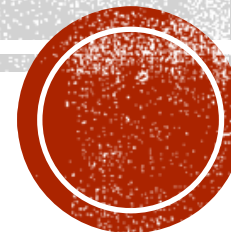


# PRIVATE FOUNDATION ALTERNATIVES

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# OVERVIEW

- Private Foundations—Good, Bad and the Ugly
- Donor Advised Funds
- Other Donor Funds
- Supporting Organizations



# PRIVATE FOUNDATION

- All Charities are PFs Unless
  - Public support or public entity
  - At least one third is exempt purpose and not more than a third in investment income
  - SO
- Donor can have total control
- Lower deduction limits
  - 20%/30% of AGI
  - Basis except Qualified Appreciated Stock
- 990 PF Public



# PRIVATE FOUNDATION LIMITS

- 5% Payout
- Self Dealing, but can employ family
- 1.39% Tax on Net Investment Income
- Excess Business Holding Limit
  - 20%/35% and 2% De minimis
- Jeopardy Investment Limit
- Taxable Expenditure
  - Limits scholarships
- Expenditure Responsibility
- No IRA Rollover Gifts



# SELF-DEALING OVERVIEW

- IRC Section 4941 prohibits acts of self-dealing between a private foundation and a disqualified person.
- Covers direct and indirect acts.
  - Can apply to transactions between estate of which foundation is a beneficiary and a disqualified person.
  - Can apply to transactions between entity controlled by the foundation and a disqualified person.
- Benefit or detriment to foundation is not relevant.



# DISQUALIFIED PERSONS

- Disqualified persons defined as:
  - Substantial contributors (generally anyone contributing more than \$5,000)
  - Foundation managers (officers, directors, or trustees)
  - 20% owner of business that is a substantial contributor
  - Any family member of the above (spouse, ancestors, and children, grandchildren, and great grandchildren, and spouses of children, grandchildren, and great grandchildren)
  - Corporation, partnership, trust, or estate in which persons described above have greater than 35% interest
  - Any government official



# ACTS OF SELF-DEALING

- Any sale, exchange, or leasing of property between foundation and disqualified person.
- Any lending of money or other extension of credit between a private foundation and disqualified person.
- Any furnishing of goods, services, or facilities between a private foundation and disqualified person.
- Foundation's payment of compensation to or reimbursement of expenses of a disqualified person.
- Any transfer to, or use by or for the benefit of, a disqualified person or the foundation's income or assets.
- Any agreement to pay money to a government official.



# EXCEPTIONS TO ACTS OF SELF-DEALING

- Lending of money by disqualified person to foundation if interest free and for exempt purposes.
- Leasing of property by disqualified person to foundation if rent free and for exempt purposes.
- Furnishing of goods, etc. by disqualified person to foundation if without charge and for exempt purposes.
- Furnishing of goods, etc. by foundation to disqualified person if on basis no more favorable than available to general public.
- Foundation's payment of reasonable compensation (or reimbursement of expenses) to disqualified person for personal services if necessary to carry out exempt purposes.





# EXCEPTIONS TO ACTS OF SELF-DEALING (CONTINUED)

- Transactions between private foundation and corporation that is disqualified person pursuant to liquidation, merger, redemption, etc. if all securities of same class as foundation's are subject to same terms and such terms provide for foundation to receive FMV.
- Estate administration exception allows certain transactions during estate administration that would otherwise be indirect acts of self-dealing if certain conditions are satisfied.



# DONOR FUNDS

- Post PPA
  - Donor Advised Funds
  - All the others
- Public Charity Contribution Limits
- Limited Donor Control
- Disclaimer planning possible



# DONOR ADVISED FUNDS

- Owned and controlled by a public charity
- Separately identified for a donor
- Donor, or any person appointed or designated by the donor has, or reasonably expects to have, advisory privileges concerning the distribution or investment of the funds.



# DAF LIMITS

- Payments to Public Charities only
- No compensation to disqualified persons
- No incidental benefits to disqualified persons
- No Excess Business Holdings
- No IRA Rollover Gifts



# 2006 PENSION PROTECTION ACT

- IRC Section 4966(d)(d)(2) defined DAFs
- IRC Section 4967 imposing excise on a distribution from a DAF that provides the donor with more than an incidental benefit—something that would reduce the charitable deduction if provide by charity to donor for a gift
- IRC Section 4958(c)(2) states that any grant, loan, compensation or similar payment from DAF to donor is automatic excess benefit



# NOTICE 2017-73

- Proposes to issue regulations to implement provisions of 2006 Pension Protection Act Impacting DAFs
- Gives some guidance and requests comments for
  - Payment splitting with quid pro quo gifts
  - Payment of pledges
  - Treating DAF payments as public support
  - Private Foundations contributing to DAFs



# **GALA TICKETS AND MEMBERSHIPS**

- Donor pays \$1,000 to charity. Donor receives dinner worth \$100. Donor can claim deduction for \$900
- Clearly DAF could not pay the \$1,000 with donor getting the \$100 dinner under IRC Section 4967
- Could DAF pay \$900 and donor pay \$100?
- IRS said no in PLR 9021066 related to private foundations
- IRS believes getting to attend event is a benefit above and beyond the monetary value of the dinner.
- Notice 2017-73 applies same logic to DAF
- IRS says same logic applies to splitting payment for memberships that have taxable benefits.



# POSSIBLE RESPONSES

- IRS—Donors can go to galas and pay for memberships without involving DAFs
- Look for ways to bifurcate on charity side:
  - Have one or two levels of tickets with all of the non-deductible portions and additional recognition packages that do not have a quid pro quo—ad journal, table location etc.
  - Have a few memberships with all the benefits with value and then other societies etc. that confer benefits without value that has to be counted as quid pro quo.





# PAYMENT OF ENFORCEABLE PLEDGES

- Treas. Reg. Sec. 53.4941(d)-2(f)(1) prohibits payment to disqualified person's enforceable pledge by a PF
- DAFs are not subject to the self-dealing rules, but most did not pay out of concern under 4958 and 4967
- IRS focuses on and limits its ruling to 4967
- IRS acknowledges it is difficult to determine whether a pledge is enforceable.
- IRS notes that a donor's relationship to a PF is much closer than the relationship to a DAF



# **DON'T ASK DON'T TELL: DAF CAN PAY PLEDGE**

- IRS says it will not be more than an incidental benefit if a DAF payment is applied to an enforceable pledge if:
  - DAF sponsor does not refer to pledge when making payment
  - Donor receives no other benefit that is more than incidental
  - Donor does not attempt to claim a deduction for payment from DAF even if charity sends a receipt to donor



# DEALING WITH PLEDGES

- Is there a fiduciary or AG issue with applying undesignated payment to pledge?
- DAF—don't reference anything other than identifying the DAF donor. Referencing a named fund or program might be a reference to a gift agreement.
- Possible to include language in gift agreements that DAF payments are to be applied to gift commitment. This can be added to existing agreements.
- Consider a general policy of applying DAF payments to pledges.
- Don't use enforceable pledges if you don't need to—still an issue with a PF.



# OTHER ISSUES IN THE NOTICE

- IRS proposes to treat payments from DAFs as gift from donor, not general public support.
  - DAF payments help publicly supported public charities.
- IRS asks for comments on
  - Use of DAFs generally by PFs
  - A time limit for redistribution if a PF makes a grant to a DAF to satisfy its minimum distribution requirement



# OTHER DONOR FUNDS

- **Scholarship Funds**
  - Objective criteria
  - Charitable class
  - Non-discriminatory
  - Donor cannot be majority of selection that must be chosen by charity
- **Designated Funds**
- **Field of Interest Funds**
- **Multiple Donor Funds**



# OTHER DONOR FUNDS

- No excess business holding limit
- IRA Rollover and Other General Public Charity Rules Apply
- May make payments to individuals for charitable purposes.



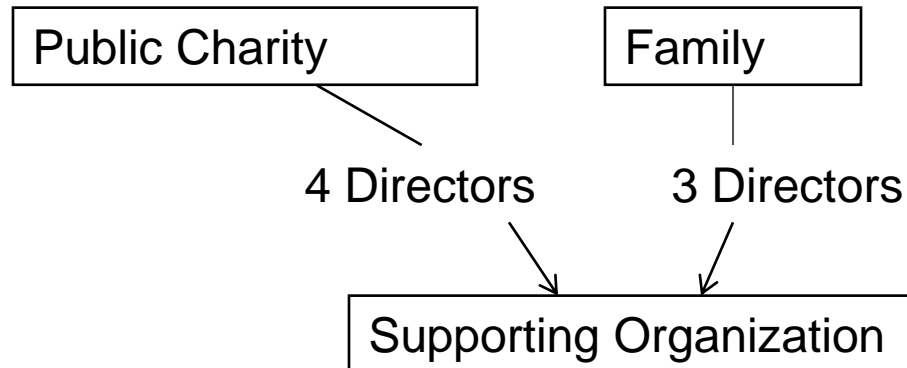
# SUPPORTING ORGANIZATIONS

- Must identify by name or by class supported public charities
- Must distribute exclusively to or for the benefit of the supported charities
- Must not be controlled by disqualified persons
- Cannot get IRA gifts
- Classified by Relationship to Public Charity Type I, II or III
- Automatic Excess Benefit Limit Applies



# TYPE I SO

- **Controlled by: public charities appoint majority of the board**
  - One or more public charities
  - Not every supported charity has to appoint
  - Current IRS Policy, one charity must appoint majority of board





# TYPE II SO

- Controlled in connection with: overlapping board members
- Must be complete overlap at board level
- Not typically used by donors



# TYPE III SO

- Operated in connection with
- Must meet
  - Responsiveness test and
  - Integral part test
- Responsiveness is met if there is some overlap in officers, directors or staff—PPA eliminated enforceable trust rule



# TYPE III SO: NOTIFICATION REQUIREMENT

- SO must provide annually to each of its supported organizations:
  - written notice describing type and amount of support provided by the SO during the preceding taxable year,
  - copy of SO's Form 990 or Form 990EZ that was most recently filed as of the date the notification is provided, and
  - copy of SO's governing documents, as most recently amended, to the extent not already provided.
- Information must be postmarked or electronically transmitted by last day of fifth month of taxable year after taxable year in which SO provided the support it is reporting.



# TYPE III SO: RESPONSIVENESS TEST

- SO meets test with regard to each supported organization if:
- the supported organization is *adequately represented* in the governing body of the SO because:
  - supported organization may appoint at least one officer, director or trustee of SO or
  - at least one member of governing body of supported organization also serves as officer, director or trustee of SO or



# TYPE III SO: RESPONSIVENESS TEST

- the officers, directors or trustees of SO and supported organization maintain a “close and continuous” working relationship and
- because of this relationship, the supported organization has a significant *voice* on how the SO manages and uses its assets.



# FI TYPE III SO: INTEGRAL PART TEST

- Functionally integrated SO meets test if it satisfies one of three tests.
- **Activities Test**
  - Direct Furtherance Prong: substantially all of SO's activities must be *direct furtherance* activities, that is, those conducted by the SO itself and not the supported organization(s). Fundraising, managing non-exempt use assets, grant making to organizations, and grant making to individuals (unless certain requirements are met) are not direct furtherance activities.



# FI TYPE III SO: INTEGRAL PART TEST

- **Activities Test**

- But For Prong: substantially all of the SO's activities must be activities in which, *but for* the SO's involvement, the supported organization would normally be involved.
- Examples include holding and managing facilities used by a church for its religious purposes, operating food pantries for a group of churches that normally would operate these food pantries themselves, and maintaining local parks for a community charity that normally would maintain those parks.



# FI TYPE III SO: INTEGRAL PART TEST

- **Parent of Supported Organizations Test**
  - Governance Prong: SO must have power to appoint a majority of the officers, directors or trustees of each of its supported organizations.
  - Substantial Degree of Direction Prong: SO and supported organizations must be part of integrated system and SO must perform activities typical of parent of integrated system, such as coordinating activities of supported organizations and engaging in overall planning, policy development, budgeting, and resource allocation for supported organizations.





# FI TYPE III SO: INTEGRAL PART TEST

- **Supporting a Governmental Entity Test**

- “governmental supported organization” (GSO) is a governmental unit described in Section 170(c)(1), or an organization described in Sections 170(c)(2) and (b)(1)(A) (other than clauses (vii) and (viii)) that is an instrumentality of one or more governmental units described in Section 170(c)(1).
- SO can support more than one GSO if all of its GSOs either operate within the same geographic area or work in close coordination or collaboration with one another to conduct service, program, or activity the SO supports.

Notice 2014-4 provides interim guidance.



# FI TYPE III SO: INTEGRAL PART TEST

- **Supporting a Governmental Entity Test**
  - To satisfy close coordination or collaboration requirement, SO must maintain on file a letter from each GSO (or joint letter from all) describing such collaborative or cooperative efforts; and
  - Substantial *part* of SO's activities must directly further the exempt purposes of its GSOs.
  - Notice 2014-4 provides additional interim guidance.



# NFI TYPE III SO: INTEGRAL PART TEST

- Non-functionally integrated SO meets test if it satisfies two requirements.
- **Distribution Requirement.** SO must distribute its “distributable amount” each year to one or more of its supported organizations.
  - distributable amount equals the greater of (1) 85% of SO’s adjusted net income for prior taxable year, and (2) 3.5% of the aggregate fair market value of SO’s non-exempt-use assets, with certain adjustments.
  - Distribution amount is not reduced by taxes imposed on UBTI.



# CONCLUSION

- Understand donor's needs
  - Intended activity
  - Funding sources
  - Staffing
  - Succession planning
- Recommend PF, DAF, Fund or SO that best fits the need.

