Administrative Risks with Foundations/Endowments

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Overview of Presentation

- Introduction
- Under-distributions in Private Foundations
- Foundations and Discretionary Distributions
- Endowments and Investments
- Questions

Under-distributions in Private Foundations

- IRC ∫4942 (a.k.a. "The 5% Rule"): Annual qualifying disbursements must be at least 5% of the fair market value of non-charitable use assets (minimum investment return)
- Penalty for failing to distribute the required amount: 30% of the amount that should have been distributed
- There is a 12 month grace period to distribute any undistributed amount from the prior year

Under-distributions in Private Foundations (continued)

- A private foundation may carry forward, for up to five years, any qualifying disbursements above the minimum distribution amount
- Calculating distribution amount annually vs. "catching up" the next year
- Related Topic: Overpayments in Charitable Remainder Unitrusts
  - the trust could lose its charitable status if overpayment is not corrected within one year

Part XIII Undistributed Income (see instructions)

	(a) Corpus	(b) Years prior to 2011	(c) 2011	(d) 2012
1 Distributable amount for 2012 from Part XI, line 7				425,026.
2 Undistributed income, if any, as of the end of 2012:				
a Enter amount for 2011 only			381,038.	
b Total for prior years: 20 10 , 20____, 20____		NONE		
3 Excess distributions carryover, if any, to 2012:				
a From 2007 . . . . . . NONE				
b From 2008 . . . . . . NONE				
c From 2009 . . . . . . NONE				
d From 2010 . . . . . . NONE				
e From 2011 . . . . . . NONE				
f **Total** of lines 3a through e	NONE			
4 Qualifying distributions for 2012 from Part XII, line 4: ▶ $ 408,764.				
a Applied to 2011, but not more than line 2a			381,038.	
b Applied to undistributed income of prior years (Election required - see instructions)		NONE		
c Treated as distributions out of corpus (Election required - see instructions)	NONE			
d Applied to 2012 distributable amount				27,726.
e Remaining amount distributed out of corpus	NONE			
5 Excess distributions carryover applied to 2012 *(If an amount appears in column (d), the same amount must be shown in column (a).)*	NONE			NONE
6 **Enter the net total of each column as indicated below:**				
a Corpus. Add lines 3f, 4c, and 4e. Subtract line 5	NONE			
b Prior years' undistributed income. Subtract line 4b from line 2b		NONE		
c Enter the amount of prior years' undistributed income for which a notice of deficiency has been issued, or on which the section 4942(a) tax has been previously assessed		NONE		
d Subtract line 6c from line 6b. Taxable amount - see instructions		NONE		
e Undistributed income for 2011. Subtract line 4a from line 2a. Taxable amount - see instructions				
f Undistributed income for 2012. Subtract lines 4d and 5 from line 1. This amount must be distributed in 2013				397,300.

Discretionary Distributions

- Discretion over who to pay vs. how much to pay
- Determine approvals required: Bank only, Board of Trustees, or both
- Policies and Procedures
- Conflict of Interest: Employees as Board Members

Endowments and Investments

- The Board's investment policy statement
  - How much of the endowment's return should be spent and how much reinvested
  - The extent to which the operating budget should be supported by the endowment
  - Overall investment strategy
  - Responsibility for investment decisions

Endowments and Investments (continued)

- Current needs of the institution vs. the obligation to preserve the endowment
- The endowment must currently warn a total return equal to the spending rate, plus inflation, plus the cost of managing the endowment's funds
- Uniform Prudent Management of Institutional Funds Act (UPMIFA)

HIGHLIGHTS

- **Investment freedom.** Portfolio managers are not limited in the kinds of assets that may be sought for the portfolio. (Broader than UMIFA)

- **Costs.** Costs must be managed prudently in relationship to the assets, the purposes of the institution and the skills available to the institution. (Not addressed in UMIFA)

- **Expenditure of funds.** Total return expenditure is expressly authorized under comprehensive prudent standards relating to the whole economic situation of the charitable institution. (UMIFA does not address this standard)

- **Historic dollar value abolished.** UPMIFA abolishes the historic dollar value limitation on expenditure in UMIFA.

- **Seven percent rule.** States may adopt an optional rule that presumes expenditure exceeding 7% of total return is imprudent.

- **Release of restrictions for small institutional funds.** UPMIFA provides new procedures for releasing restrictions on small institutional funds (less than $25,000) held for a long period of time (20 years), requiring only notice to the Attorney General 60 days in advance of the release. (Not addressed in UMIFA)

- **Application.** UPMIFA applies to funds held in any form, including nonprofit corporate form, except charitable trusts, with a commercial or individual trustee. (UMIFA applies only to endowments held by a charitable institution for its own account.)

Endowments and Investments (continued)

- Remember the Bank's Capacity

  - As Agent, Bank should only take direction from current authorized signers

  - Refrain from making accommodations for the client

QUESTIONS???

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