

PRIVATE FOUNDATIONS

QUESTIONS, ANSWERS
AND OPTIONS



California
COMMUNITY
Foundation

Clients often ask their advisors for advice about private foundations. Their questions include:

- Should we form a private foundation?
- How can we meet our annual distribution requirement if I cannot get our board to meet to approve grants?
- Now that we are older, operating our private foundation takes too much time, and our children are not interested in taking over. What can we do?
- What are the alternatives to a private foundation?

The purpose of this folder is to help you answer those questions – and others – when discussing private foundations with your clients. Each insert presents:

- Reasons why clients may be asking you these questions
- Issues to discuss with your clients
- Solutions some advisors have offered their clients by partnering with the California Community Foundation (CCF)

Advisors with whom we collaborate have found that having conversations about charitable giving helps them to better understand their clients' needs and objectives. This, in turn, has led to closer relationships with their clients and increased business.

Advisors choose CCF because of our ability to provide solutions tailored to meet their clients' specific needs. Drawing on our 100-year history and expert staff, we help advisors and their clients transform generosity into impact in Los Angeles, throughout the country and around the world.

We hope you find this information helpful during your conversations with clients. If you or your clients have any questions or would like to discuss further, please contact CCF Development & Donor Relations at **(213) 239-2310** or visit **calfund.org/advisors**.



by Don Gottesman, J.D. L.L.M. (Tax)

WHY DOES MY CLIENT WANT TO FORM A PRIVATE FOUNDATION?

People who consider forming a private foundation are often seeking to create a structure around their giving, something beyond simply writing a check to their favorite charities. Other reasons may include:

- they assume that is the only way to manage their philanthropy
- their friends have one
- someone said they should have one
- for greater visibility and recognition
- for greater overall control
- to receive tax deductions

ISSUES TO DISCUSS

When evaluating a philanthropic solution for a client, an advisor faces many considerations, ranging from selecting the asset to discovering the client's appetite for administration and method for making grants. To determine whether a private foundation is the best option, an advisor might consider asking the following questions:

TAX

What assets will be used to make the gift?

The type of asset donated and whether the donation was made to a public charity or a private foundation determine the client's total eligible deduction and how much of that deduction can be claimed each year.

- The total charitable income tax deduction available for gifts of:
 - cash and marketable securities when given to a public charity or private foundation is full fair market value
 - closely held stock, real estate and other illiquid assets:
 - when given to a private foundation is limited to basis
 - when given to a public charity is full fair market value¹

¹ For clients who make gifts of artwork, classic cars or other personal property, the deduction is limited to basis unless the property can be used by the charity to further its mission. For example, a gift of a painting to a museum.

at a glance

PRIVATE FOUNDATION CONSIDERATIONS

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- to focus their giving on areas they care about most
- to involve other family members
- to employ themselves or other family members
- to control the foundation's board of directors
- to control investment decisions
- they do not know about any other option

- In the year the gift is made, the client may claim a certain amount of that total depending upon the client's adjusted gross income. For gifts of:
 - cash:
 - to a private foundation, the deduction is capped at 30% of the taxpayer's adjusted gross income
 - to a public charity, the deduction is capped at 60% of the taxpayer's adjusted gross income
 - other assets
 - to a private foundation, the deduction is capped at 20% of the taxpayer's adjusted gross income
 - to a public charity, the deduction is capped at 30% of the taxpayer's adjusted gross income
- If the client has insufficient income to use the entire amount in the year of the gift, the client has five additional years to apply any unused portion of the deduction.

VALUE OF THE ASSETS

What is the value of the assets being donated?

For various reasons, such as start-up and administrative expenses, advisors with whom we work recommend private foundations only when clients plan to donate property valued at \$2 million or more. You or your company may have a different minimum.

IMPACT

Does my client know what causes he or she wishes to support and what charities provide that type of support so that the money given makes an impact?

Some clients do not know which charities or causes they wish to support. We usually see this when a client suddenly has more money available – due to receiving a large bonus or selling a business – than he or she previously had. For those clients, exploring possibilities and having the time to make decisions about where to give becomes crucial. In addition, clients may wish to have a partner who can help them on their journey. The journey can be long or short. Therefore, a private foundation might not be the best choice because the IRS can impose tax penalties when annual distributions are not made.

Other clients have given to various charities, yet are now seeking to make a greater impact or learn about other opportunities. Making an impact requires, among other things:

- determining the needs of the community the client seeks to serve
- developing an approach to meeting those needs
- learning which charities are aligned with the client's approach
- evaluating the effectiveness of those charities before partnering with them
- reporting on the impact made

In this situation, clients benefit by having an expert to act as a guide and share the workload. Partners can help your clients:

- create mission statements for their giving
- arrange site visits with charities
- develop questions to ask potential recipients
- discover other charities working in the field

In sum, a good partner can transform ideas into action, ensuring clients make the impact they seek.

Still other clients know exactly what causes they wish to support and are very knowledgeable about the charities working in their area of interest. For those clients, a private foundation might be a good choice after considering the other factors described in this publication.

INVESTMENT

Does my client feel comfortable investing as a fiduciary rather than as an individual?

People who form private foundations must meet prudent investor rules. The assets given away are no longer owned by the client; rather, they are owned by a charity. State and federal laws apply, such as the restriction on jeopardizing investments, excess business holdings and self-dealing transactions. Several exceptions apply, so having good investment and legal counsel is wise.

It should be noted that several charities that offer alternatives to private foundations often permit clients to recommend their financial advisor as the provider of investment management services for their fund.

ADMINISTRATION

How much time and interest does my client have for doing administrative tasks?

Operating a private foundation is like running a business. The client must form an entity at the state and federal levels; make annual tax filings; form and convene a board; evaluate grantees; make distributions; and follow rules on investing assets. At the same time, no private inurement, private benefit or self-dealing may occur. Failure to comply with the rules can result in action by the state's attorney general or the IRS, which could result in penalties and the loss of tax-exempt status. If the client decides to hire experts to do those tasks, then there will be less money available for giving to the client's cause.

Can those involved with making decisions consistently agree upon the charities to support?

Parents sometimes form a private foundation to bring their family together, teach philanthropy or impart certain values on future generations. However, future generations may view the private foundation as being solely reflective of the founders. When family members have different ideas about what the foundation's purpose should be and the types of charities to support, dysfunction often follows. This dysfunction not only causes conflict within the family, but also can result in serious tax consequences.

To avoid tax penalties, private foundations that only give money to other charities must make grants equal to approximately 5% of their endowed assets. To meet the rule, foundations calculate the minimum distribution and then distribute the amount by the end of the following year. If they fail to do so, then the IRS may impose an excise tax equal to 30% of the undistributed amount. If the private foundation fails to correct the error, then the IRS may impose an additional excise tax equal to 100% of the undistributed amount.

Does my client have any concerns with privacy, such as the public knowing the client's name and address or which charities are being supported and in what amounts?

Private foundations provide very little privacy for clients because certain information must be listed on the private foundations' annual return, the Form 990-PF. Anyone with an internet connection can access the names and addresses of the private foundation's major donors; the assets owned by the foundation and their values; contributions received; the names of the charities who received grants and the amounts they received. This is

available from sources such as Guidestar, Foundation Directory and the IRS. Consequently, neighbors, friends and other charities will be able to know a lot of financial information about the client and the causes they support.

Can my client manage the influx of unsolicited requests for grants?

Clients who form private foundations often find that they become the target of solicitations from individuals and charities, thanks to the public nature of their foundation's tax returns. Accordingly, clients will need to find a way to manage the onslaught of mail and calls.

Who would my client like to serve as successor, does that person have the ability and time and does the successor share the same charitable interests as my client?

Although private foundations can exist in perpetuity, finding a successor to lead the foundation can be challenging. Parents often form a private foundation to encourage family giving. However, future generations may have different priorities and ideas. For example:

- a. Areas of interest change – where Mom and Dad were interested in health care, the children are interested in the arts and the environment.
- b. Children do not have the time or energy to spend on private foundation matters due to jobs, a new family or other obligations.
- c. Children lack the ability or are simply not interested in managing the administrative burdens required to ensure the tax-exempt status of the family's private foundation.
- d. Family members move – where Mom and Dad were interested in supporting local charities, the children do not feel the same connection to a certain place or are more interested in supporting causes elsewhere.

Accordingly, private foundations are often dissolved after the founder's death and their assets distributed to a donor advised fund, supporting organization or public charity after the first or second generation.

ALTERNATIVES TO PRIVATE FOUNDATIONS

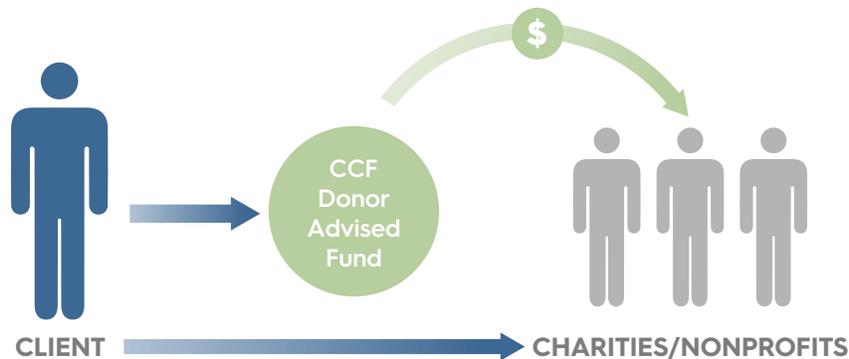
When a private foundation is simply not a good fit, the California Community Foundation offers other solutions for clients who are charitably inclined. These include:

Donor Advised Fund

A donor advised fund ("DAF") is a type of account created when a client makes an irrevocable gift to CCF. The benefits for the client are as follows:

- qualifies for an immediate income tax deduction at full fair market value regardless of whether the asset is a liquid or illiquid asset, in most cases
- pays no capital gains tax on assets donated to CCF when sold by CCF, in most cases
- does not require set-up fees, federal filings, state filings or a separate EIN because the fund is owned by CCF
- recommends which charities to support and when because, unlike private foundations, there is currently no rule requiring distributions from a DAF
- recommends how the assets are invested by choosing either:
 - an investment pool operated by CCF; or

- their trusted financial advisor under CCF’s Charitable Asset Management Partnership investment option (“ChAMP”)²
- retains the level of privacy most comfortable for the client because of the way information is presented on CCF’s tax return
- receives the assistance of a designated relationship manager – not a call center – who can provide such services as:
 - creating or refining a giving plan tailored to the client’s goals;
 - supplying custom-made research on local, national or international charities;
 - serving as a gatekeeper for solicitations from individuals and charities;
 - connecting donors to community leaders and scheduling visits to charities;
 - identifying emerging giving opportunities; and
 - engaging other family members in giving.
- creates a legacy by appointing successor advisors to the DAF whose powers can be broad or limited. For example, successors could make grants to any charity or be limited to making grants:
 - to certain types of charities or;
 - in an amount equal to a fixed percentage of the DAF’s value.
- partners with an expert about other charities, because CCF has been supporting charities for 100 years



² Only eligible for gifts having a value of at least \$500,000.

Type I Supporting Organization

A Type I Supporting Organization (“SO”) is a type of public charity whose primary function is to support the work of another public charity. People often describe the relationship between an SO and the other public charity like that of a corporate subsidiary to a parent company. The parent (i.e., the supported charity) must operate, supervise or control the SO, such as by having the power to appoint a majority of the SO’s board.

The SO’s organizational documents, to meet IRS tests, often specify the parent by name. Advisors often like to name a charity, like CCF, that has a very broad charitable mission so clients have the flexibility to support a wide range of causes. Clients will need to hire experienced counsel when creating an SO.

Because there are many organizational and operational requirements for SO’s activities, a more complete discussion of SOs is beyond the scope of this document.

CCF CLIENT SERVICES

CCF’s experts partner with clients to transform ideas into action and ensure clients make the impact they seek. Often, those services include:



case study: gift of privately-held c corporation stock

BACKGROUND

Doug, a financial advisor, called CCF to tell us that John and Mary Jones, his clients of more than 25 years, have received an offer to sell a division of their company. The company is a privately-held California C Corporation. The offer is for \$30 million, and John's and Mary's basis in their shares is \$3 million. John and Mary would like to make a gift of \$10 million to charity. They have asked Doug whether they should create a private foundation and, if not, what other options he would suggest. Finally, they would like Doug to manage the assets earmarked for charitable giving.

ISSUES

■ Tax

- charitable income tax deduction
 - If John and Mary donate their shares to a newly formed private foundation, their charitable income tax deduction will be limited to \$1 million ($\$10 \text{ million} \div \$30 \text{ million} \times \3 million) – their basis in their shares.
 - If John and Mary donate their shares to a donor advised fund (DAF) at CCF, their charitable income tax deduction will be \$10 million: the full fair market value of their shares.
 - If they cannot use the entire deduction this year, they have five more years to apply it against their income.
- capital gains tax
 - If John and Mary donate their shares before the sale is deemed complete (e.g., signing the agreement to sell), then they will likely avoid paying capital gains tax on the donated shares.

■ Investment Advisory

- John and Mary could continue to have Doug manage the assets earmarked for charity, whether they chose a private foundation or the Charitable Asset Management Partnership investment option (“ChAMP”) for their DAF at CCF.

■ Administration and Services

- With the new private foundation, John and Mary would, among other things, need to ensure that 5% of the foundation's endowed assets are distributed annually, vet the charities, make grants and serve as fiduciaries.
- With a DAF at CCF, John and Mary would not be restricted by an annual distribution requirement, allowing them to make grants on their own timeline. In addition, CCF would provide John and Mary with a designated member of our Donor Relations Team to discuss what types of services would be most helpful to them. Those services could include creating a giving plan, providing research on charities and engaging the next generation.

RESOLUTION

Two days later, Doug discussed the options with John and Mary. Consequently, they decided to donate their stock to CCF to create the John and Mary Jones Foundation Fund. They avoided paying capital gains tax on the shares and were eligible for a charitable income tax deduction of \$10 million. Further, \$10 million was available for them to grant to their favorite charities. They were thrilled that Doug, their trusted advisor, could serve as the investment manager for their fund at CCF.

REMINDERS

- *Not all charities will accept gifts of closely-held stock.*
- *Clients will generally receive the best tax benefits by donating them to a donor advised fund at CCF rather than a private foundation.*
- *Shareholder agreements may have to be amended to permit transfers to charity.*
- *Clients can often retain their investment advisor for their fund at CCF when donating property valued at \$500,000 or more.*
- *Clients must obtain a qualified appraisal to substantiate their income tax deduction.*
- *Clients who create DAFs at CCF become part of a community of like-minded individuals in Los Angeles, supported by a century-old institution.*

To discuss creating personalized giving solutions for your clients, contact your relationship manager or our Development and Donor Relations Team at donorrelations@calfund.org or (213) 239-2310.

IMPORTANT LEGAL DISCLOSURE

The information provided is general and educational in nature. It is not intended to be, and should not be construed as, legal or tax advice.

The California Community Foundation does not provide legal or tax advice. You should consult your tax advisor to properly determine the tax consequences of making a charitable gift to the California Community Foundation.

Contributions to the California Community Foundation represent irrevocable gifts subject to the legal and fiduciary control of the foundation's board of directors.

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by Don Gottesman, J.D. L.L.M. (Tax)

WHAT CHALLENGES MIGHT MY CLIENT FACE WHILE OPERATING A PRIVATE FOUNDATION?

Operating a private foundation allows a client to maintain high public visibility about their charitable work while providing great control over board appointments and investment decisions. This structure also allows clients to employ family members and make grants to individuals, under certain circumstances, and other charities.

As time goes on, clients with private foundations often face various challenges, such as:

- meeting year-end distribution requirements to avoid tax penalties
- donating appreciated closely-held business interests to maximize tax benefits
- making grants to foreign charities
- determining which charities to support
- wanting to support a charity, yet not have the support traced back to the foundation or donor
- engaging the next generation in the foundation's activities
- finding a successor

WHAT SOLUTIONS AND SERVICES ARE AVAILABLE TO MY CLIENT?

Establishing either a **donor advised fund** ("DAF") or **Type I Supporting Organization** ("SO") at a public charity, such as the California Community Foundation, can resolve many of these operational challenges.

TAX ISSUES

Meeting year-end distribution requirements to avoid tax penalties

Private foundations must distribute 5% of their endowed assets annually. Meeting this annual distribution requirement, however, can be challenging when the board cannot meet, has difficulty making decisions about which charities to support or if investment returns are greater than anticipated. Unfortunately, failure to make timely annual distributions may result in severe tax penalties for the foundation:

- a 30% tax on the undistributed amount
- a 100% tax if the amount remains undistributed by the next year

To avoid imposition of penalties, foundations often create a DAF or SO at a public charity and fund it with the amount necessary to meet the rules. Another benefit of this solution is time. Because neither a DAF nor an SO currently have an annual distribution requirement, the client has more time to determine which charities to support. Many advisors to and boards of private foundations have created DAFs at CCF so that their foundation can meet its annual distribution requirement and make grants on its own timeline.

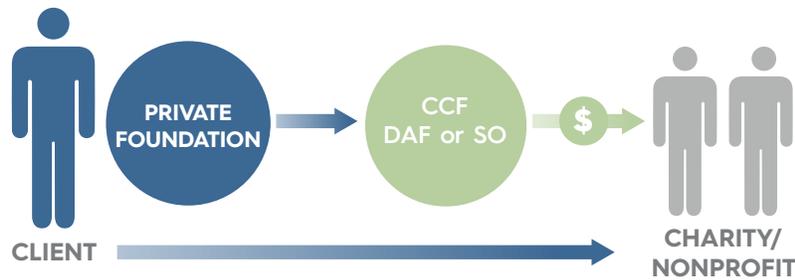
at a glance

ENHANCING THE BENEFITS OF AN EXISTING PRIVATE FOUNDATION

- Private Foundation Challenges: p 1
- Possible Solutions: pp 1-3
- Case Study: Avoiding Tax Penalties: p 4

Donating appreciated closely-held business interests

Some clients own closely-held business interests, such as C or S Corporation stock or LLC interests, that they would like to donate. Often, these interests have very low basis and a high fair market value. If they donate the interests to their private foundation, then the total deduction is limited to their basis. By contrast, if they donate the interests to a DAF or SO, their total deduction will usually be equal to the full fair market value. Clients who donate to either a DAF or SO are also able to use 10% more of their adjusted gross income when claiming their annual deduction. CCF often accepts gifts of closely held-business interests so that clients can maximize their tax benefits.



SERVICE NEEDS

Engaging the next generation

Parents sometimes form a private foundation to bring their family together, teach philanthropy or impart certain values on future generations. However, future generations may view the private foundation as being solely reflective of the founders. Also, parents may not have the time to train the children on how to vet charities or do the other work required to operate the foundation.

A simple solution is to create a DAF at a public charity and have the child (or children) serve as the advisor for grants from that DAF. Funded with only a small amount of money, the child partners with the charity's donor services team to develop areas of interest, find charities and trace the impact the grants made. At the private foundation's annual board meeting, parent and child could discuss the experience and lessons learned. This process allows the next generation to learn lessons with little risk and prepares them for leading the foundation.

When a private foundation opens a DAF at CCF, the client gets access to CCF's experts in various interest areas, such as education and health, as well as knowledge gained through 100 years of making grants. The client's children receive the assistance of a designated relationship manager, who will help create a giving plan, supply custom-made research on charities, take them on site visits and identify emerging giving opportunities. Creating a DAF at CCF can help build bridges among generations and teach critical skills to the foundation's future leaders.

Making grants to foreign charities

Some clients may wish to make grants to foreign charities and include them for the purpose of meeting annual distribution requirements. In other words, a "qualifying distribution" under Section 4942(g)(1)(A) of the Internal Revenue Code.

There are three ways to do this:

- grant to the US "Friends of" organization;
- exercise expenditure responsibility; or
- make an equivalency determination.

Granting to a "Friends of" organization would be the easiest route, but many foreign charities do not have a U.S.-based "Friends of" organization.

Accordingly, if the foundation still wants to make the grant, it has several steps to follow. First, the foundation must ensure that all the rules pertaining to anti-terrorism and anti-money laundering are met. Then, if it decides to exercise expenditure responsibility, it must take steps to ensure the grant is spent only for the purpose it was made, including obtaining reports from the grantee and providing detailed reports to the IRS. Until the foreign grantee has redistributed the funds, the foundation cannot treat the grant as a qualifying distribution.

If the foundation decides instead to make an equivalency determination, it must also follow many steps, including obtaining a written opinion from a tax practitioner. This written advice must include sufficient facts for the IRS to determine that the foreign charity would likely qualify as a public charity in the U.S.

When there’s not a “Friends of” organization, many private foundations create a DAF at a public charity, thereby shifting the regulatory burdens of making the grant to a non-U.S.-based charity to the public charity. Since the grant to establish the DAF is made to a public charity, it will count as a qualifying distribution even if, for some reason, none of the tests can be met and the grant to a non-U.S.-based charity cannot be made.

CCF routinely helps its donors to make grants directly to foreign charities from their DAFs. Over the past 25 years, we have made more than 600 grants to nonprofits in more than 40 countries. CCF has created policies and procedures to meet the equivalency determination, and we have experts on staff to ensure that grants meet all applicable laws. In addition, we usually do not charge our donors an additional fee for this service.

Privacy and Managing Grant Requests

A private foundation must make its annual return, IRS Form 990-PF, available for public inspection. Therefore, anyone with an internet connection can obtain information about the foundation’s assets, the identities of its major donors and the charities the foundation supports.

Consequently, clients often receive unsolicited grant requests and calls from financial advisors seeking to manage the foundation’s assets. In some cases, clients become the subject of stories in the media or the target of lobbyists or protestors because of the charities they support through their private foundations.

Rather than trying to manage the onslaught of solicitations, some private foundations create a DAF at a public charity with the sole purpose of having a gatekeeper to manage solicitations. The foundation’s board develops criteria for its grantmaking to guide the public charity’s staff when reviewing requests. Then, it places a notice on its website that all discretionary grantmaking will be handled by the public charity’s staff. CCF has staff to help clients develop criteria, notify charities of the criteria, review submissions and recommend grantees so that the foundation can focus on the impact it wishes to make.

To safeguard clients’ identities when making grants to certain charities or causes, advisors often recommend that clients create a DAF and make the grant from the DAF rather than the private foundation. Although public charities must report all grants on their returns, the information is reported in the aggregate, without disclosing what grant was made from what fund. In addition, at CCF, donors decide whether to include the name of their DAF on the check to the grantee. We take donor privacy very seriously at CCF.

CCF CLIENT SERVICES

CCF’s experts partner with clients to transform ideas into action and ensure clients make the impact they seek. Often, those services include:



case study: avoiding tax penalties

BACKGROUND

John, an attorney, called CCF to tell us that the board of a private foundation he has advised for many years will not be able to meet before year-end to approve its remaining grants. If it does not approve grants soon, then the foundation will not meet its minimum distribution requirements and will incur significant tax penalties.

ISSUES

The foundation's bylaws state that when family members reach a certain age, they automatically become members of the board. Currently, the board is comprised of three generations of family members. The youngest board members question its relevancy and would like to change the foundation's mission statement. In addition, the foundation has a financial advisor whose investment expertise it would like to retain. John asked whether CCF could help the family solve the looming deadline for distribution and help the family with grantmaking.

We suggested to John that the board create a donor advised fund ("DAF") at CCF and fund it with an amount equal to the private foundation's remaining minimum distribution requirement. This would prevent the foundation from incurring any tax penalties and give the foundation's board access to CCF's services. We also proposed that, for now, each board member be permitted to recommend a small grant while the full board, through a resolution, would recommend larger grants from the DAF. The hope was this structure would lead all generations to feel that they were part of the foundation and to a better functioning foundation.

RESOLUTION

After John discussed the proposal with his client and we met with the board, the private foundation decided to create a DAF at CCF. Through its initial grant to the DAF, it met the minimum distribution requirements and avoided any tax penalties. Our team interviewed all board members about their interests, suggested charities within their interest areas and provided them with methods to evaluate the charities. CCF approved the foundation's investment advisor through our Charitable Asset Management Partnership investment option ("ChAMP"), and he is managing the DAF's assets. Because the board values the research and other programmatic support CCF has given, it has made additional gifts to its DAF.

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by Don Gottesman, J.D. L.L.M. (Tax)

WHY MIGHT THE PRIVATE FOUNDATION NO LONGER MEET MY CLIENT'S GOALS?

Operating a private foundation is like running a business. The client must, among other things, hold board meetings, invest assets, review investment performance, vet charities, make grants and review and file returns. Even though the client may hire professionals to help with these tasks, they still have work to do to comply with fiduciary duties and other federal and state rules.

As time goes on, clients with a private foundation may find that:

- they are exhausted by the burdens of running the foundation and would rather spend time doing something else
- they are not making the impact they had hoped because:
 - the foundation's assets have dwindled
 - the cost of hiring professionals to help with operations has reduced the amount of money available for grantmaking purposes
 - the process of vetting charities and evaluating reports from grantees requires more expertise than they anticipated
 - they would like more privacy around their giving
 - they are unable to find a successor because their children are not interested in running the foundation or their friends are all their age

WHAT OTHER OPTIONS ARE AVAILABLE TO MY CLIENT?

When operating a private foundation no longer seems like the best fit for a client, the client can either terminate the foundation and distribute the assets outright to charities or convert the private foundation to a donor advised fund, field of interest fund, restricted fund or Type I Supporting Organization at a public charity, such as the California Community Foundation.

Choosing between these options often involves asking whether the client intends to:

- make additional charitable gifts beyond the assets remaining in the foundation;
- be involved with future grantmaking decisions and to what extent; and
- have their giving continue after death.

at a glance

WHEN A PRIVATE FOUNDATION NO LONGER FITS

- Why a Private Foundation Might Not Fit: p 1
- Options for Terminating or Converting: pp 1-5
- Case Study: Convert to Donor Advised Fund: pp 6-7

Terminating the private foundation and distributing the assets outright

Terminating an existing private foundation may be the best choice for clients who simply want out, are unlikely to make additional donations and know which charities should receive the foundation's assets.

Hiring experienced professionals is key for a successful termination. Failure to properly terminate can result in severe tax penalties and personal liability.

Some of the steps involved with termination include:

- a resolution for dissolution that transfers all assets to public charities and calls for the preparation of a Certificate of Dissolution
- a letter to the California Attorney General requesting a written waiver of objection to the dissolution and transfer
- notification to creditors and settling of outstanding debts
- filing the Certificate of Dissolution and other reports with the California Attorney General
- distribution of the remaining assets to designated charities
- filing final returns with the IRS and California Franchise Tax Board

Converting the private foundation to a donor advised fund or other fund at a public charity

Converting a private foundation to a **donor advised fund** ("DAF") or **Type I Supporting Organization** ("SO") does involve terminating the existing private foundation. However, conversion can, in some cases:

- a. allow the private foundation's name to be retained;
- b. permit the client to remain involved in grantmaking decisions;
- c. give the client access to services; and
- d. allow continued service from the foundation's investment advisor.

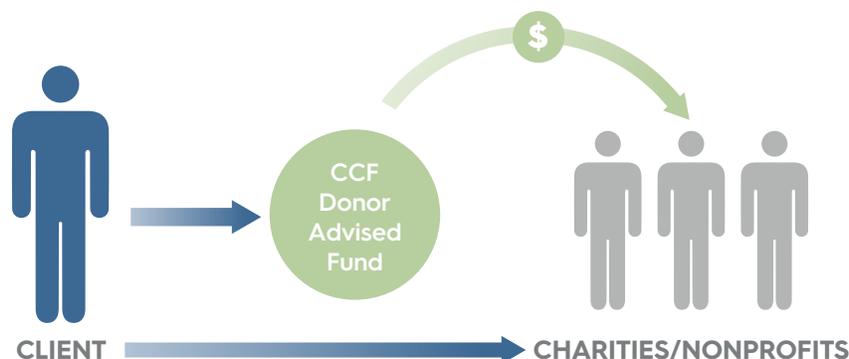
Usually, the foundation's advisor will recommend that the balance of the foundation's assets be used to create a donor advised fund ("DAF"). At CCF, donors who previously operated a private foundation typically choose a DAF, but sometimes choose instead a field of interest fund, a restricted fund or an SO.

Keep in mind that terminating and converting a private foundation may not be necessary when the main reason is to preserve family harmony. For example, if the entire family gets along except for one family member or one family member wishes to support causes outside the foundation's mission, then the foundation's board can liquidate a portion of the foundation's assets and distribute the assets to a donor advised fund naming the family member as the advisor for the fund. Liquidating a portion of the foundation's assets and distributing them to a DAF or charity is not necessarily deemed a termination.

Donor Advised Fund

A donor advised fund (“DAF”) is a type of account at CCF that allows the client to remain involved in charitable giving while giving them access to services. Some of the benefits include:

- using the private foundation’s name for the DAF
- having the choice to use the fund’s name in letters accompanying checks to the charities
- no more state or federal filings because the DAF is a part of CCF
- no more actions needed to meet fiduciary duties such as:
 - board meetings, minutes and record keeping on possible grantees and grants made
 - creating investment policies, hiring and managing outside investment advisors and ensuring other investment restrictions are met
- no more prying eyes about the identities of major donors and the charities being supported
- recommending how the DAF’s assets are invested by choosing either:
 - an investment pool operated by CCF; or
 - their trusted financial advisor under CCF’s Charitable Asset Management Partnership investment option (“ChAMP”)¹
- making grants on their timeline because, unlike private foundations, there is currently no rule requiring distributions from a DAF
- having access to a designated relationship manager and CCF’s programmatic officers for services, including:
 - supplying custom-made research on local, national or international charities in the client’s areas of interest
 - brokering meetings with community leaders and visits to charities
 - identifying emerging giving opportunities
 - refining the client’s charitable goals
 - engaging other family members in giving
- existing in perpetuity
- being part of a community of like-minded individuals in Los Angeles, supported by a century-old institution



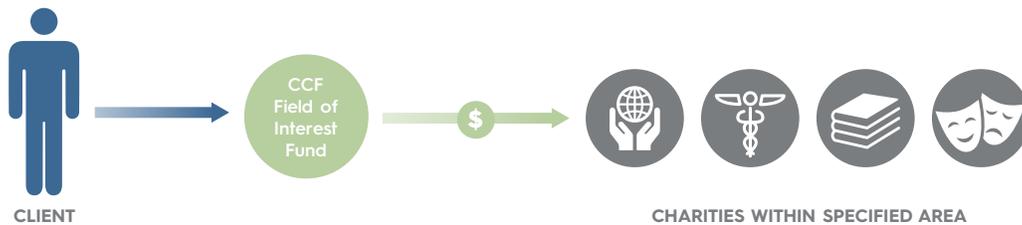
1. Only eligible for gifts having a value of at least \$500,000.

Field of Interest Fund

A field of interest fund (“FOI”) is an account at CCF that allows the former private foundation’s board to select areas of interest, such as arts, education or housing, and CCF staff to select the charities who will receive the grants. Our staff partners with the former board to craft instructions about how CCF should administer these funds and can provide reports about grants made. An FOI has many of the same benefits as a DAF, such as being able to retain the foundation’s name and eliminating the need to file returns, but after the instructions have been approved, there is no ongoing participation by the client.

Some foundation boards find an FOI helpful when:

- they have not been able to identify a successor and would like to continue to support the same charitable interests;
- they want to ensure support for their areas of interest despite the interests of future generations; or
- they want to ensure that grants are being given to charities providing “best in class” services in case their favorite charities are no longer performing well or have ceased operations.



Restricted Fund

A restricted fund is an account at CCF in which the former private foundation board selects the charities that will receive the grants at the time the account is created. It is often used to create an endowment for one or more charities and have an entity, like CCF, ensure that the grantee is using the funds for the intended purpose. A percentage of the fund’s value is given to the charities on an annual basis, and the fund can exist in perpetuity or for a term of years. While a restricted fund has many of the same benefits as a DAF, such as being able to retain the foundation’s name and eliminating the need to file returns, unlike a DAF, the client’s ongoing participation ends after it has selected the charities, the payout percentage and the term. When creating funds with perpetual duration, one must be sure to keep in mind the payout rules found in the state’s Uniform Prudent Management of Institutional Funds Act.



Type 1 Supporting Organization

A Type 1 Supporting Organization (“SO”) is a type of public charity whose primary function is to support the work of another public charity. People often describe the relationship between an SO and the other public charity as being like that of a corporate subsidiary to a parent company. The parent (i.e. the supported charity) must operate, supervise or control the SO, such as by having the power to appoint a majority of the SO’s board.

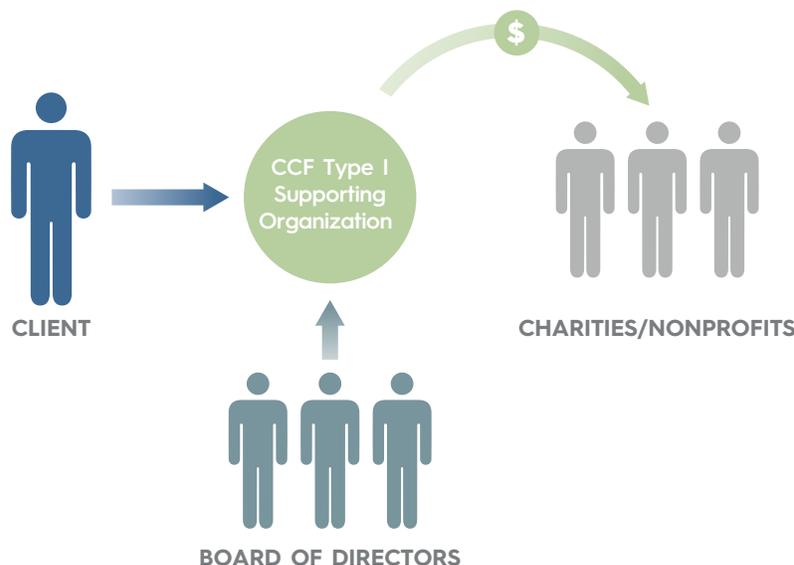
An SO provides a similar experience to a private foundation because it has a board and allows clients to remain involved in charitable giving while providing them access to services. It also permits the board to hire staff, thereby allowing, for example, the retention of the foundation’s former executive director or grantmaking expert. Keep in mind, however, that no family members can be employed. Many of the same benefits of a DAF also apply to an SO, such as the lack of an annual distribution requirement.

The SO’s organizational documents, in order to meet IRS tests, often specify the parent by name. Advisors often like to name a charity, such as CCF, that has a very broad charitable mission so that clients have the flexibility to support a wide range of causes. Clients will need to hire experienced counsel when creating an SO.

After the SO has been formed, CCF staff will handle many of the required tasks, such as:

- scheduling and preparing materials for board meetings;
- conducting research and due diligence on possible grantees; and
- preparing and filing federal and state tax returns while the SO is in operation,

thereby allowing the family to concentrate on giving to the causes they love.



case study: convert to donor advised fund

BACKGROUND

Carlos called CCF to tell us about the private foundation where he currently serves as president. He and his wife Cara are the sole officers. Carlos' father established the foundation 50 years ago, and it has made grants to charities who provide services in housing, medical care and disaster relief, as well as to disabled veterans.

At first, Carlos and Cara enjoyed running board meetings, investing the foundation's assets and doing due diligence on potential grantees. Carlos kept copious records on the grantees and relished reading their reports about the impact the foundation's grants were making.

ISSUES

Now, however, Carlos and Cara are both in their eighties and have several health issues. Carlos also has been wanting to write a book and spend more time composing music. Their only child Steve, a successful doctor living on the East Coast, is not interested in taking over as the foundation's president.

The foundation's assets have been managed by their favorite financial advisor, and Carlos would like to retain her investment expertise. Further, they would like to keep the foundation's name, in memory of Carlos' parents. Under these circumstances, Carlos asked whether CCF could help.

RESOLUTION

We suggested that Carlos and Cara convert the private foundation into a donor advised fund ("DAF"). That would allow Carlos and Cara to unload the burdens of running board meetings, doing due diligence and making filings, while allowing them to focus on giving to the causes they loved. Carlos and Cara would have a designated relationship manager who could conduct research on potential grantees, visit charities on their behalf and help them to support international charities. Through CCF's Charitable Asset Management Partnership investment option ("ChAMP"), Carlos and Cara could recommend that their foundation's financial advisor provide investment services to their DAF. Further, they could use their foundation's name for the new DAF.

Carlos and Cara, with the help of their attorney, decided to terminate their private foundation and distributed the balance of their assets to a DAF at CCF. They were able to continue supporting their favorite charities and asked CCF to enter into multi-year grants with some of them. Freed from worrying about the duties and requirements of running a private foundation, Carlos could devote time to writing his book and composing music. Giving became a joy again.

Stages of a Private Foundation Conversion

- 1 **Review** – Discuss the client’s concerns about continuing to operate the private foundation and the client’s desire to remain involved with future grantmaking.
- 2 **Plan** – Determine what fund type at CCF fits best and, if appropriate, collaborate with CCF staff.
- 3 **Terminate** – Take the necessary steps to terminate the private foundation and file notices with creditors and governmental agencies.
- 4 **Establish** – Complete fund opening paperwork and give remaining assets to the fund at CCF.
- 5 **File** – Complete and submit the final return or accounting.

REMINDERS

- *Start early, because converting a private foundation usually takes 3-6 months.*
- *Consider establishing a reserve for paying expenses from the wrap-up.*
- *Clients often can retain the foundation’s investment advisor for their fund at CCF when the value of the assets transferred is at least \$500,000.*
- *Clients can continue to support their favorite charities and gain access to CCF’s staff and services.*

To discuss creating personalized giving solutions for your clients, contact your relationship manager or our Development and Donor Relations Team at donorrelations@calfund.org or (213) 239-2310.

IMPORTANT LEGAL DISCLOSURE

The information provided is general and educational in nature. It is not intended to be, and should not be construed as, legal or tax advice.

The California Community Foundation does not provide legal or tax advice. You should consult your tax advisor to properly determine the tax consequences of making a charitable gift to the California Community Foundation.

Contributions to the California Community Foundation represent irrevocable gifts subject to the legal and fiduciary control of the foundation’s board of directors.

THE CALIFORNIA COMMUNITY FOUNDATION

For more than a century, the California Community Foundation has helped donors and advisors transform generosity into impact, in Los Angeles and around the world. Professional advisors are vital to the creation of gifts that improve lives and communities, and we welcome the opportunity to partner with you and your clients. To learn more about how the California Community Foundation can help with your and your clients' charitable giving, visit calfund.org/advisors or call **(213) 239-2310**.