Trust Topics

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Fiduciary Trust International

*This **Trust Topics** presents three ways to create a tax-advantaged gift, including advantages and disadvantages, as well as techniques to preserve the flexibility of each charitable entity.*

Private Foundations, Supporting Organizations and Donor-Advised Funds

A guide to creative and tax-wise philanthropy

There are times when an individual wants to make a major charitable gift, but is not yet ready to make a final decision about which charitable organizations to benefit. Three charitable entities—private foundations, supporting organizations and donor-advised funds—may be used to obtain current income and gift tax advantages, while preserving the ability to determine which charitable organizations the gift will benefit in the future. In this way, it is possible that a gift made now will be used to address charitable issues and meet needs that have not yet emerged.

Private foundations, supporting organizations and donor-advised funds offer the opportunity of creating a private endowment for charitable purposes. If the funds donated to these entities are properly managed, they can grow, essentially tax free, to provide for charitable gifts in perpetuity.

Private Foundations

A private foundation is a non-profit organization that may be created and controlled by an individual (the "donor") or family to contribute to charitable causes. It is not held to the requirements that govern public charities or supporting organizations (discussed below). In its simplest form, a private foundation is a separate legal entity that holds and invests funds, and uses 5% of its investment assets each year (from income, or if income is insufficient, the balance from principal) to support charitable activities and organizations.

New York
Los Angeles
Miami
San Mateo
Washington DC
Wilmington
Grand Cayman
Hong Kong
London

A private foundation is set up as a trust or nonprofit organization according to the laws of the state in which the principal office will be located. State requirements, as well as language necessary to satisfy federal tax law, should be incorporated into the organizational documents. If the state and federal laws are not accurately followed, the organization will not be granted charitable status, and contributions to the entity will not be tax deductible.

Advantages

- By creating a private foundation, the donor has complete control over the amounts and recipients of annual gifts, commonly referred to as grants. The only restriction is that at least 5% must be distributed annually.
- Control of the foundation may remain in a family over generations.

Disadvantages

- Although private foundations are exempt from federal income tax, they are subject to a number of excise taxes:

  The foundation must pay an excise tax equal to 2% of net investment income.

  The foundation must pay a 15% penalty if it does not annually distribute 5% of the average fair market value of its assets.
- Administrative responsibilities, including several annual filings, are associated with the operation of the foundation.
- Organizational documents must be prepared by a skilled attorney to ensure that the foundation receives tax-exempt status.
- Income tax deductions available to the donor are less advantageous than for a supporting organization or donor-advised fund. (See "Tax Effects of Gifts," below.)

Supporting Organizations

A supporting organization is similar in structure to a private foundation, but is generally created to benefit only one public charity. It is a good option for a donor who has a favorite charity and wants to benefit that charity over time. A supporting organization may also be created to support more than one charitable organization, so it is a good choice for a donor who wants to benefit a special type of program at a few charities.

The supporting organization must be "operated, supervised or controlled" by the selected public charity and cannot be controlled by the donor or the donor's family. The rules governing these requirements are complicated. One way to satisfy them, however, is to create a board of directors that includes directors who are selected by the charity and hold 50% or more of the voting power. A donor and members of the donor's family may also be members of the board of directors, but none may have veto power. If the supporting organization is in the form of a charitable trust to support a designated public charity, which can enforce its rights under state law, some of the control requirements may be less stringent.

Advantages

- Compared to a private foundation, larger amounts are available to fund grants because no 2% excise tax is imposed on a supporting organization, nor are there any minimum distribution requirements.
- Compared to a private foundation, more advantageous income tax deductions are available to the donor. (See "Tax Effects of Gifts," below.)

Disadvantages

- Neither the donor nor the donor's family can control the organization's functions.
- Administrative responsibilities, including several annual filings, are associated with the operation of the organization. These responsibilities are somewhat less onerous than those of a private foundation, however.
- A supporting organization may be more complicated to form than a private foundation, so it is essential that organizational documents be prepared by a skilled attorney to ensure that the organization receives the intended tax-exempt status.

Donor-Advised Funds

A donor-advised fund is a fund established by an individual (the "donor") and maintained by a public charity. Public charities that accept and administer donor-advised funds include community trust organizations and charitable trusts maintained by financial institutions.

The individual who establishes the fund may recommend gifts to various charitable organizations from the fund. Although in theory the donor-advised fund is not obligated to follow such suggestions, in practice they almost always do.

The assets of a donor-advised fund maintained by a community trust may have a corporate trustee that will invest the assets; the assets of a donor-advised fund maintained by a financial institution as a charitable trust are usually invested in mutual funds, with the donor selecting an investment strategy.

For information on Fiduciary Trust's donor-advised fund, Fiduciary Trust Charitable Giving Fund, please call Thomas Rosen or Christopher Gleason at 212-632-3000.

Advantages

- Compared to a private foundation, larger amounts will be available to fund grants because no 2% excise tax is imposed on a designated fund, nor are there any minimum distribution requirements.
- Few, if any, administrative responsibilities are associated with the operation of the fund.
- The fund is relatively simple to create and involves a minimum of start-up costs.
- Compared to a private foundation, more advantageous income tax deductions are available. (See "Tax Effects of Gifts," below.)

Disadvantages

- Neither the donor nor the donor's family will have direct control over the fund's grantmaking.
- Grants may have a less direct connection with a donor and the donor's family than if the grants are made from an organization that bears the family's name, as in a private foundation.

Tax Effects of Gifts

Gift tax. Gifts of money and publicly traded securities are eligible for a gift tax charitable deduction.

Income tax. For supporting organizations and donor-advised funds, gifts of money are deductible up to 50% of the donor's adjusted gross income; for private foundations such gifts are deductible up to 30% of adjusted gross income. In all cases, a five-year carryover is allowed for any excess.

Gifts of appreciated publicly traded securities held long term are deductible at present fair market value, with no tax on appreciation. Such gifts to supporting organizations and donor-advised funds are deductible up to 30% of adjusted gross income; such gifts for private foundations are deductible up to 20% of adjusted gross income. In all cases, a five-year carryover is allowed for any excess.

Summary

Individuals can set up a private foundation, supporting organization or donor-advised funds to create charitable funds to endow future charitable giving. Gift and income tax advantages may apply to these funds.

Proper drafting of organizational documents and responsible administration are important in establishing and maintaining these funds; proper investment is key to being able to support future charitable work.

Characteristics of Charitable Entities

	Private Foundations	Supporting Organizations	Donor-Advised Funds
No gift tax	✓	✓	✓
Absolute right to determine recipients of gifts and in what amounts	✓		
Family control, which may continue for successive generations	✓		
Greatest allowable income tax benefits		✓	✓
No excise tax		✓	✓
No minimum distribution		✓	✓
Least administrative burden			✓

Fiduciary Trust Company International was founded in 1931 to specialize in investment management and administration of assets for individuals and families. A bank charter permits Fiduciary Trust to act as executor and trustee, providing continuity of management through several generations.

Fiduciary Trust's investment management services were extended to foundations and endowments during the 1930s and then to other institutions. Fiduciary Trust began investing internationally in the early 1960s, making it one of the first American firms to develop global investment capabilities. Fiduciary Trust, an affiliate of Franklin Templeton Investments, offers the following services to clients throughout the world:

- Investment Management
- Trust and Estate Administration
- Strategic Planning
- Asset Allocation
- Manager Selection and Oversight
- Custody
- Multi-Currency Reporting
- Banking
- Tax

These services are offered to families with substantial assets in a comprehensive, integrated program called **Family Resource Management**®.

If you would like more information regarding Fiduciary Trust's services, please contact your portfolio manager, or call one of our representatives:

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San Mateo	John N. Staples, III (877) 284-2697
Colorado	William A. Douglas (303) 819-6256

About the Author

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This article and other information on wealth management can be found on Fiduciary Trust International's web site at www.ftci.com.

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