(d) *Special transitional rule for affiliated groups.* If on or before May 22, 1984 a foundation holds an interest in a common parent corporation in an affiliated group, as defined in § 53.4943–10(c)(3)(ii), the foundation may elect to have both § 53.4943–8(c)(4) and § 53.4943–10(c)(3) not apply to such common parent corporation. No election may be made to have only one section not apply. Such election shall be made by the governing body of the private foundation at any time prior to February 22, 1985.

(e) *Special transitional rule for changes to a business enterprise.* Any interest that is not an interest in a business enterprise which becomes an interest in a business enterprise under § 53.4943–10(d)(2) prior to May 22, 1984 will be treated as having been acquired other than by purchase for purposes of section 4943(c)(6).

[T.D. 7496, 42 FR 46285, Sept. 15, 1977, as amended by T.D. 7944, 49 FR 6485, Feb. 22, 1984]

Subpart E—Taxes on Investments Which Jeopardize Charitable Purpose

SOURCE: T.D. 7240, 37 FR 28747, Dec. 27, 1972, unless otherwise noted.

§ 53.4944–1 Initial taxes.

(a) *On the private foundation*—(1) *In general.* If a private foundation (as defined in section 509) invests any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes, section 4944(a) (1) of the Code imposes an excise tax on the making of such investment. This tax is to be paid by the private foundation and is at the rate of 5 percent of the amount so invested for each taxable year (or part thereof) in the taxable period (as defined in section 4944(e) (1)). The tax imposed by section 4944(a)(1) and this paragraph shall apply to investments of either income or principal.

(2) *Jeopardizing investments.* (i) Except as provided in section 4944(c), § 53.4944–3, § 53.4944–6(a), and subdivision (ii) of this subparagraph, an investment shall be considered to jeopardize the carrying out of the exempt purposes of a private foundation if it is determined that the foundation managers, in making such investment, have failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the long- and short-term financial needs of the foundation to carry out its exempt purposes. In the exercise of the requisite standard of care and prudence the foundation managers may take into account the expected return (including both income and appreciation of capital), the risks of rising and falling price levels, and the need for diversification within the investment portfolio (for example, with respect to type of security, type of industry, maturity of company, degree of risk and potential for return). The determination whether the investment of a particular amount jeopardizes the carrying out of the exempt purposes of a foundation shall be made on an investment by investment basis, in each case taking into account the foundation's portfolio as a whole. No category of investments shall be treated as a per se violation of section 4944. However, the following are examples of types or methods of investment which will be closely scrutinized to determine whether the foundation managers have met the requisite standard of care and prudence: Trading in securities on margin, trading in commodity futures, investments in working interests in oil and gas wells, the purchase of "puts," "calls," and "straddles," the purchase of warrants, and selling short. The determination whether the investment of any amount jeopardizes the carrying out of a foundation's exempt purposes is to be made as of the time that the foundation makes the investment and not subsequently on the basis of hindsight. Therefore, once it has been ascertained that an investment does not jeopardize the carrying out of a foundation's exempt purposes, the investment shall never be considered to jeopardize the carrying out of such purposes, even though, as a result of such investment, the foundation subsequently realizes a loss. The provisions of section 4944 and the regulations thereunder shall not exempt or relieve any person from compliance with any Federal or State

law imposing any obligation, duty, responsibility, or other standard of conduct with respect to the operation or administration of an organization or trust to which section 4944 applies. Nor shall any State law exempt or relieve any person from any obligation, duty, responsibility, or other standard of conduct provided in section 4944 and the regulations thereunder.

(ii)*(a)* Section 4944 shall not apply to an investment made by any person which is later gratuitously transferred to a private foundation. If such foundation furnishes any consideration to such person upon the transfer, the foundation will be treated as having made an investment (within the meaning of section 4944(a)(1)) in the amount of such consideration.

(b) Section 4944 shall not apply to an investment which is acquired by a private foundation solely as a result of a corporate reorganization within the meaning of section 368(a).

(iii) For purposes of section 4944, a private foundation which, after December 31, 1969, changes the form or terms of an investment (regardless of whether subdivision (ii) of this subparagraph applies to such investment), will be considered to have entered into a new investment on the date of such change, except as provided in subdivision (ii) *(b)* of this subparagraph. Accordingly, a determination, under subdivision (i) of this subparagraph, whether such change in the investment jeopardizes the carrying out of the foundation's exempt purposes shall be made at such time.

(iv) It is not intended that the taxes imposed under Chapter 42 be exclusive. For example, if a foundation purchases a sole proprietorship in a business enterprise within the meaning of section 4943(d)(4), in addition to tax under section 4943, the foundation may be liable for tax under section 4944 if the investment jeopardizes the carrying out of any of its exempt purposes.

(b) *On the management*—(1) *In general.* In any case in which a tax is imposed by section 4944(a)(1) and paragraph (a) of this section, section 4944 (a)(2) of the Code imposes on the participation of any foundation manager in the making of the investment, knowing that it is jeopardizing the carrying out of any of the foundation's exempt purposes, a tax equal to 5 percent of the amount so invested for each taxable year of the foundation (or part thereof) in the taxable period (as defined in section 4944(e)(1)), subject to the provisions of section 4944(d) and §53.4944–4, unless such participation is not willful and is due to reasonable cause. The tax imposed under section 4944(a)(2) shall be paid by the foundation manager.

(2) *Definitions and special rules*—(i) *Knowing.* For purposes of section 4944, a foundation manager shall be considered to have participated in the making of an investment ''knowing'' that it is jeopardizing the carrying out of any of the foundation's exempt purposes only if:

(a) He has actual knowledge of sufficient facts so that, based solely upon such facts, such investment would be a jeopardizing investment under paragraph (a)(2) of this section,

(b) He is aware that such an investment under these circumstances may violate the provisions of federal tax law governing jeopardizing investments, and

(c) He negligently fails to make reasonable attempts to ascertain whether the investment is a jeopardizing investment, or he is in fact aware that it is such an investment.

For purposes of this part and Chapter 42, the term *knowing* does not mean ''having reason to know''. However, evidence tending to show that a foundation manager has reason to know of a particular fact or particular rule is relevant in determining whether he had actual knowledge of such fact or rule. Thus, for example, evidence tending to show that a foundation manager has reason to know of sufficient facts so that, based solely upon such facts, an investment would be a jeopardizing investment is relevant in determining whether he has actual knowledge of such facts.

(ii) *Willful.* A foundation manager's participation in a jeopardizing investment is willful if it is voluntary, conscious, and intentional. No motive to avoid the restrictions of the law or the incurrence of any tax is necessary to make such participation willfull. However, a foundation manager's participation in a jeopardizing investment is not willful if he does not know that it is a jeopardizing investment under paragraph (a)(2) of this section.

(iii) *Due to reasonable cause.* A foundation manager's actions are due to reasonable cause if he has exercised his responsibility on behalf of the foundation with ordinary business care and prudence.

(iv) *Participation.* The participation of any foundation manager in the making of an investment shall consist of any manifestation of approval of the investment.

(v) *Advice of counsel.* If a foundation manager, after full disclosure of the factual situation to legal counsel (including house counsel), relies on the advice of such counsel expressed in a reasoned written legal opinion that a particular investment would not jeopardize the carrying out of any of the foundation's exempt purposes (because, as a matter of law, the investment is excepted from such classification, for example, as a program-related investment under section 4944(c)), then although such investment is subsequently held to be a jeopardizing investment under paragraph (a)(2) of this section, the foundation manager's participation in such investment will ordinarily not be considered ''knowing'' or ''willfull'' and will ordinarily be considered ''due to reasonable cause'' within the meaning of section 4944(a)(2). In addition, if a foundation manager, after full disclosure of the factual situation to qualified investment counsel, relies on the advice of such counsel, such advice being derived in a manner consistent with generally accepted practices of persons who are such a qualified investment counsel and being expressed in writing that a particular investment will provide for the long and short term financial needs of the foundation under paragraph (a)(2) of this section, then although such investment is subsequently held not to provide for such long and short term financial needs, the foundation manager's participation in failing to provide for such long and short term financial needs will ordinarily not be considered ''knowing'' or ''willful'' and will ordinarily be considered ''due to reasonable cause'' within the meaning of section 4944(a)(2). For purposes of this subdivision, a written legal opinion will be considered ''reasoned'' even if it reaches a conclusion which is subsequently determined to be incorrect so long as such opinion addresses itself to the facts and applicable law. However, a written legal opinion will not be considered ''reasoned'' if it does nothing more than recite the facts and express a conclusion. However, the absence of advice of legal counsel or qualified investment counsel with respect to the investment shall not, by itself, give rise to any inference that a foundation manager participated in such investment knowingly, willfully, or without reasonable cause.

(vi) *Cross reference.* For provisions relating to the burden of proof in cases involving the issue whether a foundation manager has knowingly participated in the making of a jeopardizing investment, see section 7454(b).

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). A is a foundation manager of B, a private foundation with assets of $100,000. A approves the following three investments by B after taking into account with respect to each of them B's portfolio as a whole: (1) An investment of $5,000 in the common stock of corporation X; (2) an investment of $10,000 in the common stock of corporation Y; and (3) an investment of $8,000 in the common stock of corporation Z. Corporation X has been in business a considerable time, its record of earnings is good and there is no reason to anticipate a diminution of its earnings. Corporation Y has a promising product, has had earnings in some years and substantial losses in others, has never paid a dividend, and is widely reported in investment advisory services as seriously undercapitalized. Corporation Z has been in business a short period of time and manufactures a product that is new, is not sold by others, and must compete with a well-established alternative product that serves the same purpose. Z's stock is classified as a high-risk investment by most investment advisory services with the possibility of substantial long-term appreciation but with little prospect of a current return. A has studied the records of the three corporations and knows the foregoing facts. In each case the price per share of common stock purchased by B is favorable to B. Under the standards of paragraph (a)(2)(i) of this section, the investment of $10,000 in the common stock of Y and the investment of $8,000 in the common stock of Z may be classified as jeopardizing investments, while the investment of $5,000 in the common stock of X will not be so classified. B would then be liable for an initial tax of $500 (i.e., 5 percent of $10,000) for each year (or part thereof) in the taxable period for the investment in Y, and an initial tax of $400 (i.e., 5 percent of $8,000) for each year (or part thereof) in the taxable period for the investment in Z. Further, since A had actual knowledge that the investments in the common stock of Y and Z were jeopardizing investments, A would then be liable for the same amount of initial taxes as B.

Example (2). Assume the facts as stated in Example (1), except that: (1) In the case of corporation Y, B's investment will be made for new stock to be issued by Y and there is reason to anticipate that B's investment, together with investments required by B to be made concurrently with its own, will satisfy the capital needs of corporation Y and will thereby overcome the difficulties that have resulted in Y's uneven earnings record; and (2) in the case of corporation Z, the management has a demonstrated capacity for getting new businesses started successfully and Z has received substantial orders for its new product. Under the standards of paragraph (a) (2) (i) of this section, neither the investment in Y nor the investment in Z will be classified as a jeopardizing investment and neither A nor B will be liable for an initial tax on either of such investments.

Example (3). D is a foundation manager of E, a private foundation with assets of $200,000. D was hired by E to manage E's investments after a careful review of D's training, experience and record in the field of investment management and advice indicated to E that D was well qualified to provide professional investment advice in the management of E's investment assets. D, after careful research into how best to diversify E's investments, provide for E's long-term financial needs, and protect against the effects of long-term inflation, decides to allocate a portion of E's investment assets to unimproved real estate in selected areas of the country where population patterns and economic factors strongly indicate continuing growth at a rapid rate. D determines that the short-term financial needs of E can be met through E's other investments. Under the standards of paragraph (a)(2)(i) of this section, the investment of a portion of E's investment assets in unimproved real estate will not be classified as a jeopardizing investment and neither D nor E will be liable for an initial tax on such investment.

[T.D. 7240, 37 FR 28747, Dec. 29, 1972, as amended by T.D. 7299, 38 FR 35304, Dec. 27, 1973]

§ 53.4944–2 Additional taxes.

(a) *On the private foundation.* Section 4944(b)(1) of the Code imposes an excise tax in any case in which an initial tax is imposed by section 4944(a)(1) and § 53.4944–1(a) on the making of a jeopardizing investment by a private foundation and such investment is not removed from jeopardy within the taxable period (as defined in section 4944(e)(1)). The tax imposed under section 4944(b)(1) is to be paid by the private foundation and is at the rate of 25 percent of the amount of the investment. This tax shall be imposed upon the portion of the investment which has not been removed from jeopardy within the taxable period.

(b) *On the management.* Section 4944(b)(2) of the Code imposes an excise tax in any case in which an additional tax is imposed by section 4944 (b)(1) and paragraph (a) of this section and a foundation manager has refused to agree to part or all of the removal of the investment from jeopardy. The tax imposed under section 4944(b)(2) is at the rate of 5 percent of the amount of the investment, subject to the provisions of section 4944(d) and § 53.4944–4. This tax is to be paid by any foundation manager who has refused to agree to the removal of part or all of the investment from jeopardy, and shall be imposed upon the portion of the investment which has not been removed from jeopardy within the taxable period.

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). X is a foundation manager of Y, a private foundation. On the advice of X, Y invests $5,000 in the common stock of corporation M. Assume that both X and Y are liable for the taxes imposed by section 4944(a) on the making of the investment. Assume further that no part of the investment is removed from jeopardy within the taxable period and that X refused to agree to such removal. Y will be liable for an additional tax of $1,250 (i.e., $5,000×25%). X will be liable for an additional tax of $250 (i.e., $5,000×5%).

Example (2). Assume the facts as stated in Example (1), except that X is not liable for the tax imposed by section 4944(a)(2) for his participation in the making of the investment, because such participation was not willful and was due to reasonable cause. X will nonetheless be liable for the tax of $250 imposed by section 4944(b)(2) since an additional tax has been imposed upon Y and since X refused to agree to the removal of the investment from jeopardy.