

**Presented:**  
30<sup>th</sup> Annual Nonprofit Organizations

January 16-18, 2013  
Austin, TX

## **Primer on Private Foundations Reference Outline**

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# **PRIMER ON PRIVATE FOUNDATIONS**

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## **PRIMER ON PRIVATE FOUNDATIONS**

### **I. INTRODUCTION**

Private foundations were segregated by Congress in 1969 from public charities, those organizations that traditionally receive their contributions from a wide range of supporters, rather than from a limited set of individuals. Private foundations are viable and valuable types of nonprofit organizations, despite the fact that they must operate under constraints not applicable to public charities. A private foundation can serve as the ideal income and estate tax planning tool for taxpayers with charitable interests. This outline describes the major considerations in the planning, creation and operation of private foundations.

### **II. FORMATION OF PRIVATE FOUNDATIONS**

#### **A. Choosing the Best Form of Organization:**

A charitable organization is established by the creation of a nonprofit entity under applicable state law. The three common structural forms for a nonprofit organization are nonprofit corporation, trust, and unincorporated association. The choice of organizational form is influenced by the laws of the states in which the nonprofit will operate. A charitable organization may be created during life or through testamentary disposition. If created testamentary, the Will should allow for the executor to create the charitable organization and should state that the charitable organization is created for charitable purposes to make distributions to qualified charities.

1. Corporation: A corporation is generally the preferred entity for the charitable organization as it provides the most flexibility of operation and protection from liability for the organization's officers and directors. Their decisions in a corporation structure are evaluated on the business judgment rule as opposed to the more strict fiduciary standards applicable to trustees of trusts.

- a. Certificate of Formation must include:

- i. Federal Law Requirements:

1. Purpose clause: The organization must limit its purposes to one or more of the eight specific purposes in §501(c)(3) which includes religious, charitable, scientific, testing for public safety, literary, educational, fostering national or international amateur sports competitions, and preventing cruelty to children or animals.
    2. Inurement clause: Qualifying organizational documents must not permit distribution of any part of the organization's net earnings to its directors, officers, or trustees, or to any private individual. Most documents affirmatively include a statement that the earnings of the corporation shall not result in any private benefit to its members, trustees, or officers, other than for reasonable compensation for services rendered.

3. Political activities clause: A charity's organizational documents must absolutely not permit political campaign involvement and so to be conservative should prohibit such activity. In addition, a private foundation is absolutely prohibited from conducting lobbying. The following statement covers both types of activities: "No part of the corporation's activities shall consist of attempts to influence legislation and it shall not participate in political campaigns."
4. Dissolution clause: Specific language in the nonprofit's charter must describe the manner in which its assets will be distributed in the event of dissolution. Assets may not be returned to contributors, directors, or any non-501(c)(3) organization or for non-501(c)(3) purposes. It is not sufficient to say that the assets will be dedicated to nonprofit purposes since those purposes may be broader than what 501(c)(3) allows. Remaining assets at the time of dissolution must either be expended for 501(c)(3) purposes or be given to another 501(c)(3) organization, or the federal, state, or local government.
5. Private foundation clause: A statement that the corporation will comply with the requirements of I.R.C. §§ 4941 through 4945 is required for those organizations which were formed in states that have not enacted statutory provisions that satisfy this requirement automatically without the inclusion of specific language in the charter.

ii. State Law Requirements (Texas):

1. Entity name and type.
2. The street address of its initial registered office and the name of its initial registered agent at such street address.
3. Management structure (i.e. The number of directors constituting the initial board of directors, (must be at least three (3)) and the names and addresses of the persons who are to serve as the initial directors unless the management of the corporation is vested in its members, in which case, a statement to such effect must be included.).
4. The purpose(s) for which the organization is organized.
5. A statement that the organization is to have no members if such is the case.
6. The name and street or post office address of each organizer, of which only one is required.
7. A statement describing the manner of distribution of the corporation's assets if the organization is to be authorized on its dissolution to distribute its assets in a manner other than as provided by State law.
8. Any other provision not inconsistent with law.

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First appeared as part of the conference materials for the  
30<sup>th</sup> Annual Nonprofit Organizations Institute session  
"Private Foundation Primer"