

## Private Foundations Bulletin

### Refresher on Self-Dealing – Scenarios and FAQs

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As we continue to see more focus on family foundations and living donor foundations in the media and regulatory bodies, we wanted to take a moment to share some scenarios of common acts of self-dealing.

“Self-dealing” is any direct or indirect transaction between a private foundation and a disqualified person.

Generally speaking, a disqualified person is one who is in a position — such as a foundation trustee, officer or a substantial contributor<sup>[1]</sup> — to exercise significant influence over the affairs of a foundation. ***This includes certain family members<sup>[2]</sup> of foundation trustees, officers and substantial contributors.*** Self-dealing is an area where the disqualified person can unknowingly violate rules and regulations pertaining to the oversight of a private foundation. It is irrelevant whether the self-dealing transaction provides any benefit to the foundation.

#### Common Scenarios of Self-Dealing

The term “self-dealing” refers to any direct or indirect action(s) corresponding to those listed below:

- Sale or exchange, or leasing, of property between a private foundation and a disqualified person, except when a disqualified person gives property to a foundation as a gift or leases property to a foundation at no charge.
- Lending of money or other extension of credit between a private foundation and a disqualified person. However, a loan to a foundation, which is interest-free and the proceeds of which are used exclusively for the foundation’s exempt purposes, is not a violation of the self-dealing regulations.
- Furnishing of goods, services or facilities between a private foundation and a disqualified person, except when goods, services or facilities are provided to a foundation by a disqualified person at no charge and the goods, services or facilities are used exclusively for the foundation’s exempt purpose.
- Payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person, except when such compensation or reimbursement is for personal services, which are reasonable and necessary in the carrying out of the foundation’s tax-exempt purposes and the compensation or reimbursement is not excessive.
- Transfer to, or use by or for the benefit of, a disqualified person of the income or assets of the private foundation. However, if a disqualified person receives only an incidental or slight benefit from the use of the foundation’s income or assets, such act by itself may not be considered an act of self-dealing.
- Agreement by a private foundation to make any payment of money or other property to a government official.

[\[1\] Disqualified Persons | IRS](#)

[\[2\] Member of the Family – Private Foundation | IRS](#)

## Self-Dealing Penalties

A federal tax is imposed on both the disqualified person, such as a trustee, who engages in an act of self-dealing and on any foundation manager who knowingly participates in the act. (There is no self-dealing tax imposed on the foundation itself.)

The initial tax on the disqualified person is equal to 10 percent of the "amount involved" in each act for each year in which the act occurred. The "amount involved" is defined as the greater of the amount of money and the fair market value of the other property given or the amount of money and fair market value of other property received.

Upon imposition of this initial tax, any foundation manager who knowingly participated in the act is taxed five percent of the amount involved unless the participation of the foundation manager was not willful and was with reasonable cause. A disqualified person must pay this tax even if the disqualified person had no knowledge of having participated in the act of self-dealing.

If the act of self-dealing is not corrected within the required time period, then a tax of 200 percent of the amount involved is imposed upon the disqualified person and a tax of 50 percent of the amount involved is imposed upon the foundation manager.

The maximum initial tax imposed on the foundation manager is \$20,000 and the maximum additional tax is \$20,000 for any one act. There is no maximum on the liability of the self-dealer including one who is a foundation manager. If more than one person is liable for the initial and additional taxes imposed for any act of self-dealing, all parties will be jointly and severally liable for those taxes.

## Frequently Asked Questions (FAQs)

As with most of the code defined by the Internal Revenue Service, we understand that there is often confusion and questions to follow. Nothing is ever straightforward, and so we have pulled together some common questions, scenarios and practical responses to understanding self-dealing:

### **Can a foundation pay a salary or fees to a disqualified person?**

Yes, so long as the total compensation is for a set of limited "personal" services and the amount is reasonable. Reasonable compensation for personal services is the biggest exception to the rule against self-dealing. Whether this is potentially in the form of compensation or director fees, the payments could be acceptable so long as the work to be performed is necessary for the operation of the foundation and the amount of compensation is reasonable.

### **Can a disqualified person receive any personal benefit from foundation grants?**

Yes, so long as the benefit is "incidental," "tenuous" or "mere recognition." In other words, the benefit bestowed on the board member must not include goods or services that have a tangible economic value.

Public recognition of the major donor to a foundation for acts of the foundation generally is incidental (or intangible). Examples include recognizing the donor in the program of a special fundraising event as a contributor or naming a building after the donor.

### **Can the foundation purchase directors' and officers' liability insurance without self-dealing?**

Yes.

### **Can a foundation satisfy the personal charitable pledge of a family member?**

No. Once any disqualified person makes a personal pledge, it becomes a legally binding and enforceable personal obligation. A private foundation is prohibited from using foundation assets to satisfy the personal obligation of a disqualified person.

### **Is it self-dealing to make a grant to a charity where a disqualified person sits on the board of the grantee?**

The regulations are very clear on this point. It is not self-dealing when a foundation makes a grant to a public charity where a disqualified person (or spouse thereof) is on the board or staff of the grantee.

However, if such a grant were earmarked to pay the salary of a disqualified person, self-dealing is probable. As a best practice, many foundations when faced with this scenario stipulate that the funds are “not to be used” for a particular person’s salary, etc.

### **Are disqualified persons allowed to attend galas, benefits or other ticketed events for which the foundation has received tickets?**

Yes and no. While there are exceptions that would allow a disqualified person to attend these types of events on the foundation’s behalf, these exceptions are limited in scope and there are a number of pitfalls to watch out for, especially when it comes to anything with “tickets” and guests.

### **Seek Outside Counsel**

If there are any additional questions as to whether or not a potential relationship or future transaction could lead to self-dealing, we recommend that the foundation contact their legal counsel or tax preparers to ensure that all considerations have been made in the determination process.

### **Conclusion**

Understanding and following the self-dealing rules are in the best interests of all associated with the private foundation. The reputation of the foundation and its governance is such an important component of public perception and is the catalyst of the foundation’s mission. Finally, we would advise the foundation management to develop and maintain a listing of all disqualified persons associated with the foundation. Additionally, the foundation’s audit and governance committees should consider performing an annual risk assessment of acts of self-dealing and report on the results of this assessment to the board of directors/trustees.

### **Contact Us**

We welcome the opportunity to answer any questions you may have related to this topic or any other accounting, audit, tax or advisory matters relative to private foundations. Please call 212.286.2600 or email any of the Private Foundation Services team members below:

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