

# WHAT BOARDS AND EXECUTIVES NEED TO KNOW ABOUT FOUNDATION TYPES

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Board members and staff of philanthropic institutions regularly reach out to CMF to learn more about the various types of grantmaking foundations. At the most basic level, these organizations provide philanthropic support to nonprofits, individuals and other entities through grants, scholarships and other charitable activities.

The “What Boards and Executives Need to Know” series of resources is designed to address questions of interest to board members and senior leaders of grantmaking organizations. These resources may be particularly useful for orientations, board trainings and general professional development and provide better understanding of key concepts that are necessary for the success of the governance and management of foundations in the field.

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## Types of Foundations

The Internal Revenue Code (“Code”) – the federal tax code that primarily describes charitable organizations and activity – categorizes all foundations as either private foundations or public charities,

with further types existing beneath those broad groups. All of these organizations are tax exempt under Section 501(c)(3) of the Code.

Other types of charitable organizations may refer to themselves as a “foundation” within their name even though they do not have a grantmaking function. State law, not federal tax law, governs the use of foundation terminology in names. Distinguishing between these organizations and grantmaking foundations is particularly important for the purpose of understanding issues of public support, governance, and other rules specific to foundations.

### **Private Foundations**

Private foundations are generally financially supported by one or a small number of sources – an individual, a family or a corporation. Most private foundations must pay out at least 5% of their net investment assets each year in the form of grants and operating charitable activities. All of these organizations must complete an IRS Form 990-PF annually and follow a stricter set of private foundation-specific rules, including with regard to prohibited self-dealing, excess business holding, jeopardizing investments and taxable expenditures.

All charitable organizations are classified as a private foundation by default. Organizations must prove (via the IRS’s public support test) that they have sufficient revenue support from a diverse set of individuals and institutions to be considered a public charity. If they lose too much public support or have too much support from only a handful of private individuals or institutions, the organization may revert to private foundation status.

#### **The Public Support Test**

The IRS has a “public support test” that applies to all charitable organizations to test the amount of public support among an organization’s revenue. Without sufficient public support, a charitable organization “tips” into becoming designated as a private foundation, subject to additional rules and taxes, and may be challenging for an organization to reacquire public charity status.

The Code identifies only two specific types of private foundations: private operating foundations and exempt operating foundations. More common terms within the philanthropic sector for different types of private foundations include corporate foundations, family foundations, independent foundations and private operating foundations.<sup>1</sup>

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<sup>1</sup> In addition, any private non-operating foundation may be classified as a “conduit foundation” (also referred to as a “pass-through foundation” or “distributing foundation”) if it meets the distribution requirements specified in Code section 170(b)(1)(F)(ii) for a taxable year. Conduit foundations must make qualifying distributions (treated as distributions out of corpus) in an amount equal to 100 percent of contributions received in a taxable year no later than the 15th day of the third month following the close of the taxable year in question. Donors are then entitled to the more favorable charitable deduction limitations available to public charities, in addition to certain other benefits.

**Corporate Foundation:** A separate organization (oftentimes established as a private non-operating foundation) that is funded by a corporation and undertakes grantmaking (including sponsorships, matching grants, employee giving programs, etc.). It typically is closely branded with the related corporation and managed by corporate leadership. Alternatively, a corporation may use an internal division to manage these activities, oftentimes known as a corporate giving program. For more information, see CMF's resource, "[Choosing a Corporate Philanthropy Approach](#)."

**Family Foundation:** A private non-operating foundation that derives its funding primarily from related family members and maintains a close connection to the family based on their continued presence on the board. The foundation's grantmaking is typically closely associated with the family's interests and/or geographic location.

**Independent Foundation:** A private non-operating foundation that may derive its initial funding from a specific family or institution, but does not necessarily maintain a limited focus on the original funders' priorities or limit its board to those associated with the original donor. The grantmaking priorities may have incorporated other priorities from those originally stated at the foundation's founding, while the board often includes representatives from the community, beyond the family or institutional representatives.

**Private Operating Foundation:** As only one of two sub-categories of private foundation defined by the IRS, a private operating foundation is one that spends at least 85% of its adjusted net income or minimum investment return to actively conduct exempt charitable activities, rather than primarily carrying out grantmaking activities.

**Exempt Operating Foundation:** In general, an exempt operating foundation is a private foundation that has been publicly supported for 10 years and whose governing body consists of individuals less than 25 of whom are disqualified individuals and is broadly representative of the general public, and has no officer who is a disqualified individual during the year. Exempt operating foundations are rare. They are subject to several advantages over other private foundations, such as not having to pay the tax on net investment income, and private foundations may make grants to them without having to comply with expenditure responsibility rules.

## Public Foundations

While many in the field use the term "public foundations," these organizations are actually defined as "public charities" by the Code. Public charities include a wide variety of charitable organizations (nonprofits). However, charities that make grants are generally referred to in the philanthropic field as "public foundations." Types of public foundations include community foundations and public charities.

**Community Foundation:** A public charity grantmaker that accepts donations from the general public and facilitates grantmaking within a specific geographic area. Grantmaking may be conducted via topic-oriented (field of interest) funds, charity-specific (designated or agency) funds, scholarships, and/or donor advised funds.

**Public Foundation:** A public charity (nonprofit) that accepts donations from the general public and conducts grantmaking as part of its regular activities. This organization may also provide some services or programming in its role as a public charity.

Most of these foundations are publicly supported, meaning that they receive their funds from multiple sources, such as private foundations, individuals, government agencies and fees that they charge for related charitable services. In order to retain their status as a public charity, they must obtain revenue from a balance of diverse sources, rather than relying on a small group of donors or private foundation grants. Most of these organizations must complete an IRS Form 990 annually and may choose to follow the private foundation rules regarding governance and grantmaking as best practice in the field. Public charities may “tip” into the private foundation category if they have insufficient levels of public support.

## To Learn More

- Council of Michigan Foundations. “An Operations Checklist for Foundation Compliance.” 2022.  
<https://www.michiganfoundations.org/resources/operations-checklist-foundation-compliance>.
- Council of Michigan Foundations. “Choosing a Corporate Philanthropy Approach.” 2021.  
<https://www.michiganfoundations.org/resources/choosing-corporate-philanthropy-approach>.
- Council of Michigan Foundations. “Comparing Philanthropic Giving Structures: Private Foundation or Community Foundation-Based Fund.” 2022.  
<https://www.michiganfoundations.org/resources/comparing-philanthropic-giving-structures-private-foundation-or-community-foundation>.
- Council of Michigan Foundations. “Michigan Philanthropy.” 2023.  
<https://www.michiganfoundations.org/about/mi-philanthropy>.
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<https://www.michiganfoundations.org/resources/options-your-financial-giving>.
- Council on Foundations. “Foundation Basics.” <https://www.cof.org/content/foundation-basics>.
- Friday, Suzanne S. “An Overview of the Law Governing Community Foundations.” In *Mastering Foundation Law: The Council on Foundations Compendium of Legal Resources*. Arlington, VA: Council on Foundations, 2016.
- Friday, Suzanne S. “Creating a Charitable Foundation: Formation and Considerations.” In *Mastering Foundation Law: The Council on Foundations Compendium of Legal Resources*. Arlington, VA: Council on Foundations, 2016.

## About Ask CMF

This document was authored by Brittany Kienker, Ph.D., Knowledge Insights Expert in Residence for the Council of Michigan Foundations (CMF). Legal aspects of this document were reviewed by Jennifer Oertel, outside legal counsel to CMF. CMF members can find answers to their most pressing questions through CMF’s Knowledge Insights division, including Ask CMF, the Knowledge Center and the Sample Documents Hub. Ask CMF is a free service to CMF members, available through the “Ask CMF” link on the CMF homepage or by visiting <https://www.michiganfoundations.org/practice/ask-cmf>.

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