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THE PRIVATE FOUNDATION IS ALIVE AND MODERATELY WELL

W. Bjarne Johnson

INTRODUCTION

Life has become more difficult for the privately supported charitable organization since the passage of the Tax Reform Act of 1969 (the "Act"). Singled out by the 91st Congress, private foundations are now subject to a series of provisions designed specifically for them.

The period before the Act was characterized by an increasing number of abuses of exempt status and the inability of prior law to cope with them. The crux of the problem was that the law was not sufficiently flexible to deal with deviations from a foundation's charitable purpose. This was so basically for two reasons. First, the only available sanction was the loss of exempt status. Second, the guidelines for application of the sanctions were essentially subjective in nature. The consequences were that the penalties were either too light or too severe, and that their application was too unpredictable.

As will be seen, the thrust of the 1969 Act was to tighten the regulation of private foundations, and to graduate the sanctions so that they would be commensurate with the violation. The changes brought about by the Act have occurred mainly in the sanctions to be applied to private foundations, the method of qualification for exempt status, and the information that must be filed each year in the annual reports. The net effect of the Act would seem to be that while private foundations are better confined to charitable purposes, they are also less attractive as a tax planning tool because of the complex set of rules governing them.

DEFINITIONS

As might be expected, there are a number of terms of art which have a carefully defined meaning as they relate to private foundations. It is well to treat the more common terms at the beginning.

1Public Law 91-172 (Dec. 30, 1969) [hereinafter cited as P.L. 91-172].
PRIVATE FOUNDATION

The term "private foundation" is a creature of the 1969 Act. Before being incorporated into the Internal Revenue Code (the "Code"), the term was often used to differentiate between types of charities on the basis of the degree of deductibility of contributions to them. Using that as a basis, Congress decided to define the term more precisely and place it in the Code. The effect was to divide Section 501(c)(3) exempt organizations into two broad categories, private foundations and public charities.

Determination of whether a charitable organization is a private foundation or not is a process of elimination. Basically, all "[c]orporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or education purposes, or for the prevention of cruelty to children or animals. . ." are private foundations unless excluded by Section 509. With certain exceptions, there is a statutory presumption that an exempt 501(c)(3) organization is a private foundation.

Code Section 509 defines a private foundation by excluding certain organizations from that classification. Generally, those organizations excluded from classification as a private foundation are those which "either have broad public support or actively function in a supporting relationship to such organizations." There are four types of organizations excluded from private foundation status:

1. An organization described in the Section on charitable contributions which permits a contributor to deduct his contribution up to a maximum of 50% of his adjusted gross income;
2. An organization which normally receives more than one-third of its support from the general public (excluding disqualified persons), and normally receives no more than one-third of its support from its gross investment income;
3. An organization that is organized either to carry out the purposes of those organizations described in (1) and (2) above, or is controlled by them;

4H.R. 91-413, supra at 40; S.R. 91-552, supra at 56.
5INT. REV. CODE of 1954, § 501(c)(3).
6INT. REV. CODE of 1954, § 509(a).
7INT. REV. CODE of 1954, § 509(a).
8INT. REV. CODE of 1954, § 508(b).
10INT. REV. CODE of 1954, § 509(a)(1).
11INT. REV. CODE of 1954, § 509(a)(2)(A). For this definition, Code section 509(a)(1) excludes only clauses (vii) and (viii) of Section 170(b)(1)(A).
12INT. REV. CODE of 1954, § 509(a)(2)(A), (B).

https://scholarship.law.umt.edu/mlr/vol35/iss1/4
4. An organization which is organized and operated exclusively for testing for public safety.¹³

DISQUALIFIED PERSON

Generally, disqualified persons are either the foundation's managers or its substantial contributors. The term includes not only the disqualified person himself, but also his business entities and members of his family. Some examples of a "disqualified person" include the following:

1. A substantial contributor to the foundation;¹⁴
2. A foundation manager;¹⁵
3. The owner of more than 20% of either the voting power of a corporation, the profits interest of a partnership, or the beneficial interest of a trust which is a substantial contributor to the foundation;¹⁶
4. A member of the family of any of the above;¹⁷
5. Either a corporation,¹⁸ partnership,¹⁹ or a trust or estate,²⁰ of which any of the persons described in (1) through (4) above own more than 35% of the control or interest.

FOUNDATION MANAGER

This term includes any person having direction of the foundation, whether he be called an officer, director or trustee.²¹ With regard to any particular act (or failure to act), the definition also includes those employees who were responsible for the performance of that act.²²

SUBSTANTIAL CONTRIBUTOR

A "substantial contributor" is any person who contributes more than $5,000 to the foundation if, before the close of the taxable year, that amount is more than 2% of the total contributions received during that year.²³

²¹ INT. REV. CODE of 1954, § 4946(b)(1).
²² INT. REV. CODE of 1954, § 4946(b)(2).
²³ INT. REV. CODE of 1954, § 4946(a)(2).
EFFECT OF THE 1969 TAX REFORM ACT ON PRIVATE FOUNDATIONS

The Tax Reform Act of 1969 sharply limited the scope of the adage that “charity begins at home.” That adage, it is safe to say, no longer covers the privately supported charitable (read “exempt”) organization. The Act was established to deal particularly with the abuses of private foundations and the inability of the Service to enforce the previous sanctions. The thrust of the Act now is to cover particular abuses of private foundations with specific Code provisions. The structure of the Act is also different in that it now imposes a graduated series of penalty taxes for violations, rather than withdrawing the exemption completely.

EXCISE TAX BASED ON INVESTMENT INCOME

Although private foundations are still exempt from tax under Section 501(a), the Act now imposes an excise tax of 4% on each foundation’s net investment income.24 The legislative history indicates that this tax was imposed for two reasons. One reason was the belief that the costs of government should be shared by all who benefit by it and are able to pay.25 More convincing, perhaps, was the idea that since private foundations were so troublesome to administer and required more extensive supervision, they should be made to share the increased burden.26

The tax is imposed only on the net investment income of the foundation. Net investment income equals the sum of the gross investment income and the net capital gain proceeds, less deductions for expenses incurred in the production of that income.27 This is separate from those taxes imposed on the foundation’s unrelated business income.28

TAXES ON SELF-DEALING

Prior to the 1969 Act, what are now known as private foundations were subject only to the prohibited transaction rules of Section 503.29 The only sanction then available was the loss of exempt status for those foundations found to have engaged in one of the listed transactions.30 The former provision imposed what were later called “arms-length standards”31 on those transactions between a foundation and

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24 INT. REV. CODE of 1954, § 4940(a).
25 H.R. 91-413, supra at 19; S.R. 91-552, supra at 27.
26 Id.
27 INT. REV. CODE of 1954, § 4940(c)(1). This tax will be reported on the annual information form 990. Treas. Reg. § 53.4940-1(a) (1972).
28 INT. REV. CODE of 1954, § 4940(c)(2).
29 This was under the former rule, INT. REV. CODE of 1954, § 503(b), which was since repealed by P.L. 91-172, § 101(j)(14), effective January 1, 1970.
30 This provision was under INT. REV. CODE of 1954, § 503(a)(1)(A) before that section was amended by P.L. 91-172, § 101(j)(7),(8), effective January 1, 1970.
31 H.R. 91-413, supra at 20; S.R. 91-552, supra at 28.
its creator or substantial contributors. But, since January 1, 1970, only three classifications of exempt organizations remained exposed to loss of exempt status under Section 503: Section 401(a) pension and profit sharing plans, Section 501(c)(17) supplemental unemployment benefit trusts, and Section 501(c)(18) employee funded pension trusts. Now, private foundations have their own provision regarding transactions between them and either their creators or substantial contributors.

Congress found that the former prohibited transaction rules were largely ineffective in governing acts of self-dealing with private foundations. There were several reasons. For one, the only available sanction, loss of exempt status, very often seemed too great for the particular violation involved. This, in connection with the element of subjectivity involved in the application of the standards, resulted in very uneven results. Attempts at enforcement very often resulted in extensive litigation, and a certain reluctance by the courts to impose so stiff a penalty.

From this, Congress determined that there were three requirements for the new legislation: it had to reduce the need to rely on subjective guidelines such as the former arms-length standards of Section 503; it had to eliminate as much as possible the temptation to misuse private foundations for noncharitable purposes; and it had to provide a more rational relationship between the violation and the sanction. To accomplish these objectives, Section 4941 details a number of transactions which constitute self-dealing, and then provides a graduated series of taxes for violations.

Self-dealing is defined in the Code as any direct or indirect:

(A) sale or exchange, or leasing, of property between a private foundation and a disqualified person;
(B) lending of money or other extension of credit between a private foundation and a disqualified person;
(C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;
(D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;
(E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation; and
(F) agreement by a private foundation to make any payment of money or other property to a government official . . . other than an agreement to employ such individual for any period after termination of his government service . . . .

\[\text{\textsuperscript{5}}\text{\textsuperscript{IT. REV. CODE of 1954, § 503(b). This was formerly Section 503(c) before being redesignated P.L. 91-172, § 101(j)(14), effective as of January 1, 1970.}\]
\[\text{\textsuperscript{6}}\text{\textsuperscript{IT. REV. Code of 1954, § 503(a)(1).}\]
\[\text{\textsuperscript{7IT. REV. Code of 1954, § 4941. Taxes on Self-Dealing.}\]
\[\text{\textsuperscript{8H.R. 91-413, supra at 20; S.R. 91-552, supra at 28.}\]
\[\text{\textsuperscript{9Id.}\]
\[\text{\textsuperscript{10H.R. 91-413, supra at 21; S.R. 91-552, supra at 29.}\]
\[\text{\textsuperscript{11IT. REV. Code of 1954, § 4941(d).}\]
\[\text{\textsuperscript{12IT. REV. Code of 1954, § 4941(a),(b).}\]
\[\text{\textsuperscript{13IT. REV. Code of 1954, § 4941(d)(1).}\]
If they are done properly, though, some of the above transactions may not be considered self-dealing. For example, the lending of money by a disqualified person to a private foundation is not considered to be an act of self-dealing if there is no interest charged and the proceeds of the loan are used exclusively for the purposes listed in Section 501(c)(3).\textsuperscript{41} Also, payment of compensation to a disqualified person for his personal services is not considered to be self-dealing if the services are reasonable and necessary to carry out the exempt purpose of the foundation, and if the payment is not excessive.\textsuperscript{42}

Individual acts of self-dealing no longer necessarily result in the loss of exempt status. Instead, Section 4941 imposes a tax on all persons involved in each act of self-dealing.\textsuperscript{43} For purposes of this provision, a foundation manager is treated differently from the disqualified person, and he is subject to a different tax liability.\textsuperscript{44} Too, the tax liability will vary depending upon whether the tax is for a first violation,\textsuperscript{45} or it is an additional tax imposed on a condition that has gone uncorrected.\textsuperscript{46}

The initial tax for each act of self-dealing on the part of a disqualified person is 5\% of the amount involved in the act. This is imposed regardless of his knowledge of the act.\textsuperscript{47} The initial tax on the foundation manager, on the other hand, is only 2\% of the amount involved in each act. Furthermore, it is imposed only if the foundation manager knew it was an act of self-dealing.\textsuperscript{48}

There are additional taxes imposed on each act not corrected in time. On each disqualified person who participated in the continued act of self-dealing, there is imposed a tax equal to 200\% of the amount involved.\textsuperscript{49} The foundation manager is subject to a tax of 50\% of the amount involved in the act, but only if he refused to agree to a correction of that act.\textsuperscript{50}

In either case, there is a $10,000 maximum limit on the amount that a foundation manager will have to pay.\textsuperscript{51} There is no corresponding limitation for the disqualified person. But, there is joint and several liability among all persons liable under each tax.\textsuperscript{52}

\begin{itemize}
  \item \textsuperscript{41}\textit{Int. Rev. Code} of 1954, § 4941(d)(2)(B).
  \item \textsuperscript{42}\textit{Int. Rev. Code} of 1954, § 4941(d)(2)(C).
  \item \textsuperscript{43}\textit{Int. Rev. Code} of 1954, § 4941(a).
  \item \textsuperscript{44}\textit{Int. Rev. Code} of 1954, § 4941(a)(1), (2).
  \item \textsuperscript{45}Id.
  \item \textsuperscript{46}\textit{Int. Rev. Code} of 1954, § 4941(b).
  \item \textsuperscript{47}\textit{Int. Rev. Code} of 1954, § 4941(a)(1).
  \item \textsuperscript{48}\textit{Int. Rev. Code} of 1954, § 4941(a)(2).
  \item \textsuperscript{49}\textit{Int. Rev. Code} of 1954, § 4941(b)(1).
  \item \textsuperscript{50}\textit{Int. Rev. Code} of 1954, § 4941(b)(2).
  \item \textsuperscript{51}\textit{Int. Rev. Code} of 1954, § 4941(c)(2).
  \item \textsuperscript{52}\textit{Int. Rev. Code} of 1954, § 4941(c)(1).
\end{itemize}
TAXES ON FAILURE TO DISTRIBUTE INCOME

Before the 1969 Act, there were few restrictions on the accumulation of income by a private foundation. The only sanction was loss of the exemption when the accumulation became "unreasonable in amount or duration," and then it applied only to the accumulation of income. There were two serious drawbacks to this scheme to prevent unreasonable accumulations. For one, the section only applied to amounts accumulated out of income. That meant that no distribution was required if all the assets were invested in growth securities which produced little current income. For another, even if the assets did produce some income, no distribution was required until the accumulation became "unreasonable." Furthermore, as in the case of self-dealing, the penalties were too harsh, and their application was too subjective.

The solution of the Act was simple. There will be a charitable distribution every year, whether or not any income was earned, or a series of taxes will be imposed on the amount undistributed. The undistributed income that is taxed is equal to the amount that the "distributable amount" for each year exceeds the "qualifying distributions" made by the foundation.

There will be a "distributable amount" each year, regardless of whether any current income is actually earned. This is because the "distributable amount" is equal to the higher of either the "minimum investment return" or the "adjusted net income," reduced by taxes on unrelated business income and the 4% excise tax on net investment income.

The "minimum investment amount" works as a floor on the distributable amount, and represents the minimum amount that must be paid out each year. This amount is determined by first finding the excess of the aggregate fair market value of all the foundation's assets (other than those used directly in its charitable work) over the indebtedness existing against those assets. This is then multiplied by a certain percentage that is set each year to reflect a proper investment rate. The current minimum investment return is set at 5.25%.

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This was under the former provision, Int. Rev. Code of 1954, § 504(a)(1), which has since been repealed by P.L. 91-172, § 101(j)(15), effective for taxable years beginning after December 31, 1969.

H.R. 91-413, supra at 25; S.R. 91-552, supra at 35.

Id.

Id.


The "adjusted net income" becomes the distributable amount only if it is higher for the year than the minimum investment return. Basically, the adjusted net income is the gross income for the taxable year less the expenses incurred in earning it. For purposes of this section gross income includes not only all interest earned from tax exempt interest on certain governmental obligations (Section 103), but also all short-term capital gain. This does not include long-term capital gain.

The final calculation required is whether the distributable amount (as determined by either the minimum investment return or the adjusted net income) exceeds the "qualifying distributions." If so, there is a tax on the failure to distribute that amount remaining. "Qualifying distributions" include any amount, including administrative expenses, that is spent to accomplish the foundation's charitable purposes. This also includes sums paid to acquire an asset used directly in carrying out the foundation's charitable purposes. This does not include, however, amounts paid to an organization that is controlled directly or indirectly either by the foundation or one of its disqualified persons.

It should be noted here, though, that although Congress was concerned with the "current-benefits-to-charity" purpose of this provision, it did provide for long term accumulations in certain cases. A foundation may set aside a certain amount each year for up to five years if it can convince the Secretary that the amount accumulated will be paid for a specific project within five years, and the project is one that can be better accomplished by accumulating the funds. For good cause shown, this period may even be extended further.

On all income remaining undistributed at the end of the taxable year, there is imposed a tax of 15% of that amount. There is an additional tax imposed if there remains any income yet undistributed at the end of the "correction period." This tax is 100% of the amount remaining undistributed at that time. The "correction period" means a period beginning with the first day of the taxable year and ending 90 days after the date the notice of deficiency was mailed.
TAXES ON EXCESS BUSINESS HOLDINGS

Before the 1969 Act, the Code did not deal directly with the problems of foundation ownership of business enterprises. Congress noted that since it was unclear at what point these noncharitable purposes became great enough to disqualify the foundation from exempt status, there was an increasing tendency to use foundations to control certain businesses. This was especially true in the case of small, family owned corporations. The danger, as Congress saw it, was twofold. If the lure of improving the foundation's business fortunes proved too great, then there was the danger of its losing sight of its charitable purposes. On the other hand, if the charitable purposes were to predominate, then the business might be run in a way that would compete unfairly with other businesses that did not have the advantage of a tax deduction. The answer to these problems was to limit the extent to which a private foundation may control a business.

Except in the case in which a third person has effective control, a private foundation and its disqualified persons may not own more than 20% of the voting stock of a corporation. If the effective control of the corporation is in a person who is not disqualified with respect to a foundation, then that foundation, together with its disqualified persons, may own a total of 35% of the voting stock. There are similar restrictions imposed on the ownership of interests in other types of enterprises such as partnerships or joint ventures.

In one instance, the holdings of disqualified persons are disregarded in computing the amount of permitted holdings. This is the de minimus rule which provides that a foundation will not be considered as having excess business holdings in a corporation as long as it owns not more than 2% of the voting stock and not more than 2% in value of all outstanding shares of all classes of stock.

Congress did not require that all private foundations with excess holdings as of May 26, 1969, dispose of them immediately. Instead, there are varying periods of divestiture permitted in order to reduce their holdings. There are even grace periods for divestiture of excess holdings acquired after that date. Though there is no grace period for holdings purchased after May 26, 1969, there is a five-year period...
allowed to dispose of any excess holdings that were the result of a gift or bequest.\textsuperscript{85}

If a private foundation is found to have excess business holdings, a tax of 5\% of the value of those holdings is imposed.\textsuperscript{86} Though the tax is imposed on the last day of the taxable year, it is to be calculated according to the day during the year when the excess holdings were at their greatest.\textsuperscript{87} Then, if the situation is not corrected within the correction period, there is imposed an additional tax of 200\% of the excess business holdings.\textsuperscript{88}

**TAXES ON INVESTMENTS WHICH JEOPARDIZE CHARITABLE PURPOSE**

The former law was also an unwieldy weapon when dealing with investments which jeopardized a foundation's charitable purpose. The law restricted only the investment of accumulated income, and not investment of the other assets of a foundation. Only loss of exemption was provided for violations.\textsuperscript{89} Following the pattern of the other provisions, Congress believed limited sanctions were preferable to the loss of exemption. It also believed that the restrictions on investment should apply to a foundation's assets as well as to its accumulated income.\textsuperscript{90}

Accordingly, there is now imposed on both the foundation and the foundation manager a tax for each investment which jeopardizes the carrying out of the foundation's exempt purposes.\textsuperscript{91} The private foundation is subject to a tax equal to 5\% of the amount so invested.\textsuperscript{92} The foundation manager is subject to the same amount of tax, but only if he participated in the making of the investment, and did so knowing it jeopardized the carrying out of the foundation's exempt purposes.\textsuperscript{93}

Additional tax of 25\% of the amount invested is imposed on the foundation for every investment that is not removed from jeopardy within the correction period.\textsuperscript{94} To remove an investment from jeopardy for purposes of this provision, the investment must be sold, and the proceeds of that sale cannot be investments which jeopardize the foundation's exempt purposes.\textsuperscript{95} For the foundation manager who refused to
remove the investment from jeopardy, there is an additional tax of 5% of the investment.\textsuperscript{96}

There is a limit to management liability under this provision. Regarding any one investment, there is a limit of $5,000 for the first level of taxes, and a limit of $10,000 for the additional taxes.\textsuperscript{97} But, if more than one person is liable under either level of taxes, then all such persons are jointly and severally liable.\textsuperscript{98}

**Taxes on Taxable Expenditures**

Prizing ingenuity less and compliance more, Congress responded to a number of abuses of private foundations with Section 4945. Here, the Congress concerned itself with various activities, such as lobbying and electioneering, that it believed should not be carried on by exempt organizations.\textsuperscript{99} The structure of this provision is similar to the others in that it imposes a series of taxes rather than the loss of exemption for violations. In this provision, the taxes are imposed on each “taxable expenditure.”\textsuperscript{100} A “taxable expenditure” means any amount paid or incurred by a private foundation in ways that are prohibited by the Code.\textsuperscript{101} There are basically five categories of taxable expenditures. Money spent in the following ways will be considered a taxable expenditure.

A. **Lobbying**

Prior law was limited to the provisions of Section 501(c)(3) which states only that “no substantial part of the activities” of the foundation may be “carrying on propaganda, or otherwise attempting, to influence legislation.”\textsuperscript{102} Here again, the only provision was for the loss of exemption. Also, since the test was based upon the substantiality of the activities in relation to the foundation, a larger foundation could carry on a greater amount of lobbying without risk.\textsuperscript{103}

Now, any amount paid by a foundation “to carry on propaganda, or otherwise to attempt, to influence legislation” is made a taxable expenditure, regardless of how substantial a part of the activities of the foundation it may be.\textsuperscript{104} This provision encompasses both attempts to influence legislation through campaigns directed at the general public,\textsuperscript{105} and through communication with any government official or em-
ployee who may participate in the formulation of legislation. There are two exceptions to these proscriptions. First, if it is in response to a written request from a governing body, a private foundation may provide technical advice or assistance. Second, if there is a decision before a governing body which might affect the existence of the foundation or its exempt status, this provision does not apply.

B. Electioneering

Congress was well aware of the fact that there were many ways for a private foundation to become politically involved without endangering their exempt status. This could be done either by financing voter registration drives in small geographical areas, or by contributing the money to other organizations which supported a particular candidate. To counter this, Congress made a taxable expenditure of any amount spent to “influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive.” If the activities are nonpartisan, however, and are carried on in five or more states, and are not confined to one specific election, then their support will not constitute a taxable expenditure.

C. Education grants

A “grant to an individual for travel, study, or other similar purposes by such individual,” will be considered a taxable expenditure, unless it can be shown that the grant was awarded on an objective basis. This must be done according to a procedure that has been approved in advance. Basically, Congress believed that the funding of tax exempt vacations abroad or providing work between jobs was not a proper activity for private foundations.

D. Expenditure responsibility

A grant to any organization other than a public charity will be a taxable expenditure unless the granting foundation exercises “expenditure responsibility.” This “expenditure responsibility” is quite involved. It means that the private foundation must not only establish

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106 INT. REV. CODE of 1954, § 4945(e) (2).
107 Id.
108 Id.
109 INT. REV. CODE of 1954, § 4945(e).
110 H.R. 91-413, supra at 32; S.R. 91-552, supra at 47.
111 INT. REV. CODE of 1954, § 4945(d) (2).
112 INT. REV. CODE of 1954, § 4945(f) (2).
113 INT. REV. CODE of 1954, § 4945(d) (3).
114 INT. REV. CODE of 1954, § 4945(g).
115 Id.
116 H.R. 91-413, supra at 33; S.R. 91-552, supra at 48.
117 INT. REV. CODE of 1954, § 4945(d) (4).
procedures to ensure that the money is spent properly,\textsuperscript{117} but it must also obtain detailed reports from the grantee organization on how the money was spent,\textsuperscript{118} and make its own reports to the service.\textsuperscript{119}

E. Taxes on other expenditures

Though Section 501(c)(3) requires that exempt organizations be operated "exclusively" for charitable purposes, the courts have not interpreted this word literally.\textsuperscript{120} Congress wanted to keep this more flexible interpretation,\textsuperscript{121} and therefore simply made all expenditures for non-charitable purposes taxable.\textsuperscript{122}

There are two levels of taxes that may be assessed against both the private foundation and the management for taxable expenditures. At the first level, the foundation is subject to a tax equal to 10\% of the taxable expenditure.\textsuperscript{123} For the foundation manager who knowingly made the expenditure, there is a 2\% tax liability, unless the agreement was due to reasonable cause, and was not willful.\textsuperscript{124} If the taxable expenditure is not corrected within the correction period, then the foundation is taxed an amount equal to 100\% of the amount of the expenditure.\textsuperscript{125} Again, there is joint and several liability, and a maximum limit on the amount of tax assessable against the management.\textsuperscript{126}

\textit{ASSESSABLE PENALTIES FOR PRIVATE FOUNDATION VIOLATIONS}

Any of these taxes relating specifically to private foundations may be effectively doubled under certain circumstances. Should there be repeated violations, or if the act is both willful and flagrant, then an additional penalty equal to the amount of the tax may be assessed as well.\textsuperscript{127} Should the violations continue, then the foundation is subject to a termination tax (\textit{infra}), under a different section of the Code.\textsuperscript{128}
TERMINATION OF PRIVATE FOUNDATION STATUS

Termination of private foundation status can come about in three ways: voluntarily, involuntarily, or by transfer to or operation as a public charity. The differences in consequences can be dramatic.

The general rule is that the terminating foundation is subject to the termination tax, whether the termination is voluntary or compulsory. Voluntary termination may occur by notifying the Secretary of the intent to terminate. Compulsory termination may result when there have been either repeated acts, or a willful and flagrant act, which give rise to tax liability under the special private foundation provisions discussed earlier.

The termination tax is the lower of either the aggregate tax benefit resulting from the foundation's tax exempt status, or the value of its net assets. The value of the net assets is self-explanatory. The "aggregate tax benefit," however, is quite comprehensive. The "aggregate tax benefit" includes the amount of taxes that should have been paid by substantial contributors if their deductions had been disallowed on all contributions after February 28, 1913, plus all the taxes that would have been imposed on the foundation itself if it had not been exempt since December 12, 1912, plus interest on these amounts.

Fortunately, there are ways of avoiding the consequences of the termination tax. For example, if imposed, the termination tax may be abated in either of two circumstances. It may be abated if the private foundation distributes all of its net assets to a public charity which has been in continuous operation for a period of 60 months. It may also be abated if, following notice given to the appropriate State officer, the officer then notifies the Service that proper corrective action has been taken to insure that the foundation's assets are preserved for appropriate charitable purposes.

There are special rules for voluntary tax free termination, too. The termination is tax free if the private foundation either transfers all of its net assets to a public charity that has been in continuous operation.
for 60 months,\textsuperscript{142} or it begins operation itself as a public charity, and so continues for a period of 60 months.\textsuperscript{143}

\textbf{GOVERNING INSTRUMENTS}

Besides denying the exemption for all private foundations unless they give notice that they are applying for exempt status,\textsuperscript{144} Section 508 also contains very specific requirements concerning the governing instruments. The term "governing instruments" is an inclusive term that means any written instrument by which the organization is created. There is no special format that is required, and the term comprehends such instruments as a corporate charter, articles of organization, or a trust instrument.\textsuperscript{145}

Unless its governing instrument contains specific provisions which in effect require the private foundation to comply with Sections 4941 through 4945, a foundation will not be exempt from taxation.\textsuperscript{146} This might seem overly technical in view of the fact that the provisions themselves do not depend upon their inclusion in the governing instruments to be effective. The purpose, however, was to "add to the enforcement tools available to State officials charged with supervision of charitable organizations."\textsuperscript{147}

These provisions must be included in the governing instruments of existing private foundations as well, but some time is allowed for the modification.\textsuperscript{148} Foreseeing the potential waste of judicial and administrative time this could cause, the Service has identified those States which have adopted legislation sufficient to satisfy the requirements of Section 508(e).\textsuperscript{149} In those States, it will not be necessary to amend the governing instruments to comply. Montana does not qualify. For those situations in which the provisions must be included in the instrument, the Service has promulgated approved provisions both for a charitable corporation and for a charitable trust.\textsuperscript{150}

\textbf{REPORTING AND PUBLICITY REQUIREMENTS FOR PRIVATE FOUNDATIONS}

The 1969 Act made extensive changes in the reporting and publicity requirements of all exempt organizations in general, and private foundations in particular. The primary purpose, of course, is to provide the

\begin{verbatim}
\textsuperscript{144}Int. Rev. Code of 1954, § 508(a).
\textsuperscript{145}Treas. Reg. § 1.508-3(c) (1972).
\textsuperscript{146}Int. Rev. Code of 1954, § 508(e).
\textsuperscript{147}H.R. 91-413, supra at 40; S.R. 91-552, supra at 56.
\textsuperscript{148}Int. Rev. Code of 1954, § 508(e)(2).
\end{verbatim}
Service with adequate information to enforce the tax laws. With that as a basis, Congress increased the number of organizations reporting, the amount of information needed, and the availability of that information to the public and to State officials. With certain exceptions such as churches, every organization exempt under Section 501(c)(3) must file an annual return. This was true before the 1969 Act, but now more information is required. The new information required includes the names and addresses of all substantial contributors, the names and addresses of the foundation managers and highly compensated employees, and the compensation and other payments made to those employees or managers. In addition to that, private foundations are required to attach a list of states to which the organization reports in any fashion concerning its organization, or under which the organization has registered.

More stringent reporting requirements are imposed on private foundations. The foundation manager of every private foundation having at least $5,000 in assets during the taxable year must file an extra annual report. This is in addition to the annual report required of all exempt organizations under Section 6033. The only requirement for the format of this report is that it be legible, although the Service will provide a form. Some of the information required on this report includes an itemized list of all grants and contributions, the name and address of each recipient, and any relationship there may be between the recipient and the foundation's managers or its substantial contributors. Also included must be an itemized statement of all securities and other assets (showing both book and market values), the address of the place where the foundation's books and records are stored, and the names and addresses of the foundation managers. A copy

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152 H.R. 91-413, supra at 36; S.R. 91-552, supra at 552.
154 INT. REV. CODE of 1954, § 6033(a)(1).
155 INT. REV. CODE of 1954, § 6033(b)(5).
156 INT. REV. CODE of 1954, § 6033(b)(6).
159 INT. REV. CODE of 1954, § 6056(a).
160 INT. REV. CODE of 1954, § 6056(d)(1).
162 INT. REV. CODE of 1954, § 6056(b)(7).
163 INT. REV. CODE of 1954, § 6056(b)(5).
164 INT. REV. CODE of 1954, § 6056(b)(8).
165 INT. REV. CODE of 1954, § 6056(b)(9).
of the notice concerning public inspection of the foundation's annual report (as required by Section 6104, \textit{infra}), plus proof of publication of that notice, must be attached to the annual report as well.\footnote{\textsc{int. rev. code} of 1954, \S 6056(d)(2).} At the time this report is sent to the Service, copies of it must be sent to various State officials.\footnote{\textsc{int. rev. code} of 1954, \S 6056(d)(3).} A copy must be sent to officials in every state in which the foundation is registered or to which it reports in any fashion, to the state in which the foundation's principal offices are located, and also to the state in which the foundation was created.\footnote{Treas. Reg. \S 1.6056-1(b)(3) (1971).} The information contained in the annual reports of both public charities and private foundations is to be made available to the public, along with the names and addresses of these organizations.\footnote{\textsc{int. rev. code} of 1954, \S 6104(b).} This includes the names of substantial contributors, but only for private foundations. Otherwise, these names may not be divulged.\footnote{\textsc{id.}} There is a special provision relating to the private foundation's annual reports.\footnote{\textsc{id.}} It requires that the annual report be made available for public inspection at the principal office of the foundation for a period of 180 days after notice of its availability is published. This notice must be published on or before the day on which the annual report is filed.\footnote{\textsc{id.}}

State officials will also be given more information concerning charitable organizations. The state official who is responsible for the activities of charitable organizations within his state will be notified whenever an organization fails to meet the requirements of its exemption, or whenever a notice of deficiency of tax is mailed to that organization.\footnote{\textsc{int. rev. code} of 1954, \S 6104(c)(1).}

There are now specific penalties for failure to file annual reports. This marks a change from the former law. Congress noted that apparently only the criminal provisions applied in the past, and that, as far as it knew, those provisions were never enforced in this context.\footnote{H.R. 91-413, \textit{supra} at 36.} Now, there is a $10 a day penalty imposed on every organization that fails to file the annual report required of all charitable organizations (Section 6033) up to a maximum of $5,000.\footnote{\textsc{int. rev. code} of 1954, \S 6652(d)(1).} The same amount is imposed on the person failing to file the report.\footnote{\textsc{id.}} For failure either to file the annual report by private foundations (Section 6056), or to comply with the publication requirements for private foundations (Section 6104), there is imposed on each person so failing, a penalty of $10 a day up to
a maximum of $5,000. There is no corresponding penalty imposed on the organization. If the person who failed to comply with the requirements relating to annual reports of private foundations, or the requirements relating to the public inspection of those reports did so willfully, then he is liable for a fine of $1,000 for each required report or notice.

CONCLUSION

The result of the 1969 Act may be simply stated. While it did not restrict the legitimate ends to which private foundations may be put, it did restrict the use of private foundations to accomplishing those ends. It has done this by imposing not only greater and continuing duties on the foundation’s principals, but also by imposing increased liabilities for failure to fulfill these duties. Concerning the desirability of using the private foundation as a planning vehicle, then, the restrictions speak largely for themselves. On the whole, the treatment accorded private foundations and their managers by the 1969 Tax Reform Act has not been charitable.

176 INT. REV. CODE of 1954, § 6652 (d) (3). 
177 INT. REV. CODE of 1954, § 6685. Assessable Penalties with Respect to Private Foundation Annual Reports.