CHAPTER 48

Setting Up a Private Foundation in Your Will or Trust

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Recently, the Internal Revenue Service released sample trust forms for private foundations on its Web site at http://www.irs.gov/charities/foundations/article/0,,id=141239,00.html. Among the provisions that should be included in your will or trust to establish a private foundation are the following.

REQUIREMENTS FOR PRIVATE FOUNDATIONS

Purpose Clause. Federal law requires that a donor organize and operate his charitable foundation "exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes. . ." To show compliance with this requirement, the trust document should include a purpose clause. The grantor can define the charitable purposes of his or her foundation broadly or narrowly.

Chapter 42 Language. Code Section 508(e)(1) requires that all private foundations, whenever and however organized, include language requiring compliance with Chapter 42 of the Internal Revenue Code: "The Foundation shall distribute its income for each tax year at such time and in such manner as not to become subject to tax on undistributed income imposed by Section 4942 of the Internal Revenue Code. Further, the Foundation shall not engage in any act of self-dealing as defined in Section 4941(d) of the Internal Revenue Code, nor retain any excess business holdings as defined in Section 4943(c) of the Internal Revenue Code, nor make any investments in such manner as to incur tax liability under Section 4944 of the Internal Revenue Code, nor make any taxable expenditures as defined in Section 4945(d) of the Internal Revenue Code." Section 1.508-3(d) of the Treasury Regulations deems a foundation's governing instrument to conform with the requirements of Section 508(e) if valid provisions of state law have been enacted that: 1) require it to act or refrain from acting so as not to subject the Foundation to the taxes imposed by sections 4941 (relating to taxes on self-dealing), 4942 (relating to taxes on failure to distribute income), 4943 (relating to taxes on excess business holdings), 4944 (relating to taxes on investments which jeopardize charitable

purpose), and 4945 (relating to taxable expenditures); or 2) treat the required provisions as contained in the Foundation's governing instrument. The Internal Revenue Service has listed those states that have enacted provisions complying with this Regulation in Revenue Ruling 75-38.[1]

Private Inurement. The governing instrument should state that "No part of the assets, income or profit of the Foundation shall be distributed to or inure to the benefit of private persons except that the Foundation shall be empowered to pay reasonable compensation for services rendered and to make payment and distributions in furtherance of the purposes of the Foundation." The law — through a doctrine imbedded in the Internal Revenue Code called the "private inurement doctrine" — prohibits a charity from using any part of its net earnings for a private use.[2] "The inurement prohibition serves to prevent anyone in a position to do so from siphoning off any of a charity's income or assets for personal use."[3] The Internal Revenue Service requires that the governing instrument include a prohibition against violating this foundational doctrine of charitable jurisprudence.

Prohibition Against Political Activities. The governing instrument of all Foundations should contain a statement similar to the following: "No substantial part of the activities of the Foundation shall involve carrying on of propaganda, or otherwise attempting to influence legislation and the Foundation shall not participate in or intervene in any political campaign on behalf of any candidate for office." Like the prohibition against private inurement, the prohibition against lobbying and campaigning activities is a fundamental part of our charitable jurisprudence.[4] So, again, the Internal Revenue Service requires that the governing instrument include prohibition against lobbying and campaigning.

Dissolution Clause. The law does not treat an organization as organized exclusively for charitable purposes unless the organization dedicates its assets to exempt purposes, even when the organization terminates.[5] So, as a rule,[6] federal law requires the governing instrument to state how the Foundation will disburse its assets if the organization goes out of existence. A typical dissolution clause will read, "Upon the dissolution of this organization, assets shall be distributed for one or more exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future federal tax code, or shall be distributed to the federal government, or to a state or local government, for a public purposes."[7]

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1. 1975-1 C.B. 161.
2. Treas. Reg. § 1.501(c)(3)-1(c)(2).
3. Gen. Coun. Mem. 39862.
4. Treas. Reg. § 1.501(c)(3)-1(b)(3). The prohibition for private foundations is even more restrictive.
5. Treas. Reg. § 1.501(c)(3)-1(b)(4).
6. Rev. Proc. 82-2, 1982-1 C.B. 367 says an express clause is not necessary if governing state law's cy pres doctrine protects the ultimate charitable purposes of the charity, even upon dissolution.
7. Id.