



COUNCIL *on* FOUNDATIONS

LEGAL COMPENDIUM FOR COMMUNITY FOUNDATIONS

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CHAPTER 7, Attracting Contributions from Private Foundations

This is an excerpt from the *Legal Compendium for Community Foundations* (Council on Foundations, 1996).

Note that while much of the information in the following excerpt is still accurate and relevant, some changes in the law and regulations may affect portions of this material. For this reason, this material should be read in conjunction with other, more recent resources, or should be used in consultation with local counsel who can advise on any changes.

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Chapter Seven

Attracting Contributions from Private Foundations

A. Overview

Community foundations frequently receive contributions from private foundations. They often receive contributions to field-of-interest funds when they act as financial depositories for the execution of a philanthropic joint venture funded by private foundations and local businesses, such as endowing a symphony.

A community foundation also offers a private foundation a combination of tax and administrative advantages because of its public charity status and its flexibility to implement philanthropic activities. Grants to a community foundation are "qualifying distributions" that satisfy the minimum distribution requirements that private foundations are subject to.⁷⁰⁸ Since a community foundation is a public charity, the grants are not "taxable expenditures" and are not subject to the expenditure responsibility requirement.⁷⁰⁹ Thus, for example, a private foundation may establish an advised fund and meet its distribution requirements and also enjoy the advantages of an advised fund.

In addition, a private foundation can work with a community foundation to terminate its private foundation status in a variety of ways. First, it can distribute all of its assets into a philanthropic fund of a community foundation and then go out of existence.⁷¹⁰ As an alternative to complete termination, a private foundation can transfer all of its assets to a philanthropic fund of a community foundation and can retain its legal existence as a private foundation to advise the community foundation on disbursements from the fund.⁷¹¹

Another way to terminate its status as a private foundation is to become a "supporting organization" of the community foundation.⁷¹² Several larger community foundations have had supporting organizations established, but the administrative burdens of administering such an organization generally require the private foundation to have significant assets for the community foundation to consider accepting such a responsibility.

Opportunities frequently present themselves when a private foundation has an aging board of directors or trustees. Frequently the founder of a private foundation designated close friends as the trustees of the private foundation since they were in the best position to know his or her philanthropic objectives. When they age, they usually look for others to assume their responsibilities. Frequently they will turn to a community

⁷⁰⁸ Section 4942. See Section SEVEN.B.

⁷⁰⁹ Section 4945. See Section SEVEN.B.

⁷¹⁰ See Section SEVEN.C.

⁷¹¹ *Id.*

⁷¹² See Section SEVEN.D for rules to terminate a private foundation into a supporting organization. Supporting organizations are analyzed at length in Chapter EIGHT.

foundation for such assistance and they might even consider terminating the private foundation into a philanthropic fund. When appropriate, the private foundation can become a supporting organization of the community foundation to relieve itself of the private foundation excise taxes and to permit donors to the supporting organization to claim the greater tax benefits available for contributions to a public charity.⁷¹⁴

B. Contributions to Philanthropic Funds from Private Non-Operating Foundations A grant from a private foundation to a component fund of a community foundation is treated as "qualifying distribution" under Section 4942 and is not a "taxable expenditure" under Section 4945.

1. QUALIFYING DISTRIBUTIONS UNDER SECTION 4942

Section 4942 imposes several levels of excise taxes on private non-operating foundations that fail to annually make "qualifying distributions" of their "minimum investment return" (generally, 5% of the foundation's net investment assets). Qualifying distributions are defined to include distributions to certain charitable organizations, including public charities such as community foundations.⁷¹⁵ Specifically excluded from the definition are distributions to organizations controlled by the private foundation or by a "disqualified person" associated with that foundation." Control is generally determined by whether the private foundation controls the organization which received the grant rather than by conditions imposed on the grant.⁷¹⁶ One exception when the terms of the grant may constitute control is if the foundation imposed a "material restriction."⁷¹⁷

By comparison, a component fund of a community foundation (whether an unrestricted, designated, field-of-interest, or advised) is defined as a fund which is governed by a community foundation and which is not subject to a "material restriction."⁷¹⁸

Consequently, because (1) a contribution to a component fund of a community foundation is treated as a contribution to a public charity,⁷¹⁹ (2) a private foundation does not control the board of directors of a community foundation and (3) a component fund of a community foundation is not subject to a material restriction⁷²⁰ a grant to such a fund should constitute a qualifying distribution. The same result should be true for a directly-held philanthropic fund of a community foundation.

2. "TAXABLE EXPENDITURES" UNDER SECTION 4945

Section 4945 imposes a 10 percent penalty tax on each "taxable expenditure" that is made by a private foundation. A payment for any non-charitable purpose is a taxable

⁷¹⁴ See Section TWO.A for a list of these advantages. ⁷¹⁴ Section 4942(8).

⁷¹⁵ *Id.*

⁷¹⁶ See Treas. Reg. 53.4942 (a)-3 (a) (3).

⁷¹⁷ *Id.* A material restriction is defined in Treas. Reg. 1.307-2 (a) (8). See Sections THREE.A.3 and THREE.C of this publication.

⁷¹⁸ Treas. Reg. 1.170A-9(e)(11)(ii)(B).

⁷¹⁹ See second to last sentence of Treas. Reg. Section 1.170A-9(e) (11) (ii) and Section SEVEN.D of this publication.

⁷²⁰ Treas. Reg. Sections 1.170A-9(e) (11) (ii) (B) and 1.507-2(a)(8).

expenditure.⁷²¹ In addition, a taxable expenditure includes a grant to a person or an organization, other than a public charity, unless the private foundation exercises "expenditure responsibility" with respect to such grant.⁷²² The IRS and the Tax Court assess these penalties even for minor and technical violations of the statute.⁷²³

Expenditure responsibility means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to see that the grant is spent solely for the purpose for which it was made. The private foundation must also obtain full and complete reports from the grantee on how the funds were spent, and it must prepare full and detailed reports with respect to such expenditures to the IRS.⁷²⁴ Thus, the administrative costs of satisfying the expenditure responsibility requirements could inhibit a private foundation from making grants to individuals or to organizations that are not public charities.

However, grants to public charities are not considered taxable expenditures and do not require expenditure responsibility.⁷²⁵ Grants to philanthropic funds of community foundations, including advised funds, also qualify for such favorable treatment.⁷²⁶ The tax regulations specifically permit private foundations to participate to a limited extent in the public charity's selection process for the charitable use of the funds, provided that the public charity retains ultimate control over the selection process.⁷²⁷ Advised funds meet this requirement.⁷²⁸ Therefore, since a contribution to a component fund is treated as a contribution to a public charity⁷²⁹ and since a component fund of a community foundation is not subject to a material restriction, a grant to such a fund should not constitute a taxable expenditure.

3. LEGAL AUTHORITY

Although there are no cases or official rulings on point, there are private letter rulings that approve contributions from private non-operating foundations to advised funds. In these rulings the Internal Revenue Service concluded that a grant from a private non-

⁷²¹ A charitable purpose is defined in Section 170(c) (2) (B) and includes a charitable, scientific, literary, educational or religious purpose.

⁷²² Section 4945(d) (4).

⁷²³ *Charles Stewart Mott Foundation v. U.S.*, 938 F.2d 58 (6th Cir. 1991) (the Foundation made a \$320,000 program-related investment in 1976 and submitted reports to the IRS even year until 1981; the IRS assessed a 10% penalty (\$32,000) for the failure in 1981); *Hans S. Mannheimer Charitable Trust v. Commissioner*, 93 T.C. No. 5 (1989) (even though it disclosed the identity of the related private foundations that received grants from the Mannheimer Trust, a penalty tax of \$40,000 per year was due because of the trusts failure to answer expenditure responsibility questions on Form 900-PF).

⁷²⁴ Section 4945(h).

⁷²⁵ Section 4945(d) (4). Public charities that are classified under paragraphs (1), (2) or (3) of Section 509(.5) meet the exception, which would include community foundations that are classified as public charities under Sections 509(.5) (1) and 170(b) (1) (A) (vi).

⁷²⁶ Private Letter Rulings 8538064 (June 25, 1985) and 9537035 to 9337033 (June 23, 1993) (involving grants to advised funds to purchase stock in a major league baseball team).

⁷²⁷ Treas. Reg. Sections 53.4943-2 (a) (5) and 53.4945-4 (a) (4) (ii).

⁷²⁸ Private Letter Rulings 8538064 (June 25, 1985) and 9537035 to 9337053 (June 23, 1993).

⁷²⁹ See second to last sentence of Treas. Reg. Section 1.170A-9 (e) (11) (ii) and Section SEVEN.D.1 of this publication.

operating foundation to a philanthropic fund of a community foundation was a "qualifying distribution" and was not a "taxable expenditure."⁷³⁰

C. Terminations of Private Foundations into Philanthropic Funds of Community Foundations

1. OVERVIEW

A private foundation can terminate its private foundation status by transferring all of its assets into a fund of a community foundation and electing with the IRS to terminate its private foundation status.⁷³¹ If both the private foundation and the community foundation are corporations, this can be accomplished with a corporate merger.⁷³²

If the private foundation is liable for any taxes, the liability generally carries over to the organization that receives the assets (i.e., the community foundation).⁷³³ It is not a material restriction for a community foundation to pay these taxes.⁷³⁴ Consequently, a community foundation should reach an understanding with a terminating private foundation that the philanthropic fund established with the assets will be charged with any taxes or other obligations associated with the predecessor private foundation.

An alternative to complete termination is for the private foundation to transfer all of its assets to a philanthropic fund of a community foundation without making the election and without liquidating its legal existence. Thus, the private foundation can avoid the excise taxes (particularly the 2% excise tax on investment income under Section 4940) and avoid any obligation to file annual tax returns (since it has no assets or income),⁷³⁵ but it can retain its legal existence as a private foundation to advise the community foundation on disbursements from the fund.⁷³⁶

2. TERMINATIONS OF SMALL PRIVATE FOUNDATIONS AT BANKS

⁷³⁰ See, for example, Private Letter Rulings 9604031 (Nov. 3, 1995) (grant from a private foundation to an advised fund of a community foundation to construct a fountain); 8831006 (Apr. 12, 1988) (transfer of all of a private foundation's assets to a component fund, but private foundation stays in existence to advise fund); 8225165 (Mar. 29, 1982) (contribution to an advised fund for mental health); 8538064 (June 25, 1985) (transfer of assets in connection with the termination of a private foundation); 9018032 (Feb. 2, 1990) (grants for photography); and 9537035 to 9337033 (June 23, 1995) (involving grants to advised funds to purchase stock in a major league baseball team).

⁷³¹ Section 507(b) (1) (A) and Treas. Reg. Sections 1.507-2(a) (7) and 1.507-2(a) (8). The private foundation must make an election to terminate in order for the termination to be complete. Treas. Reg. 1.507-1 (b) (7). An example of when the IRS approved such a termination can be found in Private Letter Ruling 8920009 (Feb. 3, 1989) and Private Letter Ruling 8538064 (June 25, 1985).

⁷³² Private Letter Rulings 8621112 (Feb. 28, 1986) and 9008007 (Nov. 16, 1989). See also Private Letter Ruling 8321098 (Feb. 24, 1983) for an example of a merger with a public charity other than a community foundation.

⁷³³ Treas. Reg. Section 1.507-1 (a) (8).

⁷³⁴ Treas. Reg. Section 1.507-2 (a) (8) (iv) (C).

⁷³⁵ Treas. Reg. Section 1.507-1 (b) (9).

⁷³⁶ Section 507(b) (1) (A) and Treas. Reg. 1.507-1 (b) (7). An example of when the IRS approved such a transaction can be found in Private Letter Ruling 8836033 (June 14, 1988).

The community foundation tax regulations provide opportunities for banks to relieve themselves of the tax and administrative burdens of administering private foundations while they retain the assets in their trust departments. For example, a private foundation can terminate into a component fund even though the assets remain at the trust department of the bank.⁷³⁷ This will save the cost of preparing a private foundation tax return and will eliminate the risk of a private foundation excise tax. Such an arrangement permits the bank to do what it does best (make investments) and the community foundation to do what it does best (make grants). Although it would be a material restriction for a donor and the community foundation to agree that one party will be the irrevocable trustee of the contributed assets,⁷³⁹ it is possible to assure the trustee that it will be legally entitled to remain trustee unless a relatively extreme situation arises.⁷³⁹

There have been numerous occasions when banks transferred trusts with small account balances (e.g., under \$100,000) to philanthropic funds at incorporated community foundations.⁷⁴⁰ The community foundation then carried out the original intent of the donors with lower administrative costs. Often a transfer from a trust to a philanthropic fund at an incorporated community foundation will require approval from a probate court that has jurisdiction over charitable trusts.⁷⁴¹ Although incorporated community foundations do not usually hold such assets in a trust, they often deposit the proceeds from the terminated trusts into a single, large account with the same bank that transferred the assets, thereby also reducing the bank's administrative costs.

3. IRS FILING REQUIREMENTS

⁷³⁷ See, generally, Chapter SEVEN for the rules for private foundation terminations.

⁷³⁹ Treas. Reg. Section 1-507-2 (a) (8) (iv) (F).

⁷³⁹ A sensitive issue that often arises is the bank's fear that if a trust becomes a component fund, the community foundation might replace it as the trustee. A bank can be informed that under the tax regulations it can be legally entitled to remain the trustee unless it has either (1) breached its fiduciary duty under state law or (2) has failed to produce a reasonable return of net income over an extended period of time. Treas. Reg. Section 1.170A-9(e) (11) (v) (B) (2) and (3). One could, therefore, have an irrevocable trust that would be treated as a component part of the community foundation even though the community foundation would not be able to change the trustee except under these two extreme situations. This should not be a problem to most reputable banks. With this assurance, a bank may be willing to accept contributions and convert existing private foundations into component funds. These two situations are the minimum required by the single entity tax regulations. As a matter of policy, a community foundation might choose to impose conditions that are stronger than the minimum required by law.

⁷⁴⁰ Struckhoff, Eugene C., "How Everybody Wins with Bank Trustee Transfers of Charitable Trusts," *The Exempt Organization Tax Review*, Vol. 4, No. 5, p.1 (Oct. 1991).

⁷⁴¹ Examples where such transfers have been approved include: *In. RE Trusts Administered Under the Maine Charity Foundation* (Probate Court of Cumberland County, Maine; Portland Docket No. 93-685 (Jan. 28, 1993) (transfer of 130 small charitable trusts from Fleet Bank (trustee) to the Maine Community Foundation); *In The Matter of Susan Matilda Watson* (Sup. CL of New York-Index No. 11724/79, Oct. 4, 1979) (transfer to New York Community Funds, Ire.); *In The Matter of Philip L. Hanbeck* (Dist. Ct. of 7th Judic. District- Stearns County, Minnesota- Court File No. C8-89-2482, Oct. 23, 1989) (transfer of scholarship fund to the Central Minnesota Community Foundation, Inc.); *Cornmerce Bank of Kansas City, N.A., Trustee v. Five Denial Clinic Trust, et al* (Probate Division of Jackson County Circuit Court, Missouri - Court File No. 162151-01, Dec. 30, 1992) (termination of ten smaller charitable trusts into philanthropic funds of The Greater Kansas City Community Foundation).

A termination is not particularly complicated, but there is a tax hazard if it is not properly carried out. A private foundation could be subject to a severe "termination tax" if the termination is not exempt under Section 507. The tax is equal to the lesser of (1) all of the tax benefits that the contributors (who received a charitable deduction) and the private foundation (which paid only the nominal 2% tax on investment income instead of the regular tax) received, plus interest, or (2) the value of the net assets of the private foundation.⁷⁴² It is designed to prevent abusive situations such as when a private foundation terminates because its charitable objectives cannot be carried out, and the money then passes to the founder's heirs. The termination tax will recoup the tax savings that the heirs were not entitled to. However, a private foundation can avoid the entire termination tax if it properly transfers all of its assets to a public charity or if it becomes a public charity itself.

If a community foundation has been a public charity for at least 60 months, a termination into a philanthropic fund is fairly simple. Assuming the private foundation is not liable for taxes because of the willful violation of private foundation laws, a private foundation will be terminated if it distributes all of its net assets to a philanthropic fund.⁷⁴³ There is no need to notify the IRS in advance,⁷⁴⁴ although there is a final return that the private foundation must file.⁷⁴⁵ The transfer must be of all of its right, title and interest in all of its net assets.⁷⁴⁶ If the private foundation imposes any "material restriction" that prevents the community foundation from freely and effectually employing the transferred assets (or income therefrom) in furtherance of its exempt purpose, the transfer will not be complete.⁷⁴⁷ It is even possible for a private foundation to terminate into a corporation that is less than 60 months old if the corporation qualifies as a component part of a community foundation that is more than 60 months old.⁷⁴⁸

If a community foundation has not been a public charity for at least 60 months, then, in addition to meeting the preceding requirements, the private foundation is required to notify the IRS in advance of its intent to dissolve.⁷⁴⁹ Newly established community foundations occasionally find that private foundations are reluctant to terminate into them because they do not want to go through this procedure. A way for a private foundation to avoid this procedure while still accomplishing its objective is to use the

⁷⁴² Sections 507 (c) and 507(4).

⁷⁴³ Section 507(b) (1) (A). A contribution to a component fund is treated as a contribution to a public charity. See second to last sentence of Treas. Reg. Section 1.170A-9(e) (11) (ii) and Section SEVEN.D.1 of this publication. See also Private Letter Ruling 9439013 (July 6, 1994) where a private foundation transferred one-fourth of its assets to a fund at a community foundation and three-fourths to other private foundations.

⁷⁴⁴ Treas. Reg. Section 1.507-2 (a) (1).

⁷⁴⁵ The terminating private foundation must file a return under the provisions of Section 6043, rather than Section 6050. It is required to comply with Section 6104(d) for the taxable year in which the termination occurs. Treas. Reg. Section 1.507-2(a).

⁷⁴⁶ Section 507(b) (1) (A) and Treas. Reg. 1.507-2 (a) (7).

⁷⁴⁷ *Id.* For the definition of a "material restriction," see Treas. Reg. 1.507-2 (a) (8) and Section THREE.A.3 of this publication.

⁷⁴⁸ The 60-month test is determined by the age of the community foundation rather than the age of the component fund. Tech. Adv. Memorandum 8621112 (Feb. 28, 1986).

⁷⁴⁹ Section 507(b) (1) (B).

alternative method described above of having the private foundation first distribute virtually all of its assets to the community foundation as an ongoing grant so that nothing is left in the private foundation upon which the excise tax could be levied.⁷⁵⁰

D. Conversion of a Private Foundation into a "Supporting Organization" of a Community Foundation

1. OVERVIEW

Another way for a private foundation to terminate its private foundation tax status without paying the termination tax and without distributing all of its assets to a public charity is to have itself reclassified as a public charity. The most likely way to accomplish this is to convert itself into a "supporting organization" under Section 509 (a) (3).

Unlike a component fund, a supporting organization is a separate trust or corporation that is recognized for tax purposes as a separate legal entity with its own governing body. Even though only one donor may have contributed to the supporting organization, it is classified as a public charity because it is organized and operated to benefit a publicly supported charity. The easiest way to qualify as a supporting organization is for the community foundation to control the selection of a majority of trustees or directors of the charity. The laws governing supporting organizations, and the policy issues of whether a community foundation should agree to accept a supporting organization, are described in Chapter EIGHT.

2. CHANGES TO ORGANIZATIONAL DOCUMENTS TO CONVERT A PRIVATE FOUNDATION INTO A SUPPORTING ORGANIZATION

In order to convert into a supporting organization, a private foundation will need to amend its organizational documents and will have to apply to the IRS to have its tax status changed. The two principal changes to the organizational documents are to state that (1) the organization's purpose is to support the community foundation⁷⁵¹ and (2) the

⁷⁵⁰ Private Letter Rulings 8836033 (June 14, 1988) (involving a community foundation) and 8823050 (Mar. 10, 1988) (probably involving a community foundation). Private Letter Ruling 9018032 (Feb. 2, 1990) had a similar transaction which involved a public charity that had been in existence for over 60 months. See also Private Letter Rulings 8703049 through 8705051 (Nov. 4, 1986) in which a private foundation undertook a reorganization and transferred one-fourth of its assets to a fund in a community foundation and one-half of its assets to another private foundation. The IRS approved the transaction and concluded that the large grants had not caused a termination. In Private Letter Ruling 9439015 (July 6, 1994) a private foundation transferred one-fourth of its assets to a fund at a community foundation and three-fourths to other private foundations.

⁷⁵¹ Under certain circumstances, the community foundation does not even have to be named in the organizational documents. If the supporting organization is "controlled by" the community foundation, it may be possible to avoid specifying the community foundation by name. See Treas. Reg. Section 1.509(5)-4(d) (2) (i); Rev. Rul. 81-43, 1981-1 C.B.350; and Rev. Rul. 75-436, 1975-2 C.B. 217. See the "Organizational Test" in Section EIGHT.C.2.

majority of its governing body will be appointed by the community foundation.⁷⁵² Trusts must frequently obtain approval from the state attorney general or from a court to amend such an instrument.⁷⁵³ If the governing instrument is amended to such an extent that it falls under the community trust single-entity regulations, the private foundation could be converted into a philanthropic fund of the community foundation rather than a supporting organization.⁷⁵⁴

3. APPLICATIONS TO THEIRS

a. Overview

The supporting organization should apply to the IRS to obtain an "advance ruling" (a temporary ruling that lasts for 60 months) that it is a Section 509 (a) (3) supporting organization.⁷⁵⁵ At the end of 60 months, it should apply for a final determination of such status.⁷⁵⁶ A community foundation that is attempting its first termination of a private foundation into a supporting organization might find it advantageous to contact another

⁷⁵² See Section SEVEN.C.5.a for the rules to have a supporting organization "controlled by" a community foundation. There are, however, ways for an organization to qualify as a supporting organization of a community foundation without having the community foundation appoint a majority of the governing body. One way is the complicated "operated in connection with" test. An example is a former hospital that affiliated with a community foundation where the community foundation only appointed 15% of the governing body. Private Letter Rulings 9538026-9538031 (June 26, 1995). See Sections SEVEN.C.1.b.i and SEVEN.C.5.c of this publication. Another way is to have a community foundation be one of several charities that appoints a majority of the governing body of a supporting organization. Treas. Reg. Section 1.509(5)-4 (c) (2).

⁷⁵³ See, for example, Annotation, "Duty of Trustees to Charitable Trust to Furnish Information and Records to Attorney General Relating to Trust Administration," 86 A.L.R. 2d 1375; Sisson, "Relaxing the Dead Hand's Grip: Charitable Efficiency and the Doctrine of Cy Pres," 74 Va. L. Rev. 635 (Apr. 1988). See also Annotation, "Charitable Trusts: Elimination or Modification by Court of Restrictions on Amount of Donation or Expenditure Which Trustee May Make for Purposes of Trust," 50 A.L.R. 3d 1116 and Annotation, "Power of Court To Authorize Modification of Trust Instrument Because of Changes in Tax Law," 57 A.L.R. 3d 1044.

⁷⁵⁴ See, for example, the series of General Counsel Memoranda in which the IRS held that certain trusts were component parts of a community foundation despite the community foundation's protests that they were not. GCMs 37818 (Jan. 11, 1979), 38812 (Aug. 31, 1981) and 38880 (Jul. 21, 1982).

⁷⁵⁵ Treas. Reg. Section 1.507-2 (e) (1). An organization may terminate its private foundation status under Section 507 (b) (1) (B) if it meets the requirements of a Section 509(a) (3) supporting organization for a continuous 60-month period beginning with the first day of any tax year, and notifies its District Director before the beginning of the 60-month period that it is terminating its private foundation status. The advance ruling is given at the discretion of the IRS based on its assessment that the organization can reasonably be expected to terminate its private foundation status over the 60-month period. Treas. Reg. Section 1.507-2 (e) (1). The decision to grant a favorable ruling will be based on the facts and circumstances, taking into account organizational structure, proposed programs and activities, intended methods of operation and projected sources of support. Treas. Reg. Section 1.507-2(c) (2).

To receive an advance ruling, the organization must also agree to an extension of time to assess the private foundation 2% tax on net investment income for the years in the 60-month termination period. Treas. Reg. Section 1.507-2 (e) (5). The organization does this by filing Form 872-B, discussed below. If the IRS agrees to the extension, the charity will not have to pay the tax on net investment income during the 60-month period.

⁷⁵⁶ Treas. Reg. Section 1.507-2(b) (1) and (4).

community foundation that has successfully completed the process to learn of the legal and practical obstacles.

A potential grant recipient may also request an advance ruling before receiving a grant or contribution from the supporting organization.⁷⁵⁷

b. Pass Test for Entire 60 Months?

If the organization meets the requirements of Section 507(b) (1) (B) during the continuous 60-month period, it will be treated as a Section 509 (a) (3) supporting organization for the entire 60-month period.⁷⁵⁸

c. Not Pass Test for Entire 60 Months?

Generally, any organization that does not meet Section 507(b) (1) (B) termination requirements during the 60-month period will be treated as a private foundation for the entire 60-month period.⁷⁵⁹ The organization will be liable for the 2% Section 4940 private foundation excise tax for the entire period, plus interest, but no penalty for late payment will be assessed.⁷⁶⁰ Innocent contributors will be able to claim favorable tax deductions as if their gifts had been made to a public charity, but large contributors may not be so fortunate.⁷⁶¹

d. Documents To File with the IRS

The supporting organization should file a "notice of termination" and a few tax forms with the IRS. The notice of termination is a letter to the District Director of the IRS.⁷⁶²

⁷⁵⁷ An organization might do this if it wants to be certain that the grant or contribution will not result in the grantee's failing to meet Section 509(a) (1), (2) or (3) requirements. The ruling request may be filed by the grantee organization with its District Director. Treas. Reg. Section 1.507-2 (e) (3).

⁷⁵⁸ Treas. Reg. Section 1.507-2(d) (2).

⁷⁵⁹ Treas. Reg. Section 1.507-2(f) (2) (i). However, the organization can be treated as a Section 509(a) (3) supporting organization for any tax year that the requirements are met. Any grants or contributions made to the organization during such year or years will be treated as made to a Section 509 (a) (3) supporting organization and the organization itself will not be subject to the private foundation excise taxes and restrictions for such year or years. Treas. Reg. Section 1.507-2 (f) (2) (ii).

⁷⁶⁰ Treas. Reg. Section 1.507-2 (f) (2) (i).

⁷⁶¹ Contributors to an organization that has obtained a favorable advance ruling may rely on that ruling until notice of revocation is published in the Internal Revenue Bulletin. However, a contributor may not rely on such a ruling if the contributor was responsible for, or aware of, the action or inaction that resulted in the organization's failure to meet the requirements of Section 509 (a) (3) or knew that the IRS had notified the supporting organization that its advance ruling would be revoked.

⁷⁶² Treas. Reg. Section 1.807-2 (b) (3). At a minimum, the notice should include:

- 1) The name and address of the private foundation;
- 2) Its intention to terminate its private foundation status;
- 3) The fact that it is seeking public charity status as a supporting organization under Section 509(a) (3);
- 4) The date its regular tax year begins;
- 5) The date the 60-month period begins (usually, the first day of a tax year); and

Usually the notice includes (1) Schedule D of Form 1023⁷⁶³ and (2) Form 872-B, "Consent to Extend the Time to Assess Tax."⁷⁶⁴

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- 6) A summary explanation of the grounds that qualify the private foundation to be classified as a supporting organization (e.g., changes in its organizational documents and operations).

⁷⁶³ Schedule D is the schedule that a charity files to obtain supporting organization status when it first seeks tax-exempt status by filing Form 1023.

⁷⁶⁴ To receive an advance ruling, an organization must agree to an extension of time to assess the Section 4940 2% tax on a private foundation's net investment income for the years in the 60-month termination period. This is an IRS precaution in the event that the private foundation does not successfully convert into a supporting organization. If an organization agrees to the extension and it is accepted, it will not have to pay the tax on net investment income during the 60-month period. The signed and dated agreement Form 872 should be filed with the request for the advance ruling. The assessment period for all years in the termination period must be extended to 4 years, 4 months and 15 days after the end of the last year in the 60-month termination period.