October 2020

Private Foundations Bulletin

It's That Time of Year

As we enter the last quarter of the year, now is the time for private foundations to review the current year's tax planning and year-end strategies.

There are a number of tools and year-end measures to consider this time of year. In this e-newsletter, we will provide some practical strategies and techniques that foundations can utilize.

Minimum Distribution Requirement and Qualifying Distributions

A private foundation that fails to pay out the minimum distributable amount in a timely manner is subject to a 30 percent excise tax under §4942 of the Internal Revenue Service (IRS) guidelines. To avoid this additional tax, a foundation should consider the following:

- Ensure its prior year undistributed income has been, or will be, distributed before year-end.
- Consider contributing to a donor advised fund to meet minimum distribution requirements.
- Develop a plan to use excess distribution carryforward as this carryforward expires after five years.
- Review the allocation of operating and administrative expenses between net investment income and charitable expenditures. By reviewing these allocations in conjunction with the IRS Federal Form 990-PF instructions, a foundation may determine that certain expenses can qualify as a charitable expense thereby meeting the mandatory distribution requirements.
- 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.

Federal Excise Tax

A foundation may be able to mitigate its tax liability using some of these strategies:

- Consider offsetting gains with capital losses. Capital losses from the sale, or disposition, of investments can reduce capital gains recognized in the current year. However, losses cannot go below zero.
- Avoid the federal excise tax by donating highly appreciated publicly-traded stock with a low cost basis to a grantee.
- 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.

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:

- 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.

- 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.

- 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:

- The *Further Consolidated Appropriations Act of 2020* signed by the President in December 2019 simplified the excise tax on net investment income for private foundations to a single flat rate of 1.39%. This is effective for tax years beginning after December 20, 2019.

- 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.

- 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 990-PF 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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