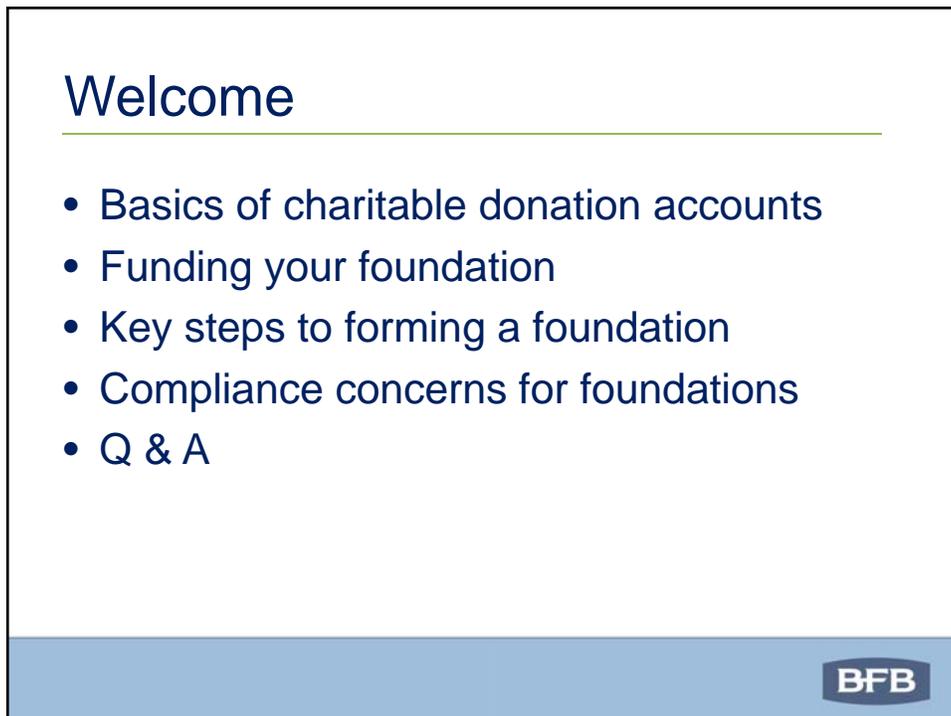




Welcome

- Basics of charitable donation accounts
- Funding your foundation
- Key steps to forming a foundation
- Compliance concerns for foundations
- Q & A



Maximize Your Philanthropic Program

- CUs consistently give back to community. Donations are either:
 - Budgeted
 - Sporadic
- NCUA promotes this community involvement by allowing the use of impermissible investments in CDAs
 - Allows for planned giving - budgeting
 - \$\$ back to the membership

The logo for BFB Gallagher, consisting of the letters "BFB" in white on a dark blue rectangular background.

What Are CDAs?

- CDAs are designated accounts that are hybrid giving and investment accounts
- Per NCUA Federal CUs can hold investments that are generally impermissible if the account is primarily charitable in nature
 - The investments must meet safety and soundness criteria
 - These investments do not count against concentration

The logo for BFB Gallagher, consisting of the letters "BFB" in white on a dark blue rectangular background.

How Do These Programs Work?

NCUA Rule Parts 703 and 721

- Federal credit unions may purchase higher yielding investments to fund a charitable donation account (CDA)
CDA must meet regulatory requirements
- Account must be primarily charitable in nature
- Assets must be held in segregated custodial account specifically identified as CDA Total investment is limited to 5% of net worth at all times
- Minimum distribution of 51% of CDA net earnings to qualified charity(ies) at least every five years

The logo for BFB Gallagher, consisting of the letters "BFB" in white on a dark blue rectangular background.

How Do These Programs Work?

- Charity must qualify under IRC Section 501(c)(3)
- Written documentation required
 - Identify charity(ies) and frequency of donations
 - Investment policy statement including strategies and risk tolerance
 - Accounting procedures
 - Liquidation and minimum distribution provisions
- CDA receives risk weight of 100% in Risk-Based Capital calculation, including equity securities

The logo for BFB Gallagher, consisting of the letters "BFB" in white on a dark blue rectangular background.

What Kind of Investments are Available?

Multiple investment options based on Credit Union's specific risk profile

- Institutional Insurance / Annuity with Fixed Account
- Institutional Insurance / Annuity with Indexed Account Asset Management
- Asset Management

The logo for BFB Gallagher, consisting of the letters "BFB" in white on a dark blue rectangular background.

Compliance and Administration?

- Assistance with required written documentation
- Coordination of underwriting and policy issue or Mutual Fund investment
- Facilitations of distributions
- Monthly recordkeeping/accounting for cumulative earnings/distributions
- Budgeting assistance
 - Annual budgets to set expectations for charity(ies)
 - Annual reviews, analysis and due diligence
- Annual reviews, analysis and due diligence

The logo for BFB Gallagher, consisting of the letters "BFB" in white on a dark blue rectangular background.



Welcome

- 93 attorneys
- Represent national clients from NC offices
- 36 practice areas, including financial services, nonprofits, and employment law



BFB

Roadmap

- What Is a Private Foundation
- Why Form a Private Foundation
- Forming a Private Foundation
 - Trust v. corporation
 - State formation
 - IRS Form 1023
- Advance Approval of Grant Procedures
- Compliance Considerations
- Partnering with a Community Foundation

 P.S.
Poyner Spruill™

 BFB

What Is a Private Foundation?

- IRC 509(a) defines a “private foundation” as any 501(c)(3) entity that is not:
 - listed under certain portions of IRC 170(b)(1)(A) (i.e. schools, churches, hospitals, etc.),
 - does not receive a significant amount of its funds from the general public (i.e. publicly supported charity),
 - is not a supporting organization to one of the two types of organizations listed above, and
 - is not organized exclusively to test public safety.
- 501(c)(3): “Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”
- A private foundation is *not* an “exempt operating foundation”

 P.S.
Poyner Spruill™

 BFB

Why Form a Foundation?

- Forming and maintaining a charitable foundation takes significant time, effort, and money
- However, it does allow the credit union to make a charitable contribution to a 501(c)(3) entity immediately to satisfy CDA requirements and postpone granting decisions
- Also allows the credit union to take a more active approach to contributing back to the community it serves
 - Control over decisions
 - Grants to individuals
- NCUA has long recognized a federal credit union's authority to create a private foundation; *however, state credit unions should always check state law to confirm whether it is permitted to form a private foundation*

P.S.
Poyner Spruill™

BFB

Formation: Trust v. Corporation

- 501(c)(3) can either be a nonprofit entity or a charitable trust
- Normally a nonprofit entity is the preferred structure
- In relation to a trust structure, setting up a nonprofit entity generally provides superior limited liability protection and flexibility
 - Who serves on the foundation board?
 - Avoiding conflicts

P.S.
Poyner Spruill™

BFB

Formation: Corporation at State Level

- File with the state to create your nonprofit entity
- Creation documents must state:
 - The organization is organized and operated exclusively for its exempt purpose and should state its exempt purpose
 - That earnings of the foundation may not inure to the benefit of insiders or any private party
 - No substantial part of the activities of the entity shall be the carrying on of propaganda, or otherwise attempting to influence legislation or political campaigns
 - Upon dissolution of the foundation, the Board will distribute assets exclusively for charitable purposes (some states require governmental approval of distributions)
 - As a private foundation, it will comply with IRC Sections 4941 through 4945
- Will need governance documents (Bylaws, Conflict of Interest Policy, Record Retention Policy, etc.)
- Apply for Federal EIN via Form SS-4 and address any additional state registrations
- *Before you form a private foundation, check your state's law to confirm particulars*

P.S.
Poyner Spruill™

BFB

Formation: Form 1023

- To obtain exempt status with the IRS, file Form 1023 “Application for Recognition of Exemption Under § 501(c)(3) of the Internal Revenue Code”
- For exemption to relate back to formation, Form 1023 should be filed within 15 months from the end of the month of the foundation’s creation (automatic extension to 27 months)
- \$850 filing fee (if annual gross proceeds > \$10,000)
- You should hear back from the IRS within 180 days, but it’s not uncommon for them to ask follow-up questions and for the process to take several months

P.S.
Poyner Spruill™

BFB

Formation: Form 1023

- Core form is 12 pages, plus several exhibits
- Things you'll need:
 - Identify Board of Directors and any conflicts of interest
 - Identify top-paid parties and any conflicts of interest
 - Articles of Incorporation, Bylaws, Conflict of Interest Policy
 - Description of the entity's goods, services, members, mission, and activities
 - Description of any fundraising programs
 - Projected budget

 P.S.
Poyner Spruill™

 BFB

Advance Approvals

- Grants to individuals must be made in accordance with procedures approved in advance by the IRS.
- Grants include:
 - Scholarships, fellowships, internships, prizes, awards
 - Loans for charitable purposes
 - Program related investments
 - Payments to exempt organizations to advance *their* charitable purposes
- Need to demonstrate:
 - Procedure awards grants on an objective and non-discriminatory basis
 - Procedure is reasonably calculated to result in performance by grantees of the activities that the grants are intended to finance, and
 - Foundation will supervise grants to determine whether grantees have fulfilled the grant terms
- Form 1023, Schedule H – Advance Approval of Individual Grant Procedures
- Form 8940 (if done later)

 P.S.
Poyner Spruill™

 BFB

Compliance – Generally

- All 501(c)(3) organizations are subject to:
 - Prohibitions on private inurement/private benefit
 - Taxes on unrelated business income
 - Annual reporting obligations
- Private foundations are subject to additional compliance considerations, including:
 - 2% tax (can be reduced to 1%) of net investment income
 - Special restrictions regarding self-dealing
 - Minimum annual distribution requirements
 - Restrictions on retention of “excess business holdings”
 - Restrictions on investment strategies
 - Expenditure restrictions
 - Taxes upon termination, unless certain requirements are met

 P.S.
Poyner Spruill™

 BFB

Compliance: Private Inurement

- Foundation must be operated for public benefit
- Concept of “private inurement” generally refers to benefits conferred upon insiders, such as directors, officers, and creators, through the use or distribution of funds
 - Incidental benefits are ok
 - Don’t confuse with more strict self-dealing rules applicable to private foundations
- Violation can lead to loss of exempt status

 P.S.
Poyner Spruill™

 BFB

Compliance: Unrelated Business Income Tax

- A private foundation can engage in activities that generate profit, and the existence of such for-profit activities will not necessarily endanger the foundation's exempt status *so long* as the activity advances the exempt purpose and the foundation is not otherwise organized to engage primarily in business activities
- However, so that exempt organizations do not have an unfair advantage over for-profit entities, the private foundation will have to pay taxes on income (net deductions) arising from any business it runs on a regular basis that is not substantially related to the organization's exempt purpose
- Taxed at regular corporate rate
- Reported on Form 990-T

P.S.
Poyner Spruill™

BFB

Compliance: IRC 4940

- Annual 2% tax on “net investment income”
- Can be reduced to 1% if the foundation meets certain criteria

P.S.
Poyner Spruill™

BFB

Compliance: IRC 4941

- IRS prohibits “self-dealing” which is a much more strict than the prohibition on private inurement
- “Self-dealing” includes all dealings between the private foundation and “disqualified persons,” regardless of whether the foundation is harmed by the transaction, with certain exceptions
- “Disqualified persons” includes:
 - Substantial contributors
 - Persons owning more than 20% of an entity that is substantial contributor
 - Foundation managers
 - Family members of the above
 - Any entity in which any of the above person owns more than 35%
- IRS imposes excise tax on the “amount involved”
 - 10% by the disqualified person
 - 5% by the foundation manager (unless self-dealing was not willful and due to reasonable cause)
 - If not timely “corrected” (i.e. transaction undone) excise tax increases to 200% and 50% as to disqualified person and foundation manager, respectively
- Not to be confused with IRC 4958 tax on excess benefit transactions

 P.S.
Poyner Spruill™

 BFB

Compliance: IRC 4942

- The IRS requires foundations to make a minimum amount of “qualifying distributions” each year and imposes an excise tax, payable by the foundation, on any shortfall:
 - 30% if not distributed by close of the following tax year
 - 100% if not timely corrected
- The required minimum distribution is basically 5% of the foundation assets (net acquisition indebtedness)
- “Qualifying distributions” include:
 - Charitable grants
 - Amounts paid to acquire assets used directly in carrying out charitable purposes
 - Reasonable administrative expenses in carrying out charitable activities
 - Set-asides and program-related expenses

 P.S.
Poyner Spruill™

 BFB

Compliance: IRC 4943

- The IRS does not want foundations to engage in certain business activities, including owning too high of a voting (and in some cases non-voting) interest in businesses (“excess business holdings”)
 - Holdings of disqualified persons are aggregated with foundation’s holdings
- Foundation has five years to divest itself of excess business holdings to non-disqualified persons
- Excise tax of 10% of the value of such excess business holdings is paid by the foundation on such excess if not timely divested; additional 200% if not timely divested thereafter

P.S.
Poyner Spruill™

BFB

Compliance: IRC 4944

- A foundation is not allowed to invest its funds in investments that would jeopardize the foundation’s ability to carry on its exempt purposes
- There is no “per-se” rule regarding what constitutes a “jeopardizing investment” but caution should be used when considering high-risk investments
- Foundation managers should use “prudent investor” standard of care
- Excise tax of 10% of the value of the jeopardizing investment imposed on both the foundation and the foundation manager
 - If not timely corrected, the foundation will have to pay a 25% excise tax and the foundation manager will owe a 5% tax

P.S.
Poyner Spruill™

BFB

Compliance: IRC 4945

- IRS imposes an excise tax on “taxable expenditures”
- “Taxable expenditures” include:
 - Carrying on propaganda to influence legislation
 - Activities carried on to affect a specific public election (except certain non-partisan activities)
 - Grants to individuals, unless certain conditions are met
 - Grants to organizations, unless the foundation either exercises “expenditure responsibility” or the grant is made to a church, school, hospital, public charity, or certain supporting organizations
- “Expenditure responsibility” includes taking all reasonable efforts:
 - To ensure that the grant is spent solely for the purpose for which it is made,
 - To obtain reports from the grantee on use of the funds, and
 - To make reports to the IRS regarding such expenditures

 P.S.
Poyner Spruill™

 BFB

Compliance: Form 990-PF

- Private foundations are required to provide an annual report to the IRS regarding:
 - The foundation’s financials and charitable distributions
 - Capital gains and losses for determination of and payment of taxes on net investment income
 - Summary of activities, charitable and not, and program-related investments
 - Information about leadership, their compensation and the compensation of highest-paid employees and contractors
 - Complete list of grants made
 - Etc. disclosures, all intended to ensure and report compliance regarding the abovementioned matters and capture appropriate excise taxes (additional forms may apply)

 P.S.
Poyner Spruill™

 BFB

Partnering: Existing Community Foundation

- Another option is to partner with a local community foundation
- This partnership would involve the credit union making charitable contributions to a donor advised fund maintained by another existing foundation
- The fund can be named the “*Insert Name of Credit Union Foundation*”
- Credit union can make recommendations on the use of the donated funds, but control ultimately resides with the separate, unaffiliated foundation
- Funds within the donor advised fund can generally be distributed to public charities and other donor advised funds, but cannot be distributed to individuals
- Foundation would charge a maintenance fee – usually a small percentage of assets maintained
- Has its own set of compliance considerations



Thank you!



Chris Burns-Fazzi, BFB Gallagher
Chris_BurnsFazzi@ajg.com
704-904-8375



Brenna Davenport, PoynerSpruill
Bdavenport@poynerspruill.com
704-342-5267



BFB Gallagher is the NAFCU Preferred Partner for Executive Benefits and Compensation Consulting.

More educational resources are available at www.BFBbenefit.com.



A DIVISION OF
Gallagher Benefit Services, Inc.