



IMPROPER PAYMENTS BY PRIVATE FOUNDATIONS

As Donald Trump learned the hard way, the consequences can be costly

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Patricia R. Beauregard, a principal in Cummings & Lockwood's Private Clients Group, published an article entitled "Improper Payments by Private Foundations" which appeared in *Trusts & Estates* magazine website on March 29, 2016. In the article, she emphasizes that failing to comply with strict regulations is risky business and can land both the foundation and its managers in hot water (as Donald Trump learned the hard way).

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A private foundation, it's been said, is a large body of money surrounded by those who want some. But, to whom may a private foundation make contributions? This question garnered mainstream media attention recently, as Donald Trump, GOP front-runner in the presidential race, made headlines after admitting that a contribution made to a political entity by his private foundation was a mistake.

This article isn't meant as a political statement but rather seeks to inform those who may not be familiar with the private foundation rules.

Private foundations are tightly regulated charities. If a foundation doesn't diligently follow the law, the consequences can be costly. Not only can the foundation lose its tax exemption, but the individuals responsible for inappropriate actions can be personally subject to money penalties.

It doesn't matter if the inappropriate action was a mistake or wasn't intended. The repercussions are the same.

The Rules

Any amounts paid or incurred by private foundations for

any of the following purposes can land the foundation and its managers in hot water: (1) to carry on propaganda or otherwise attempt to influence legislation; (2) to influence the outcome of any specific public election or to carry on, directly or indirectly, any voter registration drive, unless certain conditions are met; (3) as a grant to an individual for travel, study or other similar purposes, unless the grant meets certain requirements; (4) as a grant to an organization other than a public charity, unless the granting foundation exercises "expenditure responsibility"; and (5) for any purpose other than those specified in Internal Revenue Code Section 170(c)(2)(B) (for example, religious, charitable, scientific, literary or educational purposes, to foster certain amateur sports competitions or for the prevention of cruelty to children or animals).

Making a contribution to a political entity falls under (5) above, and is absolutely forbidden; no shades of grey whether in a red or blue state.

The Consequences

What's the cost of wrongdoing (so-called "taxable expenditures")? The initial first-tier excise tax of 20 percent is imposed on the private foundation equal to the taxable expenditure made. If the taxable expenditure was \$100,000, for example, the 20 percent excise tax would be \$20,000. If a foundation has made a taxable expenditure for which an initial tax is imposed, another initial first-tier excise tax of 5 percent of the amount of the expenditure is imposed on a foundation manager (an officer, director or trustee of the foundation, or an employee having authority or responsibility with respect to the act), who agreed to making the expenditure knowing it was a taxable expenditure. If the expenditure was \$100,000, the 5 percent payable by the foundation manager would be \$5,000.

The second-tier 100 percent excise tax is imposed if the misdeed isn't corrected within the taxable period, which is the date beginning with the date of the taxable expenditure and ends with the earlier of the date when a deficiency notice for the first-tier tax is mailed or the first-tier tax is assessed. Notice and the opportunity to correct the expenditure must be given before second-tier taxes are imposed.

Due Diligence Requirement

Foundation managers are required to perform due diligence before any grants are paid to a charitable organization, which should, in most cases, be a public charity. Any other type of grant would require "expenditure responsibility." That due diligence would include requesting a determination letter from the donee organization or searching the organization on the Internal Revenue Service website to determine that it is, in fact, a public charity.

Due diligence also includes examining the organization's latest Form 990, which is readily available on Guidestar.com and may also be available on the charity's own website. Alternatively, you may call the charity and ask for the Form 990.

Finally, managers can search the charity's name online, look at its website and find out if it's been in the news lately. At least one of these searches would have shown, in the case of Trump's foundation, that there were three organizations with similar names but with differing tax statuses and different addresses.

The buck stops with the foundation manager. Even if a clerk runs the searches, the foundation manager is responsible for checking the information before releasing the check.

To the maxim, "Ignorance of the law is no excuse," add: "Mistakes aren't either."