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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 53

REG-134974-12

RIN 1545-BL23

Reliance Standards for Making Good Faith Determinations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the standards for making a good faith determination that a foreign organization is a charitable organization, grants to which may be qualifying distributions and not taxable expenditures. The regulations will affect private foundations seeking to make such good faith determinations.

DATES: Comments and requests for a public hearing must be received by **INSERT DATE 90 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-134974-12), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-134974-12), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent

electronically via the Federal eRulemaking Portal at <http://www.regulations.gov/> (IRS REG-134974-12).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Courtney D. Jones at (202) 622-6070; concerning submissions of comments and requests for a public hearing, Oluwafunmilayo Taylor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

To avoid certain excise taxes under chapter 42, private foundations must make a minimum level of qualifying distributions (as defined in section 4942 of the Internal Revenue Code) each year and must avoid making taxable expenditures (as defined in section 4945). Grants for charitable purposes to certain foreign organizations generally may be treated as qualifying distributions under section 4942 if the private foundation makes a good faith determination that the foreign organization is an organization described in sections 501(c)(3) and 509(a)(1), (a)(2), or (a)(3) (“public charity”) that is not a supporting organization described in section 4942(g)(4)(A)(i) or (g)(4)(A)(ii) (“disqualified supporting organization”) or is an organization described in sections 501(c)(3) and 4942(j)(3) (“private operating foundation”). Similarly, grants for charitable purposes to certain foreign organizations may be treated as other than taxable expenditures under section 4945 if the private foundation makes a good faith determination that the foreign organization is a public charity (other than a disqualified supporting organization) or an organization described in sections 501(c)(3) and 4940(d)(2) (“exempt operating foundation”).

Qualifying Distributions under Section 4942

Section 4942 generally requires a private foundation (other than a private operating foundation) to make “qualifying distributions” equal to or exceeding a minimum “distributable amount” for each taxable year. If a private foundation has not distributed the full distributable amount by the end of the succeeding taxable year, section 4942 imposes an excise tax on the undistributed portion. A private foundation’s distributable amount for any taxable year generally equals five percent of the aggregate fair market value of its non-exempt-use assets, increased by any repayments of amounts treated as qualifying distributions in prior years, and reduced by any taxes imposed under subtitle A and section 4940. Section 4942(g) generally defines a “qualifying distribution” as any expenditure or grant, including program-related investments and certain set-asides of income, paid to accomplish one or more purposes described in section 170(c)(2)(B) (“charitable purposes”). Under section 4942(g)(1)(A), however, grants to organizations controlled, directly or indirectly, by the foundation or one or more of its disqualified persons are not qualifying distributions unless the grant is redistributed for charitable purposes within the period specified in section 4942(g)(3). Similarly, grants to other private foundations (except private operating foundations), are not qualifying distributions. In addition, in 2006, the Pension Protection Act of 2006, Public Law No. 109–208, 120 Stat. 780 (2006) (“PPA”), added section 4942(g)(4), which provides that a qualifying distribution does not include any amount paid to a disqualified supporting organization. Section 53.4942(a)-3(a)(6), however, has not been amended to reflect this statutory change.

For purposes of section 4942, a grant for charitable purposes to a foreign organization that does not have a determination letter from the IRS may be treated as a qualifying distribution if the grantor private foundation makes a “good faith determination” that the foreign organization is a private operating foundation or a public charity that is not a disqualified supporting organization, provided that the foreign organization is not controlled by the foundation or its disqualified persons. See §53.4942(a)-3(a)(6). Under §53.4942(a)-3(a)(6), a private foundation will ordinarily be considered to have made a “good faith determination” if the determination is based on an affidavit of the grantee or on an opinion of counsel of either the grantor or the grantee. The affidavit or opinion must set forth sufficient facts concerning the operations and support of the grantee for the IRS to determine that the grantee would be likely to qualify as a public charity or a private operating foundation.

Taxable Expenditures under Section 4945

Section 4945 imposes an excise tax on a private foundation's “taxable expenditures” as defined in section 4945(d), including expenditures for other than charitable purposes. Under section 4945(d)(4), a taxable expenditure includes any grant to an organization unless: (1) the grantee is a public charity (other than a disqualified supporting organization) or an exempt operating foundation; or (2) the private foundation exercises expenditure responsibility with respect to the grant in accordance with section 4945(h). The Deficit Reduction Act of 1984, Public Law No. 98-369, 98 Stat. 494 (1984), amended section 4945(d)(4) to provide that expenditure responsibility is not required for a grant to an exempt operating foundation. The PPA amended section 4945(d)(4) to require the exercise of expenditure responsibility with

respect to a grant to a disqualified supporting organization. Section 53.4945-5(a)(5), however, has not been amended to reflect these statutory changes.

Section 53.4945-5(a)(5) provides that a grant to a foreign organization that does not have a determination letter from the IRS will be treated as a grant to a public charity (for which the grantor is not required to exercise expenditure responsibility) if the grantor has made a “good faith determination” that the grantee is a public charity. Under §53.4945-5(a)(5), a private foundation will ordinarily be considered to have made a “good faith determination” if the determination is based on an affidavit of the grantee or on an opinion of counsel of either the grantor or the grantee. The affidavit or opinion must set forth sufficient facts concerning the operations and support of the grantee for the IRS to determine that the grantee would be likely to qualify as a public charity.

Standards Relating to Written Advice and Taxpayer Reliance

Section 330 of title 31 of the United States Code authorizes the Secretary of the Treasury to regulate practice before the Treasury Department. The Secretary has published regulations governing practice before the IRS in 31 CFR part 10 and reprinted the regulations as Treasury Department Circular No. 230 (“Circular 230”). Circular 230 provides minimum standards of conduct that tax practitioners are required to meet with respect to written advice concerning Federal tax issues. Many of these standards (including, among others, §10.37 and §10.51(a)(13)) reflect principles a qualified and competent practitioner uses when considering and rendering any written tax advice.

Section 6664 of the Internal Revenue Code provides a defense to taxpayers for certain penalties imposed on an underpayment of tax if the taxpayer shows that there was reasonable cause for the underpayment and the taxpayer acted in good faith with

respect to the underpayment. A taxpayer may demonstrate reasonable cause and good faith with respect to the underpayment by reasonably relying on written advice from a professional tax advisor. Section 1.6664-4(c)(1) provides that all pertinent facts and circumstances must be taken into account in determining whether a taxpayer has reasonably relied in good faith on written advice, including written advice from a professional tax advisor. A taxpayer's education, sophistication, and business experience are factors taken into account in determining whether the taxpayer's reliance on written advice was reasonable and made in good faith. A taxpayer will not be considered to have reasonably relied in good faith on written advice unless the requirements of §1.6664-4(c)(1) are satisfied. For example, a private foundation's reliance on written advice is not reasonable and in good faith if the private foundation knows, or reasonably should have known, that a professional tax advisor lacks knowledge of the relevant aspects of Federal tax law or that the professional tax advisor is otherwise not qualified or competent to render the written advice. Moreover, a private foundation may not rely on written advice if it knows, or has reason to know, that relevant facts were not disclosed to the professional tax advisor or the written advice is based on a representation or assumption that the private foundation knows, or has reason to know, is unlikely to be true.

Explanation of Provisions

The current regulations under sections 4942 and 4945 state that a determination is ordinarily considered as made in good faith if it is based on an affidavit of the foreign organization or an opinion of counsel of the grantor or the grantee. The proposed regulations modify this rule to identify a broader class of tax practitioners upon whose

written advice a private foundation may base a “good faith determination.” The proposed regulations also make certain conforming changes consistent with statutory amendments that have been made to sections 4942 and 4945.

Under the proposed regulations, a private foundation’s good faith determination ordinarily may be based on written advice given by a “qualified tax practitioner” who is subject to the requirements in Circular 230, including the requirements in current §§10.37 and 10.51(a)(13) (or successor provisions). A qualified tax practitioner means an attorney, a certified public accountant (“CPA”), or an enrolled agent, as those practitioners are defined in §§10.2 and 10.3 of Circular 230. The proposed regulations limit the definition of a qualified tax practitioner to attorneys, CPAs, and enrolled agents because these practitioners generally provide advice to clients with respect to taking positions on tax returns, and these practitioners are generally authorized to represent their clients before the IRS without limitations applicable to other types of practitioners (such as enrolled actuaries). The Treasury Department and the IRS believe that expanding the class of practitioners on whose written advice a private foundation may base a good faith determination will decrease the cost of seeking professional advice regarding these determinations, enabling foundations to engage in international philanthropy in a more cost-effective manner. At the same time, expressly allowing reliance on a broader spectrum of professional tax advisors may encourage more private foundations to obtain written tax advice, thus promoting the quality of the determinations being made.

Although the proposed regulations generally expand the class of practitioners on whose written advice a private foundation may ordinarily base a good faith

determination, unlike the current rule, the expanded class would not include foreign counsel unless the foreign counsel is a qualified tax practitioner (as defined in the proposed regulations). The proposed rule is consistent with the general requirements of Circular 230 that an attorney or CPA be licensed in a state, territory, or possession of the United States, and an enrolled agent be enrolled by the IRS, in order to practice before the IRS.

The proposed regulations provide that a private foundation's determination that is based on the written advice of a qualified tax practitioner will be considered as made in good faith if the private foundation's reliance on the written advice meets the requirements of §1.6664-4(c)(1), which are the standards that must be taken into account in determining whether a taxpayer has reasonably relied in good faith on advice for purposes of section 6664. Additionally, as is the case under the present regulations under sections 4942 and 4945, the written advice must provide sufficient facts about the operations and financial support of the foreign organization for the IRS to determine that the grantee would be likely to qualify as a public charity (other than a disqualified supporting organization) or as a private operating foundation or an exempt operating foundation, as applicable.

The Treasury Department and the IRS are considering whether it is appropriate to limit the timeframe during which a private foundation will be permitted to rely upon a qualified tax practitioner's written advice solely for purposes of these regulations. For example, the final regulations or future guidance published in the Internal Revenue Bulletin may provide that a private foundation may base a good faith determination on written advice of a qualified tax practitioner for distributions that occur within a particular

timeframe (such as 12 months) from the date of the written advice, provided the private foundation does not know nor have reason to know that the facts underlying the written advice have changed. The Treasury Department and the IRS request comments regarding the appropriateness of a time limit and, if appropriate, the length of the time limit.

The Treasury Department and the IRS are also considering whether the current standards in Rev. Proc. 92-94 (1992-2 CB 507) should be modified to take into account changes to the public support test for public charity status under sections 170 and 509 and whether additional guidelines regarding appropriate timeframes for gathering information upon which written advice is based should be provided in final regulations or in guidance published in the Internal Revenue Bulletin. Comments on this issue are requested.

Because the proposed rule is expected to make it easier and less costly to obtain professional tax advice that can be used as a basis to make a good faith determination, the Treasury Department and the IRS also are considering whether it is appropriate to further amend the current regulations to remove the ability of a private foundation to base a good faith determination on an affidavit of a foreign grantee, which may be a less reliable basis for making a good faith determination than advice from a qualified tax practitioner. The Treasury Department and the IRS are concerned, however, that eliminating the ability to base a good faith determination on an affidavit of a foreign grantee may inappropriately discourage foreign grantmaking by smaller private foundations, or inhibit smaller foreign grants generally. While Rev. Proc. 92-94 continues to provide a simplified procedure that private foundations may follow in

making good faith determinations based on affidavits, the Treasury Department and the IRS request comments on whether a foundation's ability to base a good faith determination on affidavits should be retained, and if so, whether the use of affidavits should be restricted. For example, future guidance could prohibit the use of affidavits for grants above a certain dollar threshold, or could require supporting factual information that might serve to corroborate the content of affidavits.

Proposed Effective/Applicability Date

The proposed regulations will apply for grants made after the date of publication of the Treasury decision adopting these paragraphs as final regulations in the **Federal Register**. However, a private foundation may rely on these proposed regulations for grants made on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this notice of proposed rulemaking, and because this notice of proposed rulemaking does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the “Addresses” heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. All comments will be available at www.regulations.gov or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Courtney D. Jones, Office of the Chief Counsel (Tax-Exempt and Government Entities). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 53

Excise taxes, Foundations, Investments, Lobbying, Reporting and recordkeeping requirements, Trusts and trustees.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 53 is proposed to be amended as follows:

Part 53--FOUNDATION AND SIMILAR EXCISE TAXES

Par. 1. The authority citation for part 53 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 53.4942(a)-3 is amended by revising paragraph (a)(6) to read as follows:

§53.4942(a)-3 Qualifying distributions defined.

(a) * * *

(6) Certain foreign organizations--(i) In general. A distribution for purposes described in section 170(c)(2)(B) to a foreign organization, which has not received a ruling or determination letter that it is an organization described in section 509(a)(1), (a)(2), or (a)(3) or section 4942(j)(3), will be treated as a distribution made to an organization described in section 509(a)(1), (a)(2), or (a)(3) (other than an organization described in section 4942(g)(4)(A)(i) or (g)(4)(A)(ii) or section 4942(j)(3) if the distributing foundation has made a good faith determination that the donee organization is an organization described in section 509(a)(1), (a)(2), or (a)(3) (other than an organization described in section 4942(g)(4)(A)(i) or (g)(4)(A)(ii) or section 4942(j)(3). A "good faith determination" ordinarily will be considered as made if the determination is based on an affidavit of the donee organization or written advice from a qualified tax practitioner that the donee is an organization described in section 509(a)(1), (a)(2), or (a)(3) (other than an organization described in section 4942(g)(4)(A)(i) or (g)(4)(A)(ii) or section 4942(j)(3). In the case of a determination based on written advice, the determination will be considered as made in good faith if the foundation reasonably relied in good faith on the written advice in accordance with the requirements of §1.6664-4(c)(1). Furthermore, the affidavit or written advice must set forth sufficient facts concerning the operations and support of the donee organization for the Internal Revenue Service to determine that the donee organization would be likely to qualify as an organization described in section 509(a)(1), (a)(2), or (a)(3) (other than an organization described in section 4942(g)(4)(A)(i) or (g)(4)(A)(ii) or section 4942(j)(3).

(ii) Definitions. For purposes of this paragraph (a)(6)--

(a) The term “foreign organization” means any organization that is not described in section 170(c)(2)(A).

(b) The term “qualified tax practitioner” means an attorney, a certified public accountant, or an enrolled agent, within the meaning of 31 CFR 10.2 and 10.3, who is subject to the requirements in 31 CFR part 10.

(iii) Effective/applicability date. Paragraph (a)(6) of this section will apply with respect to grants made after the date of publication of the Treasury decision adopting this paragraph as a final regulation in the **Federal Register**. However, a private foundation may rely on these proposed regulations with respect to grants made on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

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Par. 3. Section 53.4945-5 is amended by revising paragraph (a)(5) to read as follows:

§53.4945-5 Grants to organizations.

(a) * * *

(5) Certain foreign organizations—(i) In general. If a private foundation makes a grant to a foreign organization, which does not have a ruling or determination letter that it is an organization described in section 509(a)(1), (a)(2), or (a)(3) or section 4940(d)(2), the grant will nonetheless be treated as a grant made to an organization described in section 509(a)(1), (a)(2), or (a)(3) (other than an organization described in section 4942(g)(4)(A)(i) or (g)(4)(A)(ii)) or section 4940(d)(2) if the grantor private

foundation has made a good faith determination that the grantee organization is an organization described in section 509(a)(1), (a)(2), or (a)(3) (other than an organization described in section 4942(g)(4)(A)(i) or (g)(4)(A)(ii) or section 4940(d)(2). A “good faith determination” ordinarily will be considered as made if the determination is based on an affidavit of the grantee organization or written advice from a qualified tax practitioner that the grantee is an organization described in section 509(a)(1), (a)(2), or (a)(3) (other than an organization described in section 4942(g)(4)(A)(i) or (g)(4)(A)(ii) or section 4940(d)(2). In the case of a determination based on written advice, the determination will be considered as made in good faith if the foundation reasonably relied in good faith on the written advice in accordance with the requirements of §1.6664-4(c)(1).

Furthermore, the affidavit or written advice must set forth sufficient facts concerning the operations and support of the grantee organization for the Internal Revenue Service to determine that the grantee organization would be likely to qualify as an organization described in section 509(a)(1), (a)(2), or (a)(3) (other than an organization described in section 4942(g)(4)(A)(i) or (g)(4)(A)(ii) or section 4940(d)(2). See paragraphs (b)(5) and (b)(6) of this section for additional rules relating to foreign organizations.

(ii) Definitions. For purposes of this paragraph (a)(5)--

(a) The term “foreign organization” means any organization that is not described in section 170(c)(2)(A).

(b) The term “qualified tax practitioner” means an attorney, a certified public accountant, or an enrolled agent, within the meaning of 31 CFR 10.2 and 10.3, who is subject to the requirements in 31 CFR part 10.

(iii) Effective/applicability date. Paragraph (a)(5) of this section will apply with respect to grants made after the date of publication of the Treasury decision adopting this paragraph as a final regulation in the **Federal Register**. However, a private foundation may rely on these proposed regulations with respect to grants made on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

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Steven T. Miller

Deputy Commissioner for Services and Enforcement.

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