



Tax Issues of Private Foundations

April 30, 2015

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Agenda

- Introduction
- Excise Tax on Net Investment Income & Tax on Unrelated Business Income
- Qualifying Distributions and Redistribution Rules
- Penalty Situations
 - Self-Dealing
 - Undistributed Income
 - Excess Business Holdings
 - Jeopardizing Investments
 - Taxable Expenditures
- Reading & Understanding the Form 990-PF
- Other Tax Forms
- Conclusion



INTRODUCTION

What is a Private Foundation?

- Organizations that meet the requirements of Internal Revenue Code section 501(c)(3) are exempt from federal income tax as *charitable organizations*. In addition, contributions made to charitable organizations by individuals and corporations are deductible under Code section 170.
- While “public charities” are generally publicly supported and run programs to benefit the public, private foundations, in contrast, typically have a single major source of funding and most have as their primary activity the making of grants to other charitable organizations and to individuals, rather than the direct operation of charitable programs

What is a Private Foundation?

This webinar focuses on private non-operating foundations, otherwise known as “grant-making foundations”. These foundations are generally controlled by the people who fund them and make grants (“qualifying distributions”) to pre-selected public charities.

There are other types of Private Foundations including:

- ***Private Operating Foundations*** (run their own programs)
- ***Exempt Operating Foundations*** (a Private Operating Foundation that has been publicly supported for 10 years and meets certain other requirements)
- ***Conduit Foundations*** (100% of grants received go out to Public Charities)

Starting a Private Foundation

- The first stage in the life cycle of any organization is its creation. A nonprofit organization may be created as a corporation, a trust, or an unincorporated association. Any of these entities may qualify for exemption. Note, however, that a partnership generally may not qualify.
- To be tax-exempt under section 501(c)(3) of the Internal Revenue Code, an organization must be organized and operated exclusively for exempt (charitable purposes) set forth in section 501(c)(3), and none of its earnings may inure to any private shareholder or individual

Steps to Establish a Private Foundation

- Legal entity set up
 - Incorporating under state law (*for a Corporation*)
 - Organizing Documents
 - *For a Corporation*: Articles of Incorporation and Bylaws
 - *For a Trust*: Trust Instrument
- Employer Identification Number (EIN)
- Applying to the IRS for exempt status
- Registration with the Attorney General's Office (Charities Bureau) with any applicable states
- Apply for exemption from state income taxation

Benefits of Private Foundations

- Charitable deduction in year of contribution (however, it is limited to 30% of AGI for cash and 20% for capital gain property contributions)
- Avoid capital gain tax on appreciated marketable securities held more than one year. Donor gets charitable deduction for fair market value of securities at donation and gains will be taxed at Foundation rates of 2% or 1%.
- Donor maintains management control of the private foundation's investments
- Involve family members in collaborative philanthropic effort. Management responsibilities of the foundation can be passed down from generation to generation.

Disadvantage of Private Foundations

- Costly to set up and maintain
- Private Foundation sanctions (penalties) for noncompliance of certain rules

Important for our Clients to Remember

- A private foundation is its own legal entity that files an annual return and pays taxes
- Once set up, filing is required even if foundation is not funded. Penalties for not filing are not based on tax due.
- Not filing for 3 consecutive years will result in an automatic exempt status revocation
- Once assets are transferred to a private foundation, while the donor/board members retain “control,” the funds CANNOT be used for personal benefit.
- Be aware of prohibited transactions and investments
- Penalties can be imposed for noncompliance

Polling Question #1

A donor of a private foundation gets the following benefit:

- A. Utilize funds for personal use
- B. Get a deduction of up to 100% of AGI
- C. Maintain control of the Foundation's assets



**TAXES ON
NET INVESTMENT INCOME**

&

UNRELATED BUSINESS INCOME

(Including Estimated Tax Payment Requirements)

Tax on Net Investment Income

- Internal Revenue Code section 4940 imposes an excise tax of 2% on the net investment income of most domestic tax-exempt private foundations. Further, the tax is reduced to 1% in certain cases.
- This tax must be reported on Form 990-PF, *Return of Private Foundation*. Payment of the tax is subject to estimated tax requirements.

Net Investment Income

Definition:

- **Net investment income** is the amount by which the sum of gross investment income and the capital gain net income exceeds the allowable deductions
- Tax-exempt interest on governmental obligations and related expenses are excluded

Gross Investment Income

- In calculating the tax on net investment income, ***gross investment income*** means the total amount of income from interest, dividends, rents, payments with respect to securities loans (as defined in Code section 512(a)(5)), and royalties received by a private foundation from all sources

Capital Gain Net Income

- Include any capital gains and losses from the sale or other disposition of property held for investment purposes or for the production of income
- Capital losses from the sale or other disposition of investment property may be subtracted from capital gains incurred in the sale or disposition of other investment property during the same tax year, ***but only to the extent of the gains***. If the capital losses are greater than the capital gains, the excess may not be subtracted from gross investment income, nor may the losses be carried back or forward to other tax years regardless of whether the foundation is a corporation or a trust.
- For purposes of determining gain on property acquired **by gift** after December 31, 1969, the basis of the property is its basis in the hands of the donor at the time of the gift

Deductions for Net Investment Income

In determining net investment income, a private foundation may deduct from gross investment income all the ordinary and necessary expenses paid or incurred for the production or collection of gross investment income or for the management, conservation, or maintenance of property held for the production of income.

Where is Net Investment Income Reported?

Net Investment Income is reported in column (b) of Page 1 of Form 990-PF. While column (a) includes all receipts and disbursements, whether tax related or not, column (b) includes only those items of income and deductions which relate to Net Investment Income as defined above.

Reduction in Tax

For tax years beginning after 1984, the tax rate on net investment income is reduced from 2% to 1% for any private foundation that meets the following distribution requirements:

- The foundation makes qualifying distributions during the tax year at least equal to the sum of (a) the **non-charitable-use assets** of the foundation for the tax year multiplied by its **average percentage payout** for the base period, plus (b) one percent of the foundation's net investment income for the tax year, and
- The foundation was not liable for the Section 4942 tax on the distributable amount for any year of the **base period** (five previous tax years)

Unrelated Business Taxable Income (UBTI)

- UBTI generally means the gross income derived from any unrelated trade or business regularly conducted by the exempt organization, less the deductions directly connected with carrying on the trade or business
- UBTI includes unrelated debt-finance income from investment property
- Most commonly flowing through Schedule K-1 from Partnerships
- Need to file Form 990-T (UBTI in excess of \$1,000)
- Payment of the tax is subject to estimated tax requirements.
- If income is subject to UBIT, it is NOT subject to 2% excise tax on net investment income

Exclusions

The following types of income (and deductions directly connected with the income) are generally excluded when figuring unrelated business taxable income:

- Income from a business that is related to the foundation's exempt purposes ("functionally related business")
- Dividends, interest, annuities and other investment income
- Royalties
- Rental income (unless personal services are provided)
- Gains and losses from disposition of investment property

Caution:

- Tax-exempt organizations who are partners in certain investment partnerships should practice due diligence when reviewing their Schedules K-1
- If the underlying partnership is ever audited by the IRS, there could be tax exposure if UBTI was incorrectly or never reported on the Schedule K-1
- Also consider that there could be state UBI implications as well as foreign reporting requirements

Reviewing Schedule K-1 Received by Tax-Exempt Partner

- Make sure the foundation is listed as “Tax-Exempt Organization” so that partnership is providing information relevant to tax exempt-partners.
- UBTI should be listed in box 20, code “V”
- **Red flag:** If Schedule K-1 lists ordinary business income and debt but no UBTI reported, you may have to make inquiries as there may be important information missing.
- State implications: Most UBTI activity is sourced to a particular state and this information is normally listed in the footnotes. If it is not available, make inquiry.

Avoiding UBTI – “Blocker Structures”

- Because debt incurred by a corporation (or other entity that is treated as a corporation for federal income tax purposes) is not treated as debt of its shareholders, and there is an exclusion from UBTI for dividends received from a corporation, an investment in or held through a corporation generally does not generate UBTI (unless the shares themselves are debt-financed)
- The foundation may consider investing in funds that are invested in a flow-through operating entity through a corporation that would act to hold the interests in the operating entity. This structure prevents the fund (and its investors) from receiving UBTI from the operating entity
- Blocker structures can be organized in the U.S. or a foreign jurisdiction
- Be careful with offshore “blocker” corporations – the foundation may have foreign filing requirements

Estimated Tax Rules

- Applies for both the Tax on Net Investment Income and UBTI
- Estimated taxes must be made if the tax is \$500 or more
- Payments are due by the 15th day of the 5th, 6th, 9th and 12th months of the tax year
- Safe Harbor estimates (100% of prior year tax) are allowed unless the organization is classified as a “large corporation”

Large Corporation:

- Taxable income of \$1,000,000 or more for any of the 3 tax years immediately preceding the current tax year
- Safe Harbor may be used for 1st installment only
- Must annualize for all other installments

Form 2220

- Must be used by large corporations using the annualized income installment method
- Annualization periods and amounts are different from that of individuals
- Can annualize at February, March/April, June/July and September/October. Required estimates can be calculated earlier

Tax-Exempt Organizations and Private Foundations				
	1st Installment	2nd Installment	3rd Installment	4th Installment
Standard option	2	3	6	9
Option 1 . . .	2	4	7	10

Electronic Deposit Requirement

- The foundation **must** deposit all depository taxes (such as excise tax and unrelated business income tax) electronically. Generally, such transfers are made using the Electronic Federal Tax Payment System (EFTPS).
- **Depositing on time** – For deposits made by EFTPS to be on time, the foundation generally must initiate the transaction at least one business day before the date the deposit is due.
- ***Special Payment Option for Small Foundations*** – A private foundation may pay its section 4940 tax by check or money order, payable to the United States Treasury, with the Form 990-PF or Form 8868, if it meets all of the following requirements:
 - The tax based on investment income shown on Part VI, line 5 of Form 990-PF is less than \$500, and
 - If Form 8868 is used, the amount entered on line 3a of Part I or line 8a of Part II of Form 8868 must be less than \$500 and it must be the full balance due

Polling Question #2

What is the reduced excise tax rate on net investment income:

- A. 2%
- B. 1%
- C. 5%



QUALIFYING DISTRIBUTIONS & REDISTRIBUTION RULES

Qualifying Distributions (Section 4942)

A. What Qualifies?

- Any amount including reasonable and necessary administration expenses, paid to accomplish one or more tax-exempt purposes, other than a contribution to an organization controlled by the distributing private foundation or by one or more disqualified persons with respect to the foundation
- Direct grants to public charities
- Any amount paid to acquire an asset used or held for use directly in carrying out one or more tax-exempt purposes, and
- Qualified set-asides and program-related investments

B. Mandatory Distribution

- 5% of the average fair market value of the private foundation's assets not used in carrying out its exempt purposes, less any acquisition indebtedness [net value of noncharitable-use assets]

Qualifying Distributions (Section 4942)

C. Required Distributable Amount

1. Minimum Investment Return

- Formula:

- $5\% \times (\text{Private Foundation's investment assets} - \text{debt} - \text{Cash Reserve}) = \text{Minimum Investment Return}$
- If the foundation's tax year is less than 12 months, determine the applicable percentage by dividing the number of days in the short tax period by 365. Multiply the result by 5%. Then multiply the modified percentage by net value of non-charitable-use assets.

Example) Tax year 9/1/2014 – 12/31/2014 = 122 days

$$122/365 = .334 \times 5\% = .0167$$

Assume Net Value of non-charitable-use assets = \$500,000 x
.0167 = \$8,350 is the Minimum Investment Return

Qualifying Distributions (Section 4942)

2. Measuring FMV of Asset

- **Marketable Securities:** Securities (e.g., common and preferred stocks, bonds, and mutual fund shares) for which market quotations are readily available, the average fair market value of the securities on a monthly basis
- **Cash:** Compute cash balance on a monthly basis by averaging the amount of cash on hand on the first and last days of each month
- **All Other Assets:** The value of the asset on an annual basis at a specific date (e.g., December 31)
 - Real Estate value provided by a certified and independent appraiser may be determined on a 5-year basis

Qualifying Distributions (Section 4942)

- 3. Distributable amount:** Is equal to the minimum investment return plus any recoveries of charitable amounts paid in previous years reduced by the sum of the foundation's unrelated business income tax and the excise tax on the investment income
- 4. Distribution Deadline:** Qualifying distributions must be made by the close of the tax year subsequent to the year for which the distribution is required. Failure to do so would result in a 30% excise tax on the undistributed amount for each year that the amount remains undistributed.

Example: For a private foundation with a tax year ending on 12/31/2014, the foundation has until the end of 2015 to distribute the calculated 5% distribution to avoid the 30% tax on the undistributed income.

Qualifying Distributions (Section 4942)

D. Qualifying Distributions

- The expenditures must be for charitable purposes
- The Foundation cannot retain control over the use of the funds nor reserve for its own restricted purposes
- Direct Grants
- Direct Charitable Expenditures
- Set- Asides
- Distributions to Foreign Recipients (special rules apply)

Qualifying Distributions (Section 4942)

E. Calculation of Undistributed Income:

- The formula is:

Current year distributable amount

LESS

Current year qualifying distribution that are not applied either to offset prior deficits or to corpus

- Timing of distributions

1. Applied to make up prior year's deficiency
2. Applied to the current year's distributable amount
3. Taken out of corpus

Redistribution Rules

- Payments to another private foundation or to a controlled organization (either private or public) do not count towards meeting the distributable amount
- A private foundation is not prevented from making these grants but the disbursements do not count towards meeting the distribution requirements.
- If the recipient private foundation does not keep the grants, the grant foundation can claim its payment as a qualifying distribution. Three factors must be met:
 - The controlled grantee must be a charitable organization and distribute to a public charity an amount equal in value to the full amount of the contribution
 - The grantee may not count the distribution towards its own distribution requirement by treating this redistribution as payment of its corpus
 - The donor foundation receives records or evidence from the grantee supporting that the fact that the redistribution was accomplished

Redistribution Rules

- If all or part of the funds are not redistributed by the grantee by the next year end, the grantor's distribution amount for the subsequent year must be increased.
 - A grant treated as qualifying in the year it is paid and because of expected redistribution by the grantee is added back in the subsequent year in which the failure occurred
 - Recovery of amounts previously treated as qualifying distributions (Form 990-PF, Part XI, Line 4)



PENALTY SITUATIONS

(Undistributed Income, Self-Dealing, Taxable Expenditures, Jeopardizing Investments, etc.)

Other Excise Taxes (Sanctions)

The Internal Revenue Code contains five provisions that impose excise taxes on private foundations, foundation managers, or other disqualified persons that engage in certain prohibited acts. These are:

1. The taxes on self-dealing between private foundations and their substantial contributors or other disqualified persons
2. Requirements that the foundation annually distribute income for charitable purposes
3. Taxes on certain excess business holdings
4. Penalty excise taxes designed to discourage behavior detracting from a foundation's ability to further charitable purposes
5. Penalty taxes on certain foundation expenditures

Other Excise Taxes (Sanctions)

- Violation of these provisions give rise to taxes and penalties against the private foundation and, in some cases, its managers, its substantial contributors, and certain related persons.
 - The first tier (initial) tax is automatically imposed if the foundation engages in a prohibited act.
 - With the exception of self-dealing acts under section 4941, the initial taxes may be set aside if it is established that (1) a taxable event was due to reasonable cause and not to willful neglect, and (2) the event was corrected within the correction period.
- These penalty excise taxes are reported and paid on Form 4720.
- Form 4720, *Return of Certain Excise Taxes on Charities and Other Persons*, is intended primarily for use with Form 990-PF and provides for figuring and reporting the initial taxes imposed for all of the disallowed acts discussed.

Disqualified Persons (DQP)

The following are examples of persons are considered *disqualified persons* with respect to a private foundation:

1. All substantial contributors to the foundation
2. All foundation managers of the foundation
3. An owner of more than 20 percent of:
 - a) The total combined voting power of a corporation
 - b) The profits interest of a partnership
 - c) The beneficial interest of a trust or unincorporated enterprise, which is (during the ownership) a substantial contributor to the foundation
4. A member of the family of any of the individuals described in (1), (2), or (3)

Taxes on Self-Dealing

Section 4941 of the Internal Revenue Code imposes an excise tax on certain transactions (acts of self-dealing) between a private foundation and disqualified persons.

Acts of self-dealing by private foundation:

The following transactions are generally considered acts of self-dealing between a private foundation and a disqualified person:

- Sale, exchange or leasing of property
- Lending money or other extensions of credit
- Providing goods, services or facilities
- Paying compensation or reimbursing expenses to a disqualified person
- Transferring foundation income or assets to, or for the benefit of, a disqualified person

Exceptions to Self-Dealing

- Paying compensation or reimbursing of expenses by a private foundation to a disqualified person for personal services that are reasonable and necessary to carry out the exempt purpose of the private foundation is not considered an act of self-dealing if the compensation or reimbursement is not excessive.
- Loans by a disqualified person to a private foundation without interest or other charge if the borrower uses the loan proceeds exclusively for purposes specified in section 501(c)(3) of the Code.
 - *NOTE:* For these purposes, a loan by a disqualified person to a private foundation at below-market interest rates is treated as an act of self-dealing to the same extent as a loan at market interest rates.

Common Mistakes that are Acts of Self-Dealing

- Use of the foundation's credit card by a disqualified person for personal expenses. This would be a loan.
- Foundation satisfying pledge made by a disqualified person to a public charity (paying legal obligation of a DQP)
- Foundation purchases a ticket to gala event which will be attended by a disqualified person

Note: *Self-dealing is the one act that is subject to penalty even when it is not due to willful neglect, and there is no abatement of penalty allowed, even if there was "reasonable cause."*

Taxes on Self-Dealing

- An excise tax of 10% of the amount involved in the act of self-dealing is imposed on the disqualified person
- An excise tax of 5% of the amount involved is imposed on a foundation manager who knowingly participates in an act of self-dealing
- An excise tax of **200%** of the amount involved is imposed on the disqualified person who participated in the act of self-dealing, if the act of self-dealing is not corrected within the taxable period

Correction of Acts of Self-Dealing

To undo a self-dealing transaction, the deal must be *corrected* and rescinded (*i.e.*, property returned) if possible. The term correction means undoing the transaction to the extent possible, but, in any case, placing the private foundation in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.

Polling Question #3

The following statement about self-dealing is FALSE:

- A. The penalty can be abated if the act was accidental.
- B. Loaning money to a DQP is self-dealing.
- C. If not corrected, a second tier penalty can be imposed.

Taxes on Failure to Distribute Income

A foundation that fails to pay out the distributable amount in a timely manner is subject to a 30% excise tax under section 4942 on the undistributed income. The tax is charged for each year or partial year that the deficiency remains uncorrected. An additional **100%** tax is triggered if the foundation fails to make up the deficient distribution within 90 days of receiving notification from the IRS of its failure to make minimum distributions.

Taxes on Excess Business Holdings

- Generally, the combined holdings of a private foundation **and** all of its disqualified persons are limited to 20% of the voting stock in a business enterprise that is a corporation. The 20% limitation also applies to holdings in business enterprises that are partnerships, joint ventures, or other unincorporated enterprises. For a partnership or joint venture, profits interest is substituted for voting stock, and for any other unincorporated enterprise, beneficial interest is substituted for voting stock. A private foundation that has excess business holdings in a business enterprise may become liable for an excise tax based on the amount of the excess holdings.
- ***“De minimis rule”*** – a private foundation has to hold, directly or indirectly, more than 2% of the voting stock or other value of a business enterprise any of the limitations of excess business holdings becomes applicable

“Business Enterprise”

The term “business enterprise” does not include:

- A functionally related business (substantially related to the Foundation’s tax-exempt purpose)
- A program related investment or a trade or business of which at least 95% of the gross income is derived from passive source income such as dividends, interest, annuities and gains or losses from property held for investment
- Partnerships that engage solely in investment activities even though less than 95% of the partnerships income may be derived from passive sources

Disposing of Excess Business Holdings

- An interest purchased by a DQP which causes an excess business holding must be disposed of within 90 days of the date the foundation knows or has reason to know of the event that caused the excess business holding
- An interest purchased by a foundation that causes an excess business holding must be disposed of ***immediately***. If the foundation does not know and has no reason to know, that the 90 day period rule applies
- If a foundation obtains holdings in a business enterprise other than by purchase by the foundation or the DQP, the foundation has 5 years to dispose of the excess business holding

Taxes on Excess Business Holdings

- **Initial tax:** An excise tax of 10% of the value of the excess holdings is imposed on the foundation. The tax is imposed on the last day of each tax year that ends during the taxable period.
- After the initial tax has been imposed, an excise tax of **200%** of the excess holdings is imposed on the foundation if it has not disposed of the remaining excess business holdings by the end of the taxable period

Taxes on Jeopardizing Investments

- If a private foundation makes any investments that would financially jeopardize the carrying out of its exempt purposes, both the foundation and the individual foundation managers may become liable for taxes on these jeopardizing investments under section 4944.
- Jeopardizing investments generally are investments that show a lack of reasonable business care and prudence in providing for the long- and short-term financial needs of the foundation for it to carry out its exempt function. No single factor determines a jeopardizing investment.
- Whether an investment jeopardizes the foundation's exempt purposes is determined at the time the investment is made. If the investment was proper when made, it will not be considered a jeopardizing investment even if it later results in loss.

“Prudent Investor”

- The managers of a private foundation’s investments can be guided by the *prudent investor* rules in evaluating proposed investments for jeopardy
- “A trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust”

State Scrutiny

Many states' Attorney General's offices have Charities Bureaus responsible for supervising charitable organizations to protect donors and beneficiaries of those charities from unscrupulous practices in the management of charitable assets.

Taxes on Jeopardizing Investments

- **Initial tax:** An excise tax of 10% of the amount involved (the jeopardizing investment) is imposed on the foundation for each tax year, or part of a year, in the taxable period
- An excise tax of 10% of the amount involved is also imposed on any foundation manager who knowingly, willfully, and without reasonable cause participated in making the jeopardizing investment
- **Additional tax:** If a private foundation is liable for the initial tax and has not removed the investment from jeopardy within the taxable period, an additional excise tax of **25%** of the amount involved will be imposed on the foundation

Taxes on Taxable Expenditures

- If a private foundation makes any taxable expenditures, it is liable for taxes.
- The taxes are imposed on both the foundation and on any foundation manager who knowingly and willfully agrees to the expenditures.
- A **taxable expenditure** is an amount paid or incurred to:
 - Carry on propaganda or otherwise attempt to influence legislation (commonly referred to as *lobbying*),
 - Influence the outcome of any specific public election or carry on any voter registration drive, unless certain requirements are satisfied),
 - Make a grant to an individual for travel, study, or other similar purposes, unless certain requirements are satisfied,
 - Make a grant to an organization other than a public charity, unless the foundation exercises expenditure responsibility with respect to the grant, or
 - Carry out any purpose other than a religious, charitable, scientific, literary, or educational purpose, the fostering of national or international amateur sports competition (with exceptions) or the prevention of cruelty to children or animals

Grants by Private Foundations

Expenditure responsibility means that the foundation exerts all reasonable efforts and establishes adequate procedures:

- To see that the grant is spent only for the purpose for which it is made
- To obtain full and complete reports from the grantee organization on how the funds are spent
- To make full and detailed reports on the expenditures to the IRS. Such reports are included as part of the filing of the Form 990-PF and also indicate whether any amounts have been diverted from the purpose of the grant, and whether unused funds are returned to private foundation.

Taxes on Taxable Expenditures

- **Initial tax:** The initial tax on the foundation is 20% of the amount expended
- If a foundation manager knowingly, willfully, and without reasonable cause agrees to the taxable expenditure, the initial tax on the management is 5% of the amount expended, up to a maximum tax of \$10,000 for any expenditure.
- **Additional tax:** If the expenditure is not corrected within the taxable period, an additional tax of **100%** of the amount expended is imposed on the foundation.



**READING & UNDERSTANDING FORM 990-PF
&
OTHER REQUIRED FORMS**

Return of Private Foundation, Form 990-PF

- ***Basic Financial Information:*** Revenue, disbursements, assets and liabilities.
- ***Description of exempt purpose:*** It is an opportunity to tell the Foundation's story to the world. The words used in the detailed explanations within the form do matter
- Form is subject to public disclosure
 - Listed in Guidestar's website: www.guidestar.org
- Compliance with federal requirements for maintaining tax-exempt status
- Who "reads" the Form 990-PF?

Return of Private Foundation, Form 990-PF

- Part I, Analysis of Revenue and Expenses
 - Column (a). Revenue and Expenses per Books
 - Include all items of revenue and expense shown in the books and records that increase or decrease the net assets of the organization
 - Cash method or accrual method of accounting is permitted
 - Column (b). Net Investment Income
 - Report the investment income such as taxable interest income, dividend income, rent, royalty, partnership income reported on schedule K-1, as well as net capital gains (not net capital losses)

Return of Private Foundation, Form 990-PF

- **Column (b). Net Investment Income (continued)**
 - Does not include Unrelated Business Income which is reported on Exempt Organization Business Income Tax Return, Form 990-T
 - Expenses directly attributable to the net investment income are deducted in this column
 - Tax Exempt interest and related expenses should not be in column (b)
- **Column (c). Adjusted Net Income**
 - This column became obsolete for most foundations except for
 - Private Operating Foundation
 - Private Foundations receiving program service revenue
- **Column (d). Disbursements for Charitable Purposes**
 - Amounts reported in this column are significant because they count toward calculation of the mandatory charitable payout rules

Return of Private Foundation, Form 990-PF

- Part I, Analysis of Revenue and Expenses
 - **Schedule B, Schedule of Contributors:** If money, securities or other property valued at \$5,000 or more was received from any one person during the year, description of property received is required as well as the name and address of the donor

Return of Private Foundation, Form 990-PF

- Part II, Balance Sheet
 - Both the book value and ending fair market value are presented in Part II.
 - Detail is required for investments, other assets, mortgages and other notes payable.
 - The IRS does not require organizations to follow the Statement of Financial Accounting Standard guidance. Therefore, private foundations generally will not check the box by line 24, unless their financial statements are audited under GAAP. Private foundations will check the box by line 27 and complete line 27 through 31.
- Part III, Analysis of Change in Net Worth or Fund Balance
 - The information reported on page 1 of Form 990-PF is reconciled to Part II Balance Sheet in this part.
 - Unrealized gain or loss in the carrying value of securities

Return of Private Foundation, Form 990-PF

- Part IV, Capital Gains and Losses for the Tax on Investment Income
 - Report the sale or exchange of property capable of producing net investment income (interest, dividends, rents, royalties, etc.)
 - Private Foundations are not allowed net capital loss against Net Investment Income nor capital loss carryover
 - Capital gains and losses associated with unrelated business income should not be included in this part of the return
- Part V, Qualification for Reduced Tax on Net Investment Income
 - Planning opportunity to review reduction in tax
 - A newly established private foundation cannot qualify for the reduced tax rate in its first year.

Polling Question #4

What can be a qualifying distribution?

- A. Investment advisory fees
- B. Contributions or grants paid
- C. Foreign taxes

Return of Private Foundation, Form 990-PF

- Part VI, Excise Tax on Investment Income
 - If annual tax less than \$500, payment by check
 - If more than \$500, payment made through Electronic Federal Tax Payment Systems (“EFTPS”). Charity MUST enroll with EFTPS at least 15 days prior to tax payment (www.EFTPS.gov)

- Part VII-A, Statements Regarding Activities
 - Questions for IRS to evaluate Foundations qualifications for ongoing tax exemption

Return of Private Foundation, Form 990-PF

- Part VII-A, Statements Regarding Activities (continued)
 - Line 4, Did the foundation have more than \$1,000 of unrelated business income: Form 990-T, Unrelated Business Income Tax return may be required
 - Line 8, Submit information regarding state filings
 - Enter the name(s) of state(s) to which the foundation reports and in which the foundation is registered as a charitable organization
 - Foundation with assets more than \$5,000 is required to furnish copy of Form 990-PF to the Attorney General of each state listed
 - New York Attorney General Charities Bureau: www.charitiesnys.com
- Part VII-B, Statements Regarding Activities For Which Form 4720 May Be Required
 - Questions ask whether the foundation has violated any rules that may cause it and its managers to be penalized

Return of Private Foundation, Form 990-PF

- Part VIII, Information about Officers, Directors, Trustees, Foundation Managers, Highly Paid Employees, and Contractors
 - List all the foundation’s officials, their title, and address regardless if they received compensation or expense reimbursements
 - Do not use their personal home address as Form 990-PF is a public document
 - Report the average time devoted to their position
- Part IX-A and B, Summary of Direct Charitable Activity and Summary of Program-Related Investments
 - Conducting direct charitable activities or makes Program-Related Investments such as loans to other charities or related capital expenditures
 - Private Operating foundations generally would report their activities in this section
 - Non-operating foundations would not used this section unless they were engaging in a direct charitable activity

Return of Private Foundation, Form 990-PF

- Part X, Minimum Investment Return
 - Must pay out its minimum investment return, which is 5% of the average availability of the total fair market value of its noncharitable assets
 - Short tax period (less than 12 months) determine the applicable percentage by dividing the number of days in the short tax period by 365

Return of Private Foundation, Form 990-PF

- Part XI, Distributable Amount
 - This part begins with the calculated minimum investment return from Part X. The excise tax on investment income is allowed to reduce the required charitable payout. Recoveries of grants claimed as a distribution in the past year are added back.
- Part XII, Qualifying Distributions
 - In this part, the foundation totals the amount of its current-year disbursements that are counted towards its mandatory distribution requirement, which is calculated in Part XI.
- Part XIII, Undistributed Income
 - Has foundation paid out sufficient funds to meet payout requirement?

Return of Private Foundation, Form 990-PF

- Part XIV, Private Operating Foundations
 - This section determines if the Private Operating Foundation meets certain numeric thresholds to maintain its status as an operating foundation
- Part XV, Supplementary Information
 - Complete for foundations with assets of \$5,000 or more
 - Identifies foundation managers who are substantial contributors
 - Lines 3a and 3b lists grants paid during the year and approved for future payment

Return of Private Foundation, Form 990-PF

- Part XV, Supplementary Information (continued)
 - 3a, Paid During Year
 - List all contributions, grants, etc actually paid during the year
 - Column “Foundation Status of Recipient” must use a code . For grants to public charity, the code is PC
- Part XVI-A, Analysis of Income Producing Activities
 - This part of the return identifies unrelated business income.
- Part XVI-B, Relationship of Activities to the Accomplishment of Exempt Purposes
 - This section is used to explain how each amount in column (E) of Part XVI-A was related to the exempt function income that is the basis of the organizations exemption from tax. This section is typically used by private operating foundations.

Return of Private Foundation, Form 990-PF

- Part XVII, Information Regarding Transfers To and Transactions and Relationships With Non-charitable Exempt Organizations
 - Purpose of this section is to identify relationships and specific transfers that allow benefits, or the use of a foundations assets, to flow from the foundation to a non-charitable exempt organization

Other Tax Forms Required

- New York CHAR 500 (for New York charities)
 - All nonprofits conducting activities in New York fall under the jurisdiction of the New York State Attorney General (AG) and all must register with this office. In addition, most must file annual reports with the AG office, Form CHAR 500. FILING FEE REQUIRED (www.charitiesnys.com)
- Other state filings may be required
- Foreign Filings
 - **FinCin Form 114 (previously TD F 90-22.1)**: A United States person that has a financial interest in or signature authority over foreign financial accounts must file if the aggregate value of the foreign financial accounts exceeds \$10,000 at any time during the calendar year.
 - **Form 5471**: Information Return of U.S. Persons With Respect to Certain Foreign Corporations
 - Penalty of \$10,000 for each Form 5471 that is filed after the due date of the income tax return (including extensions) or does not include the complete and accurate information described in Section 6038 (a)
 - **Form 926**: Return by a U.S. Transferor of Property to a Foreign Corporation
 - **Form 8865**: Return of U.S. Persons With Respect to Certain Foreign Partnerships

Thank you!



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