Signs a Private Foundation Is Right for You

Are you philanthropically inclined but unsure if a private foundation would be a good fit for you or your family? Here are some compelling reasons why a private foundation might be well-suited to meet your charitable, financial, estate, or family goals.

Private foundations continue to be the vehicle of choice for many successful families, entrepreneurial individuals, and corporations looking to make a philanthropic impact. While you may easily recognize the names of the largest private foundations — such as the Ford Foundation, Bill and Melinda Gates Foundation, or Rockefeller Foundation — you may not be aware that there are also thousands of smaller, lesser-known private foundations that control billions of charitable dollars.

Based on IRS 2015 data[1], there are approximately 99,000 private foundations in the United States (a 24% increase from the roughly 80,000 reported a decade ago). Did you know that about 60% of private foundations are $1 million or less in asset size and about 90% are $10 million or less in asset size? The largest foundations we often hear about in the news only represent a marginal percentage of all private foundations. Thus, contrary to popular belief, private foundations are not just for the mega-millionaires.

Did you know that 60% of private foundations are $1 million or less in asset size and about 90% are $10 million or less?

Big or small, private foundations are responsible for tackling some of the hardest systemic issues facing our society today, as well as being significant contributors to local initiatives to improve communities across the nation. Establishing a private foundation can also have a significant impact on a personal level. Foundations can be a highly effective tool for pursuing a donor's charitable goals, realizing tax savings, instilling family values across generations, and establishing a lasting legacy.

The following are eight signs that a private foundation is the right fit for you.

1. You Want to Leave a Lasting Legacy

You have a desire, whether articulated or not, to make a difference.

While many may be drawn to private foundations because they offer a number of tax benefits, this should not be the sole reason to create a foundation. In our twenty years of charitable

[1] IRS, Domestic Private Foundations, Tax Year 2015 and 2005

experience, we have found that donors who create a private foundation are motivated by a deep-seated desire to help make the world — or a small part of it — a better place. The range of charitable causes is wide and might take the form of helping the disadvantaged, finding cures or better treatments for a specific disease, preserving the environment, protecting animals, fostering innovation, supporting the arts, and countless others. While donors may initially have a hard time articulating their vision for a better world, the desire to make a difference is central to their motivations. Establishing a foundation can be an effective means to achieve your goals.

2. You Already Give Significant Amounts to Charity

A private foundation can take your giving to the next level and maximize your charitable impact.

If you already give generously and regularly to charity, then you already know the deep personal satisfaction that comes from supporting causes you care about. Establishing a foundation not only adds more structure to your charitable giving, but can give you more control over how funds are used.

Yes, a direct gift of money is the simplest, easiest, and perhaps most familiar way to support a cause. Large direct gifts are often endowment gifts – money that will be held and invested by the charity. Over time, the charity will spend the income generated by those assets. In our experience, direct gifts are not the best strategy for an effective long-term program. Once a donor makes an endowment gift, the donor may have an opportunity to advise the charity, but will no longer have control over how funds are used. There are many examples showing charities with large endowments, such as well-known universities, museums, or hospitals, are less likely to heed or be as responsive to the donor's wishes after the gift has been received.

We have found that a private foundation is an ideal way to get the immediate tax benefits that come from an endowment-level gift, but still exercise the control and conditions you want with the gift. As an example, we have helped foundations negotiate large multi-year grant agreements where mutually agreed upon milestones must be met in order for the charity to receive the next installment of funds.

3. Your Income Was Particularly High This Year

Are you selling your business, exercising stock options, or receiving a large bonus? A private foundation may provide an immediate income tax benefit and an increase in both personal and charitable net assets.

If you are facing unusually high income this year, it may be an ideal time to establish a private foundation. A private foundation allows you to take an immediate tax deduction and decide over time how best to give to charity. Generally speaking, you can cut your income tax bill immediately by up to 30% of your adjusted gross income (AGI) depending on the type of assets you donate.

The rules allow excess deductions to be carried forward for up to five years. In addition to the immediate tax benefit, creating a foundation will result in a longer-term increase in net assets for you and your foundation.

Example A. For illustrative purposes, let's assume David has an income of $1 million and lives in New York state; thus his combined federal and state income tax is approximately 46%. If he does not make a charitable contribution, he will be taxed on the full $1 million, paying $460,000 in income tax and leaving him with $540,000 in assets.

Now, let's say David makes a cash contribution of $300,000 to his family foundation (30% of his AGI which is the maximum allowable annual personal deduction for cash donations to a private foundation). He will now pay federal tax on $700,000 of income. His family foundation gets the full $300,000 contribution. David pays a combined income tax of $322,000 which results in a savings of $138,000. He now has $378,000 in personal assets and $300,000 in foundation assets over which he has full control and mostly income-tax-free[2] growth, for a total asset value of $678,000. That is 26% more in combined assets than if he had not funded a foundation.

Without Foundation	
Income	$1,000,000
Contributed Assets	$0
Taxable Income	$1,000,000
Income Tax	$460,000
Remaining Personal Assets	$540,000
Combined Personal + Contributed Assets	$540,000

With Foundation	
Income	$1,000,000
Contributed Assets	$300,000
Taxable Income	$700,000
Income Tax	**$322,000**
Remaining Personal Assets	$378,000
Combined Personal Assets + Contributed Assets	**$678,000**

A savings of $138,000 in income tax.

An additional 26% in combined assets.

Based on combined federal and state income tax of 46%.

4. You Own Long-Term Highly Appreciated Stock

Donating highly appreciated unrestricted stock held beyond a year can result in an immediate income tax deduction for the full fair-market value (up to 20% of your AGI) and can eliminate capital gains liability.

The advantage of giving appreciated stock that is held beyond a year is twofold. First, you get a deduction for the full fair-market value that can be used against ordinary income if the appreciated

[2] Private foundations are subject to a 1% or 2% excise tax on the net investment income.

stock is held in publicly traded companies. Second, no capital gain is realized when the appreciated property is donated to the foundation.

Example B. In this example, let's assume Julia has a high income and is looking to donate highly appreciated securities in the form of publicly traded stock held for more than a year. The stock has a current fair market value of $1,000,000 and with a cost basis of $100,000.

If Julia were to sell the stock and donate the proceeds to charity, she would be subject to capital gains tax on the realized gain. As in Example A, let's assume she is in the highest income bracket and lives in a high tax state with a combined capital gains tax rate of 33%. She would be subject to a capital gains tax of $297,000 leaving her $703,000 in proceeds to donate to charity. Contributing the proceeds would save her $323,380 in income taxes.

Now let's suppose Julia contributed the stock to her private foundation. She will receive an income tax deduction for the current fair market value of $1,000,000. Although this exceeds the limit of 20% of her AGI, she can carry forward the excess deduction for up to five years which represents a total income tax savings of $460,000. In addition, she is not subject to capital gains taxes on the appreciation, thus, saving her an additional $297,000. By donating the stock to her private foundation, Julia gets a combined tax savings of $757,000.

Donating Highly Appreciated Stock to Your Private Foundation	
Donated Securities Current Fair Market Value	$1,000,000
Combined Federal and State Capital Gains Tax Savings[1]	$297,000
Charitable Income Deduction[2]	$1,000,000
Charitable Income Deduction Tax Savings[3]	$460,000
Total Combined Tax Savings[4]	**$757,000**

An additional $434,000 in combined tax savings if the stock is donated directly to the private foundation.

[1] Based on a combined federal and state capital gains tax rate of 33%. Assumes cost basis of $100,000 and long-term capital gains of $900,000.

[2] Assumes highly appreciated non-restricted stock held longer than one year for a full market value deduction. Although the contributed value exceeds 20% of the donor's AGI, the donor can carry the excess charitable income deduction up to five years.

[3] Assumes the donor is in the highest federal income tax bracket and in a high tax state for a combined income tax rate of 46%. Represents income tax savings on the full market value of the donated securities.

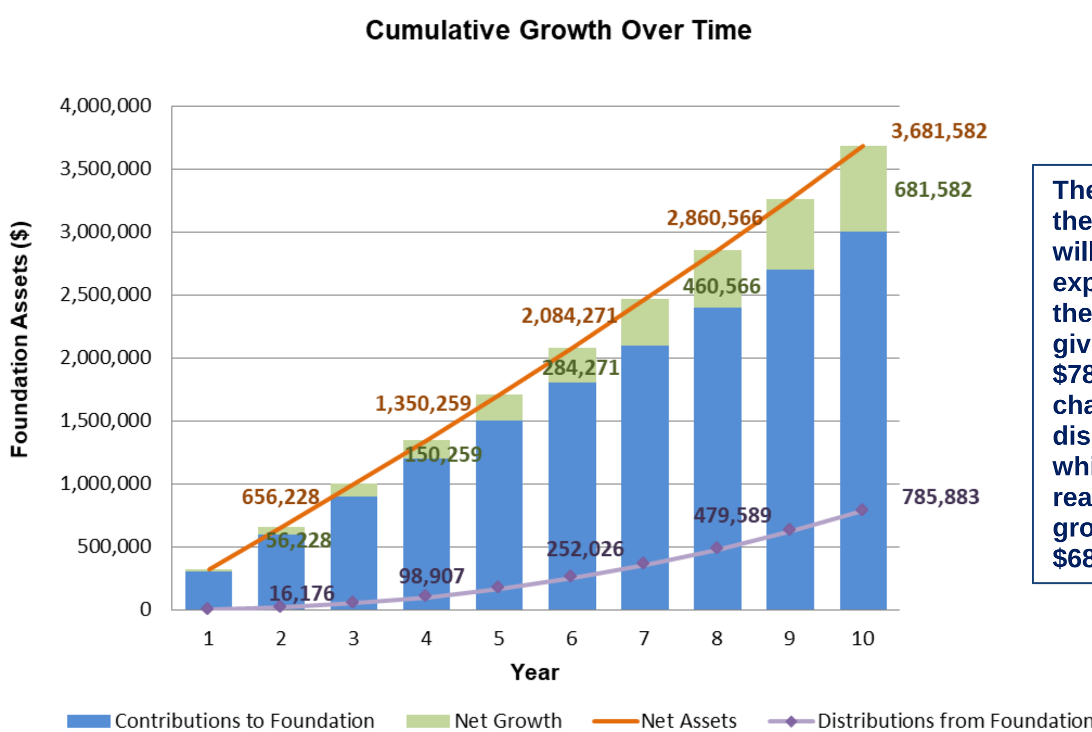
[4] Does not take into account the 1% or 2% excise tax private foundations must pay annually on investment income.

5. You Have Steady or Growing Income Beyond Your Living Needs

Contributing regularly to your private foundation provides compounding tax advantages over time.

Over time, the advantage of the foundation grows because private foundations are not subject to income tax and instead pay a nominal 1% or 2% excise tax on investment income. The following is an illustration of the compounding effect of these tax savings.

Example C. Let's now look at Charles and Carol who have a steady high income of $1 million a year and contribute 30% of their AGI to their family foundation annually. Let's also assume the family foundation earns an 8% annual return, makes the required minimum distribution of 5%, and pays an excise tax of 2% on investment income. After 10 years, they will have increased their foundation's assets by over $681,000 as a result of nearly tax-free growth compounded over time. They will also have complete control over their foundation that is now worth almost $3.7 million and, more importantly, gained the personal satisfaction of distributing over $785,000 toward causes they care deeply about.



The family and the foundation will have experienced the joy of giving over $785,000 in charitable disbursements while still realizing a net growth of over $681,000.

Assumes foundation asset growth rate of 8%, 5% annual minimum distribution, and 2% excise tax on investment income.

6. You Want Control of Your Charitable Assets

A private foundation allows the founder, family, or designated successors to maintain binding, legal control over the charitable assets — unlike a donor-advised fund.

Control is very important for most successful or entrepreneurial individuals. In many cases, this carries over into their charitable preferences as well. Private foundations allow foundation creators to retain full legal control over the foundation during their lifetime and to pass that control to their chosen successors in perpetuity. As such, private foundations allow their creators maximum flexibility, unlike other alternatives for charitable giving. Since donors retain control over the way their assets are invested, when money is given, and how much money is given (as long as it meets the required minimum distribution), the private foundation enables donors to adapt their charitable behavior as needed.

We cannot stress enough the benefit of maintaining legal control over private foundation assets. We have seen too many examples of donors giving large endowed gifts directly to charity or to donor-advised funds, only to be frustrated by the limitations on disbursements, investments, or succession designation.

7. You Want to Pass Down Family Values

Private foundations offer a number of unique advantages to involve children in the family's philanthropy and foundation governance.

Studies have shown the numerous benefits of engaging in philanthropy as a family – such as instilling shared family values, unifying members around a common cause, and providing opportunities to discuss family finances. In our experience, we have found the best way for donors to teach their children about their values is to involve them in the process of charitable giving.

A family foundation provides an excellent vehicle for involving the next generation. The formal structure of a family foundation provides a natural framework for involving family, for example as directors or board members. Getting children involved in governing the family foundation is not only a great way to equip them to take on larger roles in the family's charitable activities, but can be an effective training ground before taking on the family business or other leadership roles. In some cases, children may become seriously involved in the foundation and can be provided reasonable compensation for their services. There are, of course, many different approaches to involve family and the next generation, as every family is unique in make-up and dynamics, further highlighting the broad flexibility of foundations.

8. You Plan to Leave a Substantial Amount to Charity Upon Death

Creating a foundation now and funding it annually takes full advantage of income tax benefits each year and realizes savings beyond estate tax savings.

While there may be good reasons to postpone donating assets to a foundation until death, tax planning is not often one of them. It is usually best to create a foundation now and take advantage of the income tax benefits, as well as income tax-free growth on the foundation's assets (with the exception of a 1% or 2% excise tax on net investment income). Donors with large estates should also consider a private foundation as part of their estate planning strategy. All contributions to private foundations are generally exempt from transfer and estate taxes, similar to contributions to qualified charities. Hence, all contributions, whether made during life or upon death, are outside the donor's estate and therefore free of any gift, estate, or generation-skipping transfer tax. This is particularly important when considering the long-term intergenerational accumulation of wealth for charitable use.

In Conclusion

These are just some of the major considerations for creating and funding a private foundation. For qualified clients, setting up a private foundation can have tremendous benefits ranging from immediate income-tax advantages to the unparalleled satisfaction of making the world a better place. A private foundation can also add structure to your philanthropy, encourage family involvement, provide leadership opportunities, and give the donor assurance he or she has full control over their charitable assets. While the regulations regarding private foundations are extensive, professionally managed foundations allow donors to obtain all the benefits without the administrative burdens.

Contact Us

With over twenty years of charitable expertise and managing nonprofits, Sterling Foundation Management is uniquely qualified to assist you in creating and managing your foundation. If you would like more information, contact us by phone at **1-866-479-7185** or **703-437-9720,** or by email at foundations@sterlingfoundations.com.

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