

WILLMS, S.C.

LAW FIRM

MEMORANDUM

TO: Clients and Friends of Willms, S.C.
FROM: Atty. Maureen L. O’Leary
DATE: March 10, 2014
RE: Administration of Private Foundations

Introduction

An important part of engaging in planned giving, especially when considering the use of a private foundation, is understanding the technical aspects and requirements of how private foundations work.

A private foundation is a non-profit organization that donates its funds to various charities or uses its funds directly for charitable purposes. A person (known as the “donor”) can establish and fund a private foundation during their lifetime and leave an additional bequest to the foundation upon their death as part of their estate plan. The private foundation then carries on after the donor’s death, led by a Board of Directors, to fulfill the charitable purposes set forth by the donor in the foundation’s governing documents.

Mission Statement and Governing Documents

The creator of a private foundation should arrange to have a mission statement and corporate governing documents prepared to give the Board of Directors guidance for how the foundation should be managed and how its funds should be distributed so that it is consistent with the donor’s charitable goals.

Permissible purposes for a private foundation are: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. The term “charitable” includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency.

Annual Filing Requirements

Private foundations must file an annual return (IRS Form 990-PF) with the IRS by May 15th of each year. Failure to file for 3 years in a row will result in automatic termination of the private foundation's tax-exempt status. There is no requirement to file any returns with the Wisconsin Department of Revenue, but a copy of the federal annual return should be mailed to the Wisconsin Attorney General's Office.

For foundations organized in Wisconsin, an annual report must also be filed with the Wisconsin Department of Financial Institutions and an annual fee must be paid. For foundations organized outside of Wisconsin, each state will have its own filing requirements.

Minimum Distributions

Private foundations are required to distribute a certain amount of money annually for charitable purposes. The minimum amount that must be distributed annually is the foundation's "distributable amount." The distributable amount is generally 5% of the prior year's fair market value of all foundation assets. The distributable amount is calculated each year on the foundation's annual return that is filed with the IRS.

The distributable amount must be distributed as "qualifying distributions." A foundation that fails to pay out the distributable amount as qualifying distributions in a timely manner is subject to a 30 percent excise tax on the undistributed amount.

The foundation can make additional qualifying distributions in addition to the distributable amount. The distributable amount is just the minimum that must be distributed annually to avoid the 30% tax.

Qualifying Distributions

Qualifying Distributions are amounts spent to accomplish religious, charitable, scientific, literary, or other public purposes. In general, a distribution to a public charity (i.e. churches, hospitals, qualified medical research organizations affiliated with hospitals, schools, colleges and universities) to accomplish a religious, charitable, scientific, literary, educational or other permitted public purpose is a qualifying distribution.

If the foundation desires to make a distribution to an organization that is not a public charity, there are restrictive rules that must be followed before and after the distribution is made.

Important record keeping requirements must be followed for all distributions.

Tax on Investment Income

Even though a private foundation is a “tax-exempt” organization, the Internal Revenue Code still imposes an excise tax of 1% - 2% on the foundation’s net investment income (i.e. interest and capital gains). The excise tax will be calculated and reported on the foundation’s annual return that is filed with the IRS.

Prohibited Activities

It is very important to make sure a foundation does not engage in any prohibited activities. Prohibited activities will jeopardize a private foundation’s tax-exempt status. Prohibited activities include, but are not limited to:

- Self-Dealing (i.e. paying unreasonable compensation or lending money to yourself or other disqualified persons);
- Political Campaigning; and
- Lobbying.

Tax Benefits

Despite the substantial technical requirements that must be carefully followed when creating and administering a private foundation, there can be substantial payoffs that are well worth the work.

First, contributions made to private foundations during a donor’s lifetime are gift tax deductible and generally income tax deductible (subject to income tax charitable deduction limitations).

Additionally, bequests left to private foundations upon death are estate tax deductible, which make private foundations particularly well-suited for donors with large estates and charitable intentions.

Conclusion

Given the numerous rules governing the administration of private foundations and the risk of losing tax-exempt status and other penalties if the rules are not properly followed, we recommend that private foundations seek advice from an attorney knowledgeable in private foundation management. When private foundations are run properly, the benefit to our charitable community can be immense.

Please contact us if you would like information regarding private foundation management services offered by Willms, S.C.

END OF MEMO