IEA

11-29-2011

Last week Dick and I had a conference call with Betsy Jones and Skip Wise of IEA. Betsy invited another person who she did not formally identify during the call. I believe her name is Ellen and I think she is legal counsel for IEA. During this meeting we discussed the options for working around IEA’s potential tipping problem. Ellen did not participate except with respect to the donor advised fund, which I’ll discuss more below under options.

Before discussing the options I am going to explain the two basic qualifying rules that drove the discussion. The first rule is that an organization is a public charity if it receives 33 1/3% it’s funding from the public. No further testing is required. The second rule applies to any organization that doesn’t meet the 33% test. It is that any organization that receives 10% or more (up to 33 1/3%) must also meet the Facts and Circumstance (F&C) test in order to be a public charity. The closer the public support ratio is to 33%, the less in F&C it needs to support its position. Conversely, the closer the support ratio is to 10%, the more F&C it needs to support its position.

IEA has been using the second test, the 10% test, to qualify as a public charity in the past. IEA’s public support ratio was above 20%. The accountants for IEA have been comfortable the F&C test combined with public support of 20% or higher. The current grants from the Bradley Foundation threaten to bring the support ratio to around 16%. The accountants are not comfortable with IEA’s ability to claim public charity status if the support ratio falls to this level. For the call, the accountants prepared a spreadsheet which shows the Foundation making an award to IEA of $2,045,000 in 2010. That is a combination of $345,000 awarded in November and not fully paid in 2010, $100,000 awarded and paid in 2010, and $1,600,000 which has yet to be formally awarded. If the entire amount is awarded in 2010 the public support ratio will be around 16%. They also prepared another spreadsheet that shows the Foundation awarding $1,045,000 in 2010 which brings the support ratio back up to around 23%. This is a possibility if the Foundation does not award the entire $1.6 million in 2010.

The other consideration during our call was cash flow needs of IEA. Sarah made her gift of $1.6 million every December. Betsy said they will need cash to pay scholarships and run the Bradley seminar. She will need about $419,000 through February. I will forward her email with cash flow projections to you. As of November they will receive from the Foundation $100,000 paid earlier in the year plus $86,250. The $345,000 grant is scheduled to be paid in 4 installments with the first installment of $86,250 paid this November. This is not enough to make scholarship payments.

Four options have been identified as of this time. I’m presenting them below for your consideration in order of my preference along with the pros and cons.

**Option 1**: Formally award only $600,000 in 2010 of the potential $1.6 million that could be awarded by the Foundation. Award the remainder of the possible $1.6 million in 2011. This is still an option because Dan has not sent the award letter to IEA and he will not send the letter until you confirm that he should. The Foundation will accelerate payment of the November award to pay the entire $345,000 in 2010. The Foundation will pay the award of $600,000 in December 2010.

Pros: It defers the $1 million award into 2011 and IEA’s support ratio will be around 23%. IEA will have enough cash to support its programs.

Cons: The $1 million deferral is a short term solution that will have to be dealt with in 2011.

**Option 2:** Award $1 million to a donor advised education fund. Award and pay $600,000 in 2010.

Pros: IEA will receive the grant from a public charity. IEA will have cash to cover programs through February.

Cons: There are several cons. (1) a donor advised fund is also short term solution. (2) We need an independent 3rd party to advise the fund. (3) Betsy and Skip are not comfortable with the loss of control of the funds. Ellen, the attorney I mentioned above, believes that a donor advised fund used for this situation is prohibited by the IRC. After the conference call Dick researched the applicable statute. He determined this is still a viable option if properly constructed. I agree with his reasoning and advice.

**Option 3**: IEA changes into a private foundation. Award the entire amount this year and pay the grant according to cash flow needs.

Pros: The Foundation could make grants with proper documentation.

Cons: There are several serious issues with this. (1) IEA would need a private letter ruling in advance of making scholarships. (2) IEA would lose many funders. Some of the private foundations currently funding IEA are prohibited in their by-laws to make grants to private foundations. (3) This is not a solution that could be implemented this year. Many individuals would not be motivated to contribution if the amounts are limited on their tax return. A less serious issue is that IEA would have to do expenditure accounting.

**Option 4**: IEA could set up a supporting organization.

Pros: The supporting organization could gather significant assets to support IEA. Awards and payments could be made according to cash flow needs.

Cons: Dick has some concerns that a supporting organization may not be independent. Aside from that it is a long term solution that requires organizing new entities and significant fundraising efforts. The obvious is answer is that if they could raise funds from other sources, tipping would probably not be an issue anyway.