value of the securities using the twelve-monthly ending values.
2	Do the same for the bank statements.
3	Compare the amounts to Form 990-PF Part X Line 1.
4	Identify the program related investments, if reported on Form 990-PF Part IX-B, and determine whether they qualify as such.
5	Determine if there is any overlap between program related investments and non-charitable use investments.
6	Identify any assets purchased in the year(s) under audit.
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 the set aside. See IRM 7.27.16.6.8, Set-Asides.
11	Identify any acquisition indebtedness.
12	Determine whether IRC 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 IRC Section 4941 as a loan with a disqualified person.
14	Determine whether any of the asset purchases trigger IRC 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 dis- qualified persons.
18	Review the cancelled checks and check registers. Request explanations for questionable expenditures.
19	Inspect any receipts provided for the questionable expenditures.
20	Identify all payments that are grants or scholarships to disqualified persons.
21	Determine whether the payments meet the exceptions to IRC Section 4941 and IRC 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.

Determine how assets were used. Verify the relationship of the asset to the exempt purposes of the foundation.

Using a blank Form 990-PF, revise the amounts reported according to your findings. Changes to the return impact the IRC Section 4940 tax, and may trigger the IRC Section 4942 tax. If you have reviewed the financial records from prior years, revise the prior year Forms 990-PF as needed. Use the modified information from the prior years to revise Parts V and XIII of the exam year Form 990-PF.

If you determine that amounts reported in Part I Column d are not charitable expenditures, remove the amounts in your revised Form 990-PF. Remove self-dealing transactions and taxable expenditures from Part I Column d if previously reported as such. This in turn modifies Part XII, directly impacting the computations in Part XIII.

Determine whether the foundation has:

a) Engaged in any self-dealing transactions.
b) Failed to make qualifying distributions.
c) Held or acquired excess business holdings.
d) Made jeopardizing investments.
e) Made taxable expenditures.

If there are any acts/failures to act giving rise to Chapter 42 taxes, ensure that the statute of limitations is protected. Request extensions from the foundation and from each disqualified person party to an act/failure to act. Open AIMS controls on BMF for the foundation and any business entities and on NMF for any individuals.

For any Chapter 42 taxes, prepare a report of examination for each liable party. Ensure that there are no disclosure violations. See IRM 4.75.15 for the report letter and attachments. All excise tax reports include Forms 4621, 4883, 886-A, and 870-E.

If an act requires correction, verify that correction is made before you close an agreed case. See IRM 4.75.15 for the initial report, formal report, protest to Appeals, and rebuttal procedures.

See IRM 4.75.15.8.6, Private Foundation Excise Taxes, for additional information on the necessary letters and forms to complete. However, before issuing a 30-day letter to a foundation manager where you propose the second-tier tax, you must first issue a Thorne letter. For help in drafting a Thorne letter, contact Area Counsel. (See Exhibit 16 for sample language used in a Thorne letter for an IRC Section 4945 scenario.)

For egregious cases, consider involuntary termination and revocation. Discuss these possibilities with your group manager and Area Counsel before pursuing these actions. See IRM 4.75.32, Declaratory Judgment Cases and the Administrative Record, for information on preparing an administrative record.

Exam Case Closing Procedures

Resolve the following types of related cases:

- Employment tax cases such as worker reclassification, fringe benefit treatment, and unreported amounts.
- Income tax cases (Forms 990-T for tax-exempt foundations, Forms 1120 or 1041 for taxable foundations).
- Excise tax cases (gaming and/or Chapter 42 taxes).

Discuss with your group manager whether to close the related cases separately from the Form 990PF.

Close Form 990-PF as a no change/no change with advisory if there is no modification to the IRC Section 4940 tax, foundation status, or exempt status. See IRM 4.75.16 for case file assembly and other common closing procedures.

For agreed cases involving employment, income, or gaming excise taxes:

- Issue report of examination.
- Secure the agreement.
- Collect payment or complete a request for an installment agreement. See IRM 4.75.16.
- Prepare the appropriate closing letter. See IRM 4.75.15.
- Close the case to your manager, who in turn closes it to the EO Closing Unit.

For agreed cases involving Chapter 42 taxes:

- Request correction.
- Obtain verification of correction.
- Correction made: Issue report of examination.
- Correction not made: Treat as unagreed.
- Secure the agreement on Form 870-E.
- Collect payment and/or complete the installment agreement request.
- Prepare the appropriate closing letter.
- Close the case to your manager, who in turn closes it to the EO Closing Unit.

Note: If you plan to impose excise taxes on the foundation manager(s), issue a Thorne letter, before you issue the 30-day letter. See Exhibit 16 for sample language used in a Thorne letter. Consult with Area Counsel for pre-issuance review of the Thorne letter.

For cases requiring correction, follow the procedures below:

- If correction is acceptable, issue the acceptance letter. See Letter 5305.
- If correction is inadequate or unacceptable, issue the rejection letter. See Letter 5306.
- If uncorrected, determine whether additional time is needed for correction.
- Grant an extension of time with managerial approval for the correction to be made.
- 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.

For agreed cases involving revocation or foundation status modification:

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

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

- Issue a Thorne letter before issuing the 30-day letter if proposing excise taxes on the foundation manager(s). (See Exhibit 16 for sample language used in a Thorne letter for a theoretical IRC Section 4945 scenario.)

- 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.
- Issue a formal report of examination with the appropriate waiver/agreement form(s).
- Ensure that there are 425 days remaining on the statute of limitations when closed from the group.

Note: Effective September 2, 2014, all cases received in Appeals require 365 days remaining on the assessment statute of limitations.

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

Note: If applicable, consider offering a Fast Track Settlement before you issue the formal report of examination. Both agent and manager must approve a request to enter into fast track negotiations. See IRM 4.75.15 for Fast Track Settlement procedures.

A valid protest contains the following elements:

- The taxpayer's name, address, Employer Identification Number (EIN) and a daytime phone number.
- A statement that they (the taxpayer) want to protest the proposed determination.
- A copy of the 30-day letter showing the findings that they disagree with (or the date and IRS office symbols from the letter).
- An explanation of their reasons for disagreeing, including any supporting documents.
- The law or authority, if any, on which they are relying.

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." 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. (Pub 892, How to Appeal an IRS Decision on Tax Exempt Status.)

For cases subject to IRC Section 7428 declaratory judgment procedures, prepare an administrative record. See IRM 4.75.32.

Exhibit 1 – IRC Section 4940 Example

During your audit of Private Foundation Alpha, you review Part I of the Form 990-PF for the year under audit and the prior years. You obtain the books and records for the four previous years.

Note: The amounts reported on Part V of the return under audit come from the prior years' Forms 990-PF. Because prior year amounts are reported on the return for the year under audit, you may request books and records from those years in order to verify the reported amounts.

On Form 990-PF, the taxpayer paid an IRC 4940 tax of $13,192, claiming to be entitled to the IRC Section 4940(e) 1 percent tax rate. (The net investment income reported on Part I Line 27(b) was $1,319,200.)

Private Foundation Alpha reported the following amounts for 201112 on Form 990-PF Part V:

Base period years	Adjusted qualifying distributions	Net value of non-charitable use assets	Distribution ratio
2010	207,577	22,902,232	0.009063614
2009	1,708,660	30,524,083	0.055977439
2008	1,586,932	20,563,743	0.077171359
2007	1,854,083	20,386,458	0.090946794
2006	840,244	39,168,308	0.021452139
The sum of the distribution ratios			0.254611346
Average distribution ratio for the 5-year base period			0.050922269
The net value of non-charitable use assets for 2011			24,303,581
The average distribution ratio multiplied by the assets net value			1,237,593
1% of net investment income			13,192
The sum of the two above amounts			1,250,786
Qualifying distributions from Part XII			1,261,332

In reviewing the records, you find that in lieu of taking the average of 12 end of month balances for each year as required by IRC Section 4940(e)(5) and IRC Section 4942(e)(1), the foundation used the January and December ending values divided by two to arrive at the net value of non-charitable use assets each year. You compile the following table of ending balances (cash and securities combined).

Month	2011	2010	2009	2008	2007	2006
Jan.	31,467,378	22,909,633	7,790,548	24,772,425	22,498,813	2,600,472
Feb.	36,106,867	38,109,497	7,812,389	28,594,378	21,152,025	20,145,814
Mar.	47,136,598	26,182,305	10,788,337	28,817,860	16,681,252	2,370,000
Apr.	32,926,971	29,863,039	19,031,437	21,156,140	20,279,695	25,270,619
May	31,875,373	27,058,917	33,118,231	39,092,678	39,887,291	26,965,403
Jun.	31,583,880	38,884,273	39,294,219	36,296,967	30,376,780	27,435,181
Jul.	30,528,076	36,832,683	53,680,220	10,716,462	29,931,354	29,136,744
Aug.	21,076,814	36,796,071	29,049,515	14,748,143	27,100,917	44,368,653

Sep.	19,892,556	42,501,813	57,976,763	15,576,231	19,211,371	50,075,854
Oct.	16,916,854	44,633,691	48,008,689	14,969,542	31,419,935	61,041,198
Nov.	16,298,983	19,057,261	33,245,104	14,814,622	23,810,364	74,151,584
Dec.	17,139,784	22,894,831	53,257,618	16,355,061	18,274,103	75,736,144
12 month avg.	27,745,845	32,143,668	32,754,423	22,159,209	25,051,992	36,608,139

Using the 12 month averages, you redo Part V. The schedule now reads:

Base period years	Adjusted qualifying distributions	Net value of non-charitable use assets	Distribution ratio
2010	207,577	32,143,668	0.006457788
2009	1,708,660	32,754,423	0.052165779
2008	1,586,932	22,159,209	0.071615011
2007	1,854,083	25,051,992	0.074009405
2006	840,244	36,608,139	0.022952382
The sum of the distribution ratios			0.227200367
Average distribution ratio for the 5-year base period			0.045440073
The net value of non-charitable use assets for 2011			27,745,845
The average distribution ratio multiplied by the 2011 assets value			1,260,773
1% of net investment income			13,192
The sum of the two above amounts			1,273,965
Qualifying distributions from Part XII			1,261,332

For PF Alpha to qualify for the 1% IRC Section 4940 rate, the last line in the table has to be greater than the second to last line. As the foundation failed the computational test, you prepare Forms 4883 and 4621 to assess the additional $13,192 in tax.

Exempt Organizations Excise Tax Audit Changes

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

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

		Taxable Years Ended		
		12/31/2011		
Internal Revenue Code Section for Proposed Adjustment		4940(a)		
1. Adjustments				
2.	Total adjustments	0		
3.	Amount reported on return or as previously adjusted	1,319,200.00		
4.	Total amount as corrected	1,319,200.00		
5.	Applicable tax rate %	2%		
6.	Initial tax liability as corrected (line 4 x line 5)	26,384.00		
7.	Initial tax liability reported	13,192.00		
8.	Increase (or decrease) in tax	13,192.00		
9.	Additional tax (minimum)			
10.	Penalties (Code section_____)			

Explanation of Adjustments

See attached Explanation of Items

Form 4883 (Rev. 1-2004)	Catalog Number 42083F	Department of the Treasury **Internal Revenue Service**

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

1. Form No. 990-PF	2. Area Office [Insert name of your area]	3. Date of Report [Insert date]

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Private Foundation Alpha [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	
[Insert EIN]	12/31/2011				

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No
12. Findings Discussed with (Name and Title)	**13. Agreement Date**
[Insert name of a foundation manager or representative]	[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)
4940(a)	12/31/2011	13,192			

15 Remarks

See attached Explanation of Items

16 Attachments

Form 4621 Rev (1-2004)	Catalog Number 41830Q	Department of the Treasury **Internal Revenue Service** www.irs.gov

Exhibit 2 - IRC Section 4941 – First-Tier Tax Example - PF Payment to DP (No Services Rendered)

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 IRC 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 (Letter 1076) 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.

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 an audit of the Form 990-PF for 201006, you notify PF Bravo that the transaction constitutes a self-dealing transaction. Based on DP Charlie's work history, you recommend assessment of the foundation manager excise tax under IRC Section 4941(a)(2). For the report of examination, you propose the taxes on DP 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. (Treas. Reg. 53.4941(e)-1(b)(1)), or $25,000. The amount of correction is also $25,000 plus any income derived from the use of the $25,000.

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.

Exempt Organizations Excise Tax Audit Changes

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

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

Name of Exempt Organization *(if different from taxpayer)*

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 10/10/2009	25,000.00	25,000.00	25,000.00
2.	Total adjustments	25,000.00	25,000.00	25,000.00
3.	Amount reported on return or as previously adjusted	0	0	0
4.	Total amount as corrected	25,000.00	25,000.00	25,000.00
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x line 5)	2,500.00	2,500.00	2,500.00
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	2,500.00	2,500.00	2,500.00
9.	Additional tax (minimum)			
10.	Penalties (Code section_____)			

Explanation of Adjustments

See attached Explanation of Items

Form 4883 (Rev. 1-2004)	Catalog Number 42083F	Department of the Treasury **Internal Revenue Service**

Exempt Organizations Excise Tax Audit Changes

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

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

Name of Exempt Organization *(if different from taxpayer)*

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 10/10/2009	25,000.00	25,000.00	25,000.00
2.	Total adjustments	25,000.00	25,000.00	25,000.00
3.	Amount reported on return or as previously adjusted	0	0	0
4.	Total amount as corrected	25,000.00	25,000.00	25,000.00
5.	Applicable tax rate %	5%	5%	5%
6.	Initial tax liability as corrected (line 4 x line 5)	1,250.00	1,250.00	1,250.00
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	1,250.00	1,250.00	1,250.00
9.	Additional tax (minimum)			
10.	Penalties (Code section_____)			

Explanation of Adjustments

See attached Explanation of Items

Form 4883 (Rev. 1-2004)	Catalog Number 42083F	Department of the Treasury **Internal Revenue Service**

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

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

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Disqualified Person Charlie [Insert street address] [Insert city, state, and zip code]	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	
[Insert SSN]	12/31/2009	12/31/2010	[Insert EIN]	6/30/2010	
	12/31/2011				

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

12. Findings Discussed with (Name and Title)	13. Agreement Date
[Insert name of taxpayer or representative]	[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	2,500.00			
4941(a)(2)	12/31/2009	1,250.00			
4941(a)(1)	12/31/2010	2,500.00			
4941(a)(2)	12/31/2010	1,250.00			
4941(a)(1)	12/31/2011	2,500.00			
4941(a)(2)	12/31/2011	1,250.00			

15. Remarks

See attached Explanation of Items

16. Attachments

Form 4621 Rev (1-2004)	Catalog Number 41830Q	Department of the Treasury **Internal Revenue Service** www.irs.gov

Exhibit 3 – IRC Section 4941 – First-Tier Tax Example - DP Sale of Property to PF

Disqualified Person Victor creates Foundation Foxtrot on August 15, 2007. DP Victor initially deposits $50,000 into PF Foxtrot to fund the foundation, and obtain a favorable determination letter. DP Victor files the application for exemption on November 10, 2009, and receives a Letter 1076, 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.

DP Victor's basis in the apartment complex consists of the $135,000 spent to purchase the land, and $1,473,000 spent to build the complex in 2005. As of the date of donation, DP Victor has a $365,000 construction loan outstanding on the property. The property tax valuation for the property for 2010 is $1,825,000.

DP Victor spent $3,486,000 to purchase the retail mall in July 2003. 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 $3,254,800.

DP Victor's office tower cost $65,375,000 to build (including the cost of the land.) DP Victor obtained a construction loan for $58,500,000 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 non-recourse with the properties as collateral, and DP Victor obtained them within 10 years of transferring the properties to PF Foxtrot. PF Foxtrot assumed the mortgages.

The following table briefly summarizes the values of the properties:

Building	Basis	Tax Valuation
Apartment complex	135,000 + 1,473,000 1,608,000	1,825,000
Retail mall	3,486,000	3,254,800
Office tower	65,375,000	84,325,000

In accepting the three donated properties, PF Foxtrot has entered into three self-dealing transactions. (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. (Treas. Reg. 53.4941(e)-1(b)(1)) In this case, the amounts involved are $1,825,000, $3,486,000, and $84,325,000. To achieve correction, the donation must be rescinded, and the foundation must be reimbursed for any amounts expended on the loans or properties in excess of the income received from the properties. (Treas. Reg. 53.4941(e)-1(c)(1)).

During the audit of the 201012 Form 990-PF, you inform DP Victor that the donations constitute self-dealing transactions. You issue the initial report 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	Employer ID No.	Schedule or Exhibit
Disqualified Person Victor	[Insert SSN]	1

Name of Exempt Organization *(if different from taxpayer*

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	1,825,000.00	1,825,000.00	1,825,000.00
	Mortgaged property donation (8/30/2010) - retail mall	3,486,000.00	3,486,000.00	3,486,000.00
	Mortgaged property donation (8/30/2010) - office tower	84,325,000.00	84,325,000.00	84,325,000.00
2.	Total adjustments	89,636,000.00	89,636,000.00	89,636,000.00
3.	Amount reported on return or as previously adjusted	0	0	0
4.	Total amount as corrected	89,636,000.00	89,636,000.00	89,636,000.00
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x line 5)	8,963,600.00	8,963,600.00	8,963,600.00
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	8,963,600.00	8,963,600.00	8,963,600.00
9.	Additional tax (minimum)			
10.	Penalties (Code section_____)			

Explanation of Adjustments

See attached Explanation of Items

Form 4883 (Rev. 1-2004) Catalog Number 42083F Department of the Treasury **Internal Revenue Service** www.irs.gov

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

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

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Disqualified Person Victor [Insert street address] [Insert city, state, and zip code]	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	
[Insert SSN]	12/31/2010	12/31/2011	[Insert EIN]	12/31/2010	
	12/31/2012				

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

12. Findings Discussed with (Name and Title)	13. Agreement Date
[Insert name of taxpayer or representative]	[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	8,963,600.00			
4941(a)(1)	12/31/2011	8,963,600.00			
4941(a)(1)	12/31/2012	8,963,600.00			

15. Remarks

See attached Explanation of Items

16. Attachments

Form 4621 Rev (1-2004)	Catalog Number 41830Q	Department of the Treasury **Internal Revenue Service** www.irs.gov

Exhibit 4 - IRC Section 4941 – First-Tier Tax Example - DP Use of PF Property

On January 1, 2011, Disqualified Person Victor (the same individual in Exhibit 3) 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.

You expand of the audit to the 201112 Form 990-PF, and inform 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.

The leasing of property from the foundation constitutes a continuing self-dealing transaction. (Treas. Reg. 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) for the entire length of the lease, without considering unexercised extensions or renewals, over the amount paid (and that would have been paid if the lease ran for the full term). (Treas. Reg. 53.4941(e)-1(c)(4). The correction amount is computed below.

Calendar Year	FMV Amount	Lease Payments	Difference
2011	$1.85 x 3500 x 12 = $77,700.00	$350.00 x 12 = $4,200.00	$73,500.00
2012	$1.85 x 3500 x 12 = $77,700.00	$400.00 x 12= $4,800.00	$72,900.00
2013	$1.85 x 3500 x 12 = $77,700.00	$450.00 x 12 = $5,400.00	$72,300.00
2014	$1.85 x 3500 x 12 = $77,700.00	$500.00 x 12 = $6,000.00	$71,700.00
2015	$1.85 x 3500 x 12 = $77,700.00	$550.00 x 12 = $6,600.00	$71,100.00
Total Correction Amount			$361,500.00

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. (Treas. Reg. 53.4941(e)-1(b)(2)(ii)) For 2011, the amount involved is $76,650.00, ($1.825/sq. ft./month x 3500 sq. ft. x 12 months). For 2012, the amount involved is $77,700.00 ($1.85/sq. ft./month x 3500 sq. ft. x 12 months). For 2013, the amount involved is $32,375 ($1.85/ sq. ft./month x 3500 sq. ft. x 5 months).

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 SSN]	Schedule or Exhibit 1

Name of Exempt Organization *(if different from taxpayer)*

Private Foundation Foxtrot

		Taxable Years Ended		
		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	76,650.00	76,650.00	76,650.00
	Lease of office space 1/1/2012		77,700.00	77,700.00
	Lease of office space 1/1/2013			32,375.00
2.	Total adjustments	76,650.00	154,350.00	186,725.00
3.	Amount reported on return or as previously adjusted	0	0	0
4.	Total amount as corrected	76,650.00	154,350.00	186,725.00
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x line 5)	7,665.00	15,435.00	18,672.50
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	7,665.00	15,435.00	18,672.50
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.	2. Area Office	3. Date of Report
4720-A	[Insert name of your area]	[Insert date]

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Disqualified Person Victor [Insert street address] [Insert city, state, and zip code]	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	
[Insert SSN]	12/31/2011	12/31/2012	[Insert EIN]	12/31/2011	
	12/31/2013				

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

12. Findings Discussed with (Name and Title)	13. Agreement Date
[Insert name of taxpayer or representative]	[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)	12/31/2011	7,665.00			
4941(a)(1)	12/31/2012	15,435.00			
4941(a)(1)	12/31/2013	18,672.50			

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621 Rev (1-2004) | Catalog Number 41830Q | Department of the Treasury **Internal Revenue Service** www.irs.gov

Exhibit 5 – IRC Section 4941: First-Tier Tax Example - PF Loan of Money to DP

On July 1, 2010, Private Foundation Golf lends Partnership Hotel $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 makes the first payment on August 1, 2010. PF Golf and Hotel have fiscal tax years endings September 30th.

Hotel has three partners, 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 IRC Section 4946(a)(1)(B), India is also a disqualified person under IRC Section 4946(a)(1)(D). The loan constitutes a self-dealing transaction. As this transaction constitutes a continuing transaction, you must separately compute the amount involved for each new act deemed to occur on the first day of each succeeding tax year of the Partnership Hotel as well as a separate correction amount. The two amounts are not necessarily identical.

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 under the highest fiduciary standards. For correction, the Partnership Hotel must pay increased interest if the interest actually paid is below market, and return the principal to the foundation. If hotel paid interest equal to or greater than fair market value (FMV) of interest for the deemed loans, no additional interest would have to be paid for correction.

Freddie Mac provides historical information on the national average mortgages rates for 1 year adjustable rate mortgages, 5/1 hybrid adjustable rate mortgages, 15-year fixed rate mortgages, and 30-year fixed rate mortgages. For July 2010, the 15-year rate was 4.04 percent. For October 2010, the 15-year rate was 3.68 percent. For October 2011, the 15-year rate was 3.35 percent, and for October 2012, the 15-year rate was 2.69 percent. The amount of correction is the principal and additional interest owed. The table below computes the interest owed on correction as of the date of your examination on December 10, 2012:

Date	Principal Amount	Annual Interest Rate	Number of Payments	FMV Interest	Interest Payments Received	Interest Amounts Owed
7/1/2010	150,000	x .0404	x 2/12	= 1,010.00	- 500.00	= 510.00
10/1/2010	148,500	x .0368	x 12/12	= 5,464.80	- 3,000.00	= 2,464.80
10/1/2011	139,500	x .0335	x 12/12	= 4,673.25	- 3,000.00	= 1,673.25
10/1/2012	130,500	x .0269	x 4/12	= 1,170.15	- 1,000.00	= 170.15
				Total additional interest owed:		$4,818.20

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 $154,818.20 ($150,000 + $4,818.20) is immediately made on December 10, 2012. Because DP Hotel made correction, no second-tier taxes will be proposed on the report of examination. The report of examination is dated December 15, 2012.

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. (Treas. Reg. 53.4941(e)-1(b)(2)(ii)) (See IRM 4.72.11-5, Computation of the Amount Involved and the IRC 4975(a) Excise Tax for a Continuous Prohibited Transaction with Repayments for more information. (IRC Section 4975 mirrors IRC Section 4941.))

Date of Act	Principal Amount	Annual Interest Rate	Number of Payments	FMV Interest	Interest Payments Received	Amount Involved
7/1/2010	150,000	x .0404	x 2/12	= 1,010.00	500.00	1,010.00
10/1/2010	148,500	x .0368	x 12/12	= 5,464.80	3,000.00	5,464.80
10/1/2011	139,500	x .0335	x 12/12	= 4,673.25	3,000.00	4,673.25
10/1/2012	130,500	x .0269	x 4/12	= 1,170.15	1,000.00	1,170.15

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, Partnership Hotel could file the Form 4720 early and pay the tax in 2013.

Reminder: The amount involved is often less if there is proof of a loan transaction under IRC Section 4941(d)(1)(B) versus a mere transfer of assets under IRC Section 4941(d)(1)(A), such as a straightforward payment to a disqualified person. For loans, 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. For straightforward payments, 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.

Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer Partnership Hotel	Employer ID No. [Insert SSN]	Schedule or Exhibit 1

Name of Exempt Organization *(if different from taxpayer)*

Private Foundation Golf

		Taxable Years Ended		
		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 Golf to Hotel on 7/1/2010	1,010.00	1,010.00	1,010.00
	Continuing loan on 10/1/2010		5,464.80	5,464.80
	Continuing loan on 10/1/2011			4,673.25
2.	Total adjustments	1,010.00	6,474.80	11,148.05
3.	Amount reported on return or as previously adjusted	0	0	0
4.	Total amount as corrected	1,010.00	6,474.80	11,148.05
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x line 5)	101.00	647.48	1,114.81
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	101.00	647.48	1,114.81
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**

Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer	Employer ID No.	Schedule or Exhibit
Partnership Hotel	[Insert SSN]	1

Name of Exempt Organization *(if different from taxpayer)*

Private Foundation Golf

		Taxable Years Ended		
		9/30/2013		
Internal Revenue Code Section for Proposed Adjustment		4941(a)(1)		
1. Adjustments	Loan from Golf to Hotel on 7/1/2010	1,010.00		
	Continuing loan on 10/1/2010	5,464.80		
	Continuing loan on 10/1/2011	4,673.25		
	Continuing loan on 10/1/2012	1,170.15		
2.	Total adjustments	12,318.20		
3.	Amount reported on return or as previously adjusted	0		
4.	Total amount as corrected	12,318.20		
5.	Applicable tax rate %	10%		
6.	Initial tax liability as corrected (line 4 x line 5)	1,231.82		
7.	Initial tax liability reported	0		
8.	Increase (or decrease) in tax	1,231.82		
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**

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

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

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Partnership Hotel [Insert street address] [Insert city, state, and zip code]	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	[Insert EIN]	9/30/2010	9/30/2011
	9/30/2012	9/30/2013		9/30/2012	9/30/2013

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

12. Findings Discussed with (Name and Title)	13. Agreement Date
[Insert name of taxpayer or representative]	[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	101.00			
4941(a)(1)	9/30/2011	647.48			
4941(a)(1)	9/30/2012	1,114.81			
4941(a)(1)	9/30/2013	1,231.82			

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621 Rev (1-2004)	Catalog Number 41830Q	Department of the Treasury **Internal Revenue Service** www.irs.gov

Exhibit 6 – IRC Section 4941: Second-Tier Tax Example

Assume the same facts as in Exhibit 3 and Exhibit 4, except that the disqualified person didn't make correction before you issue your report of examination and that you make your report on Dec. 1, 2012. See table below for additional property values for 2011 and 2012.

To determine the amount involved for the second-tier tax, use the highest fair market value of the property during the taxable period. See IRC Section 4941(e)(2)(B). Note that the second-tier tax is assessed 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	1,825,000.00	
	04/01/2011	1,834,226.00	
	04/01/2012	1,891,430.00	3,782,860.00
Retail mall	08/30/2010	3,486,000.00	6,972,000.00
	04/01/2011	3,204,269.00	
	04/01/2012	3,388,821.00	
Office tower	08/30/2010	84,325,000.00	
	04/01/2011	88,432,648.00	176,865,296.00
	04/01/2012	87,773,023.00	
Building lease 1/1/2011 act	01/01/2011	766,500.00	
	01/01/2012	777,000.00	1,554,000.00
Building lease 1/1/2012 act	01/01/2012	777,000.00	1,554,000.00
Total second-tier taxes			190,728,156.00
* The county in which the buildings are located issues the property tax bill annually on April 1st of each year.			

Report the second-tier tax on the final tax year of the taxable period. The following Form 4883 illustrates how the second-tier tax is proposed after combining the examples in Exhibits 3 and 4.

Exempt Organizations Excise Tax Audit Changes

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

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

Name of Exempt Organization *(if different from taxpayer)*

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)
	Mortgaged property donation (8/30/2010) - apartment	1,825,000.00	1,825,000.00	1,825,000.00
	Mortgaged property donation (8/30/2010) - retail mall	3,486,000.00	3,486,000.00	3,486,000.00
	Mortgaged property donation (8/30/2010) - office tower	84,325,000.00	84,325,000.00	84,325,000.00
	Lease of office space 1/1/2011		766,500.00	766,500.00
	Lease of office space 1/1/2012			777,000.00
2.	Total adjustments	89,636,000.00	90,402,500.00	91,179,500.00
3.	Amount reported on return or as previously adjusted	0	0	0
4.	Total amount as corrected	89,636,000.00	90,402,500.00	91,179,500.00
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x line 5)	8,963,600.00	9,040,250.00	9,117,950.00
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	8,963,600.00	9,040,250.00	9,117,050.00
9.	Additional tax (minimum) at 200% (4941(b)(1))			190,728,156.00
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.	2. Area Office	3. Date of Report
4720-A	[Insert name of your area]	[Insert date]

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

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No
12. Findings Discussed with (Name and Title)	**13. Agreement Date**
[Insert name of taxpayer or representative]	[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	8,963,600.00			
4941(a)(1)	12/31/2011	9,040,250.00			
4941(a)(1)	12/31/2012	9,117,050.00	190,728,156.00		

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621 Rev (1-2004)	Catalog Number 41830Q	Department of the Treasury **Internal Revenue Service** www.irs.gov

Exhibit 7 – IRC Section 4942: First-Tier Tax Example

Private Foundation Lima is under audit for three years: 200912, 201012, 201112. You are conducting the audit in March of 2013. PF Lima reports on Form 990-PF Part XIII the following information:

Description	Amount reported
2009 Distributable amount	85,071
2010 Distributable amount	77,553
2011 Distributable amount	72,260
2009 Qualifying distributions	320,000
2010 Qualifying distributions	270,000
2011 Qualifying distributions	70,000
2004 Excess distributions	0
2005 Excess distributions	0
2006 Excess distributions	0
2007 Excess distributions	10,469
2008 Excess distributions	0
2009 Excess distributions	234,929
2010 Excess distributions	192,467

You determine that for 2009, PF Lima made only $4,525 in qualifying distributions, for 2010 only $2,425 in qualifying distributions, and for 201112 only $3,750 in qualifying distributions. No qualifying distributions were made in 2012. You find no issues with Parts X or XI of the Form 990-PF. The following tables shows how to redo Part XIII. (When completing Part XIII, use the PDF version of the Form 990-PF to see the fields to complete. Much of the page is grayed out, limiting the possible entries.)

2009 Form 990-PF Part XIII			
Line #	Title (abbreviated/paraphrased)	Amount as Reported	Amount as Corrected
1	Distributable amount for 2009	85,071	85,071
2a	2008 undistributed income	0	0
2b	Prior years undistributed income	0	0
3a	Excess distributions carryover from 2004	0	0
3b	Excess distributions carryover from 2005	0	0
3c	Excess distributions carryover from 2006	0	0
3d	Excess distributions carryover from 2007	10,469	10,469
3e	Excess distributions carryover from 2008	0	0
3f	Total excess distributions carryover to 2009	10,469	10,469
4	2009 qualifying distributions	320,000	4,525
4a	Applied to 2008	0	0

4b	Applied to prior years	0	0
4c	Treated as distributions out of corpus (election)	0	0
4d	Applied to 2009 distributable amount	85,071	4,525

2009 Form 990-PF Part XIII

Line #	Title (abbreviated/paraphrased)	Amount as Reported	Amount as Corrected
4e	Remaining amount out of corpus	234,929	0
5	Excess distributions carryover applied to 2009	0	10,469
6a	Corpus	245,398	0
6b	Prior years undistributed income	0	0
6c	Stat notice/previously taxed undistributed income	0	0
6d	Taxable amount	0	0
6e	Undistributed income for 2008 (taxable)	0	0
6f	Undistributed income for 2009 (must be distributed in 2010)	0	70,077
7	170(b)(1)(E)/4942(g)(3) corpus distributions	0	0
8	2004 excess distributions carryover not applied	0	0
9	Excess distributions carryover to 2010	245,398	0
10a	Excess distributions from 2005	0	0
10b	Excess distributions from 2006	0	0
10c	Excess distributions from 2007	10,469	0
10d	Excess distributions from 2008	0	0
10e	Excess distributions from 2009	234,929	0

2010 Form 990-PF Part XIII

Line #	Title (abbreviated/paraphrased)	Amount as Reported	Amount as Corrected
1	Distributable amount for 2010	77,553	77,553
2a	2009 undistributed income	0	70,077
2b	Prior years undistributed income	0	0
3a	Excess distributions carryover from 2005	0	0
3b	Excess distributions carryover from 2006	0	0
3c	Excess distributions carryover from 2007	10,469	0
3d	Excess distributions carryover from 2008	0	0
3e	Excess distributions carryover from 2009	234,929	0
3f	Total excess distributions carryover to 2010	245,398	0
4	2010 qualifying distributions	270,000	2,425

4a	Applied to 2009	0	2,425
4b	Applied to prior years	0	0
4c	Treated as distributions out of corpus (election)	0	0
4d	Applied to 2010 distributable amount	77,553	0
4e	Remaining amount out of corpus	192,447	0
5	Excess distributions carryover applied to 2010	0	0
6a	Corpus	437,845	0
6b	Prior years undistributed income	0	0
6c	Stat notice/previously taxed undistributed income	0	0
6d	Taxable amount	0	0
6e	Undistributed income for 2009 (taxable)	0	67,652
6f	Undistributed income for 2010 (must be distributed in 2011)	0	77,553
7	170(b)(1)(E)/4942(g)(3) corpus distributions	0	0
8	2004 excess distributions carryover not applied	0	0
9	Excess distributions carryover to 2011	437,845	0
10a	Excess distributions from 2006	0	0
10b	Excess distributions from 2007	10,469	0
10c	Excess distributions from 2008	0	0
10d	Excess distributions from 2009	234,929	0
10e	Excess distributions from 2010	192,447	0

2011 Form 990-PF Part XIII

Line #	Title (abbreviated/paraphrased)	Amount as Reported	Amount as Corrected
1	Distributable amount for 2011	72,260	72,260
2a	2010 undistributed income	0	77,553
2b	Prior years undistributed income	0	67,652
3a	Excess distributions carryover from 2006	0	0
3b	Excess distributions carryover from 2007	10,469	0
3c	Excess distributions carryover from 2008	0	0
3d	Excess distributions carryover from 2009	234,929	0
3e	Excess distributions carryover from 2010	192,447	0
3f	Total excess distributions carryover to 2011	437,845	0
4	2011 qualifying distributions	70,000	3,750
4a	Applied to 2010	0	3,750
4b	Applied to prior years	0	0

4c	Treated as distributions out of corpus (election)	0	0
4d	Applied to 2009 distributable amount	70,000	0
4e	Remaining amount out of corpus	0	0
5	Excess distributions carryover applied to 2011	2,260	0
6a	Corpus	435,585	0
6b	Prior years undistributed income	0	67,652
6c	Stat notice/previously taxed undistributed income	0	0
6d	Taxable amount	0	67,652
6e	Undistributed income for 2010 (taxable)	0	73,803
6f	Undistributed income for 2011 (must be distributed in 2012)	0	72,260
7	170(b)(1)(E)/4942(g)(3) corpus distributions	0	0
8	2006 excess distributions carryover not applied	0	0
9	Excess distributions carryover to 2012	435,585	0
10a	Excess distributions from 2007	8,209	0
10b	Excess distributions from 2008	0	0
10c	Excess distributions from 2009	234,929	0
10d	Excess distributions from 2010	192,447	0
10e	Excess distributions from 2011	0	0

Before preparing your report, PF Lima makes full correction by making qualifying distributions of $213,715 ($67,652 + $73,803 + $72,260) to an independent public charity described under IRC Section 170(b)(1)(A)(vi). You determine that abatement under IRC Section 4962 doesn't apply in this case. You'd issue the following initial report when you solicit correction, or as part of your formal report after they make full correction.

Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer Private Foundation Lima		Employer ID No. [Insert EIN]		Schedule or Exhibit 1
Name of Exempt Organization (if different from taxpayer)		Taxable Years Ended		
		12/31/2009	12/31/2010	12/31/2011
Internal Revenue Code Section for Proposed Adjustment		4942(a)	4942(a)	4942(a)
1. Adjustments	Failure to distribute 2009 income (taxable as of 1/1/2011)	67,652.00	67,652.00	67,652.00
	Failure to distribute 2010 income (taxable as of 1/1/2012)		73,803.00	73,803.00
	Failure to distribute 2011 income (taxable as of 1/1/2013)			72,260.00
2.	Total adjustments	67,652.00	141,455.00	213,715.00
3.	Amount reported on return or as previously adjusted	0	0	0
4.	Total amount as corrected	67,652.00	141,455.00	213,715.00
5.	Applicable tax rate %	30%	30%	30%
6.	Initial tax liability as corrected (line 4 x line 5)	20,295.60	42,436.50	64,114.50
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	20,295.60	42,436.50	64,114.50
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**

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

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

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Private Foundation Lima [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				

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

12. Findings Discussed with (Name and Title)	13. Agreement Date
[Insert name of a foundation manager or representative]	[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)
4942(a)	12/31/2009	20,295.60			
4942(a)	12/31/2010	42,436.50			
4942(a)	12/31/2011	64,114.50			

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621 Rev (1-2004)	Catalog Number 41830Q	Department of the Treasury **Internal Revenue Service** www.irs.gov

Exhibit 8 – IRC Section 4942: Second-Tier Tax Example

Using the example in Exhibit 7, assume no correction was made. See the following Form 4883 for how to propose the second-tier tax. Note that under IRC Section 4942(b), the second-tier tax is on the remaining undistributed amount at the end of the taxable period. This tax is assessed once for the undistributed amount. Report the second-tier tax on the last year for which there is a tax assessment.

Without correction, you'd issue the following formal report of examination that includes the second-tier tax with a 30-day letter (Letter 3614).

Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer Private Foundation Lima	Employer ID No. [Insert EIN]	Schedule or Exhibit 1

Name of Exempt Organization (if different from taxpayer)

Private Foundation Lima

		Taxable Years Ended		
		12/31/2009	12/31/2010	12/31/2011
Internal Revenue Code Section for Proposed Adjustment		4942(a)	4942(a)	4942(a)
1. Adjustments	Failure to distribute 2009	67,652.00	67,652.00	67,652.00
	Failure to distribute 2010		73,803.00	73,803.00
	Failure to distribute 2011			72,260.00
2.	Total adjustments	67,652.00	141,455.00	213,715.00
3.	Amount reported on return or as previously adjusted	0	0	0
4.	Total amount as corrected	67,652.00	141,455.00	213,715.00
5.	Applicable tax rate %	30%	30%	30%
6.	Initial tax liability as corrected (line 4 x line 5)	20,295.60	42,436.50	64,114.50
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	20,295.60	42,436.50	64,114.50
9.	Additional tax (minimum) at 100% (4942(b))			213,715.00
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**

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

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

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Private Foundation Lima [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	
[Insert EIN]	12/31/2011				

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No
12. Findings Discussed with (Name and Title)	13. Agreement Date
[Insert name of a foundation manager or representative]	[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)
4942(a)	12/31/2009	20,295.60			
4942(a)	12/31/2010	42,436.50			
4942(a)	12/31/2011	64,114.50	213,715.00		

15. Remarks

See attached Explanation of Items

16. Attachments

Form 4621
Rev (1-2004)

Catalog Number
41830Q

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

Exhibit 9 – IRC Section 4943: First-Tier Tax Example

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

You are examining the 200912 Form 990-PF for the foundation. The highest value of the stock for the year is listed as $3,000, per the foundation's records. You obtain an LB&I engineer via a SRS referral to perform a valuation. The engineer appraises the stock's highest value for 2009 at $2,895,000, using the information reported on the Form 1120 and other valuation sources. After conferring with the Fraud Technical Specialist and presenting the information in a conference with CI, you're informed that CI will pass on the case.

You expand the audit to the 201012 and 201112 tax years. In 2010, Oscar gifts DP Delta with 2% of the stock, and in 2011, Oscar further gifts DP Delta with another 2% of the stock. In 2012 Oscar breaks the engagement. The Form 990-PF lists the value of its stock at $5,000 for 2010, and $4,000 for 2011. The engineer subsequently determines the highest value for the stock in 2010 to be $4,256,000, and in 2011 to be $3,748,000. Based on the fact pattern, you decide to assert the civil fraud penalty under IRC Section 6663 (75%).

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

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

You determine that abatement under IRC Section 4962 doesn't apply in this case. You issue your report Dec. 1, 2012. Note that IRC Section 4943(a) taxes are not imposed until the end of each year in the taxable period, unlike excise taxes under IRC Sections 4941(a), 4942(a), and 4944(a). You would issue the following initial report when you solicit correction, or as part of your formal report after full correction.

Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer		Employer ID No.		Schedule or Exhibit
Private Foundation Kilo		[Insert EIN]		1
Name of Exempt Organization *(if different from taxpayer*		Taxable Years Ended		
		12/31/2009	12/31/2010	12/31/2011
Internal Revenue Code Section for Proposed Adjustment		4943(a)	4943(a)	4943(a)
1. Adjustments	Excess business holdings in PHC	144,750.00	297,920.00	337,320.00
2.	Total adjustments	144,750.00	297,920.00	337,320.00
3.	Amount reported on return or as previously adjusted	0	0	0
4.	Total amount as corrected	144,750.00	297,920.00	337,320.00
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x line 5)	14,475.00	29,792.00	33,732.00
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	14,475.00	29,792.00	33,732.00
9.	Additional tax (minimum)	0	0	0
10.	Penalties (Code section 6663)	10,856.25	22,344.00	25,299.00

Explanation of Adjustments

See attached Explanation of Items

Form 4883 (Rev. 1-2004)	Catalog Number 42083F	Department of the Treasury **Internal Revenue Service**

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	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Private Foundation Kilo [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	
[Insert EIN]	12/31/2009	12/31/2010			
	12/31/2011				

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

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

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

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621 Rev (1-2004)	Catalog Number 41830Q	Department of the Treasury **Internal Revenue Service** www.irs.gov

Exhibit 10 – IRC Section 4943: Second-Tier Tax Example

Use the example in Exhibit 9. See the following Form 4883 for how to propose the second-tier tax. Note that under IRC Section 4943(b), the second-tier tax is on the amount of the excess business holdings at the end of the taxable period. This tax is assessed once for the amount of uncorrected excess business holdings. Report the second-tier tax on the last year for which there is a tax assessment.

Note that the civil penalty under IRC Section 6663 is on the entire amount of tax. The penalty substantially increases when accounting for the second-tier tax.

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

IRC Section 4943(b) civil penalty computation						
Tax year	Excess value	Tax rate	Tax	Penalty arising from 2nd tier tax	Penalty arising from 1st tier tax	Total penalty
201112	337,320.00	200%	674,640.00	505,980.00	25,299.00	531,279.00

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

Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer Private Foundation Kilo		Employer ID No. [Insert SSN]		Schedule or Exhibit 1
Name of Exempt Organization *(if different from taxpayer)*		**Taxable Years Ended**		
		12/31/2009	12/31/2010	12/31/2011
Internal Revenue Code Section for Proposed Adjustment		4943(a)	4943(a)	4943(a)
1. Adjustments	Excess business holdings in PUC	144,750.00	297,920.00	337,320.00
2.	Total adjustments	144,750.00	297,920.00	337,320.00
3.	Amount reported on return or as previously adjusted	0	0	0
4.	Total amount as corrected	144,750.00	297,920.00	337,320.00
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x line 5)	14,475.00	29,792.00	33,732.00
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	14,475.00	29,792.00	33,732.00
9.	Additional tax (minimum) at 200% (4943(b))			674,640.00
10.	Penalties (Code section 6663)	10,856.25	22,344.00	531,279.00

Explanation of Adjustments

See attached Explanation of Items

Form 4883 (Rev. 1-2004)	Catalog Number 42083F	Department of the Treasury **Internal Revenue Service**

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

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

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Private Foundation Kilo [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	
[Insert EIN]	12/31/2009	12/31/2010			
	12/31/2011				

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

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

14a. Summary of Proposed Adjustments				14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)	Internal Revenue Code Section (1)	Amount (2)
4943(a)	12/31/2009	14,475.00		6663	10,856.25
4943(a)	12/31/2010	29,792.00		6663	22,344.00
4943(a)	12/31/2011	33,732.00	674,640.00	6663	531,279.00

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621 Rev (1-2004)	Catalog Number 41830Q	Department of the Treasury **Internal Revenue Service** www.irs.gov

Exhibit 11 – IRC Section 4944: First-Tier Tax Example

On July 1, 2010, Foundation Manager Papa makes an investment in an international hedge fund, using funds from Private Foundation Quebec. The foundation has a portfolio valued at $25,575,000, which consists of cash, common stocks of companies on the Dow Jones Industrial Index, mutual fund investments, and Build America Bonds issued by a very large metropolitan city. At the time of the investment, the foundation had $15,000 in cash. FM Papa is the newest foundation manager for PF Quebec, having been on the job six months. FM Papa previously worked at a larger private foundation for two years.

FM Papa acquires a loan from a bank using the bonds as collateral. The loan is for $16,500,000, which FM Papa invests in the hedge fund. The expected return from the hedge fund is 10% per year, which should generate sufficient revenue to repay the loan, which has an APR of 4%.

FM Papa made the investment on advice obtained from a friend, who received their advice from another friend, who in turn received it from a local celebrity. The celebrity is more known for appearing and succeeding on a national syndicated reality competition show than for financial acumen. FM Papa has performed a few discrete searches on the web, finding a website for the fund, and a few mentions in the foreign press. FM Papa printed the web pages for PF Quebec's records.

The hedge fund's business address is located in the Philippines, and the fund manager operates out of Hong Kong. The hedge fund manager is not affiliated with any domestic or international brokerage or investment firms. There is little information available about the fund manager.

Upon inspection, you determine that after receipt of an initial series of four $5,000 dividend payments no further funds were received. The foundation manager kept the investment on the Form 990-PF for 2010, but was unable to contact the hedge manager to inquire about the investment. The foundation has taken no actions with respect to the investment.

You determine that PF Quebec is subject to IRC Section 4944, and develop the case for asserting the foundation manager tax on FM Papa. FM Papa is a calendar year taxpayer. See the table below for the tax computations.

Tax Year	Investment	Tax Rate	Tax	FM Tax Rate	FM Tax
201009	16,500,000.00	10%	1,650,000.00	10%	10,000.00
201109	16,500,000.00	10%	1,650,000.00	10%	0.00
201209	16,500,000.00	10%	1,650,000.00	10%	0.00
Reminder: The tax for any one investment caps at $10,000 for 4944(a)(2).					

You determine that abatement under IRC Section 4962 does not apply in this case. You issue your reports May 1, 2012. You would issue the following initial reports when you solicit correction, or as part of your formal reports after there is full correction.

Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer		Employer ID No.		Schedule or Exhibit
Private Foundation Quebec		[Insert EIN]		1
Name of Exempt Organization *(if different from taxpayer)*		Taxable Years Ended		
		9/30/2010	9/30/2011	9/30/2012
Internal Revenue Code Section for Proposed Adjustment		4944(a)(1)	4944(a)(1)	4944(a)(1)
1. Adjustments	Jeopardizing investment - Hedge Fund	16,500,000.00	16,500,000.00	16,500,000.00
2.	Total adjustments	16,500,000.00	16,500,000.00	16,500,000.00
3.	Amount reported on return or as previously adjusted	0	0	0
4.	Total amount as corrected	16,500,000.00	16,500,000.00	16,500,000.00
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x line 5)	1,650,000.00	1,650,000.00	1,650,000.00
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	1,650,000.00	1,650,000.00	1,650,000.00
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

Explanation of Adjustments

See attached Explanation of Items

Form 4883 (Rev. 1-2004) Catalog Number 42083F Department of the Treasury **Internal Revenue Service** www.irs.gov

Exempt Organizations Excise Tax Audit Changes

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

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

		Taxable Years Ended		
		12/31/2010		
Internal Revenue Code Section for Proposed Adjustment		4944(a)(2)		
1. Adjustments	Jeopardizing investment - Hedge Fund	16,500,000.00		
2.	Total adjustments	16,500,000.00		
3.	Amount reported on return or as previously adjusted	0		
4.	Total amount as corrected	16,500,000.00		
5.	Applicable tax rate %	10%		
6.	Initial tax liability as corrected (line 4 x line 5) *	10,000.00		
7.	Initial tax liability reported	0		
8.	Increase (or decrease) in tax	10,000.00		
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

Explanation of Adjustments
See attached Explanation of Items

See attached Explanation of Items
*Subject to $10,000 limit on tax

Form 4883 (Rev. 1-2004)	Catalog Number 42083F	Department of the Treasury **Internal Revenue Service**

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

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

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

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

14a. Summary of Proposed Adjustments				14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)	Internal Revenue Code Section (1)	Amount (2)
4944(a)(1)	9/30/2010	1,650,000.00			
4944(a)(1)	9/30/2011	1,650,000.00			
4944(a)(1)	9/30/2012	1,650,000.00			

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621 Rev (1-2004)	Catalog Number 41830Q	Department of the Treasury **Internal Revenue Service** www.irs.gov

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

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

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

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

10. Report Preparer's Name [Insert your name]	11. Agreement Secured (Check one.) Yes No
12. Findings Discussed with (Name and Title) [Insert name of a foundation manager or representative]	13. Agreement Date [Leave blank]

14a. Summary of Proposed Adjustments				14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)	Internal Revenue Code Section (1)	Amount (2)
4944(a)(2)	12/31/2010	10,000.00			

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621
Rev (1-2004)

Catalog Number
41830Q

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

Exhibit 12 – IRC Section 4944: Second-Tier Tax Example

Taking the example in Exhibit 11 a step further, you determine that PF Quebec and FM Papa are subject to the failure to file and failure to pay penalties under IRC Section 6651(a). You establish Substitute for Returns for the Form 4720 on IDRS. The failure to file penalty, normally 5% per month for up to five months, is limited to 4.5% per month when the failure to pay penalty is also imposed, at the 0.5% rate for each month or part of a month the tax isn't paid.

You issue a Thorne letter to FM Papa requesting correction. (See Exhibit 16 for sample language used in a Thorne letter for a theoretical IRC Section 4945 scenario.) You don't receive a response to the certified letter.

You issue your report of examination via a 30-day letter on September 1, 2012. Your report explains the failure to file and pay penalties and why they apply. The return due dates for the years ending 201009 and 201109 were February 15, 2011 and February 15, 2012. (The due date for the 201209 return is February 15, 2013, thus no failure to file or failure to pay penalties apply to the proposed assessment for the 201209 return.) The penalties for the foundation are computed as follows:

Tax Year	Tax Amount	Penalty Rate	Months Late	Penalty
201009	1,650,000.00	4.5%	5	371,250.00
201009	1,650,000.00	0.5%	34	280,500.00
Total Penalty				651,750.00
201109	4,125,000.00	4.5%	5	928,125.00
201109	4,125,000.00	0.5%	22	453,750.00
Total Penalty				1,381,875.00

Note that under IRC Section 4944(b), the second-tier tax is on the amount of the investment, provided that the investment is not corrected by the end of the taxable period. This tax is assessed once per uncorrected jeopardizing investment. Report the second-tier tax on the last year for which there is a tax assessment. The second-tier tax on management is 20% of the investment, not to exceed $20,000.

You subsequently learn from a call from SB/SE Collection that FM Papa is being sought for an IRC Section 4941 tax assessment from 200412. Using the W-2 information from PF Quebec, SB/SE found the -L freeze on PF Quebec's Form 990-PF, and pulled an AMDISA print to find your group. Because FM Papa was previously liable for a chapter 42 tax, you propose the IRC Section 6684 penalty on him after conferring with Area Counsel. The penalties for FM Papa are:

Tax Year	Tax Amount	Penalty Rate	Months Late	Penalty
201012	10,000.00	4.5%	5	2,250.00
201012	20,000.00	4.5%	5	4,500.00
201012	10,000.00	0.5%	34	1,700.00
201012	20,000.00	0.5%	34	3,400.00
201012 (IRC 6684)	10,000.00	100%	N/A	10,000.00
201012 (IRC 6684)	20,000.00	100%	N/A	20,000.00
Total Penalty				41,850.00

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

Exempt Organizations Excise Tax Audit Changes

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

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

		Taxable Years Ended		
		9/30/2010	9/30/2011	9/30/2012
Internal Revenue Code Section for Proposed Adjustment		4944(a)	4944(a)	4944(a)
1. Adjustments	Jeopardizing investment	16,500,000.00	16,500,000.00	16,500,000.00
2.	Total adjustments	16,500,000.00	16,500,000.00	16,500,000.00
3.	Amount reported on return or as previously adjusted	0	0	0
4.	Total amount as corrected	16,500,000.00	16,500,000.00	16,500,000.00
5.	Applicable tax rate %	10%	10%	10%
6.	Initial tax liability as corrected (line 4 x line 5)	1,650,000.00	1,650,000.00	1,650,000.00
7.	Initial tax liability reported	0	0	0
8.	Increase (or decrease) in tax	1,650,000.00	1,650,000.00	1,650,000.00
9.	Additional tax (minimum) at 25% (4944(b)(1))			4,125,000.00
10.	Penalties (Code section 6651(a))	651,750.00	1,381,875.00	

Explanation of Adjustments
See attached Explanation of Items

Form 4883 (Rev. 1-2004)	Catalog Number 42083F	Department of the Treasury **Internal Revenue Service**

Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer	Employer ID No.	Schedule or Exhibit
Foundation Manager Papa	[Insert SSN]	1

Name of Exempt Organization *(if different from taxpayer)*
Private Foundation Quebec

		Taxable Years Ended		
		12/31/2010		
Internal Revenue Code Section for Proposed Adjustment		4944(a)(2)		
1. Adjustments	Jeopardizing investment	16,500,000.00		
2.	Total adjustments	16,500,000.00		
3.	Amount reported on return or as previously adjusted	0		
4.	Total amount as corrected	16,500,000.00		
5.	Applicable tax rate %	10%		
6.	Initial tax liability as corrected (line 4 x line 5) *	10,000.00		
7.	Initial tax liability reported	0		
8.	Increase (or decrease) in tax	10,000.00		
9.	Additional tax (minimum) at 5% (4944(b)(2))	20,000.00		
10.	Penalties (Code section 6651(a), 6684)	41,850.00		

Explanation of Adjustments
See attached Explanation of Items
*Subject to $10,000 limit on tax on 4944(b)(1), $20,000 limit on tax under 4944(b)(2).

Form 4883 (Rev. 1-2004)	Catalog Number 42083F	Department of the Treasury **Internal Revenue Service**

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

6. Social Security Number or Employer Identification Number	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	
[Insert EIN]	9/30/2010	9/30/2011			
	9/30/2012				

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

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

14a. Summary of Proposed Adjustments				14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)	Internal Revenue Code Section (1)	Amount (2)
4944(a)(1)	9/30/2010	1,650,000.00		6651(a)(1)	371,250.00
	9/30/2010			6651(a)(2)	928,125.00
4944(a)(1)	9/30/2011	1,650,000.00		6651(a)(1)	280,500.00
	9/30/2011			6651(a)(2)	453,750.00
4944(a)(1)	9/30/2012	1,650,000.00	4,125,000.00		

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621 Rev (1-2004)	Catalog Number 41830Q	Department of the Treasury **Internal Revenue Service**

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

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

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Foundation Manager Papa [Insert street address] [Insert city, state, and zip code]	Private Foundation Quebec [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	
[Insert SSN]	12/31/2010		[Insert EIN]	9/30/2010	

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

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

14a. Summary of Proposed Adjustments				14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)	Internal Revenue Code Section (1)	Amount (2)
4944(a)(2)	12/31/2010	10,000.00	20,000.00	6651(a)(1)	6,750.00
	12/31/2010			6651(a)(2)	5,100.00
	12/31/2010			6684	30,000.00

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621
Rev (1-2004)

Catalog Number
41830Q

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Exhibit 13 – IRC Section 4945: First-Tier Tax Example

Be aware that some transactions may trigger multiple excise taxes. It's common for a tax to be both a self-dealing transaction and a taxable expenditure.

Use the example in Exhibit 2. The expenditure doesn't meet any exception listed in IRC Section 4945 (IRM 7.27.19.7.2, Permitted Expenditures). The transaction is a taxable expenditure. The table below shows how the tax is computed for the foundation and the foundation manager.

Description	Amount
10/10/2009 Transaction	25,000.00
Foundation Tax at 20%	5,000.00
Foundation Manager Tax at 5% (Cap at $10K)	1,250.00

Expanding upon the example, assume that Private Foundation Bravo subsequently files a late Form 4720. The Form 4720 is filed 10 days after you issued your initial audit appointment letter on July 2, 2012. The foundation reports only $5,000 as a taxable expenditure. Upon further inquiry, you find that the $20,000 not reported was placed into an IRC Section 529 tuition plan. The foundation didn't report any taxes on the foundation manager. Your resulting adjustment is computed below.

Description	Amount
10/10/2009 Transaction	25,000.00
Amount reported	5,000.00
Adjusted transaction amount	20,000.00
Foundation Tax at 20%	4,000.00
Foundation Manager Tax at 5% (Cap at $10K)	1,250.00

Due to PF Bravo's filing of the late Form 4720, you are unable to propose failure to file or failure to pay penalties. (IRM 4.8.9.16.2.2, Failure to Pay Penalty). For Foundation Manager (FM) Charlie, you establish the substitute for return on IDRS and propose the failure to file and failure to pay penalties. You issue your report on December 3, 2012. See below for penalty computations:

Taxpayer	Tax	Penalty Rate	Months Late	Penalty
FM Charlie	1,250.00	4.5%	5	281.25
FM Charlie	1,250.00	0.5%	25	156.25

You determine that abatement under IRC Section 4962 does not apply in this case. You'd issue the following initial reports when you solicit correction, or as part of your formal reports after there is full correction.

Exempt Organizations Excise Tax Audit Changes

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

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

		Taxable Years Ended		
		6/30/2010		
Internal Revenue Code Section for Proposed Adjustment		4945(a)(1)		
1. Adjustments	Taxable expenditure (birthday gift)	20,000.00		
2.	Total adjustments	20,000.00		
3.	Amount reported on return or as previously adjusted	5,000.00		
4.	Total amount as corrected	25,000.00		
5.	Applicable tax rate %	20%		
6.	Initial tax liability as corrected (line 4 x line 5)*	5,000.00		
7.	Initial tax liability reported	1,000.00		
8.	Increase (or decrease) in tax	4,000.00		
9.	Additional tax (minimum)			
10.	Penalties (Code section)			

Explanation of Adjustments
See attached Explanation of Items

Form 4883 (Rev. 1-2004)	Catalog Number 42083F	Department of the Treasury **Internal Revenue Service**

Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer Foundation Manager Charlie	Employer ID No. [Insert SSN]	Schedule or Exhibit 1

Name of Exempt Organization *(if different from taxpayer)*
Private Foundation Bravo

		Taxable Years Ended		
		12/31/2009		
Internal Revenue Code Section for Proposed Adjustment		4945(a)(2)		
1. Adjustments	Taxable expenditure (birthday gift)	25,000.00		
2.	Total adjustments	25,000.00		
3.	Amount reported on return or as previously adjusted	0		
4.	Total amount as corrected	25,000.00		
5.	Applicable tax rate %	5%		
6.	Initial tax liability as corrected (line 4 x line 5)*	1,250.00		
7.	Initial tax liability reported	0		
8.	Increase (or decrease) in tax	1,250.00		
9.	Additional tax (minimum)			
10.	Penalties (Code section 6651(a))	437.50		

Explanation of Adjustments
See attached Explanation of Items
* Tax on foundation managers is capped at $10,000.

Form 4883 (Rev. 1-2004)	Catalog Number 42083F	Department of the Treasury **Internal Revenue Service**

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

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

4. Name and Address of Taxpayer	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	
[Insert EIN]	6/30/2010				

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

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

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)
4945(a)(1)	6/30/2010	4,000.00			

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621
Rev (1-2004)

Catalog Number
41830Q

Department of the Treasury
Internal Revenue Service
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Exempt Organizations - Report of Examination

(Proposed Tax Changes)

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

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Foundation Manager Charlie	Private Foundation Bravo
[Insert street address] [Insert city, state, and zip code]	[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	
[Insert SSN]	12/31/2009		[Insert EIN]	6/30/2010	

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

12. Findings Discussed with (Name and Title)	13. Agreement Date
[Insert name of taxpayer or representative]	[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)
4945(a)(2)	12/31/2009	1,250.00		6651(a)(1)	281.25
	12/31/2009			6651(a)(2)	156.25

15. Remarks
See attached Explanation of Items

16. Attachments

Exhibit 14 – IRC Section 4945: Second-Tier Tax Example

Continuing with the example in Exhibit 13, you issue a Thorne letter to Foundation Manager Charlie, who refuses to make correction. (See Exhibit 16 for a sample language used in a Thorne letter for a theoretical IRC Section 4945 scenario.) DP Charlie disputes that he is liable under IRC Section 4945(a)(2), and plans to file a formal protest to Appeals upon receipt of your report, issued on January 2, 2013.

In Exhibit 2, Charlie was found to be a CPA who worked for a decade for a large public charity. After consulting Area Counsel, you determine that Charlie is further liable for both the IRC Sections 6684 and 6663 penalties for a willful and flagrant violation and for fraud on the Form 4720. The computations for Charlie's liability are shown below:

IRC Code	2nd Tier Tax	Penalty Rate	Months Late	Penalty
6651(a)(1)	12,500.00	4.5%	5	2,812.50
6651(a)(2)	12,500.00	0.5%	26	1,625.00
6663	12,500.00	75%	N/A	9,375.00
6684	12,500.00	100%	N/A	12,500.00

As the transaction is not corrected, Private Foundation Bravo is subject to the second-tier tax on the entire amount of the transaction. Without correction, you would issue the following formal reports of examination that includes the second-tier tax with a 30-day letter (Letter 3614):

Exempt Organizations Excise Tax Audit Changes

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

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

		Taxable Years Ended		
		6/30/2010	6/30/2010	
Internal Revenue Code Section for Proposed Adjustment		4945(a)(1)	4945(b)(1)	
1. Adjustments	Taxable expenditure (birthday gift)	20,000.00	25,000.00	
2.	Total adjustments	20,000.00		
3.	Amount reported on return or as previously adjusted	5,000.00		
4.	Total amount as corrected	25,000.00		
5.	Applicable tax rate %	20%		
6.	Initial tax liability as corrected (line 4 x line 5)*	5,000.00		
7.	Initial tax liability reported	1,000.00		
8.	Increase (or decrease) in tax	4,000.00		
9.	Additional tax (minimum) at 100% (4945(b)(1))		25,000.00	
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**

Exempt Organizations Excise Tax Audit Changes

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

Name of Taxpayer: Foundation Manager Charlie	[Insert SSN]	Schedule or Exhibit 1
Name of Exempt Organization *(if different from taxpayer)* Private Foundation Bravo		

		Taxable Years Ended		
		12/31/2009		
Internal Revenue Code Section for Proposed Adjustment		4945(a)(2)		
1. Adjustments	Taxable expenditure (birthday gift)	25,000.00		
2.	Total adjustments	25,000.00		
3.	Amount reported on return or as previously adjusted	0		
4.	Total amount as corrected	25,000.00		
5.	Applicable tax rate %	5%		
6.	Initial tax liability as corrected (line 4 x line 5)*	1,250.00		
7.	Initial tax liability reported	0		
8.	Increase (or decrease) in tax	1,250.00		
9.	Additional tax (minimum) at 50% (4945(b)(2))	12,500.00		
10.	Penalties (Code sections 6651(a), 6663, 6684)	26,312.50		

Explanation of Adjustments
See attached Explanation of Items
* The tax is capped at $10,000 for 4945(a)(2) and $20,000 for 4945(b)(2).

Form 4883 (Rev. 1-2004)	Catalog Number 42083F	Department of the Treasury **Internal Revenue Service**

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

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

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

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

10. Report Preparer's Name [Insert your name]	11. Agreement Secured (Check one.) Yes No
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)
4945(a)(1)	6/30/2010	4,000.00	25,000.00		

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621 Rev (1-2004)	Catalog Number 41830Q	Department of the Treasury **Internal Revenue Service** www.irs.gov

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

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

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Foundation Manager Charlie [Insert street address] [Insert city, state, and zip code]	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	
[Insert SSN]	12/31/2009		[Insert EIN]	6/30/2010	

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

12. Findings Discussed with (Name and Title)	13. Agreement Date
[Insert name of taxpayer or representative]	[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)
4945(a)(2)	12/31/2009	1,250.00	12,500.00	6651(a)(1)	2,812.50
	12/31/2009			6651(a)(2)	1,625.00
	12/31/2009			6663	9,375.00
	12/31/2009			6684	12,500.00

15. Remarks
See attached Explanation of Items

16. Attachments

Form 4621 Rev (1-2004) — Catalog Number 41830Q — Department of the Treasury **Internal Revenue Service**

Exhibit 15 – IRC Section 507 Termination Tax Example

Because of a Form 5666 filed during a previous audit, you are inspecting the records of Private Foundation Echo. The trustees, Sierra, Tango, and Uniform, were previously assessed IRC Section 4941 taxes for transactions in 200512, 200612, and 200712.

According to the Form 5666, on the day after inception in 2005, PF Echo loaned 75% of its cash to Victor, a corporation wholly owned by Sierra, Tango, and Uniform. There had been no loan instrument on file. The corporation later corrected the transaction, paying the money back on 12/1/2008, with additional interest computed at prime rate. The previous agent pro-rated the tax assessments on the trustees based on their shares of ownership. The agent also assessed IRC Section 4945 taxes on the foundation for taxable expenditures not serving an IRC Section 170(c)(2)(B) purpose.

During your audit of 201012 through 201112, you find that PF Echo has since paid 80% of its cash to the trustees reported as notes receivable on Forms 990-PF. Each trustee took turns signing the notes receivable, as shown below:

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

All the notes have 30 year terms, with payment in full upon maturity. The notes fail to specify any amount of interest or any interim payments.

After consulting with Area Counsel, you propose revocation and involuntary termination. Using Online SEIN, you retrieve the Forms 990-PF from 2005 onward. You also pull the IMFOLR prints for each trustee's Forms 1040 from 2005 to the present. The following tables show the amounts donated by each trustee (Form 990-PF Schedule B), adjusted gross income, contribution amount deducted, and individual income marginal tax bracket for each year from 2005 through 2011. None of the trustees made any contributions in 2011.

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

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

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

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

The tables below show the calculation of the gift taxes on DP Sierra, DP Tango, and DP Uniform, that would've been assessed if PF Echo were a taxable entity. The tables assume that each DP had a $1 million "applicable exclusion amount" available to apply to lifetime gifts in 2005, and made no other taxable gifts between 2005 and 2010. The tables list the year, donation, exclusion, the gift tax on the net taxable amount, and interest.

DP Sierra - Gift Tax Benefit				
Year	Donation	Exclusion Amount Used	Gift Tax	Interest
2005	360,000	360,000	0	0
2006	270,000	270,000	0	0
2007	290,000	290,000	0	0
2008	160,000	80,000	18,200	2,443

DP Sierra - Gift Tax Benefit				
Year	Donation	Exclusion Amount Used	Gift Tax	Interest
2009	75,000	0	16,900	1,517
2010	190,000	0	51,600	2,560
Total		$ 1,000,000	$ 86,700	$ 6,520

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

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

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

PF Echo - Income Tax Benefit			
Tax Year	Taxable Income	Tax (at Trust Tax Rates)	Interest
2005	11,600	3,167	1,259
2006	107,000	36,529	10,699
2007	218,000	75,343	14,862
2008	283,000	98,069	13,164

2009	269,000	93,137	8,360
2010	363,000	126,036	6,254
Total		$ 432,281	$ 54,598

There are no estate taxes to compute, and no amounts were received from other foundations in IRC Section 507(b)(2) transfers. The net assets per PF Echo's financial records on 11/30/2008 (closest available date using bank records and brokerage statements) were $2,932,270. The net assets as of 9/30/2012 were $4,640,806. Interest on the tax liabilities, using RGSNT, computed to 9/30/2012 is shown below:

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

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

Exempt Organizations Excise Tax Audit Changes

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

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

		Taxable Years Ended		
		12/31/2012		
Internal Revenue Code Section for Proposed Adjustment		507(c)		
1. Adjustments				
2.	Total adjustments	0		
3.	Amount reported on return or as previously adjusted	0		
4.	Total amount as corrected	0		
5.	Applicable tax rate %	0		
6.	Initial tax liability as corrected (line 4 x line 5)*	$2,741,622.00		
7.	Initial tax liability reported	0		
8.	Increase (or decrease) in tax	$2,741,622.00		
9.	Additional tax (minimum)			
10.	Penalties (Code sections)			

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

Form 4883 (Rev. 1-2004)	Catalog Number 42083F	Department of the Treasury **Internal Revenue Service**

Exempt Organizations - Report of Examination

(Proposed Tax Changes)

1. Form No. 990-PF	2. Area Office [Insert name of your area]	3. Date of Report [Insert date]

4. Name and Address of Taxpayer	5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4)
Private Foundation Romeo [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	
[Insert EIN]	12/31/2012				

10. Report Preparer's Name	11. Agreement Secured (Check one.)
[Insert your name]	Yes No

12. Findings Discussed with (Name and Title)	13. Agreement Date
[Insert name of a foundation manager or representative]	[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)
507(c)	12/31/2012	$2,741,622.00			

15. Remarks
See attached Explanation of Items

16. Attachments

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Exhibit 16 – Thorne Letter

This exhibit contains sample language for a theoretical situation involving IRC Section 4945. Consult Counsel when you need to draft a Thorne letter. Counsel approves the issuance of all Thorne letters, and helps to individually design each letter specific to the fact pattern presented.

I am nearing the conclusion of the audit of the [Insert name of foundation]'s Form 990-PF for [Insert calendar/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 Aection 4945(d) of the Internal Revenue Code. I have concluded that the expenditures are either described in section 4945(d)(1) (amounts paid to carry on propaganda or otherwise attempt to influence legislation) or section 4945(d)(5) (amounts paid for any purpose other than one specified in Section 170(c)(2)(B)).

The purpose of this letter is to advise you that I intend to propose liabilities under Section 4945(a)(1) on the Foundation and 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 Section 4945(b)(1) on the Foundation. In addition, and as explained in more detail below, I also intend to propose Section 4945(b)(2) liabilities on you as foundation manager.

[Short statute case (<270 days on statute remaining):]
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.

[Sufficient time left on 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 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.

Exhibit 17 – Statute Extension Example - Single Act

Form **872**	Department of the Treasury - Internal Revenue Service	In reply refer to: SE:T:EO:E:XX:79XX
(Rev. July 2014)	Consent to Extend the Time to Assess Tax	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 49XX)] tax due from the above taxpayer(s) for the

(Kind of Tax)

taxable years that are fully or partially within the taxable period that began

[insert date of act or failure to act]

may be assessed at any time on or before *[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.

(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

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

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

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Exhibit 18 – Statute Extension Example - Multiple Acts

Form **872**	Department of the Treasury - Internal Revenue Service	In reply refer to: SE:T:EO:E:XX:79XX
(Rev. July 2014)	Consent to Extend the Time to Assess Tax	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 49XX)] tax due from the above taxpayer(s) for the

(Kind of Tax)

taxable years that are fully or partially within the taxable period(s) that began

[tax period that includes date of act or failure to act]
[insert additional dates of acts or failures to act]

may be assessed at any time on or before *[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.

(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

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

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

Catalog Number 20755I www.irs.gov Form **872** (Rev. 7-2014)