FAMILY FOUNDATIONS

FAMILIES LOOKING FOR AN EFFECTIVE WAY to fulfill charitable intentions and to use values, skills, and creativity to make positive changes within a community may want to consider a private family foundation. Private family foundations allow you to exercise control over your assets and charitable decisions so your donations may be leveraged for maximum good. The strategy also offers attractive estate, gift, and income tax benefits. We have compiled some of the questions our clients frequently asked regarding private family foundations, along with our responses. We hope you find it helpful, and we welcome any additional questions you might have.

What are Private Family Foundations?

A private family foundation is a legal entity established with a philanthropic intent. Trustees or boards of directors provide all management and oversight. Trustees govern if the foundation was established by a trust; boards of directors govern when founded as corporations.

Are There Different Kinds of Foundations?

There are three kinds of private family foundations. Private endowed foundations are most common. In this structure, the endowment annually distributes a percentage of its value to chairty. Usually the endowment itself is not spent, allowing for potential growth opportunities. In contrast, pass-through foundations distribute all of the funding received each year. This is an attractive option for those who want to operate on a year-by-year basis. A private operating foundation uses the majority of its income to actively run its own charitable program or service. For example, the income of a private operating fund could go toward running a museum.

Why Do People Create Foundations?

The desire for positive social change motivates most foundation originators. Foundation creators are individuals who want to preserve their philanthropic values for years to come and instill those values into their families. Typically, they view the estate planning, gifting, and income tax savings as ancillary benefits.

Why Set Up My Own?

A private foundation allows unparalleled control in how and where your charitable intentions are realized and how the money is invested. It also provides an efficient way to funnel charitable requests.

If you have a philanthropic family, the foundation creates a "family office" economy to create uniform grant procedures, process requests, and evaluate applications. All charitable requests made of family members can be funneled to the foundation, thus inserting an administrative-type layer into the process. This alleviates pressure placed on family members from those seeking grants. Family members gain the added benefit of no longer having to make and track charitable donations themselves. They can simply add funds to the foundation if they are so inclined.

A private foundation is also a meaningful way to involve other family members, even young ones, in charitable decision-making. It instills charitable values and demonstrates to all family members your charitable goals and intentions.

Are There Tax Benefits, Too?

Contributions to a private foundation qualify for gift tax, estate tax, and income tax deductions.

If you make a gift of cash to fund the foundation, you may take an income tax deduction in the year of the gift. Your deduction for a cash contribution will generally be limited to 30% of your adjusted gross income, and you may carry forward excess deductions for five years. Appreciated stock owned by you for over a year offers an income tax deduction equal to the fair market value of the stock. If you contribute appreciated tangible personal property (like artwork), your deduction is limited to your cost basis as long as the property is "related to" the charities' exempt purpose. For example, if you had a private operating foundation and donated a piece of art for display at the museum your foundation sponsored, the donation would be deemed "related to" the charity's exempt purpose. The same donation to a private endowed function with a mission of eliminating poverty would not qualify. In addition to the income tax deduction for stock gifts, you would also avoid paying capital gains on any appreciation.

You may also take unlimited gift and estate tax deductions. Once you transfer property to the foundation, it is no longer considered part of your gift and estate tax base.

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What is Required for this Strategy to Work?

It's most practical for someone who donates over $50,000 a year to charity and may earmark around $1 million for future giving. Due to set up and operational requirements, the strategy could be cost prohibitive for estates valued at less than $3 million.

Does It Have To Be Funded All At Once?

Foundations do not have to be funded all at once. For example, $500,000 could seed the foundation, and you could add additional funds throughout your lifetime or at death.

How are Distributions Handled?

Within fairly broad limits, you control the distribution of foundation assets to qualifying charitable organizations in a manner consistent with your charitable goals. The terms of the trust or corporation will also guide future charitable distributions, ensuring the preservation of your charitable intent. Self-dealing is prohibited. Therefore, your foundation must refrain from grants to organizations affiliated with staff, board members, or family members.

Are There Other Restrictions?

The IRS may review distributions and expenses to ensure compliance with laws that prohibit self-dealing and the inappropriate use of foundation assets. To remain compliant with these laws, the foundation must refrain from frivolous spending, direct lobbying, and wasteful or imprudent investment practices.

Can the Foundation Employ Family Members?

Family members may be employed if their skills and compensation commensurate with the charitable work of the foundation. For example, family members may serve as trustees and receive reasonable compensation for their services and foundation-related expenses.

How do I Set it Up?

The first step is to consult with knowledgeable and experienced legal, tax, and investment professionals. Your advisors will help you establish the trust or corporation, prepare a mission statement outlining the foundation's conduct, put operating procedures in place, and educate you on issues of self-dealing, excess business holdings, jeopardizing investments, and required distributions. The final step in the process is to notify the IRS of the tax-exempt status of your foundation within 27 months from the organization date.

How is the Money Managed?

This is yet another area where you have a good deal of flexibility and influence. You may develop an investment strategy by working with your advisor to meet your long-term goals. The advisor you select, however, must be qualified to uphold their fiduciary responsibility to act prudently, refrain from making jeopardizing investments, or compromise the foundation's ability to carry out its tax-exempt function.

Is it Expensive?

At a minimum, you should expect to pay a few thousand dollars in legal fees to get the foundation up and running. There will also be modest, annual legal and accounting expenses. However, you do not pay the fees—the foundation does.

How Can I Learn More?

In addition to talking with your advisory team, we recommend the National Center for Philanthropy's guidebook, "Splendid Legacy," available on their website and on Amazon.