

IOWA LIBRARY ASSOCIATION

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Cultivating the Library's Financial Future:
"Whether an Endowment Fund is right for
your Library and if so, how to set one up."

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What did the conference planners have in mind for
this presentation?

A particular kind of financial support with three key features:

1. "Private support" – to supplement public support.
"Private support" is somewhat of a misnomer.
2. A large gift or an accumulation or combination of
gifts into a larger fund.
3. Restriction on expenditures from the fund, to
stretch the benefits over time.

Disclaimer

- This presentation is not intended to provide you with specific answers. Its purpose is to provide general information and basic concepts to assist you in thinking about issues relevant to your particular circumstance when considering an endowment fund.
- The information contained in this presentation has been summarized and/or simplified for ease of presentation. It should not be relied upon without independent verification together with more comprehensive review of then current laws and regulations applicable to your unique circumstances and choices.
- This presentation is not intended as legal, financial or tax advice. It constitutes general information for presentation purposes only and may not be applicable or appropriate to your particular circumstances.
- You should not rely on this presentation for making decisions that might affect your library or a donor's gift. Such decisions should only be made after first fully investigating all choices applicable to your unique circumstances, and then only after consulting with one or more appropriate professionals fully informed of the circumstances.

Mrs. Willson, a life-long resident of Johnson County, Iowa died last April at the age of 92. She was preceded in death by her husband and one son who had never married and had no children. While Mrs. Willson had been a periodic Iowa City Public Library user, she had never given to the Iowa City Public Library Friends Foundation or indicated any intent to anyone about making a gift to benefit the Library.

Mrs. Willson's Last Will and Testament was admitted to probate by the Johnson County District Court last June. It provided in part as follows:

I give my entire estate
to the Iowa City Public Library
to be held until the end of time
to use the income therefrom,
but never any of the principal,
for the purposes of maintaining its collection
of books
about miniature poodles.

\$100 \$1000 \$10,000 \$100,000
\$1,000,000 \$10,000,000

"Gift Instrument" means a will, deed, grant, conveyance, agreement, memorandum, writing or other governing document, including the terms of any institutional solicitations from which an institutional fund resulted, under which property is transferred to or held by an institution as an institutional fund.

"Institution" means an incorporated or unincorporated organization organized and operated exclusively for educational, religious, charitable or other eleemosynary purposes, or a governmental organization to the extent that it holds funds exclusively for any of these purposes.

"Institutional Fund" means a fund held by an institution for its exclusive use, benefit or purposes, but does not include a fund held for an institution by a trustee that is not an institution and does not include a fund in which a beneficiary that is not an institution has an interest, other than possible rights that could arise upon violation or failure of the purpose of the fund.

Legal Definitions – State Law
Chapter 504A of the Iowa Code --
Uniform Management of Institutional Funds Act

"Endowment Fund" means an institutional fund, or any part of an institutional fund, not wholly expendable by the institution on a current basis under the terms of the applicable gift instrument.

A Possible Working Definition of Endowment

Anticipated support in the form of a regular periodic payout from a separately accounted for fund that is sufficiently large to support the donor's designated purpose of the gift, and the expenses of administering the fund, while preserving the fund's capacity to sustain such a level of support over the long term considering the effects of inflation.

Gift Terminology

- gifts
- grants
- pledges
- deferred gift
- lifetime gift
- planned gift – estate gift – testamentary gift

Gift Terminology (continued)

- unrestricted gift - but use is restricted by IRS regulations, articles of incorporation and organizational mission
- donor restricted gift
 - investment restriction
 - use restriction
 - i) for what purpose
 - ii) over what time frame
- temporarily restricted
- permanently restricted (endowment; quasi-endowment)

Gift Terminology (continued)

- statement of gift intent
- gift agreement
- retained interest gift (e.g. charitable remainder trust)
- Donor/Benefactor - Donee/Recipient

An endowment is a time restricted and use restricted (or unrestricted) gift.

Organization Terminology

- governmental unit
- “charity” – nonprofit, tax exempt, publicly supported, 501(c)(3) organization
- support organization – 501(c)(3) that does not meet the support test but is controlled by or aligned with a governmental unit or charity
- community foundation
- charitable gift fund – donor advised
- private foundation
- perpetual trust (qualify as a 501(c)(3)?)

Generally an Endowment Fund Involves:

Pre-gift matters:

- determination/formation/qualification of recipient organization
- identification of prospective donors
- cultivation (pre-request)
- solicitation (ask)
- negotiate terms and restrictions
 - outright (lifetime)
 - pledged (lifetime/upon death)
 - deferred (upon death)
 - combination
 - matching gifts
 - publicity
 - naming rights
 - quid pro quo issues
 - tax exempt bond issues
- documenting gift (enforceable vs. unenforceable)

Opportunity for Participation in Pre-gift Process:

- *good opportunity* – when lifetime or testamentary gift with significant donor and donee pre-gift engagement
- *limited opportunity* – when lifetime or testamentary gift without significant donor and donee pre-gift engagement
- *no opportunity* – when a testamentary gift with no pre-gift engagement

Post-gift matters:

- receiving gift
- recognizing gift (publicity, naming, memorializing)
- receiving gift
- liquidation/conversion of gift for investment
- investment
 - investment policy (to fulfill purpose and preserve purchasing power)
 - investment management or manager selection
 - investment custodian selection
- clarification of donor intent (investment restrictions; use restrictions; time restrictions)
- preservation of donor intent (over time)
- accounting of fund financial activities
- auditing of fund
- distributions from the fund
- verification of proper use of distributed funds

Participation in the Pre-gift Process is Important!

- to specify the correct recipient
- to help align the donor's restrictions to the donee's needs/priorities for endowment support
- to possibly help donor make good gift planning choices (IRA/appreciated stock/cash)
- to help to carefully craft the gift instrument
 - to correctly identify the recipient
 - to clarify intentions/restrictions
 - to properly address annual payout
 - to give reasonable discretion for alternative use and expenditure flexibility

What you Should Generally Know about to Receive, Manage and Distribute Endowment Funds.

- nonprofit corporations - formation and compliance
- tax exempt organizations - qualification, restrictions and compliance
- charitable gift laws - enforceable pledges; unenforceable pledges; gift agreements (pitfall - personal pledge paid by a donor advised fund or a private foundation)
- tax laws -- Donor charitable gift deductions; Donee charitable gift receipting; Donor gift substantiation; Donee disposition reporting
- donor development and fundraising

What you should know about to receive, manage and distribute endowment funds (continued).

- gift stewardship (gift recognition; preservation of donor intent; post-gift donor relations; leveraging gift)
- fund management/fund managers
- investments (investment policy)
- payout policy (monitor and adjust from time to time)
- Board of Directors duties and responsibilities
- state gift enforcement - attorney general

Some Issues/Observations/Misperceptions:

A. Why do people give?

- altruism
- tax planning (generally, best to give the most highly taxed asset under the circumstances)
- guilt
- immortality
- all of the above, some of the above, none of the above

B. Successful fundraising is not easy.

Some Issues/Observations/Misperceptions (Continued)

C. Least restricted gift is usually the best.

The second best is a restricted gift with flexibility for variance.

However, always understand the potential impact of a large gift or endowment on one's traditional sources of revenue.

In other words, will the City Councilors cut your budget?

Some Issues/Observations/Misperceptions (Continued)

D. Governmental bodies are not usually the most appropriate environment for development and fundraising activities; or for endowment management.

- not a traditional role
- statutory limitations on investment and spending
- stewardship issues
- loss of control
- confidentiality/trust issues

Some Issues/Observations/Misperceptions (Continued)

E. Gift Trends

- less tax benefit from charitable deductions
 - tax rates have been reduced (capital gains-income-estate)
 - exemptions are increasing
 - estate tax repeal?
- easier to stretch QRRs and IRAs
- increasing IRD assets
- “Boomers” - as beneficiaries and as donors
- “enough is enough” – gifts to children
- donor restrictions on gifts
- increased enforcement – increased compliance (1023 application; 990 annual reporting form; Sarbanes Oxley)
- donor standing
- fewer or more charitable gifts in the future?

Some Issues/Observations/Misperceptions (Continued)

F. Troublesome and prohibited activities

- actions in violation of donor’s intent
- using funds other than for qualified (charitable) purposes
- using funds for other than organization’s specified purposes
- private inurement
- personal benefits more than merely incidental to fulfilling charitable purposes
- unrelated business activities
- reckless investing
- political campaigning
- influencing legislation (lobbying)

Some Issues/Observations/Misperceptions (Continued)

G. Understanding the distinction between and overlap of “nonprofit” and “tax exempt” organizations

- nonprofit – is a state classification under specific statutory provisions (Chapter 504 of the Iowa Code; the Iowa Revised Nonprofit Corporation Act) - established by filing an appropriate set of articles of incorporation with the Secretary of State, adopting bylaws and having an organizational meeting (can be quick & relatively straight forward)
- tax exempt – a federal classification under IRS laws and regulations – file 1023 application with the IRS for 501(c)(3) organizational status and obtain a determination letter – first temporary and then “permanent” (can be cumbersome and delayed)

[CHART]

Some Issues/Observations/Misperceptions (Continued)

What does "tax exempt" mean?

- Generally for federal tax purposes, exempt from paying income tax on most forms of revenue related to tax exempt activities. (Unrelated business income is taxable.)

- State income tax exemption is usually similarly available.

What about real estate taxes, excise taxes, sales taxes and so on?

If a tax exempt organization is qualified under 501(c)(3), gifts to it are also deductible by the donor.

501(c)(3) Organizations Oversimplified (continued)

A "public charity"

- is a charitable organization that does not constitute a private foundation
- is given preferred tax exemption and donor deductibility
- must satisfy applicable organizational and public support criteria in order to achieve/retain its tax exempt status

501(c)(3) Organizations Oversimplified

- 501(a) of IRC provides income tax exemption for organizations described in 501(c)(3)

- 501(c)(3) organizations operate exclusively for "charitable" purposes

- "charitable" is defined rather broadly, including:

- advancement of education and science
- promotion of arts
- instrumentality of government
- others

- organizations are generally considered private foundations (and targeted by more onerous federal regulations and not as favorable tax treatment) except those that specifically qualify otherwise

- use of "foundation" in the name of an organization is not determinative

Four Types of 501(c)(3) Public Charities:

1. Public institutions – churches, schools, colleges, universities, hospitals, medical research organizations, governmental units
2. Publicly supported charity – receives a substantial part of its support for direct or indirect contributions from the general public

Publicly Supported Charity - Categories

- A. publicly supported donative charities – support tests
 - i. generally one-third “support” from qualifying contributions or grants; generally when a contribution is from a single contributor or grantor and is in excess of 2% of the total annual support, only the portion that does not exceed 2% is counted as public support;
 - or
 - ii. facts and circumstances test for organizations like museums, libraries and community foundations that often rely principally or heavily on endowments:
 - a) at least 10% governmental or public support
 - b) continuous and bona fide solicitations for public or government support
 - c) other pertinent facts and circumstances
 - makeup of governing board
 - public availability of programs and services
 - other relevant matters
- B. community foundations – special rules
- C. service provider publicly supported organizations – special rules
- D. foundations supporting public colleges and universities – special rules

Entity Choice for Endowments

It depends on the circumstances:

- was the gift “manna from heaven” or do you need to do it the old fashioned way with hard work?
- a single endowment fund or a full fledged annual and planned giving program?
- what “resources” are available in your community?
 - quality of Board of Directors
 - quality of financial institutions and investment managers
 - appropriateness of other organizations (city government or community foundation)
 - availability of administrative, professional and volunteer expertise

Four Types of Public Charities (continued):

- 3. Support organizations
 - sufficiently related to one or more qualified organizations, including public institutions and publicly supported organizations
 - organized and operated exclusively for the benefit of one or more specified qualified supported organizations
- types:
 - I. Operated, supervised or controlled by (parent-subsidiary relationship)
 - II. Supervised or controlled in connection with
 - III. Operated in connection with (programmatic relationship – problematic)
- 4. Organizations that test for public safety

Entity Choice for Endowments (continued)

Generally need an organization for some or all of the following:

1. To cultivate and fundraise;
 2. To receive, receipt, hold and invest funds;
 3. To perform gift stewardship;
 4. To distribute funds; and
 5. To perform regulatory compliance.
- An organization with capability to fundraise, fulfill administrative functions, and properly steward endowment gifts.

Entity Choice for Endowments (continued)

The usual options:

1. City/library – governmental body
2. An independent 501(c)(3) nonprofit corporation
3. A controlled 501(c)(3) nonprofit corporation (support organization)
4. Another organization
 - community foundation
 - private foundation

Sample of Endowment Language

It is the Donor's direction that this gift to CHARITY be used to establish an endowment fund. The investment of the endowment fund is to be in accordance with the investment policies of the CHARITY as established by its Board of Directors. The portion of the fund's value spendable annually for the designated purpose is also to be determined, from time to time, by the CHARITY'S Board of Directors. Among criteria for such determination will be preservation of principal, protection from the long-term effects of inflation, current and future funding necessary to fulfill the designated purpose of the fund, continuity in funding the designated purpose, expected total return on investments over the long-term, and other relevant general economic conditions.

Basic Questions to Consider:

1. What are you trying to accomplish with private support and is a time restricted gift appropriate?
2. Will your donor base (numbers/dollars) be sufficiently large to create an endowment substantial enough to finance the intended purpose?
3. Can you reasonably influence the donor's use restrictions to assure alliance with library priorities?
4. How can you best assure appropriate documentation of the donor's gift intentions?
5. What are the local resources available to properly support the administration of an endowment fund, and what organizational "recipient" might these resources suggest?

Sample Variance Language

This document provides a record of the Donor's wishes for administering the gift described above. If at some time in the future, for unforeseen reasons, the original purpose of the gift cannot be met, the CHARITY will make every effort to consult with the Donor to appropriately modify the designated purpose. However, if it becomes apparent to CHARITY'S Board of Directors that the gift's purpose has become no longer necessary, practical or possible to perform, and consultation with the Donor is not possible, then the Donor agrees CHARITY'S Board of Directors may, after due deliberation, designate the gift funds to be used in some other manner that reasonably approximates the Donor's original designation.