

Which Private Foundation is Right for You: Corporate or Trust Form?

A private foundation may be either a not-for-profit corporation or a trust. The differences between the two forms are both operational and legal. For reasons that will become clear, in most cases we have found that the corporate form is preferable. Both forms are treated the same from the point of view of tax issues.

Corporate Form

It is a routine matter to establish a foundation as a not-for-profit corporation. As with a for-profit corporation, incorporation requires a certificate of incorporation which is filed with the Secretary of State. In addition to the certificate of incorporation, corporate form requires by-laws, which describe the internal workings of the organization. Annual meetings are required, with minutes and financial reports to the Board of Directors. The corporate documents should contain the specific type of language required by Sec 508(e) of the IRC restricting the activity of the foundation to permitted exempt activity.

Whereas Delaware is often regarded as the state of choice for for-profit corporations, this is not generally true for not-for-profit corporations. If the founder's state of residence is inappropriate (e.g. perhaps because it imposes relatively high franchise fees), Virginia may be a better choice than Delaware. We have found that Virginia has several advantages. For example, the fees and taxes are low, and Virginia permits not-for-profit corporations to operate under different names under the fictitious business name rules. This flexibility may

be valuable when a foundation wants to do a special project, or use multiple names, each of which is designed to help it reach a different class of intended beneficiaries.

A not-for-profit corporation operates in much the same manner as a for-profit corporation, except that there are no shareholders. Instead of shareholders, a not-for-profit corporation may have members, who elect the Board of Directors, which in turn appoints the officers. Alternatively, the Board of Directors can elect its own successors.

There are several advantages of corporate form. These include limited liability for officers and directors, greater flexibility (compared to a trust) to adapt the organizational structure as circumstances change, and the ability to have perpetual life (which is still not available for trusts in most states). Another feature of corporate form is that it permits changes in the charitable goals of the foundation. As the family's interests grow, mature, and become more adapted to changing circumstances, changes in the corporate documents allow the foundation to keep up. While this flexibility is sometimes viewed as a negative initially by control-oriented founders, we have found that they can have the best of both worlds by using a corporate form, which allows flexibility, and imposing control by making restricted grants to the foundation.

Not-for-profit corporations, just like for-profits, are managed by their directors or

officers. Certain management tasks, such as investment management and administration, may be delegated to professional advisors. Officers and directors may be paid reasonable compensation for services they actually perform for the corporation.

Corporate form requires the usual corporate formalities be observed, i.e. annual meetings, minutes, etc. Many families view this as an opportunity to expose younger members to corporate formalities relatively early in life.

Trust Form

A foundation can be established as a trust by a grantor making a gift, in trust, to one or more trustees. The trust document should be written, and should contain the specific type of language required by Sec 508(e) of the IRC restricting the activity of the foundation to permitted exempt activity. The trust should have a situs in a state in which the donor has a nexus, usually his home state. Registration rules vary from state to state.

Within limits, the terms of the trust can be broad or narrow, as the founder desires. For this reason, some founders believe that a trust inherently permits more control. However, structuring a trust very narrowly is not better than making restricted gifts to the foundation, and may inadvertently tie the hands of the trustee, even if the founder is the trustee, when unforeseen changes occur.

Whereas a corporation has directors, a trust will have one or more trustees. The trustees will generally select their successors. Trust-

ees may receive reasonable compensation for services actually performed, although various states may have more limiting rules than will apply for corporations. Because investment management is traditionally seen as part of the trustee's duty, payments to professional investment managers may reduce the amount which can be paid to trustees under state law.

There are several drawbacks of trust form vs. corporate form. Perhaps most important of these is the fact that trustees have a fiduciary duty to the trust beneficiaries. This is a higher standard than the business judgement rule which applies to corporate directors, and can make it more difficult to attract outside directors if they are desired. A second potential disadvantage of trust form is that beneficiaries may have standing to sue that they would not have if the foundation were a corporation. Although this has not been an issue, it is a theoretical concern as some public charities have become increasingly aggressive in recent years.

Conclusion

If the client has no preference, we believe the balance lies in favor of corporate form. However, if for whatever reason, the client has a strong preference for trust over corporate form, a trust can be perfectly adequate.

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