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Private Foundations Bulletin

Getting a Jump on Year-End Tax Planning Pays Off

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For private foundations with calendar year-ends, this is a great time to consider getting a head start on year-end tax planning. The remaining months provide an opportunity to review the foundation's current year position, ensure that the foundation is in compliance with federal and state regulations and look for any tax efficiencies, where possible, in the current year and beyond.

A few of our favorite tips, as well as helpful reminders, are recapped 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 percent 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 the required amount and give sufficient time to write out the checks or process the grant wires. For wire payments to grantees, the foundation should confirm the wire instructions with a trusted individual at the grantee's organization before making the transfer to ensure the proper bank information is verified and avoid any delays. We also recommend review of the latest bank reconciliations for any old checks that have not yet cleared the bank. If these checks are stale and become written off, the foundation may have a higher distribution requirement.

- **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 a five-year period.**

- **Review the allocation of operating and administrative expenses between net investment income and charitable expenditures.** Most common administrative expenditures that are charitable consist of employee salaries, legal, accounting, grant administration and other costs that help a foundation further its mission. 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), ensure 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.** The fair value of the appreciated securities counts toward the calculation of the five percent minimum distribution, and the payment of excise tax on the gain of the appreciated securities is avoided.

- **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 15th day of the 5th, 6th, 9th and 12th months of the foundation's fiscal year. At this point, the foundation most likely already made two or three tax deposits for the current tax year via the **Electronic Federal Tax Payment System®** (EFTPS). Please note a new foundation will need to register on this site to make electronic tax payments. Also, the IRS does not accept physical checks or money orders from private foundations for estimated tax payments, and so they must be made online through EFTPS.

Review Investment Portfolio

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

- **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 and more complex tax form related to investments in foreign corporations is Form 5471. It is important to note that failure to file a complete and accurate foreign filing by the due date could result in monetary penalties beginning at $10,000.

- **Review the foundation's investment ownership interest and percentage in corporations and limited partnerships.** Further disclosures may be required; for example, if the foundation owns over 50 percent 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 (UBIT), 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 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 helpful reminders for this time of year include:

- Foundations that have paid directors, officers and/or management should consider having a compensation study performed by an independent consultant every few years to provide a reasonable basis for the compensation being provided.

- Update, if necessary, the top-five highest paid employees and list of foundation officers to ensure their average hours per week devoted to their position is accurate for the current tax year.

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

- 1099 tax forms are required to be issued for payments of at least $600 to certain professionals including accountants, attorneys and other independent contractors. 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 by January 31, 2025.

- Foundations must monitor substantial contributors who generally contribute individually more than $5,000 to the foundation or whose contributions exceed two percent of the foundation's total donation revenue. To ensure transparency, the foundation needs to maintain accurate records for all contributions and track potential substantial contributors separately.

- 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.

- Review the foundation's bylaws and, if there are any amendments, notify the tax preparer as the updated copy is required to be attached to the foundation's filed 990-PF.

Timely Planning

The time spent planning and utilizing any combination of these tips could prove to save the foundation considerable resources depending on its current financial position and year-to-date activities. Considering them now also allows for sufficient time to utilize any of these strategies and coordinate with trusted advisors to execute them in a timely manner, efficiently and correctly.

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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