Planning Tips for Private Foundations

Private foundations are an ingrained part of American philanthropic history. As the gold standard of charitable vehicles, they have steadily increased in popularity with nearly 100,000 foundations having distributed over $56 billion. However, despite their best intentions, some foundations have garnered unwanted media attention for questionable practices or conflicts of interest. Foundation directors and trustees are not typically compliance professionals, and it is recommended to seek help in navigating the statutory regulations and management strategies. The following provides some helpful planning tips for private foundations.

Monitoring Deadlines

Foundations need to closely monitor federal, state, and corporate reporting requirements and deadlines, which can vary between fixed deadlines or by the anniversary of initial approvals. For example, every private foundation must file their tax return by the 15th day of the 5th month after the organization's accounting period. This due date varies by organization as some follow a fiscal year that is not the same as the calendar year. Foundations should also be aware of any state filing requirements particularly state incorporation agencies and filings related to paid staff. Additionally, foundations need to track renewal dates for charitable solicitation registrations within applicable states. If it becomes clear that a deadline will not be met (e.g., an audit delaying the completion of a foundation's tax return and filing), be sure to notify the appropriate agency and, when possible, apply for extensions in a timely manner. By taking these factors into account, foundations can prevent delinquencies and costly fines.

Conducting Due Diligence

Private foundations typically give grants to public charities; but in cases where it makes a grant to a non-tax exempt organization, it must demonstrate all reasonable efforts to ensure the funds were used solely for charitable purposes, otherwise known as "expenditure responsibility." Thus, all private foundations should have a formal due diligence process in place before issuing any grants. The due diligence process should include verifying charities are eligible to receive grants or the foundation risks not being able to include the grant toward its (five-percent) minimum distribution requirement. The foundation can also check for the charity efficiency ratings as well as independent charity watch ratings and reports as part of its process. Once a decision is made, the foundation should require regular reports from the grantee on how the funds were used or to coordinate visits to the grantee to observe program effectiveness. In cases where the foundation would like to issue grants to foreign charities or non-501(c)(3) recognized organizations, it is important to determine that the foreign organization is equivalent to a U.S. public charity, also known as equivalency determination.

Budgeting for Liabilities

Budgeting for sufficient insurance coverage against liability risks should be considered a necessary private foundation expense. Unfortunately, this area is often overlooked. While foundations may assume there will be no wrongdoing within the organization, they are still susceptible to legal action because they are perceived as a wealthy target. Foundations should properly assess the risks and vulnerability of the officers, directors, and organization when selecting the right coverage. While the needs will vary depending on the size of the organization, consider plans that offer protection for the employees, volunteers, spouses, and heirs. Protection against personal liability is of particular importance if the organization currently has, or plans to have, staff. By investing these resources upfront, foundations can avoid the potential of larger financial costs later.

Being Aware of Self-Dealing

Foundations should always be mindful or seek professional counsel on rules against self-dealing, and ensure that "disqualified persons" do not engage in any direct or indirect financial transaction with the foundation. "Disqualified persons" include directors or trustees and their family members, managers, and substantial contributors; in general, it refers to any party that is closely related to the foundation, whether it is an individual, corporation, partnership, or trust. While there are certain exceptions that permit reasonable and necessary actions that serve to carry out the exempt purposes of the foundation, there are also actions made without ill-intent that would be considered a conflict of interest. It is important to recognize the distinction and seek legal counsel when in doubt, as penalties for self-dealing include a 10% tax of the amount involved on the self-dealer and an additional 5% tax against the foundation manager. If these acts are not corrected within a given period of time, an additional 200% and 50% tax can be levied respectively.

Conclusion

The desire to establish a private foundation comes from a deeply-felt motivation to make a social impact and create a legacy. Yet foundations find themselves under incredible scrutiny and subject to considerable regulations. Whether monitoring deadlines, vetting prospective grantees, understanding transactional limitations, or securing coverage for those involved with the organization, every planning effort helps the foundation to operate more effectively, efficiently, and better poised to make an impact on its philanthropic goals.

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