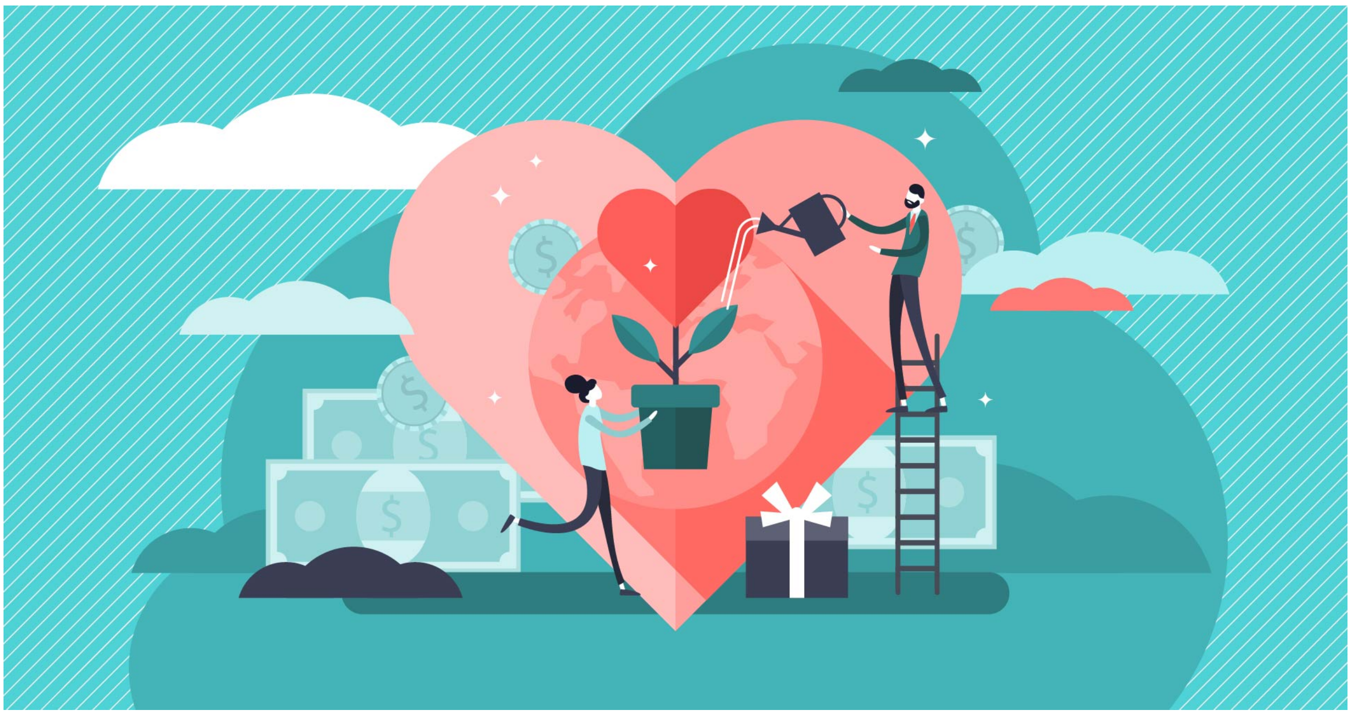

Private Foundations

Beyond Traditional Charitable Giving

For many affluent individuals, occasional gifts to a favorite charity may satisfy their charitable inclinations. The added incentive of an often substantial tax deduction, coupled with various estate planning benefits, can be the driving force behind such charitable gifts. However, for some individuals, philanthropy is a far more serious endeavor, often involving a succession of substantial gifts of at least $5 to $10 million, which may necessitate the need for control and general oversight. In such situations, a private foundation can be an ideal mechanism for managing a large, continuous charitable giving program.

Private Foundation Basics

In its simplest form, a private foundation is a charitable, grant-making organization that is privately funded and controlled. When properly arranged and operated, a private foundation is an income tax-exempt entity,[i] and tax deductions are permitted for individuals (donors) who donate to them.

Contributions to a private foundation are deductible for gift and estate tax purposes.[ii] The income tax deduction of gifts to a private foundation is a bit more complex.[iii] Generally, the deduction is based on the fair market value of the gift (at the time of the gift), and it is limited by the donor's adjusted gross income. The charitable deduction will also be limited (to 20%, 30%, or 50% of AGI) depending on the type of charitable organization that is ultimately receiving the gift from the private foundation *and* the type of gift being made. Gifts that are not cash or publicly traded securities, and that are valued at more than $5,000, require adherence to additional rules in order to ensure deductibility.[iv]

In addition to the advantages of a tax deduction (which is generally not exclusive to private foundations), private foundations may also offer an array of other benefits. Because a private foundation is typically established to manage a long-term charitable gifting program, it may in turn highlight the philanthropic presence and identity of the donor within the community and/or a particular charitable cause. It can also serve to create a family charitable legacy while, at the same time, protecting individual family members from the pressures of other charitable appeals. Finally, a private foundation can serve as an appropriate mechanism for controlling distributions to charities, as well as determining which charities the foundation will benefit.

On the Technical Side

When a private foundation is established, there are two issues that need to be addressed. First, what type of private foundation should the donor establish? And second, how should the private foundation be structured? There are generally three types of private foundations: 1) nonoperating, 2) operating, and 3) company-sponsored. Each type of foundation has specific characteristics that make it appropriate for a particular situation. There are also strict requirements and guidelines that must be followed for each type of foundation.[v]

The most common type of foundation is nonoperating. Essentially, a donor, or group of donors, makes contributions to the foundation, which in turn, makes grants to a charity. In this case, the donor has no direct participation in any charitable work. There are several variations of this type of foundation.[vi]

On the other hand, in an operating foundation, the foundation may have direct involvement in charitable causes (e.g., an inner-city youth center) while retaining the tax benefits of a "private" foundation (although, in some respects, operating similarly to a “public” charity). To qualify as an operating foundation, a foundation must also meet several requirements and tests.[vii]

In addition, a company-sponsored foundation can be used when the majority of contributions are from a for-profit corporate donor. Generally, this type of foundation operates similarly to a nonoperating foundation. It is usually managed by corporate officers, and it has the added benefit of allowing some contributions to accumulate over time. This can help the foundation make continual grants when corporate profits are low (at a time when, ordinarily, contributions would be otherwise forgone).

After careful thought is given to the type of foundation to be established, the foundation’s structure should be taken into consideration. There are three ways in which a foundation can be structured: 1) a nonprofit corporation, 2) a trust, or 3) an unincorporated association.

There are a number of factors to be weighed when deciding on which structure is best. Generally, if the donor intends to keep the foundation in existence permanently, a nonprofit corporation or trust may be a better choice. Additional considerations include state and local laws governing private foundations, the type of foundation, the type of donor, the need or desire to make future changes or delegate responsibilities, and personal liability issues.

Complex, Yet Effective

Creating and maintaining a private foundation is much more involved than the use of more traditional charitable giving mechanisms (e.g., CRTs). Therefore, legal and accounting professionals who have experience with private foundations must play a significant role in such an endeavor. In addition, due to the added complexity and need for highly specialized legal and tax expertise, the expenses for design, set-up, management, and grant administration in a private foundation will generally be substantial. Typically, a private foundation is only viable for individuals who intend on making periodic gifts in excess of $5 million.

Certainly, the private foundation allows today’s philanthropist the opportunity to manage substantial charitable gifts, as well as the ability to actually become involved in charitable work if he or she so chooses. It also affords the donor the opportunity to be recognized for charitable giving, while solidifying his or her philanthropic legacy. Like all advanced planning issues, appropriate counsel should be sought in order to meet the goals and objectives of all involved parties.

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[i] IRC Secs. 501(c)(3) and 509(a).
[ii] IRC Secs. 2522 and 2055.
[iii] IRC Sec. 170.
[iv] Treas. Reg. § 1.170A-13.
[v] As described under IRC Sec. 508(e).
[vi] IRC Secs. 170(b)(1)(E)(ii) and 170(b)(1)(E)(iii).
[vii] IRC Sec. 4942(j)(3).

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