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Lifecycle of Private Foundation Engagement and Compliance Concerns

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I. INTRODUCTION

Our discussion will consist of a practical guide to navigating the excise tax regime set forth in Chapter 42 of the Internal Revenue Code of 1986, as amended (the “Code”), from a legal and accounting perspective. We will offer insight for individuals working with private foundations to promote compliance in the areas of complex grant-making, direct programmatic activities and investing. We will also address the reporting and excise tax implications for violations. This outline provides an introduction to some of the key rules applicable to private foundations, including the means of addressing noncompliance, and common traps for the unwary both during the establishment of the private foundation and during the operating life of the private foundation.

II. CODE SECTION 4941 – SELF-DEALING

1. Key Rules.

a. *Introduction.*

Private foundations are subject to the prohibition on self-dealing transactions.¹

b. *Direct and Indirect Self-Dealing Defined.*

Self-dealing is a direct or indirect (i) sale, exchange or leasing of property between a private foundation and a disqualified person, (ii) lending of money or other extension of credit between a private foundation and a disqualified person, (iii) furnishing of goods, services or facilities between a private foundation and a disqualified person, (iv) payment of compensation by a private foundation to a disqualified person, (v) transfer to, or use for the benefit of, a disqualified person of the assets of a private foundation and (vi) an agreement by a private

¹ See Code section 4941.

foundation to make any payment of money to a government official, other than an employment agreement where the official is terminating his government service within 90 days.²

The self-dealing rules include certain exceptions. The following transactions will not constitute self-dealing transactions: (i) the lending of money on an interest-free basis by a disqualified person, if the private foundation uses the proceeds for charitable purposes; (ii) the furnishing of goods, services and facilities by a disqualified person without charge if the goods, services and facilities are used by the private foundation for charitable purposes; (iii) the furnishing of goods, services and facilities by a private foundation to a disqualified person if the goods, services and facilities are furnished on a basis no more favorable than that on which such goods, services and facilities are made available to the general public; (iv) except in the case of a government official, the payment of compensation by a private foundation to a disqualified person for personal services which are reasonable and necessary, so long as the payment is not excessive; and (v) any transaction between a private foundation and a corporation that is a disqualified person pursuant to liquidation, merger, redemption, recapitalization or other corporate adjustment if all securities of the same class are subject to the same terms and the private foundation receives not less than fair market value.³ In addition, the fact that a disqualified person receives an incidental or tenuous benefit from the use by a private foundation of its income or assets will not, by itself, make the use an act of self-dealing.⁴ Therefore, public recognition to a disqualified person in connection with a private foundation grant will not constitute self-dealing.⁵

The Treasury Regulations do not expressly define what constitutes indirect self-dealing. Instead, the Treasury Regulations identify certain specific transactions as not constituting indirect self-dealing transactions.

The term “indirect self-dealing” does not include any transaction described between a disqualified person and an organization controlled⁶ by a private foundation if (i) the

² See Code section 4941(d)(1).

³ See Code section 4941(d)(2).

⁴ See Treas. Reg. § 53.4941(d)-2(f)(2).

⁵ See *id.*

⁶ For these purposes, an organization is controlled by a private foundation if the private foundation or one or more of its foundation managers (acting only in such capacity) may, only be aggregating their votes or positions of authority, require the organization to engage in a transaction that, if engaged in with the private foundation, would constitute self-dealing. Similarly, an organization is controlled by a private foundation in the case of a transaction between the organization and a disqualified person, if the disqualified person, together with one or more persons who are disqualified persons by reason of such person’s relationship to the disqualified person, may, only by aggregating their votes or positions of authority with that of the private foundation, require the organization to engage in such a transaction. An organization will be considered to be controlled by a private foundation or by a private foundation and disqualified persons, as applicable, if such persons are able, in fact, to control the organization (even if their aggregate voting power is less than 50 percent of the total voting power of the organization’s governing body) or if one or more of

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