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Ten Things You Need to Know About Private Foundations (*and other exotic charitable beasts*)

Linda A. Wasserman
Honigman Miller Schwartz & Cohn

Financial and Estate Planning Council of Metropolitan Detroit
Leave a Legacy, Southeast Michigan
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Thing One
What is a Private Foundation?

- A nonprofit corporation or a trust.
- Exempt from income taxation under IRC §501(c)(3).
- “Fails” the IRC’s “public charity” test.
  - doesn’t receive public support from gifts, grants, fees.
  - doesn’t qualify as a “supporting organization.”

Income Tax Deduction

- Gifts to a Public Charity:
  - 50% limit for cash.
  - 30% limit for appreciated property (generally fair market value deduction).
- Gifts to a Private Foundation:
  - 30% limit for cash.
  - 20% limit for appreciated property (only publicly-traded securities are deductible at fair market value).

Five-year carry forward for amounts in excess of limitations.

Thing Two
The Excise Taxes

- Tax on Net Investment Income
- 5% Distribution Requirement
  - 2 years to satisfy requirement
  - 5 year carry forward for excess distributions
- Self –Dealing

  Prohibits any financial transaction with a disqualified person
- Excess Business Holdings

  Limits ownership in business enterprises
- Jeopardy Investments
- Taxable Expenditures

Thing Three
The Estate Administration Exception

Don bequeathed one-half of his estate to his wife, Megan, and the balance of his estate to the Draper Family Foundation of which Don was the primary funder. Megan and Don's three children are directors of the Foundation.

Don's estate includes stock in Sterling Draper (a closely held corporation), publicly traded securities and a home.

Estate Administration Exception

1. PR/Trustee must have (i) power to sell the asset, or (ii) power to reallocate the asset to another beneficiary, or (iii) be subject to an option with respect to the property.

2. **The transaction is approved by the Probate Court.**

3. The transaction occurs before the estate is terminated for federal income tax purposes.
4. The estate receives at least fair market value of the foundation's interest in the property at the time of the transaction (subject to any option).
5. The Foundation receives an interest at least as liquid as the one it gave up or an asset related to its exempt purpose or the transaction was required under an option agreement.

Thing Four
Grants to Non-Charitable Beneficiaries

- Generally – a private foundation only makes grants to public charities.
- Under the “Taxable Expenditure Rule” a private foundation cannot make an expenditure other than for purposes other than (generally) religious, charitable, scientific, literary and educational purposes.

Expenditure Responsibility

There must be a written agreement stating the purpose of the grant and which requires the donee to:

- Submit full and complete annual reports on use of funds.
- Maintain records of receipts and expenditures
- Not engage in lobbying or political activities
- Repay any portion that is not used for the stated purpose.

Program Related Investments

- A private foundation can make an investment, a loan or guarantee debt to nonprofits, individuals or for profits - if the primary purpose is to accomplish one of the foundation's charitable purposes.
- New proposed regulations clarify that PRIs can be used for a wide range of purposes.
- The primary goal cannot be to make money, but a PRI may be made even if there may be a high rate of return.

Thing Five
Grants to Foreign Charities

- Individuals cannot deduct contributions to foreign charities.
- There is no prohibition on grants to foreign charities by foundations.
- Two methods:
  - “Equivalency determination” – or
  - Exercise Expenditure Responsibility and maintain a separate fund for the grant.

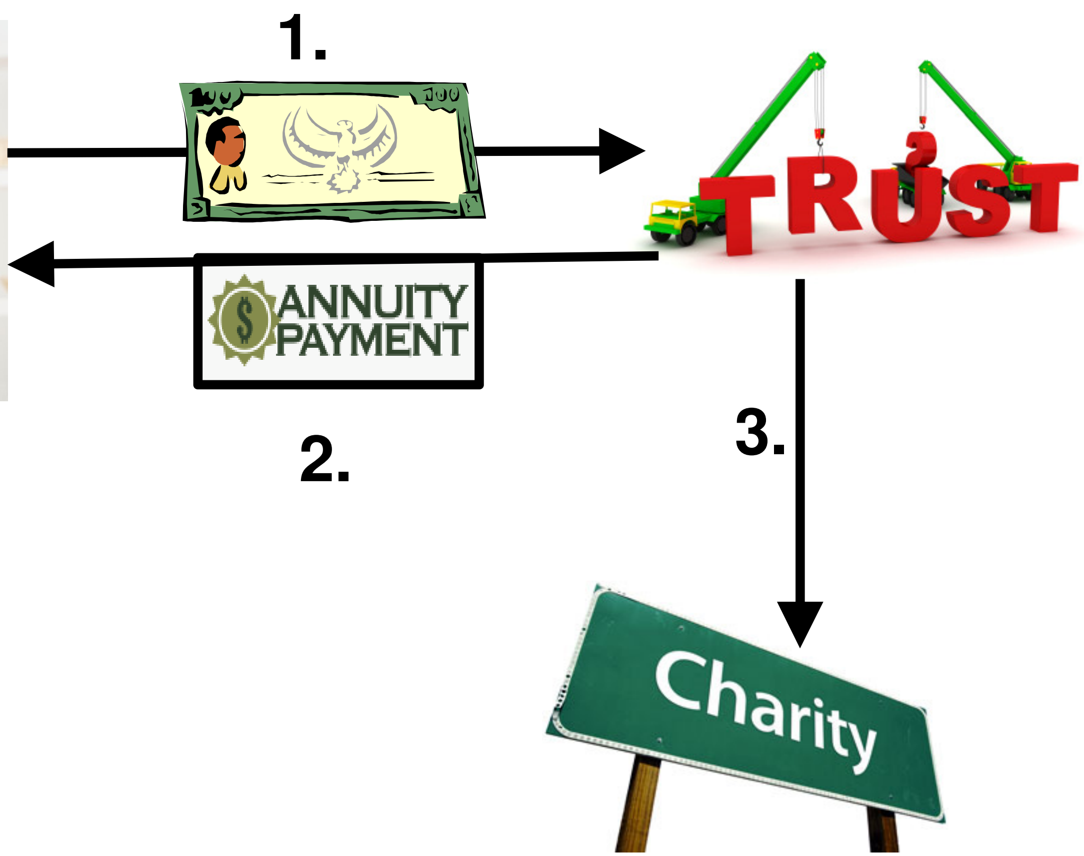
Thing Six
Terminating a Private Foundation

- Must comply with state law and federal tax law.
- Private foundations are subject to a “termination tax” unless the termination occurs after all of the assets have been distributed to charities.
- Must obtain approval from the state attorney general.

Thing Seven
Charitable Remainder and Lead Trusts

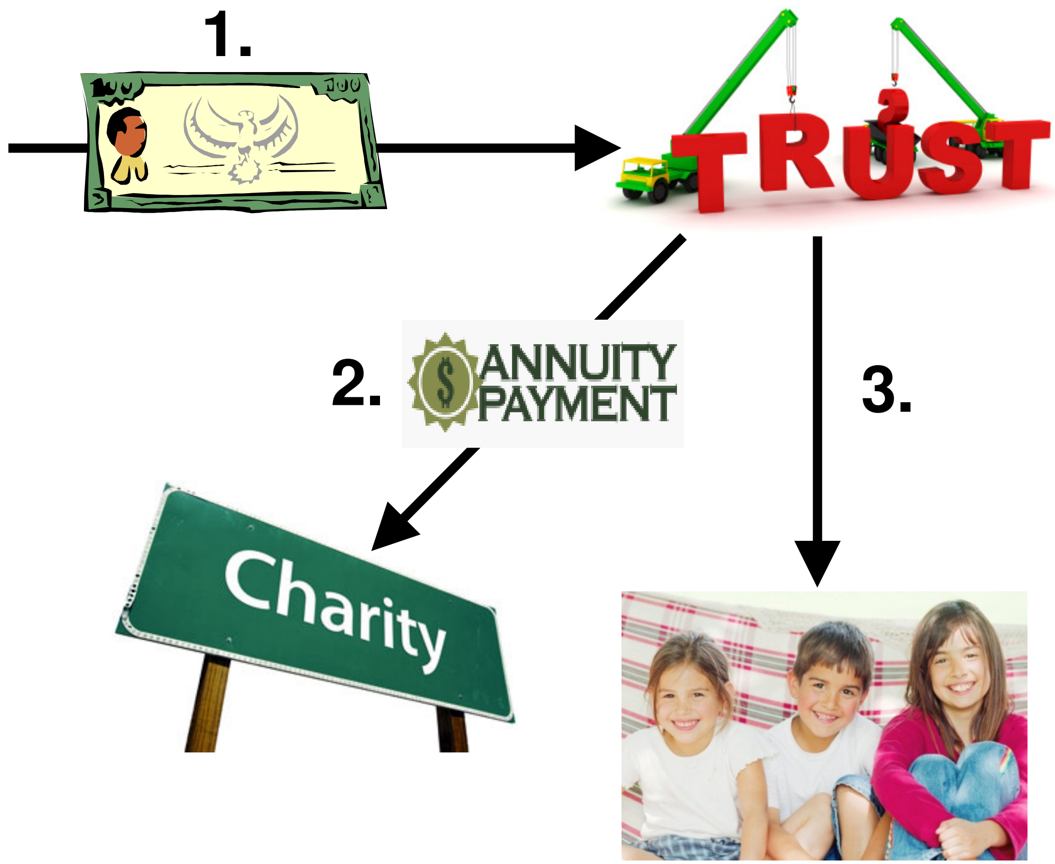
- Charitable remainder trusts and charitable lead trusts are subject to some of the same excise taxes as private foundations.
- A private foundation can be the beneficiary of a split-interest trust.
- If the charitable beneficiary is a private foundation – the lower deduction limitations apply.

Charitable Remainder Trust



1. Donor funds a trust
2. Trust pays donor an annuity for life or term of years.
3. At end of annuity term the balance goes to charity

Charitable Lead Trust



1. **Donor funds a trust**
2. **Trust pays charity an annuity.**
3. **At end of annuity term the balance goes to noncharitable beneficiaries**

CLAT with Private Foundation beneficiary

- The CLAT will be included in the donor’s estate if the donor retains the power to select the charitable beneficiaries – even as a director or trustee of a private foundation.
- Can avoid the issue if the beneficiary foundation holds the annuity in a segregated fund and the donor does not participate in distribution decisions over those funds.

Thing Eight
Charitable LLCs

- Single Member LLCs

  As long as all other requirements are met a charity may have a single member LLC to own a specific assets (like real estate) or to engage in an unrelated business.

- L3C – Low-profit limited liability company

  Intended to facilitate PRIs

Thing Nine
NonExempt Charitable Trusts

- A trust that has only charitable beneficiaries.
- Not tax-exempt – although may be functionally tax-exempt.
- Treated as a private foundation for all other tax purposes.

Examples

- A charitable remainder trust that does not terminate at the end of the annuity term.
- A revocable trust with only charitable beneficiaries remaining that continues after a reasonable administration period.
- A trust created for a charitable purpose but an application for tax exemption is not timely filed.

Non-Exempt Charitable Trust

- Must file both a 990-PF and a 1041.
- May not actually pay tax because of the unlimited charitable income tax deduction for distributions of gross income made to charities.
- Contributions are deductible!
- Can apply for exemption but only if the governing document includes the necessary provisions.
- Can avoid the 3.8% tax on net investment income.

The Last Thing(s)

Other Charitable Planning Ideas

- Donor-advised fund as grantee of a private foundation to satisfy 5% distribution requirement.
- CRUT to provide for a spouse on divorce.
- Testamentary CRUT for a spouse that ends on remarriage.
- CLAT to avoid the excess business holdings rules.
- Using a disclaimer plan to allow beneficiaries to decide whether to fund the family foundation.