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Private Foundations Bulletin

Year-End Tax Planning Tips

As the year comes to a close for some private foundations, there are a number of tax planning tools and year-end measures that we have compiled to help mitigate any excise tax on net investment income and prevent some common pitfalls that could result in other types of excise taxes.

It is also a good time to review the foundation's current investment portfolio composition for changes from the prior year. Any new investments made during the current year could potentially require new or increased tax compliance and filings in the coming year.

In this e-newsletter, we will provide some considerations and tools used by foundations when performing such an assessment.

Tax Planning Tips

A foundation may be able to mitigate its tax burden using some of this guidance:

- Consider offsetting gains with capital losses.

- Prior to year-end, the foundation should monitor its current financial position to ascertain if it can qualify for a reduction from a 2% to a 1% federal excise tax. For example, a foundation that distributes an extra $10,000 in grants could possibly save that amount or greater in taxes. Some foundations may wish to accelerate the distribution of grants from the next tax year to the current tax year to possibly qualify for the reduction in tax. Most importantly, a foundation should ensure its prior year undistributed income has been, or will be, distributed before year-end.

- Avoid the federal excise tax by donating highly appreciated publicly-traded stock with a low cost basis to a grantee.

- Review the allocation of operating and administrative expenses between net investment income and charitable expenditures. By reviewing these allocations in conjunction with the Form 990PF instructions, a foundation may determine that certain expenses can qualify as a charitable expense thereby reducing the mandatory distribution requirements and possibly enabling the foundation to qualify for a reduction in the federal excise tax from 2% to 1%.

- Foundations that invest in foreign securities should ask their investment advisors to file for refunds for any foreign taxes withheld. Depending on the country, foundations may be eligible for a refund of all or a portion of foreign taxes withheld by the source country.

Investment Changes

A foundation should review any changes in its investment composition in order to address and plan around any new potential compliance and filing requirements. For example:

- Investments in limited partnerships and foreign hedge funds should be reviewed to determine if any foreign filings are required. Two common foreign filings are Form 926, *Return by a U.S. Transferor of Property to a Foreign Corporation*, and Form 8865, *Return of U.S. Persons with Respect to Certain Foreign Partnerships*. Another foreign filing that has been increasingly filed due to blocker corporations is Form 5471, *Information Return of U.S. Persons with Respect to Certain Foreign Corporations*.

- Review all investments in limited partnerships to see if the foundation is subject to unrelated business income tax, which would be taxed at corporate or trust rates. Also, review tax exposure to states in which the foundation would not normally be required to file.

- Furthermore, if a foundation has unrelated business income (UBI), consider utilizing the charitable contributions deduction on the Form 990T. There may be income shown on line 1 of Schedule K-1, which is ordinary income from trade or business, yet UBI may not be indicated on Schedule K-1 or its statements. In analyzing its UBI-generating investments, the foundation should identify separate trades or businesses and analyze potential exposure to UBIT under the new siloing rules.

- Review the foundation's investment ownership interest/percentage in corporations and limited partnerships. Further disclosures may be required; for example, if the foundation owns over 50% of another entity.

Other Things to Remember

A few other reminders for this time of year include:

- If the excise tax for the current year is $500 or greater, estimated tax payments for the subsequent year are required. If using the standard option, these estimated tax payments are due the fifteenth day of the fifth, sixth, ninth and twelfth month of the foundation's fiscal year.

- Foundations that have paid directors, officers and/or management should consider having a compensation study done by an independent consultant every few years to provide a reasonable basis for the compensation being provided. In addition, 1099s are required to be issued for payments of at least $600 to certain consultants and professionals including accountants and attorneys.

- For grants subject to expenditure responsibility (i.e., certain grants to foreign organizations, grants to other private foundations and other non-public charities) make sure that expenditure responsibility requirements were met. If the foundation is making equivalency determinations, make sure the written advice used meets requirements.

- Individuals who donate to private foundations must be provided with a proper acknowledgement letter in order for the individual to receive a charitable deduction on their federal tax return in accordance with IRS Publication 526. This is the responsibility of the private foundation and should be done in a timely manner.

- Review prior year's filings, especially the state filings (if any). Each individual state may have a different time frame as to when a filing is required; therefore, the time for filing state reports may differ from the time for filing the 990PF tax return.

Contact Us

We welcome the opportunity to answer any questions you may have related to this topic or any other accounting, audit, tax or advisory matters relative to private foundations. Please call 212.286.2600 or email any of the Private Foundation Services team members below:

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