NEW PUBLICATION LAW
TAKES NEW YORK STATE PRIVATE FOUNDATIONS BY SURPRISE

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On August 16, 2000, Governor Pataki signed into law New York State Bill S07256, which creates an annual newspaper publication obligation for private foundations formed under the laws of the State of New York. The bill seems to have been promoted as a measure to encourage public disclosure. However, a more expansive public disclosure regime was recently enacted at the federal level, and the bill does not accurately reflect these current disclosure obligations. As a practical matter, the bill may cost New York's approximately 7,000 private foundations some $350,000 annually in publication fees that would better be spent on charitable needs in the State's schools and communities, rather than in advertising coffers. In addition, the bill gives county clerks an opportunity to choose where the foundations must publish, thereby reducing choice for the private foundations. The bill could also be another factor in driving new foundations to form under the laws of states other than New York, thereby depriving the New York Attorney General of jurisdiction over their operations. For all these reasons, the New York law is undesirable and should be repealed. If repeal is not possible, the law should at least be amended to correct its currently incomplete terms.

<u>Background on Private Foundation Disclosure</u>. Federal tax law historically required organizations classified by the IRS as private foundations (IRC section 509(a))[1] to publish an annual disclosure notice. Before its amendment, IRC section 6104(d) provided that a private foundation's annual return had to be accompanied by a published notice of its availability. The notice was to be published not later than the day prescribed for filing such annual return (determined with regard to any extension of time for filing) in a newspaper having general circulation in the county in which the principal office of the private foundation is located. The notice was required to state that the annual return of the private foundation was available at its principal office for inspection during regular business hours by any citizen who requested it within 180 days after the date of such publication and to state the address and the telephone number of the private foundation's principal office and the name of its principal manager. To enforce this requirement, IRC section 6033(c)(2) required that a copy of the notice, together with proof of publication thereof, be filed by the foundation with the IRS together with the annual

1 All IRC citations are to the Internal Revenue Code of 1986, as amended (the "IRC").

return. Treas. Reg. Section 1.6033-3(b) provided that the copy of the notice must be accompanied by a statement signed by a foundation manager stating the notice had been published, setting forth the date of publication, and the publication in which the notice appeared. Since the notice could be published in any newspaper of general circulation in the county in which the foundation's principal office was located, choice of the publication was often made by price. In the authors' experience, such notices cost $75 to $250 per notice per year. As noted above, federal law required a copy of the notice to be attached to the return filed with the IRS. If the notice was not attached, the return was considered "incomplete" and penalties applied.

In a major overhaul, Congress decided to broadly expand the disclosure obligations of public charities. In the course of the discussions, questions were raised as to why private foundations should have more limited disclosure obligations as the public might be at least as interested in private foundation returns as in those of public charities. The concept was that prospective donors might be especially interested in the returns of public charities, while prospective grantees might be especially interested in the returns of private foundations.

In the course of reviewing the provisions requiring amendment, it became clear that if the public charity and private foundation disclosure obligations were to be harmonized, the existing private foundation publication rules would have to be eliminated or amended. Given the new, broader disclosure obligations, the drafters decided that elimination was the better course. This was especially true since the requirements for public charities and private foundations were intended to be greatly expanded.

<u>Federal Disclosure Obligations</u>

The new Federal provisions, which became effective for foundation returns filed after March 13, 2000, require the following: (1) the foundation must make available for inspection returns for the three (not just one, as under the old law) most recent years, (2) the foundation must provide copies of any or all of these documents in response to requests received in person, by phone, by fax, by mail, or by email (rather than just in person, as under the old law); and (3) the materials must be made available to any individual who requests them (not just to citizens, as under the old law). The new Federal regulations also permit a foundation to satisfy these disclosure obligations by posting its documents on a website widely available to the public (not just in-person inspection as under the old law, which was criticized as costly and inconvenient). In a related development, the Urban Institute in cooperation with the IRS funded a project whereby information returns were scanned onto disks and those disks eventually became the basis of the Guidestar website (www.guidestar.org). The Guidestar website provides free, fast public access to the returns of some 640,000 charities, including foundations. Thus, interested persons now have the broadest ever access to returns of both public charities and private foundations.

Given this vastly increased disclosure obligation, and this more expansive, 365-days-per-year disclosure responsibility, Federal law relieved foundations of the now-obsolete newspaper publication obligation.

In a related development, the IRS completed a study of compliance by private foundations. In summary, private foundations were found to be very compliant taxpayers.[2] However, a review of their returns showed that one of the most common errors was the failure to obtain and attach the required publication notice. This problem could lead to penalties for failure to file an incomplete return. Those penalties disproportionately affected small and family foundations. Therefore, Treasury and other officials and legislators supported repeal of the provision requiring publication of the newspaper notice.

After proposed federal regulations were issued, from across the country, Ms. Bjorklund was contacted by telephone and email by foundation officials—who supported the repeal—and by newspaper publishers who decried the potential loss of revenue from the foundation notices.

Imagine, then, the surprise of those of us who work with foundations to see that soon after the new Federal disclosure rules took effect, New York State enacted Bill S07256 reinstating for New York State foundations the repealed Federal publication requirement.[3]

<u>The New New York Law</u>

The new New York law does not even accurately state a foundation's current disclosure obligations. Instead, it re-enacts verbatim the obsolete Federal provision (e.g., 180 days not 365, in-person inspection only—not website, email, phone, etc., access for requests). Thus, the New York law requires a foundation to publish a notice that states that the annual return will be available for inspection at the foundation's principal office to citizens who request it within 180 days after the date of publication, when in reality, any person who calls the foundation, at any time during the year, can receive a copy of the annual return.

The New York law applies to trusts, as defined in section 8-1.8(a) of the Estates, Powers and Trusts Law (the "EPTL") and domestic, not-for-profit corporations that are private foundations as defined in IRC section 509. EPTL section 8-1.8 does not, by its terms, define a trust. Section 8-1.8 was enacted in 1971 (at the same time the not-for-profit corporation law and the education law were amended), to amend trust instruments by legislation, so that they would comply with recently enacted Federal restrictions on private foundations with respect to distribution of income (IRC Section 4942), excess business holdings (IRC section 4943), jeopardizing investments (IRC Section 4944) and taxable expenditures (IRC Section 4945).

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2 <u>See</u> Remarks of Marcus Owens, The Jan. 21, 2000, ABA Tax Section Exempt Organizations Committee Meeting, 28 Ex. Org. Tax Rev. 59 (2000).

3 <u>See</u>, <u>e.g.</u>, Herman, Tom, "Tax Report", The Wall Street Journal, Section A, page 1, column 5, Sept. 6, 2000.

EPTL section 8-1.8(a) states that a trust means a private foundation as defined in IRC section 509, including a private foundation charitable trust defined in IRC section 4947(a)(1) or a split-interest trust as defined in IRC section 4947(a)(2), which is administered by a trustee described in EPTL section 8-1.4(a)(1). Section 8-1.4 addresses the supervision of trustees for charitable purposes, and states that a trustee described in section 8-1.4(a)(1) is any "individual, group of individuals, corporation or other legal entity holding and administering property for charitable purposes, whether pursuant to any will, other instrument or agreement, court appointment, or otherwise pursuant to law, over which the attorney general has enforcement or supervisory powers." The statute does not specifically define the trustees "over which the attorney general has enforcement or supervisory powers." However, EPTL section 8-1.4(b) provides that certain entities are not subject to the registration and reporting provisions of section 8-1.4 (e.g. any trust in which and so long as the charitable interest is deferred or contingent, a trust for which there is a corporate trustee under the terms of a trust instrument executed by a non-resident of New York).

As may be evident, it is less than clear to which trusts the law is meant to apply. Does the new publication requirement apply to entities that are exempt from the reporting provisions? What about the fact that section 8-1.4(f) specifically states that the fact that an entity is exempt from the reporting requirements does not absolve the trustees from any responsibility for accounting for property or income held for charitable purposes? Does this give the Attorney General "enforcement or supervisory powers" over all trustees? If so, must a charitable remainder trust, in which all charitable beneficiaries remain contingent, comply with the new publication requirements?

The new law also reduces choice for a private foundation. In contrast to the old Federal requirement, which allowed a foundation manager to choose in which publication to place the required notice, the New York law provides that the county clerk for the county in which the foundation's principal office is located shall designate the publication in which the notice must be placed. Since the county clerk has no incentive to choose the least expensive publication, this may have the effect of increasing the cost of compliance.

Assuming that there are 7,000 foundations in New York State and that each of them must pay $50 per year to purchase a legal notice, the cost to charity will be $350,000 per year. This figure does not take into account that the publication costs might be more than $50 (as stated above, county clerks, not the foundations, choose where to publish under the new New York law) or the legal or accounting costs involved in contacting the county clerk and determining in which paper the notice must be published that year and placing the notice.

Moreover, there is no requirement that the notice be attached to any return, nor is there any enforcement procedure or explanation of what penalties apply for failure to publish.

New York State's broad-reaching charities laws already encourage many New York-based charities to incorporate in Delaware and other states. It is the opinion of the authors that this new publication obligation will be perceived as another reason to send foundations away from New York State.

For the reasons stated above, various charitable groups and bar-association committees seek to repeal or at least correct this law. Interested organizations include the Council on Foundations (contact: John Edie, Esq.); the Nonprofit Coordinating Committee of New York (contact: Jonathan Small, Executive Director); the New York Regional Association of Grantmakers (contact: Barbara Bryan, President); the Non-Profit Organizations Committee of the Association of the Bar of the City of New York (contact: Pamela Mann, Esq.); the Exempt Organizations Committee (contact: Dickson Brown, Esq. and Michelle Scott, Esq.) and the Trusts and Estates Committee (contact: Ronald Weiss, Esq.) of the New York State Bar Association. In addition, the Charities Bureau of the New York State Attorney General has informally expressed interest in charities' reactions to the new law.

In summary, it is clear that the new New York disclosure law is an unwelcome burden on private foundations formed under the laws of New York State (and possibly other on trusts). It is also clear that the advertising revenues to local newspapers selected by county clerks will be welcome by publishers. For this reason, efforts may be made to copy the New York State law in other states. Since no public discussion of this law with the affected charities seems to have occurred, private foundations in other states should be vigilant. As for New York State private foundations, it remains to be seen how and by whom the new law will be publicized, interpreted, applied and enforced.