Enhancing the Benefits of an Existing Private Foundation

California COMMUNITY Foundation

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at a **glance**

ENHANCING THE BENEFITS OF AN EXISTING PRIVATE FOUNDATION

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

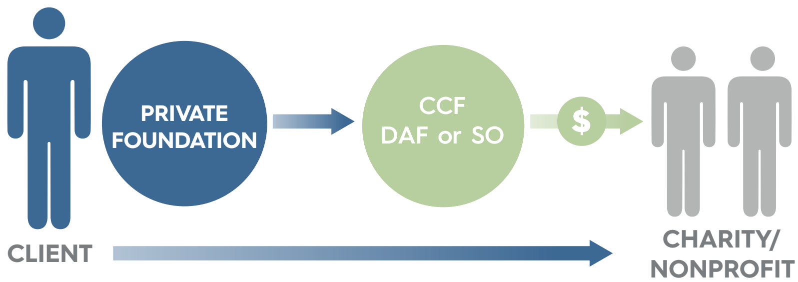
Private foundations must distribute 5% of their endowed assets annually. Meeting this annual distribution requirement, however, can be challenging when the board cannot meet, has difficulty making decisions about which charities to support or if investment returns are greater than anticipated. Unfortunately, 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.

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.

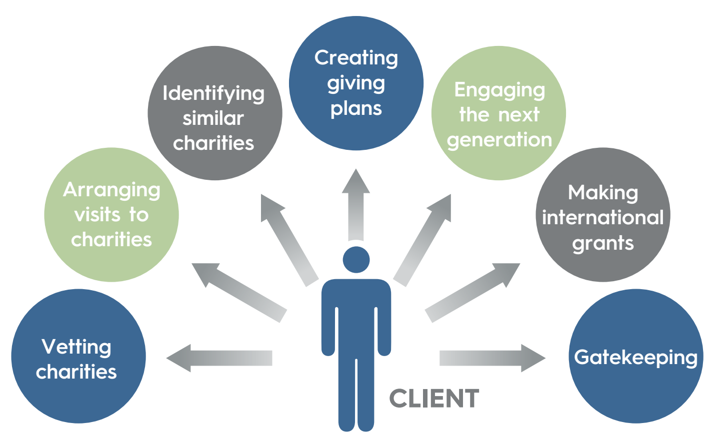
Consequently, clients often receive unsolicited grant requests and calls from financial advisors seeking to manage the foundation's assets. In some cases, clients become the subject of stories in the media or the target of lobbyists or protestors because of the charities they support through their private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

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.

California COMMUNITY Foundation

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