

Wiley Nonprofit Authority

+ website

The Tax Law of Private Foundations

2022 Cumulative Supplement

Fifth Edition

Shane T. Hamilton,
Bruce R. Hopkins

WILEY

Table of Contents

[Cover](#)

[Title Page](#)

[Copyright](#)

[Preface](#)

[Book Citations](#)

[CHAPTER ONE: Introduction to Private Foundations](#)

[§ 1.1 PRIVATE FOUNDATIONS: UNIQUE ORGANIZATIONS](#)

[§ 1.2 DEFINITION OF PRIVATE FOUNDATION](#)

[§ 1.4 PRIVATE FOUNDATION LAW PRIMER](#)

[§ 1.5 FOUNDATIONS IN OVERALL EXEMPT ORGANIZATIONS CONTEXT](#)

[§ 1.6 DEFINITION OF CHARITY](#)

[§ 1.7 OPERATING FOR CHARITABLE PURPOSES](#)

[§ 1.9 PRIVATE FOUNDATION SANCTIONS](#)

[PRIVATE FOUNDATION LAW SANCTIONS](#)

[§ 1.10 STATISTICAL PROFILE](#)

[§ 1.11 PRIVATE FOUNDATIONS AND LAW 50 YEARS LATER](#)

[NOTES](#)

[CHAPTER TWO: Starting, Funding, and Governing a Private Foundation](#)

[§ 2.1 CHOICE OF ORGANIZATIONAL FORM](#)

[§ 2.3 ESTATE PLANNING PRINCIPLES](#)

[§ 2.4 FOUNDATIONS AND PLANNED GIVING](#)

§ 2.5 ACQUIRING RECOGNITION OF TAX-EXEMPT STATUS

§ 2.6 SPECIAL REQUIREMENTS FOR CHARITABLE ORGANIZATIONS

§ 2.7 WHEN TO REPORT BACK TO THE IRS
NOTE

CHAPTER THREE: Types of Private Foundations

§ 3.1 PRIVATE OPERATING FOUNDATIONS

§ 3.3 CONDUIT FOUNDATIONS

§ 3.4 COMMON FUND FOUNDATIONS

§ 3.8 SPLIT-INTEREST TRUSTS

§ 3.9 FOREIGN PRIVATE FOUNDATIONS

NOTES

CHAPTER FOUR: Disqualified Persons

§ 4.1 SUBSTANTIAL CONTRIBUTORS

§ 4.2 FOUNDATION MANAGERS

§ 4.3 CERTAIN 20 PERCENT OWNERS

§ 4.4 FAMILY MEMBERS

§ 4.5 CORPORATIONS OR PARTNERSHIPS

§ 4.6 TRUSTS OR ESTATES

NOTES

CHAPTER FIVE: Self-Dealing

§ 5.1 PRIVATE INUREMENT DOCTRINE

§ 5.2 PRIVATE BENEFIT DOCTRINE

§ 5.3 DEFINITION OF SELF-DEALING

§ 5.3A EXCESS COMPENSATION TAX

§ 5.4 SALE, EXCHANGE, LEASE, OR FURNISHING OF PROPERTY

§ 5.5 LOANS AND OTHER EXTENSIONS OF CREDIT

§ 5.6 PAYMENT OF COMPENSATION

§ 5.8 USES OF INCOME OR ASSETS BY DISQUALIFIED PERSONS

§ 5.11 INDIRECT SELF-DEALING

§ 5.12 PROPERTY HELD BY FIDUCIARIES

§ 5.14 ADDITIONAL EXCEPTIONS

§ 5.15 ISSUES ONCE SELF-DEALING OCCURS
NOTES

CHAPTER SIX: Mandatory Distributions

§ 6.1 DISTRIBUTION REQUIREMENTS—IN GENERAL

§ 6.2 ASSETS USED TO CALCULATE MINIMUM INVESTMENT RETURN

§ 6.3 DETERMINING FAIR MARKET VALUE

§ 6.4 DISTRIBUTABLE AMOUNT

§ 6.5 QUALIFYING DISTRIBUTIONS

§ 6.7 SATISFYING THE DISTRIBUTION TEST
NOTES

CHAPTER SEVEN: Excess Business Holdings

§ 7.1 GENERAL RULES

§ 7.2 PERMITTED AND EXCESS HOLDINGS

§ 7.3 FUNCTIONALLY RELATED BUSINESSES

§ 7.7 EXCISE TAXES ON EXCESS HOLDINGS

NOTES

CHAPTER EIGHT: Jeopardizing Investments

§ 8.2 PRUDENT INVESTMENTS

§ 8.3 PROGRAM-RELATED INVESTMENTS

§ 8.4 INVESTMENT FRAUDS

§ 8.5 EXCISE TAX FOR JEOPARDIZING INVESTMENTS

NOTES

CHAPTER NINE: Taxable Expenditures

§ 9.1 LEGISLATIVE ACTIVITIES

§ 9.2 POLITICAL CAMPAIGN ACTIVITIES

§ 9.3 GRANTS TO INDIVIDUALS

§ 9.4 GRANTS TO PUBLIC CHARITIES

§ 9.6 GRANTS TO FOREIGN ORGANIZATIONS

§ 9.7 EXPENDITURE RESPONSIBILITY

§ 9.8 INTERNET AND PRIVATE FOUNDATIONS

§ 9.9 SPENDING FOR NONCHARITABLE PURPOSES

§ 9.10 DISTRIBUTIONS TO CERTAIN SUPPORTING ORGANIZATIONS

§ 9.10A DISTRIBUTIONS TO GROUP EXEMPTION ORGANIZATIONS

§ 9.11 EXCISE TAX FOR TAXABLE EXPENDITURES

NOTES

CHAPTER TEN: Tax on Investment Income

§ 10.1 RATE OF TAX

§ 10.1A PAYMENT OF TAX

§ 10.2 REDUCING EXCISE TAX

§ 10.3 FORMULA FOR TAXABLE INCOME

§ 10.4 REDUCTIONS TO GROSS INVESTMENT INCOME

§ 10.5 FOREIGN FOUNDATIONS

§ 10.6 EXEMPTION FROM TAX ON INVESTMENT INCOME

NOTES

CHAPTER ELEVEN: Unrelated Business Activity

§ 11.1 GENERAL RULES

§ 11.2 EXCEPTIONS

§ 11.3 RULES SPECIFICALLY APPLICABLE TO PRIVATE FOUNDATIONS

§ 11.4 UNRELATED DEBT-FINANCED INCOME RULES

§ 11.5 CALCULATING AND REPORTING THE TAX NOTES

CHAPTER TWELVE: Tax Compliance and Administrative Issues

§ 12.1 FORM 990-PF

§ 12.2 FORM 990-PF PENALTIES

§ 12.3 AUTOMATIC REVOCATION FOR NON-FILING

§ 12.4 PUBLIC DISCLOSURE AND INSPECTION OF RETURNS

§ 12.5 REPORTING AND PAYMENT OF EXCISE TAXES

NOTES

CHAPTER THIRTEEN: Termination of Foundation Status

§ 13.1 VOLUNTARY TERMINATION

§ 13.3 TRANSFER OF ASSETS TO A PUBLIC CHARITY

§ 13.4 OPERATION AS A PUBLIC CHARITY

§ 13.5 MERGERS, SPLIT-UPS, AND TRANSFERS BETWEEN FOUNDATIONS

§ 13.5A TERMINATION OF TRUSTS TREATED AS PRIVATE FOUNDATIONS

NOTES

CHAPTER FOURTEEN: Charitable Giving Rules

§ 14.1 CONCEPT OF GIFT

§ 14.2 BASIC RULES

§ 14.3 GIFTS OF APPRECIATED PROPERTY

§ 14.4 DEDUCTIBILITY OF GIFTS TO FOUNDATIONS

§ 14.5 QUALIFIED APPRECIATED STOCK RULE

§ 14.6 DEDUCTION REDUCTION RULES

§ 14.7 SPECIAL GIFT SITUATIONS

§ 14.8 PLANNED GIVING REVISITED

§ 14.9 ADMINISTRATIVE CONSIDERATIONS

NOTES

CHAPTER FIFTEEN: Private Foundations and Public Charities

§ 15.1 DISTINCTIONS BETWEEN PUBLIC AND PRIVATE CHARITIES

DISTINCTIONS BETWEEN PUBLIC CHARITIES AND PRIVATE FOUNDATIONS

§ 15.2 EVOLUTION OF LAW OF PRIVATE FOUNDATIONS

§ 15.3 ORGANIZATIONS WITH INHERENTLY PUBLIC ATTRIBUTES

§ 15.4 PUBLICLY SUPPORTED ORGANIZATIONS—DONATIVE ENTITIES

§ 15.5 SERVICE PROVIDER ORGANIZATIONS

§ 15.7 SUPPORTING ORGANIZATIONS

§ 15.8 CHANGE OF PUBLIC CHARITY CATEGORY

§ 15.9 NONCHARITABLE SUPPORTED ORGANIZATIONS

§ 15.14 TERMINATION OF PUBLIC CHARITY STATUS

NOTES

CHAPTER SIXTEEN: Donor-Advised Funds

§ 16.1 BASIC DEFINITIONS

§ 16.3 TYPES OF DONOR FUNDS

§ 16.7 PUBLIC CHARITY STATUS OF FUNDS

§ 16.8 INTERRELATIONSHIP OF PRIVATE FOUNDATION RULES

§ 16.9 STATUTORY CRITERIA

§ 16.9A LITIGATION

§ 16.12 TAX REGULATIONS

§ 16.13 DAF STATISTICAL PORTRAIT

§ 16.14 CRITICISMS AND COMMENTARY

§ 16.15 PROPOSED LEGISLATION

NOTES

CHAPTER SEVENTEEN: Corporate Foundations

§ 17.2 REASONS FOR ESTABLISHMENT OF A CORPORATE FOUNDATION

§ 17.3 PRIVATE INUREMENT DOCTRINE

§ 17.3A PRIVATE BENEFIT DOCTRINE

§ 17.5 SELF-DEALING RULES

§ 17.6 OTHER PRIVATE FOUNDATIONS RULES

§ 17.7 TAX ON EXCESS COMPENSATION: POTENTIALLY APPLICABLE EXCEPTIONS ILLUSTRATED

NOTES

APPENDIX A: Sources of the Law

[FEDERAL LAW](#)

[JUDICIARY](#)

[PUBLICATIONS STATE LAW](#)

[PUBLICATIONS](#)

[NOTES](#)

[APPENDIX B: Internal Revenue Code Sections](#)

[Table of Cases](#)

[Table of IRS Revenue Rulings and Revenue Procedures](#)

[Table of IRS Private Determinations Cited in Text](#)

[Table of IRS Private Letter Rulings, Technical Advice Memoranda, and General Counsel Memoranda](#)

[About the Authors](#)

[About the Online Resources](#)

[Cumulative Index](#)

[End User License Agreement](#)



Update Service

BECOME A SUBSCRIBER!

Did you purchase this product from a bookstore?

If you did, it's important for you to become a subscriber. John Wiley & Sons, Inc. may publish, on a periodic basis, supplements and new editions to reflect the latest changes in the subject matter that you *need to know* in order to stay competitive in this ever-changing industry. By contacting the Wiley office nearest you, you'll receive any current update at no additional charge. In addition, you'll receive future updates and revised or related volumes on a 30-day examination review.

If you purchased this product directly from John Wiley & Sons, Inc., we have already recorded your subscription for this update service.

To become a subscriber, please call 1-877-762-2974 or send your name, company name (if applicable), address, and the title of the product to:

mailing address: **Supplement Department**
 John Wiley & Sons, Inc.
 10475 Crosspoint Blvd.
 Indianapolis, IN 46256

e-mail: **subscriber@wiley.com**
fax: **1-800-605-2665**
online: **www.wiley.com**

For customers outside the United States, please contact the Wiley office nearest you:

Professional & Reference Division
John Wiley & Sons Canada, Ltd.
90 Eglinton Ave. E. Suite 300
Toronto, Ontario M4P 2Y3
Canada
Phone: 416-236-4433
Phone: 1-800-567-4797
Fax: 416-236-8743
Email: canada@wiley.com

John Wiley & Sons Australia, Ltd.
42 McDougall Street
Milton, Queensland 4064
AUSTRALIA
Phone: 61-7-3859-9755
Fax: 61-7-3859-9715
Email: aus-custservice@wiley.com

John Wiley & Sons, Ltd.
European Distribution Centre
New Era Estate
Oldlands Way
Bognor Regis, West Sussex
PO22 9NQ, UK
Phone: (0)1243 779777
Fax: (0)1243 843 123
Email: customer@wiley.co.uk

John Wiley & Sons (Asia) Pte., Ltd.
1 Fusionopolis Walk
#07-01 Solaris South Tower
SINGAPORE 138628
Phone: 65-6302-9838
Fax: 65-6265-1782
Customer Service: 65-6302-9800
Email: asiacart@wiley.com

+ website

The Tax Law of Private Foundations

2022 Cumulative Supplement

Fifth Edition

Shane T. Hamilton,

Bruce R. Hopkins

WILEY

Copyright © 2023 by John Wiley & Sons, Inc. All rights reserved.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.

Published simultaneously in Canada.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, (978) 750-8400, fax (978) 646-8600, or on the Web at www.copyright.com. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, or online at <http://www.wiley.com/go/permissions>.

Trademarks: Wiley and the Wiley logo are trademarks or registered trademarks of John Wiley & Sons, Inc. and/or its affiliates in the United States and other countries and may not be used without written permission. All other trademarks are the property of their respective owners. John Wiley & Sons, Inc. is not associated with any product or vendor mentioned in this book.

Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor author shall be liable for any loss of profit or any other commercial damages, including but not limited to special, incidental, consequential, or other damages.

For general information on our other products and services or for technical support, please contact our Customer Care Department within the United States at (800) 762-2974, outside the United States at (317) 572-3993 or fax (317) 572-4002.

Wiley publishes in a variety of print and electronic formats and by print-on-demand. Some material included with standard print versions of this book may not be included in e-books or in print-on-demand. If this book refers to media such as a CD or DVD that is not included in the version you purchased, you may download this material at <http://booksupport.wiley.com>. For more information about Wiley products, visit www.wiley.com.

Library of Congress Cataloging-in-Publication Data is Available:

ISBN 9781119930266 (Paperback)

ISBN 9781119985365 (ePDF)

ISBN 9781119985358 (ePub)

ISBN 9781119512585 (main book)

Cover Image: Stucco Spira © Massimo Ravera/Getty Images

Cover Design: Wiley

Preface

This is the fourth supplement to accompany *The Tax Law of Private Foundations, Fifth Edition*. The supplement covers events occurring from the middle of 2018 (where the main volume ended) through the middle of 2022.

Much of the law developments that have occurred during the period reflected in this supplement concern the self-dealing rules, with emphasis on the law concerning indirect self-dealing. The book's treatment of this area of private foundation law has been rewritten and expanded.

Particular attention is accorded the estate administration exception, in part because of two recent significant IRS private letter rulings on the point, plus a ruling on the matter of a foundation's expectancy.

Private foundation law is not frequently the subject of court opinions. One court case emerged during the covered period: the *Dieringer* case. Framed as an estate tax charitable deduction valuation case, the set of facts really is a case study in indirect self-dealing. The case is treated from that perspective in this supplement.

Other interesting private letter rulings during the period include aspects of the mandatory payout rule, the law concerning functionally related businesses and program-related investments, spending for charitable purposes, and the qualified appreciated stock rule.

There was some hope that the proposed Department of the Treasury regulations concerning donor-advised funds would materialize during the period—they are likely to constitute the stuff of a supplement by themselves—but, to date, nothing in that regard has occurred.

A supplement of this nature would not be complete without an update on applicable law generated by the Tax Cuts and Jobs Act. Included in this supplement are summaries of the Treasury Department's and the IRS's regulation on the bucketing and excess compensation tax laws. Discussion of the latter has been expanded to include summaries of exceptions particularly applicable to private foundations. A section has also been added discussing proposed legislation, the "Accelerating Charitable Efforts Act," which if enacted would make significant changes to the tax law applicable to private foundations and to donor-advised funds and the ways in which private foundations currently utilize them.

The discussion of the IRS's rules concerning private foundations' funding of disaster relief programs has been expanded and a section has been added on the import of the prospective revision of the group exemption rules. In celebration (if that is the right word) of the 50-year existence of the private foundation tax laws, a brief perspective on that phenomenon is included.

A new chapter has also been added covering tax reporting and administration issues, including Form 990-PF filing requirements, penalties and automatic revocation for non-filing, public disclosure and inspection requirements, and reporting and payment of private foundation excise taxes on Form 4720. This new chapter also includes an expanded discussion of abatement of the private foundation excise taxes and consolidates that discussion in one place in the book rather than treating it separately across the several chapters dealing with each private foundation excise tax.

Thanks go to Brian T. Neill, Deborah Schindlar, and Selvakumaran Rajendiran at John Wiley & Sons, Inc., for their hard work and invaluable help in connection with preparation of this supplement.

Bruce R. Hopkins
Shane T. Hamilton

Book Citations

Throughout this book, 11 books by the authors (in some instances, as co-author), all published by John Wiley & Sons, are referenced in this way:

1. Hopkins, *IRS Audits of Tax-Exempt Organizations: Policies, Practices, and Procedures* (2008): *IRS Audits*.
2. Hopkins, *The Law of Fundraising, Sixth Edition* (2022): *Fundraising*.
3. Hopkins, *The Law of Intermediate Sanctions: A Guide for Nonprofits* (2003): *Intermediate Sanctions*.
4. Hopkins, *The Law of Tax-Exempt Organizations, Twelfth Edition* (2019): *Tax-Exempt Organizations*.
5. Hopkins, *Nonprofit Governance: Law, Practices & Trends* (2009): *Nonprofit Governance*.
6. Hopkins, *Nonprofit Law for Colleges and Universities: Essential Questions and Answers for Officers, Directors, and Advisors* (2011): *Colleges and Universities*.
7. Hopkins, *Planning Guide for the Law of Tax-Exempt Organizations: Strategies and Commentaries* (2004): *Planning Guide*.
8. Hopkins, *The Tax Law of Charitable Giving, Sixth Edition* (2021): *Charitable Giving*.
9. Hopkins, *The Tax Law of Unrelated Business for Nonprofit Organizations* (2005): *Unrelated Business*.
10. Hopkins, *The Law of Tax-Exempt Healthcare Organizations, Fourth Edition* (2013): *Healthcare Organizations*.

11. Hopkins, *Tax-Exempt Organizations and Constitutional Law: Nonprofit Law as Shaped by the U.S. Supreme Court* (2012): *Constitutional Law*.

The second, fourth, eighth, and tenth of these books are annually supplemented.

CHAPTER ONE

Introduction to Private Foundations

[§ 1.1 Private Foundations: Unique Organizations](#)

[§ 1.2 Definition of Private Foundation](#)

[§ 1.4 Private Foundation Law Primer](#)

[§ 1.5 Foundations in Overall Exempt Organizations Context](#)

[§ 1.6 Definition of Charity](#)

[§ 1.7 Operating for Charitable Purposes](#)

[§ 1.9 Private Foundation Sanctions](#)

[\(a\) Sanctions \(a Reprise\)](#)

[\(b\) Self-Dealing Sanctions as Pigouvian Taxes](#)

[\(c\) Self-Dealing Sanctions: Taxes or Penalties?](#)

[\(d\) Abatement](#)

[\(e\) Potential of Overlapping Taxes](#)

[\(f\) Influence on Subsequent Law](#)

[§ 1.10 Statistical Profile](#)

[§ 1.11 Private Foundations and Law 50 Years Later](#)

§ 1.1 PRIVATE FOUNDATIONS: UNIQUE ORGANIZATIONS

p. 1, first line. *Delete millions of and insert:*

over 1.5 million¹

p. 1, second line. *Delete 98,000 and insert 90,000.*

p. 1. *Delete second paragraph.*

p. 2, note 1, third line. *Insert period following 26; delete remainder of note.*

p. 2, note 1. *Change footnote number to 1.1.*

§ 1.2 DEFINITION OF PRIVATE FOUNDATION

p. 5, note 10. *Insert before period:*

; IRS Revenue Procedure (Rev. Proc.) 2022-5, 2022-1 I.R.B. 256, § 7.03

§ 1.4 PRIVATE FOUNDATION LAW PRIMER

p. 8, last line. *Insert footnote 22.1 following period:*

^{22.1}IRC Chapter 42 (IRC §§ 4940–4948).

p. 9, note 28. *Delete § 12.1, 12.2 and insert 12.1(a).*

p. 9, note 30. *Delete 12.3(b) and insert 12.4.*

p. 9, note 33. *Delete 1.10 and insert 12.5(c).*

p. 11, fourth line. *Delete Tax abatement and insert Abatement of the initial tax on self-dealers and foundation managers.*

p. 11, fourth and fifth lines. *Delete in this context.*

p. 11, note 44. *Delete 6.7 and insert 12.5(c).*

p. 11, note 47. *Delete 7.6 and insert 12.5(c).*

p. 12, note 51. *Delete 8.4 and insert 12.5(c).*

p. 13, note 59. *Delete 9.10 and insert 12.5(c).*

§ 1.5 FOUNDATIONS IN OVERALL EXEMPT ORGANIZATIONS CONTEXT

p. 16, note 75. *Delete second 75.; convert semi-colon to period and delete remainder of note.*

p. 16, note 76. *Convert semi-colon to period and delete remainder of note.*

p. 16, note 77. *Convert semi-colon to period and delete remainder of note.*

p. 16, note 78. *Convert semi-colon to period and delete remainder of note.*

p. 16, note 79. *Convert semi-colon to period and delete remainder of note.*

p. 16, note 82. *Convert semi-colon to period and delete remainder of note.*

§ 1.6 DEFINITION OF CHARITY

p. 17, note 85. *Convert semi-colon to period and delete remainder of note.*

p. 17, note 86. *Convert semi-colon to period and delete remainder of note.*

p. 17, note 87. *Convert second comma to period and delete remainder of note.*

§ 1.7 OPERATING FOR CHARITABLE PURPOSES

p. 18, carryover paragraph, first line. *Insert footnote 88.1 following period:*

^{88.1}Reg. § 1.501(c)(3)-1(c)(1).

p. 18, carryover paragraph, sixth line. *Delete organizational and insert operational.*

p. 18, carryover paragraph. *Delete fifth complete sentence, including footnote.*

p. 18, note 89. *Delete text and insert:*

A private foundation had its tax-exempt status revoked for failing to engage in any exempt activities over a long period of time (Community Education Foundation v. Commissioner, 112 T.C.M. 637 (2016), appeal dismissed due to lack of representation by legal counsel).

p. 18, note 90. *Delete text and insert:*

In general, *Tax-Exempt Organizations* § 4.4.

p. 19, note 102. *Delete text beginning with and and through Compliance.*

§ 1.9 PRIVATE FOUNDATION SANCTIONS

p. 24. *Change heading to read:*

PRIVATE FOUNDATION LAW SANCTIONS

pp. 24-26. *Delete text following heading on page 24 and through the first complete paragraph on page 26, and insert:*

The federal tax rules pertaining to private foundations^{[136](#)} are often characterized in summaries as if they are typical laws, in the sense of prescriptions governing human behavior. This is not the case; these rules, comprising portions of the Internal Revenue Code, are tax provisions.

Thus, this body of law states that, if a certain course of conduct is engaged in (or, perhaps, not engaged in), imposition of one or more excise taxes will be the (or a) result. For example, there is no rule of federal tax law that states that a private foundation may not engage in an act of self-dealing;¹³⁷ rather, the law is that an act of self-dealing will trigger one or more excise taxes and other sanctions.¹³⁸

(a) Sanctions (a Reprise)

Because of the nature of this statutory tax law structure, a person subject to an excise tax does not merely pay it and continue with the transaction and its consequences, as is the case with nearly all federal tax regimes. This structure weaves a series of spiraling taxes from which the private foundation, and/or disqualified person(s) with respect to it, can emerge only by paying one or more taxes and correcting (undoing) the transaction involved by paying or distributing assets or having the foundation's income and assets confiscated by the IRS.

The private foundation rules collectively stand as sanctions created by Congress for the purpose of curbing what was perceived as a range of abuses being perpetrated through the use of private foundations by those who control or manipulate them. These provisions comprise Chapter 42 of the Internal Revenue Code. Some of these constraints were placed on supporting organizations and donor-advised funds in 2006.¹³⁹

(b) Self-Dealing Sanctions as Pigouvian Taxes

In the self-dealing context, two excise taxes are imposed on self-dealers—the initial tax¹⁴⁰ and the additional tax.¹⁴¹ The first tax has a rate of 10 percent; the second a rate of 200 percent. There are also taxes on foundation managers

where there is knowing participation in the self-dealing transaction (a scienter requirement).¹⁴² The foundation self-dealing tax subjects the entire amount involved in a self-dealing transaction to tax. Also, the initial self-dealing tax cannot be abated by the IRS.¹⁴³ There is the correction feature, by which the self-dealer is required to pay the amount involved to the foundation.¹⁴⁴

What has come to be known as the *Pigouvian tax* is the brainchild of English economist Arthur Cecil Pigou (1879–1959), a contributor to modern welfare economics. He introduced the concept of *externality* and the belief that externality (social problems) can be corrected by imposition of a tax. A commentator wrote that Pigouvian taxes “aim to regulate behavior by placing a small tax, usually in the form of a uniform excise tax, on the activity to be regulated because of the harm it produces for members of the public.”¹⁴⁵

Does the federal self-dealing tax regime constitute one or more Pigouvian taxes? On the face of it, the answer would seem to be yes.¹⁴⁶ This commentator nicely observed that the self-dealing taxes “have the Pigouvian impulse to protect the public from harm by imposing an excise tax.”¹⁴⁷ Despite this impulse, however, three reasons were posited why the self-dealing taxes are not Pigouvian in nature. One, the additional excise tax rate of 200 percent is not “small.” Two, the initial tax subjects the entire amount involved in a self-dealing transaction to tax, “even if the transaction benefits the foundation,” so that, in those circumstances, the requisite “social costs” are not involved.¹⁴⁸ Third, a Pigouvian tax assumes uniform social costs across all individuals and firms; the commentator mused whether “differences between large and small foundations, between corporate and family foundations, local and national

foundations, old and new foundations, etc. should shape the applicable excise tax rules.”¹⁴⁹

Yet, it is understandable why one, perhaps not an economist, would conclude that the self-dealing taxes are Pigouvian in nature, if only because the initial tax cannot be abated and because of the correction requirement. The U.S. Supreme Court stated the general rule about a tax: “Imposition of a tax nonetheless leaves an individual with a lawful choice to do or not do a certain act, so long as he is willing to pay a tax levied on that choice.”¹⁵⁰ The self-dealing tax regime does not allow for that type of “lawful choice.”

(c) Self-Dealing Sanctions: Taxes or Penalties?

Federal constitutional law differentiates between a tax and a penalty—at least conceptually. This distinction may be drawn in determining whether the exaction passes constitutional muster. A dramatic illustration of this point occurred when a bare majority of the U.S. Supreme Court upheld the constitutionality of the Patient Protection and Affordable Care Act (the “Affordable Care Act”) on the basis of Congress's taxing power, construing the health insurance individual mandate (or shared-responsibility payment) as a tax, after the decision was made that the mandate could not be justified as constitutional pursuant to the Commerce Clause.^{150.1} On that occasion, however, the Court observed that “Congress's ability to use its taxing power to influence conduct is not without limits.”^{150.2}

In this opinion, the fact that there is a difference between a tax and a penalty was raised, but not resolved. The Court wrote that “there comes a time in the extension of the penalizing features of the so-called tax when it loses its character as such and becomes a mere penalty with the characteristics of regulation and punishment.”^{150.3} Also,

the Court stated that, “[i]n distinguishing penalties from taxes, this Court has explained that ‘if the concept of penalty means anything, it means punishment for an unlawful act or omission.’”[150.4](#) The Court concluded, having decided that the individual mandate (or shared-responsibility payment) is a tax for constitutional law purposes, wrote that “we need not here decide the precise point at which an exaction becomes so punitive that the taxing power does not authorize it.”[150.5](#) It should be remembered that, even if an exaction is determined to be a penalty, the constitutionality of the statutory structure may be upheld under the Commerce Clause.[150.6](#)

In the opinion, the Court principally relied on two of its precedents in discussing what is and is not a tax. In one of these cases, decided in 1953, the Court wrote that a “federal excise tax does not cease to be valid merely because it discourages or deters the activities taxed.”[150.7](#) It was stated that a tax may have a “regulatory effect” but remains a tax if it “produces revenue.”[150.8](#) The Court added: “It is axiomatic that the power of Congress to tax is extensive and sometimes falls with crushing effect on businesses deemed unessential or inimical to the public welfare.”[150.9](#) In the other of these cases, the Court concluded that an ostensible tax was a penalty, because the sanction imposed a heavy burden, included a scienter requirement, and was enforced by a federal agency other than the Department of the Treasury.[150.10](#)

The Supreme Court observed, in 1974, that the Court in some of its early cases “drew what it saw at the time as distinctions between regulatory and revenue-raising taxes,” adding “[b]ut the Court has subsequently abandoned such distinctions.”[150.11](#)

Several court opinions focus on the constitutionality of the federal self-dealing law. In one of these cases, the principal

contention was that the provision is an unconstitutional extension of the congressional taxing power.^{150.12} That is, the allegation in that case was that the purpose of the statute is not to raise revenue but to regulate private foundations by imposing penalties on persons who use them for noncharitable, private purposes. The court involved rejected the contention.

The court began its analysis by observing that, in its early decisions analyzing the constitutionality of tax statutes, the Supreme Court “often drew distinctions between regulatory and revenue raising taxes.”^{150.13} The court, however, wrote that the Court “has subsequently abandoned such distinctions.”^{150.14} The court quoted a 1937 Supreme Court opinion stating that “[i]t is beyond serious question that a tax does not cease to be valid merely because it regulates, discourages, or definitely deters the activity taxed.”^{150.15} In that opinion, the Court wrote that this “principle applies even though the revenue obtained is obviously negligible”^{150.16} “or the revenue purpose of tax may be secondary.”^{150.17} The Court also stated: “Nor does a tax statute necessarily fall because it touches on activities which Congress may not otherwise regulate.”^{150.18} The court concluded that, “[u]nder the present posture of the law, tax statutes are constitutional unless they contain provisions which are extraneous to any tax need.”^{150.19}

This court stated that “[i]t is clear that [the self-dealing statute] is constitutional as measured by the standards set forth in [the 1953 case].”^{150.20} It continued: “Congress has seen fit, in enacting the internal revenue laws, to grant tax exempt status to certain entities” and “has allowed individuals, corporations, and estates the right to escape taxation of the amounts donated for charitable purposes.”^{150.21} “However,” the court wrote, “when

Congress observed that its legislative grace was being abused, it enacted [the self-dealing statute] to insure that its original intent in granting non-taxable status was complied with.”[150.22](#) The court concluded that, “[a]lthough [the statute] has a regulatory effect on the activities of charitable organizations and might not raise any revenue, it insures that revenue will be collected under income, estate, and gift tax laws which otherwise might have gone uncollected.”[150.23](#)

Another court case directly involving a private foundation regulatory provision in relation to the sanction's status as a tax is a challenge to the mandatory payout rule.[150.24](#) In that case as well, the argument was that, by enacting the provision, Congress exceeded its power to lay and collect excise taxes. The contention was that the provision does not impose a tax for constitutional law purposes but “imposes a penalty measured by a prescribed rate of return on the value of the foundation's noncharitable property even though the foundation may have no income.”[150.25](#) The court rejoined that the Supreme Court “has repeatedly rejected this argument,” and found that a tax may be “a legitimate exercise of the taxing power” notwithstanding that it has a “collateral regulatory purpose and effect.”[150.26](#)

This court wrote that, “[b]y enacting [the mandatory payout rule] ... Congress decided to subject tax-exempt private foundations to [the rule that the tax must be paid even though the foundation has no income] in order to deal with what it perceived to be an abuse of the foundation's tax-exemption privilege,” in that “[w]hile donors to the exempt private foundation could receive substantial current tax benefits from their contributions, charity might receive no current benefits because the foundation invested in growth assets that produce no current income but are expected to

increase in value.”[150.27](#) Although the court did not expressly so state, private foundations in this circumstance are required to dip into principal to make the required distribution.[150.28](#)

The legislative history of the self-dealing rules is replete with references to the sanctions as penalties. The report of the House Committee on Ways and Means accompanying its version of the 1969 tax legislation states that the “permissible activities of private foundations ... are substantially tightened to *prevent* self-dealing between the foundations and their substantial contributors.”[150.29](#) The committee added that it “has determined to generally *prohibit* self-dealing transactions and provide a variety and graduation of sanctions.”[150.30](#) In this report, there are numerous references to these sanctions as constituting “prohibitions” or arising out of “prohibited” conduct. Identical or similar language appears in the report of the Senate Committee on Finance in connection with its version of the 1969 legislation.[150.31](#) This continues to be the view of Congress on this topic, as reflected in a report issued by the Ways and Means Committee in 1996 referring to the private foundation rules as a “penalty regime.”[150.32](#)

A commentator, following a review of the case law, wrote that the “character” of the self-dealing and similar private foundation provisions “as a tax or a penalty seems uncertain” under the Supreme Court opinion upholding the Affordable Care Act.[150.33](#) It is pointed out that the Court's most recent discussion of what constitutes a penalty “turns, at least in part, not on the purpose of or motive for an assessment, but on its level—whether it imposes a heavy burden.”[150.34](#) Here are the features posed for such a “heavy burden” under the self-dealing sanctions regime: (1) the imposition of the first-tier level of taxation on the entire amount of a self-dealing transaction, rather than just the

amount by which the foundation is harmed; (2) the second-tier tax rate of 200 percent, which “gives a disqualified person little if any meaningful choice of whether or not to pay the tax”; (3) the implication of the scienter requirement in connection with the excise taxes on foundation managers who knowingly participate in a self-dealing transaction; (4) the court opinions that view the self-dealing sanctions as having the “regulatory purpose [of] rendering self-dealing unlawful”; and (5) the IRS's inability to abate the first-tier excise tax.^{150.35} A sixth indicator of penalty status in this context may be the correction requirement.

This commentator concludes that “private foundation excise taxes do not fit easily into either the category of constitutional taxes or constitutional penalties.”^{150.36} As to the self-dealing taxes, the commentator writes that the “status of section 4941 is uncertain under [the Supreme Court opinion upholding the Affordable Care Act], under the private foundation cases from the 1980s, and the positions of key governmental bodies.”^{150.37} Nonetheless, a good case can be made, at least as to the self-dealing tax regime, that the sanctions amount to one or more penalties. The Pigouvian impulse tugs.

(d) Abatement

p. 26, note 152. *Insert following existing text:*

See § 12.5(c).

p. 26, second complete paragraph, last line. *Delete in the self-dealing setting and insert with respect to the initial tax on acts of self-dealing.*

pp. 26-27. *Delete text beginning with third complete paragraph on page 26 and through the last complete paragraph on page 27.*

p. 27. *Insert before carryover paragraph:*