Leading by Example:
Best Practices in Charitable Giving

The Boston Foundation
INNOVATION. INFORMATION. IMPACT.

BOSTON COLLEGE

ROPES & GRAY

Comparison of Charitable Contribution Deduction

Gift to	Adjusted Gross Income Limitation	Deduction Based on
Public Charity (includes donor-advised fund sponsoring organizations)	50% for cash 30% for long-term capital gain property	Fair market value
Private Foundation	30% for cash 20% for long-term capital gain property	Fair market value for cash and publically traded long-term appreciated securities; tax cost for other long-term capital gain property, including closely held stock and real estate

Facts about the B Family Foundation:

- Mr. and Mrs. B established a private foundation 15 years ago
- It was enjoyable at first , but Mr. and Mrs. B no longer enjoy operating the Foundation
- Mr. and Mrs. B have decided to get a divorce
- Mr. and Mrs. B want to know what their options are

Option 1: Distribute out all of the assets to existing public charities and terminate the private foundation

Ordering is important:

1. Distribute out all foundation assets
2. Terminate foundation status with IRS (only for distributions to certain charities)
3. File Articles of Dissolution

Additional considerations:

- File final Form 990-PF
- Pay all distributions and service fees before year end

Option 2: Divide the foundation into two

- How will the investment assets be divided?
  - Liquidate and transfer/transfer based on value?
- One new foundation or two?
- Transfer of tax attributes to transferee foundation(s)
  - Distribution requirements
  - Substantial contributors
  - Expenditure responsibility requirements
  - Other attributes
- Status of the transferor foundation post-transfer
  - Dormant foundations
  - IRS notification?

Option 3: Distribute out all of the assets to two donor-advised funds (DAF)

- No restriction under current law on distributing from a private foundation to a DAF

- Ordering is important:
  1. Distribute out all foundation assets
  2. Terminate foundation status with IRS (if sponsoring organization in existence for less than 60 months)
  3. File Articles of Dissolution

Transfer Foundation assets to a donor advised fund

Pros:

Termination process is easy

Both Mr. and Mrs. B can continue to make grants until assets are fully distributed

Flexible payout

Grantmaking due diligence process simplified; sponsoring organization responsible for ensuring that grantees meet requirements

No individual DAF filing requirement; sponsoring organization files Form 990

Cons:

Mr. and Mrs. B no longer control the funds; as donor-advisors to the DAF they can recommend grants but they no longer control the assets

Facts about <u>Mr. T Foundation,</u> a nonoperating foundation founded by Mr. T, a Guatemalan soccer star.

2005	Forms the Mr. T Foundation via a trust instrument with $500,000. Foundation assets are maintained in a Vanguard investment and checking account (for making grants). The Foundation supports various organizations in the New York area through grants.
2006	Mr. T purchases *10 acres of land* in Villa Neuva, Guatemala.
2008	Mr. T marries Ms. T. Mr. T and Ms. T hold dual US-Guatemalan citizenship and Ms. T is formally appointed Trustee of the Mr. T. Foundation.
2009	Ms. T sees that there are significant needs in Villa Neuva, specifically prenatal care and infant nutrition.
2010	Ms. T builds a small clinic on the *10 acres of land* and opens a Guatemalan bank account. The Mr. T Foundation stops making grants and its funds are used to support the clinic and its programs.
2012	The clinic expands and opens a nutrition program and conducts prenatal education classes. Various improvements are made to the existing site, including better access to the clinic by building a road. The Foundation's assets are used to fund the land improvements and expand the programs.

Current day issues

- Ms. T has obtained legal and accounting help.

- The Foundation has been filing as a nonoperating foundation but is, in fact, functioning as an operating foundation. IRS has not been notified of this change.

- Are there potential issues with ***self-dealing*** and ***private inurement***?

- There are potential internal control issues whereby many vendors and employees are paid via cash.

- Ms. T wants to sustain and build the programs through ***fundraising in the US.***

- Mr. T is less invested and would prefer to dissolve the Foundation. He is concerned about the potential risks that his advisors are mentioning.

	Stay as Nonoperating Foundation	Convert to a public charity	Transferring assets to a DAF
Advantages	Easy	Self dealing eliminated (potentially)	Very easy
	Control high	Fundraising easier	
Disadvantages/Challenges	Need to establish a foreign charity	60 month waiting period!	Need to establish a foreign charity
	Does not meet Ms. T's desire to increase fundraising--cannot obtain gifts from other private foundations	Loss of control as board needs to expand	Loss of control is high--donor has ability to suggest but not direct
	Self-dealing not addressed	No guarantee that support test will be met	Lack of internal controls-DAF could reject donor's suggested request
	Donor contributions are limited	The US charity would be subject to MA audit requirements	

Inform IRS that the Foundation is acting as an operating foundation

Pros:

- Easy to do
- As an operating foundation the Foundation could solicit grants from nonoperating foundations, thereby meeting Ms. T's desire to expand fundraising
- They easily pass the numerical tests to be an operating foundation
- Control high
- No need to establish a foreign charity
- No need to pass the support test

Cons:

- Self-dealing and private inurement issues are still problematic
- Mr. T may need to donate the land, or a portion of the land to address self-dealing and private inurement issues

Becoming a Private Operating Foundation

Mr. and Mrs. T wanted comfort that the IRS approve the change in status.

Nonoperating foundations converting to an operating foundation must pass the income test, whereby 85% of income must be on <u>direct</u> (i.e. not grants) charitable expenditures. In other words, they must "distribute" 85% of the minimum distribution requirement. AND they must pass either the endowment, asset or support test.

1) Aggregate <u>all</u> the 4 years [useful if expenditures in one year were greater than the other 3 years]
2) 3 out of <u>each</u> of 4 years passes the income test

A private foundation may seek IRS approval for its conversion to an operating foundation by filing Form 8940 *Request for Miscellaneous Determination* and pay a $400 fee.

- Check box 8g on Form 8940
- Attach a completed 990-PF, Part XIV, reflecting that it satisfies the requisite tests
- A listing and description of distributions for the active conduct of its own programs or activities

The IRS says "a private foundation that has been existence for at least four years and meets the requisite tests is considered an operating foundation effective the final year of the four-year period." IRS Exempt Organizations CPE Technical Program for Fiscal Year 1984

On-Going Issues

- As for a US Charity conducting foreign operations: There are no special IRC 509 rules for domestic organizations with foreign operations. In fact, there are several revenue rulings which do not place restrictions on foreign operations.

- In general, contributions to domestic organizations with foreign operations are allowable.

- Trust vs. corporate structure: Is a corporate structure more appropriate?

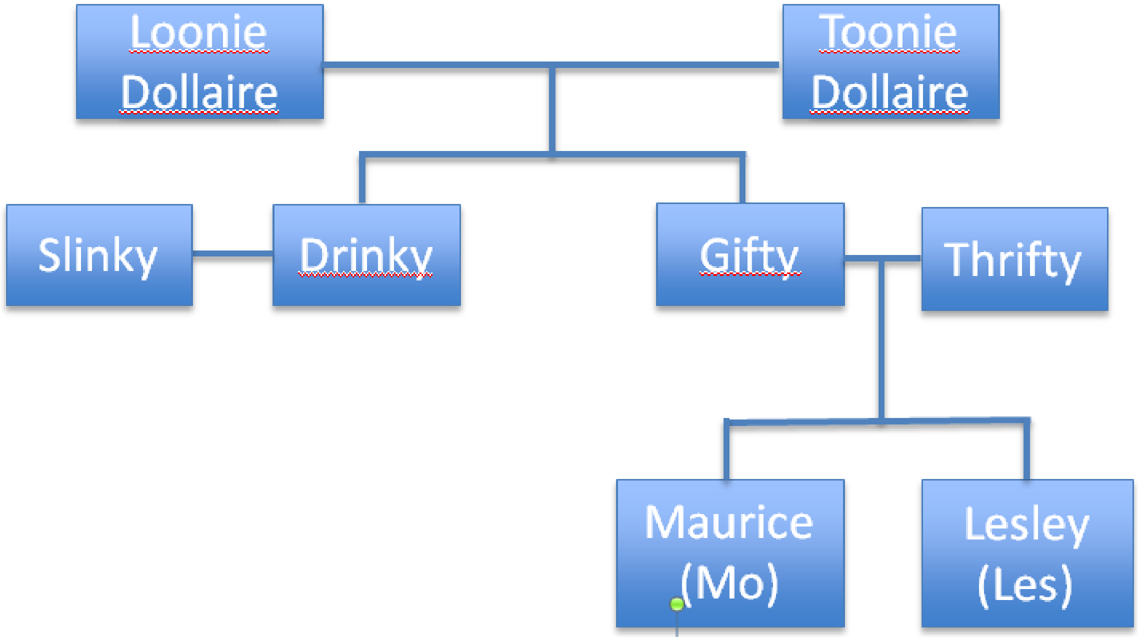
- Determining whether Mr. T will donate the land to the Foundation.

- Compliance with US Department of Treasury's Office of Foreign Asset Control.

- Recording transactions in QuickBooks or other accounting software.

- Developing policies and procedures related to cash payments and establishing adequate internal controls.

Private Foundation and Donor Advised Fund: A Complementary Approach



Loonie and Toonie Dollaire established the Dollaire Family Foundation, a Private Foundation, the Trustees of which currently include: Loonie, Toonie, their two adult children, Drinky and Gifty, and the children's respective spouses, Slinky, and Thrifty.

Gifty and his lovely wife, Thrifty, are parents to twins, Maurice and Lesley.

Private Foundation and Donor Advised Fund: A Complementary Approach

Gifty and Thrifty have decided it is time to invite Mo and Les to become more involved with the family's philanthropy. Gifty and Thrifty have made every effort to educate their children about the relative burdens, responsibilities and opportunities associated with their privileged position, without accentuating the family's financial resources.

The children are not yet aware of the precise magnitude of the Dollaires' fortune, and their parents are hesitant to give them complete access to the details of the sizeable Dollaire Family Foundation.

In addition, Gifty and Thrifty have a difficult enough time reaching consensus when making funding decisions with Loonie, Toonie, Drinky and Slinky, and hope to avail their children of the opportunity to cut their teeth on a more modest philanthropic endeavor before joining an already complex Board of Trustees.

Private Foundation and Donor Advised Fund: A Complementary Approach

A trusted advisor to the Dollaires suggests they explore establishing a Donor Advised Fund (DAF) for the purpose of introducing Mo and Les to philanthropic decision making. Gifty and Thrifty create the DAF, naming themselves, Mo and Les, as Advisors to the Fund, each with the authority to submit grant recommendations.

Gifty and Thrifty are delighted to see the ways in which adding the DAF to their existing Private Foundation (PF) satisfies their aspirations for their children:

Original Rationale for Establishing the DAF

- Exploring personal philanthropic interests vs. Collective decision making
- Developing identity for the next generation
- Introducing greater flexibility

Private Foundation and Donor Advised Fund: A Complementary Approach

Although the Dollaires' initial motivation for establishing the DAF is to introduce their children to philanthropy, the family soon realizes several additional benefits to using these companion charitable vehicles:

Maintain Anonymity/Privacy

- Make anonymous grants through DAF

Satisfy Required Minimum Payout

- Permissibility of gifts from PF to DAF

Maximize Income Tax Deductions

- Fair Market Value vs. Cost Basis Deduction
- Cash gift limitations
- Appreciated property limitations against Adjusted Gross Income (AGI)

Private Foundation and Donor Advised Fund: A Complementary Approach

Contribute Complex Assets

- Some complex assets more easily contributed to DAF

Avoid Chasing the Excise Tax

- When a larger distribution may be desirable in one year… but not the next

Additional Resources of some Sponsoring Organizations

- Research & Education
- Peer to Peer learning
- Donor Services
- In-house expertise
- Staff to perform due diligence on donor's behalf
- Community presence

Why Fund A Charitable Remainder Trust (CRT)?

- The grantor receives an income tax deduction
- The grantor reduces his taxable estate
- The trust provides an annual income stream to a non-charitable beneficiary
- The grantor can avoid capital gains by contributing appreciated assets to a CRT. The CRT then sells the assets
- The grantor can diversify his assets to enhance his annual income stream
- The grantor retains the right to change the charitable beneficiary

Are There Any Restrictions in the Operations of a CRUT?

A CRUT is prohibited from engaging in:

- Acts of Self-Dealing
- Incurring expenditures for a non-charitable purpose

Why Terminate a CRT?

- The income beneficiary does not need an income stream
  - reduce income tax liability
- The income beneficiary has substantial capital losses which can offset any capital gains realized upon a termination
- The intended charitable beneficiary has a current, immediate need of the assets

How to Terminate a CRT?

- Assignment Termination:

  The income beneficiary can receive an income tax deduction for the donation to the charity.

  The charity receives all of the trust assets immediately.

- Division Termination:

  The income beneficiary receives the immediate use of their respective interest in the CRT.

  The remainder beneficiary receives the immediate use of their respective interest in the CRT.

What are the Procedures to Terminate a CRT?

- Determine if an early termination is allowed by state statute
- Obtain an agreement from all beneficiaries that their intent is to terminate the CRT
- Distribute the present value of the remainder interest to the charity
- Distribute the remaining funds to the income beneficiaries
- Obtain a statement from the income beneficiaries that the life expectancies of the income beneficiaries has not been reduced since the trust was created

What are the Tax Consequences of an Early Termination?

- Non-Charitable Beneficiary:

  Early termination is considered a taxable exchange.

  The non-charitable beneficiary is treated as though he/she exchanged their right to future unitrust payments for a current distribution of money and property.

  1. Determine the gain from the sale of the trust property:
     (a) the non-charitable beneficiary is treated as having NO basis in their interest
     (b) all proceeds are considered a gain
     (c) the gain is considered a capital gain

  2. To avoid the appearance of self-dealing, the distribution to the non-charitable beneficiary should equal the actuarial value of their income interest, and, the charity holding the remainder interest should be a public charity (as opposed to a private foundation)

  3. Income tax deduction for gift to the charity of the remaining interest