



Private Foundations Fundamentals

September 24, 2009

Janet Suh

David Trimner

AGENDA



Session	Time
What Is A Private Foundation?	20 mins.
Excise Taxes	80 mins.
Other Considerations	20 mins.
Total	2 Hours

What Is A Private Foundation?

Conceptual Definition

A nongovernmental, nonprofit organization with its own funds (usually from a single source) and programs, managed by its own trustees and directors, established to maintain or aid educational, social, charitable, religious, or other activities serving the common welfare, primarily by making grants to other nonprofit organizations.

What Is A Private Foundation?

Technical Definition

A domestic or foreign organization

described in IRC § 501(c),

other than an organization described in IRC § 509(a)(1),(2),(3),(4).

- Not a church
- Not a school
- Not a hospital
- Not a research organization
- Not a public charity
- Not a service charity
- Not a supporting organization
- Not testing for public safety

What Is A Private Foundation?

Public Charity

vs.

Private Foundation

- Funding sources
- Filing Exemption
- Disclosure of Investments and Investment Income
- Public Disclosure of Donors
- Direct Charitable Activities
- Basis/Gain for Noncash Contributions
- Taxes

What Is A Private Foundation?

Nonoperating Foundation

- Makes grants to other charitable organizations who provide the charitable services to the public
- May also operate some of its own programs

Operating Foundation

- Primarily directly carries out its own charitable programs
- Makes limited grants
- Subject to Income Test
- Subject to either Assets, Endowment, or Support Test
- IRC § 4942(j)(3)

What Is A Private Foundation?

Terminology

- Support - Gifts, grants, contributions, membership fees, gross receipts from a nonbusiness activity, gross investment income and unrelated business net income. Does not include capital gains.
- Gross investment income – Gross income from interest, dividends, certain payments with respect to securities loans, rents and royalties to the extent they are not considered unrelated business income.
- Unrelated business income – Income derived from conducting a business activity that is not substantially related to the purpose for which the foundation was granted its tax exemption.
- Disqualified person – Substantial contributor, foundation manager or officer (director, trustee etc), certain individuals and entities (corporations, partnerships, trusts) related to such individuals, and certain government officials. (Section 4946)

Excise Taxes

- Section 4940 - Net Investment Income
- Section 4941 - Self Dealing
- Section 4942 - Failure To Distribute Income
- Section 4943 - Excess Business Holdings
- Section 4944 - Jeopardizing Investments
- Section 4945 - Taxable Expenditures

Excise Taxes – 4940

Net Investment Income



If You See...

1. Noncash contributions
2. Interest, dividends, royalties
3. Capital gains
4. Capital losses
5. Net Investment Income
6. A 2% tax rate
7. Tax liability over \$500

...Remember

1. Book Basis is FMV on date of gift
Tax Basis is donor's carryover
2. Include as taxable investment income
3. Book gain and tax gain may be different because of basis
4. No capital losses may be carried forward or back
5. Deduct ordinary and necessary expenses connected to investment income
6. Tax planning for 5 year average
7. Consider making ES payments

Excise Taxes – 4941

Self Dealing

If You See...

1. Furnishing of goods, services or facilities
2. Sale, exchange or leasing of property
3. Lending of money or extension of credit
4. Payment of compensation or reimbursement of expenses
5. Transfer to, or use by or for the benefit of, a disqualified person of a foundation's income or assets
6. Payments to government officials

...Remember

1. Free is permissible
General public exception
2. Even incidental amounts at bargain prices are prohibited, free is permissible
3. 0% interest loans are permissible
4. Reasonable, necessary compensation for personal services rendered is permissible
5. Stock price manipulation, Fdn assets as collateral, payment of pledges or membership dues, friends and family use of benefit tickets prohibited
6. Employment, scholarships, travel reimbursements permissible

Excise Taxes – 4942

Failure To Distribute Income

If You See...

1. Charitable disbursements
Part I, column (d)
2. Cash, securities,
noncharitable-use assets
Part X, line 1
3. Grants that have been returned
Part XI, line 4
4. Undistributed Income
Part XIII

...Remember

1. Report on cash basis
2. Use correct averaging methods
3. Treat as recovery of qualifying distribution
4. Ensure appropriate amount is distributed
in subsequent year

Excise Taxes – 4943

Excess Business Holdings

If You See...

- Ownership of over 20% of any corporation, partnership, joint venture, sole proprietorship, etc.
- Ownership of over 2% of the above, but over 20% in the aggregate with all disqualified persons
- Either of the above, but a third-party controls 35% or more of the business
- Business is functionally related

...Remember

- If a disqualified person purchased the excess holding, the Foundation has 90 days to dispose of it
- If the Foundation purchased the excess holding, the Foundation must dispose of it immediately
- If the excess holding was obtained by gift or bequest, the Foundation has 5 years to dispose of it
- Excess business holdings rules do not apply to a functionally related business

Excise Taxes – 4944

Jeopardizing Investments

If You See...

- Trading on margin
- Commodity Futures
- Oil and Gas speculation
- Puts, calls, straddles
- Warrants
- Short selling

...Remember

- Apply the “Prudent Investor” rules
- Consider expected rates of return
- Review Foundation investment policy
- Consider affect of catastrophic loss
- Analyze staff competence

Excise Taxes – 4945

Taxable Expenditures

If You See...

...Remember

- | | |
|--|---|
| 1. Lobbying | 1. May not influence legislation through direct or grassroots lobbying, but may support education on social and public policy |
| 2. Political activities | 2. May not attempt to influence an election, register voters, or make a campaign contribution |
| 3. Grants to individuals | 3. Travel and study grants require IRS pre-approval. Grants for charitable purposes or to award past achievement are permissible |
| 4. Expenditures for noncharitable purposes | 4. Even grants to non-charities must be for religious, charitable, scientific, literary, educational, international sports, or prevention of cruelty purposes |
| 5. Grants to non-public charities | 5. Expenditure responsibility |

Excise Taxes – 4945 cont.

Expenditure Responsibility

If You See...

- Grants to other private foundations
- Grants to noncharitable nonprofits
- Grants to for-profit businesses
- Grants to supporting organizations
- Grants to individuals
- Grants to foreign organizations

...Remember

1. Conduct a pre-grant inquiry
2. Written grant agreement requiring that grant be spent solely for identified charitable purpose and setting forth required limitations
3. Regular written status reports from grantee on how funds are spent
4. Report on Form 990-PF
5. Funds must be kept in a separate account (unless grant is to a private foundation).
6. Documentation

Tax return

1. Due 15th day of the fifth month
2. Automatic first extension for 3 months
3. Second extension for additional 3 months
4. File a copy of the 990-PF with the state attorney general in any state where the organization is registered or otherwise has nexus

Donor considerations

1. Contributions to foundations are subject 30% limit (not 50%)
2. Long term appreciated stocks get the deduction equal to the FMV (20% limit)
3. Foundation can be subject to state registration requirements if “founder” solicits donations
4. Expenses paid personally on behalf of the foundation can be charitable contributions
5. Can't use foundation assets to satisfy a pledge in the donor's name – excise tax for “self dealing”

Out of Corpus Rules

Rules come into play in two areas:

- PF to PF: Grant from one private foundation to another private foundation – Grant will not count as qualifying distribution without meeting out of corpus (expenditure responsibility also required) – section 4942(g)(3)
- Larger Deduction for Donor: Donor to private foundation wants larger deduction (example: gift of land deductible at FMV instead of at cost/basis) --- donee foundation must qualify as a conduit or “pass-through” foundation – section 170(b)(1)(E)(ii)

Reason for the rule: Close a Loophole

1. Ford pays 5% to Rockefeller and vice versa

Out of Corpus Rules

Five Requirements for Out of Corpus:

1. **5% Previous Year** - Donee foundation must satisfy 5% payout for tax year immediately preceding year in which it receives grant/donation
2. **5% Current Year** - Donee foundation must satisfy 5% payout for current tax year (year it receives grant/donation)
3. **PLUS QDS Equal to Grant** - Over and above #1 and #2, donee foundation must have qualifying distributions equal to the amount of the grant/donation
4. **Written Documentation** - Grantor foundation (or donor) must obtain adequate written records or documentation that steps #1, #2 and #3 have been completed
5. **Notice on Grantee's 990-PF** - Grantee must indicate use of out of corpus option on its Form 990-PF (includes attaching a written statement)

Out of Corpus Rules

Timing Requirements for Out of Corpus

Private Foundation to Private Foundation

Steps #1, #2, and #3 must be completed no later than 12 months after end of tax year in which grant is received

Donation to Private Foundation For Larger Deduction

Steps #1, #2, and #3 must be completed no later than 2.5 months after end of tax year in which donation is received



Nonprofit Organizations

Jeffrey Schragg, Exempt Organizations Practice Leader
jschragg@argy.com
703.770.6313

Leslie Pine, Audit Partner
lpine@argy.com
703.770.6334

David Trimner, Tax Partner
dtrimner@argy.com
703.770.4450

Maili Montgomery, Audit Principal
mmontgomery@argy.com
703.770.6322

Lori Collingsworth, Tax Senior Manager
lcollingsworth@argy.com
703.770.6393

These materials have been created by and belong solely to Argy, Wiltse & Robinson, P.C. Tax advice contained herein is not intended or written to be used and cannot be used for the purpose of avoiding tax-related penalties that may be imposed on the taxpayer. Argy, Wiltse & Robinson, P.C. is not rendering legal advice and assumes no liability whatsoever in connection with its use.