When a Private Foundation No Longer Fits

California COMMUNITY Foundation

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at a glance

WHEN A PRIVATE FOUNDATION NO LONGER FITS

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.

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.

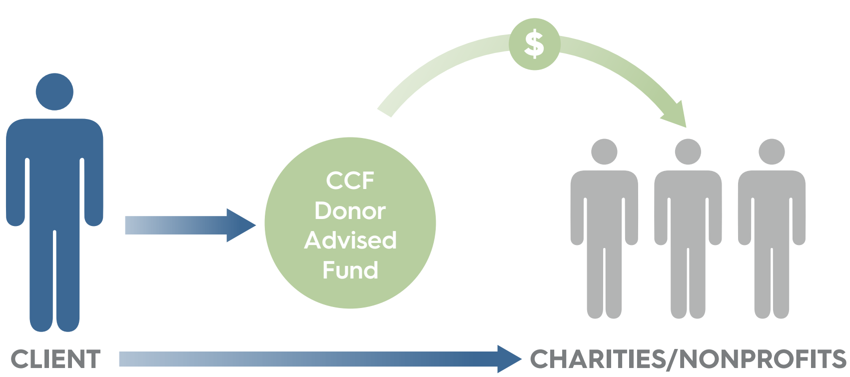
Usually, the foundation's advisor will recommend that the balance of the foundation's assets be used to create a donor advised fund ("DAF"). At CCF, donors who previously operated a private foundation typically choose a DAF, but sometimes choose instead a field of interest fund, a restricted fund or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



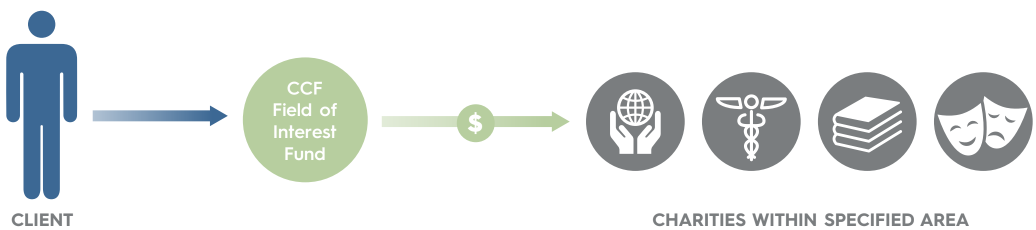
1. *Only eligible for gifts having a value of at least $500,000.*

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.

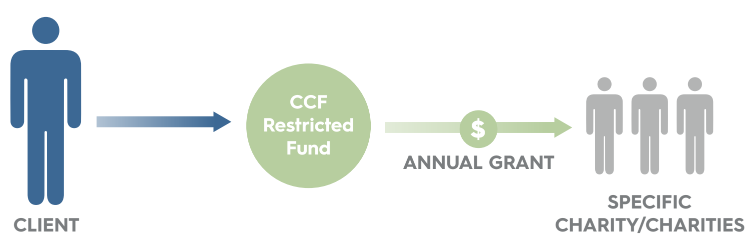
Some foundation boards find an FOI helpful when:

- 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.

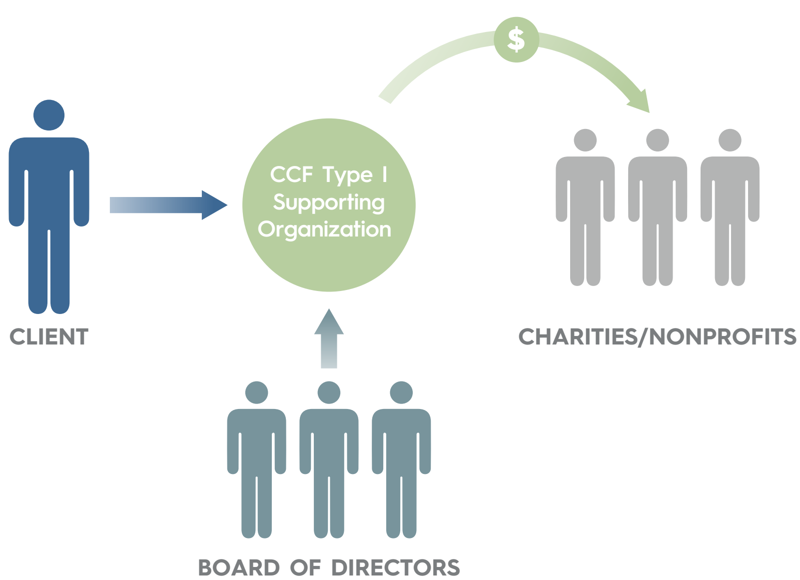
An SO provides a similar experience to a private foundation because it has a board and allows clients to remain involved in charitable giving while providing them access to services. It also permits the board to hire staff, thereby allowing, for example, the retention of the foundation's former executive 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 Carla 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.

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