

## **FORMING A NEW 501(C)(3) NON-OPERATING PRIVATE FOUNDATION IN WISCONSIN**

### **WISCONSIN PLANNED GIVING COUNCIL MEETING**

**JULY 9, 2013**

*This brief outline sets forth the typical formation process followed to create a new Wisconsin private foundation.<sup>1</sup>*

#### **A. Three Phases**

1. Phase 1: Form a New Non-stock Corporation
  - a. Educate founders on the requirements of section 501(c)(3) tax exempt status.
  - b. Determine governance structure.
  - c. Determine the initial board members and officers for the foundation (there must be at least three initial board members).
  - d. Prepare initial corporate documents (articles of incorporation, bylaws, policies, etc.).
  - e. File necessary documents to incorporate foundation and obtain a tax identification number for the new foundation.
  - f. Phase 1 can take as little as a week or a few months, depending upon how quickly the founders can make decisions and how complex the governance structure will be. To simply form a legal entity and open a bank account can take as little as a few days.
2. Phase 2: Apply for Tax-exempt Status
  - a. New organizations have about two years to apply with the IRS for section 501(c)(3) tax-exempt status, most organizations find that it is easier, more efficient and more cost-effective to apply right away.
  - b. Prepare and file exemption application with the IRS.
  - c. Respond to IRS inquiries about the exemption application (if any).
  - d. Obtain Section 501(c)(3) determination letter.

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<sup>1</sup> *This guide is applicable to non-operating foundations that plan to give grants rather than operate their own charitable programs.*

- e. Donations to the foundation are deductible from the incorporation date if (1) the new foundation files an exemption application within 27 months of legal formation *and* (2) the IRS issues a favorable 501(c)(3) determination. Donors giving more than \$250 to their foundation should ensure that the foundation sends an appropriate written acknowledgement of the donation.
  - f. Phase 2 is usually the most time-consuming part of forming a new foundation. This depends on the founder's ability to quickly provide his/her attorney with information for the application, the complexity of the planned foundation, and the time it takes the IRS to process the application. After the application is filed with the IRS, the IRS's review process commonly takes 3 to 8 months, although the process can take longer for applications that raise complex issues. The IRS commonly assigns applications to a reviewer for follow-up. When the IRS assigns a reviewer, the foundation may need to answer additional questions before the IRS issues a final determination. The IRS process can be sped up in some special situations, such as when a substantial grant will be lost if the foundation cannot provide proof of exempt status before a certain deadline. However, many applications must wait months or even a year for IRS action.
  - g. A foundation can generally commence operations while it waits on an IRS determination.
3. Phase 3: Maintain Tax-exempt Status
- a. After receiving tax-exempt status from the IRS, the new foundation must comply with state and federal laws to maintain tax-exempt status and corporate existence. This includes appropriately maintaining corporate records and policies, completing appropriate tax filings and returns, complying with mandatory income distribution requirements, managing employment and compensation matters, and not running afoul of self-dealing or investment prohibitions.
  - b. Phase 3 lasts for the entire lifetime of the foundation.

## B. Special Considerations for Private Foundations

- 1. For private foundations, one of the most common initial concerns is understanding the special tax rules applicable to private foundations. These rules generally include the self-dealing prohibitions, minimum distribution requirements, excess business holdings limitations, taxable expenditures, and deduction limitations for gifts to the foundation. A few common issues that arise under these rules:
  - a. It may not be advantageous for a founder to donate closely-held stock or S corporation stock to a foundation due to the deduction limitations and tax rules applicable to such gifts.

- b. It may not be advantageous to donate other low-basis property to a foundation.
  - c. Founders are generally prohibited from loaning money to their foundations, charging their foundations rent, or otherwise engaging in business transactions with their foundations.
  - d. Private Foundations must generally distribute 5% of their assets each year, even in years of poor market returns.
  - e. Foundations may not make grants to individuals without prior approval from the IRS, even for scholarships or other bona fide charitable purposes.
  - f. Special concerns apply to Foundations that make grants to foreign organizations.
2. These rules are very complex. The above examples are not complete descriptions of these rules, but are areas for founders to be aware of when beginning a new private foundation.

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