



# Check This

## *A Compliance Checklist for Private Foundations*

*By Jane C. Nober\**

**The persistent scrutiny of nonprofit governance has prompted leaders at many types of organizations to take steps to assure that their own houses are in good legal and financial order. For private foundations, this checklist is a good place to start.**

Wouldn't it be great if you could assure yourself that your foundation is following all applicable laws and regulations simply by working your way through a checklist? Unfortunately, the legal aspects of private foundation management are too complicated to review that way.

All the same, we have developed the following checklist and offer it as a helpful tool to begin the assessment of whether a foundation is operating in accordance with the relevant legal requirements and whether any modifications to foundation legal documents or procedures are necessary.

The list is, of course, no substitute for consultation with an attorney who is knowledgeable about the ever-changing laws that apply to private foundations and the operations of your particular organization.

### **Organizational and Operational Documents**

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A. **Articles of incorporation or declaration of trust.** This document is the "constitution" of your foundation, its formative document. The following questions should be asked and reviewed:

1. Are the foundation's activities authorized by the purposes set forth in its articles or declaration?
2. Is the actual number of foundation directors or trustees in accordance with the number required in its articles or declaration?
3. Are the registered agent and registered office that are named in the articles or declaration still appropriate, or should the foundation notify the appropriate state office (secretary of state or attorney general) of its current registered agent/or office?
4. Are any provisions authorizing the foundation to indemnify directors, officers and/or employees consistent with current law? Many states have revised their laws regarding indemnification.
5. Have your articles or declaration been amended since your organization applied for exempt status? If so, you are required to notify the IRS of the changes and submit a copy of the revised articles.

B. **Bylaws.** State laws governing nonprofit corporations require bylaws. Bylaws are the rules that govern a corporation's day-to-day operations, meetings, the election of officers and directors or

trustees and other governance issues. Some foundations organized in trust form have also adopted bylaws to guide their managers. The following questions should be asked and reviewed:

1. Are meetings of directors or trustees held at the times and in the places required by the bylaws? Is an annual meeting required by state law?
2. Are notices of meetings given (or appropriate waivers obtained) in accordance with the notice requirements in the bylaws?
3. Are the activities of each officer of the foundation consistent with the activities prescribed for such office in the bylaws?
4. Does your foundation have all of the officers that its bylaws require it to have?
5. Do the bylaws require the existence of an advisory committee or any other such group? If so, does your foundation have such a committee or group, and are its actions in accordance with the rules set forth in the bylaws?
6. Are your foundation's procedures for naming new and substitute directors and officers carried out as directed in the bylaws?
7. Are additional bylaws desirable to govern activities of your foundation or its managers that are not fully delineated in the current bylaws?
8. Do the bylaws authorize such things as the holding of meetings by telephone or other virtual means or action by the directors by unanimous written consent, instead of the holding of a regular meeting? Most states allow board meetings to take place virtually under the condition that all board members can hear one another simultaneously. This would include, among others, teleconferencing, videoconferencing and web conferencing. A few states, while allowing virtual meetings, require the full board to consent to meeting virtually.

*HINT: E-mail can be a handy way for scattered directors to reach consensus on foundation issues, but most states have not yet amended their nonprofit corporation laws to permit voting by e-mail. Those that do may require unanimous votes, which may be practically unfeasible. In addition, there are some that question how secure voting by email is. Check to see what your state allows before relying on a vote taken by e-mail.*

9. Are indemnity provisions consistent with current law and your Articles of Incorporation?
10. If the bylaws require use of a corporate seal, does your foundation have such a seal and is it used regularly?  
*HINT: You don't have to have a corporate seal if you don't want one. Usually, you can amend your bylaws to eliminate the corporate seal.*
11. Do the bylaws require certain financial accounting activities, and, if so, are your foundation's actual activities in accordance with these requirements?
12. Does anything in the bylaws conflict with statements made on your foundation's application for its federal tax exemption? If your bylaws have been amended since you applied for

exemption, have you sent the IRS a copy? IRS rules require that you provide them with a copy of your bylaws if they have changed.

13. Are your bylaws consistent with both state law and your articles of incorporation? If not, your bylaws will need to be amended.

## Documents Relating to Federal Tax Exemption

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*You should be familiar with the following documents relating to your foundation's exemption from federal income tax and be sure they are kept in a safe place:*

- A. **Form 1023**, the application for recognition by the Internal Revenue Service (IRS) as a tax-exempt organization. You need to keep a complete copy of the application along with all attachments and schedules. You should also keep copies of any correspondence between your organization and the IRS relating to the application.
- B. **Form SS-4**, the application for employee identification number.
- C. **The IRS's favorable determination letter** certifying that your foundation is exempt from income tax and specifying that it is a private foundation or a private operating foundation.

*Hint: You should check **IRS Publication 78**, The Cumulative List of Organizations Contributions to Which Are Deductible Under Section 170(c) periodically to be certain that your foundation is listed accurately. Private foundations are indicated by a footnote "4" and operating foundations by a footnote "3."*

- D. **Any IRS letters approving your foundation's grantmaking procedures**. Such a letter is normally required for grants to individuals for study or travel or for set-asides (see below).
- E. **Any other official correspondence from the IRS** concerning the status or operations of the foundation including private letter rulings or audit findings.

## Documents Relating to State Tax Exemption

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*You should be familiar with any documents granting or denying your foundation's exemption from state income, sales, property or franchise taxes and be sure they are kept in a safe place.*

### **Special Private Foundation Rules**

**(Internal Revenue Code, Title 26, Chapter 42, and Code of Federal Regulations (Treasury Regulations), Title 26, Part 53)**

- A. **Internal Revenue Code (IRC) § 4940** imposes an **excise tax on net investment income**, which is due on the 15th day of the fifth month after the close of the foundation's tax year; however, estimated taxes must be paid during the year based on the same rules applicable to for-profit corporations. The tax is 2 percent and may be reduced to 1 percent if the foundation meets certain maintenance of effort tests.

1. Be familiar with these tests so that you can advise the foundation about designing a system to determine when meeting these tests might be most advisable.
  2. Be familiar with the definition of "net investment income" and be certain that adequate [recordkeeping](#) procedures are in place to keep track of all expenses that can be attributed to the production of investment income.
- B. **IRC § 4941** prohibits all acts of **self-dealing**, which are defined generally as financial transactions with disqualified persons (such as substantial contributors, related corporation and foundation board members and their families) using foundation funds. A 10 percent initial excise tax is imposed on the self-dealer. In addition, a five percent tax is imposed on foundation managers who participated in the transaction knowing that it was self-dealing; the tax on foundations managers is capped at \$20,000 per act of self-dealing.
1. Understand the [definition of disqualified persons](#) as set out in IRC § 4946. In general, disqualified persons include substantial contributors to the foundation and foundation managers as well as certain family members of these contributors and managers. Note that the term "persons" is not limited to individuals so may include other entities like a corporation.
  2. Review arrangements for payments for personal services, offices and facilities, transportation, and the like that involve disqualified persons to be certain it is [reasonable compensation for personal services](#) that are necessary to the foundation's charitable operations.
  3. Review the use of any tickets or other tangible benefits resulting from grants and make sure they are either declined or handled properly (for more on this topic, read [this](#) article).
  4. Review banking and investment dealings with banks that are disqualified persons to be sure they fit within the narrow exceptions from the self-dealing rules for general banking services [[Treas. Reg. 53.4941\(d\) – 2\(c\)\(4\)](#)]
  5. Note [restrictions](#) on direct or indirect payments to "[government officials](#)."
- C. **IRC § 4942** imposes a **minimum payout** requirement for private foundations. This payout is roughly the equivalent of five percent of net investment (non-charitable) assets. The first tier tax on the foundation is 30 percent of any undistributed amount.
1. Be familiar with [how this payout requirement is calculated](#) paying particular attention to the definition of "[qualifying distributions](#)" which includes not only grants (with the exception of [grants from private non-operating foundations to certain types of public charities classified as supporting organizations in certain situations](#)), but also necessary and reasonable administrative expenses to accomplish the grant program and other direct charitable activities as well as the acquisition of assets for charitable purposes, program-related investments and set-asides.
  2. Understand how assets are calculated. Assets are measured using a monthly average formula; certain assets such as real estate must be valued on the basis of a qualified appraisal that is no more than five years old.

3. Apply a credit for any investment income taxes paid.
  4. Understand that qualifying distributions that exceed the minimum required may be carried over and applied to later years (up to five). The payout must be met no later than 12 months after the end of the tax year in question; in other words, payments in the following year may be applied retroactively to make up any shortfall.
  5. Design accounting and recordkeeping procedures to provide accurate and reliable information for these calculations.
- D. **IRC § 4943** prohibits a foundation in conjunction with all of its disqualified persons from having **excess business holdings** (a controlling interest in a for-profit company, partnership, etc.). The first tier **excise tax on a foundation that violates these rules** is 10 percent of the fair market value of excess business holdings that are held beyond the permitted time period; the permissible holding period is generally five years.
1. Determine whether any such holdings exist or whether they might be created by additional purchases by disqualified persons.
  2. Plan for any required divestiture and design a method for keeping track of the holdings of all disqualified persons.
  3. Know that regardless of the percentage owned by disqualified persons, the foundation need not divest if its holdings are less than two percent.
  4. Know that excess holdings acquired after 1969 must be divested within five years, although an additional five years may be granted by the IRS Commissioner under limited circumstances.
- E. **IRC § 4944** imposes a penalty on the foundation and its managers for any investment that might jeopardize the carrying out of any of the foundation's exempt purposes (**jeopardy investment**). A tax is imposed upon the foundation and foundation managers that participated in making the investment knowing that it was a jeopardy investment. The tax rate for violating these rules is 10 percent of the investment on the foundation and 10 percent of the investment on foundation managers. The maximum first tier tax for foundation managers is \$10,000 per investment.
1. Know that no type of investment is *per se* a jeopardy investment, but certain types are subject to special scrutiny (commodities futures, trading on margins, working interests in oil and gas wells, "puts" and "calls", etc.).
  2. Be familiar with the definition of a "**program related investment**," which is an exception to the jeopardy investment rules. For example, a below-market interest loan to a minority low-income housing development company could meet the definition, avoid the jeopardy investment prohibition and count toward meeting the minimum payout requirement.
- F. **IRC § 4945** provides a list of various kinds of grantmaking or other expenditures that can subject a private foundation and its manager to penalty for making **taxable expenditures**. For example, funds spent in support of or in opposition to a political candidate, grants to non-charities and certain supporting organizations without **exercising expenditure responsibility**, and grants for non-charitable purposes would subject a foundation to taxes. The first tier excise taxes for violating

these rules are 20 percent of the impermissible expenditure on the foundation and five percent on foundation managers, with a maximum of \$10,000 per expenditure for foundation managers who participate in making the expenditure knowing the expenditure constitutes a violation.

1. Make sure that the foundation does not spend funds on a political campaign or for a non-charitable purpose. These expenditures are prohibited.
2. Understand [when the foundation can advocate](#) and when it cannot. Generally, lobbying is prohibited, but there are several exceptions including self-defense communications, responding to written requests from legislative committees, and providing nonpartisan analysis, study or research.
3. Know that strict rules apply to grants or expenditures for voter registration.
4. Make sure that the foundation has secured advance approval from the IRS before making grants to individuals for study or travel (scholarships, fellowships, prizes, awards).
5. Exercise expenditure responsibility for [grants to non-charities](#) (trade associations, chambers of commerce, social welfare organizations, labor unions, for-profit companies, etc.).
6. Exercise expenditure responsibility for all grants to private foundations other than exempt private operating foundations (a very specific type of private operating foundation). Make sure that the grantee can satisfy the "out-of-corpus" requirement if it is a non-operating foundation and your foundation wants to count the grant towards its own "payout."
7. All private foundations must follow expenditure responsibility procedures when making grants to [certain types of supporting organizations](#). A supporting organization is one type of public charity.

## Administrative Reporting and Public Accountability

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- A. Establish procedures to supply information required for completing various **notice and filing requirements** such as:
1. [Form 990-PF](#), *Return of Private Foundation*. You should be generally familiar with the information in the return and should be sure that it is completed accurately. Instructions are located [here](#).
    - Be sure to [report direct charitable expenses](#) correctly.
    - Any transfers to and transactions and relationships with *noncharitable exempt organizations* (such as trade associations, or social welfare organizations) must also be reported on the Form 990-PF (such as loans, rental of facilities, performance of services, etc.).
  2. *Quarterly IRS filings* and payment of estimated tax, [Form 990-W](#).
  3. *Annual filings* required by state law.
  4. *SEC annual information returns* for very large holdings (over \$100 million).
  5. For foundations with *paid staff*:

- FICA (Social Security and Medicare);
  - Federal, state and local income tax withholding; unemployment insurance (FUTA and any state requirements);
  - Reporting requirements as to fringe benefits under the Employees' Retirement Income Security Act of 1974.
6. Forms [W-9](#) (instructions [here](#)) and [1099-MISC](#) (instructions [here](#)) for consultants, professional fees, director or trustee fees, etc.
  7. Special IRS notice requirements for reporting a dissolution or substantial contraction of a foundation (IRC § 6043 and see § 507).
  8. Foundations with [unrelated business income](#) must file [Form 990-T](#) (income from debt financed investment property and certain publicly traded partnerships are examples). The Form 990-PF also has a section on income-producing activities.

The IRS [Private Foundation Life Cycle](#) is a very useful tool to ensure the foundation is in compliance with federal required filings and ongoing compliance. In addition, IRS publication [4221-PF](#), Compliance Guide for 501(c)(3) Private Foundations explains all the filing and recordkeeping rules applicable.

**B. Foundations that receive contributions from individuals or corporations may have [reporting obligations](#):**

1. A foundation that receives a gift of \$250 or more from an individual or corporation must provide a [written acknowledgement](#) to the donor. This acknowledgement should state the name of the foundation, the amount of the contribution (or describe the property given if it was something other than cash) and should state whether goods or services were received in exchange for the contribution (a quid pro quo contribution). In the case of a quid pro quo contribution, a written acknowledgment must be sent to the donor for any amount donated in excess of \$75. The letter should indicate the name of the donee, the amount contributed, a statement that the charitable deduction is limited to the amount by which the contribution exceeds the fair market value of the goods/services received by the donor, as well as a good faith estimate of the amount of those goods and services received. *Where the [donated property](#) is valued at over \$5,000 and is something other than cash or publicly traded stock, it may be necessary for the donor to complete [Form 8283](#), Noncash Charitable Contributions, and file this form with the donor's tax return. The foundation will have to sign this form. If the donated property is sold within three years of the gift, the foundation must complete and file [Form 8282](#), Donee Information Return. Further reporting requirements may apply when the donation involves certain types of property, for example, a vehicle (see IRS [Publication 4302, A Charity's Guide to Vehicle Donations](#)).*
2. *Where a foundation manager contributes more than \$5,000 to the foundation and the amount contributed is more than 2 percent of the foundation's total contributions, the foundation manager must be listed in Part XV, Line 1(a) of the foundation's 990-PF.*

3. If contributions of appreciated property (other than publicly traded stock) are made to the foundation and the donor wishes to take maximum income tax deductions, plan sufficient distributions to meet the "flow-through" requirements under section 170(b) (1) (E). Note also the need to maintain records and show that such distributions are made out of "corpus" on Form 990-PF.

See IRS [Publication 1771 Charitable Contributions: Substantiation and Disclosure Requirements](#) for further details. The IRS also has a detailed online [FAQ](#) on public disclosure requirements for exempt organizations.

## Public Disclosure Requirements

Every private foundation is required to make certain information available to the public:

1. Copies of the foundation's Form 990-PF filed with the IRS within the past three years **must be made available for public inspection** at the foundation's offices or another reasonable location. In addition, foundations must supply "take-home" copies of such returns to individuals who request them in writing. Unlike other exempt organizations, private foundations must disclose the name and address of any contributor to the organization listed on the 990-PF.
2. If the foundation's Application for Recognition on Form 1023 was on hand or filed after July 15, 1987, this document, as well as any IRS responses, and all relevant correspondence relating to the foundation's exempt status must also be made available to the public for inspection or as a "take home" copy.
3. For both the Form 990-PF and the Form 1023, the foundation may charge a requester the actual cost of mailing the documents and a copying fee that does not exceed 20 cents per page.
4. The public must also have access to Form 990-T, *Exempt Organization Business Income Tax Return*, filed after August 17, 2006. Returns must be available for a three-year period beginning with the due date of the return (including any extension of time for filing). See [Public Inspection and Disclosure of Form 990-T](#) for more information. Also see a [Council resource](#) on this.
5. A foundation may satisfy the requirement of providing copies by making a copy of the relevant Forms 990-PF, 990-T and 1023 "widely available" on a web site. The site may be maintained by the foundation or by another group that maintains a database of foundation documents. The website must (1) inform readers that the document is available and provide instructions for downloading it; (2) must contain an exact replica of the foundation's documents; and (3) may not charge a fee for downloading the documents. Note that making the information widely available does not exempt you from the public inspection requirement.
6. Foundations should check their state law for any disclosure requirements. For example, private foundations located in New York State are—under state law—still obligated to publish an annual newspaper notice that their Form 990-PF is available.



## Grant Programs and Policies

- A. Review grant programs in the light of the *self-dealing rules*, paying special attention to conflict of interest situations. Treasury regulations warn that it is an act of self-dealing for a private foundation to [satisfy a legally enforceable personal pledge](#) made by a disqualified person (for example, an individual, spouse or corporate donor to the foundation) to an independent charity [[Treas. Reg. 53.4941\(d\) – 2 \(f\) \(1\)](#)].
- B. *Determine status of recipient organizations* as private foundations, private operating foundations, publicly supported charitable organizations, or "other" by consulting [IRS Publication 78](#).  

This publication is coded to indicate the status of numerous charitable organizations. Organizations listed with no code number following their name are "public charities," grants to which generally do not require expenditure responsibility under Code section 4945 (as noted earlier, an exception would be [grants to certain types of supporting organizations](#)). Some well-known nonprofit organizations, such as the League of Women Voters and the NAACP, are not themselves charities, but their section 501(c)(3) affiliates are listed in Publication 78 as public charities. Note also, however, that federal law permits grants to "noncharitable" organizations for charitable purposes, provided requirements for expenditure responsibility are met.
- C. Develop procedures and wording for *grant letters*, especially where **expenditure responsibility provisions** may apply [[IRC § 4945](#) (d) (4) and (h)], or where the grantee must expend the grant in the year following its receipt [[IRC § 4942 \(g\) \(3\)](#)]. (See sample provisions [here](#))
- D. Don't be intimidated by the *expenditure responsibility rules* under **IRC § 4945**. IRS data and the Council on Foundations' experience indicate that a significant number of Council members make expenditure responsibility grants as a matter of course. These foundations report that the expenditure responsibility rules are not burdensome and are generally consistent with their own grantmaking procedures. Expenditure responsibility can be particularly helpful in making [international grants](#).
- E. Note especially *limitations on types of grants* (IRC § 4945), such as restrictions on direct or indirect payments to "[government officials](#)" [[IRC § 4941 \(d\) \(1\) \(F\) and \(2\) \(G\)](#)], [IRC § 4946 \(c\)](#)].

## Other Issues

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- A. **Insurance**. Does your foundation wish to [indemnify directors, officers and employees for legal liabilities](#) that may be incurred while performing their duties? Are the foundation's indemnification provisions up-to-date with state law? Does your foundation wish to purchase directors and officers (D&O) liability insurance that would offer coverage for losses and legal costs related to damage claims? If you already have a D&O policy, you should have a copy of the policy and be familiar with what it covers, what the premiums are, and when it needs to be renewed. If you don't have insurance yet, consider the [Council-endorsed D&O Insurance Policy](#).

- B. **Contracts.** Are all contracts and agreements recorded in written, signed documents, in order to avoid disputes about the terms of the agreements? Is the foundation in compliance with all contracts to which it is a party? Is there a written policy for completion and review of contracts with clear direction from the governing body as to what foundation managers may obligate the foundation?
- C. **Real Estate and Other Property.** Are all of your foundation's documents of title to real, personal, and intangible property located in a safe place and in the control of the proper persons?
- D. **Employment.** Should the foundation have employment contracts with any of its employees? Is there a clear employment policies and procedures manual? Are the foundation's employment practices discriminatory? *Note: Wrongful termination suits are the claims most often filed under directors and officers liability policies.*
- E. **Pension.** Do the foundation's pension plans conform with the Equal Retirement Income and Security Act (ERISA)?
- F. **Permits and Licenses.** Does the foundation need a charitable solicitation permit in the states where it raises funds? Does the foundation need any other licenses or permits? Is the foundation qualified to do business in every state in which it conducts activities for which such qualification is required?
- G. **Copyright and Trademark.** Does the foundation hold the copyright on materials that it publishes? Has it registered those publications with the Copyright Office? Has it received appropriate permissions to reproduce work created by others? Has the foundation spent time and money marketing and creating public recognition of its name, slogans or logos? If so, has the foundation taken any steps to protect those trademarks? Has it registered those marks with the U.S. Patent and Trademark Office? *Note: While registration is optional for both copyrights and trademarks, there are many benefits that such registration provides.*
- H. **Sales tax.** Should your foundation be collecting and paying state or local sales tax?
- I. **Minutes.** Is the corporate minute book up-to-date and complete? Are the minutes kept in a safe place?

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