Strafford

Form 990-PF: Meeting IRS Demands for Fiscal, Grant and Other Data From Private Foundations

THURSDAY, AUGUST 20, 2015, 1:00-2:50 pm Eastern

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Form 990-PF

Aug. 20, 2015

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Form 990-PF: Latest Compliance Strategies

Amanda Adams, CPA

August 20, 2015

Form 990-PF Review

Amanda Adams, CPA

Part I: Analysis of Revenue and Expenses

- Column (a) reflects revenue and expenses per books – cash or accrual.
- Column (b) reflects revenue and expenses that are subject to the §4940 excise tax on net investment income.
- Column (c) reflects revenue and expenses that are included in the calculation of adjusted net income. For private operating foundations, this column is relevant to determining the spending requirement. For non-operating foundations, this column is generally not completed unless the foundation has income from a charitable activity.
- Column (d) reflects expenses which are treated as qualifying distributions. This column is relevant to determining satisfaction of both operating and non-operating foundations' minimum spending requirements.

Part II: Balance Sheets

This section of the return presents the balance sheet of the foundation at the beginning of the year and the end of the year. The FMV of assets held at the end of the year is also reported. A detailed listing of investments held at the end of the year (other than mortgage loans) is required.

Lines 6 and 20 report receivables/payables occurring between the foundation and disqualified persons. Having an entry on either of these lines could be a sign that impermissible self-dealing has occurred.

Part III: Analysis of Changes In NA Or FB

This section of the return demonstrates the components of the change in net assets from the beginning of the year to the end of the year. For many cash-basis foundations, current income is the only change. For foundations that follow the accrual method and report their investments at fair market value, unrealized gains and losses are reported here. Returned grants are also reported in this section rather than as a reduction of expense or income in Part I.

Part IV: Capital Gains And Losses

Details regarding the sales of capital assets which are subject to the 4940 tax on net investment income are reported here. (Details regarding the sales of capital assets which are not subject to the 4940 tax are instead reported on an attachment to Part I, line 6.)

Remember that all sales of publicly traded securities can be reported on a single line. Details are only required for non-publicly traded securities and other assets.

Part V: Qualification For Reduced Tax

The normal rate of §4940 tax on net investment income is 2%. This section of the return provides a calculation that may enable the foundation to reduce the tax percentage to 1%. A ratio of qualifying distributions to non-charitable-use assets is calculated based on a five-year history. If current year qualifying distributions equal or exceed the amount determined by multiplying the five-year ratio by the current year's average of non-charitable-use assets plus 1% of net investment income, then the foundation qualifies for the 1% tax rate for the year.

Part VI: Excise Tax

This section reports the tax due on the return as well as any payments made towards the tax. If the foundation was erroneously subject to back-up withholding, such amounts can be reported here as credits toward the foundation’s tax liability.

Foundations whose tax liability exceeds $500 for the year must make quarterly tax payments (which must be deposited electronically), and those whose net investment income has exceeded $1 million in the past three years must base their 2Q-4Q payments using annualization calculations, which use actual income earned during the year. This can be problematic for those foundations with partnership investments and that do not have timely information.

Part VII-A: Statements Regarding Activities

Although questions 1(political activities), 6 (governing instrument) and 13 (public inspection) search for possible non-compliance with the requirements of §501(c)(3), the bulk of the questions in this part ask for information that does not necessarily have a negative impact on the foundation. Changes in activities, organizing documents, new substantial contributors and similar information are required to be reported.

Part VII-B: Statements Regarding Activities For Which Form 4720 May Be Required

Care should be taken in answering the questions in this section, as “Yes” answers may indicate that Form 4720 (a penalty return) is required to be filed. Questions 1-5 seek information to determine if the foundation is subject to one of the Chap. 42 excise taxes on self-dealing, under-distribution, excess business holdings, jeopardizing investments and taxable expenditures. Questions 6 and 7 relate to non-Chap. 42 excise taxes.

Part VIII: Information About Officers, Etc.

All officers, directors, trustees and foundation managers that served during the year are reported along with their compensation and average hours per week devoted to the foundation.

The top five highest-paid employees compensated >$50,000 are reported.

The top five highest-paid independent contractors compensated >$50,000 are reported.

Part IX-A: Summary Of Direct Charitable Activities

Many foundations conduct direct programs in conjunction with, or instead of, making grants to other organizations. Even if the foundation is a non-operating foundation, it has the opportunity to describe its four largest activities and provide the total expenditures related to each. Some foundations are concerned about the appearance of a large percentage of expenses coming from non-grant sources, because it may seem that administrative expenses are too high. Describing direct activities in this part can help indicate when expenses are related to a charitable program rather than being administrative.

Part IX-B: Summary Of Program-Related Investments

Program-related investments are made primarily to accomplish a charitable purpose of the foundation, rather than to produce investment income or capital gain from the sale of the investment.

Examples include educational loans to individuals and low-interest loans to other 501(c)(3) organizations.

Only PRIs made during the year are reported, so that ongoing investments are not reported on succeeding returns.

Part X: Minimum Investment Return

This section of the return reports the average fair market value of non-charitable use assets including cash, securities and other assets. This calculation is the first step in determining the amount the foundation is required to spend for charitable purposes.

Part XI: Distributable Amount

The minimum investment return (5% of investment assets) is reduced in this section by the excise tax on investment income for the year, as well as the income tax (990-T) for the year. Recoveries of amounts previously treated as qualifying distributions (i.e., returned grants) are added to the MIR to determine the distributable amount.

Part XII: Qualifying Distributions

This section calculates the total amount of qualifying distributions for the year by combining the expenses paid from Part I, Col. (d) with amounts spent to purchase program-related investments or charitable use assets and any amounts set aside for charitable purposes.

Set-asides:

- Type I: Suitability test – straightforward and applicable to foundations of any age; must request in advance and may not receive approval until after deadline for return to be filed
- Type II: Cash distribution test – generally applicable to foundations in their first few years of existence; complex rules which are difficult to understand; advance approval not required

Part XIII: Undistributed Income

This section illustrates satisfaction or failure of a non-operating foundation's payout requirements. It is important to remember that the amount shown on Line 6f, Col. (d) is not required to be distributed until the end of the tax year after the tax year covered by the return.

Normal ordering of application of distributions:

1. Current-year payout requirement (calculated on prior return)
2. Next year's payout requirement (calculated on current return)
3. Excess distribution carryover

Elections can be made to divert distributions after Step 1 in order to satisfy requirements from a prior year (penalty situation) or to meet redistribution requirements.

Part XIV: Private Operating Foundations

This section illustrates satisfaction of a private operating foundation's payout requirements. The test can be met on an aggregate basis (i.e., total for all four years), or on a three-out-of-four-year basis.

Two-part test:

1. Income test (based on lesser of adjusted net income or MIR)
2. One of the following:
   I. Asset test (65%-plus are charitable-use)
   II. Endowment test (spend 2/3 of MIR)
   III. Support test (certain required percentages of support from public)

Failure of test means the foundation becomes a non-operating foundation that completes Part XIII.

Part XV: Supplementary Information

This section provides information about grant programs. Foundation can describe what kinds of organizations/individuals it supports or attempt to forestall submission of unsolicited applications by checking the box.

Details regarding grants paid during the year and those approved for future payment are presented. Importantly, the public charity status code (on the return, this is referred to as foundation status) must be reported for each grantee [e.g., PC or NC].

Part XVI-A: Analysis Of Income-Producing Activities

This section analyzes the sources of revenue during the year to show how much revenue was unrelated business income that is taxable, unrelated business income that is not taxable, and related/exempt function income.

Part XVI-B: Relationship of Activities

For exempt function revenue reported in Col. (e) of Part XVI-A, a description is reported in this section explaining how the income-producing activity contributed to the foundation’s exempt purposes.

Part XVII: Information Regarding Transfers To, And Transactions And Relationships With, Non-Charitable Exempt Organizations

As the title implies, this section reports information about transfers and other transactions with non-charitable exempt organizations, as well as relationships with such organizations. It is important to demonstrate that such transactions, etc. do not result in the improper use of charitable funds for non-charitable purposes.

Private Foundation Reporting Pitfalls

Jeffrey D. Haskell, J.D., LL.M.
Chief Legal Officer

Foundation Source

Calculating Excise Tax on Net Investment Income Section 4940

Examples of 4940 Income

- Includes:
  - Interest
  - Dividends
  - Rents
  - Payments from securities loans
  - Royalties (generated from both investment and exempt purpose assets)
  - Net capital gains over capital losses (net losses are trapped in period incurred)
- Excludes:
  - Income subject to unrelated business income tax (UBIT)
  - §103 Tax exempt bond income

§4940 PPA Expanded Taxable Income

- Since 2007, dividends, interest, royalties, rents, payments for security loans, options, straddles, and currency transactions PLUS capital gain from sale of ALL assets, except §1031-type exchange of exempt function assets, are taxed.
- Capital losses not deducted against other investment income or carried over to future year(STILL the RULE, including Wash Sales).

[*Tax Compliance* ¶¶13.1 and 13.2]

4940 – Excise tax based on Inv. Inc. - Part I

Part I	**Analysis of Revenue and Expenses** *(The total of amounts in columns (b), (c), and (d) may not necessarily equal the amounts in column (a) (see instructions).)*	(a) Revenue and expenses per books	(b) Net investment income	(c) Adjusted net income	(d) Disbursements for charitable purposes (cash basis only)
Revenue 1	Contributions, gifts, grants, etc., received (attach schedule)	500			
2	Check ▶ ☐ if the foundation is **not** required to attach Sch. B				
3	Interest on savings and temporary cash investments	2,500,000	2,500,000		
4	Dividends and interest from securities	75,000	75,000		
5a	Gross rents				
b	Net rental income or (loss)				
6a	Net gain or (loss) from sale of assets not on line 10	200,000			
b	Gross sales price for all assets on line 6a				
7	Capital gain net income (from Part IV, line 2)		350,000		
8	Net short-term capital gain				
9	Income modifications				
10a	Gross sales less returns and allowances				
b	Less: Cost of goods sold				
c	Gross profit or (loss) (attach schedule)				
11	Other income (attach schedule)	500,000	500,000		
12	**Total.** Add lines 1 through 11	3,275,500	3,425,000		
Operating and Administrative Expenses 13	Compensation of officers, directors, trustees, etc.	160,500	80,250		80,250
14	Other employee salaries and wages	60,000			60,000
15	Pension plans, employee benefits	55,000	20,000		35,000
16a	Legal fees (attach schedule)	10,000	2,500		7,500
b	Accounting fees (attach schedule)	15,000	7,500		7,500
c	Other professional fees (attach schedule)	140,000	100,000		40,000
17	Interest				
18	Taxes (attach schedule) (see instructions)	15,000			
19	Depreciation (attach schedule) and depletion				
20	Occupancy	22,000			22,000
21	Travel, conferences, and meetings	5,200			5,200
22	Printing and publications	500			500
23	Other expenses (attach schedule)	85,000	20,000		65,000
24	**Total operating and administrative expenses.** Add lines 13 through 23	568,200	230,250		322,950
25	Contributions, gifts, grants paid	800,000			800,000
26	**Total expenses and disbursements.** Add lines 24 and 25	1,368,200	230,250		1,122,950
27	Subtract line 26 from line 12:				
a	**Excess of revenue over expenses and disbursements**	1,907,300			
b	**Net investment income** (if negative, enter -0-)		3,194,750		
c	**Adjusted net income** (if negative, enter -0-)				

For Paperwork Reduction Act Notice, see instructions. Cat. No. 11289X Form **990-PF** (2014)

Interest
Dividends
Capital Gains
Other Income
Deductions
Net Investment Income

Common Pitfalls

Calculating Net Investment Income

- Failure to count appropriate expenses as investment expenses
- Double counting the same expense as both an investment expense and as a qualifying distribution
- Treating the PF's excise tax as an investment expense
- Including unrelated business taxable income in col. b

Net Capital Gains – Part IV

Purchased or donated?

Part IV Capital Gains and Losses for Tax on Investment Income

	(a) List and describe the kind(s) of property sold (e.g., real estate, 2-story brick warehouse; or common stock, 200 shs. MLC Co.)	(b) How acquired P - Purchase D - Donation	(c) Date acquired (mo., day, yr.)	(d) Date sold (mo., day, yr.)
1a	Publicly traded securities	P	Various	Various
b	Capital gain distributions	P	Various	Various
c	Equity partnership investment	P	Various	Various
d	Sale of Leopard LTD	P	10/07/09	09/10/13
e	Sale of Arch Match Capital Management	P	03/22/11	04/13/13

	(e) Gross sales price	(f) Depreciation allowed (or allowable)	(g) Cost or other basis plus expense of sale	(h) Gain or (loss) (e) plus (f) minus (g)
a	39,432,305.		36,104,111.	3,328,194.
b	31,509.			31,509.
c	2,615,062.			2,615,062.
d	22,887.		36,612.	-13,725.
e	34,567.		27,689.	6,878.

Complete only for assets showing gain in column (h) and owned by the foundation on 12/31/69

	(i) F.M.V. as of 12/31/69	(j) Adjusted basis as of 12/31/69	(k) Excess of col. (i) over col. (j), if any	(l) Gains (Col. (h) gain minus col. (k), but not less than -0-) **or** Losses (from col. (h))
a				3,328,194.
b				31,509.
c				2,615,062.
d				-13,725.
e				6,878.

2 Capital gain net income or (net capital loss) { If gain, also enter in Part I, line 7 / If (loss), enter -0- in Part I, line 7 } .... **2** 5,967,918.

Common Pitfalls

<u>Calculating Capital Gains and Losses</u>

- Failure to track carryover basis of donated property for use when calculating net capital gains
- Attaching the details of all publicly traded securities sold or brokerage statements when details are not required

Part V – Do we qualify for 1% tax rate?

Part V | **Qualification Under Section 4940(e) for Reduced Tax on Net Investment Income**

(For optional use by domestic private foundations subject to the section 4940(a) tax on net investment income.)

If section 4940(d)(2) applies, leave this part blank.

Was the foundation liable for the section 4942 tax on the distributable amount of any year in the base period? ☐ Yes ☒ No

If "Yes," the foundation does not qualify under section 4940(e). Do not complete this part.

1 Enter the appropriate amount in each column for each year; see the instructions before making any entries.

(a) Base period years Calendar year (or tax year beginning in)	(b) Adjusted qualifying distributions	(c) Net value of noncharitable-use assets	(d) Distribution ratio (col. (b) divided by col. (c))
2012	9,864,799.	126,526,379.	.077966
2011	7,621,808.	118,305,473.	.064425
2010	10,831,818.	127,452,944.	.084987
2009	11,676,863.	157,802,159.	.073997
2008	14,631,591.	143,622,110.	.101876

2 **Total** of line 1, column (d)	2	.403251
3 Average distribution ratio for the 5-year base period - divide the total on line 2 by 5, or by the number of years the foundation has been in existence if less than 5 years	3	.080650
4 Enter the net value of noncharitable-use assets for 2013 from Part X, line 5	4	128,523,572.
5 Multiply line 4 by line 3	5	10,365,426.
6 Enter 1% of net investment income (1% of Part I, line 27b)	6	78,833.
7 Add lines 5 and 6	7	10,444,259.
8 Enter qualifying distributions from Part XII, line 4	8	7,359,356.

If line 8 is equal to or greater than line 7, check the box in Part VI, line 1b, and complete that part using a 1% tax rate. See the Part VI instructions.

- **Never in Year 1**
- **Not for 5 years if the PF has a 4942 penalty for underdistribution**
- **What is the PF's historical payout ratio?**
- **What is the value of the return year's investment assets?**
- **What is 1% of the return year's net investment income?**

Common Pitfalls

Eligibility for the 1% Reduced Tax Rate

- Failure to make the calculations to determine if the PF is eligible for a reduced tax rate
- Claiming qualification for the reduced tax rate in the PF's initial tax year
- Claiming qualification for the reduced tax rate where the PF has had a Section 4942 penalty within the past five years (even if the PF has since made up its required distributions)

Calculating, Reporting, and Paying – VI

Form 990-PF (2013) Sample Private Foundation 12-3345678 Page 4

Part VI Excise Tax Based on Investment Income (Section 4940(a), 4940(b), 4940(e), or 4948 - see instructions)

1a Exempt operating foundations described in section 4940(d)(2), check here ▶ ☐ and enter "N/A" on line 1. Date of ruling or determination letter: ________ **(attach copy of letter if necessary-see instructions)**				
b Domestic foundations that meet the section 4940(e) requirements in Part V, check here ▶ ☐ and enter 1% of Part I, line 27b			**1**	157,667.
c All other domestic foundations enter 2% of line 27b. Exempt foreign organizations enter 4% of Part I, line 12, col. (b).				
2 Tax under section 511 (domestic section 4947(a)(1) trusts and taxable foundations only. Others enter -0-)			**2**	0.
3 Add lines 1 and 2			**3**	157,667.
4 Subtitle A (income) tax (domestic section 4947(a)(1) trusts and taxable foundations only. Others enter -0-)			**4**	0.
5 **Tax based on investment income.** Subtract line 4 from line 3. If zero or less, enter -0-			**5**	157,667.
6 Credits/Payments:				
a 2013 estimated tax payments and 2012 overpayment credited to 2013	**6a**	170,233.		
b Exempt foreign organizations - tax withheld at source	**6b**			
c Tax paid with application for extension of time to file (Form 8868)	**6c**	75,000.		
d Backup withholding erroneously withheld	**6d**			
7 Total credits and payments. Add lines 6a through 6d			**7**	245,233.
8 Enter any **penalty** for underpayment of estimated tax. Check here ☐ if Form 2220 is attached			**8**	
9 **Tax due.** If the total of lines 5 and 8 is more than line 7, enter **amount owed** ▶			**9**	
10 **Overpayment.** If line 7 is more than the total of lines 5 and 8, enter the **amount overpaid** ▶			**10**	87,566.
11 Enter the amount of line 10 to be: **Credited to 2014 estimated tax** ▶ 87,566. **Refunded** ▶			**11**	0.

Calculating
Qualifying Distributions
Section 4942

Qualifying Distributions

- Expenses & Grants
  - Charitable expenses and grants - Part I
  - Direct Charitable Activity - Part IX-A (informational)
  - Grants - Part XV (informational)
- Charitable Asset Acquisitions - Parts II and XII
- Set-Asides - Parts II and XII
- Program Related Investments - Parts II, IX-B and XII

Reporting PF Operating Expenses and Grants

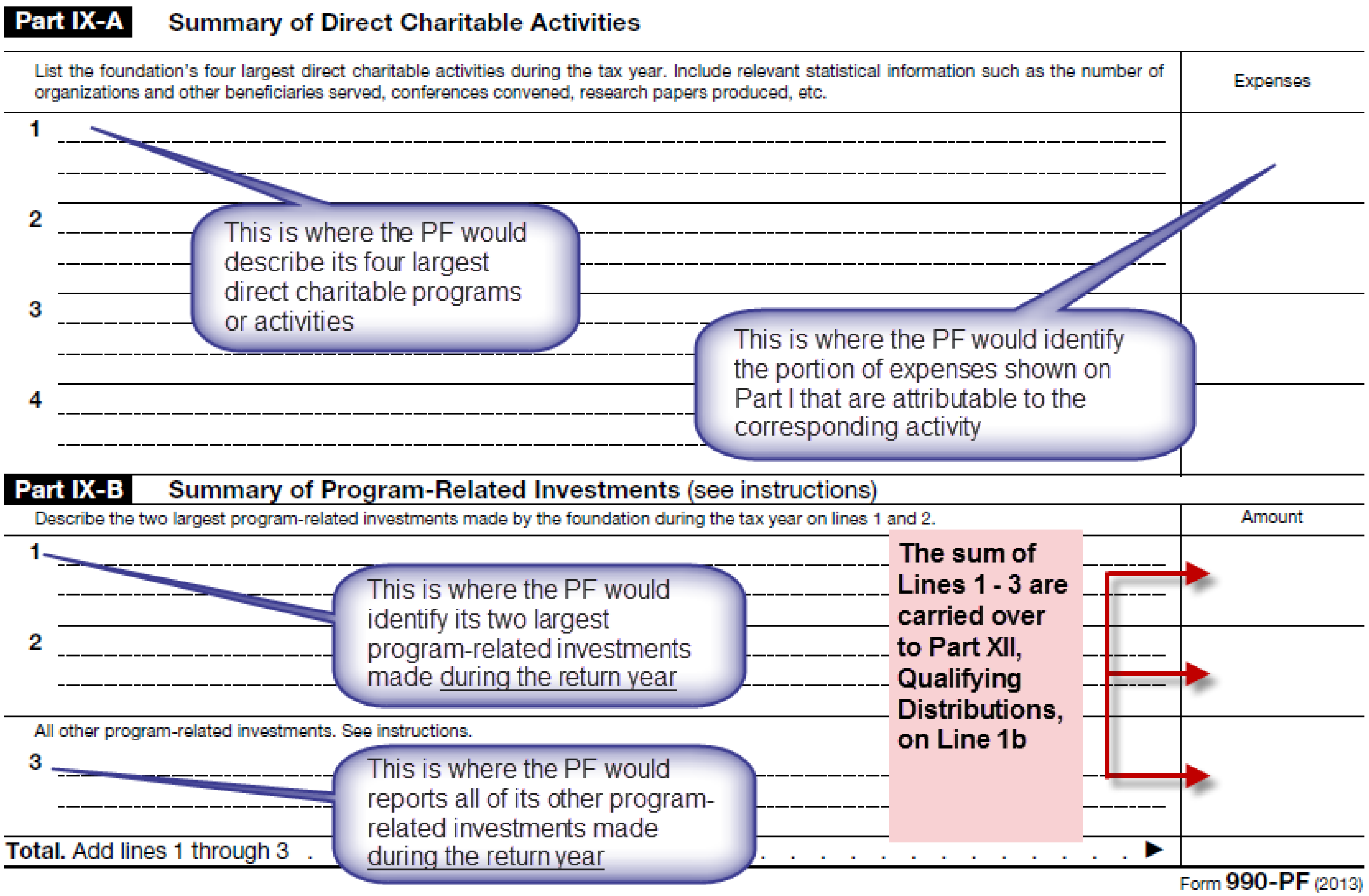
Operating and Administrative Expenses	Line	Description	(a) Revenue and expenses per books	(b) Net investment income	(c) Adjusted net income	(d) Disbursements for charitable purposes (cash basis only)
	13	Compensation of officers, directors, trustees, etc.	160,500	80,250		80,250
	14	Other employee salaries and wages	60,000			60,000
	15	Pension plans, employee benefits	55,000	20,000		35,000
	16a	Legal fees (attach schedule)	10,000	2,500		7,500
	b	Accounting fees (attach schedule)	15,000	7,500		7,500
	c	Other professional fees (attach schedule) . . .	140,000	100,000		40,000
	17	Interest				
	18	Taxes (attach schedule) (see instructions)	15,000			
	19	Depreciation (attach schedule) and depletion . .				
	20	Occupancy	22,000			22,000
	21	Travel, conferences, and meetings	5,200			5,200
	22	Printing and publications	500			500
	23	Other expenses (attach schedule)	85,000	20,000		65,000
	24	**Total operating and administrative expenses.** Add lines 13 through 23	568,200	230,250		322,950
	25	Contributions, gifts, grants paid	800,000			800,000
	26	**Total expenses and disbursements.** Add lines 24 and 25	1,368,200	230,250		1,122,950
	27	Subtract line 26 from line 12:				
	a	**Excess of revenue over expenses and disbursements**	1,907,300			
	b	**Net investment income** (if negative, enter -0-) .		3,194,750		
	c	**Adjusted net income** (if negative, enter -0-) . .				

Common Pitfalls

<u>Quantifying the Amount of Qualifying Distributions</u>

- Using the accrual method of accounting to calculate return year qualifying distributions
- Failure to count appropriate administrative expenses as qualifying distributions
- Double counting the same expense as both a qualifying distribution and an investment expense
- Treating the PF's excise and income taxes as qualifying distributions
- For non-operating PFs, completing:
  - Part I, column c, when there is no exempt function revenue to report
  - Part XIV, which is specific to operating PFs

Direct Charitable Activities and PRIs



Part IX-A **Summary of Direct Charitable Activities**

List the foundation's four largest direct charitable activities during the tax year. Include relevant statistical information such as the number of organizations and other beneficiaries served, conferences convened, research papers produced, etc.	Expenses
1	
2	
3	
4	

Part IX-B **Summary of Program-Related Investments** (see instructions)

Describe the two largest program-related investments made by the foundation during the tax year on lines 1 and 2.	Amount
1	
2	
All other program-related investments. See instructions.	
3	
Total. Add lines 1 through 3 . . . . ▶	

Form **990-PF** (2013)

Qualifying Distributions

- What qualifies under §4942?

Part XII **Qualifying Distributions** (see instructions)

1	Amounts paid (including administrative expenses) to accomplish charitable, etc., purposes:		
a	Expenses, contributions, gifts, etc. - total from Part I, column (d), line 26	1a	7,321,361.
b	Program-related investments - total from Part IX-B	1b	0.
2	Amounts paid to acquire assets used (or held for use) directly in carrying out charitable, etc., purposes	2	37,995.
3	Amounts set aside for specific charitable projects that satisfy the:		
a	Suitability test (prior IRS approval required)	3a	
b	Cash distribution test (attach the required schedule)	3b	
4	**Qualifying distributions.** Add lines 1a through 3b. Enter here and on Part V, line 8, and Part XIII, line 4	4	7,359,356.
5	Foundations that qualify under section 4940(e) for the reduced rate of tax on net investment income. Enter 1% of Part I, line 27b	5	0.
6	**Adjusted qualifying distributions.** Subtract line 5 from line 4	6	7,359,356.

Note. The amount on line 6 will be used in Part V, column (b), in subsequent years when calculating whether the foundation qualifies for the section 4940(e) reduction of tax in those years.

What types of expenses <u>don't</u> count as qualifying distributions?

- Excise and income tax payments*
- Pledges made during the return year to make a grant in a future year (in the absence of a "set-aside")
- Investment and banking expenses
- Compensation to employees who perform investment functions
- Certain taxable expenditures, including:
  - Lobbying, electioneering, and other non-charitable expenditures
- Grants to controlled entities that are not Section 501(c)(3) organizations
- Grants to certain controlled entities that <u>are</u> Section 501(c)(3) organizations or other PF grantees, unless the grantees and grantor PF follow certain technical requirements
- Grants to non-functionally integrated Type III supporting organizations

**Such tax payments do not count as qualifying distributions for non-operating foundations. Note, however, that operating foundations treat excise tax payments as qualifying distributions*

Critical Compliance Issues With Form 990-PF

Amanda Adams, CPA

Minimum Distribution Requirement Issues

Basic Formulas:

- Distributable amount = Minimum Investment Return less 4940 tax on investment income and 990-T tax plus recoveries of amounts previously claimed as qualifying distributions.
- Minimum Investment Return = Net value of noncharitable-use assets multiplied by 5%. (If short year, then less than 5% - based on number of days in tax year/365.)
- Net value of noncharitable-use assets = Average monthly FMV of securities plus average monthly cash balances plus fair market value of all other assets not used (or held for use) directly in carrying out charitable, etc. purposes less 1.5 % “cash reserve.”

Minimum Distribution Requirement Issues

Valuation methods for assets other than cash/publicly-traded securities:

- Must be reasonable and consistently used
- Estate tax valuation methods acceptable
- Foundation can establish value using commonly acceptable methods
- Opinion of an independent appraiser useful but not always required

Minimum Distribution Requirement Issues

Common sources for valuation of assets other than cash/publicly-traded securities:

- K-1 prepared on a GAAP basis
- Audited financial statements
- Net asset value (NAV) per share
- Purchase price/sales price
- Property tax valuation
- Mineral interest reserve report (in conjunction with current prices)

Minimum Distribution Requirement Issues

Valuation frequency:

- Cash and publicly-traded securities – monthly
- Other assets – annually
- Real estate – every 5 years with certified independent appraisal
- If asset held less than the full year, value is prorated based on number of days held/number of days in tax year

Minimum Distribution Requirement Issues

Timing concerns:

- 12/31 may be easiest date to obtain information for but using an earlier date may facilitate planning (If PF has 12/31 fiscal year and uses 12/31 as valuation date, there may be a substantial delay in knowing prior year FMV for 1% calculation and spending purposes.)
- OK to use monthly average if monthly FMV available?

Disclosing Operational Activities: Part VII-A, Question 2

Has the foundation engaged in any activities that have not been previously reported to the IRS?

1. Generally, any substantially different activities that have not previously been reported (Form 1023 or 990-PF) should be reported here. The foundation will not receive a letter from the IRS approving of such activities as a result. However, it may protect the foundation from retroactive challenges to exempt status by putting the IRS on notice of new activities.
2. Certain new activities require advance approval from the IRS:
   I. Grants to individuals for study, travel, similar purposes
   II. Termination of private foundation status through operation as a public charity

Disclosing Operational Activities: Part IX-A, Direct Charitable Activities

The top four programs are reported. Statistical data such as the number of persons served, classes taught, books distributed, etc. enhance the descriptions. The expenses reported include capital expenditures for related assets but not depreciation. A reasonable and consistent allocation of overhead expenses is permitted.

Unless there is significant involvement in the foundation’s grant programs, they are typically not reported as direct charitable activities.

This section is critical for private operating foundations.

Disclosing Operational Activities: Part IX-B, Program Related Investments

- Program-related investments are made for the purpose of accomplishing charitable purposes rather than the production of income or the appreciation of property. (§ 4944(c))
- The descriptions should be consistent with the above and provide sufficient details to evaluate their charitable nature.
- Connection to Part I, line 11 column (c) and Part XVI-A & B

Disclosing Operational Activities: Part XV, Grants

Line 2 – PF has opportunity to describe process for grant applications OR check the box that it doesn’t accept unsolicited applications.

- PFs checking the box MAY get less applications but typically do still get them.
- Providing info can be useful to potential grantees.
- Refer to website if applicable

Disclosing Operational Activities: Part XV, Grants

Line 3 – Grants Paid/Approved

- Individuals must be listed (unless less than $1,000 and indigent)
- Purpose should reflect as much detail as possible (i.e. For assistance to indigent families)
- Group by “class of activity”
- Additional info required for noncash grants
- New codes
- Adjustments (returned grants/PRI forgiveness) go elsewhere

Tips to Cut Net Investment Income Tax Rate in Half

Cutting Tax Liability in Half

Consider strategies that could cut a foundation's tax liability
in half upon its sale of highly appreciated stock

Qualifying distributions must equal or exceed:

1% of net investment income

\+ Asset average x historic ratio of distributions to assets

= Minimum qualifying distributions to qualify for 1% tax rate

Cutting Tax Liability in Half

Foundation Will Not Qualify for 1% Tax Rate:

- Foundation's formation year.
- Foundation did not meet its annual minimum distribution requirement within past 5 years.

Cutting Tax and Liability in Half

Example:

Foundation has $10 million of assets and makes grants of $600,000 each year, making its historical ratio of qualifying distributions to assets 6%.

In the current year, Foundation makes $610,000 in qualifying distributions and has $950,000 net investment income.

Does the Foundation qualify for the reduced 1% tax rate?

Cutting Tax Liability in Half

9,500	Current year's net investment income times 1% ($950,000 x 1% = $9,500)
$600,000	Historical ratio times current year's average assets (6% x $10 million = $600,000)
$609,500	Baseline amount to compare with current year's qualifying distributions ($600,000 + $9,500)
$610,000	**✓ Current year's qualifying distributions**

Cutting Tax Liability in Half

Formation year strategy -

Qualifying for 1% tax rate for next five years:

- Don't fund PF for first tax year; or, if you do fund the foundation, limit qualifying distributions
- If granting commitments by PF have been made for formation year, fund Foundation as early as possible after its formation to ensure that the asset average is more favorable
- Limit qualifying distributions
- Planning to qualify in alternating years

Cutting Tax Liability in Half

Trap for the Unwary

- Foundation formed early in year but not funded until end of year
  - Results in low investment asset average
- Foundation makes significant grants or makes significant qualifying distributions in formation year
- Ratio of qualifying distributions to asset average artificially high in formation year
- Historical ratio of qualifying distributions to assets skewed for next several years

Cutting Tax Liability in Half

Trap for the Unwary

Foundation remains unfunded for most of its formation year and is funded with $500,000 in the last month of year. Foundation's asset average for the year only $50,000.

In the last week of its formation year, Foundation makes grants of $40,000. **Ratio of assets to qualifying distributions in formation year is a whopping 80%.**

In Year 2, Foundation receives major funding of $2 million of zero basis stock, which it sells immediately.

Foundation's asset average for Year 2 is $1.5 million.

Cutting Tax Liability in Half

Trap for the Unwary

How much must the foundation distribute in Year 2 to qualify for the 1% tax rate?

$20,000	Current year's net investment income times 1% ($2 million x 1% = $20,000)
$1.2 million assets	Historical ratio times current year's avg. (80% x $1.5 million = $1.2 million)
$1.22 million	Baseline amount to compare with current year's qualifying distributions ($20,000 + $1.2 million)

STRAFFORD PRIVATE FOUNDATIONS

Brian Yacker, JD/CPA

YH ADVISORS
THE EXEMPT ORG EXPERTS

August 20, 2015

EXCESS DISTRIBUTIONS

GENERAL OVERVIEW

- Undistributed Income
  - Distributable amount minus qualifying distributions
- Applicable Rules
  - Two years to make required qualifying distributions
- Carryovers Permitted
  - 5-year period

EXCESS DISTRIBUTIONS

FORM 990-PF REPORTING

Form 990-PF (2014) Page **9**

Part XIII **Undistributed Income** (see instructions)

		(a) Corpus	(b) Years prior to 2013	(c) 2013	(d) 2014
1	Distributable amount for 2014 from Part XI, line 7				
2	Undistributed income, if any, as of the end of 2014:				
a	Enter amount for 2013 only				
b	Total for prior years: 20___,20___,20___				
3	Excess distributions carryover, if any, to 2014:				
a	From 2009				
b	From 2010				
c	From 2011				
d	From 2012				
e	From 2013				
f	**Total** of lines 3a through e				
4	Qualifying distributions for 2014 from Part XII, line 4: ▶ $ ________				
a	Applied to 2013, but not more than line 2a .				

EXCESS DISTRIBUTIONS

FORM 990-PF REPORTING (CONT'D)

	applied on line 5 or line 7 (see instructions) .					
9	**Excess distributions carryover to 2015.** Subtract lines 7 and 8 from line 6a					
10	Analysis of line 9:					
a	Excess from 2010					
b	Excess from 2011					
c	Excess from 2012					
d	Excess from 2013					
e	Excess from 2014					

Form **990-PF** (2014)

SELF-DEALING

DISQUALIFIED PERSONS

- Definition (see Sec. 4946 of the Internal Revenue Code)
  - Substantial contributor to the private foundation
    - Contributed greater than $5,000 (if more than 2% of total accumulated contributions to private foundation since its inception)
    - See Sec. 507(d)(2)(A) of the Internal Revenue Code
    - Loss of classification as a substantial contributor
      - No contributions to the private foundation for 10 years
      - Not foundation manager for 10 years
  - Foundation manager
    - Any member of the private foundation's Board
    - Top management individual for the private foundation
      - Attribution rules
        - Parents | Spouse | Children | Related entities
        - NOT Siblings

SELF-DEALING

GENERAL OVERVIEW

- Applicable to Transactions Between Private Foundation and Disqualified Person
  - Sale, exchange or leasing of property
  - Lending money or other extension of credit
  - Providing goods, services, or facilities
  - Paying compensation to, or reimbursing the expenses of, a disqualified person
- Liable Parties
  - Disqualified person
  - Foundation manager
  - Private foundation
    - Potential loss of tax-exemption
- No De Minimis Self-Dealing

SELF-DEALING

PROHIBITED TRANSACTIONS

- Sale / Lease of Property

Part VII-B Statements Regarding Activities for Which Form 4720 May Be Required

File Form 4720 if any item is checked in the "Yes" column, unless an exception applies. | Yes | No

1a During the year did the foundation (either directly or indirectly):

(1) Engage in the sale or exchange, or leasing of property with a disqualified person? . . ☐ **Yes** ☐ **No**

(2) Borrow money from, lend money to, or otherwise extend credit to (or accept it from) a disqualified person? . . . . ☐ **Yes** ☐ **No**

(3) Furnish goods, services, or facilities to (or accept them from) a disqualified person? . . ☐ **Yes** ☐ **No**

(4) Pay compensation to, or pay or reimburse the expenses of, a disqualified person? . . ☐ **Yes** ☐ **No**

(5) Transfer any income or assets to a disqualified person (or make any of either available for the benefit or use of a disqualified person)? . . . . ☐ **Yes** ☐ **No**

(6) Agree to pay money or property to a government official? (**Exception.** Check "No" if the foundation agreed to make a grant to or to employ the official for a period after termination of government service, if terminating within 90 days.) . . . . ☐ **Yes** ☐ **No**

b If any answer is "Yes" to 1a(1)–(6), did **any** of the acts fail to qualify under the exceptions described in Regulations section 53.4941(d)-3 or in a current notice regarding disaster assistance (see instructions)? **1b**

Organizations relying on a current notice regarding disaster assistance check here . . . . ▶☐

c Did the foundation engage in a prior year in any of the acts described in 1a, other than excepted acts, that were not corrected before the first day of the tax year beginning in 2014? **1c**

SELF-DEALING

PROHIBITED TRANSACTIONS

- Sale / Lease of Property (cont'd)
  - Encompasses any sales or exchanges of property between a private foundation and a disqualified person
    - Sale made by private foundation to disqualified person will almost always be self-dealing
    - Sale made by disqualified person to private foundation will generally be self-dealing
      - EXCEPTION – disqualified person "sells" item to private foundation for nothing in return
        - Really is just a "contribution"
    - Traps for the unwary
      - Encumbrance issues related to gratuitous transfers (see IRC Sec. 4941(d)(2)(A))
        - Transfers real property with mortgage
        - Transfer insurance policy with premium payments still due

SELF-DEALING

PROHIBITED TRANSACTIONS

- Lending Transactions

Part VII-B **Statements Regarding Activities for Which Form 4720 May Be Required**

File Form 4720 if any item is checked in the "Yes" column, unless an exception applies. | Yes | No

1a During the year did the foundation (either directly or indirectly):

(1) Engage in the sale or exchange, or leasing of property with a disqualified person? . . ☐ **Yes** ☐ **No**

(2) Borrow money from, lend money to, or otherwise extend credit to (or accept it from) a disqualified person? . . . . ☐ **Yes** ☐ **No**

(3) Furnish goods, services, or facilities to (or accept them from) a disqualified person? . . ☐ **Yes** ☐ **No**

(4) Pay compensation to, or pay or reimburse the expenses of, a disqualified person? . . ☐ **Yes** ☐ **No**

(5) Transfer any income or assets to a disqualified person (or make any of either available for the benefit or use of a disqualified person)? . . . . ☐ **Yes** ☐ **No**

(6) Agree to pay money or property to a government official? (**Exception.** Check "No" if the foundation agreed to make a grant to or to employ the official for a period after termination of government service, if terminating within 90 days.) . . . . ☐ **Yes** ☐ **No**

b If any answer is "Yes" to 1a(1)–(6), did **any** of the acts fail to qualify under the exceptions described in Regulations section 53.4941(d)-3 or in a current notice regarding disaster assistance (see instructions)? **1b**

Organizations relying on a current notice regarding disaster assistance check here . . . . ▶ ☐

c Did the foundation engage in a prior year in any of the acts described in 1a, other than excepted acts, that were not corrected before the first day of the tax year beginning in 2014? **1c**

SELF-DEALING

PROHIBITED TRANSACTIONS

- Lending Transactions (cont'd)
  - Lending of money (or other extension of credit) between private foundation and disqualified person will be self-dealing
    - Loan from private foundation to disqualified person will always be self-dealing
    - Loan from disqualified person to private foundation will generally be self-dealing
      - EXCEPTION – disqualified person makes no-interest loan to private foundation and the loan proceeds are utilized for charitable purposes
  - Imputed interest rules when disqualified person makes interest-free loan to private foundation (Reg. §1.7872-5T(b)(9))
    - Imputed interest must be charged under Sec. 7872 of the Internal Revenue Code if disqualified person makes loan in excess of $250,000 to the private foundation
  - Watch out for travel advances to disqualified persons
    - See Reg. §53.4941(d)-3(c)(1)

SELF-DEALING

PROHIBITED TRANSACTIONS

- Providing Goods / Services / Facilities

Part VII-B	**Statements Regarding Activities for Which Form 4720 May Be Required**			
	File Form 4720 if any item is checked in the "Yes" column, unless an exception applies.		**Yes**	**No**
1a	During the year did the foundation (either directly or indirectly):			
	(1) Engage in the sale or exchange, or leasing of property with a disqualified person? . . ☐ **Yes** ☐ **No**			
	(2) Borrow money from, lend money to, or otherwise extend credit to (or accept it from) a disqualified person? . . . . ☐ **Yes** ☐ **No**			
	(3) Furnish goods, services, or facilities to (or accept them from) a disqualified person? . . ☐ **Yes** ☐ **No**			
	(4) Pay compensation to, or pay or reimburse the expenses of, a disqualified person? . . ☐ **Yes** ☐ **No**			
	(5) Transfer any income or assets to a disqualified person (or make any of either available for the benefit or use of a disqualified person)? . . . . ☐ **Yes** ☐ **No**			
	(6) Agree to pay money or property to a government official? (**Exception.** Check "No" if the foundation agreed to make a grant to or to employ the official for a period after termination of government service, if terminating within 90 days.) . . . . ☐ **Yes** ☐ **No**			
b	If any answer is "Yes" to 1a(1)–(6), did **any** of the acts fail to qualify under the exceptions described in Regulations section 53.4941(d)-3 or in a current notice regarding disaster assistance (see instructions)?	**1b**		
	Organizations relying on a current notice regarding disaster assistance check here . . . . ▶ ☐			
c	Did the foundation engage in a prior year in any of the acts described in 1a, other than excepted acts, that were not corrected before the first day of the tax year beginning in 2014?	**1c**		

SELF-DEALING

PROHIBITED TRANSACTIONS

- Providing Goods / Services / Facilities (cont'd)
  - Generally encompasses any transactions whereby the disqualified person provides goods, services, or facilities to a private foundation for any sort of charge (Reg. §53.4941(d)-2(d)(1))
    - Typical
      - Office space
      - Autos
      - Administrative support
      - Meals
      - Parking lots
    - EXCEPTION – provided by disqualified person without charge
  - Generally encompasses any transactions whereby the private foundation provides goods, services, or facilities to a disqualified person, however, there are some exceptions
    - Terms must be no more favorable than to the general public
    - Requirement of functional relationship of goods/services/facilities being provided

SELF-DEALING

PROHIBITED TRANSACTIONS

- Compensation / Expense Reimbursements

Part VII-B **Statements Regarding Activities for Which Form 4720 May Be Required**

File Form 4720 if any item is checked in the "Yes" column, unless an exception applies. | **Yes** | **No**

1a During the year did the foundation (either directly or indirectly):

(1) Engage in the sale or exchange, or leasing of property with a disqualified person? . . . ☐ **Yes** ☐ **No**

(2) Borrow money from, lend money to, or otherwise extend credit to (or accept it from) a disqualified person? . . . . ☐ **Yes** ☐ **No**

(3) Furnish goods, services, or facilities to (or accept them from) a disqualified person? . . ☐ **Yes** ☐ **No**

(4) Pay compensation to, or pay or reimburse the expenses of, a disqualified person? . . ☐ **Yes** ☐ **No**

(5) Transfer any income or assets to a disqualified person (or make any of either available for the benefit or use of a disqualified person)? . . . . ☐ **Yes** ☐ **No**

(6) Agree to pay money or property to a government official? (**Exception.** Check "No" if the foundation agreed to make a grant to or to employ the official for a period after termination of government service, if terminating within 90 days.) . . . . ☐ **Yes** ☐ **No**

b If any answer is "Yes" to 1a(1)–(6), did **any** of the acts fail to qualify under the exceptions described in Regulations section 53.4941(d)-3 or in a current notice regarding disaster assistance (see instructions)? **1b**

Organizations relying on a current notice regarding disaster assistance check here . . . . ▶☐

c Did the foundation engage in a prior year in any of the acts described in 1a, other than excepted acts, that were not corrected before the first day of the tax year beginning in 2014? **1c**

SELF-DEALING

PROHIBITED TRANSACTIONS

- Compensation / Expense Reimbursements (cont'd)
  - Requirements
    - Reasonable compensation
      - Determine scope of work, skills and expertise, full or part time, job description, competitive environment
      - Board approval without input or persuasion from the disqualified person
        - Query – family foundation situations
    - Personal services
      - Legal / Investment advisory / Banking (see Reg. §53.4941(d)-3(c)(2))
        - See PLR 200637041 for listing of all sorts of different personal services
      - NOT Repairs / Janitorial / Cleaning / Landscaping
  - Traps for the unwary
    - Free tickets situation (see Reg. §53.4941(d)-2(d)(2))
      - Situation when disqualified persons use tickets and other tangible benefits received when private foundation makes a contribution to a public charity

SELF-DEALING

PROHIBITED TRANSACTIONS

- Compensation / Expense Reimbursements (cont'd)
  - Traps for the unwary
    - Free tickets situation (see Reg. §53.4941(d)-2(d)(2))
      - Situation when disqualified persons use tickets and other tangible benefits received when private foundation makes a contribution to a public charity
  - Expense reimbursements
    - Should require contemporaneous business purpose documentation before reimburse any expenses of a disqualified person
    - Should implement a written expense reimbursement policy
    - Traps for the unwary
      - Payment of companion travel
      - Foundation credit cards

SELF-DEALING

PENALTIES

- Taxable Period
  - Begins on date when the self-dealing occurs
  - Ends when initial penalty tax has been assessed or when correction completed
- Correction
  - Correction period begins when self-dealing occurs and ends 90 days after the additional tax has been assessed (notice of deficiency mailed)
    - Correction = reversal of the self-dealing transaction
- Penalties Imposed
  - First tier
    - Disqualified person – 10% of amount involved (no maximum)
    - Foundation manager – 5% of amount involved ($20,000 maximum)
  - Second tier
    - Disqualified person – 200% of amount involved (no maximum)
    - Foundation manager – 50% of amount involved ($20,000 maximum)

SELF-DEALING

OVERSIGHT / BEST PRACTICES

- Determination
  - Does a transaction undertaken by a private foundation involve a disqualified person?
  - If so, is the transaction considered to be a self-dealing transaction?
  - If so, do any of the various exceptions apply?
- Best Practices
  - Adopt conflict of interest policy
    - Actually follow the conflict of interest policy
  - Require competitive bids
  - Recuse disqualified person from the discussion regarding the self-dealing transaction
  - Contemporaneously document everything

MINIMUM DISTRIBUTIONS

GENERAL OVERVIEW

- Requirement
  - Need to make annual qualifying distributions to the extent of the private foundation's minimum investment return
- Definitions
  - Undistributed income
    - The amount by which the distributable amount exceeds qualifying distributions for any given year
  - Distributable amount
    - Minimum investment return (generally 5% of the fair market value of the private foundation's non-charitable use assets)
      - Reduced by the federal excise tax on net investment income
  - Minimum investment return
    - Examples of exempt purpose assets

MINIMUM DISTRIBUTIONS

GENERAL OVERVIEW (CONT'D)

- Definitions (cont'd)
  - Minimum investment return
    - Examples of exempt purpose assets
      - Art owned by private foundation that is displayed in museum
      - Desks in classroom of school operated by a private foundation
  - Fair market value
    - Cash
      - Calculate average monthly cash balances
    - Securities
      - Consistently calculate average monthly fair market value
        - Readily available market quotations

MINIMUM DISTRIBUTIONS

GENERAL OVERVIEW (CONT'D)

- Definitions (cont'd)
  - Fair market value (cont'd)
    - Other assets
      - Fair market value consistently determined annually
        - Real estate - 5-year optional reliance if written appraisal prepared by unrelated (Reg. §53.4942(a)-2(c)(4)(iv))

Form 990-PF (2014) Page **8**

Part X **Minimum Investment Return** (All domestic foundations must complete this part. Foreign foundations, see instructions.)

1	Fair market value of assets not used (or held for use) directly in carrying out charitable, etc., purposes:		
a	Average monthly fair market value of securities	1a	
b	Average of monthly cash balances	1b	
c	Fair market value of all other assets (see instructions)	1c	
d	**Total** (add lines 1a, b, and c)	1d	
e	Reduction claimed for blockage or other factors reported on lines 1a and 1c (attach detailed explanation) . . . 1e		

QUALIFYING DISTRIBUTIONS

- Definition
  - Any amount, including reasonable and necessary administrative expenses, paid to accomplish charitable purposes and any amount paid to acquire an asset used directly in carrying out these charitable purposes
    - NOT include amounts paid to directly on indirectly controlled charitable organizations (see Sec. 4942(g)(1)(A)) or paid to non-functionally integrated Type III supporting organizations (see also Reg. §53.4942(a)-3(a)(3))
- Planning Considerations
  - Non-cash
    - Amount of a qualifying distribution is equal to the fair market value of the property on the date of distribution
  - Program-related investments
    - Examples
      - Loans to public charity to help develop treatment to cure disease
      - Low-interest loans to blind persons to help them establish businesses

MINIMUM DISTRIBUTIONS

PENALTIES

- Taxable Period
  - First day of relevant tax year through the date that the initial tax is assessed
- Correction
  - Satisfy minimum distribution requirements
- Penalties Imposed
  - First tier
    - 30% of the private foundation’s undistributed income
  - Second tier
    - 100% of the private foundation’s undistributed income
  - Exceptions
    - Private operating foundations
    - Incorrect asset valuation

Excess Business Holdings
Tips for Avoiding Issues

Excess Business Holdings

- Intended to limit the stake a PF can have in a going business concern, a business enterprise
- Generally, a PF and its disqualified persons, collectively, are limited to a 20% ownership stake in a business enterprise (sometimes 35%)
- De minimis exception available if a PF owns no more than 2% of the voting stock and value of all classes of outstanding stock

Excess Business Holdings

- Exception allows for unlimited ownership stake in a passive investment vehicle (as opposed to a business enterprise)
- 5-year grace period for ownership interests donated to the PF
- A 10% penalty can be assessed on the value of the PF's excess holdings each year until corrected

Passive Investment Vehicles

Any trade or business which derives at least 95% of its gross income from passive sources, including:

- Dividends and interest
- Payments relative to securities, loans, and annuities
- Royalties
- Capital gains
- Rent (with certain exceptions)

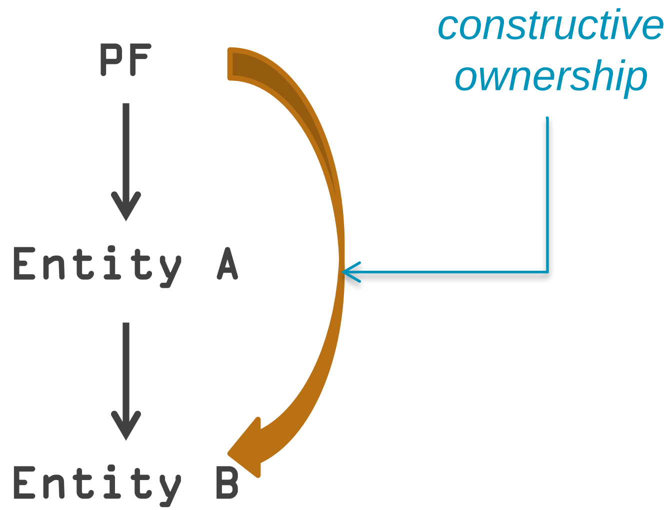
Private Foundation as a DP

- The definition of a DP normally excludes 501(c)(3) organizations
- Special expansion of DP definition to include certain related private foundations for EBH rules
  - Common control over PFs
  - Common funding sources
- The purpose of the expanded definition is to preclude rule avoidance

Constructive Ownership

The EBH rules may apply to entities both directly and indirectly owned by a PF

Generally, if a PF owns stock in Entity A, and Entity A owns stock in Entity B, the PF is deemed to have proportional constructive ownership of Entity B



Best Practices

- Institute annual monitoring procedures for investments in which the foundation has more than a de minimis ownership interest; be wary of concentrations in ownership levels due to redemption of other shareholders/partners

- Method for obtaining information regarding investments by DPs in business enterprises directly and constructively owned by PF, such as by an annual questionnaire for known DPs

- Advising known DPs of the PF's ownership interest in business enterprises (in which the PF owns more than a de minimis interest)

Best Practices

- Be wary of accepting contributions of ownership interests in business enterprises for which there are unlikely to be unrelated potential buyers within a five year period
- Consider donating excess business holdings to a public charity if an unrelated party isn't available
- Adopt investment policy that requires consideration of excess business holdings implications before making any investment
- Monitor passive investment vehicles to determine if they have flipped to business enterprise status due to a change in the composition of its gross income

JEOPARDIZING INVESTMENTS

GENERAL OVERVIEW

- Prohibition
  - Private foundation will be penalized for making jeopardizing investments
- Definition
  - Not specifically defined in the Internal Revenue Code or corresponding Regulations
    - Generally, investments which demonstrate a lack of reasonable and prudent care by the one making the investment
    - "Outdated" list set forth in Reg. §53.4944-1(a)(2)(i)
      - Trading securities on margin
      - Trading commodities futures
      - Investing in oil/gas working interests
      - Buying puts, calls and straddles
      - Selling short
    - Prudent trustee standard

JEOPARDIZING INVESTMENTS

RELEVANT CONSIDERATIONS

- Determination
  - Determine whether an investment is a jeopardizing investment at the time when the investment is actually made (even if eventually recognize loss on a particular investment)
  - See how the particular investment fits within an overall prudent investment plan
  - Generally not include investments in publicly-traded stocks
  - Recommendation
    - Maintain a well-balanced investment portfolio

JEOPARDIZING INVESTMENTS

PENALTIES

- Taxable Period
  - Begins with the date of the jeopardizing investment and ends on the earliest of:
    - Date of mailing of first-tier tax deficiency
    - Date first-tier tax is assessed
    - Date that the invested amount is removed from jeopardy
- Correction Period
  - Correction period starts on the date that the jeopardizing investment is made and ends 90 days after the additional tax is assessed
    - Correction = private foundation removes an investment from jeopardy when it sells or otherwise disposes of it

JEOPARDIZING INVESTMENTS

PENALTIES (CONT'D)

- First Tier
  - 10% of the amount invested in a jeopardizing investment
  - 10% excise tax can also be imposed on a foundation manager with knowledge of the jeopardizing investment
    - Maximum = $10,000 per jeopardizing investment
- Second Tier
  - 25% of the amount invested in a jeopardizing investment
  - An additional excise tax of 5% can also be imposed on a foundation manager with knowledge of the jeopardizing investment if there is no correction within the correction period
    - Maximum = $20,000 per jeopardizing investment
- Exceptions
  - Reasonable cause

TAXABLE EXPENDITURES

GENERAL OVERVIEW

- Definition
  - Essentially, expenditures that the private foundation should NOT be making
- Examples
  - Lobbying
    - Exception – legislation affecting existence / operations of the private foundation
  - Political campaign activities
  - Grants to individuals
    - Exception – Hardship assistance
    - Exception – scholarship grants with prior approval from IRS
  - Grants to foreign charities
    - Exception – exercising of expenditure responsibility
  - Grants to other private foundations | non public charities | certain Types of supporting organizations
    - Exception – exercising of expenditure responsibility

TAXABLE EXPENDITURES

EXPENDITURE RESPONSIBILITY

- Exercising of Expenditure Responsibility
  - Pre-grant due diligence
    - Investigate, based on readily available information, that the grantee will use the granted funds from the private foundation for proper purposes
  - Written grant application
    - Ensure that grant is actually spent only for the purpose for which it is made
  - Financial statements
    - Obtain full and complete reports from the foreign grantee organization on how funds were spent
  - Form 990-PF attachment
    - Make full and detailed reports on the expenditures to the IRS on Form 990-PF

TAXABLE EXPENDITURES

EXCEPTIONS

- Following Expenditures Not Considered to be Taxable Expenditures
  - Expenditures to acquire investments that generate income used to further exempt purposes
    - Reasonable expenses related to acquiring these investments
  - Payment of taxes
    - Expenses that qualify as allowable deductions in figuring the tax on unrelated business income
  - Any payment that is a qualifying distribution
  - Any deduction allowed in arriving at taxable net investment income
  - Reasonable expenditures to evaluate, acquire, modify, and dispose of program-related investments
    - Business expenses of the recipient of a program-related investment

TAXABLE EXPENDITURES

PENALTIES

- Taxable Period
  - Begins on the date of the taxable expenditure
- Correction Period
  - Recovery of the entire amount of the taxable expenditure
- First Tier
  - Private foundation - 20% of the amount of the taxable expenditure
  - Foundation manager – 5% of the amount of the taxable expenditure
    - Exception – advice of counsel
- Second Tier
  - Private foundation – 100% of the amount of the taxable expenditure
  - Foundation manager – 50% of the amount of the taxable expenditure
    - Maximums ($10K)

FOR MORE INFORMATION…

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Thank You

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