STERLING FOUNDATION MANAGEMENT LLC	Why You Should Create a Private Foundation
	Top 5 Reasons

Do you want to do more good in the world? Are you interested in advancing causes you believe in while gaining significant tax deductions? Would you like to establish a family legacy of philanthropy? If you answered “yes” to any of these questions, you should create a private foundation. But, before explaining the benefits of creating one, let’s clarify what a private foundation is. In essence, a private foundation is a tax-exempt charity that is funded and controlled by an individual or a family. A private foundation may be set up as a not-for-profit corporation or as a trust. Whichever arrangement you choose, a private foundation is treated the same for tax purposes.

Private Foundations: The Gold Standard

For a donor with the means, no other charitable vehicle can match the unique combination of flexibility, control, and tax advantages offered by private foundations. A private foundation offers its founder the ability to make a difference in the world, build a permanent legacy, gain personal satisfaction and recognition, and keep control in the family forever. It also offers an array of tax and financial benefits.

1. Make a difference. A truly effective foundation is much more than a sum of money set aside for philanthropic use. It is the carefully cultivated, ever-evolving product of the founder’s vision, drive, and ethical will. The ways in which foundations make a difference are as varied and interesting as their founders.

We see many healthcare providers creating their own foundations to support research and improve care for conditions they have treated throughout their healthcare careers. For example, in 2001, a donor wanted to make a difference in the field of epilepsy as his daughter was then recently diagnosed with the disease. He had some ideas of how to improve epilepsy research and treatment and worked with a foundation management services provider to develop priorities, determine where his resources could make a difference, and implement a practical plan for making that difference in a measurable way. As a result, his foundation was the catalyst for achieving several breakthroughs in the field over the next 15 years including creation of the world’s largest epilepsy website for people and their families suffering from epilepsy to learn about the disorder, creation of the Epilepsy Therapy Project dedicated to bringing new treatments from the lab to the patient faster, and helping to create the Epilepsy Study Consortium that makes it easier for drug companies with new compounds to conduct clinical trials without the months or years it takes most other disease states to identify patients for new drug trials.

2. Create a legacy. Charitable foundations have a long and honorable history. When Plato died in 347 B.C., he left income from his estate for the perpetual support of his academy. Control passed through heirs who each designated their successor, and the academy thrived until 529 A.D., when Roman emperor Justinian terminated it for spreading pagan doctrines. While 856 years is not exactly forever, Plato’s foundation surely ranks among the most long-lived individual institutions in the history of humankind.

When Benjamin Franklin died, he left 1,000 pounds sterling to the cities of Boston and Philadelphia with detailed instructions for use of the money. Franklin directed that some of the earnings be used initially for loans to young married couples, allowing principal and interest to grow, with the first use of the accumulated funds to be made 100 years later. The endowment helped finance the Franklin Institute of Philadelphia and the Franklin Institute of Boston, and the remainder continues to grow today.

But a private foundation offers more than a long-lasting legacy. Because it is private, it can be and do exactly what the founders and directors want – even if what they want is considered unconventional by others. The John D. and Catherine D. MacArthur Foundation pursues an unconventional path, known for its “genius” grants – unrestricted grants, with no required reports or expected outcomes, given to “exceptionally creative individuals, regardless of field of endeavor.” The MacArthurs’ son, Roderick, a trustee of the foundation, revels in the foundation’s freedom to pursue its own vision. “Foundations should be striving to do the kinds of things that the government cannot do. I repeat, cannot do: things that are not politically popular, things that are too risky, things that are just too far ahead of what the public will put up with….A private foundation, where the board of directors is answerable only to itself, is in a completely different situation, and if it doesn’t take advantage of that uniqueness, it’s just blowing its opportunity, and perhaps even its moral obligation.”

3. Achieve personal satisfaction and recognition. Personal gratification and the recognition that comes from having a foundation are priceless intangible benefits derived from establishing a private foundation. Researcher Teresa Odendhal, author of several books on philanthropy and foundations, quotes one donor who created a private foundation: “If you are an individual making small contributions, you are magically transformed when you become a foundation making small grants. I feel that I am taken very seriously.”

A 1999 article in Scientist Magazine predicted that in the coming millennium, the private foundation would become the status symbol of choice. And in the first decade of the this millennium, the number of foundations has continued to grow, despite two of the worst stock market dives in the past century. Donors who intend to have their children eventually run their foundations will also benefit—not merely by having a status symbol, but by being able to give more. As one adviser who also has his own foundation told the authors, “It’s a great way to give my kids my influence, and it makes good financial sense, too.”

4. Maintain family control. Control over how money is spent is often an issue. With private foundations, the donor retains full control. Control extends to all aspects of a foundation: the name; who is on the board; when, how, and to whom the money is donated; how the money is invested; and the choice of the bank or institution that will actually hold the funds.

5. Tax Incentives. Since 1913, when the Sixteenth Amendment introduced the income tax, Americans have found themselves with financial incentives for charity. When the estate tax was introduced three years later, more incentives for charitable donations were created. Although tax rates change – rising and falling with the political tide – the one perfectly legal, actively encouraged way to save on taxes has been to contribute to charity.

Four Powerful Tax Incentives. Private foundations, as well as public charities, benefit from four tax incentives designed to encourage charitable giving:

1. Current-year income tax deductions.
2. Income-tax-free growth.
3. Exemption from estate and gift taxes.
4. Ability to avoid capital gains tax on appreciated stock.

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Income Tax Deductions. A donor to a private foundation can take an immediate deduction on both federal and state taxes. Like all charitable deductions, these are subject to some limits. At the federal level, contributions of cash (or other so-called basis property) are deductible up to 30 percent of the donor's adjusted gross income.

The immediate income tax deduction for contributions lowers the cost of giving to charity. For example, if a donor is in a 50 percent combined state and federal income tax bracket, it will cost him just 50 cents, after taxes, to put a dollar in his foundation.

Income Tax Free Growth of Assets. Returns on assets in a private foundation are not subject to income tax. The source of the investment return does not matter: Interest, dividends, capital gains, and other forms are all free of income tax when earned within a foundation. This is a valuable benefit, making all returns (except two percent payable as excise tax) available for the foundation to use. And add to that the power of tax-free compounding. For example, one dollar invested at a return of eight percent a year will take 15 years to double in value if it's subject to a tax rate of 40 percent. If the returns are exempt, the dollar will double in just nine years.

Gift and Estate Taxes. All assets in a private foundation are exempt from estate and gift taxes. During most of the past 70 years the top federal estate tax rate has been well over 50 percent, and was 77 percent for about three decades. 2010 was the only year since the adoption of the modern tax system almost 100 years ago with no estate tax. With an estate and gift tax in effect, this exemption is obviously quite valuable.

Capital Gains Tax. Contributions of appreciated publicly traded stock that has been held by the donor for at least one year will qualify for an income tax deduction at the stock's fair market value. In addition, neither the donor nor the foundation will pay capital gains tax when the stock is sold. For stock that was acquired much below its current price, this greatly increases the value of the contribution. For example, consider a donor in a 50 percent combined income tax bracket and 25 percent capital gains tax bracket (combined state and federal) who gives $100,000 of zero basis stock to his foundation.

If the donor were to sell the stock first, he would pay $25,000 of capital gains tax, leaving just $75,000 for charity. But if the donor gives the stock to the foundation, and the foundation sells the stock, it keeps the entire $100,000. (It should be noted that while there are no income or capital gains taxes on private foundation asset returns, there is an excise tax on net investment income. This excise tax is usually levied at the rate of two percent of net investment income, but under certain conditions can be just one percent.)

The cumulative value of these tax benefits over time is staggering. In one generation, proper use of the tax incentives can double the amount available for charity without reducing the amount the donor keeps for his own use. Over two generations, of course, the value of the savings compounds even further.

Conclusion. In sum, only the private foundation offers legal control along with its tax benefits. A private foundation also offers more flexibility – in how to invest and how to spend the money – than the alternatives. As for eventual disposition of assets, if a donor creates a private foundation but later changes her mind and wants to stop running it, she can still give some or all of the foundation assets to a donor-advised fund.

In addition, if its assets are large enough, a private foundation can be very cost-effective. While it is possible to spend upwards of $20,000 to set up a foundation, it does not necessarily cost that much. It may be $10,000 or less. Many foundation management services companies – especially those providing grants administration, program consultation, and full foundation management – set fees based on a foundation's assets. For example, a foundation might pay an annual fee of one percent of total assets to a company that handles all the foundation's financial and administrative operations.

Private foundations play an important role in the charitable universe. They each offer a unique combination of grant-making control, investment flexibility, and tax benefits while providing the donor and his family all the joy and satisfaction that comes with making a charitable impact in society.

This article was provided by Sterling Foundation Management LLC. Please contact us at (703) 437-9720 or foundations@sterlingfoundations.com, or visit our website at www.sterlingfoundations.com to learn more about private foundations and our comprehensive suite of personal, customized foundation management services.

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