§ 1.503(e)–4 Disallowance of charitable deductions for certain gifts made before January 1, 1970.

Paragraphs (a), (b), and (c) of this section shall apply only to gifts or contributions made before January 1, 1970, to an organization described in section 501(c)(3). For rules relating to the denial of deductions with respect to gifts or contributions made after December 31, 1969, see §1.503(e)–1(d).

(a) No gift or contribution which would otherwise be allowable as a charitable or other deductions under section 170, 642(c), or 545(b)(2) shall be allowed as a deduction if made to an organization described in section 501(c)(3) which at the time the gift or contribution is made is not exempt under section 501(a) by reason of the provisions of section 503.

(b) If an organization which is described in section 501(c)(3) is not exempt because it engaged in a prohibited transaction involving a substantial part of its income of corpus with the purpose of diverting its income or corpus from its exempt purposes, and if the organization receives a gift or contribution during, or prior to, its taxable year in which such prohibited transaction occurred, then a deduction by the donor with respect to the gift or contribution shall not be disallowed under section 503(b) unless the donor (or any member of his family if the donor is an individual) is a party to such prohibited transaction. For the purpose of the preceding sentence family is defined in section 267(c)(4) and includes brothers and sisters, whether by whole or half blood, spouse, ancestors, and lineal descendants. See the regulations under section 267(c).

(c) The application of §1.503(e)–4 may be illustrated by the following example:

Example. In 1954, Corporation M, which files its income tax returns on the calendar year basis, creates a foundation purportedly for charitable purposes and deducts from its gross income for that year the amount of the gift to the foundation. Corporation M makes additional gifts to this foundation in 1955, 1956, and 1957, and takes charitable deductions for such years. B, an individual, also contributes to the foundation in 1955, 1956, and 1957, and takes charitable deductions for such years. In 1955, the foundation commences purposely to divert its corpus to the benefit of Corporation M, and a substantial amount of such corpus is so diverted by the close of the taxable year 1956. For 1955 and subsequent taxable years, the exemption allowed the foundation as an organization described in section 501(c)(3) is denied by reason of the provisions of section 503(a). Both Corporation M and individual B would be disallowed any deduction for the contributions made during 1957 to the foundation. Moreover, the charitable deductions taken by Corporation M for contributions to the foundation in the years 1955 and 1956 would also be disallowed since Corporation M was a party to the prohibited transactions. If the facts and surrounding circumstances indicate that the contribution in 1954 by Corporation M was for the purpose of the prohibited transaction, then the charitable deduction for the year 1954 shall also be disallowed with respect to Corporation M, since the prohibited transaction would then have commenced with the making of such contribution and the exemption allowed the foundation would then be denied for 1954 by reason of the provisions of §1.503(e)–4. B’s deductions for his contributions for the years 1955 and 1956 will not be disallowed since he was not a party to the prohibited transaction.

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section 401(a) if the loan bears a reasonable rate of interest and certain conditions are met. Section 503(f) also applies to the renewal of loans to the employer and, in the case of demand loans, to the continuation of such loans.

(2) The provisions of section 503(f) do not limit the effect of section 401(a) and § 1.401–2, relating to use or diversion of corpus or income of an employees’ trust, or the effect of any of the provisions of section 503 other than section 503(b)(1). Consequently, although a loan made by an employees’ trust described in section 503(a)(1)(B) meets all the requirements of section 503(f) and therefore is not treated as a loan made without the receipt of adequate security, an employees’ trust making such a loan will lose its exempt status if the loan is not considered as made for the exclusive benefit of the employees or their beneficiaries. Similarly, a loan which meets the requirements of section 503(f) will constitute a prohibited transaction within the meaning of section 503(b)(6) if it results in a substantial diversion of the trust’s income or corpus to a person described in section 503(b).

(b) Conditions. (1) Section 503(f) applies to a loan only if, with respect to the making or renewal of the loan, the conditions described in paragraphs (b)(2), (3), and (4) of this section are met. For purpose of this paragraph, the mere continuance of a demand loan is not considered as the making or renewal of such a loan.

(2) The employer must be prohibited (at the time of the making or renewal of the loan) by any law of the United States or regulations thereunder from directly or indirectly pledging, as security for such a loan, a particular class or classes of his assets the value of which (at such time) represents more than one-half of the value of all his assets. If a loan is made or renewed when the employer is prohibited by a law of the United States (or the regulations thereunder) from pledging a class of his assets, the qualification of such a loan under section 503(f) will not be affected by a subsequent change in such law or regulations permitting the employer to pledge such assets, unless such loan is renewed after such change. See section 8(a) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78h(a)), which prohibits certain persons from pledging a class of assets as security for loans, and 12 CFR 220.5(a) (credit by brokers, dealers, and members of national securities exchanges).

(3) The making or renewal, as the case may be, must be approved in writing as an investment which is consistent with the exempt purposes of the trust by a trustee who is independent of the employer, and such written approval must not have been previously refused by any other such trustee. A trustee is independent of the employer, for purposes of this subparagraph, if he is entirely free of influence or controlled by the employer. For example, if the employer is a partnership, then a partner in such partnership, or a member of a partner’s family would not be considered independent of the employer. Similarly, an employee of the employer would not be considered independent of the employer. For purposes of this subparagraph, the term trustee means, with respect to any trust for which there are two trustees who are independent of the employer, both of such trustees and, with respect to any trust for which there are more than two such independent trustees, a majority of the trustees independent of the employer.

(4)(i) Immediately following the making or renewal, as the case may be, the aggregate amount lent by the trust to the employer, without the receipt of adequate security must not exceed 25 percent of the value of all the assets of the trust.

(ii) For purposes of paragraph (b)(4)(i) of this section, the determination as to whether any amount lent by the trust to the employer is a loan made without the receipt of adequate security must not exceed 25 percent of the value of all the assets of the trust.
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would be considered made without ade-
quately security if it were not for the
provisions of section 503(f).

(iii) For purposes of paragraph
(b)(4)(i) of this section, in determining
the value of all the assets of the trust,
there shall be used the fair market
value of those assets on the day of the
making or renewal.

(c) Reasonable rate of interest. Section
503(f) only applies if, in addition to
meeting the conditions described in
paragraph (b) of this section, the loan
bears a reasonable rate of interest
when it is made, renewed, or, in the
case of demand loans, during the period
of its existence.

(d) Change of terms of loan. A change
in the terms of a loan (including a re-
duction in the security for a loan) is
considered as the making of a new
loan. If such a new loan is not ade-
quately secured, the requirements of
section 503(f) must be met at the time
the terms of the loan are changed for
such section to be applicable to such
new loan.

(e) Effective date. (1) This section and
section 503(f) are effective for taxable
years ending after September 2, 1958,
but only with respect to periods after
such date. Thus, if a loan was made on
or before September 2, 1958, without
the receipt of adequate security and if,
when such loan was made, it met all of
the requirements of section 503(f) and
this section, then the loan is not sub-
ject to section 503(b)(1) after Sep-
tember 2, 1958, and would not consti-
tute a prohibited transaction after that
date because of a lack of adequate se-
curity.

(2) See paragraph (b)(2) of § 1.503(b)–1
for the effective date for application
of the definition of adequate security.

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§ 1.504–2 Certain transfers made to
avoid section 504(a).

(a) Scope. Under section 504(b), a
transfer described in paragraph (b) or
(c) of this section to an organization
exempt from tax under section 501(a)
may result in loss of exemption by the
transferee unless the Commissioner de-
termines, under paragraph (e) of this
section, that the original transfer did
do not effect an avoidance of section
504(a). For purposes of this section, the
term transfer includes any use by, or
for the benefit of, the recipient of the
transfer, but does not include any
transfer made for adequate and full
consideration.

(b) Transferor and transferee commonly
controlled—(1) Loss of exemption. A
transfer is described in this paragraph
(b) if it is described in paragraphs (b)(2)
through (b)(6). The transferee of a
transfer described in this paragraph
will cease to be exempt from tax under
section 501(a), unless the provisions of
paragraph (e) of this section apply.

(2) Transferor organization. A transfer
is described in this paragraph (b)(2)
only if it is from an organization that—