

Message from the Executive Suite

## Death, Taxes, and Death Taxes



Roger Silk, CEO



James Lintott, Chairman

**"**In this world nothing is certain but death and taxes," Benjamin Franklin wrote in 1789. Part of this wisdom is now being challenged by a number of politicians. Congress has debated a bill that would slowly phase out the estate tax. President Clinton has vowed to veto the bill. And George W. Bush has included the eventual elimination of the estate tax in his campaign platform. This is welcome news indeed to people with significant estates. But the question is, what does it mean?

It means nothing this year, assuming President Clinton vetoes the pending legislation as he has committed to do. Will the issue survive into next year? Who knows?

For the great majority of charitable donors, the estate tax issue serves mainly as a distraction from the real tax issue—income taxes.

It's tempting to postpone thoughts of taxes—after all, they're not due until April 15—but key decisions need to be made now. Made correctly, those decisions can make April 15 much less painful.

If you're reading this newsletter, chances are you're interested in giving money to charity. Our interest is in helping you do so wisely—that is, in a way that *maximizes* your charitable contributions and *minimizes* your taxes, while simultaneously *increasing* the amount you can leave to your heirs. How's that for a win-win-win situation? You benefit, your favorite charities benefit, and your heirs benefit—plus, of course, the

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world benefits from the good works made possible by your charitable donations.

This month's *Consultation Corner*, on Page 3, demonstrates the enormous advantages of establishing a foundation early. Because returns on foundation assets are exempt from income tax, even a fairly modest initial contribution can quickly grow to substantial size. Just as with funding a tax-advantaged retirement account such as an IRA or 401(k), the key point is to start early to take full advantage of income-tax-free growth. The good Dr. Franklin may not have foreseen the modern Internal Revenue Code, but he did warn, "He that riseth late must trot all day."

### Did You Know?

- Los Angeles Mayor Richard Riordan has a **private foundation** (he made millions in business before becoming mayor) that has given \$30 million to education over the past 20 years.

- Pais Libre is a **private foundation** established to help families of kidnap victims in Colombia, where 3,000 people were kidnapped last year.

- A **private foundation** has given the state of Maryland \$250,000 to help build special playgrounds where handicapped children can play without fear of injury.

- Former Conrail Chairman David LeVan has established a **private foundation** in his home town of Gettysburg, Pa. "It is not of the size that can solve world hunger," he said, but is big enough to have an impact in the Gettysburg area.

- A **private foundation** has saved a Texas town from dying of thirst. The Meadows Foundation gave the city of Throckmorton \$50,000 to finish a pipeline bringing water to the town. Three consecutive years of drought had reduced water levels at Lake Throckmorton, and the town had expected to run out of water soon.

# Philanthropy Tremendously Fulfilling, Donors Report

**W**hen most people think of philanthropists, the names Ford, Carnegie and Rockefeller usually come to mind pretty quickly. But their donations—even after adjusting for inflation—have already been dwarfed by those of 44-year-old Microsoft Chairman Bill Gates. In 1999 dollars, Andrew Carnegie gave away \$4.8 billion and John D. Rockefeller Sr. gave away \$5.8 billion. Gates has already donated \$22 billion to the Bill and Melinda Gates Foundation.

While Gates' giant contributions get the headlines, important philanthropy is not limited to the extremely wealthy. "Let's not just praise billionaires," says retired General Colin Powell. "This has been American culture—moms and pops." In a recent survey, 73% of Americans reported giving to charity, compared with 43% of the French and 44% of Germans. In 1999, charitable donations by Americans totaled \$190 billion, equivalent to one-third of the federal domestic budget.

Gates may well have captured the true essence of philanthropy when he said that he now views his life as a tripod. One leg is his family, another is his business, and the third is "philanthropy, where I'm seeing that by engaging the smart people and highlighting the possibili-

ties, there's a chance to do something that every day I feel good about." Again, this opportunity isn't limited to the super-rich. Many successful people find that philanthropy offers more opportunities than most areas of life to accomplish something rewarding.

"I want to see and feel the results," says Lily Kanter, a Microsoft employee who started the Sarosi-Kanter Foundation with her husband Marc. Kanter's foundation has been using some of its \$2 million to fund technical training for young would-be computer professionals. Meeting her beneficiaries has enabled Kanter to see first-hand the results of her donations. "This is the most fulfilling thing I've ever done," she concludes.

Lawrence Ellison, founder of Oracle Corp. and of the Lawrence Ellison Foundation, offers a similar perspective. He says his philanthropy is "a strategy for happiness. If you're on the road for self-esteem, it's not about accumulating as much money as possible. The best way to be happy is to help someone else."

At the other end of the wealth scale from Ellison is Morris Pope, a retired railroad engineer who gives away at least \$3,500—a whopping 17%—of his \$20,000 income every year. "I look at how God has blessed me during my working years and raising my family, and I can't tell you how many times I've come to these homeless shelters and heard people say, 'My children haven't had a bite to eat today.' Everyone should have the pleasure of giving to others. If they knew that, they would give too."

While Pope supports his church and a food bank, and Ellison sponsors medical research, philanthropists sometimes start by tapping knowledge they've gained through their jobs and applying it to solve problems. For example, several CEOs of computer-related high-tech firms created MOUSE (Making Opportunities for Upgrading Schools and Education). After two years, MOUSE has wired 38 inner-city schools, providing Internet connections for 75,000 kids. Joanne Wilson, who chairs MOUSE's board, says, "If we don't give something back, history will say that we created as much wealth as the Industrial Revolution, and we didn't do anything intelligent."

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Sterling Foundation Management is the nation's leading manager of private charitable foundations. Our mission is to ensure that our clients achieve the maximum possible results from their charitable giving. We do this by providing turn-key foundation management, along with advice to make sure clients enjoy the greatest available tax benefits, optimal control, desired family involvement, and long term continuity of purpose.

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## Consultation Corner by Roger Silk

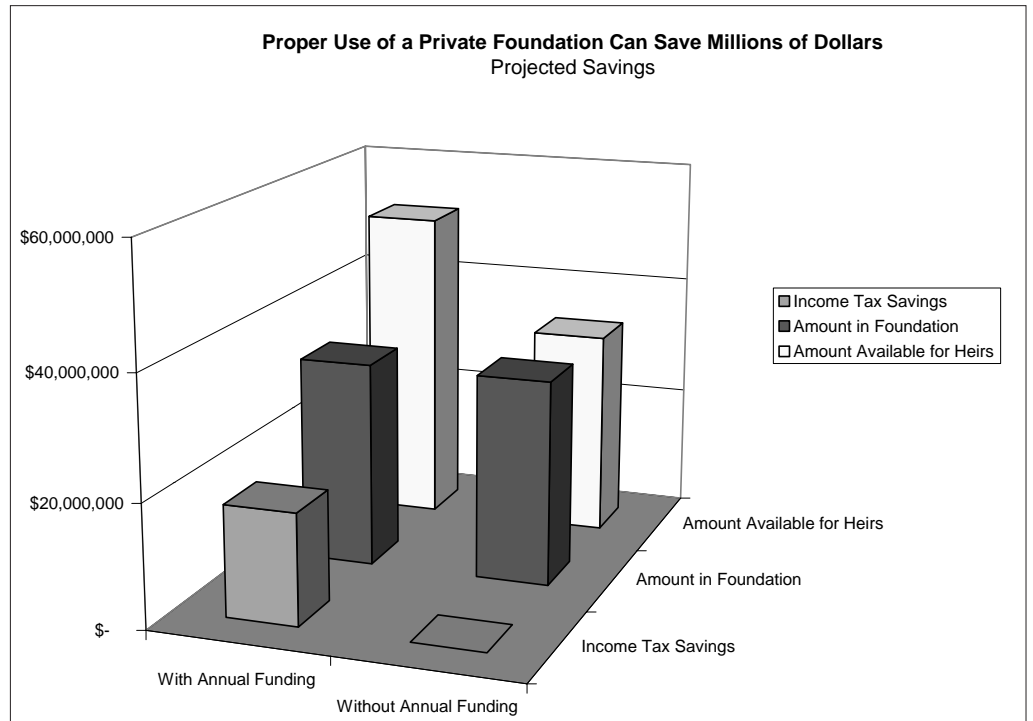
**B**ob (not his real name) is a successful businessman whose income totals about \$2 million a year. His net worth is about \$15 million. Bob would like to leave half of his estate to charity, and half to his children. Like most of us, Bob likes to think he will live a long time and is not eager to dwell on thoughts of his death. His plan, before he consulted us, was to provide in his will that, upon his death, half of his assets would go to his favorite charities and half to his heirs.

We showed Bob how intelligent but uncomplicated planning can save him more than \$18 million in taxes over the next 25 years. This will allow him to leave significantly more to charity *and* more to his heirs.

At one point in the discussion, Bob raised the issue of how the estate tax, or its elimination, would affect his plan. The answer, which surprised him, is: not at all. Here's why. All of the \$18 million tax savings in the plan come from *income* taxes. These income tax savings are completely unaffected by any changes in the estate tax.

By creating a private foundation and funding his foundation *now*, Bob can take maximum advantage of income tax breaks that reduce his income taxes each year, and also take advantage of the income-tax-free growth of assets in his private foundation. The longer these assets are in the foundation rather than in Bob's taxable personal account, the larger they will grow.

After reviewing our analysis, Bob asked how much he should put into his foundation. While stressing that



there is no right answer, we suggested that his initial funding be on the order of \$3.5 million. We arrived at this by figuring out how much he could put in and still be able to deduct it all. Of course, Bob could get even more benefit by putting in more; his

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### We showed Bob how to save \$18 million in income taxes.

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income tax deduction would be limited, but he would still get income-tax-free growth of all money he puts into the foundation.

After his big initial contribution, Bob will add to his foundation each year the amount he can deduct from his income.

By following this plan, Bob will save \$18 million in income taxes over

25 years. The accompanying graph shows this as an increase in the "amount available for heirs," but Bob could decide to put some or all of this additional money into his foundation instead.

Taking advantage of the annual income tax breaks, and the income-tax-free growth of assets inside a foundation, provides enormous benefits over time to anyone who, like Bob, decides to act soon.

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*If you have a private foundation, or are considering creating one, Sterling will be happy to consult with you at no cost and no obligation. Our professionals can help determine how to get the maximum possible tax savings, and how to use your foundation to most effectively achieve your charitable goals. Please call 888-567-3090 and ask to speak to Erica to schedule a free consultation.*

# Questions and Answers

**Q:** Does it make sense to create a private foundation now, if the estate tax may be eliminated soon?

**A:** Absolutely. First, the prospects for estate tax repeal are uncertain. Second, what Congress does, it can undo: the estate tax could be re-imposed. Third and most importantly, creating a private foundation gives you enormous income-tax advantages—even in the absence of an estate tax. You can make a tax-deductible contribution to your foundation now, let the money grow free of income tax, and distribute a vastly larger amount to charity in the future. Even if your charitable giving is motivated largely by a desire to avoid estate taxes, the income tax advantages of a private foundation are just too good to pass up. See this month's Consultation Corner on page 3 for a case study illustrating how the income tax advantages are completely separate from estate tax considerations.

**Q:** I've been told that a donor-advised fund is better than a private foundation. Do I have the whole story?

**A:** No. It's not possible to make a blanket statement that one is better than the other. Each has its advantages and disadvantages. The main promised advantage of a donor-advised fund is simplicity. The main advantage of a private foundation is control. When you contribute to a donor-advised fund, you are actually giving your money to a special-purpose charity. Because you're giving your money away, and not retaining legal control, it is simpler.

However, once you give your money to the donor-advised fund, this charity (the donor-advised fund) has full control. It now owns the assets. These entities are called *donor-advised* funds for a reason: once you make your contribution to the fund, you are barred by law from controlling contributions made by the fund. You can only *advise* the fund where to donate your money. A private foundation, in contrast, gives you full, legal control. And if you have a professional management firm, such as Sterling, manage your foundation, it is just as simple as a donor-advised fund.

While we are not aware of any major donor-advised funds that have disregarded donor requests, keep in mind that a popular "Mom and apple pie" charity you wish to support can quickly become highly controversial. (For example, consider how the Boy Scouts have become the center of a controversy which, despite a Supreme Court ruling, continues to swirl and grow). Once that happens, public and political pressure may be placed on donor-advised funds to stop directing funds to such charities—regardless of your wishes. Private foundations, in contrast, can

support any cause as long as it is a recognized charity.

The companies that run donor-advised funds generally require donors to put their money into their own mutual funds or other investment vehicles. And, the future of these funds is cloudy. The Internal Revenue Service opposes these funds, which have been operating under guidelines negotiated with

the IRS, but no actual law. Congress may tackle this issue next year. Private foundations, by contrast, enjoy a very settled and stable area of the law, and enjoy the support of Congress.

Because a donor-advised fund is currently treated as a public charity for purposes of income tax deduction limitations, it can offer some benefits if you want to give more than 30% of your income to charity each year. If this is your only reason for considering a donor-advised fund, though, you may wish to consult an advisor about other possibilities that can allow you to give a higher percentage of income and maintain better control.

If you have a small amount of money, or if you don't care at all about the limited investment options and lack of control, a donor-advised fund might make sense. If you do care about control, family involvement, or investment flexibility, consider a private foundation.

*If you would like to submit a question, please email Q&A@sterlingfoundations.com.*

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