

Disclosures of Endowments & DAFs

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Endowments – Slides 2-12
Donor-Advised Funds – Slides 13-27

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Accounting for Endowments (a Background Toddler-Primer) – 1 of 4

- CAVEAT: This session is not “about” either accounting for endowments *per se* or responsibilities under UPMIFA, but GAAP and UPMIFA principles guide financial disclosure and fiduciary responsibilities, respectively
- Historically, endowments had been managed as INDIVIDUAL Funds (not pooled) AND for yield rather than for return
 - yield looks at amount investment earns during a time period; return looks at how much an investment earns or loses over time
 - yield is forward-looking; return is backward-looking
- Ford Foundation leads attack on managing for yield. That leads to Model UMIFA law NCCUSL approves in 1972 and recommends to states. UMIFA requires NPOs:
 - Spend \$\$s from endowments prudently (diversify investments for growth + income); and
 - Maintain inviolate AND in perpetuity the asset’s historical value
 - \$15M gift 120 years ago worth \$700M today? Under UMIFA that DELTA CAN BE SPENT
 - Stock market crash 1973-1978 spurs states’ adoption of UMIFA

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Accounting for Endowments (a Background Toddler-Primer) – 2 of 4

- UPMIFA eventually comes about as limitations of UMIFA register.
 - ELIMINATES concept of historic value and the need for spending floors
 - Appropriation of funds for expenditure is to be guided by prudent look at circumstances IN TOTAL
 - Endowment funds can be pooled, but still have to look at fund-by-fund
 - Underwater funds have to appear in financial statements
 - Endowments (donor-created “endowments”, i.e., not Board-created “quasi-endowments”) must:
 - (1) provide NPO-owner with annual financial support (SPENDING POLICIES re what %-age of the fund’s market value will be appropriated are thus required!)
 - (2) the spending policy’s appropriation amount must be supported by an investment policy commitment that recognizes generational equity (i.e., the amount of support provided by the fund in future years is to be “as valuable” as the amount of support provided today)

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Accounting for Endowments (a Background Toddler-Primer) – 3 of 4

- UPMIFA was approved by NCCUSL in 2006 and has been enacted in all states except for Pennsylvania (which has its own law), D.C., and the U.S. Virgin Islands. Several states enactments having revised one or more specific provisions.
 - Seven criteria “guide” the NPO in its yearly expenditure decisions
- FASB FSP 117-1 and now ASC 958-205-05 require NPOs subject to UPMIFA to classify portion of perpetual donor-restricted endowment fund as permanently restricted net assets
 - “Historical dollar value” continues, for practical purposes, to be classified as permanently restricted with appreciation classified as temporarily restricted under “old GAAP” (pre-**ASU 2016-14**); current GAAP of course merges permanently and temporarily restricted fund \$\$s into one class (see next slide)
- FASB has mandated extensive disclosures for all endowment funds
 - Board’s interpretation of the lies that underlie their net asset class classification
 - Description of the NPO’s spending and investment policies
 - The composition of, and changes in, endowment net assets

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Detour: Comparing Net Asset Classes Once ASU 2016-14 Implemented

| | | | |
|--|---|--|--------------------|
| OLD GAAP Had Three | 1-Unrestricted | 2-Temp. Restricted | 3-Perm. Restricted |
| Revised GAAP | 1st = <u>Without Donor Restrictions</u> * | 2nd = <u>With Donor Restrictions</u> * | |
| With These Required Disclosures ** | Amount, purpose, and type of board designations ** | Nature and amount of donor restrictions | |

* NFPs may choose to disaggregate further

** Didn’t exist under PRIOR GAAP

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Accounting for Endowments (a Background Toddler-Primer) – 4 of 4

- **UNDERWATER ENDOWMENTS – additional disclosures and compliance issues**

FASB Glossary definition: “Underwater” status exists when donor-restricted endowment fund’s fair value of the fund at the reporting date is less than **either** *the original gift amount* **or** *the amount required to be maintained by the donor or by law that extends donor restrictions*

- Disclosure requirements mandate that for each period a statement of financial position is presented, each of the following need be presented, in the aggregate, for all underwater endowment funds:

- ❖ The fair value of the underwater endowment funds
- ❖ Original endowment gift amount or level required to be maintained by donor stipulations or by law that extends donor restrictions
- ❖ Amount of the deficiencies of the underwater endowment funds

- **AGENCY ENDOWMENT FUNDS – *not pertinent to our topic here at all***

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Sample Underwater Endowment Footnote (with thanks to Jennifer Becker Harris & Clark Nuber PS)

Underwater Endowment Funds with Deficiencies -

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or the State Prudent Management of Institutional Funds Act requires NFP to retain as a fund of perpetual duration.

Deficiencies of this nature exist in three donor-restricted endowment funds, which together have an original gift value of \$14,500, a current fair value of \$13,416, and a deficiency of \$1,084 as of December 31, 20X1.

These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new contributions for donor-restricted endowment funds and continued appropriation for certain programs that was deemed prudent by the Board of Directors.

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Agency Endowment Funds (a/k/a Organization Endowment Funds)

- The HOLDER (who is typically a Community Foundation, thus “CF”) is the legal owner of the funds raised for or transferred to the CF *by the benefiting organization* (“NPO”).
- Since 1999, SFAS No. 136, “Transfers of Assets to a Not-for-Profit Organization or Charitable Trust that ... Holds Contributions for Others”, now codified as FASB ASC 958-605 (principally in sections 15 and 25), rules. Its premises are two-fold:
 - The NPO who is the benefiting agency reports *on its books* the assets of the endowment (which thus are included in the NPO’s net assets)
 - The CF *on its books* reports the assets but with an offsetting entry that is classified *as a liability to the NPO*. Those entries of course “wash” the result to \$-0- net assets!
- Much confusion arises for NPOs as to their reporting obligations and even as to WHO is the legal owner of the funds (clear answer: THE CF!) The analogy here is to a “Trust-Trustee” relationship **and thus the \$\$’s are not an “endowment” of the CF.**
- For 990 purposes, assuming the CF serves as “agent” for the Endowment Fund, the CF would report these funds as escrow or custodial accounts on Schedule D, Part IV.

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990 Reporting: Schedule D, Part V – Endowment Funds

How donor-restricted “endowments” (as opposed to “quasi-endowments”) are presented in Schedule D’s Part V were altered as of the 2019 Form 990 in light of the changes in FASB’s Not-for-Profit Topic (ASC 958) effected for years ended after 12/15/2017. The two “bucket” choices (noted earlier on slide 20) track these Glossary definitions:

Net assets with donor restrictions

Includes **endowment funds** established by donor-restricted gifts that are maintained to provide a source of income for either a specified period of time or until a specific event occurs (see **ASC 958-205-45**), as well as all other temporarily restricted net assets held in a donor-restricted endowment, including unappropriated income from **permanent endowments** that isn’t subject to a permanent restriction. After Accounting Standards Update 2016-14, **ASC 958** uses two classifications, instead of three—net assets with donor restrictions and net assets without donor restrictions. **ASC 958** no longer uses the term “temporarily-restricted endowment.”

The part of net assets of a not-for-profit entity that is subject to **donor-imposed restrictions**.

Net assets without donor restrictions

Part of net assets of a not-for-profit entity that is not subject to **donor-imposed restrictions**.

As to the specific “categories” of reporting for endowment in Schedule D, Part V, let’s look at both the trigger question to this Part (below) and then the Part itself (next slide) –

- 10 Did the organization, directly or through a related organization, hold assets in donor-restricted endowments or in quasi endowments? If “Yes,” complete Schedule D, Part V

Noting the instructions to the Core Form’s Balance Sheet, Part X, regarding “Net Assets and Fund Balances” is helpful here AS IS THE Glossary definition of “Endowment Fund”

Net Assets and Fund Balances

FASB Accounting Standards Codification 958, Not-for-Profit Entities (**ASC 958**) provides standards for external financial statements certified by an independent accountant for certain types of nonprofit organizations. ASC 958-10-15-5 doesn’t apply to credit unions, voluntary employees’ beneficiary associations, supplemental unemployment benefit trusts, section 501(c)(12) cooperatives, and other member benefit or mutual benefit organizations.

While some states may require reporting according to FASB ASC 958, the IRS doesn’t. However, a Form 990 return prepared according to ASC 958 will be acceptable to the IRS.

Organizations that follow ASC 958. If the organization follows ASC 958, check the box above line 27, and complete lines 27 through 28 and lines 32 and 33. Classify and report net assets in two groups in Part X (unrestricted, donor-restricted) based on the existence or absence of donor-imposed restrictions and the nature of those restrictions. Enter the sum of the two classes of net assets on line 32. On line 33, add the amounts on lines 26 and 32 to show total liabilities and net assets. The amount on line 33 must equal the amount on line 16.

CAUTION Effective for reporting years ending after December 15, 2017, ASC 958-205, Not-for-Profit Entities—Presentation of Financial Statements (**ASC 958**), addresses reporting of donor-restricted endowments and board-designated (quasi) endowments. Further, most states have enacted the Uniform Prudent Management of Institutional Funds Act (UPMIFA). If the organization is subject to UPMIFA or **ASC 958**, it may affect the amounts reported on lines 27 through 28.

Endowment Fund

An established fund of cash, securities, or other assets to provide income for the maintenance of a not-for-profit entity. The use of the assets of the fund may be with or without donor-imposed restrictions. Endowment funds are generally established by donor-restricted gifts and bequests to provide a source of income perpetuity or for a specified period. Alternatively, a not-for-profit’s governing board may earmark a portion of its net assets (see **Quasi-endowment**).

Schedule D, Part V's Reporting "Buckets" (Line 2's a-c)

The 990 Instructions set out "**Quasi-Endowment**" as a Glossary Term; the Schedule D instructions define "**Permanent Endowment**" and further "flesh out" the Glossary definition of "Term Endowment" via verbiage highlighted all extracted here in support of Part V line 2 reporting:

- 2 Provide the estimated percentage of the current year end balance (line 1g, column (a)) held as:
- a Board designated or quasi-endowment ▶%
 - b Permanent endowment ▶%
 - c Term endowment ▶% THRU 2018 FORM 2c WAS LABELED "TEMPORARILY RESTRICTED" ENDOWMENT
- The percentages on lines 2a, 2b, and 2c should equal 100%.

| | |
|------------------------|--|
| Quasi-endowment | <i>Net assets without donor restrictions designated by an entity's governing board to be invested to provide income for generally a long but not necessarily specified period. A board-designated endowment, which results from an internal designation, is generally not donor-restricted and is classified as net assets without donor restrictions. The governing board has the right to decide at any time to expend such funds. Also referred to as a board-designated endowment.</i> |
|------------------------|--|

| |
|---|
| Permanent endowments are endowment funds that are established by donor-restricted gifts and are maintained to provide a permanent source of income, with the stipulation that principal must be invested and kept intact in perpetuity, while only the income generated can be used by the organization. |
|---|

| |
|--|
| Term endowment includes endowment funds established by donor-restricted gifts that are maintained to provide a source of income for either a specified period of time or until a specific event occurs. |
|--|

| |
|---|
| Term endowment <i>An endowment fund established to provide income for a specified period.</i> |
|---|

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Although the following term is NOT used in the Schedule D instructions, this Glossary definition should be noted:

Donor-Restricted Endowment Fund

An endowment fund created by a donor stipulation (donors include other types of contributors, including makers of certain grants) requiring investment of the gift in perpetuity or for a specified term. Some donors or laws may require that a portion of income, gains, or both be added to the gift and invested subject to similar restrictions.

Schedule D, Part V's Line 1 (presentation of endowment holdings annual changes over 5 years)
 NOTE: Instructions are reprinted in note below

- Line 1b's contributions here are to include "additional funds established by the organization's governing board to function like an endowment" even though these are technically not contributions!
- Line 1c reflects need to be tracking each endowment fund separately (of course here results are reported on aggregate basis). Earnings are generally donor-restricted until appropriated by the Board for expenditure (this is NOT the case for quasi-endowments' earnings as they are unrestricted).
 NOTE: this Schedule D reporting is mark-to-market and will thus likely differ from Core Form Part VIII!

Part V Endowment Funds.

Complete if the organization answered "Yes" on Form 990, Part IV, line 10.

| | (a) Current year | (b) Prior year | (c) Two years back | (d) Three years back | (e) Four years back |
|--|------------------|----------------|--------------------|----------------------|---------------------|
| 1a Beginning of year balance | | | | | |
| b Contributions | | | | | |
| c Net investment earnings, gains, and losses | | | | | |
| d Grants or scholarships | | | | | |
| e Other expenditures for facilities and programs | | | | | |
| f Administrative expenses | | | | | |
| g End of year balance | | | | | |

Line 1a. Enter the beginning-of-year balances of the organization's endowment funds for the current year and prior year. The amounts entered should agree with the organization's total permanent endowment, term endowment, and board or quasi-endowment funds at the beginning of the current year and prior year.

Line 1b. Enter the amounts of current year and prior year **contributions** and transfers to the organization's **endowment** funds. These amounts include all donor gifts, grants, and contributions received, as well as additional funds established by the organization's governing board to function like an endowment, but that can be expended at any time at the discretion of the board.

Line 1c. Enter the current year and prior year net amounts of investment earnings, gains, and losses, including both realized and unrealized amounts. For earnings reported net of transaction costs, enter the net amount on line 1c. For earnings reported on a gross basis, enter the transaction costs on line 1f.

Line 1d. Enter the current year and prior year amounts distributed for grants or scholarships.

TIP Because scholarships represent direct aid to individuals, they are distinguished from general programmatic aid referenced in line 1e.

Line 1e. Enter the current year and prior year amounts distributed for facilities and programs. Amounts on this line should include withdrawn amounts, and amounts disinvested from an organization's **quasi-endowments** to reduce or eliminate capital investment.

Line 1f. Enter the current year and prior year administrative expenses charged to the **endowment** funds. These expenses can arise from either internal or third party sources.

Line 1g. Enter the year-end balances of the organization's **endowment** funds for the current year and prior year. To determine the year-end balances, add lines 1a, 1b, and investment earnings on line 1c, and subtract line 1c investment losses and the amounts on lines 1d through 1f.

Schedule D Part V's Lines 3a/3b and 4

| | | |
|---|---------------|---------------|
| 3a Are there endowment funds not in the possession of the organization that are held and administered for the organization by: | | |
| (i) Unrelated organizations | 3a(i) | Yes No |
| (ii) Related organizations | 3a(ii) | |
| b If "Yes" on line 3a(ii), are the related organizations listed as required on Schedule R? | 3b | |

4 Describe in Part XIII the intended uses of the organization's endowment funds.

Line 3 Instructions are pretty basic! (And Line 4's just repeat what the Form says!)

- NOTE: Lines 3(a)(ii) and 3(b) invigorate need to ensure consistency with Schedule R's disclosure of related organizations!

Line 3. Report information on endowment funds not in possession of the organization.

Line 3a(i). Enter "Yes" if any of the organization's endowment funds are in the possession of and administered by unrelated organizations.

Line 3a(ii). Enter "Yes" if any of the organization's endowment funds are in the possession of and administered by related organizations.

Line 3b. All related organizations are required to be reported on Schedule R (Form 990), Related Organizations and Unrelated Partnerships. Enter "Yes" on line 3b if the organization answered "Yes" to line 3a(ii) and the organization listed all related organizations referred to on line 3a(ii) in Schedule R.

- Filers with agency endowments at a Community Foundation will have a "yes" answer at 3a!

DAFs (Donor-Advised Funds)

DONOR ADVISED FUNDS (& THEIR “SPONSORING ORGANIZATIONS”)

Glossary definition of “donor advised fund” (a/k/a “DAF”)

A fund or account:

1. That is separately identified by reference to **contributions** of a donor or donors;
2. That is owned and controlled by a **sponsoring organization**; and
3. For which the donor or **donor advisor** has or reasonably expects to have advisory privileges in the distribution or investment of amounts held in the donor advised funds or accounts because of the donor's status as a donor.

A donor advised fund doesn't include any fund or account:

1. That makes distributions only to a single identified organization or governmental entity, or
2. In which a donor or donor advisor gives advice about which individuals receive grants for travel, study, or other similar purposes, if:
 - a. The donor or donor advisor's advisory privileges are performed exclusively by such person in his or her capacity as a committee member in which all of the committee members are appointed by the sponsoring organization;
 - b. No combination of donors or donor advisors (and related persons as defined below) directly or indirectly control the committee; and
 - c. All grants from the fund or account are awarded on an objective and nondiscriminatory basis following a procedure approved in advance by the board of directors of the sponsoring organization. The procedure must be designed to ensure that all grants meet the requirements of section 4945(g)(1), (2), or (3); or

Glossary definition of Sponsoring Organization

Any organization which is all of the following:

- Described in section 170(c), other than governmental units described in section 170(c)(1) and without regard to section 170(c)(2)(A);
- Not a **private foundation** as defined in section 509(a); and
- Maintains one or more **donor advised funds**.

3. That the IRS exempts from being treated as a donor advised fund because either such fund or account is advised by a committee not directly or indirectly controlled by the donor or donor advisor or such fund benefits a single identified charitable purpose. For example, see Section 5.01 of Notice 2006-109, 2006-51 I.R.B. 1121, and any future related guidance.

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The Schedule D Part I instructions do little more than restate the Glossary definitions provided above but they do note two additional points that will come in handy:

FIRST – “Donor advised funds aren’t limited to funds or accounts that meet the definition of “funds” under generally accepted accounting principles.”

SECOND – “A person related to a donor or donor advisor includes any family member (as defined in section 4958(f)(4)) of the donor or advisor and any **35% controlled entity (as defined in section 4958(f)(3)) of the donor, donor advisor, or their family members.”**

[The cited Code sections are those that define such terms under the intermediate sanctions excise tax scheme that is the subject of Schedule L’s Part I as there are *specific-to-DAF prohibited excess benefit transactions* defined in the Pension Protection Act of 2006!]

AS TO determining what are “funds or other accounts” that fall outside of the Glossary definition of a DAF, but are – as next slide notes – ALSO the subject of this Part, one must track the numbered exceptions set out in the Glossary definition above –

- (1) A fund whose distributions are dedicated to ONE specific entity;
- (2) A fund meeting the a/b/c conditions, which makes grants to individuals for travel, study, or similar purposes, all of which in a private foundation realm would not be a taxable expenditure within the meaning of Code sec. 4945(d)(3) (this due to Code sec. 4945(g)’s [cited at ‘c’] bootstrap into 4945(d)(3)’s recital of grants comprising those that are made on an objective and nondiscriminatory basis in awarding to individuals: scholarships or fellowships under IRC sec. 117(a); prizes or awards under Code sec. 74(b) when recipients are selected from the general public; or grants whose purpose is to achieve a specific objective, produce a report, or improve the capacities, skills, or talent of the grantee; or
- (3) A fund determined by the IRS to fit (1) or (2) above.

The 990's Schedule D, Part I seeks INFORMATION SOUGHT (1 of 2)

- As shown in excerpt below, this Part's Lines 1 – 4 require filers to report both on glossary-term DAFs (*set out in prior slide*) as well as excepted-from-DAF-classification *similar* “funds and other accounts”!
 - Per the col. (b) instructions, the latter includes any other “fund or account held . . . over which a donor [or donor-appointee] had advisory privileges for distribution or investment” including those EXCEPTED from DAF-definition (again, *see prior slide*), “as well as funds otherwise prescribed by statute as excepted from the meaning of a donor advised fund.”
 - THE ONLY instructions for this Part are brief address of Lines 1 – 4 (*see notes below*)

| Part I Organizations Maintaining Donor Advised Funds or Other Similar Funds or Accounts. Complete if the organization answered “Yes” to Form 990, Part IV, line 6. | | |
|---|--|------------------------------|
| | (a) Donor advised funds | (b) Funds and other accounts |
| 1 Total number at end of year | | |
| 2 Aggregate contributions to (during year) | | |
| 3 Aggregate grants from (during year) | | |
| 4 Aggregate value at end of year | | |
| 5 Did the organization inform all donors and donor advisors in writing that the assets held in donor advised funds are the organization's property, subject to the organization's exclusive legal control? | <input type="checkbox"/> Yes <input type="checkbox"/> No | |
| 6 Did the organization inform all grantees, donors, and donor advisors in writing that grant funds can be used only for charitable purposes and not for the benefit of the donor or donor advisor, or for any other purpose conferring impermissible private benefit? | <input type="checkbox"/> Yes <input type="checkbox"/> No | |

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Line 1. Report in column (a) the total number of **donor advised funds** and in column (b) the total number of other similar funds or accounts held by the organization at the end of the year.

Line 2. Report in column (a) the aggregate value of **contributions** during the year to all **donor advised funds** and in column (b) the aggregate value of contributions during the year to all other similar funds or accounts held by the organization.

Line 3. Report in column (a) the aggregate value of grants made during the year from all **donor advised funds** and in column (b) the aggregate value of grants made during the year from all other similar funds or accounts held by the organization. Report both grants outside the organization and transfers within the organization.

Line 4. Report in column (a) the aggregate value at the end of the year of all **donor advised funds** and in column (b) the aggregate value at the end of the year of all other similar funds or accounts held by the organization.

NOTES

Line 1: it is possible that # of funds in the year differs from # at year end (Line 1).

Lines 2 and 3: It is possible that accrual basis filers will have their aggregate grants FROM each fund (Line 2) be reported in amounts higher than cash actually distributed if grants paid out in filing year had been approved (but not paid) by yearend OR, conversely, impacted in the other direction if grants were actually distributed in the current year but approved in the PRIOR year. Also, contributions TO each fund (Line 3) may be higher than cash received if there were outstanding pledges receivable existing at year end.

Line 4: As evidenced by preceding note, an accrual-basis filer may report a larger or smaller number than the amount of cash it had on hand bAsed upon outstanding pledges receivable or grants payable.

DISTORTED CONCLUSIONS THUS WILL BE DRAWN IN THE ABSENCE OF CASH-BASED REPORTING!

Column (b): The Congressional mandate by which col. (b) data was being sought (i.e., IRS was required to report on such data to Congress – and did so in 2011(!)) has “been met” but the Form still requires this information.

The 990's Schedule D, Part I seeks INFORMATION SOUGHT (2 of 2)

- Lines 5 and 6 relate to statutory mandates imposed by the Pension Protection Act of 2006 – NOTE: Income Tax Regulations have not yet been issued (14+ years and counting – see next slide) on KEY issues here.
- No instructions are provided for either line! Both inquiries relate to TAX LAW mandates that are implicated:
 - Line 5 requires to DAF-sponsor to certify they DO have exclusive legal control of the properties “donated” to the fund. A “no” answer at 5 is a problem!
 - Line 6 raises an obligation both for donor relations and tax law overall (including IRC section 4966 obligations) – a DAF-sponsor can grant funds to any organizations “advised of” by a Donor or Donor/Advisor (hereafter, “Donor/DA”) as long as the grant is *for permissible purposes* and most readily IF the grantee is recognized by the IRS as a public charity!

Part I Organizations Maintaining Donor Advised Funds or Other Similar Funds or Accounts. Complete if the organization answered “Yes” to Form 990, Part IV, line 6.

5 Did the organization inform all donors and donor advisors in writing that the assets held in donor advised funds are the organization’s property, subject to the organization’s exclusive legal control? Yes No

6 Did the organization inform all grantees, donors, and donor advisors in writing that grant funds can be used only for charitable purposes and not for the benefit of the donor or donor advisor, or for any other purpose conferring impermissible private benefit? Yes No

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The Pension Protection Act of 2006 added a new excise tax via Code section 4966, and also added amendments to the “excess benefit transaction”/“intermediate sanctions” Code section 4958 excise tax scheme already in place, all **relating to DAFs!**

Code section 4966 imposes a tax on “taxable distributions” of DAFs via 4966(c)(1) and (2)) as follows:

- (1) The term “taxable distribution” means any distribution from a donor advised fund—
 - (A) to any natural person, or (B) to any other person if—
 - (i) such distribution is for any purpose other than one specified in section 170(c)(2)(B) [basically those are the 501(c)(3) enumerated purposes], or
 - (ii) the sponsoring organization does not exercise expenditure responsibility with respect to such distribution in accordance with section 4945(h).

(2) Exceptions—

Such term shall not include any distribution from a donor advised fund—

- (A) to any organization described in section 170(b)(1)(A) (**other than** a “disqualified supporting organization”) [that term, per 4966(d)(4), picks up all **Type III-nonfunctionally integrated supporting organizations**, as well as any **Type I or II supporting organizations if the donor or any person designated by the donor for the purpose of advising with respect to distributions from a donor advised fund (and any related parties) directly or indirectly controls any supported organization** of the supporting organization]
- (B) to the sponsoring organization of such donor advised fund, or
- (C) to any other donor advised fund.

Code section IRC 4958(c)(2) sets out that **ANY grant, loan, compensation, or other similar payment from a donor-advised fund to a person that with respect to such fund is a donor, donor advisor, or a person related to a donor or donor advisor automatically is treated as an excess benefit transaction under section 4958, with the entire amount paid to any such person treated as the amount of the excess benefit.**

DAFs ARE CONTROVERSIAL!

- **Tons of Public Policy Issues and Debate**

- Should they be subjected to mandatory minimum payout percentages?
- A DAF donor-advisors' "gifts" count as public support – so a sole DAF can be an entity's only revenue stream and they would be 100% "publicly supported"
- Should private foundations be able to make gifts to DAFs (or set up their own)?
- Donor control/benefit issues are hard to police (see upcoming slides on PPA 2006 excise tax scheme that attempts to do so)
- To what extent should sponsoring organizations be entitled to limit permissible grantees?
- Role of DAFs in granting funds to impact investing is uncertain

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I have further info I can share as necessary in response to your questions on the above topics!
As to the MONSTOUS size of this arena . . .

Total grant dollars awarded through donor-advised funds in 2020 increased 27 percent on a year-over-year basis, to \$34.67 billion, a report from the [National Philanthropic Trust](#) finds. Based on data from 976 DAF-sponsoring organizations, including fifty-five national charities, 603 community foundations, and 318 single-issue charities, the [2021 DAF Report](#) found that total contributions to DAFs increased 20.6 percent, to \$47.85 billion, or 10.1 percent of total estimated charitable giving in the United States last year. Total charitable assets held [again, at end of 2020] in DAFs grew 9.9 percent, to \$159.83 billion; the number of DAF accounts rose 16.3 percent, to more than a million; and the payout rate ticked up from 22.3 percent in 2019 to 23.8 percent in 2020, while the average size of DAF accounts declined 5.5 percent, to \$159,019. By comparison, approximately ninety thousand independent foundations awarded grants totaling \$63.6 billion, up 17 percent on a year-over-year basis, and held \$1.1 trillion in charitable assets, up 10 percent.

According to the report, national charities sponsored 864,099 DAF accounts in 2020 — an increase of 20 percent from 2019 — which awarded grants totaling \$21.17 billion, an increase of 23.2 percent, with contributions totaling \$33.26 billion, up 18.7 percent; assets totaling \$100.15 billion, up 12.9 percent; a payout rate of 23.9 percent, up slightly from 23.7 percent; and an average account size of \$115,901, down 5.9 percent. Community foundations sponsored an estimated 84,334 DAF accounts, up 0.4 percent, which awarded grants totaling \$8.29 billion in 2020, a 33.7 percent increase, with contributions totaling \$9.64 billion, a 41.5 percent increase; assets totaling \$45.84 billion, up 9.5 percent; a payout rate of 19.8 percent, up from 17.1 percent; and an average DAF account size of \$543,553, up 9 percent. And single-issue charities sponsored an estimated 56,666 DAF accounts, up 5.3 percent, which awarded grants totaling \$5.21 billion in 2020, an increase of 33.6 percent, with contributions totaling \$4.95 billion, up 1.6 percent; assets totaling \$13.84 billion, down 6.9 percent; a payout rate of 35 percent, up from 29.1 percent; and an average DAF account size of \$244,238, down 1.8 percent.

DAF Excise Taxes

- Topic here is still a “work in progress” (as noted before, no Notice of Proposed Rule-making yet – as of 5/9/2022— been issued on DAFs in the now-almost 16 years since PPA-2006 enactment!)
- **IRC section 4966’s** excise tax reaches “taxable distributions,” imposing a 20% tax on the DAF-sponsor and potentially a 5% tax (capped at \$10k) on fund managers and on the recipient.
- In addition, excise tax is imposed under **IRC section 4967** on a Donor/DA who has advised a DAF distribution that *provides more than incidental benefit to either a Donor/DA, or a related party of a Donor/DA*. This excise tax is **NOT** minor: *125% tax (measured based on the value of the benefit provided to the Donor/DA); and potentially a 10% tax on fund managers.*
- What IS “more than incidental benefit” to a Donor/DA or their related parties? : **Notice 2017-73, “Request for Comments on Application of Excise Taxes With Respect to Donor Advised Funds in Certain Situations”** comments on “fixing” various arenas IRS that are potentially problematic.

9 Sponsoring organizations maintaining donor advised funds.

| | | | |
|----------|--|-----------|--|
| a | Did the organization make any taxable distributions under section 4966? | 9a | |
| b | Did the organization make a distribution to a donor, donor advisor, or related person? | 9b | |

The 990 Core Form, at Part V, Line 9a asks if the filer has made any taxable distributions during the tax year, which relates to Code section 4966’s excise tax (addressed in *prior slide’s notes!*). **The instructions to 9a note that a yes answer requires filing of Form 4720, Schedule K, to calculate and pay the tax.** And Line 9b asks if the filer has made a distribution to any Donor/DA or any related person to any Donor/DA.

As noted in the slide here, were a “yes” answer obtained to 9b AND the distributions had been advised by any Donor/DA and one that conveyed “MORE THAN INCIDENTAL BENEFIT,” the Donor/DA who so advised that distribution, and the beneficiary of the distribution is liable for 4967 TAX!

As to 4958 liability (addressed in *prior slide’s notes*), the instruction for Line 9b (below) notes, in the 2nd paragraph of its “CAUTION,” that distributions to a Donor, DA, family member of any Donor/DA, or 35% controlled entity of one or more of these persons “may” (should the IRS show up!) be an “excess benefit transaction” as 4958(c)(2)AUTOMATICALLY treats grants, loans, compensation, or similar payments to any of the aforementioned PARTIES as excess benefit transactions!

Line 9b. Answer “Yes” if the organization made a distribution from a **donor advised fund** to a donor, **donor advisor**, or related person during the organization’s **tax year**. For purposes of this question, a *related person* is any **family member** of the donor or donor advisor and any **35% controlled entity** (as defined in section 4958(f)) of the donor or donor advisor. If “Yes,” complete and file Form 4720, Schedule L.

tax (because none is DUE from the DAF’s sponsoring organization), but the filer is required to file the 4720 to inform the IRS of the fact of the distribution, including “whether or not it provided 4967-prohibited benefit.”



If an organization makes a distribution from a donor advised fund resulting from the advice of a donor, donor advisor, family member, or a 35% controlled entity of any of these persons, which distribution directly or indirectly provides a more than incidental benefit to one of such persons, section 4967 imposes a tax on (1) the person upon whose advice the distribution was made, (2) the beneficiary of the distribution, and (3) the fund manager for knowingly agreeing to make the distribution. The persons liable for the section 4967 tax must file Form 4720 to pay the tax. No section 4967 tax will be imposed on a distribution if a tax has been imposed for the distribution under section 4958.

If an organization makes a distribution from a donor advised fund to a donor, donor advisor, family member, or 35% controlled entity of these persons, then the transaction might be a section 4958 transaction. Such transactions include any grant, loan, compensation, or other similar payment to these persons, as well as any other payment resulting in excess benefit.

Notice 2017-73, issued Dec 2017: SOLE Quasi-Guidance on Reach of DAF Excise Taxes Since Their August 2006 Enactment

- Describes three arenas in which issues involving distributions that may result in benefit to (or abuse by) a Donor/DA should be addressed:
 1. Sole-payment by DAF OR bifurcated payments from a DAF and its Donor/DA to a charity that provides tickets to an event that will be used by Donor/DA
 2. Donations that satisfy a Donor/DA's charitable pledge
 3. Describes changes being considered to the public support test for charities receiving distributions from DAF sponsoring organizations to address concerns of that DAFs are used to circumvent the private foundation rules (i.e., are "contribution laundering")
- The Notice requested comments on the above three issues and also on use of DAFs by private foundations overall! Comments were largely supportive of changes 1 and 2; and everyone hated 3!

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Notice 2017-73 Provides PROPOSED Answers –

1st: On Whether a "Bifurcated Donation" Methodology Avoids Incidental Benefit – Treasury Position (for now) is: "NO, IT DOES NOT!"

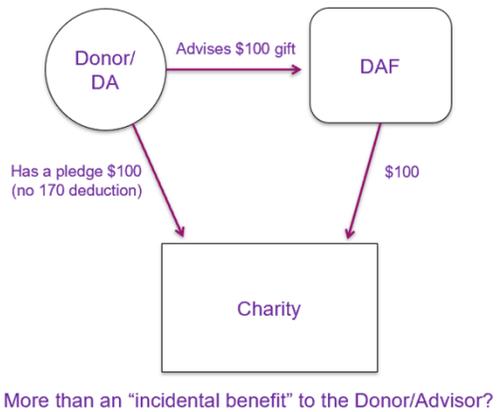


- Notice indicates that DAF payment of **any portion** of the price for a ticket to a charity-sponsored event = "**more-than-incidental**" benefit to the Donor, thus to be subject to excise tax
- Similarly, a DAF distribution to a charity that pays the deductible portion of a membership fee, enabling the Donor to get the benefits of membership by paying only the non-deductible portion, would be a "more-than-incidental" benefit to the Donor.

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2nd: On Whether DAF MAY SATISFY Donor's Pledge with No Incidental Benefit – Treasury Position is Conditional YES (for now)



Distributions from a DAF to a charity do not provide more than incidental benefit to a Donor/DA merely because the Donor/DA has made a charitable pledge to the same charity, **SO LONG AS:**

- DAF sponsor makes no reference to the pledge when making the DAF distribution;
- Donor/DA receives no other benefit, directly or indirectly, that is more than incidental; and
- Donor/DA does not claim a charitable contribution deduction for the DAF distribution **(even if the charity erroneously sends the Donor/DA a written acknowledgment).**

3rd: Proposing Public Support Testing Be Altered to Prevent “Contribution Laundering” In Favor of Accessing Existing Law’s Benefits re Gifting to DAF vs. PF



- 501(c)(3) recipient is a private foundation
- PF has annual distribution requirement overall
- PF's contribution to grantee will be subject to 2% PST-limitation (because PF is not 509(a)(1)/170(b)(1)(A)(vi)-PC)
- **Donor deduction = property's basis (with 20% AGI limit!)**



- 501(c)(3) recipient is a 509(a)(1)/170(b)(1)(A)(vi)-PC
- DAF has no annual distribution requirement
- DAF's contribution to grantee is 100% public support to the grantee, regardless of Donor/DA's relationship to that grantee
- **Donor deduction = property's FMV (with 30% AGI limit!)**

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Notice indicated distributions from a DAF would be considered indirect contributions from a Donor for purposes of the donee charity's public support test, rather than 100% public support from the sponsoring organization.

Distributions from a sponsoring organization would be 100% public support only if the sponsoring organization indicates that the distribution was not advised by a Donor from a DAF.

Charity must treat all anonymous contributions as being made by one person (including all DAF distributions without identified donors).

Donee organizations would need more information from a sponsoring organization in order to treat grants as unlimited public support!

NOTE: public's comments on this proposed change were UNIFORMLY NEGATIVE!

Examples of Other Practices Violative (or Not) of IRS Sections 4966 & 4967

- Donor/DA pledges to provide support to a charity via the DAF and receives personal benefits back via:
 - “Raising the paddle” at a fundraising event *or* “add to the table’s pledge cards” **IS OKAY** (i.e., not subject to excise tax) **IF** it is specifically stated by the Donor/DA that their paddle raise or pledge card is not for them personally, but is in favor of them “recommending” such a \$\$-distribution be made the DAF **NOTE: if condition here not met, the Donor/DA has MADE A PERSONAL PLEDGE!**
 - It’s **NOT OKAY** for Donor/DA to:
 - ❖ Have a DAF satisfy their personal pledge if violate conditions noted in slide 9
 - ❖ Have use of or otherwise access to tickets (including transfer to others) purchased by the DAF for an annual dinner [see slide 8].
 - ❖ Same applies *to all quid pro quo exchanges* (for example, via bidding on auction item) – access to exchanged goods/services NOT okay if Donor/DA to “pays for” their FMV!

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Proposals in U.S. Dept. of Treasury’s “Green Book” of FY2023 Tax Proposals re “Fixing” Some of DAF’s Foibles

Released on March 28, 2022, the Green Book *takes aim at private foundations making gifts to DAFs in two ways:*

1. It would not allow such payments to be accorded a “qualifying distribution” under the Chapter 42 excise tax rules *unless*:
 - The recipient DAF expended the donated dollars in accord with what constitutes a PF-“qualifying distribution” by end of the following tax year; and
 - The private foundation-donor maintains adequate books and records or other evidence showing the DAF has made a qualified distribution within the required timeframe set out above.

2. Prohibiting private foundations from setting up DAFs!

NOTE: the effective date for any such legislation would be the day AFTER enactment.

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Congressional Action on DAFs Looms Too: the “ACE Act”

Senate Bill S. 1981

- ❖ Introduced June 9, 2021
- ❖ Co-sponsored by Senators King (I-ME) and Grassley (R-IA)
- ❖ Read into Senate Finance Committee
- ❖ No further legislative action taken to date (as of end of April 2022)

House Bill H.B. 6595

- ❖ Introduced February 3, 2022
- ❖ Co-sponsored by Congresspersons Pingree (D-ME), Reed (R-NY), Khanna (D-CA), and Porter (D-CA).
- ❖ Bill was referred to the House Ways and Means Committee

- If Bills are approved by both chambers, there is a clear path to passage as there is no need for reconciliation between the two Bills
- The President can sign and both parties can claim a win for working on bipartisan effort to move charitable dollars into the public sector

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How the Accelerating Charitable Efforts Would Impact on DAFs

This legislation would overcome the most common criticism of this sector (which at end of 2020 held just UNDER \$160 BILLION in hand for future charitable gifts):

that DAFs can accept and hold charitable donations that have generated a federal income tax deduction for the donor, but those resources can sit and never be paid out toward to charitable work. It would reform existing DAF rules by creating two new types of DAFs:

- 14/15-year DAFs (“Qualified DAFs”): The bill will create a new form of DAF under which a donor would get upfront tax benefits (as under current law), but only if DAF funds are distributed (or advisory privileges are released) within 14/15 years of the donation. To avoid overvaluations, the income tax deduction for complex assets – such as closely-held or restricted stock – would be the amount of cash made available in DAF accounts as a result of the sale of the asset (instead of the appraised value). THERE IS ALSO a carve-out for “Qualified Community Foundation” DAFs.
- 50-Year DAFs (“Nonqualified DAFs”): As an alternative, donors who want more than 15 years to distribute their DAF funds will be allowed to elect an “aligned benefit rule.” Under this rule, a DAF donor would continue to receive capital gains and estate tax benefits upon donation but would not receive the income tax deduction until the donated funds are distributed to the charitable recipient. All funds would be required to be distributed outright to charities no later than 50 years after their donation.

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DAF Highlights: Each DAF will need to be classified . . .

The Choices Fall Into Four Buckets

QDAF

- A DAF that has a 15-year limitation on advisory privileges: All assets (including earnings) are to be distributed before the end of the 14th year after the date of contribution - measured from the first donation date; remainder to be distributed at the end of 15 years (and cannot be retained by the sponsoring organization)
- Note: NO geographic limitation

NQDAF

- A DAF as it exists prior to the ACE Act *that is sponsored by any public charity other than a Qualified Community Foundation*
- DAFs created at or after the ACE Act effective date which do not meet the 15-year limitation of a QDAF

QCFDAF

- A DAF owned and controlled by a 'qualified community foundation(QCF)'
 - ✓ QCF = 501(c)(3) that operates in no more than 4 states' area; and not less than 25% of its assets are non-DAFs
 - ✓ And
 - Has a 50-year limitation on advisory privileges – all assets are to be distributed before end of the 49th year after created - measured from the first donation date with remainder to be distributed at the end of 50 years (not retained by the sponsoring organization), **OR**
 - Has limited value, defined as <\$1M (inflation adjusted rounded to \$10k), **OR**
 - Distributes 5% of the DAF assets each year (based upon each prior year's assets value)

NQCFDAF

- A DAF in existence prior to the ACE Act *that are sponsored by a Qualified Community Foundation;*
- That does NOT meet the 50-year life limitation;
- Exceeds the \$1M (inflation adjusted) threshold; **AND**
- Does not distribute 5% of its assets based upon each prior year's asset values

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WE'VE REACHED THE END – QUESTIONS?

- And if we run out of time or you realize you had a question you failed to ask – contact me (see next slide!)

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Slide Numbers appear above

Thanks for your work assisting tax-exempt organizations – it is much needed!



Eve Borenstein, J.D. – two contexts in which I provide services:

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