Private Foundation – Form 990-PF

INTRODUCTION — WHAT IS A PRIVATE FOUNDATION?

- **Definition** – In IRC § 509(a) defined as: "private foundation means a domestic or foreign organization described in Section 501(c)(3)" = basically a foundation other than a public charity.
- **Taxation** – Tax-exempt under IRC § 501(a); however, under IRC § 4940 is subject to a one or two percent excise tax on income generated by investments.
- **Funding** – Funded by an investment of cash, securities and other assets from the founder.
- **Activities** – Making grants to public charities to support their activities.

INTRODUCTION — WHY SET UP A PRIVATE FOUNDATION?

- **Tax Advantages** – You can donate cash up to 30% of your adjusted gross income to a private foundation and receive a tax deduction.
- **Control** – A private foundation allows the founder to control what types of charities receive support, as well as the management of the assets funding that support.
- **Creating a Legacy** – Naming the foundation after yourself or someone you want to honor.
- **Involving Your Family** – A private foundation can be a way to get your family members involved in charitable activities.

INTRODUCTION — PUBLIC VS. PRIVATE FOUNDATION

	PUBLIC	PRIVATE
General	Performs charitable work	Supports charitable work
Filing	990 or 990 EZ	990-PF
Tax Deductibility	Cash - up to 50% of the AGI Property - up to 30% of the AGI	Cash - up to 30% of the AGI Property - up to 20% of the AGI (subject to limitation)
Taxation	N/A	Net investment income subject to 1% or 2% excise tax Might be subject to 30%/100% tax for failure to distribute income
Distributions	N/A	Must distribute 5% of net assets to charities
Proof	An applicant for 501(c)(3) status must prove why it should be considered a public charity	Fallback position of not qualifying for public charity status via either the organizational or income test (or both), it is most often the choice made
Support	Must be supported by the general public. 33% support test or 10% facts and circumstances test. At least 33%/10% must come from relatively small donors (those who give less than 2% of the organization's income). See Schedule A.	Can be funded by a relatively small group

INTRODUCTION — PRIVATE OPERATING FOUNDATION

- Private Operating Foundation:
- Hybrid of a private and public foundation
- A private foundation that conducts/manages at least a portion of its own charitable programs (e.g., museum)
- Still **subject to the tax** on net investment income, but not **subject the excise tax** on failure to distribute income
- Contributions are deductible by the donors to the extent of 50% (not 30%) of each donor's AGI.

INTRODUCTION — PRIVATE OPERATING FOUNDATION

- The rules are strict, as control can be like that of private foundations, but with some of the benefits of public charities.
- Must spend a significant portion of its assets on its active programs
- Must satisfy two annual distributions tests:
  - Income Test (at least 85% of its "adjusted net income" or its "minimum investment return" on the direct operations of its charitable programs)
  - Asset Test (three different tests)

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	Titles	Comments
Part I (page 1)	Analysis of Revenue & Expenses	**Column a,** "Revenue and Expenses per Books" – has to agree to your books/financial statements, if any **Column b,** "Net Investment Income" – foundation pays tax based on this column **Column c,** "Adjusted Net Income" – applies to: ▪ Private **operating** foundations ▪ Private foundation that received income from a charitable activity and wishes to claim a qualifying distribution for expanses incurred in the activity ▪ Private foundation that maintains a common fund **Column d,** "Disbursement for charitable purposes" – flows to qualifying distribution calculation – Part XII **Interest Income — muni bonds** ▪ Column a includes all interest income, including muni bond interest ▪ Column b does not include interest income from muni bonds

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Titles		Comments
Part I (page 1) - *continued*	Analysis of Revenue & Expenses	▸ **Accounting for property contributed during the year** ▪ Amount has to be reported at FMV on line 1, PART I (column a) ▪ Investment on the balance sheet (PART II) can be reported either at FMV or cost – If at FMV, original basis needs to be kept outside of the books – If at cost, adjustment needs to be shown on PART III in current year ▪ Note: when taxpayer contributes **publicly traded security** to private foundation, donor gets a deduction equal to the FMV of the property donated on his/her 1040. ▸ **Expenses** ▪ Need to allocate between investment (column b) and charitable purposes (column d) ▪ There are no set rules for allocating expenses - must be reasonable and consistent ▪ Nondeductible items - Expenses related to tax-exempt interest are not deductible on column b ▪ Must be on cash basis

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Titles		Comments
Part II (page 2)	Balance Sheet	- Property received can be reported either at FMV or cost on the balance sheet - Need to disclose FMV of assets on column c (Note: private foundation must distribute 5% of net assets to charities)
Part III (page 2)	Analysis of Changes in Net Assets or Fund Balances	- Reconciles net assets/fund balances with PART II (Think of it as M-1/M-2 on the 1065 return) - Refer to “Accounting for property contributed during the year” described under PART I

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Titles		Comments
Part IV (page 3)	Capital Gains and Losses for Tax on Investment Income	• PART IV needs to be completed and total from PART IV should agree to line 7, PART I • Capital losses may be subtracted from capital gains, but only to the extent of the gains • There might be a difference in capital gains/losses between columns a and b (PART I), depending on how the contributed investment is reported on the balance sheet (FMV vs. cost - refer to “Accounting for property contributed during the year” described under PART I) • Gain on column b (net investment income) is calculated using original/donors cost basis • Gain on column a (revenue and expenses per books) is calculated using basis from trial balance/financial statements. Thus, it depends whether the investment was reported on the balance sheet at FMV or original/ donor’s basis (at the time the property was received by the foundation).

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Titles		Comments
Part V (page 3)	Qualification Under Section 4940(e) for Reduced Tax on Net Investment Income	▸ Foundations can reduce their tax rate to 1% (normally pay 2%) if the amount of current year qualified distributions equals or exceeds the sum of: ▪ An amount equal of the assets of the foundation multiplied by the average percentage payout for the five-year base period plus ▪ One percent of the net investment income for the taxable year ▸ Payout current year must exceed five-year average ▪ Need to be careful and make sure amounts under columns b and c agree to prior years for foundations with year-end other than December 31st due to timing of GoSystem rollovers ▸ Part V is nonapplicable to “private operating foundations,” section 4940(d)(2) ▸ If subject to excise tax (for failure to distribute income) – disqualified for five years ▪ Basically, if the foundation failed to make required distributions in any of the last five years, the foundation is not entitled to the lower tax rate ▪ Then, need to check “yes” to question under PART V
Part VI (page 4)	Excise Tax Based on Investment Income	▸ Calculation of tax (either 1% or 2%) based on net investment income (from column b, PART I)

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Titles		Comments
Part VII-B (page 5)	Statements Regarding Activities for Which Form **4720 May Be Required**	‣ Self-Dealing Under IRC §4941 (Part II and **Part VII-B, Q1a**) ▪ IRC §4941 imposed tax on each act of self-dealing between a foundation and a disqualified person (e.g., substantial contributors, managers) ▪ Form 4720 may be required ▪ The tax is be paid by a disqualified person ▪ "Self-dealing" means: – Loans to/from disqualified persons – Expenses (including compensation) paid to disqualified persons – Other - see IRC §4941 (six in total; all six listed under Part VII-b, line 1a) ‣ Taxes on failure to distribute income under IRC §4942 **(Part VII-B, Q2b)** ▪ Need to mark "yes" to question 2b (discussed further under PART XIII)

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Titles		Comments
Part X (page 8)	Minimum Investment Return	▸ **Minimum Investment Return Under IRC §4942 (Part X)** ▪ Valuation of cash/securities/other assets (rules set up in Reg. §53.4942(a)-2(c)) – Cash and securities on a monthly basis – Other assets on an annual basis – Real estate - five-year valuation ▪ Payout to charity - 5% of asset values (line 6, of PART X) – Must distribute 5% of the average FMV of the noncharitable assets (=investment assets for the preceding year) – Does not apply to “private operation foundations” – No requirement for the first year
Part XI (page 8)	Distributable Amount	▸ 5% of FMV less taxes on investment income (from PART VI)
Part XII (page 8)	Qualifying Distributions	▸ Basically amounts paid to charities plus related expenses (total from PART I, column d)

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Titles		Comments
Part XIII (page 9)	Undistributed Income	▸ Payout required by the end of the following year (see line 7, PART XIII; make sure it flows correctly to the filing instructions) ▸ Excess distributions can be carried over for up to five years ▸ If foundation fails to make required distributions, need to check "yes" to question 2, under PART VII-B, and need to file Form 4720 to pay penalties ▸ Penalties for failure to distribute: ▪ First Tier (initial tax, IRC §4942(a)) - 30% excise tax on undistributed income ▪ Second Tier (additional tax, IRC §4942(b)) - 100% excise tax on the remaining undistributed income ▪ Third Tier - Involuntary termination possible for repeated willful violations

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Titles		Comments
Part XV (page 11)	Grants and Contributions Paid During the Year	▸ Verify payout is to a charitable organization ▪ Publication 78 no longer available ▪ Use "Exempt Organization Select Check" at "http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check" ▸ Special rules on payments to private foundation ▪ Usually payments do not qualify as "qualifying distributions" ▪ If private foundation "A" distributes to private foundation "B," and "B" makes a distribution to a public charity (assuming distribution not made out of corpus) and "B" does not claim it as qualifying distributions on its return, then "A" can include the amount in its qualifying distributions. ▸ Cash basis is utilized ▸ Payments to foreign charities - qualify as "qualified distributions" if the foreign organization receives a determination letter from the IRS that it is a public charity

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Titles		Comments
Part XVI-A (page 12)	Analysis of Income-Producing Activities	• Need to split income reported on PART I, lines 3 to 11 (Column a) into three categories • Column b, "Unrelated business income" - not substantially related to the organization's exempt purpose • Column d - Exclusions under §512, §513 & §514 ▪ Dividends, interest and capital gains • Column e, "Related or Exempt Function Income" - Any income earned that is related to the organization's purpose

PRIVATE FOUNDATION – UNRELATED BUSINESS INCOME TAX (UBIT)

Unrelated business income tax (UBIT):

- Form 990T required (if a foundation has gross income of $1,000 or more from unrelated trade or business)
- PTPs owned by foundation
- Investment partnership owned (look for Code V, “unrelated business taxable income,” under line 20 on the K-1)
- Borrowing by foundation

PRIVATE FOUNDATION – OTHER ITEMS

- Due Date – 15th day of the 5th month after the year-end (5/15 for calendar year)
- First Extension – Automatic, must file Form 8868/pay tax
  - Late filing penalty is $20/day ($100/day for large organizations)
- Second Extension - Not automatic, must show reasonable cause
- Two most important items/questions we need to ask when working on extensions:
  - Need to get amount of net investment income (e.g., all 1099's for dividends, interest and capital gains)
  - Need to get amount of charitable donations made, to ensure minimum required distribution was made (the 5% of prior year assets).

PRIVATE FOUNDATION – OTHER ITEMS

- Payments of Tax – Foundations need to pay tax using EFTPS (Electronic Federal Tax Payment System)
  - Exception if balance due is less than $500
- Electronic Filings – Mandatory only if foundation files at least 250 returns (1099's/W-2's, etc.)
- Estimates – Due May 15th, June 15th, September 15th and December 15th
  - Mandatory if $500 or greater
- Verify changes to officers/directors (Part VIII)
- Placement of Ad – NYS foundations

QUESTIONS

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VCARD

