The 23rd Annual

Planned Giving CONFERENCE

presented by the **Northern California Planned Giving Council**

in association with Colonial Consulting, LLC

SPECIAL TOPICS IN PLANNED GIVING TRACK

Session 1: 9:30 am – 10:45 am

Topic:

Choosing the Right Charitable Vehicle: A Guide to Donor Advised Funds, Private Foundations, and Supporting Organizations

Presented by:

Barbara A. Murphy, Esq.

Workshop Summary:

This workshop will explore the various philanthropic goals, needs, and objectives of donors, as well as compare and contrast the advantages and disadvantages of various charitable vehicles in light of such goals, needs, and objectives. We will review case studies, and will leave time for Q&A. By the end of this workshop, participants will be able to assess donor's goals, needs, and objectives, and advise on the right choice of vehicle for a particular donor.

Workshop Presenter

Barbara Murphy, is chair of Farella Braun + Martel's Exempt Organization practice and a partner in the Family Wealth Group. She focuses on advising and counseling exempt organizations, major public charities and private foundations on entity formation, business planning, grant strategies, tax planning, governance, applicable agency filings, board disputes, mergers and dissolutions.

Ms. Murphy is an experienced trusts and estates attorney where she counsels clients on estate planning, estate and gift taxation, trust and estate administration and compliance review of individual and trust tax returns.

Ms. Murphy is active in many professional and charitable organizations. She serves as the President Emeritus of the San Francisco Estate Planning Council, Vice Chair of the California Pacific Medical Center Foundation Planned Giving Committee and a member of the St. Raymond Pastoral Council.

Ms. Murphy earned her LL.M. in taxation from Golden Gate University School of Law in 1998, her J.D. from the University of Southern California, Gould School of Law in 1992, and her B.A. from the University of California, Los Angeles in 1988.

Barbara A. Murphy, Esq.
Partner
Farella Braun + Martel LLP
235 Montgomery St., 17th Fl.
San Francisco, CA 94104
415-954-4933
bmurphy@fbm.com

FARELLA BRAUN + MARTEL LLP

<u>Choosing the Right Charitable Vehicle</u>:
A Guide to Donor Advised Funds, Private Foundations, and Supporting Organizations

April 29, 2015

Presenter: Barbara A. Murphy

big firm know how + small firm know you

Donor Goals

- Amount of contribution? Current, short-term and long-term?
- What type of assets are being contributed?
  - Do the differences in tax deduction limitations and FMV/basis matter?
  - Does the Donor want to contribute an interest in an operating business?
  - Does the Donor want to contribute non-income producing property?
- Type and flexibility of grants? To individuals? Off shore? Joint ventures/alliances with for-profits?

Donor Goals (continued)

- Level of Control? over investments? over disposition of assets? over a potential donee?
- Start-up costs?
- Maintenance time and administrative resources costs?
- Compensation of family or related parties in operating a charitable vehicle?
- Anonymity?
- Creation of a permanent legacy?
- Philanthropic expertise?

Donor Advised Funds (DAFs)

- Funds held within and managed by a sponsoring public charity
- Sponsoring public charities are:
  - National sponsoring organizations, which are usually established by investment firms (i.e., Fidelity Charitable Gift Fund, the Swab Fund for Charitable Giving, etc.)
  - Community foundations (i.e., San Francisco Community Foundation, Silicon Valley Community Foundation)
  - Public foundations, which give nationally/internationally, but only to a particular cause (i.e., Los Angeles Women's Foundation, Rose Foundation for the Environment)
  - Other public charities that set such up funds within their institutions to support their own charitable mission (i.e., universities and hospitals)

DAFs

- Advantages:
  - Simple and quick to set up for a donor
  - Can be established with a small amount of $$
  - Modest fee to establish
  - Most beneficial AGI (Adjusted Gross Income) limitations, i.e., treated as a donation to a public charity; therefore cash donations are deductible up to 50% of the donor's AGI (only 30% for private foundations), and long-term capital gain property donations are deductible up to 30% of the donor's AGI (only 20% for private foundations)

DAFs

- Advantages (continued)
  - Most beneficial amount deductible, i.e., treated as a donation to a public charity; therefore amount deductible is the FMV for all long-term capital gain property (a donor only obtains FMV for gifts of publicly traded stock held for more than a year to private foundations)
  - Sponsoring organization handles all administration/compliance for a modest fee
  - Not a separate entity so no separate tax returns/accountings

DAFs

- Advantages (continued)
  - Experience and extensive resources in grant making
  - Grants to international/foreign organizations (maybe; depends on the sponsoring PC)
  - No annual distribution requirement
  - Anonymity, if desired

DAFs

- Disadvantages:
  - Most are only set to handle cash and marketable securities and will not accept real estate/other similar assets
  - No Control: Relationship of donor and DAF is advisory ONLY
    - Final selection of grantee is determined by the sponsoring charity (however, donor's recommendations are generally followed)
    - Limited control in the management of assets (however, you derive the benefits of the sponsoring charity's investment expertise and large investment pool)

DAFs

- Disadvantages (continued)
  - Limited to granting to certain type of IRC §501(c)(3) public charities; generally will not or can not allow grants to the following type of entities:
    - Private non-operating foundations
    - For-profit organizations for charitable projects
    - International/foreign organizations (maybe)
    - New charitable organizations that have not received their IRS Determination Letters
    - Tax-exempt non-IRC §501(c)(3) organizations for charitable projects
    - Individuals

DAFs

- Disadvantages (continued)
  - May not compensate donor or related parties for services provided to the DAF
  - Excess business holdings rule applies, i.e., can not hold more than 20% in a business enterprise

Private Foundations (PFs)

- A Private Foundation is a separate legal entity (corporation or trust) that applies for and obtains its own tax-exempt status
- "Private" because it receives its funding from one or a few donors (usually an individual, family, or business)
- Most are non-operating, i.e., primary programs are grant making
- Subject to onerous tax laws and regulations (unlike public charities)

PF Rules

- Mandatory Distributions: PFs must make annual qualifying distributions of at least 5% of the value of the preceding year's average investment assets.
- Self-Dealing Prohibitions: Any transaction between the PF and a disqualified person (i.e., substantial contributor, officer, director, 20% or more owner of an entity that is a substantial contributor, family members of any of the above, a corporation in which previous persons own more than 35% of the total combined voting power) are prohibited, even if such transaction would be beneficial to the PF.

PF Rules (continued)

- Net Investment Income Tax: PFs must pay a 1 % to 2% excise tax on net investment income.
- Excess Business Holdings: A PF and its disqualified persons may not hold more than 20% of voting/ownership interest in a business.
- Jeopardizing Investments: PFs can not invest in any way that may jeopardize its ability to carry out its exempt purposes.

PF Rules (continued)

- Taxable Expenditures: The law prohibits PFs from influencing elections, lobbying, making certain grants to individuals without prior IRS approval, making non-charitable grants.
- Lobbying: The law prohibits PFs from making grants to public charities for lobbying.

PFs

- Advantages
  - Total control in the management of assets
  - Total control in the selection of grantees and grant amounts
  - May reasonably compensate family for services
  - Great flexibility in selection of grantees –
    - May give to individuals (under certain restrictions with procedures for selection of recipients)
    - May give to for-profit (for charitable purposes and proper procedures are followed)
    - May give to foreign charity (by following certain procedures)

PFs

- Disadvantages
  - Creation of an new entity can be quick, but the process of obtaining tax exempt status, as well as establishing its governance structure, etc., can be a lengthy process
  - Creation costs: generally you need an attorney to create the entity and obtain its tax exempt status
  - No anonymity, but can maintain privacy

PFs

- Disadvantages (continued)
  - Not as beneficial AGI limitations, i.e., cash donations are only deductible up to 30% of donor's AGI (as opposed to 50% with a DAF and a supporting organization) and long-term capital gain property donations are only deductible up to 20% (as opposed to 30% with a DAF and a supporting organization)
  - Not as beneficial amounts deductible, i.e., other than publicly traded stock held for more one year (which is allowed FMV deduction), all other long-term capital gain property is only allowed a deduction for the property's basis

PFs

- Disadvantages (continued)
  - Administration must all be handle by the donor, i.e., due diligence when making grants, tax compliance reports, etc.
  - Staffing: May need to hire staff/consultants to assist with running the PF
  - Separate entity so need to complete and file separate tax returns and accountings
  - Required Distributions: PF must make a minimum distributions of 5% of the average value of the previous year's investment assets

Supporting Organizations (SOs)

- An IRC §501(c)(3) organization that is classified as a public charity, but does not have to meet the public support test; i.e., can be funded by a single donor
- Relationship between the SO and PC:
  - Operated, supervised, or controlled by the PC (Type I)
  - Supervised or controlled in connection with the PC (Type II)
  - Operated in connection with the PC (Type III)

SOs

- Advantages
  - Control, but *very limited* by relationship with PC
  - Exempt from all private foundation rules and regulations
  - Most beneficial AGI limitations, i.e., cash donations are deductible up to 50% of the donor's AGI (only 30% for private foundations), and long-term capital gain property donations are deductible up to 30% of the donor's AGI (only 20% for private foundations)

SOs

- Advantages (continued)
  - Most beneficial amount deductible, i.e., treated as a donation to a public charity; therefore amount deductible is the FMV for all long-term capital gain property (a donor only obtains FMV for gifts of publicly traded stock held for more than a year to private foundations
  - Good tool for donating closely held stock or other zero or low basis assets not suitable or allowed to be held by a PF

SOs

- Advantages (continued)
  - Administration/operations can be handled by the donor, or more typically the supported charity
  - No annual distribution requirement, except for Type III SOs
  - Can benefit from the advice and support of the established supported organization

SOs

- Disadvantages:
  - Creation of an new entity can be quick, but the process of obtaining tax exempt status, as well as establishing its governance structure, etc., can be a lengthy process
  - Creation costs: generally you need an attorney to create the entity and obtain tax exempt status
  - Less flexibility in grantee selection, limited to finite pool or single charity

SOs

- Disadvantages (continued)
  - Staffing: May need to hire staff/consultants to assist with running the SOs
  - Separate entity so need to complete and file separate tax returns and accountings
  - No anonymity, but can maintain privacy
  - Non-functionally integrated Type III SOs may not support foreign charities (only allowed if Type I or II)
  - Type I or Type III SOs will not qualify as a PC if a donor controls the supported PC

SOs

- Disadvantages (continued)
  - May not compensate donor or related parties for services provided to the SO
  - Limited application of excess business holding rule
    - Type III non-functionally integrated SOs
    - Type II SOs if it accepts contributions from a person (other than a PC that is not a SO) who controls the governing body of the supported PC