



# **Exempt Organizations Technical Guide**

## **TG 64: Application of Taxes on Denial of Exemption to Certain Foreign Organizations - IRC Section 4948**

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**Technical Guide Revision Date: 4/9/2024**

# Table of Contents

I. Overview.....	4
A. Background / History .....	4
B. Relevant Terms .....	4
C. Law / Authority .....	5
II. Requirements.....	7
A. Tax on Investment Income .....	7
A.1. Gross Investment Income .....	7
A.2. United States Source Income .....	8
III. Other Considerations .....	10
A. Withholding and Reporting IRC 4948(a) Tax .....	10
B. Effect of Tax Treaty .....	10
C. Foreign Private Foundations Which Receive Substantially All Support from Sources Outside the United States.....	11
D. Denial of Exemption for Prohibited Transactions.....	11
D.1. Meaning of Prohibited Transaction.....	12
D.2. Taxable Years Affected with Respect to Denial of Exemption.....	13
D.3. Reestablishment of Exempt Status.....	13
E. Disallowance of Charitable Deductions .....	13
IV. Examination Techniques .....	15
A. Introduction .....	15
B. Foreign Tax-Exempt Foundations .....	16

C. Foreign Taxable Foundations .....	16
V. Issue Indicators and Audit Tips .....	18
A. Issue Indicators .....	18
B. Audit Tips.....	18

## I. Overview

- (1) This Technical Guide discusses Internal Revenue Code (Code) Section 4948 and addresses issues that may arise with respect to foreign organizations that are private foundations.

## A. Background / History

- (1) Some of the private foundation rules set out in Sections 507 and 508 and Chapter 42 of the Code, enacted in the Tax Reform Act of 1969, couldn't easily be applied in practice to foreign organizations. To remedy this, Section 4948 modifies some of the private foundation rules for application to foreign organizations.
- (2) Under Section 3101 of Public Law 116-25 (Taxpayer First Act of 2019), a private foundation filing Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation, for a tax year beginning on or after July 2, 2019, must file it electronically.
- (3) Electronic filing requirements have not changed for Form 990-PF filers with tax years beginning before July 2, 2019 (which includes calendar year 2019 Forms 990-PF).
- (4) For tax years beginning in 2020, an individual liable for a Chapter 42 excise tax will not have the option to file jointly with the private foundation. See Notice 2021-01, 2021-02 I.R.B. 315. Beginning with tax year 2020, Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code, has been revised to identify whether the filer is the organization or an individual. Accordingly, for tax years after 2019, an agent which secures a Form 4720 or prepares a substitute for return (SFR) to report an individual's excise tax liability during an audit will no longer convert Form 4720 to "Form 4720-A." The revenue agent will, instead, complete Form 4720 identifying the filer as an individual as described in the instructions for Form 4720. Please see IRM 4.70.13, Executing the Examination, and Form 4720 instructions for further information.

**Note:** Private foundations described in Section 4948(b) are not liable for Chapter 42 taxes (other than Section 4948(a) tax) and thus do not file Form 4720.

- (5) In addition, any 2020 (or future year) Form 4720 filed by a private foundation with a due date on or after July 15, 2021, must be filed electronically and not on paper (unless mailed with a postmark date on or before June 16, 2021). Organizations other than private foundations may continue file Form 4720 on paper. See Notice 2021-01, 2021-02 I.R.B. 315.

## B. Relevant Terms

- (1) **Foreign organization:** For purposes of Section 4948, a foreign organization is any organization not created or organized in the United States or any possession thereof, or under the laws of the United States, any state, the

District of Columbia, or any possession of the United States. See Treas. Reg. 53.4948-1(a)(1). U.S. possessions are referred to as U.S. territories in this guide.

- (2) **Private foundation:** A private foundation is a domestic or foreign organization that is exempt from income tax under Section 501(a), described in Section 501(c)(3), and is other than an organization described in Sections 509(a)(1) through (4). See Section 509(a). A private foundation whose exemption is revoked remains a private foundation (although taxable) until its private foundation status is terminated under Section 507. See Section 509(b) and Treas. Reg. 1.509(b)-1(b).

## C. Law / Authority

- (1) Foreign organizations that are private foundations, and that have been granted tax-exempt status under U.S. tax law, are required to pay a 4% excise tax on gross investment income received from sources in the United States, any territory, any political subdivision of a territory or the District of Columbia. An exception to this rule is made when a tax treaty between the United States and the private foundation's foreign country of residence specifically exempts income received by these organizations from any tax. See Section 4948 and Treas. Reg. 53.4948-1(a)(1).
- (2) Foreign private foundations receiving at least 85% of their support (excluding gross investment income) from sources outside the United States are not subject to the taxes on self-dealing, failure to distribute income, excess business holdings, investments that jeopardize charitable purposes, and taxable expenditures. Such foundations also are not subject to Section 507, relating to termination of private foundation status, and Section 508, regarding special rules for giving notice that they are applying for recognition of exempt status. See Treas. Reg. 53.4948-1(b).
- (3) An exempt organization that is organized in a foreign country and receives a substantial portion of its support from a foreign government is not a private foundation. Instead, it may qualify as a public charity under Section 170(b)(1)(A)(vi). See Rev. Rul. 75-435, 1975-2 C.B. 215.
- (4) A foreign private foundation can have its exempt status terminated for repeatedly engaging in prohibited transactions. A prohibited transaction is an act or a failure to act by a foreign organization that, if engaged in by a domestic organization, would subject the domestic organization to the taxes and sanctions imposed on private foundations. See Section 4948(c) and Treas. Reg. 53.4948-1(c)(2).
- (5) If a foreign private foundation engages in one such act or failure to act, and has been notified by a written advisory by the IRS that a second act or failure to act would result in a prohibited transaction, the second act or failure to act will be considered a prohibited transaction. See Treas. Reg. 53.4948-1(c)(2)(iii).

- (6) The repeated act or failure to act doesn't necessarily have to be related to the earlier act or failure to act that caused the IRS to issue a written advisory. See Treas. Reg. 53.4948-1(c)(2)(iii).
- (7) Any foreign private foundation whose exemption has been terminated under the provisions outlined earlier may re-apply for exemption by filing a Form 1023 in the 2nd tax year following the tax year in which exemption was denied. See Section 4948(c)(3)(B) and Treas. Reg. 53.4948-1(c)(3)(ii).

## II. Requirements

- (1) In general, Section 4948 imposes an excise tax on U.S. sourced gross investment income received by foreign private foundations. This section discusses the taxes applicable to foreign private foundations.

### A. Tax on Investment Income

- (1) Foreign organizations that are private foundations, and that have been granted tax-exempt status under U.S. tax law, are required to pay a 4% excise tax on gross investment income received from sources in the United States, any territory, any political subdivision of a territory or the District of Columbia. An exception to this rule is made when a tax treaty between the United States and the private foundation's foreign country of residence specifically exempts income received by these organizations from any tax.

**Note:** Foreign taxable private foundations and foreign Section 4947(a)(1) nonexempt charitable trusts aren't subject to excise tax under Section 4948(a) or 4940 but are subject to income tax under subtitle A of the Code.

#### A.1. Gross Investment Income

- (1) Gross investment income is defined in Section 4940(c)(2) and the regulations thereunder. Gross investment income means the total amount of income from, and from sources like:
  - a. Interest,
  - b. Dividends,
  - c. Rents,
  - d. Payments with respect to securities loans (as defined in Section 512(a)(5)), and
  - e. Royalties (including overriding royalties) received by a private foundation.
  - f. Gross investment income also includes income from similar sources; examples set forth in the General Explanation of the Pension Protection Act (PPA) of 2006 include income from notional principal contracts, annuities, and other substantially similar income from ordinary and routine investments.

**Note:** Unlike under Section 4940, capital gains aren't taxed under Section 4948(a). Section 4948(a) taxes only gross investment income (within the meaning of Section 4940(c)(2)) from U.S. sources. Capital gains and losses aren't included within the definition of gross investment income under Section 4940(c)(2) (instead, they are separately defined in Section 4940(c)(3) as a component of net investment income under Section 4940(c)(1)). Since its enactment in 1969, Section 4940 has always distinguished between gross investment income and capital gains in the computation of net investment income; thus, the 2006 addition to gross investment income under Section

4940(c)(2) of income from similar sources was not meant to include capital gains.

- (2) Gross investment income doesn't include income to the extent included in computing unrelated business income tax imposed by Section 511.
- (3) However, gross investment income does include interest, dividends, rents, and royalties received from assets devoted to charitable activities. Therefore, interest received on a student loan would be includible in the gross investment income of a private foundation making a student loan to be used for educational purposes. See Treas. Reg. 53.4940-1(d)(1).
- (4) The PPA of 2006 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:
  - a. Prohibits including carrybacks or carryovers of capital losses in computing gross investment income.
  - b. Redefines capital gain net income to include property used to produce gross investment income.

## A.2. United States Source Income

- (1) United States source income is defined in Section 861 and the regulations thereunder.

**Note:** For purposes of Section 861 (cross-referenced in Section 4948(a)), the term "United States" doesn't include any U.S. territory. See Section 7701(a)(9). Thus, while an organization created or organized in a U.S. territory is not a foreign organization for purposes of Section 4948, income sourced to a U.S. territory is not derived from U.S. sources.

- (2) In general, interest that is paid by an obligor that is a corporate or noncorporate resident of the United States is treated as U.S.-source income. For this purpose, a corporation is treated as a resident of its place of incorporation. See Section 861(a)(1) and Treas. Reg. 1.861-2(a)(1). Special rules apply to a foreign corporation engaged in a U.S. trade or business, including U.S. branches of foreign banks. See Section 884(f) and Treas. Reg. 1.884-4(b)(1). Interest paid by the United States or a political subdivision or agency of either is treated as interest from sources within the United States.
- (3) Dividend income is generally governed by the place of incorporation of the payor corporation. Therefore, dividends paid by a corporation that is incorporated under the laws of one of the 50 states or the District of Columbia are U.S.-source income and dividends paid by a corporation incorporated under the laws of a U.S. territory or of a foreign country are generally foreign-source income. See Section 861(a)(2).
- (4) Income from the use, rental, or lease of real property is sourced based on the location of the real property. See Section 861(a)(4). Thus, income from real

property (or an interest in real property) located in the United States (as defined above) is U.S.-source income.

- (5) Rent, royalties, and other income from the lease, license, or other use of tangible and intangible personal property are sourced to the place of use. See Section 861(a)(4). Payments made for the use of tangible personal property related to the exploration or exploitation of natural resources on the U.S. outer continental shelf also are treated as U.S.-source income. Royalties from intangible property are sourced to the place in which the taxpayer is entitled to use and uses the property; some non-competition agreements may be subject to a similar analysis. If intangible property provides rights in multiple jurisdictions, only those jurisdictions in which the property is used are taken into account for sourcing purposes.

### **III. Other Considerations**

- (1) There are other considerations that must be reviewed when looking at foreign private foundations. This section discusses complex and interrelated issues regarding the application of the Code.

#### **A. Withholding and Reporting IRC 4948(a) Tax**

- (1) Section 1443(b) regulations describe requirements for withholding of tax on gross investment income of foreign private foundations subject to the Section 4948(a) tax. See also Treas. Reg. 1.1443-1(b) (for information about withholding agent's obligation to withhold taxes subject to Section 4948 tax).
- (2) The Section 4948(a) tax (if any) is to be reported on the Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation, required to be filed by the foundation under Section 6033 for the taxable year, at the time prescribed for filing such annual return without regard to any extension of time for filing.

#### **B. Effect of Tax Treaty**

- (1) A tax treaty between the United States and a foreign country may specifically eliminate the 4% excise tax for which a foreign private foundation would otherwise be liable under Section 4948(a). See Treas. Reg. 1.1443-1(b)(4) (claiming benefits under an income tax treaty). For example, our treaties with Canada and Mexico provide, under certain circumstances, for an exemption from the tax on foreign private foundations. To qualify, a private foundation must be:
  - a. Organized for religious, scientific, literary, educational, or other charitable purposes,
  - b. Be a resident of Canada or Mexico, respectively (including meeting the requirements of any limitation on benefits article), and
  - c. Have received substantially all its support from persons other than citizens or residents of the United States. See Articles 2(3)(a) and 22(4) of the U.S.-Mexico income tax treaty (1993); Articles II(2)(b)(ii) and XXI(5) of the U.S.-Canada income tax treaty (as amended by five protocols through 2007).
- (2) Alternatively, a tax treaty between the United States and a foreign country may provide that a resident of a foreign country (including a resident foreign private foundation) may exclude a particular item or items of gross investment income (for example interest income) from income tax (or may exempt a resident charitable organization from income tax generally). If so, such item or items are not to be taken into account by the foreign private foundation in computing the excise tax imposed under Section 4948(a) for any taxable year for which the treaty applies. See Treas. Reg. 53.4948-1(a)(3). Thus, for example, a foreign private foundation that is a resident of the United Kingdom and that qualifies under the treaty's limitation on benefits article may exclude its U.S.-source

interest income in determining its gross investment income. See Article 11 (Interest) of the U.S.- U.K. income tax treaty (2001).

- (3) In order to be eligible for an exemption from the Section 4948 tax, the excise tax imposed with respect to private foundations must be identified as a covered tax within an applicable U.S. income tax treaty (See United States Income Tax Treaties – A to Z for more information on tax treaties). If the tax is not identified as a covered tax, then the private foundation is not eligible for an exemption from the 4% excise tax imposed under Section 4948(a). In addition, if the income tax treaty does include taxes imposed on private foundations as a covered tax, the treaty must be examined to determine whether the United States has retained any right to impose excise tax on the type of gross investment income that is received by the foundation.
- (4) If an income tax treaty treats excise taxes imposed on private foundations as a covered tax, or if it is unclear how a treaty applies, consult Division Counsel to determine the effect of the treaty on Section 4948(a) tax.

### **C. Foreign Private Foundations Which Receive Substantially All Support from Sources Outside the United States**

- (1) Foreign private foundations that received at least 85% of its support (as defined in Section 509(d), other than gross investment income) from sources outside the United States aren't subject to the taxes on self-dealing, failure to distribute income, excess business holdings, investments that jeopardize charitable purposes, and taxable expenditures. See Section 4948(b).
- (2) "Substantially all" for purposes of the exception in Section 4948(b) means the organization, from the date of its creation, has received at least 85% of its support as defined in Section 509(d), other than gross investment income, from sources outside the United States. See Treas. Reg. 53.4948-1(b).
- (3) In computing support for purposes of Section 4948(b), gifts, grants, contributions, or membership fees directly or indirectly from a United States person (as defined in Section 7701(a)(30)) are from sources within the United States. See Treas. Reg. 53.4948-1(b).
- (4) Such foundations also aren't subject to Section 507, relating to termination of private foundation status, and Section 508, regarding special rules for giving notice they're applying for recognition of exempt status.
- (5) Note that Section 4948(b) applies to foreign public charities and other foreign exempt organizations as well as foreign private foundations, and applies to all Chapter 42 provisions, not just those relating to private foundations.
- (6) Section 4948 and the regulations thereunder don't provide any exceptions concerning the application of the private foundation rules to foreign private foundations which have not received substantially all of their support (other than gross investment income) from sources outside the United States.

### **D. Denial of Exemption for Prohibited Transactions**

- (1) A foreign private foundation which receives substantially all its support from sources outside the United States is generally excepted from the private foundation rules (other than Section 4948(a)).
- (2) However, a foreign organization described in Section 4948(b) shall not be exempt from taxation under section 501(a) if it has engaged in a “prohibited transaction” after December 31, 1969. See Treas. Reg. 4948-1(c)(1).

## D.1. Meaning of Prohibited Transaction

- (1) “Prohibited transaction” for purposes of denial of exemption under Section 4948(c)(1) means any act or failure to act (other than with respect to Section 4942(e) relating to minimum investment return) which would subject a foreign private foundation, or a disqualified person with respect thereto, to liability for a penalty under Section 6684 (assessable penalties with respect to liability for tax under Chapter 42) or a termination tax under Section 507 if the foreign private foundation were a domestic private foundation. See Treas. Reg. 4948-1(c)(2)(i).

**Note:** When Section 4948 was enacted, Section 4942 required foundations to distribute the greater of their minimum investment return or their adjusted net income. In 1981, Section 4942 was amended to require foundations to distribute only their minimum investment return. This amendment is considered to have effectively eliminated a Section 4942 violation as a prohibited transaction.

- (2) Foreign private foundations described in Section 4948(b) and their disqualified persons are held to the same requirements as other private foundations except for Section 4942 requirements and certain special variances concerning grants (see below). However, for such foundations the sanction for failure to observe requirements is a potential denial of exemption under Section 501(a) as opposed to a tax on nonconforming activity.
- (3) In applying the “prohibited transaction” rule described above, approval by an appropriate foreign government of grants by a foreign private foundation to individuals is sufficient to satisfy the requirements of Section 4945(g). In the case of a grant to an organization by a foreign private foundation, the grantor’s determination as to the status of the grantee for purposes of Section 4942(g)(1)(A)(ii) (relating to qualifying distributions to a private foundation which is not an operating foundation) or for purposes of Section 4945(d)(4) and (h) (relating to grants for which expenditure control is required of the grantor) will be accepted if such determination is made in good faith after a reasonable effort to identify the status of its grantee. See Treas. Reg. 53.4948-1(c)(2)(ii).
- (4) If a foreign private foundation (or disqualified person with respect to such foundation) commits a willful and flagrant act in violation of Chapter 42 (except as discussed above), then such act is a prohibited transaction.
- (5) Otherwise, the following events must occur for an act in violation of Chapter 42 to constitute a prohibited transaction:

- a. The foreign foundation or a disqualified person commits an act in violation of Chapter 42.
- b. The Commissioner warns the foundation that another act in violation of Chapter 42 would result in a prohibited transaction.
- c. The foundation or disqualified person commits another act in violation of Chapter 42 (not necessarily the same type of act).
- d. The commissioner warns the foundation that the second act is a prohibited transaction unless corrected within 90 days after the warning.
- e. The foundation or disqualified person fails to correct within 90 days. See Treas. Regs. 53.4948-1(c)(2) and (3).

## **D.2. Taxable Years Affected with Respect to Denial of Exemption**

- (1) If a foreign private foundation described in Section 4948(b) engages in a prohibited transaction, it will be denied exemption for all taxable years (except as provided below) beginning with the taxable year during which it is notified by the commissioner that it has engaged in a prohibited transaction. See Section 4948(c)(3)(A). At a minimum, it will be denied exemption for the remainder of that tax year and the following tax year.
- (2) The commissioner shall publish notice of such denial in the Federal Register on the day on which the foreign private foundation is so notified. Treas. Reg. 53.4948-1(c)(3).

## **D.3. Reestablishment of Exempt Status**

- (1) A foreign private foundation whose exempt status is denied because it engaged in a prohibited transaction may file a request for recognition of exemption under Section 501(a) on Form 1023, Application for Recognition of Exemption, regarding the second or any subsequent taxable year following the taxable year in which the notice of denial was issued. In addition to the information generally required in Form 1023, the foreign organization is also required to have a principal officer submit a written declaration made under the penalties of perjury that it won't knowingly again engage in a prohibited transaction. See Treas. Reg. 53.4948-1(c)(3)(ii)(a).
- (2) If the IRS is satisfied that such foreign private foundation will not knowingly again engage in a prohibited transaction and that it otherwise satisfies the requirements for recognition of exemption, it will be notified in writing that the foundation will not be denied exemption by reason of any prohibited transaction engaged in before notice of denial was issued. However, in no case may an organization denied exemption under Section 4948(c) be again exempt under Section 501(a) sooner than the conclusion of one full taxable year following the year in which notice of loss of exemption is given.

## **E. Disallowance of Charitable Deductions**

- (1) Section 4948(c)(4) provides that no charitable deduction is allowed under Sections 170, 545(b)(2), 642(c), 2055, 2106(a)(2) or 2522 for a gift, bequest, legacy, devise or transfer, if made:
  - a. To a foreign private foundation after the date on which notice has been published in the Federal Register that the organization has been notified that it has engaged in a prohibited transaction, and
  - b. In a taxable year of such organization for which it isn't exempt by reason of the issuance of a notice of denial of exemption for engaging in a prohibited transaction. See Treas. Reg. 53.4948-1(d).

## IV. Examination Techniques

- (1) This section focuses on examination specific issues.

### A. Introduction

- (1) Foreign organizations are those not created in or under the laws of the U.S. or U.S. territories, which include:
  - a. American Samoa
  - b. Guam
  - c. Northern Mariana Islands
  - d. Puerto Rico
  - e. U.S. Virgin Islands

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

- (3) The primary benefit of Section 501(c)(3) exemption for foreign organizations is to reduce the income tax liability on U.S.-sourced investment income. Foreign private foundations are taxed at a 4% rate on U.S.-sourced gross investment income (instead of a statutory 30% rate for foreign entities). Some foundations are exempted from the tax due to tax treaties that change the tax treatment of the income. For Section 4948, gross investment income is defined per 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 Section 4948(a) tax computation.

- (4) 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.
- (5) 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. However, there is a possibility an officer or employee of the foreign corporation may be required to file an FBAR. A United States person who is an officer or employee employed and residing outside of the United States and who has signature authority over a foreign financial account that is owned or maintained by the individual's employer is only required to

complete Part I and Part IV, Items 34-43 of the FBAR, as well as the signature section of the FBAR.

## B. Foreign Tax-Exempt Foundations

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

- (2) Engaging in prohibited transactions will result in revocation.

**Note:** Except for willful and flagrant violations, Chapter 42 transactions (excluding 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 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 or failure to act, place the foundation on notice. Contact Area Counsel for help to prepare and issue the notice.

- (3) Foreign foundations can qualify as both Section 4942(j)(3) private operating foundations and Section 4940(d) exempt operating foundations. Classification as an exempt operating foundation is a moot issue for Section 4940 as foreign foundations aren't subject to Section 4940, though it may matter for Section 4945(d)(4). Private operating foundations and Section 4940(d) exempt operating foundations are not required to complete certain parts of the Form 990-PF. They are required to attach a computation of the 85% test to the Form 990-PF. If they are claiming to be an operating foundation, they're required to complete Part X of the Form 990-PF.
- (4) Foreign foundations can apply for reclassification as a public charity by filing Form 8940 if it can demonstrate that it qualifies as a public charity. See Rev. Proc. 2024-5, 2024-1 I.R.B. 262 (updated annually).
- (5) When examining these entities, verify that the foundation properly computed the Section 4948 tax; look at all the sources of the income and determine the percentage of non-investment income from domestic sources; identify the type of foundation (such as grant making, private operating or exempt operating); then look at the transactions to determine liability under Chapter 42.

## C. Foreign Taxable Foundations

- (1) A foreign taxable private foundation is one that has been revoked. Unless a termination tax is imposed, the foundation retains its assets upon revocation. These foundations can re-apply for exemption.
- (2) Foreign taxable private foundations are subject to the 30% withholding rate of Section 1441 or Section 1442 on U.S.-source income (unless the tax is reduced or eliminated by treaty) but are not subject to Section 4948(a) tax.
- (3) Foreign foundations (whether exempt or taxable) may be subject to the Section 507(c) termination tax if they are not described in Section 4948(b). The entity that remains after a Section 507(a)(1) or (a)(2) termination is generally taxable

as either a corporation or a trust. Regardless of the type of entity, the 30% tax rate applies, as the entity is considered a foreign person.

- (4) Sections 511 through 514, regarding unrelated business income, no longer apply to a foreign taxable foundation. Regular corporate or trust tax rules apply instead.
- (5) Foreign taxable foundations and their disqualified persons may 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.

## **V. Issue Indicators and Audit Tips**

- (1) This section provides for possible issue indicators and audit tips when reviewing a private foundation issue.

### **A. Issue Indicators**

- (1) The foreign foundation doesn't meet its requirement to pay the 4% excise tax on gross investment income received from sources in the United States, any territory, any political subdivision of a territory or the District of Columbia. (An exception to this rule is made when a tax treaty between the United States and the foreign country of which the private foundation is a resident specifically exempts income received by these organizations from any tax).
- (2) The foreign foundation (or a disqualified person) appears to have violated one or more Chapter 42 requirements or Section 501(c)(3) requirements.

### **B. Audit Tips**

- (1) Check whether the organization is a foreign foundation and determine the percentages of foreign support.
- (2) Determine whether a tax treaty between the United States and the private foundation's foreign country of residence specifically exempts income received by the organization from any tax. If an income tax treaty includes excise taxes imposed on private foundations as covered tax, consult Division Counsel to determine the effect of the treaty on Section 4948(a) tax.
- (3) Foreign foundations receiving at least 85% of their support (excluding gross investment income) from sources outside the United States are not subject to the taxes on self-dealing, failure to distribute income, excess business holdings, investments that jeopardize charitable purposes, and taxable expenditures. Such foundations also are not subject to Section 507, relating to termination of private foundation status, and Section 508, regarding special rules for giving notice that they are applying for recognition of exempt status.
- (4) Review the foreign foundation's attachment showing the computation of the 85% test that must be attached to the return.
- (5) A foreign foundation can have its exempt status terminated for repeatedly engaging in prohibited transactions. A prohibited transaction is an act or a failure to act by a foreign organization that, if engaged in by a domestic organization, would subject the domestic organization to the taxes and sanctions imposed on private foundations.
- (6) A foreign foundation described in Section 4948(b) doesn't complete Form 990-PF Parts X (unless claiming status as an operating foundation), XI, XIII, and XV; isn't required to report to a state official; and isn't required to comply with public inspection requirements for annual returns.
- (7) Foreign taxable foundations and foreign Section 4947(a)(1) nonexempt charitable trusts aren't subject to excise tax under Section 4948(a) or 4940 but

are subject to income tax under Subtitle A of the Code, generally at the normal 30% withholding rate.