Seven Options in Family Philanthropy

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After serving as a law clerk to Judge Clarence Allgood in the United States District Court for the Northern District of Alabama, Kathryn joined AmSouth Bank (now Regions) as a trust officer, managing its Estate Administration Team, Charitable Trust Team, and then serving as Senior Vice President and Manager of the Personal Trust Division. In 1994 she moved to Sterne, Agee & Leach, a privately owned brokerage firm, to establish and serve as President & CEO of its Trust Company. In 1997 she established Kathryn W. Miree & Associates, Inc. to focus on charitable gift planning, administration and compliance in management of planned gifts and endowments, and effective communication with and engagement of donors. Her client include nonprofits from all charitable sectors across the United States and in Canada.

Kathryn has been actively professionally as past president of the National Committee on Planned Giving, past president of the Alabama Planned Giving Council, and past President of the Estate Planning Council of Birmingham, a member of the NAEPC board, and as Vice Chair of the Task Force on Legal Education of the Alabama Bar Association. She was inducted into the National Association of Charitable Gift Planners Hall of Fame in 2018. She was inducted into the National Estate Planners and Councils Estate Planning Hall of Fame in 2020.

In her community Kathryn has served as Chair of the Community Foundation of Greater Birmingham, Chair of United Way of Central Alabama, and Chair of The Altamont School as well as serving in various capacities on more than twenty other nonprofit boards. Kathryn is a frequent lecturer, co-author of *The Family Foundation Handbook* (CCH Publishers 2014) and author of *The Professional Advisor's Guide*

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SEVEN OPTIONS IN FAMILY PHILANTHROPY

I. The Challenges in Choosing a Philanthropic Form

A. The U.S. Culture of Philanthropy

Individuals in this country are philanthropic - more so than any country the world. Tax laws incentivize giving, and donors give generously. Giving USA 2021, which measures charitable giving for the years 2020 reports donors gave $471.44 billion to charity in 2020 as shown in Table 1. As shown, 78% of the charitable gifts came from individuals, and perhaps more when you consider gifts from family foundations.

Matt Frei, a BBC writer and Washington correspondent, shared this perspective in *Washington Diary: Culture of Giving*[1] gained when his child attended an American University and he was solicited by the school:

> "*It is impossible to imagine modern America without philanthropy, because so many of the institutions funded by the state in Europe are financed by private citizens in this country…Whether it is the quest for a legacy, the desire to change the world, the determination not to spoil one's children or simply the tax code, Americans - wealthy and not so wealthy - are giving their dollars away by the lorry load. And the rest of the world has a long way to catch up.*"

Individuals in this country invest in quality of life through their philanthropy. They teach their children about giving. They volunteer to support the charities important to them. So it is only natural that this passion for philanthropy would have a role in their estate planning. Often they want to institutionalize their giving and create a mechanism to get the family involved in philanthropy - and keep them involved. That's when they begin to talk with you about creating a private foundation or similar structure to accomplish that. The more important philanthropy is to the client, the more appealing the idea of institutionalizing that practice.

Selecting the right form for the client to institutionalize the family's philanthropy is not as easy as it sounds. Clients like the idea of an entity like a private foundation but often have buyer's remorse when they realize how difficult it is to manage it effectively. This session is designed to help you ask the right questions and select a structure that best fits the client and will achieve the client's planning goals.

B. Creating Entities That Donors Can Manage

The single greatest challenge to planners is selecting an entity that fits the client from a practical point of view. That is, the client must not only have the support system and cognitive ability, but the temperament to manage the foundation as well.

1. Responsibilities of Administration and Management

Donors interested in family philanthropy and community responsibility are often focused solely on philanthropic outcomes and give little thought to the implications or obligations in the choice of entity. Even activities that appear simple – like selecting grant recipients – can become complex and rule-laden tasks. Take the client through a checklist of responsibilities associated with each option to ensure they are willing to take on the responsibilities, or assign those responsibilities to third party managers, before making a decision on entity form.

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[1] Frei, Matt, "Washington diary: Culture of Giving," http://news.bbc.co.uk/2/hi/americas/4756363.stm.

2. Complying With the Rules

The most frequently used institutional family philanthropy options – private foundations, supporting organizations, and donor advised funds – are subject to strict operating rules. Clients managing their own foundations must understand the applicable sections of the Code and its regulations governing everyday administration and tax filings, investment management limitations. The prohibited transaction rules in IRC §§ 4940-4947 are difficult to navigate and far from intuitive. The taxes under Chapter 42 are unfamiliar. Clients must make a commitment to learn the rules or retain staff or counsel with that expertise.

3. Dodging Penalties

The penalties imposed upon violation of philanthropic entity rules impact both the individuals responsible and the philanthropic assets. These penalties may be assessed for failing to meet administrative requirements (tax filings, public disclosure), making distributions to non-qualified entities, investing in jeopardizing investments, or engaging in transactions with disqualified persons as shown in Table 1.

TABLE 1
SANCTIONS IMPOSED ON PROHIBITED TRANSACTIONS BY THE INTERNAL REVENUE CODE

Activity	First-Tier Sanction/Trigger for Payment	Second-Tier Sanction/Trigger for Payment
Self-Dealing IRC §4941	10% of the transaction on the self-dealer, plus 5% on the foundation manager(s), for each year the transaction is outstanding and has not been corrected, with a $20,000 limit for the managers of the foundation	200% of the transaction on the self-dealer if the transaction is not corrected in timely fashion, plus 50% of the transaction (up to a maximum of $20,000) imposed on the manager if he or she refuses to resolve the situation and agree to all or part of the penalty
Failure to Distribute Income IRC §4942	30% of undistributed income remaining at the beginning of the second (or succeeding) taxable year following the required distribution period	100% of the undistributed income amount remaining at the close of the taxable period in which the original penalty was imposed
Excess Business Holdings IRC §4943	10% of the value of the excess business holdings held by the foundation during any taxable year which ends during the taxable period	200% of the value of the excess business holdings in any case in which an initial tax is imposed and the foundation still holds those excess business holdings at the close of the taxable period
Jeopardizing Investments IRC §4944	10% of the transaction amount on the foundation, plus another 10% (up to $10,000 per investment transaction) on management, imposed for each year that the jeopardizing investment is held by the foundation	25% of the transaction amount on the foundation, plus another 5% (up to a maximum of $20,000) imposed on those managers who do not agree to remove the jeopardizing asset

Taxable Expenditures IRC §4945	20% per expenditure on the foundation, plus 5% (up to $10,000 per expenditure) imposed on those managers who knew about and agreed to make the expenditure	100% per expenditure on the foundation, plus 50% (up to a maximum of $20,000) imposed on those managers who refuse to correct the expenditure
Political Expenditures IRC §4955	10% of each expenditure on the organization, plus 1 ½% of each expenditure (up to a maximum of $5,000) imposed on any manager who agreed to making the expenditure	100% of each expenditure on the organization, plus 50% (up to a maximum of $10,000) imposed on any manager who refuses to agree to all or part of the correction

4. Creating Results

The final frequent challenge is translating the donor's philanthropic goals into reality. Those goals are specific to each donor but may involve engaging family members in philanthropy, creating a specific impact community impact, or perpetually connecting the family's name to a specific philanthropic endeavor. It takes more than creation of a philanthropic entity to accomplish the goals. Benchmarks must be established, measures – someone or some process must guide the donor through the exercise of his or her philanthropic goals.

C. Overcoming Confident Possessiveness

Donors – especially donors with wealth – are accustomed to taking control and making decisions. These donors tend to treat entities such as foundations or donor advised funds just as they would a personal business, making decisions based on personal preferences and perspectives. However, the basic underlying truth about any philanthropic entity is that it no longer belongs to the donor. Rather, it is either a separate philanthropic entity created by the donor or a component of an existing public charity. These entities are separate citizens and taxpayers under state and federal law. The public "owns" the funds and the state Attorney General and the IRS oversee the use of the funds. The donor may have control of the board of directors and be able to make decisions within parameters, but ultimately answers to outside authorities. For donors with extreme possessiveness, it is important not only to reset expectations but to select an entity form that goes as far as possible to accommodate those goals without creating too much risk the donor will violate the rules.

D. Avoiding Legislative Backwash

1. Ongoing Professional Advice

As noted above, clients managing separate philanthropic entities need ongoing professional advice to avoid disaster. This recommendation to retain and use counsel is one that most clients understand, but few follow. Without professional advice and a solid administrative structure or support, clients drift towards personal preferences that may lead them to taxable transactions. This is especially true in the current legislative environment where some entities – such as Type III Supporting Organizations – are now subject to new rules, regulations, and penalties related to distribution requirements, and restrictions on distributions to related parties. Donor advised funds may also create problems because of legislative change, although clients are often saved from themselves because of oversight by the charity holding the funds.

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2. Anticipating Change

Nonprofit entities are perpetual – yet the rules governing those entities are not. Advisors should counsel donors to be prepared for change, and understand the entity so careful constructed may be deconstructed if the law changes in a way that prevents the donor from meeting stated goals. Since the process of creating the philanthropic entity can be costly, time consuming, and require the donor to make difficult personal decisions, it all the more important to clarify operating goals and preferences at the outset, and perhaps to take a test run under a non-formalized structure to understand the impact of entity decisions.

In June 2004 Senate Finance Committee conducted the first hearing, "Keeping Bad Things From Happening to Good Charities," in a series of ongoing hearing on nonprofit abuse. Prior to this June 2004 hearing, the Senate Finance Committee staff published a staff discussion draft proposing reforms for the nonprofit world. These reforms affected taxpayers and the deductibility of certain gifts as well as the form, structure, and taxation of nonprofit entities.[2] Many of draft proposed changes have been enacted through a series of legislation beginning with the American Jobs Creation Act of 2004,[3] and extending to the Pension Protection Act of 2006.[4] A number of those proposals remain under legislative consideration.

3. The Climate in Washington - What Will Happen?[5]

The past year brought two potential threats of drastic changes that could seriously affect private foundations and charitable planning in general. The first is a concern that has been with us for some time, as a sort of background consideration that has become gradually more immediate – growing dissatisfaction with our income tax system. The other, of relatively recent origin, is the recent tidal wave of criticism leveled at the Internal Revenue Service, much of it originating in its administration of tax exempt organizations.

There is no specific legislation under consideration, at least at the present time, and thus early action is not likely. This is particularly unlikely given the considerable dysfunction in Congress and the total lack of consensus about what is wrong and what should be done about it. Nevertheless, members of both parties have called for action of one sort or another on both of these subjects, and they may eventually agree on some strategy on one or both issues. (Well, it could happen.)

a. Tax Reform

The current talk about tax reform offers a classic political quandary. Anyone who has filled out a Form 1040 marvels at the complexity of our income tax and most observers agree that some simplification is needed. Less agreement arises, however, when the discussion turns to just how that simplification would be achieved.

Most income tax simplification proposals start with reduced rates and fewer exemptions and deductions. So far, so good. But what sort of rate structure should apply under a new, simplified tax scheme? Should we attempt to lower the rates that would apply under the new, simplified tax structure, so that the overall effect would be to raise the same amount of tax revenue with lower tax rates? This revenue-neutral approach is favored by some tax theorists. Others argue that income tax rates could be

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[2] Senate Finance Committee, Staff Discussion Draft, http://finance.senate.gov/hearings/testimony/2004test/062204stfdis.pdf, (June 2004).

[3] American Jobs Creation Act of 2004, Pub. L. 108-357, 118 Stat. 1318 (2004).

[4] Pension Protection Act of 2006, Pub. L. 109-280, 120 Stat. 780 (2006).

[5] This section was co-authored by Jerry McCoy and appears in Chapter One of the 2014 Edition of Family Foundation Handbook, Kathryn Miree and Jerry J. McCoy (CCH 2013).

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adjusted downward to some extent, but still allow for sufficient new revenue to allow for sorely needed expenditures for such things as deficit reduction and improved infrastructure. Obviously this choice would set off a bitter struggle between persons holding opposing viewpoints on this issue.

Any change to the current system will almost certainly produce winners and losers. Eliminating or restricting one person's tax preference will create a de facto tax increase on that person, and no taxpayer is likely to accept that gracefully. Will Congress be able to engage in the meaningful discussions and compromises that would be required for implementation of tax reform? Nothing in the recent past suggests that this is likely or even possible. Our tax structure is the product of a large number of special interest provisions, and each one of those has a dedicated group of taxpayers, legislators and trade associations who are prepared to defend it against all challenges.

In the present context, the charitable deduction itself can be viewed as a special interest provision. Long regarded as an important incentive for philanthropy, the income tax deduction for charitable giving is itself a tax preference. It is not available to taxpayers who opt for the standard deduction. Thus it is limited to higher-income taxpayers – and has no application to the 60% or so who use the standard deduction. Correction of this imbalance would be a logical outcome of the coming tax reform debate, but that would be regarded by many as a penalty on charities. This deduction was further compromised (in terms of its impact on donors) when the standard deduction was raised to $24,000, indexed for inflation. In 2022, that deduction for married couples filing jointly is $25,900. In 2019, the first year after the increase, only 11% of all taxpayers itemized.[6]

b. IRS Exempt Organization Function Criticized

The IRS received a great deal of scrutiny in 2013 with allegations that the Service was using a political lens to approve new tax exempt organizations and to focus on the misuse of tax-exempt organizations that had a political purpose. Much of the focus was on the seemingly peaceful area of "social welfare organizations," exempt from tax under section 501(c)(4) [rather than the more familiar section 501(c)(3)]. These 501(c)(4) organizations have become useful as political fundraising devices, since they offer a number of features that are attractive for political purposes.

- They are required to devote their earnings "exclusively to charitable, educational or recreational purposes." However, the IRS has construed this to mean that a 501(c)(4) organization can engage in political campaign activity so long as this is not its primary activity.
- A (c)(3) is severely limited in its ability to lobby, while a (c)(4) is free to engage in substantial lobbying activity.
- A (c)(3) is exempt from tax only if it seeks (and obtains) IRS recognition of its tax exempt status, while a (c)(4) can self-declare, without notifying IRS.
- Contributions to a (c)(4) are totally anonymous, while a (c)(3) must reveal its contributors.

For all these reasons and more, section 501(c)(4) social welfare organizations have become a standard device for political campaigns.

The Internal Revenue Service was unprepared for the rapid proliferation of 501(c)(4) organizations after the Supreme Court decision in *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010) held that rules restricting lobbying by corporations and other organizations, including social welfare organizations described in section 501(c)(4), violated the First Amendment. This led to a

[6] This data is from the most recent Statistics of Income Bulletin from the Internal Revenue Service, https://www.irs.gov/statistics/soi-tax-stats-historic-table-2. Statistics show 157,705,360 taxpayers filed returns and only 17,223,980 itemized (10.92%).

rapid rise in the number of lobbying organizations seeking to qualify under the new rules. The IRS reaction was criticized by applicants who found their exemption applications under section 501(c)(4) delayed. Many objected to the resultant delay and, moreover, protested that they had been singled out on the basis of their political views. Congressional hearings followed.

This concern is certain to be reflected in whatever legislative reaction follows. There is a predictable variety of views on what happened and why, and how the law should react. This is likely to be an important component of any Congressional response, and the effect on the rules governing tax exempt organizations is likely to be meaningful. It is important to stay informed of developments in this area, especially if this is an area of active practice.

c. So What Does It All Mean?

Yogi Berra is often quoted as saying "It's tough to make predictions, especially about the future," and that is as true today as ever. The problems that face our Congress are serious ones and the members must, as always, balance conflicting views in seeking answers. There is not a reliable crystal ball to provide answers about what the future will bring about tax reform or the IRS. The need for tax reform has been a current national issue for many years now, and the controversy over reports of IRS favoritism likewise has deep roots in the past. It is probably much too early to evaluate the long term implications of these issues.

Professionals who advise tax-exempt organization clients find themselves at the center of these disputes, and they must complete their work and move on to other matters. Here are some guidelines can provide help for such situations:

- Know what current law is (or is likely to be upheld) on the legal issues presented, and act accordingly. Remember, you minimize risk when you follow current law faithfully, even where you can visualize another viewpoint.
- In keeping with this, be aware of situations that promise to attract attention. For example, a client who wishes to utilize a section 501(c)(4) organization for a purely political objective (e.g., to influence and election) should be aware that he or she is pushing the limits of the law, and should not be surprised if IRS challenges such a bold disregard of the law. True, it may be difficult to identify such a clear violation, and the absence of clear rules is a major part of the problem. But one who doesn't even realize when he/she is nearing a violation of the law should clearly be concerned,
- Remain alert to future developments as they occur, and where they have immediate consequences, keep clients advised, through general newsletters or specific notifications, whichever is appropriate under the circumstances. If your client follows an aggressive tax position on such issues, he/she takes on an added degree of risk.
- Consider the implications of indirect or unintended consequences and not just those that are directly involved.

One of the complaints raised by organizations caught up in the IRS scandal is that their exemption applications were delayed and they were subjected to disruptive and excessive requests for additional information. This is a common reaction from applicants who encounter delays in the exemption process. Delays have always been a problem for applicants, and these may become more common in the post-scandal period. Some causes of such delays in processing exemption applications are foreseeable:

- New IRS scrutiny
- Increased volume of applications

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- Distractions created by requests from Congressional inquiries
- Understaffing in the Exempt Organizations function (including threatened cutbacks in funding by angry members of Congress)
- Or more mundane causes such as insufficient supply of capable and trained staff

V. Seven Practical Options for Family Philanthropy

There are at least seven options for family philanthropy, each of which has its own strengths and weaknesses from tax, regulatory, and personal perspectives. Some are extremely complex while others are simple. While a detailed analysis of each form is beyond the scope of this review, this comparative analysis should help advisors match donor goals and objectives with the practical realities of ongoing administration.

A. Private Foundation

1. A Description

A private foundation is an IRC §501(c)(3) entity whose funding comes from one or a few sources (as opposed to broad public support) and whose board is controlled by the funder (rather than a broader public group). While all recognized charities are tax-exempt under IRC §501(c)(3) their status as a public or private charity is determined under IRC §509(a) which provides that all charitable entities are deemed private foundations unless they fit the exceptions under:

- *§509(a)(1)* – organizations "described in section 170(b)(1)(A) (other than in clauses (vii) and (viii))". These are traditional charities such as churches, schools, and hospitals that receive broad public support in the form of gifts, grants, and contributions.
- *§509(a)(2)* – organizations that receive more than 1/3 of their annual revenue from gifts, grants, and contributions as well as fees for products or services, and not more than 1/3 of their annual income from investment revenue and unrelated business income.
- *§509(a)(3)* – organizations whose mission is to support one or more public charities and therefore enjoy public charity status because of that focus.

While in the past private foundations were considered one of the most beleaguered forms of charitable life because of the lower contribution limits and the prohibited transaction rules which include excise taxes on income, mandatory annual distribution amounts, investment restrictions, and self-dealing rules, they now have plenty of company in these burdens. In fact, when the tax disadvantages are set aside, private foundations now have some advantages over donor advised funds and Type III supporting organizations that may make them appealing to some donors. (Note: There are three types of foundations that are treated more like public charities: operating foundations,[7] conduit/pass through foundations,[8] and pooled fund foundations.[9] These are rarely used as family foundation substitutes. This review excludes focuses solely on private non-operating foundations.)

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[7] IRC §4942(j)(3).

[8] IRC §170(b)(1)(E)(ii).

[9] IRC §170(b)(1)(E)(iii).

2. Numbers

According to the IRS, there are more than 93,436 private foundations in this country in Tax Year 2010 (the most recent year for which statistics are public)[10] many of which are informally classified as family foundations.

TABLE 2
IRS STATISTICS ON PRIVATE FOUNDATIONS[11]

Assets	Number of Foundations in Category	% of All Foundations	Assets (Market Value, in Thousands)
$0 - $999,999	59,285	58.08%	$12,495,416
$1,000 - $9,999,999	30,200	29.59%	$80,613,408
$10,000,000 - $24,999,999	5,029	4.93%	$63,215,409
$25,000,000 - $49,999,999	2,165	2.12%	$62,024,481
$50,000,000 - $99,999999	1,162	1.14%	$65,239,426
$100,000,000	1,242	1.22%	$539,754,185
$0 or unreported	2,995	2.93%	
Total	102,078	100.00%	$0

More recent figures from Cause IQ estimate there are 142,831 private foundations in the United States.[12] These foundations employ 8,269 people, earn $121.02 billion in revenue, and have assets of $1.04 trillion. These big dollars are largely driven by the big foundations such as Bill & Melinda Gates Foundation, Wellcome Trust, Genetech Access to Care Foundation, Gppd Ventures Foundation, and Walton Family Foundation (some of which are corporate versions of a private foundation). This study estimates that 90/7% of those entities are less than $1 million in size. Only .13% are $100 million or larger.

Family foundations are a type of private foundation. There is no legal definition of a family foundation, although they generally share the following characteristics:

- An individual founder as opposed to corporate founder;
- A foundation name that includes the family's surname;
- A board comprised largely of family members;
- A grantmaking committee comprised largely of family members;
- A board where family members control new appointments;

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[10] IRS Data Book, Domestic Private Foundations, Table 1: Number and Selected Financial Data, by Type of Foundation and Size of End-of-Year Fair Market Value of Total Assets, Tax Year End 2018, www.irs.gov.

[11] IRS Data Book, Domestic Foundations, Table 1: Number and Selected Financial Data by Type of Foundation and Size of End-of-Year Market Value of Total Assets, Tax Year End 2018, www.irs.gov.

[12] Cause IQ, https://www.causeiq.com/directory/private-foundations-list/.

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- A board designed to incorporate multiple generations of family or extended family members;
- Family members exercising leadership roles; and/or
- A philanthropic mission reflecting family values.

For many years, The Foundation Center surveyed the foundation community to monitor the growth and operation of family foundations. The last survey (based on 2011 data), showed family foundations increased in number by 65.52% from 2000 to 2011 as shown in Table 3.

TABLE 3
FOUNDATION CENTER SURVEY RESULTS FOR FAMILY FOUNDATIONS
(DOLLAR AMOUNT IN THOUSANDS)[13]

	2000	2005	2008	2009	2010	2011
Number of family foundations	24,434	34,715	38,339	38,701	38,671	40,444
Assets held by family foundations	$197,734,202	$233,217,737	$246,044,927	$247,669,220	$279,586,642	$294,070,619
Distributions made by family foundations	$11,312,690	$14,375,124	$21,117,277	$20,268,001	$20,662,174	$21,325,414
% of foundations less than $1 million	N/A	62%	64%	64%	62%	N/A

3. Advantages to Private Foundations

a. Tax Advantages

- *Charitable deduction for the gift.* Private foundation donors are entitled to deduct contributions to private foundations. However, as described below in the disadvantages, there are no personal tax advantages greater than the advantages provided for a charitable gift to a public charity, and in some instances, the deduction value of those gifts is limited.

- *Distributions to individuals and foreign charities.* While individuals may not deduct personal gifts to individuals or to foreign charities not recognized by the IRS, private foundations may do so.[14] Therefore, donors interested in gifts to individuals or to foreign charities can receive a charitable income tax deduction for a gift to a private foundation that distributes to individuals and foreign charities while he would not receive a deduction for gifts made personally.

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[13] "Key Facts on Family Foundations, The Foundation Center, for years through 2010; The Foundation Center, Online Librarian for 2011.

[14] The regulations require that private foundations receive prior approval for programs making grants to individuals, and require the foundation to exercise expenditure responsibility for grants to foreign charities not approved by the IRS or law.

b. Non-Tax Advantages

- *Control of charitable distributions.* The singles greatest factor distinguishing a private foundation from other institutional forms of family philanthropy is the control the foundation board maintains over charitable distributions. Distributions for charitable purposes are limited only by the foundation's Articles of Incorporation and the law governing private foundations. Directors may focus on one or more charitable sectors, organizations, or purposes as they chose.

- *Control of administrative and investment management decisions.* Continuing with the control theme, directors (including donors and their family members) may make decisions on administrative matters (record keeping, tax returns, grants management) and investment management, again subject to any restrictions in the articles of incorporation and the law.

- *Memorializing the family.* A private foundation is a separate, perpetual charitable entity and as such is an ongoing community presence, reminding the current generation of the family's generosity and impact.

- *Endowing the family's charitable priorities while maintaining long-term flexibility.* A private foundation is similar to an endowment. The assets are invested for long-term growth and impact, and the distributions can permanently fund the family's charitable priorities. However, the family's control over distributions allow long-term flexibility in meeting changing needs within those areas.

- *Platform for family philanthropy.* Private foundations create a formal training ground for generational philanthropy. Through formal meetings, and ongoing discussion and training, one generation teaches the next how to give, and why to give.

- *Visibility and influence for family members.* Family members who control thousands – or millions – in charitable distributions achieve instant visibility and standing in the community. For those families who want younger generations to have influence over community decisions – especially in the charitable arena.

- *Protection of assets from personal bankruptcy.* Assets owned by a private foundation are beyond the reach of personal bankruptcy (unless fraudulently transferred to avoid bankruptcy).

4. Disadvantages

a. Tax Disadvantages

- *Lower annual gift limitations.* Individual charitable deduction limits are 30% of adjusted gross income for gifts of cash, or 20% of adjusted gross income for gifts of property compared to 50%/ 30% limits for public charity gifts.

- *Limitations on the value of some contributed assets.* Donors may deduct the market value of contributions of cash or "qualified appreciated stock"[15] made to private foundations but are limited to tax basis for gifts of other long-term appreciated property such as real estate, closely held business interests, and tangible personal property.

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[15] IRC §170(e)(5). Qualified appreciated stock is publicly traded stock for which market quotations are readily available on an established securities market. Gifts are limited to up to 10% of the outstanding shares.

- *Excise taxes on income.* Private foundations must pay an excise tax on income (either 1% or 2% depending on grantmaking for the year)[16] and must file quarterly estimated tax returns.[17]

b. Non-Tax Disadvantages

- *Costs of creation and ongoing management.* Private foundations are separate legal entities and are expensive. There is cost associated with creating the entity as well as cost associated with its ongoing management.

- *Investment restrictions*. Private foundations have limitations on the assets they can hold, investments they can make, and permissible grants, expenditures, and activities.

- *Potential for personal liability.* Clients who manage private foundation have potential for personal liability. Foundation managers – including the donor and the donor's family – are subject to penalties if the foundation makes distributions or generates expenses not allowed by the law and regulations.

- *Complicated rules and procedures.* Private foundations must now exercise expenditure responsibility when making grants to non-functionally integrated Type III supporting organizations, or Type I and Type II supporting organizations if a disqualified person to the private foundation directly or indirectly controls the supporting organization (or the Secretary of the Treasury determines the distribution is inappropriate). In addition, these grants are not used to calculate the minimum distribution requirement.

B. Type III Supporting Organization

1. A Description

A supporting organization (SO) is a separately-established public charity that makes distributions to or for one or more public charities. Since the SO exists solely to support the public charity, it derives its "public" tax-exempt status from its nexus to those charities rather than from meeting the public support tests on its own.[18] To qualify as a supporting organization, the supporting organization must be controlled by the supported organization in one of three ways. The manner of control classifies it as a Type I, Type II, or Type III supporting organization.

- *Type I supporting organization*. A Type I SO, an entity "operated, supervised, or controlled by" the supported organization, creates the tightest link between the supporting and supported organization and is often referred to as a parent-subsidiary relationship in which the supported organization's board appoints a majority of the board of the supporting organization.

- *Type II supporting organization*. A Type II SO, one that is "supervised or controlled in connection with" the supported organization, is linked but not as closely. It is often considered a brother-sister type relationship in which a majority of the supporting organization are also on the board of the supported organization.

- *Type III supporting organization*. Type III SO, one that is "operated in connection with" the supported organization. A Type III SO has the least direct involvement of the

[16] IRC §4940 (a), (c).

[17] IRC §6655(g)(3).

[18] IRC §509(a)(3).

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supported organization but must meet the "responsiveness" and "integral part" tests in the regulations to ensure it has a close enough tie to the supported organization.[19] A Type III SO may either provide the supported organization with financial support or may carry out the charitable work of the supported organization. New rules under the Pension Protection Act of 2006 created two distinct types of Type III supporting organizations:

- *Functionally integrated Type III supporting organization.[20]* A functionally integrated Type III supporting organization is one that engages or carries out an essential element of the supported organization's mission that the supported organization would otherwise perform. For example, a Blood Bank organized as a Type III supported organization to the Red Cross would be considered functionally integrated.

- *Non-functionally integrated Type III supporting organization.[21]* A non-functionally related Type III supported organization includes all other Type IIIs. Non-functionally integrated Type IIIs are under intense scrutiny by the IRS and will now have to make required minimum annual distributions as soon as the Treasury finishes its study, makes its recommendations, and sets the required amount.

From 1969, when the supporting organization form was created, through August 2006, when the Pension Protection Act imposed new rules on non-functionally integrated Type III supporting organizations, the Type III supporting organization have been the most popular for families who wanted to create a legal entity will almost as much control as a private foundation, but all the tax benefits and reduced administrative requirements of a public charity. Type I's and Type II's have more direct control by the supported organization and therefore less appeal. Type III SO's, therefore, are the focus of this analysis.

2. Advantages of Supporting Organizations

a. Tax Advantage

- *Full benefit of public charity deduction rules*. Supporting organizations are public charities, and as such are subject to the most advantageous charitable deduction rules.

b. Non-Tax Advantages

- *Supporting organization administrative role.* The supporting organization may be administered or managed by the supported organization, relieving the donor of handling such details.

- *Supporting organization grantmaking role.* The supported organization may serve as a resource in grantmaking for the supporting organization. Many donors interested in creating family philanthropy have created supporting organizations that support community foundations to provide the broadest grantmaking platform possible. In these instances, the community foundation's program staff can play an important role in identifying grant needs and opportunities.

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[19] Reg. §1.509(a)-4(i)(2) and (3).

[20] Functionally integrated Type III supporting organizations are defined under IRC §4943(f)(5)(B).

[21] Non-functionally integrated Type III supporting organizations are Type IIIs that do not fit the requirements of functionally integrated Type III supporting organizations under IRC §4943(f)(5)(B).

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3. Disadvantages

a. Tax Disadvantages

- *Supporting organizations under Congressional scrutiny.* Foundation managers – and supported organizations – face new penalties under the Pension Protection Act of 2006.

- *Public status at risk with certain transactions.* Type I and Type III supporting organizations may lose their public charity status (defaulting to private foundations) if they accept a contribution from a person who directly or indirectly controls the supported organization. Individuals who control the supported organization may include: i) those who either alone or with those listed in ii and iii control the governing body of the supported organization; ii) family members – spouse, siblings, spouses of siblings, ancestors, lineal descendants and spouses of lineal descendants – of the individual; or iii) corporations, partnerships, trusts, or estates in which the person owns more than 35% of the voting power, profits, or beneficial interest.

- *Burden to establish support status.* Type III supporting organizations must now provide information it is responsive to the needs or demands of the supported organization.

b. Non-Tax Disadvantages

- *Less control than with private foundation.* The control exercised by the supported charity(ies) extends to majority control of the supporting organization's board, meaning that the donor and donor's family do not have absolute control over charitable distributions or administrative decisions made by the foundation.

- *Ongoing Congressional involvement.* The rules governing supporting organizations –especially Type III supporting organizations – are likely to continue to undergo metamorphosis and further restrict the freedom enjoyed by many Type III supporting organizations. Examples of the impact are the changes imposed by the Pension Protection Act of 2006 that limited distributions from these entities, created restrictions on who could contribute, imposed new personal penalties, and resulted in the change in form from public to private.

- *Limits on payments to family members or related parties.* Type I, II, and III supporting organizations are subject to excess benefit transactions. An excise tax is imposed on supporting organizations that make grants, loans, pay compensation or similar payments to the supporting organization's substantial contributor, members of that individual's family, or businesses they control. Individuals who are disqualified persons with respect to the supporting organization are also disqualified with respect to the supported organization.[22]

- *Type III SOs subject to as yet to be determined mandatory distributions.* Type III non-functionally integrated supporting organizations will now have mandatory payout requirements to ensure a "significant amount" is paid to the supported organization. Treasury has not yet set this amount, but the effective date was date of enactment.

- *Limits on family business holdings in Type III SOs.* Type III supporting organizations are now subject to the excess business holdings rule under IRC §4944 (unless they are functionally integrated); Type I supporting organizations will also be subject to the excess business holdings rule if the supported organization is controlled by the supporting organization's donors.

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[22] IRC §4958(c)(3).

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C. Donor Advised Funds

1. A Description

a. A New Legal Definition

A donor advised fund is created by making a charitable gift to a publicly supported charity to create a segregated fund over which the donor or named individuals reserve the right to make non-binding recommendations to the sponsoring charity on the charitable entities to receive the funds. In the past, traditional community foundations and Jewish community foundations were the primary sponsors of donor advised funds. Over the last fifteen years, however, commercially sponsored donor advised funds have become popular. Under the legal definition established under the Pension Protection Act of 2006, a donor advised fund has the following three characteristics:[23]

- A fund identified by reference to one or more donor contributions;
- Which is owned and controlled by the publicly supported (sponsoring) entity; and
- Over which the donor(s) has a reasonable expectation to advise on distributions or investments for the amount (because of his status as donor).

b. Exceptions

Donor advised funds do not include a fund that makes distributions to only a single charity or governmental entity, or a fund that makes travel, study, or similar grants to individuals if the fund is advised by a committee appointed by the sponsoring organization, the committee is not controlled by the donor or someone controlled by the donor, and the awards are made using an objective and nondiscriminatory set of standards approved by the sponsoring entity's board similar to standards for such purposes required for private foundation. The Treasury may exempt funds that are advised by a committee (not controlled by the donor) or benefits a single charitable purpose.

2. Advantages of Donor Advised Funds

a. Tax Advantages

- *Contributions subject to higher public charity deduction rules.* This includes not only the higher annual deduction limits, but a market value deduction for long-term appreciated property such as real estate and closely held businesses.

- *Timing charitable deduction and charitable distributions.* Donors can time the charitable deduction by making the gift in the year in which the deduction will prove most valuable, and advising distributions in later years.

b. Non-Tax Advantages

- *Funds managed by charitable sponsor/manager.* This entity serves as administrator and manager, translating and communicating about changes in the law, investing the underlying assets, and taking care of distributions and record keeping.

- *Staff resources support grantmaking*. The fund sponsor/manager often has staff resources providing support for decisions to be made about distribution recommendations. These staff resources may help the donor and donor's family develop its knowledge of the needs and outcomes in the charitable community.

[23] IRC §4966(d)(2).

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- *Anonymous giving possible.* While private foundations are required to make donor records public, public charities are not. Therefore, donor advised funds provide a curtain of anonymity for interested families. Public charities are not required to provide donor names to the public, and by creating a non-family name for the fund, distributions may be made without revealing the source of the funds. This is particularly attractive for families who want to make significant charitable gifts without attracting a cadre of hopeful fundraisers.

3. Disadvantages

- *Loss of control*. Donors must give up the absolute control in decision on the charitable distributions made from the funds.

- *Institutionalized nature of fund may extend for only one or two generations below the donor*. If the donor has a perpetual timeline in mind, donor advised funds will fall short.

- *New limitations and requirements for charitable deduction.* Charitable deductions are not allowed unless the sponsoring entity is a qualified IRC §170(c) organization (excluding private foundations and non-functionally integrated Type III supporting organizations). In addition, to receive a charitable deduction, the sponsoring charity must provide a written acknowledgement that it (the sponsoring charity) maintains exclusive legal control over the contributed assets.

- *Limitation on distributions from the advised fund.* After changes in the law under the Pension Protection Act of 2006, donor advised funds are limited in the types of distributions permitted. Donor advised funds may not make distributions to individuals, to any entity if the distribution is not for charitable purposes. Grants to non-operating private foundations, to non-functionally integrated Type III supporting organizations, or to Type I or Type II supporting organizations controlled by the donor or fund advisor controls the supporting organization require the exercise of expenditure responsibility.

- *Limitation on holdings through application of the excess business holdings rule.* The private foundation excess business holdings rules now apply to donor advised funds. As with private foundations, donor advised funds have five years to bring holdings within proscribed limits and an additional five years if approved by the Secretary of the Treasury.

- *Penalties for taxable distributions.* IRC §4966 taxes prohibited distributions The sponsoring charity is taxed in an amount equal to 20% of the amount of the distribution, and the fund manager who agrees to make the distribution knowing it is taxable is taxed in an amount equal to 5% of the distribution up to $10,000.

- *Penalties for more-than-incidental benefit distributions*. If a distribution from a donor advised fund generates a benefit to the donor, donor advisor, or related person who provided advance on the distribution, the new IRC §4967 imposed a tax of 125% of the amount on the person advising the distribution and the charity receiving the benefit. If the fund manager agreed to make the distribution knowing about the more-than-incidental benefit, there is a tax of 10% (not to exceed $10,000) imposed.

- *Penalties for excess benefit transactions.* Donor advised funds that may grants, or pay compensation to donors, advisors, and related parties are subject to penalties under IRC §4948 of 25% and the requirement that the full amount be repaid. (The amount repaid may not be held in a donor advised fund.)

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D. **Charitable Lead Trust**

1. **A Description**

A charitable lead trust is an irrevocable trust that creates an income, gift, and estate tax charitable deduction for the present value of amounts irrevocably set aside for one or more charities over the term of the trust. When there is greater than a 5% probability the assets will be returned to the grantor at the end of the trust term, it is treated as a grantor trust. The donor is entitled to a charitable income tax deduction for the charitable portion in the year of gift but is taxed on the undistributed income and gains in the trust over its term. When the trust is structured to distribute the assets to family members or other individuals at the end of the trust term, the donor is entitled to a gift or estate tax deduction for the charitable portion of the transfer and the trust is taxed as a complex trust, responsible for payment of taxes on undistributed income.

2. **Using a Charitable Lead Trust as a Substitute Family Foundation**

Non-grantor charitable lead trusts are extremely attractive in the current interest rate environment since the low federal midterm rate leverages the amount individuals may pass to lower generations at a rate discounted to reflect the charitable payments. There are two primary ways a charitable lead trust can be used to further family philanthropy:

1) The document can give the trustees the right to spray the annual distribution amount among a named or unnamed group of charitable beneficiaries. Family members may serve as trustees, or serve as an advisory board to the trustees on the recipients. The primary limitation (or benefit) of this arrangement is its short-term nature. It will survive only as long as the term of the trust.

2) As an alternative, the lead trust payments can be used to fund a private foundation, a supporting organization, a donor advised fund, or to create a permanent fund at a charity to be advised by the family.

3. **Advantages of a Charitable Lead Trust**

- *Platform to combine personal and charitable goals.* A non-grantor charitable lead trust allows the donor to combine personal planning goals (maximizing the assets transferred to heirs) with charitable goals (short-term or long-term philanthropy).

- *Current environment attractive to lead trust gifts.* The current environment – assets with battered market values and low charitable federal midterm rates – create excellent results for clients concerned about the impact of estate tax who also have charitable objectives.

- *Short-term foundation substitute.* A charitable lead trust can be a platform for short-term or long-term philanthropy. If the trust gives the trustees a sprinkle/spray power to make distributions to a wide range of charities, and those funds are distributed outright to those charities, the arrangement is by nature short-term and limited to the term of the trust.

- *Long-term philanthropy funding mechanism*. If the charitable lead trust is used to fund a private foundation, supporting organization, or donor advised fund, then the lead trust can create a permanent pool of funds to be distributed by the family.

4. **Disadvantages**

- *Complex trust tax rates.* Non-grantor charitable lead trusts are not tax-exempt but are taxed as complex trusts. Complex trusts (and estates) hit the 37% tax rate with income of $13,451 in

2022.[24] However, the impact of the tax on ordinary income can be offset through the distribution of income to the charitable beneficiary(ies).

- *Prohibited transaction rules apply.* Charitable lead trusts are subject to the prohibited transaction rules on self-dealing, jeopardizing investments, and when the charitable interest in the trust exceeds 60 percent, the excess business holdings rules apply.[25]

- *Donor involvement limitations when lead trust funds private foundation.* When the donor creates a non-grantor trust (and wants to ensure the gift is not included in his estate), he may not control or direct the distribution of funds from the foundation.[26] Planners continue to look for ways to involve the donor without triggering the estate tax. A blueprint for one approach is set forth in Private Letter Ruling 200138018. Also see Private Letter Ruling 200029003 in which a grantor created three charitable lead annuity trusts naming a corporate fiduciary.

E. A "Charitable" Revocable Trust

1. A Description of a Charitable Revocable Trust

A "charitable" revocable trust is simply a revocable trust used for family philanthropy. The donor funds the revocable trust with dollars that will be used to make charitable gifts. The trust adopts by-laws and operating procedures that bring the family together as trustees or an advisory board for the purpose of making distributions. And the donor – without creating an expensive, irrevocable structure– can engage in the process of teaching younger generations about philanthropy, engaging the family in philanthropic impact, and benefiting the community. In addition, the donor can add a testamentary provision that distributes any remaining assets to a donor advised fund, a private foundation, or any of the other philanthropic entities discussed here to perpetuate that giving.

2. Advantages of a Charitable Revocable Trust

- *Control and use of assets during life*. The donor maintains ownership and flexibility in use and distributions of the funds during life. This allows the donor total control over the funds.

- *Platform to engage and train family members. If th*e donor is using the trust for annual giving, he can engage the family in that decision making to determine the ultimate preference in form for the charitable remainder.

- *Little or low cost to create.* The charitable revocable trust costs little to create and has no additional costs to create a separate tax entity and get that entity approved by the Internal Revenue Service. In addition, since there is no separate tax entity, there is no annual tax return.

- *Flexibility in determining charitable form at death.* The donor maintains flexibility during life and after working with the family during life, can determine the most appropriate testamentary entity to use to continue the family's giving.

- *Income, gift, and estate tax charitable deductions.* Amounts given to charity during the operation of the trust are deductible to the grantor as charitable income tax and gift tax deductions during life; amounts transferred to charity through a testamentary provision in the trust are deductible as charitable estate tax deductions.

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[24] Smart Asset, https://smartasset.com/taxes/trust-tax-rates.

[25] IRC §4947(b)(3).

[26] See IRC §2036(a)(2); *Rifkind v. United States*, 5 Ct. Cl. 362 (1984).

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- *Discount and defer transfers to heirs.* Naming a charitable lead trust or charitable remainder trust whose charitable distributions/termination are used to fund a foundation or charitable entity may be attractive for donors who want to discount – as well as delay – the ultimate distribution to heirs. This is especially attractive for individuals who want to distribute large amounts of estate assets to heirs in stages.

3. Disadvantages of a Charitable Revocable Trust

- *There is no immediate charitable deduction for assets transferred to the trust.* Since the trust is a revocable (grantor) trust, the income, gains, and other tax impact of the assets in the trust flow to the grantor.

- *Assets set aside for charity not protected.* The assets set aside for charity in the revocable trust are not protected from the grantor's personal creditors and if the donor has financial trouble, could be used to satisfy personal debts.

F. Partnership With the Charity

Sometimes donors do not need to create a separate entity, especially when charitable interests are focused narrowly on a single charity. In these instances, the donor may want to engage family members to fund a program over a defined period of time (or lifetime) or may want to create a permanent endowment using family members to provide ongoing advice and counsel.

1. Options in Structure

a. Provide Ongoing Funding

If the donor has a narrow focus, short-term goals and wants to retain a voice in the development of a specific charitable project managed by a public charity, it may be possible to partner with a charity to achieve those goals. For example, if the donor is interested in working with a university to develop or dramatically upgrade its music program or to build or increase the ranking of its business school, it might approach the university in partnership, offering to provide a multi-year stream of revenue for the project. In exchange, the family may ask to have a voice at the table as the project develops and would have the option of discontinuing its funding if the project got off track. If the project is large enough, the family's name may be permanently attached. All these elements are negotiable.

b. Restricted Endowment Gift with Family Advisors

If the donor has a narrow focus but a longer-term duration in mind, consider creating an endowment fund and retaining the right for the donor and the donor's family to provide ongoing advice. Since this fund focuses its distributions on a single beneficiary (the public charity) the arrangement fits squarely into the exception to treatment as a donor advised fund under the Pension Protection Act of 2006.[27]

The key with the endowment arrangement is to capture the donor's goals in the endowment agreement in a way that provides focus, but does not proscribe, how the goals are accomplished. In

[27] Funds over which the donor retains the right to advise are not considered donor advised funds if the fund i) makes distributions to only one charity or government entity; ii) makes grants to individuals for study, travel, and similar purposes if the fund is advised by a committee appointed by the sponsoring charity and the committee is not controlled by the donor or individuals appointed by the donor and grant awards are made using an objective and nondiscriminatory process approved in advance that the sponsoring charity's board and meets similar requirements for private foundations; or iii) which is exempted by the Secretary of the Treasury if the fund is either advised by a committee not controlled by the donor or benefits a single charitable purpose.

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these arrangements it is important to think long-term and provide for use of the funds when the family is no longer engaged, no longer exists, or the original purpose specified for the funds is no longer needed or otherwise viable.

2. Advantages of a Partnership with Charity

- *Public charity tax benefits.* The donor receives the charitable deduction benefits associated with public charities.

- *Achieving specific results and controlling the terms*. This arrangement is not much different than a private foundation that determines it will solicit grants to achieve a particular purpose or goal, such as starting a new business school, or creating a new day care or other charitable program. The donor is limited only by practical considerations and the recipient charity's gift acceptance policies in choice of assets, and receives a full market value deduction for long-term appreciated assets such as real estate and closely held business interests that may only be deducted at basis in gifts to private foundations.

- *Flexibility to stop funding.* While the donor would not want to entice a charity to take on capital and financial responsibilities and then pull funding from the project, it is possible to structure the arrangement so that in the case of ongoing funding, the donor will terminate the funding if the charity is not using the funds as intended. In the case of endowment, the document can be drafted to provide that if the charity does not meet its obligations, the funds will be used for another purpose or even be transferred to another charity.[28]

- *Louder voice.* Active ongoing participation may actually give the donor a greater voice than grantmaking.

- *Meeting goals.* Long-term projects using an endowment agreement can be structured to meet family goals in both participation, and in setting out secondary options (and a mechanism to move to the secondary option) if the original purpose is no longer relevant or gets too far from the donor's vision.[29]

3. Disadvantages of a Partnership with Charity

- *No tax disadvantages.* There are no tax disadvantages to this arrangement since the donor enjoys the full benefit of the deduction rules for public charities.

- *For short-term projects, no ongoing pool of funds.* The money is gone. Once the funds are allocated to the project, those funds are gone. Short-term projects will consume the funds so that nothing is left to redirect. Long-term projects that are endowed can provide for alternate uses and their use cannot be redirected unless otherwise provided for in an agreement with the institution as stated above.

- *Potential lack of family interest.* Charitable interests vary by generation and by individual. While the project may be one that the donor is passionate about, it may not be one that engages family members. If one of the client's goals is to engage family members, that may be difficult to do with a narrowly focused project, especially one that reflects only the client's interests. Generational

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[28] The key is to draft the document to anticipate this type of change, and to put a decision making or trigger mechanism in place that does not require court approval. See Miree, Kathryn W., "Perfecting Donor Intent: Legal Lessons and Practical Advice," 2005 National Conference on Planned Giving, National Committee on Planned Giving (Indianapolis, Indiana: October 2005).

[29] Miree, *supra.*

philanthropic interests range broadly, and it is almost certain that the client's passion will not be the passion of his child or grandchild.

G. Take a Test Drive: Kitchen Table Philanthropy

1. A Description of Kitchen Table Philanthropy

One of the central goals in creating a form of institutional philanthropy is to pass charitable and community values and passions from generation to generation. Kitchen table philanthropy is simply a mechanism to engage and teach children how to give. The format can be replicated in a foundation's junior board, for an advisory group for a donor advised fund, or simply used in place of a formal entity in the earlier years. It is an easy way for donors to determine what is and is not most important to them about a philanthropy entity.

Children or grandchildren as young as 7 or 8 can engage in kitchen table philanthropy. Begin by allocating a dollar amount – such as $100 – that the child will have the right to distribute. Then identify an area of charitable interest for that child. This will likely be different from the charitable interests of the parent or grandparent which may run to art museums, the symphony, or health care. The child's interests may focus on something more relevant to their lives, such as children's museums, boy (or girl) scouts, or zoos. Once that charitable interest is identified, select two or three local organizations that represent that interest. Give the child a list of questions to research on the Internet. These may include:

- The number of individuals served by the charity;
- The annual operating budget;
- Types of services offered by the charity; and
- Specific programs of interest to the charity.

Once the child has completed the research, call the executive directors of the organizations you've selected to arrange a tour. This is perhaps the most impactful element of the process. For the participants, it is one thing to collect clothes and deliver those items to the doorstep of a charity for the homeless; it is far more compelling and enlightening to meet the people who wear the clothes. Before the tour, help the child develop two or three additional questions for the director and encourage him to ask any questions that come to mind.

Once the research is done and the tour is complete, bring the child back to the kitchen table to make a decision about how the amount set aside will be spent. The child may allocate it all to one charity, split it among two charities, or divide it unevenly among all three. Let the child make the decision and explain why he made the decision. Mail the amounts to the selected charities under the child's signature. The thank you letters will then come to the child. Mid-way through the year, send the child back to the Internet to check on the charities receiving the distributions. Many list donors on their website and the child may be able to discover his or her own name.

2. The Advantages of Kitchen Table Philanthropy

- *Direct engagement with and training of family.* This arrangement ensures the most direct engagement with lower generation and a clear way to reinforce the basics of thoughtful, impactful philanthropy.

- *Flexibility.* The arrangement is as flexible as the donor's goals and objectives. He can tweak the rules, change the location, change the focus each year as the training progresses and he learns what is most effective.

- *Ability to adjust annual contributions based on convenience, the economy, and need.* The donor makes annual distributions and can time the distributions as appropriate for personal taxes.

- *Ability to “test drive” and determine priorities.* The donor can “test drive” various combinations, approaches, and processes to see which best suits his personal and philanthropic goals. It is easier to make decisions about perpetual entity forms once he has had experience with the basic mechanisms of the process.

3. The Disadvantages of Kitchen Table Philanthropy

- *Temporary structure.* The forum is not institutionalized – it only exists as long as the donor is there to make it go.

- *Avoids experience with administration*. While this format provides a great platform to learn about how to work with lower generations, it does little to prepare the donor or give the donor insight into the more burdensome requirements of private or supporting organizations.

4. An Alternative to an Institutional Form

As noted earlier, the kitchen table philanthropy model can be used in more formal or institutional arrangements. For example, a family foundation or supporting organization may create a junior board that operates on these principals. Or, a donor advised fund can create a family board that operates in this manner. If this process is the real goal of the donor, if none of the structural advantages of a separate entity are required, and if timing of the distribution is not a primary goal, it may be possible to achieve the donor’s philanthropic goals around the kitchen table without the added expense and ongoing management.

III. The Client Conversation: Gathering the Critical Facts

Selecting the appropriate entity for a client revolves around the client’s goals, expectations, management skills, and adaptability. For the planner, this means asking the right questions before establishing the entity. Appendix A contains a checklist to guide you through this process.

A. Client’s Personal Goals

Many of your clients structure charitable bequests under will, name charities as beneficiary of their IRAs, or make significant charitable gifts during their lifetimes. While tax impact is always a consideration, how often do you engage in a discussion with your client about their non-tax objectives in making the gift?

Knowing the donor’s goals is essential to selecting the right form for institutionalized philanthropy. Consider these common objectives and probe the donor to determine their priorities in creating the philanthropic entity. Many of these goals are overlooked because they do not relate to legal or tax considerations, and yet they are important in achieving the client’s objectives.

1. Philosophical Goals

One of the difficulties in counseling clients about a family philanthropy form is that they have had little experience with either the management or outcomes of the available options. For that reason, it is difficult to articulate priorities, and almost impossible to anticipate administration. Suggest the client use the kitchen table philanthropy model to test drive the family’s philanthropy style and goals. To start the conversation, get them to answer these questions:

- Have you successfully engaged your children in the giving process in any way?
- Was it a positive experience for you and for them? What would have made the process stronger?

- Were you able to use that platform to teach them the process of making effective gifts? Did you need or use outside help to identify charities or analyze effectiveness?
- What part of the process was most meaningful to you and your family members?
- Which part of the process would you prefer not to do again?
- How easy was it to manage the paperwork during the process? Do you have methods to track and analyze giving long-term? Do you anticipate that if this work load were quadrupled to include quarterly tax reporting, annual tax returns, short-term and long-term accounting (up to five years of records), meeting minutes, grants oversight, and compliance you could accommodate the work? Would you need to hire outside advisors? Would you prefer to shift responsibility to third parties?
- What is the next step in developing the philanthropic process for your family? Do you want more professional help, or would you prefer to develop that expertise within your family?

2. Effective Giving

Some clients want to be more effective in their giving. They are inundated with requests for capital campaigns, major gifts, special projects, disaster relief, and year-end solicitations. Most quickly tire of writing a stream of checks and want to focus funds on an area of personal interest that will "make a difference." They may believe that creating a foundation will give them a permanent pool of resources to ensure effectiveness through long-term fund, or will allow them to invest in staff and research to identify the most effective organizations.

3. Giving for Impact – Not To Specific Charities

Other clients, especially those with an entrepreneurial or business background, prefer to give to outcomes. They may want to improve the quality of public education, and raise graduation rate, because they believe these outcomes will improve the community's economic future. Or more simply, they want to focus their giving to groups of organizations that have a cooperative plan, measure outcomes, and report progress.

4. Engaging Family

Some individuals want to institutionalize their philanthropy simply as a means of engaging family in philanthropic decisions and sharing their passions for giving with lower generations. Always probe for specifics:

- How does the client want to engage family? In a formal way, such as board members or more casually as consultants to the ultimate decision?
- How frequently do they want to engage family in the decisions making? It may be once a year, or the client may want an ongoing, quarterly family meeting.
- How much power do they want to invest in family members, and does this vary by generation or relationship to the client?
- Are there any family relations difficulties they hope to solve in the process?

5. The Generational Gap

Some clients may want to bridge the generational gap and find a way to work side by side with grandchildren in philanthropy, while others may simply be interested in having children and grandchildren admire their philanthropic decision making. In truth, every individual has specific charitable interests and these interests shift as they move through the decades. It is rare to find multiple members of a family on the same generational levels who share interests, much less on multiple generational levels. Ask the client to be as specific as possible in articulating these objectives.

6. Teaching Values

Many individuals relish the idea of teaching the family's values on a stage that perpetuates the teaching from generation to generation. The idea is that family members will learn from being involved, and will automatically assume those values and pass them to their descendants.

7. Protection from Solicitations

Some clients believe that by creating a private foundation or supporting foundation they will protect themselves from the relentless pursuit of charitable solicitors by being able to say: "My foundation handles the charitable giving – just send the request to them for consideration." In this day, with easy access to Form 990-PF and required disclosure, a foundation will not insulate the donor from solicitations. Most charities know that donors use family foundations to execute their personal giving. There are simpler ways (such as saying "no") to create that protection if that is all that is desired.

8. Visions of Tax Savings

While it is true that gifts to private foundations (and all charitable gifts) generate tax benefits, gifts to private foundations – the most popular institutionalized philanthropy options – are far less substantial than gifts to public charities. For example, instead of 50% (cash/ordinary income property) and 30% (long-term capital gain property) adjusted gross income limits for deductions in a single year, gifts to private foundations are limited to 30%/20%. And while gifts of long-term capital gain property of all types to public charities may be deducted at market value, only gifts of qualified appreciated stock receive a market value deduction for gifts to private foundations. Other long-term appreciated property – such as real property and closely-held business interests – are limited to the donor's tax basis. Therefore, one of the big planning decisions revolves around the property that will be used to fund the gift as well as the donor's deduction goals.

B. Size of Philanthropic Commitment

1. A Range of Options

The intended ultimate size of the philanthropic entity drives the choice of form from a practical perspective. While much attention is giving to the nation's largest family foundations such as the Bill and Melinda Gates Foundation in Seattle, Washington with assets of $46.9 billion at the end of the 2018 tax year,[30] little attention is paid to the thousands of smaller foundations (58.08% of al foundations) with less than $1 million in assets which distribute $50,000 or less each year as shown earlier in Table 2.

2. A Practical Yardstick

There are no legal minimum sizes for entities proscribed by law. Rather, the client should consider the costs of creation and administration relative to asset size, the impact of grantmaking, and if hosted by a public charity, the charity's policies. Separate tax entities such as private foundations, Type III non-functionally integrated supporting organizations, and charitable lead trusts should probably have at least $3 million in assets to support the creation, administrative, and oversight costs as well as to engage in impactful grantmaking. Consider the charitable impact of various size foundations shown in Table 4.

[30] This is the most recent Form 990PF available to the public; the Foundation's annual report no longer provides the Foundation's asset value.

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TABLE 4
CHARITABLE IMPACT AFTER EXPENSES OF VARIOUS SIZE FOUNDATIONS[31]

	$100,000	**$1,000,000**	**$3,000,000**	**$5,000,000**
Cost to create/percentage of funding amount	$15,000/ 15%	$15,000/ 1.5%	$15,000/ .5%	$15,000/ .3%
Annual expense:				
• Investment management and fund accounting	$1,500	$7,000	$15,000	$25,000
• Tax return	$800	$800	$1,200	$1,200
• Grant oversight, legal advice, operating expenses	$500	$750	$1,500	$2,000
• Miscellaneous	$1,000	$1,500	$3,000	$4,000
TOTAL/%	$3,800/ 3.8%	$10,050/ 1.01%	$20,700/ .69%	$32,200/ .64%
Charitable distribution net, assuming 5% total distribution	$1,200/ 1.2%	$39,950/ 4.0%	$129,300/ 4.31%	$217,800/ 4.36%

C. Duration of Entity

Philanthropic entities require time and money in creation, management, and disassembling the entity if it does not operate as expected. Clients must stay engaged and be willing to take the steps necessary to set the tone, planning, purpose, and ensure generational involvement. Training and engaging lower generations takes time and patience. Keeping the foundation out of trouble requires professional advice. And perpetual is a long time.

1. Insight Into Current Generational Duration

While founders may create family foundations with the idea the family will thrive forever and maintain control of the foundation, statistics show that like family businesses, this is rarely the case.

a. Family Business Statistics

Family businesses – C Corporations, S Corporations, LLCs, LLPs, partnerships, and other less formal arrangements – are often the largest single asset of wealthy clients. The generational transfer attrition rate is high. 70 percent do not survive to the second generation; 88 percent do not make it to the third generation; and 97 percent do not make it to the fourth generation or beyond.[32]

b. Family Foundation Statistics

Most family foundation creators intend that family foundations will continue for generations with family involvement. Family foundations statistics are more difficult to gather simply because it is often difficult to tell the trustee or board member's relationship to the founder simply by examining the surname.

[31] Costs provided here vary depending upon the complexity of the chosen entity, the assets, the firm, and other factors. The chart is designed to focus on the impact of serial expenses on grantmaking options.

[32] Joseph Astrachan, Ph.D., editor, *Family Business Review*, www.ffi.org.

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Anecdotal evidence shows that most family involvement has been lost by the second, and certainly the third generation.

The loss of family involvement may occur in a variety of ways. Sometimes family foundations lose family involvement because family members die out or because older generations are unwilling to involve or accept input from younger family members. In other cases, the family does not work together well (they fight vigorously) and the foundation is split into multiple entities, one for each family branch. In still other cases, the lower generation was never effectively engaged during the founder's life and simply has no interest in managing the entity. These are the realities of family life spans and behavior.

2. Trends in Short-Term Foundations

Although the general nature of foundations is perpetual, some are created with intentionally shorter timelines. Others reach the decision to adopt a limited timeline after they begin to operate. Consider these two examples among a growing attitude that operational timelines may enhance charitable effectiveness.

- *The John M. Olin Foundation*. The John M. Olin Foundation was established in 1953 and had assets of $118 million at one point, was established with the goal that it would be distributed within a generation. Following the death of Mr. Olin's wife, the foundation distributed its assets and terminated in December 2005. It had a duration of 52 years, a term well suited to a separate nonprofit entity, especially when the size of the assets were considered.[33]

- *The Bill and Melinda Gates Foundation.* Bill and Melinda Gates recently announced the foundation would distribute its assets – in excess of $33.9 million in its 2009 annual report – within fifty years of the death of the three current trustees, bill Gates, Melinda Gates, and Warrant Buffet. This announcement, made after the announcement of the Buffet transfer to the foundation, will focus the foundation in its goals and grantmaking.

IV. Other Determinants in Philanthropic Structure

A. Assets Used to Fund the Structure

The assets available and intended for funding the philanthropic entity also impact the choice of entity. On the most basic level, individuals who plan to use long-term appreciated assets other than publicly traded securities will most likely need to consider a public charity as opposed to a private foundation since the contribution value to the donor will be limited to the donor's cost basis rather than market value. Table 5 provides a basic look at the impact of special assets for the seven philanthropic options.

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[33] For more information on the John M. Olin Foundation's termination, see the foundation profile on the International Relation Center's Right Web, http://rightweb.irc-online.org/profile653, the funder profile on Media Transparency's website at http://www.mediatransparency.org/funderprofile.php?funderID=7, and Roger William's article, "Sustaining Ideas on the Right," in *Foundation News and Commentary* (Vol. 47., No.1, January/February 2006), http://www.nationalreviwe.com/miller/miller200504060758.asp.

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TABLE 5
IMPACT OF ASSET CHOICE ON DEDUCTION VALUE FOR VARIOUS PHILANTHROPIC FORMS[34]

	Private Foundation	Type III Supporting Organization	Donor Advised Fund	Charitable Lead Trust	Charitable Revocable Trust	Kitchen Table Philanthropy (assuming public charitable)
Cash	Deductible at face	Deductible at face	Deductible at face	Deductible at face	Deductible at face	Deductible at face
Publicly Traded Securities, Mutual Funds	"Qualified appreciated stock" deductible at market value; other appreciated assets deductible at tax cost.	LTCG Deductible at market value	LTCG Deductible at market value	LTCG Deductible at market value	No tax impact when contributed to the trust; if used to make in-kind gift to public charity, deductible at market value	Deductible at market value
Real Estate	Deductible at cost basis	Deductible at market value	Deductible at market value		No tax impact when contributed to the trust; if used to make in-kind gift to public charity, deductible at market value	Deductible at market value
Closely held business interests	Deductible at cost basis – beware excess business holding rules	Deductible at market value – Type III non-functionally integrated SOs are subject to excess business holding rules	Deductible at market value – subject to excess business holding rules	Deductible at market value – will be subject to excess business holding rules if charitable interest exceeds 60%	No tax impact when contributed to the trust; if used to make in-kind gift to public charity, deductible at market value	Deductible at market value

[34] Amounts shown as deductible are without regard to the 50%/30% or 30%/20% adjusted gross income limits discussed earlier, or the split interest calculation required for the charitable lead trust.

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Tangible personal property	Deductible at cost basis	Deductible at cost basis if sold; deductible at market value if used in charitable mission	Deductible at cost basis if sold; deductible at market value if used in charitable mission		Deductible at date of death value	Deductible at cost basis if sold; deductible at market value if used in charitable mission

B. Charitable Deduction Objectives

1. Overview

There are at least three elements to consider in analyzing the tax impact of the gift on the donor:

a) *The type of charitable recipient:* Public charities – which include Type III supporting organizations, donor advised funds, and public charities – are considered 50% type organizations.[35] These are entities to which cash gifts are deductible up to 50% of the donor's adjusted gross income, and property gifts are deductible up to 30% of the donor's adjusted gross income, with a five-year carry forward for unused amounts.[36] Private foundations, and lead trusts which may terminate to private foundations and similar entities, are 30% organizations.[37] These are entities to which cash gifts are deductible up to 30% of the donor's adjusted gross income, and property gifts are deductible up to 20% of the donor's adjusted gross income, with a five-year carry forward for unused amounts.[38]

b) *The type of asset used to fund the gift:* As noted above, while cash and long-term appreciated assets are generally valued for deduction purposes at the market value of the gift, gifts of capital gain property to private foundations is limited to the donor's basis in the contributed property with the exception of publicly traded securities ("qualified appreciated stock"[39]) which are deductible at their full fair market value under IRC §170(e)(5).

c) *The donor's personal tax situation:* Obviously, the donor's adjusted gross income and tax bracket impact the tax benefit of the gift to the donor. Other factors include the character of the donor's income, any special tax circumstances (sale of business, sale of large asset), and any prior year carry forward amounts.

2. Summarizing the Impact

Table 9 summarizes the codified limits for various family philanthropy options. Be sure to consult IRC §170(b) for details and exceptions to the basic rules.

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[35] IRC §170(b)(1)(A).

[36] IRC §170(b)(1)(C).

[37] IRC §170(b)(1)(B).

[38] IRC §170(b)(1)(C).

[39] IRC §170(e)(5). Qualified appreciated stock is defined as long-term appreciated stock for which market quotations are readily available on an established securities market and which does not represent more than 10% of the outstanding shares in the company.

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TABLE 6
CODIFIED LIMITS ON CHARITABLE DEDUCTION FOR GIFTS TO VARIOUS FAMILY PHILANTHROPY ENTITIES

Type of Entity	Charitable Income Tax Deduction
Private foundations	Cash, 30%; property, 20%; unused amounts may be carried forward for 5 years
Type III supporting organizations, donor advised funds, kitchen table philanthropy (gifts to public charities)	Cash, 50%; property, 30%; unused amounts may be carried for 5 years
Non-grantor Charitable Lead Trust	No income tax deduction; unlimited gift tax charitable deduction; $5,000,000 (2011, 2012) lifetime gift tax exclusion for non-charitable portion; unlimited estate tax deduction
Charitable revocable trust	Charitable income tax deduction will be recognized in the year the trust makes a distribution to a charity; the income tax limits will depend upon the character of the recipient organization as shown above.

C. Costs of Creation and Administration

1. The Impact of Expenses on Grantmaking

As noted earlier, size is a consideration when creating a permanent philanthropy form because costs eat into available funds for grantmaking. Private foundations are allowed to include the portion of the administrative costs allocable to charitable mission as part of the required distribution, but these costs generally reduce available dollars for distribution to charity as they do with charitable entities without mandatory distribution requirements.

2. Overview of Costs for Various Family Philanthropy Forms

Table 7 summarizes creation and ongoing administrative costs for the average foundation.

TABLE 7
CREATION AND ONGOING ADMINISTRATIVE COSTS FOR $3 MILLION PHILANTHROPIC ENTITY WITHOUT STAFF

	Private Foundation	Type III SO	Donor Advised Fund	Charitable Lead Trust	Char. Rev. Trust	Kitchen Table Philanthropy
Anticipated Creation Costs	$15,000	$15,000	$0	$2,000	$500	$0
Annual Administration/ Fund Accounting	$15,000	$15,000	$30,000	$15,000	$15,000 (Prof. Trustee)	$0
Legal Costs	$3,000	$3,000	$0	$1,000	$0	$0
Tax Acct./Return	$1,200	$1,200	$0	$1,200	$0	$0

D. The Role of the Family and Self Dealing

It is critical to define the client's anticipated family roles in administration and management. While any of these forms will accommodate family involvement in decision making (other than the limitations on the charitable lead trust noted), few will accommodate payments to children or other family members as salary or for investment or management advice. Table 11 sets out key considerations and limitations which may shape the client's decision about form.

TABLE 8
CONSIDERATIONS AND LIMITATIONS IN DEALING WITH FAMILY MEMBERS AND RELATED PARTIES

	Private Foundation	Type III SO (Non-functionally integrated)	Donor Advised Fund	Charitable Lead Trust	Charitable Revocable Trust	Kitchen Table Philanthropy
Can pay family members/ related parties salary?	Yes, if the work is necessary in achieving the foundation's charitable mission, and the amount is not excessive.	No	No	Yes, if the work is necessary in achieving the foundation's charitable mission, and the amount is not excessive.	Trustee may receive payment	N/A

Can pay family members/ related parties fees for services?	Yes, for legal, investment or banking services if those services are necessary in achieving the foundation's charitable mission and the amount is not excessive.	No	No	Yes, for legal, investment or banking services if those services are necessary in achieving the foundation's charitable mission and the amount is not excessive.	Yes	N/A
Can engage in transactional business (sales, purchases, etc.) with family members/ related parties?	No – may lease space to foundation without cost, and the foundation may sell items to disqualified person at same rate as to public.	No	No	No – may lease space to foundation without cost, and the foundation may sell items to disqualified person at same rate as to public.	Yes	N/A

E. Grantmaking Support

The need for grantmaking support should be explored with the goal of determining whether the client wants this "built in" support or simply needs to hire third party support periodically. By design, donor advised funds and supporting organizations attached to community foundations have access to the community foundation's program staff. These services may be provided as part of the hosting/sponsoring role, or may be available on a fee basis. If the family wants to "institutionalize" this support, it may be best to choose a form that permanently aligns the philanthropic entity to that support.

Many private foundations and even families without philanthropic entities use third party services. These third party services may be provided by a consultant in the field, as a purchased service from a community or similar foundation, or through outside or online services that help donors screen and review gifts. In this event, the advisor may need to understand the options available in the community and bring this advice to the conversation. Appendix B provides a list of possible resources.

V. Changing Gears When Your Client Makes the Wrong Decision on Philanthropic Form

No discussion of selection of an institutional option would be complete without at least a brief look at how you remedy a poor selection. In my experience, most poor selections are made not through faulty legal advice, but rather through the donor's inability to fully appreciate the new obligations for management and the consequences of errors. While the discussion of changing forms is worth a session of its own, basic choices are briefly reviewed below.

A. Changing Private Foundations to Other Philanthropic Forms

1. Termination and Distribution of All Assets

Terminating a private foundation and distributing its assets must be executed carefully to avoid a termination tax. IRC §507 details four ways to terminate private foundation status, two of which involve payment of a significant termination tax under IRC §507(c). Those include:

1. Voluntary termination by notifying the IRS the foundation intends to terminate and pay the tax on the net assets;[40]
2. Involuntary termination in which private foundation status is revoked because of repeated violations of Chapter 42 provisions;[41]
3. Transfer of assets to one or more public charities;[42] or
4. Give notice to the IRS of the intent to operate as a public charity (under IRC §509(a)(1), (2), or (3)) and to do so for 60 months.[43]

The termination tax under IRC §507(c) is essentially equivalent to the foundation's net assets.[44] While this tax can be abated under certain circumstances, options (1) and (2) are obviously to be avoided if at all possible. The more likely solution is to distribute all the foundation's assets to other public charities, or to change to form of the foundation to a public charity.

2. Distribution of Assets to Another Public Charity

Private foundations that decide to terminate by distributing all of their assets to qualified charities may do so without advance notice to the IRS. However, the charities receiving the assets must be public charities described in IRC §170(b)(1)(a) – other than in clauses vii and viii – that have been in continuous operation for a period of at least 60 calendar months prior to the distribution.[45] This is generally considered the easiest way to terminate a private foundation. The transfer can even include a donor advised fund at a public charity, which may continue to give the family a voice in distributions, so long as the charity holding the donor advised funds meets the requirements under IRC §507. Depending on the family's goals, this may or may not avoid the issues creating the struggle in the private foundation form. The Pension Protection Act of 2006 has restricted grants from donor advised funds, payments to individuals from donor advised funds, and the Treasury is likely to set required distribution amounts from donor advised funds.

3. Transformation of the Private Foundation to a Public Charity

Private foundations have several options in change of form. Any change that results in changing from a private foundation to a public charity under IRC §509(a)(1), (2), or (3) requires that the foundation first notify the Secretary that it is terminating its private foundation status and then begin a 60 month

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[40] IRC §507(a)(1).

[41] IRC §507(a)(2).

[42] IRC §507(b)(1)(A).

[43] IRC §507(b)(1)(B).

[44] The tax is the lesser of (1) the combined tax benefit resulting from the section 501(c)(3) status of the organization or (2) the value of the net assets of the organization. Since the "combined tax benefit" is comprised of the value of all tax benefits of tax-exemption – including deductions by substantial contributors and taxes the entity would have paid – the tax is essentially equal to the net assets of the foundation.

[45] IRC §507(b)(1)(A).

period in which it continuously operates in a way to meet the requirements of IRC §509(a)(1), (2), or (3) for a period of 60 months.[46]

- *The foundation may merge with a public charity* by transferring its assets to that charity. This charity must be a qualified public charity in continuous operation for at least 60 months prior to the transfer. (This is essentially the distribution option noted above.) In two recent rulings, the IRS approved the merger of a non-operating private foundation into a related, existing private operating foundation.[47]

- *The foundation may become a private operating foundation.* For example, a private foundation that focused its grantmaking on addressing homelessness may change to actually take on the work itself of operating a shelter and providing related services.

- *The foundation may become a new public charity and begin raising funds and operating as a public, rather than private, entity.* The W. Alton Jones Foundation in Charlottesville, Virginia announced that its board of trustees had agreed to dissolve the foundation and to distribute its assets among three new charitable organizations that will be headed by members of the founding Jones family. The foundation, formed in 1944, characterized the change as enabling it to build upon its prior achievements while "providing the opportunity to explore additional areas of philanthropic activity." Becoming a traditional public charity because the foundation will likely be required to meet the public support test – a difficult challenge, especially for an experienced family or a small foundation.[48]

4. Private Foundation to Private Foundation Transfer

Private foundations may also transfer their assets to merge with other private foundations. One example of a merger is the Charles and Helen Schwab Foundation, based in Northern California, went in the other direction. This foundation was formed in 2001 from the merger of the Schwab Foundation for Learning (established in 1998) and the Schwab Family Foundation (created in 1993). This merger was said to have grown out of a two-year strategic planning process aimed at enhancing the effectiveness and impact of the predecessor entities as they grew in resources and expertise.

B. Type III Supporting Organizations May Default to Private Foundations

Type III supporting organizations that fail to meet the integral part and responsiveness tests of the regulations will find that their status defaults to private foundation status making them subject to all of the private foundation excise taxes and prohibited transaction rules. Many Type III supporting organizations organized as trusts failed to meet the more stringent responsiveness tests under the Pension Protection Act of 2006 which require that Type III supporting organizations organized as trusts must demonstrate a "close and continuous relationships" with the supported organization. In the past, Type III SO's organized as trusts could meet the responsiveness requirement if the supported charity could demand a trust accounting under state law. This requirement was effective as of August 17, 2006 for new trusts, or August 17, 2007 for trusts in existence as of date of enactment.[49] In addition, practitioners should review

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[46] IRC §507(b)(1)(B).

[47] See Private Letter Rulings 200843040 and 200843041.

[48] The private foundation will be required to qualify under the public support test since it will not be a church, school, hospital, or similar entity in the alternative category.

[49] Pension Protection Act of 2006, Public Law, Public Law 109-280, §1241(c). Prior to the Pension Protection Act of 2006, where state law allowed the charitable beneficiary to force an accounting under state law, the Type III supporting organization met the responsiveness test. The Pension Protection Act required such trusts to have other methods of proving responsiveness. As a result, many Type III supporting organization trusts defaulted to private foundation status.

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Lapham Foundation, Inc. v. Commissioner,[50] in which the Tax Court held that a Type III supporting organization that supported a donor advised fund did not meet the integral part test and therefore was a private foundation. The Sixth Circuit affirmed the Tax Court's decision. The Tax Court reached a similar result in *Christie E. Cuddeback and Lucille M. Cuddeback Memorial Fund v. Commissioner*,[51] again relying on the integral part test to deny the foundation's Type III supporting organization status.

C. Changing Donor Advised Funds to Other Philanthropic Forms

The donor does not own or control donor advised funds, so transforming a donor advised fund to another form is not possible. The donor is probably best advised to take one of three courses:

- Use the funds in the donor advised fund as a pool for end of year giving, family giving, or to train children in philanthropic giving;
- Distribute all remaining funds to a public charity. If the donor wants to move to a family advised fund at a public charity, the donor can first established the fund arrangement with the charity and then request a distribution of remaining funds to that public charity.

D. Changing Charitable Lead Trusts to Other Philanthropic Forms

Charitable lead trusts are irrevocable trusts and as such may not be "changed" to other philanthropic forms. It is apparently possible, however, to accelerate the income interests in the trust to make an early termination of the trust provided un-discounted values are used.

E. Changing the Form or Purpose of a Permanent Endowment with a Family Advisory Committee

Permanent endowments by definition belong to public charities but are managed in accordance with an endowment agreement drafted by the donor. The key to allowing change is to anticipate alternative uses for funds in the event the original purpose is no longer effective or a priority and draft those options into the endowment agreement.[52]

VI. Final Thoughts

Institutionalizing family philanthropy is not an easy task. Planners must realize permanent philanthropic entities may not always meet the donor's goals, especially where that donor has not fully thought through his or her priorities Sometimes using one of the temporary alternative devices discussed herein can allow the family to realize its goals without creating a permanent entity that turns out to be inappropriate. Decisions hinge not only on the client's goals and objectives but on the donor's and family's ability to operate the entity to meet those goals and avoid tax disaster. Clearly determining the goals, communicating the responsibilities, pros, and cons of each choice, and ensuring ongoing legal oversight, advice and support is critical to success.

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[50] T.C. Memo 2002-293, aff'd, 389 F.3d. 606 (6th Cir. 2004).

[51] T. C. Memo 2002-300 (Dec. 6, 2002).

[52] Miree, "Perfecting Donor Intent," *supra.*

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APPENDIX A
CLIENT GOAL SETTING WORKSHEET

Setting goals for care of family and distribution of funds is important. Use this chart to list your goals, and indicate the dollar figure required to fund those goals.

Priority	Goal	$$ Required
	Provide for personal lifestyle.	$
	Provide for family care and lifestyle.	$
	Provide for assets for children. Note: determine if that gift should be outright or in trust.	$
	Provide for assets for grandchildren.	$
	Provide for elderly parents or family.	$
	Provide for family members with disabilities or other special medical needs.	$
	Provide for charities supported during life.	$
	Provide for the U. S. Government's programs and activities through a gift to the Internal Revenue Service	$
	Other:	$
		$
		$
		$
	TOTAL	$

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APPENDIX B
CHECKLIST FOR USE IN ANALYZING APPROPRIATE FAMILY PHILANTHROPY OPTION

I. Client Goals: What do you hope to accomplish in creating this entity?

___ A vehicle for personal philanthropy
___ A way to work with children in creating more effective philanthropy
___ A way to pass family values from generation to generation
___ A way to bring the family together
___ A way to memorialize the family's name in the community
___ Creating a permanent pool of funds to focus on a specific organization or purpose
___ Big tax savings to offset a specific taxable transaction
___ Insulate the client from charitable solicitations

II. Size of Entity

___ Under $250,000
___ $250,000 - $1,000,000
___ $1,000,000 - $3,000,000
___ $3,000,000 - $10,000,000
___ $10,000,000+

III. Duration of Entity

___ Less than 5 years
___ 5 to 25 years
___ 50 to 100 years
___ Perpetual

IV. Assets Used to Fund Entity

___ Cash
___ Publicly traded securities
___ Privately traded securities
___ Real estate
___ Insurance
___ Tangible personal property

V. Grantmaking Goals

___ Wants to make grants to domestic IRC §501(c)(3) entities
___ Wants the freedom to make grants for any charitable purpose, regardless of whether the entity is a recognized IRC§501(c)(3) entity
___ Wants to make grants overseas to IRC§501(c)(3) recognized entities as well as those that are not
___ Wants to award scholarships
___ Wants to make grants to individuals in distress

VI. Importance/Size of Charitable Deduction

___ Want to maximize charitable income tax deduction
___ Reduce lifetime transfer tax
___ Reduce estate tax
___ Charitable deduction less important that personal goals

VII. Costs to Create Entity

___ Determine creation costs – how does this compare to asset size?

VII. Annual Administration Costs

____ Make list of annual administrative duties (legal, transactional accounting, tax accounting, staff, space, postage, stationary, marketing, other miscellaneous)

VIII. Family's Role in Administration/Management

___ How old are the family members?
___ Will any of those family members potentially serve on the board?
___ Will any of those family members provide ongoing administrative services to the foundation; if so, describe those services.
___ Will any of those family members service as staff members?

IX. Client Support System

___ Does the client have office support to help with administration and record keeping?
___ Is the client willing to use professional services for this support?
___ Who will be responsible for managing the client's entity records?

X. Miscellaneous Considerations

___ What is the client's temperament?
___ Does he or she have the discipline to follow direction?
___ Is he or she likely to be able to run the entity within the requirements proscribed for the form?
___ Is the client likely to use you or other professional to provide oversight of grantmaking?

APPENDIX C
RESOURCES FOR GRANTMAKING SUPPORT

Name	***Contact Information***
Exponent Philanthropy	1720 N Street NW Washington, DC 20036 202-580-6560 (phone) info@exponentphilanthropy.org www.exponentphilanthropy.org
BBB Wise Giving Alliance	BBB Wise Giving Alliance 3303 Wilson Boulevard, Suite 710 Arlington, VA 22201 703-247-9321 (phone) info@give.org www.give.org
Board Source	750 9th Street NW, Suite 650 Washington, DC 20001-4793 202-349-2544 (phone) (member support and customer service) members@boardsource.org *www.boardsource.org*
Center on Nonprofits & Philanthropy	Urban Institute 500 L'Enfant Plaza SW Washington, DC 20024 202-833-7200 https://www.urban.org/policy-centers/center-nonprofits-and-philanthropy#about
Lilly School of Philanthropy at Indiana University	Indiana University Lilly Family School of Philanthropy IUPUI University Hall, Suite 3000 301 University Boulevard Indianapolis, Indiana 46202-5146 317-274-4200 (phone) https://philanthropy.iupui.edu/contact/index.html
Charity Navigator	299 Market Street, Suite 250 Saddle Brook, NY 07663 www.charitynavigator.org *info@charitynavigator.org*
Philanthropy Southwest	1910 Pacific Avenue, Suite 13500 Dallas, Texas 75201 214-740-1787 (phone) 214-740-1790 (fax) info@philanthropysouthwest.org www.philathropysouthwest.org

Council on Foundations	1255 23rd Street NW, Suite 200 Washington, DC 20037 202-991-2225 (phone) info@cof.org www.cof.org
Evangelical Council for Financial Accountability	440 West Jubal Early Drive Suite 100 Winchester, VA 22601 800-323-9473 (toll-free) 540-535-0103 (phone) 540-535-0533 (fax) www.ecfa.org
Family Office Exchange LLC	100 S. Wacker Drive Suite 800 Chicago, IL 60606 312-327-1200 (phone) info@familyoffice.com
Forum of Regional Association of Grantmakers	1020 19th Street NW, Suite 360 Washington, DC 20036 888-391-3235 www.givingforum.org
Candid (Formerly The Foundation Center and Guidestar)	www,candid.org
Foundation Source	55 Walls Drive Fairfield, CT 06824 800-839-0054 (phone) www.foundationsource.com
Grantmakers Without Borders	P. O. Box 181282 Boston, MA 02118 www.gwob.net 617-794-2253 GWOB@gwob.net
Grantsmanship Center	The Gransmanship Center 50 South Bixel St. Suite 110 Los Angeles, CA 90017 213-482-9860 info@tgci.com www.tgci.com
Independent Sector	1602 L Street NW, Suite 900 Washington, DC 20036 202-467-6100 (phone) info@independentsector.org www.independentsector.org

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National Center for Charitable Statistics	The Urban Institute 500 L'Enfant Plaza SW Washington, DC 20024 202-833-7200 memdia@urban.org www.urban.org
National Center for Family Philanthropy	1667 K St. NW, #550 Washington, DC 20006 202-293-3424 www.ncfp.org
National Committee for Responsive Philanthropy	1900 L. Street NW, Suite 825 Washington, DC 20036 202-387-9177 info@ncrp.org www.ncrp.org
National Council of Nonprofits	1001 G Street NW Suite 700 East Washington, DC 20001 202-962-0322 www.councilofnonprofits.org
National Network of Consultants to Grantmakers	440-465-3303 info@nncg.org www.nncg.org
Philanthropy Roundtable	1120 20th Street NW, Suite 550 South Washington, DC 20036 202-822-8333 www.philanthropyroundtable.org
Social Venture Partners	SVP International 3815 S. Othello Street, Suite 100 #374 Seattle, WA 98118 206-471-0410 info@svpi.org www.socialventurepartners.org
Philanthropy Southeast	100 Peachtree street NW, Suite 2080 Atlanta, Georgia 30303 404-524-0911 www.philanthropysoutheast.org

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