PKF O'CONNOR DAVIES
ACCOUNTANTS AND ADVISORS

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Private Foundations Bulletin

A Jump-Start on Year-End Tax Planning

As the 3rd quarter of 2022 commences, tax planning and year-ending strategies may be best to be considered now. The summer months may provide an opportunity to review the foundation's current year position, ensure the foundation is in compliance with federal and state regulations, and plan for tax savings, where possible, in the current year and beyond. A few tips and reminders are summarized in this bulletin.

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% excise tax under §4942 of the Internal Revenue Service (IRS) guidelines. To avoid this additional tax, a foundation should consider the following:

- Ensure prior year undistributed income has been, or will be, distributed before year-end. If most grant-making is performed at the end of the tax year, consider giving out more than required in case a check gets lost in the mail. Review the latest bank reconciliation for old checks that have not yet cleared the bank. If these checks become stale and are written off, the foundation may have a higher distribution requirement. For wire payments to grantees, have the foundation's bank representative confirm the wire instructions with a trusted individual at the grantee organization before making the transfer.

- Consider contributing to a donor-advised fund (DAF) to meet minimum distribution requirements. (*Note:* this is still permitted under current tax law but could be subject to change as it's an area currently under debate by lawmakers.)

- 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, non-public charities and taxable corporations) make sure that expenditure responsibility requirements were met. Generally, an expenditure responsibility grant requires a pre-grant inquiry and a written signed grant agreement containing certain requirements including reporting by grantee to grantor foundation. If the foundation is making equivalency determinations, make sure the written advice used meets requirements.

Federal Excise Taxes

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

- Consider offsetting capital 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 and cannot be carried back or forward to another tax year.

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

- If the estimated excise tax for the current tax year is $500 or greater, estimated tax payments are required. These estimated tax payments are due the fifteenth day of the fifth, sixth, ninth and twelfth month of the foundation's fiscal year. By now, the foundation may have already made one or two tax deposits for the current tax year via the Electronic Federal Tax Payment System®. A new foundation will need to register at that site to make electronic tax payments.

Review Investment Portfolio

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

- Investments in limited partnerships and offshore funds should be reviewed to determine if any foreign filings are required. Generally, when $100,000 or greater in cash is transferred to an offshore entity (directly or indirectly), the IRS requires information reporting on Form 926 with respect to certain foreign corporations and Form 8865 with respect to foreign partnerships. Different sections of the forms are completed based on the specifics of the transaction(s*).* Another common, yet more complex, tax form related to investments in foreign corporations is the Form 5471.

- 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. Certain ownership percentages of foreign corporations may trigger a filing mentioned in the bullet above.

- Any person or entity (including individuals, corporations, partnerships, trusts and estates) having a financial interest, signature or other authority over bank accounts, securities, or other financial accounts having an aggregate value exceeding $10,000 outside the U.S. must report such a relationship. Filing requirements also apply to taxpayers that have direct or indirect control over a foreign or domestic entity with foreign financial accounts, even if the taxpayer does not have foreign account(s). Failure to disclose the required information to the U.S. Department of the Treasury may result in substantial civil and/or criminal penalties.

- Review all investments in limited partnerships to see if the foundation is subject to unrelated business income tax, which is 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.

Other Things to Remember

A few other reminders for this time of year include:

- 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.

- Form 1099s are required to be issued for payments of at least $600 to certain consultants and professionals including accountants and attorneys. The foundation should have W-9 forms on file for vendors, which include payee addresses and tax identification numbers for ease of filing these forms come January 2023.

- Individuals who donate to private foundations must be provided with a proper acknowledgment 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.

Timely Planning

Consider the time your foundation dedicates to year-end review and planning as an investment; an investment in the financial success of the foundation, with less room for mistakes, time spent on corrections and more time spent furthering the mission of the foundation.

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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