

J. IRC 507(b)(1)(B): TERMINATION OF PRIVATE FOUNDATION STATUS BY OPERATION AS A PUBLIC CHARITY

1. Introduction

An organization described in IRC 501(c)(3) that was a private foundation on October 9, 1969, or became a private foundation on any subsequent date, can terminate its private foundation status only by using one of the methods described in IRC 507 of the Code. This article discusses the method described in IRC 507(b)(1)(B). IRC 507(b)(1)(b) provides that a private foundation can voluntarily terminate its private foundation status, without incurring the tax imposed by IRC 507(c), by operating as a public charity for 60 continuous months.

2. Requirements

The basic requirements for terminating private foundation status under IRC 507(b)(1)(B) are:

- a) the organization has not been involved in willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) giving rise to liability for tax under chapter 42;
- b) the organization meets the requirements of IRC 509(a)(1), (2) or (3) for a continuous period of 60 calendar months (the transition period is over for the 12-month period referred to in the Code);
- c) the organization notifies its key district director, before the start of the 60-month period, that it is terminating its private foundation status; and
- d) the organization, within 90 days after the end of the 60-month period, furnishes the key District Director sufficient information to allow a determination that the organization met the requirements of IRC 509(a)(1), (2) or (3).

3. Operation as a Public Charity

Whether the organization operates as a public charity is determined by whether it meets the requirements of IRC 509(a)(1), (2) or (3) and the regulations thereunder.

4. Notification of the District Director

a) Reg. 1.507-2(b)(3) provides that the notification of termination by the private foundation must furnish the key District Director with the following information:

- 1) the name and address of the private foundation;
- 2) its intent to terminate its private foundation status;
- 3) whether the 60-month period applies;
- 4) the Code section under which it seeks classification (IRC 509(a)(1), (2) or (3));
- 5) if IRC 509(a)(1) is applicable, the clause of IRC 170(b)(1)(A) involved;
- 6) the date its regular taxable year begins; and
- 7) the date the termination period begins.

b) when a private foundation files a notification, it may also file a consent under IRC 6501(c)(4) extending the period of limitations for assessment of the tax imposed under IRC 4940. By consenting to an extension, the organization can avoid paying the IRC 4940 tax during the 60-month period. If the organization does not file a consent under IRC 6501(c)(4), it must pay the IRC 4940 tax and file a claim for return if it successfully completes the 60-month termination. Also, an organization that does not file a consent cannot obtain an advance ruling for the 60-month period.

5. Advance Rulings for 60-Month Terminations

a) Reg. 1.507-2(e) provides that an organization filing the notification that it is beginning a 60-month termination may obtain an advance ruling that it can reasonably be expected to satisfy the requirements of IRC 507(b)(1)(B)(i) during the 60-month period.

- b) Requirements for obtaining an advance ruling.

1) Issuance of an advance ruling is discretionary with the Service. The basic consideration, set out in Reg. 1.507-2(e)(2), is whether the organization's structure (including changes made before the 60-month period), proposed programs or activities, intended method of operation, and projected sources of support indicate that it is likely to complete the 60-month termination successfully.

2) The organization must file a consent under IRC 6501(c)(4) to extend the period of limitation on assessment of IRC 4940 tax. Reg. 1.507-2(c)(5) provides that the period of limitations for all taxable years in the 60-month period must be extended to one year after expiration of the time prescribed by law for assessment of a deficiency for the last taxable year in the 60-month period.

c) Effect of an advance ruling: reliance

1) Reg. 1.507-2(e)(3) provides that grantors and contributors may rely on an advance ruling until notice is published that the advance ruling is revoked, unless the grantor or contributor was responsible for, or aware of, the act or failure to act responsible for the organization's failure to meet the requirements of IRC 509(a)(1), (2) or (3), or learned that the Service had given notice to the organization that its advance ruling would be revoked. The reliance is for purposes of IRC 170, 545(b)(2), 556(b)(2), 642(c), 4942, 4945, 2055, 2106(a)(2) and 2522.

2) The organization itself, however, cannot rely on the advance ruling. See, Reg. 1.507-2(e)(4). It is treated as a private foundation until it successfully completes the 60-month termination period. Thus, if the organization files a consent and does not pay the tax imposed by IRC 4940 for any taxable year or years during the 60-month period, and it is subsequently determined that the tax is due for such year or years, the organization is liable for interest under IRC 6601 on any IRC 4940 tax not paid on or before the prescribed payment date. However, because failure to pay the tax during the 60-month period was due to reasonable cause, the IRC 6651 penalty does not apply.

d) Filing requirements during the 60-month period

1) Although an organization terminating its private foundation status under IRC 507(b)(1)(B) may be considered a public charity for some purposes, it is still considered a private foundation for purposes of the filing requirements under 6033 and 6056. Thus, the organization must file its annual return on Form 990-PF. Page 1 of Form 990-PF has a block the organization should check to indicate that it is terminating its private foundation status under the

60-month provisions of IRC 507(b)(1)(B). An organization with an advance ruling under Reg. 1.507-2(e) should attach a copy of the advance ruling letter to its Form 990-PF.

2) An exception to the requirement that an organization file returns on Form 990-PF during the 60-month period is that an organization that furnishes its key District Director, within the 90 days after the end of the termination period as required by the regulations, information that shows the termination was effective should file Form 990 for the final year of the termination period. This applies even if the key district has not affirmed that the organization has terminated its private foundation status by the time the return for the final year of termination is due.

6. Establishment of Termination

a) Reg. 1.507-2(b)(4) provides that to comply with IRC 507(b)(1)(B)(iii), the organization, within 90 days of the end of the 60-month period, must furnish information to its key District Director establishing that it has terminated its private foundation status and, therefore, qualifies as a public charity.

b) The information the organization must furnish to its key District Director is set out in the Code and regulations for the particular subsection of IRC 509(a) under which it is qualifying.

7. Effect of Satisfaction of the Requirements for Termination

An organization that satisfies the requirements of IRC 507(b)(1)(B) for termination of its private foundation status during the continuous 60-month period, and establishes that fact at the end of the period, is treated as a public charity for the entire 60-month period.

8. Failure to Meet Termination Requirements

a) In determining whether an organization met the requirements of IRC 507(b)(1)(B) as an IRC 509(a)(1) and 170(b)(1)(A)(vi) or an IRC 509(a)(2) organization, its aggregate support for the 60-month period is considered. Support received before the 60-month period is not considered. If the organization's total support fails to meet the requirements of the subsection of IRC 509(a) it seeks to qualify under, it retains its status as a private foundation.

b) If an organization fails to satisfy the requirements of IRC 509(a)-(1), (2) or (3) for the continuous 60-month period but does satisfy the requirements of IRC 509(a)(1), (2) or (3), as the case may be, for any taxable year or years in the 60-month period, the organization is treated as an IRC 509(a)(1), (2) or (3) organization for those years and contributions and grants made during those years are treated as made to an organization described in IRC 509(a)(1), (2) or (3).