

KEY TAKEAWAYS

# Managing Risk: How to Avoid Private Foundation Penalties



**P**ivate foundations offer donors a number of benefits, including control, flexibility, tax savings, and estate planning. But foundations have many rules and regulations governing them. During a recent webinar hosted by *Trusts & Estates* magazine, **Jeffrey Haskell, Foundation Source’s chief legal officer**, walked through the regulatory framework foundations must follow. Although the IRS rules are complex, experts like Haskell can offer support to help foundations stay in compliance.

These are the **three** key takeaways from the presentation.



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## All Foundation Activities Must Be in Service to Its Charitable Mission /

Unlike public charities, private foundations don't raise money from the public and therefore don't have the same level of public accountability. However, they are accountable to the IRS and must show that their activities serve their charitable mission. Foundations can't be used as a place to park assets indefinitely without distributing them for charitable purposes.

For that reason, IRS rules require foundations to make their annual returns available for public inspection detailing how much they distributed and to whom. Further, they have a minimum 5% annual distribution requirement, which they can satisfy by making grants and paying certain qualifying expenses. Foundations are free to make grants to IRS approved public charities without special oversight.

Finally, foundations can't engage in lobbying, electioneering, or voter registration drives, although they may undertake advocacy.

## Watch Out for Rules Around Self-Dealing—the Penalties Can Be Big /

The IRS's self-dealing rules govern transactions between the foundation's insiders known as disqualified persons, or DPs, and private foundations. The self-dealing rules are so strict that they even prohibit transactions that would be beneficial to a foundation, such as a disqualified person's sale of property to a foundation at a below-market price.

Examples of disqualified persons would be the foundation's officers, directors, trustees, substantial contributors, businesses in which the disqualified persons collectively have a significant ownership stake, and some family members of DPs.

Penalties for self-dealing start at 10% of the amount involved and are imposed on the disqualified person, not on the foundation. For example, if a DP sells a piece of property to a foundation for \$5 million, the penalty would be \$500,000. The penalty would be applied each year until the transaction is unwound. If the violation continues, the penalty could go as high as 200%, or \$10 million in the example above. Finally, if the violation is so flagrant without corrective action, the IRS could terminate the foundation's status and pull its assets.



## The Rules Around Grants to Individuals Are Complex /

Some types of grants to individuals need IRS approval and others don't. Two types of grants to individuals that do not require IRS approval are grants designed to alleviate human suffering, such as those given in the aftermath of a natural disaster, and grants that are made in recognition of past accomplishments, such as an award for writing a brilliant and original poem.

Grants that do require advance IRS approval include scholarships or fellowships as well as grants to individuals to achieve a specific objective, produce a report, or similar product that will be delivered in the future. Finally, grants made to individuals to improve or enhance a literary, artistic, musical, scientific, teaching or similar capacity, skill, or talent require IRS approval too.

Regardless of whether grants need IRS approval or not, these rules govern grants to individuals.

- Grants can't be made to disqualified persons, which would constitute self-dealing.
- Grantees must come from a broad charitable class.
- The selection criteria must be related to the purpose of the grant.
- Grantees have to be selected on a non-discriminatory basis.
- Foundations must publicize the programs so individuals other than the foundation's own officers and directors know about them.

To learn more about these key takeaways and other important insights, [check out the full conversation here.](#)

### ABOUT FOUNDATION SOURCE

Foundation Source empowers people and companies to create a better world through philanthropy. We make giving easier for more than 2,000 foundations with innovative technology backed by philanthropic expertise.

### HAVE A QUESTION?

Call 800.839.0054 or send us an email at [info@foundationsource.com](mailto:info@foundationsource.com).

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