

Tax & Legal

Is Our Foundation Likely to Have an I.R.S. Audit?

Probably Not, but Your State Attorney General May be Coming

By Thomas F. Blaney, CPA, CFE and Christopher D. Petermann, CPA, O'Connor Davies Munns & Dobbins, LLP

The latest Internal Revenue Service (IRS) statistics revealed that the IRS examined only 132 tax returns of private foundations (including certain trusts) in fiscal year 2001. The IRS also reported that as of September 30, 2001, there were approximately 88,000 private foundations (including operating foundations). Therefore less than one quarter of 1% of all tax returns filed by private foundations were examined by the IRS. Unfortunately, in certain states, there has been a recent increase in Attorney General inquiries (audits) into the operations of private foundations as well as the components of the Federal Return of Private Foundations (Form 990-PF), which usually accompanies a state filing.

These Attorney General audits can arise from questions raised during a routine desk review of a state filing or from a complaint or allegation made by an employee or former employee, grantee, or even a potential grantee turned down for a grant. The Attorney General in certain jurisdictions (e.g., Illinois, New York, and Pennsylvania) seem to be more active than other jurisdictions.

Areas that typically are scrutinized by the Attorney General's office are:

- Trustee and employee compensation
- Expense accounts
- Investments in businesses or partnerships owned or managed by foundation trustees
- Investment vehicles such as limited partnerships
- Self-dealing issues
- Related-party transactions
- Contributions to non-public charities
- Certain administrative expenditures
- Loans

Don't Panic!

Inquiries made by a representative from an Attorney General's office can be quite thorough. For example, during one audit, the representative asked how trustee compensation was determined and by whom, the amount of time a trustee spends on the foundation's behalf, and the nature of duties performed by each trustee. In addition, the representative requested minutes from board meetings indicating approval of trustee compensation and asked if the foundation had an independent compensation committee.

If a representative from an Attorney General's office contacts your foundation either in writing or over the phone, don't panic. Contact the foundation's attorney and/or CPA. All communications with the Attorney General's office should go through these representatives. These audits are not generally centered on the calculation of the amount of tax a foundation pays but concentrate on the legal and compliance issues a foundation faces.

Unfortunately, self dealing regulations are an area that trustees can unknowingly violate, therefore, in connection with the foundation's annual audit, have your CPA review all compliance and self-dealing issues. For those foundations that do not have an annual audit, have your CPA review the appropriate documentation for compliance when preparing the 990-PF tax return. Attorney General representatives from different states may focus on different compliance or regulatory issues, therefore it is imperative that a foundation maintain appropriate documentation and annually review its compliance with all applicable laws.

Use the upcoming Professional Directory for Foundations to find an ASF member recommended advisor!