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The misunderstood world of private foundations

By Frank H. Smith, opinion contributor — 01/11/19 02:00 PM EST

Beyond the media craze and the flexing of muscles by the New York Attorney General's Office and advisers of the Trump Foundation, there are lessons to be learned on the often misunderstood world of private foundations. The rules are complex and, in some ways, illogical and arcane. The general public doesn't understand the rules; many attorneys and accountants who advise foundations are woefully undertrained; and many foundation managers haven't learned the "dos and don'ts." In addition, even many IRS agents don't know more beyond the basic rules.

Even those with the best intentions can get in trouble. Those with not-so-good intentions can really get in trouble. These organizations are open to public scrutiny, and their assets are considered public funds under the jurisdiction of the attorneys general. The battle between New York's attorney general and the Trump Foundation is the most recent example.

The primary accusations raised in connection with the Trump Foundation are self-dealing, political activity and poor governance. Whether or not any of these accusations is proved accurate, it does focus attention on some very important issues.

Self-dealing relates to any number of transactions (such as sales, loans, rents, compensation, use of assets, etc.) between a private foundation and those individuals or entities that are considered disqualified persons of the foundation. Knowing exactly who is considered a disqualified person is the first important step, whether that be board members, officers, or substantial donors, including their families and certain controlled entities.

While many headlines focus on the now-famous portrait and well-known signed sports memorabilia and the stories of how they became assets of the Trump Foundation, the true tax issue revolves around how those items were used by disqualified persons after they were acquired. The fact that the items were purchased at a charity auction using foundation funds does not cause any real tax concerns. The primary purpose of most private foundations is to distribute charitable funds to other charities. However, both sides agree that some of the purchased items ended up being displayed at a business owned by a disqualified person, which would be considered

self-dealing. To rectify such a violation, the business would have to return the item and pay a fair rental fee and a 10 percent excise tax penalty.

Another claim is that the foundation paid for expenses that were the legal responsibility of a disqualified person. A private foundation cannot pay for even personal pledges made to charities by disqualified persons, much less pay for their personal expenses. In addition to self-dealing, these kind of payments also might be considered taxable expenditures, subjecting the foundation to even more excise tax penalties.

Probably the most interesting of the charges is that of campaign involvement in what might be considered political activities, which are not allowed to be conducted by 501(c)(3) public charities or private foundations. Such exempt organizations need to be very careful when engaging in any activities that might seem to be supporting or opposing a candidate for political office. What becomes murky in this situation is that the disqualified person is actually the person who was up for election. Is it possible for a candidate for office to raise funds for a foundation? Can a foundation distribute charitable contributions to other charities in key voting areas? It is easy to see how the basic self-dealing and taxable expenditure rules can get complicated very quickly.

One area that does not get its deserved attention is that of governance. This becomes more important when dealing with states, because the attorney general of the state where the charity is incorporated or operating has broad oversight responsibilities over the charitable assets and operations of the charity in question. Has the board fulfilled its fiduciary responsibilities? Is there a conflict of interest policy in place and has it been monitored and followed? Have the assets been used solely for charitable purposes? Has proper documentation been maintained to prove appropriate use of the assets?

In the end, both sides have requested this particular private foundation be dissolved and the assets distributed to other charitable organizations. In addition, the private foundation and its disqualified persons may be subject to some penalties and other legal consequences as the courts and the IRS resolve the issues. The question is: Will other foundations and those who are involved with them learn from this public discussion and make sure they understand the rules to avoid similar problems?

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