How private foundations can avoid accusations of self-dealing

IRS rules governing private foundations are complex and include many exceptions, which is why your foundation needs to write and *follow* a detailed conflict-of-interest policy. Taking this proactive step can help you avoid potentially costly public and IRS attention.

Casting a wide net

Conflict-of-interest policies are critical for all not-for-profits. But foundations are subject to stricter rules and must go the extra mile to avoid anything that might be perceived as self-dealing. Specifically, transactions between private foundations and disqualified persons are prohibited.

The IRS casts a wide net when defining “disqualified persons,” including substantial contributors, managers, officers, directors, trustees and people with large ownership interests in corporations or partnerships that make substantial contributions to the foundation. Their family members are disqualified, too. In addition, when a disqualified person owns more than 35% of a corporation or partnership, that business is considered disqualified.

Avoiding dangerous transactions

Prohibited transactions can be hard to identify because there are many exceptions. But, in general, you should ensure that disqualified persons don’t engage in the following transactions with your foundation:

- Selling, exchanging or leasing property,
- Making or receiving loans or extending credit,
- Providing or receiving goods, services or facilities, or
- Receiving compensation or reimbursed expenses.

Disqualified persons also shouldn't agree to pay money or property to government officials on your behalf.

Facing the consequences

What happens if you violate the rules? Your foundation's manager and the disqualified person may be subject to an initial excise tax (5% and 10%, respectively) of the amount involved *and*, if the transaction isn't corrected quickly, an additional tax of up to 200% of the amount. Although liability is limited for foundation managers ($40,000 for any one act), self-dealing individuals enjoy no such limits. In some cases, private foundations that engage in self-dealing lose their tax-exempt status.

Private foundations that run afoul of the IRS usually have good intentions. You may assume, for example, that transactions with insiders are acceptable so long as they're fair or benefit your foundation. Unfortunately, this isn't the case. Most activities defined by the IRS as self-dealing — regardless of whom or what they reward — are off-limits.

If you're unsure about whether a transaction might violate IRS rules, please contact us.