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THE CHARITABLE FOUNDATION IN WISCONSIN-SOME TAX CONSIDERATIONS

GEORGE M. CHESTER*

I. INTRODUCTION

At her press conference held in Washington, D.C., on September 25, 1959, Mrs. Nina Khrushchev, wife of the Soviet Premier, was asked how she spent her time at home. She is reported to have replied:

'I don't do any charity work. In our country, all that in your country requires charity, collection of funds, and so on—the state takes care of all that.'

Mrs. Khrushchev's reply summarized in a few words the Soviet solution to the multitude of problems associated with private philanthropy in the United States. An extremely simple solution it is too—except that few persons in the free world would willingly accept it. As long as private philanthropy is preferred to the all-encompassing and rigid welfare system of a totalitarian state, the problems of charitable giving and the desirability of fostering sources of charitable dollars will be with us.

In Wisconsin, as elsewhere, the charitable foundation as a source of charitable dollars has come of age. Raymond S. McClelland, Director of the Greater Milwaukee Community Chest Campaign, estimates that over 325 charitable foundations contributed more than $1,000,000 of the record-breaking $5,022,000 raised in the 1959 campaign, or about one-fifth of the total amount raised. Nationally, charitable foundations contribute hundreds of millions of dollars annually to charity.

It appears evident that such an important source of private philanthropy should be fostered for the benefit of the community, and indeed both federal and Wisconsin tax laws do grant special tax concessions to charitable foundations and to the donors that support them. Unfortunately, however, the maze of federal and state tax exemption statutes,

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2 The use of the word "charitable foundation" herein is intended to include within its meaning educational and religious foundations and similar organizations. See Part II of this article for a further definition of this term.

3 Letter from Mr. McClelland to the writer dated November 3, 1959.

4 In 1957, 110 larger foundations (including the Ford Foundation) gave away the tremendous sum of $521 million according to F. Emerson Andrews of the Foundation Library Center as reported in New York University Fourth Biennial Conference on Charitable Foundations (1959), Matthew Bender & Company, p. 46.
applicable regulations and changing policies governing the granting of exemption rulings provides so many tax pitfalls to an unwary management or founder of a charitable foundation that in some instances the foundation's funds may be dissipated or sources of future revenue jeopardized.

This article will attempt to point out a few of the tax considerations which must be taken into consideration by a Wisconsin charitable foundation without attempting to cover all tax problems or to explore each problem minutely. Some practical guide to the creation and operation of a charitable foundation in Wisconsin appears to be needed, especially for the smaller foundation which usually exists without the technical staff available to the larger foundation.

II. THE TERM "CHARITABLE FOUNDATION" DEFINED

Before listing the various federal and state tax considerations it may be wise first to define the term "charitable foundation" and to set forth some of the reasons for the growth of charitable foundations. A "foundation" has been defined as a nongovernmental, nonprofit organization having a principal fund of its own, managed by its own trustees or directors, and established to maintain or aid social, educational, charitable, religious, or other activities serving the common welfare.5 The same definition applies equally well to the term "charitable foundation" as that term is generally used and as it is used herein. In a narrower sense the term "charitable foundation" can refer to an organization limited to strictly eleemosynary purposes, as distinguished from, for instance, educational or religious purposes, but in practice these purposes are so entwined that the term has taken on the broader meaning and is often used to refer to any nonprofit organization which will qualify under Section 501(c)(3) of the Internal Revenue Code of 1954.6

A charitable foundation can be a charitable trust (such as The Duke Endowment) or a nonstock, nonprofit corporation (such as The Rockefeller Foundation).7 This article will concern itself only with the corporate form of organization which is the preferred method in most

6 §501(c) List of Exempt Organizations. The following organizations are referred to in subsection (a) [organizations exempt from income tax]:
(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office."
A charitable foundation may be funded by a business corporation (in which event it is sometimes referred to as a company-sponsored foundation) or by a family, an individual or a group of individuals, or by a combination of these. Its purposes may be varied and may range from being a mere device for the more orderly handling of the multiplying charitable requests to being a philanthropic bank, making it possible to level off contributions between good and bad years. It may also provide a means for accumulating funds tax-free for a particular charitable project.

The charitable foundation has a number of tax advantages. If properly organized and operated its income will be free of federal and state income tax. Contributions to the foundation both by corporations and by individuals will be deductible from the income of the donors to the extent provided by federal and state law. Bequests to a foundation for use in Wisconsin may be made free of both the federal estate tax and the Wisconsin inheritance tax. Donations to a foundation may enable a Wisconsin resident to obtain Wisconsin income tax deductions for contributions which are later donated or used outside the state so long as the foundation operates principally within Wisconsin. A foundation may make grants to individuals, whereas no charitable deduction is available to a company or individual which does so.

The foundation is also receiving increased attention from estate planners. Usually it is more advantageous for the wealthy individual to give to a charitable foundation during his lifetime than to give a similar amount to charity at death. The reason—it is better taxwise to take a charitable deduction against the higher federal income tax rates than against the lower estate tax rates. At the donor's death, a

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3 The corporate form of organization has the additional advantage in Wisconsin of permitting the accumulation of income free of Wisconsin income tax under the broad coverage of §71.01(3), Wis. Stats. Accumulated income of a charitable trust is subject to the Wisconsin income tax unless such income is permanently set aside during the taxable year pursuant to the terms of the will, deed or other trust instrument creating the trust for a permitted charitable purpose under §71.08(9), Wis. Stats.

4a Under the Internal Revenue Code individual taxpayers generally may deduct up to 20% of their adjusted gross incomes for charitable contributions, as such term is defined in §170(c), and an additional 10% for charitable contributions to churches, schools, hospitals and medical research organizations as defined in §170(b) (1) (A). Gifts to charitable foundations will rarely qualify for the additional 10% deduction. Corporations may deduct charitable contributions, as defined, to the extent of 5% of their taxable incomes but may carry over excess contributions as deductions in each of the two succeeding taxable years. See §170 Int. Rev. Code, for specific requirements for charitable deductions federally. For Wisconsin income tax purposes, §71.05(6), Wis. Stats., allows persons other than corporations to take deductions for charitable contributions to charitable foundations, etc. "operating within this state" to an amount not in excess of 10% of their net incomes and §71.04(5), Wis. Stats., allows corporations to take similar deductions but limited to 5% of their net incomes. There is no carry-over of unused charitable deductions under the Wisconsin income tax law.
charitable foundation which has been funded in this way can make substantial gifts in memory of the donor not only to the extent of the funds received during the donor’s lifetime but also including any income which may have been accumulated tax-free in the foundation.  

Of equal significance with these tax advantages are the nontax considerations. The charitable foundation has become an ideal device for handling the multiplying charitable requests. A corporation can decide on its annual contribution to the foundation and leave the problem of its distribution to the foundation’s directors and officers who, presumably, are interested in this field of endeavor. Family members can pool their gifts through the foundation device and thus contribute a significant gift to set the “pattern” for a charitable campaign. Examples of the flexibility (within limits) of the charitable foundation can be multiplied.

III. FEDERAL TAX CONSIDERATIONS

The most important event in 1959 affecting the charitable foundation under the federal tax laws undoubtedly was the issuance by the Treasury Department on February 26, 1959, of “proposed” regulations covering charitable organizations under Section 501(c)(3) and civic organizations promoting social welfare under Section 501(c)(4) and the issuance of “final” regulations on June 26, 1959. These new regulations had been long awaited (they apply to calendar years commencing with 1954) but as revised in their final form have been generally well received by tax practitioners.

The distinction between having a status of a charitable organization under Section 501(c)(3) or having a status of a civic organization promoting social welfare under Section 501(c)(4) is an important one. In each case the income of the organization is exempt, but if the corporation cannot qualify under Section 501(c)(3), contributions to it are not deductible.

Over the past decade the dividing line between charitable organizations and social welfare organizations has been variously drawn by the Treasury Department much to the consternation of the borderline organizations. (The typical social welfare organization was an action organization dedicated to one or more forms of civic betterment or social improvement such as the elimination of prejudice and discrimi-

9 The extent to which income is accumulated, however, must be carefully considered. The Code denies exempt status to any organization which accumulates income in an unreasonable amount or for an unreasonable duration as measured by its charitable purposes, but this does not prevent the foundation accumulating gifts to it which are made in the nature of contributions to its capital. See §504(a)(1), Int. Rev. Code.

10 According to the Report of the Fund Raising Study Committee of the Greater Milwaukee Committee, published April 4, 1957, there were at least 36 major campaigns for operating purposes and at least 10 major capital fund campaigns in Milwaukee County during the previous year.

nation, the defense of human and civil rights, or the prevention of community deterioration and juvenile delinquency.) Under the new regulations there is forthright recognition that the term "charitable" includes, among other things, the promotion of social welfare and that a social welfare organization can qualify under Section 501(c)(3) if it otherwise qualifies under this paragraph.\(^{12}\) Charitable foundations concentrating in the social welfare field will find their status in the future more readily determinable. The test under the new regulations becomes whether the foundation is an "action" organization as defined in regulation 1.501(c)(3)-1(c)(3). An organization is deemed an "action" organization not only if it attempts to influence legislation or intervenes in behalf of candidates in political campaigns, but also if its primary objective may be attained only by legislation or the defeat of proposed legislation and it advocates, or campaigns for the attainment of that objective (as distinguished from engaging in nonpartisan analysis, study or research and making the results available to the public.)

The typical charitable foundation under review, however, is more apt to be concerned with the "organizational" test and "operational" test established by the new regulations than with the clarification of status of the social welfare organization described above. These two tests find their authority in the language of Section 501(c)(3) which refers to foundations which are "organized and operated" exclusively for exempt purposes. Accordingly, the regulations require for exemption that an organization be both organized and operated in the proper manner.

Under the organizational test, the regulations require that the purposes set forth in the articles of incorporation of the organization be no broader than the purposes specified under Section 501(c)(3).\(^{13}\) The permitted purposes are: (a) religious, (b) charitable, (c) scientific, (d) testing for public safety, (e) educational and (f) prevention of cruelty to children or animals.

These limitations are not as difficult as might at first be supposed. The regulations define "charitable" in the broad sense as developed by judicial decisions to include: "Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare. . . ."\(^ {14}\) The term "educational" is defined as relating to the "instruction or training of the individual for the purpose of improving or developing his capabilities" or the "instruction of the

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\(^{12}\) Reg. §1.501(c)(4)-1(a)(2).

\(^{13}\) Reg. §1.501(c)(3)-1(b)(1)(a).

\(^{14}\) Reg. §1.501(c)(3)-1(d)(2).
public on subjects useful to the individual and beneficial to the community." Examples of educational organizations range from trade schools to universities, from discussion groups to educational TV, from zoos to symphony orchestras, and include organizations which engage in general or basic research (as contrasted with applied or product research) in either the physical or social sciences or otherwise so long as the results of such research are freely available to the public.

The problems involved in the organizational test can usually be met by careful draftsmanship. Two specific problems should be avoided. Although the Wisconsin Nonstock Corporation Law, Chapter 181 of the Wisconsin Statutes, authorizes a general purpose clause which would permit the charitable foundation to engage in any lawful activity within the purposes for which corporations may be organized under the law, such a provision should be avoided even though the provision is added that the corporation is organized exclusively for charitable purposes. Currently the Exempt Organizations Branch of the Treasury Department is raising questions on ruling applications when the general purpose clause is contained in the Articles. The problem can be avoided easily by using a purpose clause similar to the one quoted in footnote sixteen.

The second problem can be avoided if one merely remembers that it is safer to be "charitable" than "benevolent." A sentence in the "proposed" regulations, which was deleted from the "final" regulations, points this out as follows:

For example, if an organization is created for 'benevolent' purposes, the term 'benevolent', being, in its generally accepted sense, a broader term than 'charitable', will not be regarded as synonymous with 'charitable' as used in section 501(c)(3) in the absence of proof as to State law.\[15\]

\[16\] Reg. §1.501 (c) (3)-1(d)(3).

\[17\] The following is a suggested form of purpose clause for a typical Wisconsin charitable foundation:

"The purposes of the corporation shall be to engage in exclusively charitable, scientific, religious and educational activities and endeavors within the State of Wisconsin and elsewhere; to make donations to charitable, scientific, religious and educational organizations, corporations, societies or associations which shall use the property so transferred within the State of Wisconsin or elsewhere; and supplementary to such purposes, to engage or participate in any activity, business or enterprise to procure funds for the foregoing to the extent that such activity, business or enterprise will not jeopardize the tax-exempt status of the corporation; and to invest in, receive, hold, use and dispose of all property, real or personal, as may be necessary or desirable to carry into effect the above mentioned purposes. No part of the activities of the corporation shall ever consist in carrying on propaganda, or otherwise attempting to influence legislation."

\[18\] The same statute also requires all new Wisconsin corporate charitable foundations to contain "corporation", "incorporated" or "limited", or abbreviations thereof, in their names. See §181.06, Wis. Stats. The name "Charities Limited" may still be available.

\[19\] Prop. Reg. §1.501(c)(3)-1(b)(5).
The "final" regulations merely state that the terms of the articles shall be construed according to the law of the state of incorporation with the burden of proving any unusual construction being on the incorporators.\(^\text{19}\) In Wisconsin it would appear that "benevolent" and "charitable" were synonymous since Section 71.01(3), Wis. Stats., expressly exempts from Wisconsin income tax "benevolent" corporations without mentioning "charitable" corporations. The Wisconsin Department of Taxation has long construed this section to exempt "charitable" corporations from the Wisconsin income tax so the careful and nonlitigious draftsman will favor use of the word "charitable" because of the federal preference for this adjective.

The management of a charitable foundation will certainly want to familiarize itself thoroughly with the provisions of the new regulations covering Section 501(c)(3) and (4) organizations. Only the more important aspects of these regulations have been referred to herein. But even these regulations cannot be used as a comprehensive guide for the charitable foundation. The regulations under Section 503(c) with respect to "prohibited transactions" and under Section 540 with respect to "denials of exemption" should be analyzed as well. Also any charitable foundation which has funds to invest must consider the provisions of Sections 511 to 515 of the Code which deal with "unrelated business taxable income" and "business leases" and Section 502, dealing with "feeder organizations".\(^\text{20}\) These sections have been added to the Code to prevent real and alleged abuses by a relatively small number of charitable foundations in the past.

Section 503(c) prohibits certain transactions between a charitable foundation and substantial contributors to the foundation or their families or corporations controlled by them. These transactions are:

1. lending money without adequate security and without a reasonable rate of interest;
2. making the organization's services available on a preferential basis to these related persons;
3. paying excessive compensation to the related persons;
4. purchasing assets from the related persons for excessive consideration;
5. selling assets to the related persons for inadequate consideration; and
6. engaging in any other transaction which results in a substantial diversion to the related persons of the foundation's income or corpus.

A charitable foundation which participates in a "prohibited trans-
\(^\text{19}\) Reg. §1.501(c)(3)-1(b)(5).
\(^\text{20}\) A "feeder organization" is one which carries on a trade or business for profit but all of whose income is payable to an exempt organization. The Code quite properly taxes the income of a feeder organization.
action" loses its exemption for taxable years after the year in which
the organization is notified by the Internal Revenue Service that it has
engaged in a "prohibited transaction" and until its exempt status is
reinstated. The only exception (permitting retroactive revocation of
exemption) is for a purposeful diversion of a substantial part of the
organization's assets. The important consideration under this section
is that altruistic motives are not enough; the "prohibited transactions"
must be carefully avoided whatever the motives. For instance, a sub-
stantial donor to a charitable foundation might arrange for the founda-
tion to obtain additional income by investing in a note of a controlled
corporation paying a high rate of interest. This would be a "prohibited
transaction" unless adequate security were given to protect the indebt-
edness even though the controlled corporation had net assets of millions
of dollars.

Section 504 denies exempt status to a charitable foundation which:

(1) accumulates income which is unreasonable either in size or
duration, or

(2) uses accumulated income to a substantial extent for other than
charitable purposes, or

(3) invests its income in such a manner as to jeopardize the carry-
ing out of the foundation's charitable purposes.

Neither the statute nor the regulations are clear as to how far a charit-
able foundation may accumulate income. A lower federal court has
upheld accumulations for as much as eight years as reasonable where
the earnings were accumulated in accordance with definite plans. In
contrast, the United States Court of Appeals, Ninth Circuit, has held
that vague plans (coupled with speculation in the market) did not
justify accumulations for as little as two years. Until this area of the
law becomes more certain a charitable foundation should accumulate
income with great care.

Sections 511 to 515 of the Code relating to "unrelated business
taxable income" and "business leases" do not deny exempt status to
charitable foundations under certain circumstances but rather tax certain
types of income of charitable foundations. If a foundation conducts a
trade or business the conduct of which is not substantially related to
the exercise or performance of its charitable purposes (without refer-
ence to the foundation's need for funds) the income from such trade

22 Samuel Friedland Foundation v. United States, 144 F. Supp. 74, 93 (D.C. N.J.
1956).
23 Randall Foundation v. Riddell, 244 F. 2d 803 (9th Cir. 1957).
24 For an excellent discussion of the problems involved in accumulating income
and other "unauthorized transactions" see Greisman, "The Problem of the 'Unauthorized Transaction'", New York University Fourth Biennial Con-
ference on Charitable Foundations (1959), supra, p. 253 et seq.
or business will be taxable to the foundation. The statutory provisions are technical and detailed. Many charitable foundations avoid the problems of "unrelated business taxable income" by limiting their investments to stocks, bonds and real property, the holding of which does not constitute a trade or business. However, in the case of real property the "business lease" provisions of Section 514 become involved if the real property is leased for a term of more than 5 years and the foundation assumed an indebtedness in acquiring or improving the property or an indebtedness was otherwise incurred as specified in Section 514(c)(1). The result is that for practical purposes the charitable foundation can invest its funds in real estate which it owns outright but not in real estate subject to a mortgage. This paradox is merely another example of the unexpected tax problems involved in operating a charitable foundation. To be forewarned is to be forearmed.

IV. WISCONSIN TAX CONSIDERATIONS

The tax pitfalls awaiting a Wisconsin charitable corporation under Wisconsin tax laws may not be as numerous as those under the federal tax laws but they are often more troublesome because so often overlooked. The applicable statutes generally are contained in Chapter 71 (Income Taxes) and Chapter 72 (Inheritance and Gift Taxes) of the Wisconsin Statutes. Lack of general organization and cross references in these chapters leaves the typical director of a Wisconsin charitable foundation confused and dismayed as to the course he must chart to avoid the Scylla of the Wisconsin tax laws after having navigated the Charybdis of the Internal Revenue Code.

The main problem under Wisconsin tax law is the extent to which the charitable foundation must limit its activities to Wisconsin in order to obtain the benefit of the Wisconsin exemption provisions. Generally speaking, if the activities of the foundation qualify as charitable under the Internal Revenue Code no problem will be raised by the State in this regard. Where the funds are spent, however, does make a difference.

Wisconsin has the fourth highest corporate income tax rate in the nation with a top rate of seven per cent applicable to all taxable income above $6,000. This is one provision of the Wisconsin tax laws, however, which should cause no problem to the charitable foundation as Section 71.01(3), Wis. Stats. provides:

There shall be exempt from taxation under this chapter . . . of all religious, scientific, educational, benevolent or other corporations or associations of individuals not organized or conducted for pecuniary profit.

Note that there is no requirement whatever that the corporation or association operate within Wisconsin to be exempted from the Wisconsin corporate income tax. The statute applies as well to foreign as to domestic corporations. However, a predecessor statute was held by the Wisconsin Supreme Court not to apply to a religious or charitable trust fund established by a business corporation since the statute speaks in terms of corporations and associations. Thus, a religious or charitable trust should not rely on the exemption provisions of Section 71.01(3), but must meet the requirements of Section 71.08(9), as set forth in footnote eight, in order to have its accumulated income not subject to the Wisconsin income tax.

Exemption from Wisconsin income tax is not enough. The Wisconsin charitable foundation will probably suffer premature death unless it can receive and make gifts for its charitable purposes free of gift taxes and, of equal importance in most cases, unless the generosity of the donor to the foundation is fostered by the anticipation of a tax benefit at income-tax time.

Wisconsin is one of twelve states that presently levy gift taxes. Gifts to or by a corporation, unless exempted, are taxed at the maximum rates which, with the 30% "emergency" surtax remaining in effect year after year, range from an effective rate of 10.4% to 52% before application of the 5% discount for prompt payment. The importance to the charitable foundation of qualifying for exemption under the Wisconsin gift tax laws is obvious.

Prior to 1949 the Wisconsin gift tax laws exempted transfers to Wisconsin charitable foundations only where the property transferred was used exclusively within Wisconsin. From a practical standpoint the statute was deficient in several respects. It only applied to charitable corporations or associations organized in Wisconsin. Technically, it did not exempt all donations by Wisconsin charitable foundations even though made within the state. The statute was provincial in outlook and for all practical purposes limited the scope of operations of a Wisconsin foundation to Wisconsin because of the high Wisconsin gift tax rates applicable to out-of-state donations.

On June 29, 1949, Chapter 356, Laws of 1949 was published amending the exemption statute to read substantially as it does today in Section 72.79(1) of the Wisconsin Statutes. This exemption statute contains three tests which a charitable foundation must meet in order for donations to or by such corporation to be exempt from the Wisconsin gift tax law:

(1) The corporation, either domestic or foreign, must be organized

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26 First Wisconsin Trust Co. v. Tax Commission, 238 Wis. 199, 298 N.W. 595 (1941).
27 Formerly §72.75(5) (a), Wis. Stats., (1949).
and operated exclusively for religious, charitable, scientific, educational or municipal purposes, or for the prevention of cruelty to children or animals.

(2) No part of the net income of the corporation may inure to the benefit of any private stockholder or individual.

(3) The corporation must be “operating principally within this state.”

The phrase “operating principally within this state” is defined in the statute to include a corporation if fifty (50) per cent or more of its funds during the specified period “have been used within this state for the purposes of its organization or have been contributed to a donee or donees transfers to which are exempt under this section.” This is referred to hereinafter as the “fifty-per-cent test.”

The specified period in which to apply the fifty-per-cent test is cumulative, being generally from date of organization of the charitable foundation to the close of the corporation’s fiscal year immediately preceding the date of the transfer in question. If the charitable foundation was organized prior to enactment of the first Wisconsin gift tax law on July 9, 1933, the test period commences with the latter date. If the charitable foundation was organized after December 31, 1948, and the transfer in question occurs during its first fiscal year the test period is such first fiscal year. The statute is silent as to what period should be used to test a transfer during a charitable foundation’s first fiscal year where the charitable foundation was organized before December 31, 1948, or where the charitable foundation expended no funds during its first fiscal year. The wise foundation will make at least one contribution to an exempt Wisconsin charity during its first fiscal year to protect its initial funding from Wisconsin gift tax.

The Wisconsin Board of Tax Appeals has held that the fifty-per-cent test is the exclusive test for determining whether the charitable foundation has been “operating principally within this state.” Some doubt is cast on this, however, by the decision of the Wisconsin Supreme Court in the Greenebaum case which involved a statutory test of doing business under the Wisconsin income tax law practically identical to the fifty-per-cent test in the exemption statute under the gift tax law. In the Greenebaum case the Court held that even if the fifty-per-cent test were not met it would still be necessary to “determine the still-vital fact of principal business by any other appropriate tests.” Whether or not the requirements of the fifty-per-cent test must be met under all circumstances, it would be foolish for a charitable foundation not to comply with the exact requirements of the statute.

29 Greenebaum v. Dept of Taxation, 1 Wis. 2d 234, 83 N.W. 2d 682 (1957).
30 Id. at 239.
A cumulative record of funds used in Wisconsin and gifts to exempt Wisconsin donees should be kept where there are a substantial number of out-of-state gifts. A suitable margin of safety in meeting the fifty-per-cent test should be maintained. It is well to remember that since in the ordinary case no gift tax returns are filed, the Wisconsin Department of Taxation is not barred by any statute of limitations and can, and has, made additional assessments, with interest computed at ten per cent per annum, on gifts made as much as ten years previously against charitable foundations which have slipped up in meeting the requirements of the exemption statutes. The results can devastate the funds of a foundation.

To comply with the fifty-per-cent test it is not necessary to donate or use within Wisconsin fifty per cent of the funds expended each year. The cumulative total to the close of the prior fiscal year is determinative. Some organizations to be on the safe side and for the sake of simplicity habitually restrict fifty per cent or more of their contributions to Wisconsin charities. The important points to remember are these: A completed donation or use is required to be counted for purposes of the fifty-per-cent test. Committed but unexpended funds set aside within the charitable foundation for specific Wisconsin charitable projects are not counted. The reciprocal exemption statute\(^3\) enacted in 1951 may exempt gifts by a Wisconsin charitable foundation to a charity operating principally in another state even though the fifty-per-cent test has not been met by the donor foundation. Such a gift is exempt from gift tax if the law of such other state grants a like and equal exemption to gifts by its residents to Wisconsin charities. This does not mean, however, that such a gift will count toward the fifty-per-cent test which test still applies in respect to gifts to a Wisconsin charitable foundation.

One further problem remains. The Wisconsin Department of Taxation publishes no record of organizations “transfers to which are exempt” under the exemption statute similar to the Treasury Department’s “Cumulative List—Organizations Described in Section 170(c) of the Internal Revenue Code of 1954.” The Department does, however, maintain its own unofficial list and where the information is important, advice should be sought from the Department.

Exemption under the Wisconsin inheritance tax law is a completely separate matter. Where a testator desires to benefit an out-of-state charity in his will it is usually better not to use a Wisconsin charitable foundation as an intermediary. The reciprocal exemption statute applicable to bequests\(^3\) does not apply to a bequest to a Wisconsin corporation but may exempt a bequest to a foreign charitable corporation

\(^3\) §72.79(3), Wis. Stats.
\(^3\) Wis. Stats., §72.04(2).
whose state grants reciprocity to Wisconsin. Furthermore, a bequest to a Wisconsin foundation is not exempt merely because the foundation meets the fifty-per-cent test. A different rule entirely applies where a bequest, instead of a gift, is made to a Wisconsin charitable foundation. The exemption statute under the Wisconsin inheritance tax law\textsuperscript{32} is similar to the old gift tax exemption statute before it was changed in 1949 and requires use of the property transferred exclusively within Wisconsin.

The law as it developed in Wisconsin required something more than mere use in Wisconsin of the bequeathed property. In the well-known \textit{Jussen}\textsuperscript{33} case, the Wisconsin Supreme Court held that a bequest to a Wisconsin religious corporation organized to promote and aid "home and foreign missions" of the Roman Catholic Church was not exempt from inheritance tax even though the board of directors of the religious corporation adopted a resolution confining the use of the proceeds of the bequest to Wisconsin. The Court held that the intent of the testator as shown in his will whether or not the bequest should be limited to Wisconsin was determinative inasmuch as the rights of all parties, including the state, are determined as of the instant of death and not by any subsequent action taken by the beneficiary. The Court concluded that the testator in the \textit{Jussen} case must have intended that his bequest be used either within or without the state since there was no restriction in his will. The result of this decision was an addition to the statute which provided that the requirement of use or purposes in Wisconsin would be deemed satisfied as to all property which is used or permanently set aside for use exclusively within Wisconsin by the corporate-recipient at any time before the tax which would otherwise be payable had been finally and conclusively fixed and determined.

Although the entire amount bequeathed to a Wisconsin charitable foundation must be limited to use in Wisconsin to be exempt there is no requirement that the bequest itself must be distributed so long as the income thereon is used in Wisconsin.\textsuperscript{34} Thus, income from bequeathed property can be used within Wisconsin and income from donated property can be used outside Wisconsin. The income from bequeathed property used or donated in Wisconsin will help the foundation meet the fifty-per-cent test under the gift tax law as apparently this test can be satisfied with any funds available to the charitable foundation.

Obtaining a Wisconsin income tax deduction for gifts to a Wisconsin charitable foundation is simpler than avoiding a Wisconsin gift tax

\textsuperscript{32} Wis. Stats., §72.04(1).
\textsuperscript{33} Estate of Jussen, 263 Wis. 274, 57 N.W. 2d 343 (1953).
\textsuperscript{34} See Estate of Fulton, 273 Wis. 599, 79 N.W. 2d 230 (1956) which contains a form of resolution adopted by a board of directors which the Court found satisfied the requirements of Wis. Stats., §72.04(1).
on the transfer. Apparently there is no reason for this except that "Topsy just grew that way." Corporations are allowed to deduct charitable contributions from their Wisconsin income tax to an amount not in excess of five per cent of their net incomes. Persons other than corporations are allowed to deduct not in excess of ten per cent of their net incomes. In each case the term "charitable contributions" is limited to a "corporation, trust or community chest, fund or foundation operating within this state." What constitutes operation within Wisconsin? The statute seems to require only substantial operation in Wisconsin. Obviously, if the charitable foundation operates principally within Wisconsin this requirement is met. The Department of Taxation agreed in one case that a company-sponsored charitable foundation which had made donations in Wisconsin in proportion to the amount of business its corporate sponsor did in Wisconsin qualified as operating within Wisconsin but this seems to be only a practical solution to this question. The problem probably will remain moot as long as operation principally in Wisconsin is required for exemption under the Wisconsin gift tax law.

V. EXEMPTION RULINGS AND RETURNS

A study of the charitable foundation in Wisconsin would be incomplete without at least brief mention of the procedure for obtaining exemption rulings and filing returns, both federal and state.

The charitable foundation may not safely assume itself to be exempt from federal income tax unless it has been first determined to be an exempt organization within the meaning of Section 501(c)(3). This requires submitting proof of exemption on Form 1023 to the appropriate District Director's office. This form and accompanying papers are eventually made available for public inspection at the District Director's office, but the District Director will normally forward the application to the Exempt Organizations Ruling Branch in Washington for ruling. Once a favorable exemption ruling has been granted, the organization's name is published in the Monthly Supplement to the "Cumulative List" which appears in the Internal Revenue Bulletins.

During the first two years of its existence the typical charitable foundation will operate without the protection of an exemption ruling. One reason for this is that the application for exemption should not be filed by a charitable foundation until it has had at least twelve months of active operation so the Rulings Branch may have some evidence on which to determine whether the foundation has met the operational test previously referred to in Part III of this article. Secondly, the Rulings Branch in Washington is receiving about 1,000 exemption applications a month and the processing of even a simple application presently takes up to eight months to complete. The Rulings Branch is working
on reducing this processing time to three months but this cannot be anticipated in the near future although the new regulations should cause some speed up in the processing time.

The first year of operation of a foundation is critical under this system and therefore should be planned with care. Any questionable contribution should be avoided. To the extent possible the first year of operation should reflect the type of activities and contributions contemplated for the foundation. Sufficient activity should be generated so a representative picture may be presented. Sometimes the Rulings Branch will hold off a decision until it can examine operations of a foundation for a period longer than one year and it is also quite normal for additional information to be requested.

Treasury Department Form 990-A, Return of Organization Exempt from Income Tax, should be filed by a charitable foundation which claims exemption as well as by one which has been determined to be exempt. The return must be filed on or before the 15th day of the fifth month following the close of the annual accounting period. Portions of this return are made available to the public. Certain educational and religious organizations are exempted from filing returns but the typical charitable foundation is not exempted. A charitable foundation which has unrelated business taxable income must report such income on Form 990-T and pay a tax thereon.

Wisconsin does not have any procedure comparable to the federal procedure for obtaining exemption rulings. Usually once a charitable foundation has been determined to be an exempt organization under the Internal Revenue Code it can proceed on the assumption that it is also exempt for Wisconsin income tax purposes. A problem sometime arises, however, when the foundation solicits contributions from the public. The donors will deduct such contributions on their Wisconsin income tax returns and if the Wisconsin Department of Taxation has no record of the organization these charitable deductions may be denied. In order to prevent this problem from arising, it is advisable to obtain an informal letter from the Department of Taxation stating that the organization will be considered a charitable foundation operating within Wisconsin, contributions to which will be considered deductible for purposes of the Wisconsin income tax as provided by law.

Section 71.10(1) of the Wisconsin Statutes requires that every corporation, whether taxable under Chapter 71 or not, shall furnish to the Department of Taxation a true and accurate statement, on or before March 15 of each year for calendar year corporations, "in such manner and form and setting forth such facts as said department shall deem necessary to enforce the provision of this chapter." In view of this requirement, it is also wise to obtain a letter from the Department
of Taxation to the effect that no Wisconsin income tax returns need be filed by the foundation. This exemption from filing will be readily granted to the typical corporate charitable foundation.

VI. Conclusion

The incorporated charitable foundation is an extremely useful device to charitably-minded corporations and individuals. It is assuming increased importance and stature in the scheme of private philanthropy.

The organization and management of a charitable foundation must be accomplished with as much consideration being given to the federal and state tax exemption statutes as is given to the philanthropic aspects of the foundation. The foundation must plan its first year or two of operations knowing that such operations will, in part, determine whether or not it will obtain a federal exemption ruling and throughout its existence the foundation must operate principally in Wisconsin to assure itself of maximum benefits under the Wisconsin Statutes. Any attempted use of a charitable foundation for tax gimmicks is an unfortunate distortion of its fundamental charitable purpose and will only lead to further government regulation. On the other hand, government regulation of charitable foundations should recognize the important and beneficial role which the charitable foundation undertakes.

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