Talking Taxes: Private Foundation vs. Public Charity

BY BROOKE DAWSON, CPA

All nonprofit organizations recognized by the Internal Revenue Service (IRS) as exempt from federal income tax under 501(c)(3) are classified as either a private foundation or a public charity. Although these classifications may sometimes be used simultaneously, they are subject to different rules and regulations.

What is a Private Foundation?

A private foundation typically has a single primary source of funding. This support usually comes from one family or corporation rather than funding from many sources. Additionally, its ongoing revenue is derived from investments.

Examples of private foundations include the W.K. Kellogg Foundation and the Bill & Melinda Gates Foundation. As a foundation, these organizations generally invest, manage assets, and make grants to other charitable organizations. Since private foundations have a limited number of donors and are open to less public scrutiny, the IRS imposes various rules and regulations to ensure the foundation operates as it should and pays out a sufficient amount of grants to public charities. Any violation of these rules could result in additional taxes and penalties.

What is a Public Charity?

Public charities receive the largest share of their financial support from public donors, private foundations, and governmental agencies, which leads to greater reliance on the public. Watchdog organizations such as Guidestar and Charity Navigator assist donors in monitoring public charities through specific metrics that indicate best practices and financial stability.

Unlike private foundations, public charity board members represent the interest of their community members. They are not managed or controlled by one person or family. As a result, public charities benefit from more flexible rules governing their operations. Donations to public charities also experience more flexible tax benefits to the donor.

In Summary: Private Foundation vs. Public Charity

Both private foundations and public charities are valid models for operating a nonprofit. However, they serve different purposes and depending on the founder's goals, one may be a better fit.

A public charity boasts the most beneficial tax deductions to donors, while a private foundation offers complete control over contributions. Public charities may require more managerial effort than a private foundation as they have certain state filing requirements and are sometimes subject to additional reporting requirements such as a review or audit.

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A summary of the tax implications of each is as follows:

	Public Charity	Private Foundation
Tax Benefit to the Donor	60% of the donor's adjusted gross income (AGI) for cash contributions and 30% AGI for stock contributions. Both individuals and corporations can donate and take a deduction. 5-year carryover of contribution deduction if unable to take it in the initial year.	30% of the donor's AGI for cash contributions and 20% AGI for stock contributions. Both individuals and corporations can donate and take a deduction. However, it is a potentially smaller benefit than a contribution to a public charity. Five-year carryover of contribution deduction if unable to take it in the initial year.
Entity Tax Implications	None. Public charities do not pay taxes on investment income or income related to their exempt purpose.	1.39% net investment income tax to Foundation. 30% excise tax if minimum distributions aren't made (1 year to catch up on required distributions).
Minimum Distribution Required by IRS	None	5% of assets are required to be distributed to public charities annually

Moving Forward: Making a Determination

In the eyes of the IRS, a private foundation is the default organizational structure when structuring a nonprofit unless it requests and qualifies for a ruling or determination as a public charity. Whether the determination is to proceed with establishing a private foundation or a public charity, interactions with the IRS are unavoidable. Luckily the IRS provides information, explanations, guidelines, and publications to address questions and help navigate the process.

Final Thoughts

No matter which 501(c)(3) designation you choose, getting started with knowledgeable legal counsel and a CPA firm with experience in the nonprofit industry is critical. They will assist with staying compliant with local government agencies and the IRS.

About the Author: Brooke Bauerle Dawson joined Rivero, Gordimer & Company in 2014. Prior to joining the company, Ms. Dawson spent 2 years in Forensic Accounting and Litigation support and has experience in both civil and criminal cases. Ms. Dawson has experience in auditing governmental and not-for-profit organizations. Ms. Dawson's experience in the areas of not-for-profit and governmental auditing includes that of Uniform Guidance and State of Florida Single Audit Acts. She has served a number of Not-for-profit organizations including A Kid's Place of Tampa Bay, National Pediatric Cancer Foundation, the Special Operations Warrior Foundation and the Centre for Women. Additionally, Ms. Dawson has experience with commercial organizations through operations of court-appointed trusteeships and receiverships.

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