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Self-Dealing Transactions: What Private Foundations Need to Know

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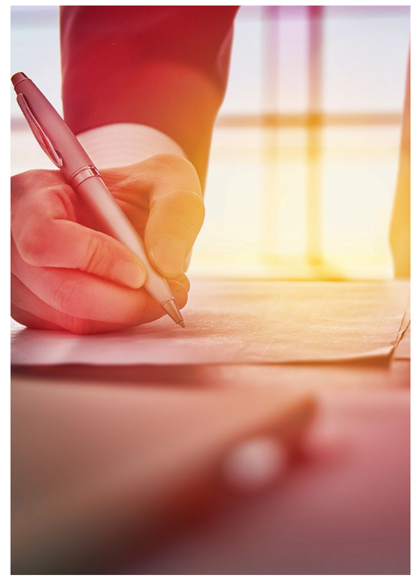

Private foundations are a useful vehicle to help individuals and families transfer wealth out of their estates and into charitable organizations that need funding. However, in recent years, the IRS has been investigating acts of self-dealing within private foundations. Fiduciaries of private foundations need to be aware of what constitutes self-dealing so they can avoid running afoul of the IRS.

Direct self-dealing transactions are easily identified and prevented; however, indirect self-dealings are more difficult to identify and create a personal liability for the fiduciary.

What is a self-dealing transaction?

Self-dealing occurs when a director, officer or other fiduciary of a private foundation directly or indirectly receives a personal benefit from a transaction in which the private foundation engages. Some examples of transactions which would be considered self-dealing by the IRS include: the sale or exchange of personal property between a disqualified person and the foundation, lending money or extending credit to a disqualified person, transferring assets to a disqualified person, compensating a disqualified individual, and providing goods or services to disqualified parties.

Direct self-dealing transactions are easily identified and prevented; however, indirect self-dealings are more difficult to identify and create a personal liability for the fiduciary. Charitable donations by a private foundation can quickly turn into an indirect self-dealing transaction.

For example, let's say a charity solicits a $1,000 donation from a foundation and in return, offers two tickets to an upcoming event that have a fair market value of $300. If the fiduciary of the foundation were to accept the tickets, this would constitute a self-dealing transaction. The fiduciary has gained a personal benefit (the event tickets) in exchange for the foundation's donation.

In this case, the fiduciary should decline the benefits offered by the charity OR pay the $300 cost for the event tickets personally and have the foundation make the remaining $700 contribution.

What are the consequences of participating in a self-dealing transaction?

Participating in a self-dealing transaction can result in excise taxes being levied on the fiduciaries of the private foundation. If a fiduciary of a private foundation participates in a self-dealing transaction, they can personally incur an excise tax of 10 percent of the value they received. If the foundation manager knows of a self-dealing transaction and overlooks it, they could be taxed five percent of the self-dealing transaction amount.

The IRS also requires that self-dealing transactions be corrected. In the event the person who benefited from the transaction chooses not to correct the transaction, he/she will be subject to an additional tax of up to 200 percent of the benefit amount. A foundation manager could find themselves subject to an additional 50 percent tax if they do not correct the self-dealing transaction.

Note that these additional excises taxes are incurred by the individuals, not the private foundation.

What actions should my foundation and its fiduciaries take?

Fiduciaries should be on the lookout for transactions that would be considered self-dealing. They should carefully monitor the goods or services charitable organizations provide in exchange for donations. A tax advisor can help fiduciaries create internal policies that will prevent and monitor for self-dealing. Your tax advisor can also review the terms of the donation to help identify any prohibited transactions before the donation is made. If a director finds they have engaged in a self-dealing transaction, they should immediately reimburse the foundation for the value of the benefits they received.

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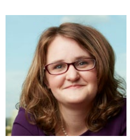
Morison KSi
Independent member

Unsure if a transaction would be classified as self-dealing? Contact:



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