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Private Foundations—An Alternative to Charitable Giving

For many individuals with accumulated wealth, occasional gifts to a favorite charity may satisfy their charitable inclinations. The added incentive of an often-substantial tax deduction, coupled with various estate planning benefits, can be the driving force behind such charitable gifts. However, for some individuals, philanthropy is a far more serious endeavor, often involving a *succession* of substantial gifts of at least $5 to $10 million, which may necessitate an amount of control and general oversight. In these situations, a **private foundation** can be an ideal venue for managing a large, ongoing charitable giving program.

The Basics

In its simplest form, a private foundation is a charitable, grant-making organization that is privately funded and controlled. When properly arranged and operated, a private foundation can be an entity that is exempt from income taxes and which thereby permits tax deductions for those who donate to the foundation.

Contributions to a private foundation are deductible for gift and estate tax purposes. However, the income tax deduction for gifts to a private foundation is a bit more complex. Generally, the deduction is based on the fair market value of the gift (at the time it was given), and it is limited by the donor's **adjusted gross income (AGI)**. The charitable deduction is also limited (to 20%, 30%, or 50% of AGI) by the type of charitable organization that is ultimately receiving the gift from the private foundation *and* the type of gift being made. Gifts that are not cash or publicly traded securities, and that are valued at more than $5,000, need to adhere to specific rules to ensure that they are tax deductible.

In addition to offering the advantages of a tax deduction (which is usually not exclusive to private foundations), private foundations may also offer an array of other benefits. Because a private foundation is typically established to manage a long-term charitable gifting program, it may highlight the philanthropic presence and identity of the donor within the community or associate the donor with a particular charitable cause. It can also serve to create a family charitable legacy while at the same time protecting individual

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The Importance of Domicile for Your Estate Plan

Increased mobility in today's society has changed the way we live, work, and play. Compared to previous generations, it is now quite common for work and recreational activities to cross state lines, resulting in ownership of property and formal relationships in more than one state.

When you consider the terms **domicile, statutory residence**, and **residence,** they may seem similar at first, but it is important to understand how they are different. Your ***domicile*** is the state where you maintain your permanent residence and intend to return to for prolonged periods. An individual can have only one legal domicile at a time. A ***statutory residence*** is the place where you live and work; you are subject to the income tax for that state. If you are a statutory resident of one state, while claiming a domicile in another, your domicile state may also require you to file a tax return. Your ***residence*** is any place (or places) where you live; the term "residence" bears little or no legal significance.

Estate Planning

Where your will is **probated** is determined by your domicile. If your domicile is unclear at your death, several states may be able to claim you as a domiciliary and tax your estate accordingly. Keep in mind that estate tax laws vary by state, and state laws may differ from Federal laws. In some states, your spouse may be taxed on a portion of his or her inheritance that, in another state, would pass to him or her free of state estate tax. Some states exempt smaller estates and certain property from the probate process. Other considerations may also apply.

In addition, your choice of domicile can affect your overall financial plan, especially regarding property ownership. Not all states define property ownership in the same way. Some allow married couples to own property and income separately. In other states, known as community property states, married couples share ownership of all assets acquired *during* the marriage, but each spouse may own previously acquired property separately.

Further, your choice of domicile can affect your state income tax. Your income may be taxed in your state of domicile, the state where you earn income, or both. If you change your domicile during the tax year and both your present and former domiciles tax income, you may have to file partial-year tax returns in both states.

Establishing or Changing Domicile

You can take certain steps to establish your state of domicile. In general, your domicile is not determined by the length of time you spend in a state. You may establish a domicile when you first occupy a property, or you may spend decades in a place and never call it your domicile. If you marry a person domiciled in another state, you may be able to claim your spouse's domicile as your own, even if you never visited that state.

If you have moved, your "true" domicile may hinge on the *number* and *significance* of the contacts you have in your former and present state. Here are other significant factors for you to consider:

Retention of "historical" home. If you have moved, have you sold your long-time residence in a former state?

Business relationships. In which state are your significant business contacts located?

Location of property. Where is most of your significant real and tangible personal property located?

Social connections. Where do you maintain civic, religious, or family connections?

Time spent. Where do you spend the majority of your time?

While you may feel your *intent* is clear, it is most likely that your *actions* will determine the evidence of your intentions. Consequently, simple acts such as registering to vote in a new locale, changing your automobile registrations and driver's license, resigning from organizations in your former state, and joining organizations in a new state may also be viewed as evidence of intent to change your domicile.

Because your choice of domicile can affect your overall estate planning, be sure to consult your professional legal and tax advisors for specific guidance on your unique circumstances.

private foundations—an alternative to charitable giving

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family members from the pressures of other charitable appeals. Finally, a private foundation can serve as an appropriate mechanism for controlling distributions to charities, and it can determine which charities it will benefit.

The Technicalities

When a private foundation is established, two important questions need to be asked. First, what type of private foundation should the donor establish? And second, how should the private foundation be structured? There are generally three types of private foundations: **nonoperating, operating**, and **company-sponsored**. Each type of foundation has specific characteristics that make it appropriate for a particular situation. Also, each type of foundation must adhere to a set of strict requirements and guidelines.

The most common type of foundation is the *nonoperating*. Essentially, a donor or group of donors make contributions to the foundation, which in turn makes grants to a charity. In this case, the donor does not participate directly in any charitable work. There are several variations on this type of foundation.

An *operating* foundation may have direct involvement in charitable causes (e.g., an inner-city youth center) while retaining the tax benefits of a "private" foundation (in some respects, operating as a "public" charity does). To qualify as an operating foundation, several requirements need to be met.

A *company-sponsored* foundation is useful when the majority of contributions are from a for-profit corporate donor. Typically, the operation of this type of foundation is similar to that of a nonoperating foundation. It is usually managed by corporate officers, and it has the added benefit of allowing some contributions to accumulate over time. This can help the foundation make continual grants when corporate profits are low.

After careful thought is given to the type of foundation to be established, a decision about structure must be made. A foundation can be structured three ways; it can be a **nonprofit corporation**, a **trust**, or an **unincorporated association**.

A number of factors need to be considered to determine which structure is best. Generally, if the donor intends to keep the foundation in existence permanently, a nonprofit corporation or a trust may be the better choice. But it is important to consider a number of factors, including state and local laws governing private foundations, the type of foundation, the type of donor, the need or desire to make future changes or delegate responsibilities, and personal liability issues.

The Cost

Creating and maintaining a private foundation is much more involved than using more traditional charitable-giving vehicles (e.g., a charitable remainder trust). Therefore, legal and accounting professionals who have experience with private foundations must play a significant role in such an endeavor. And it is important to know that expenses are likely to be substantial because of the complexity of foundations, the need for highly specialized legal and tax expertise, and the costs associated with design, set-up, management, and grant administration. Typically, a private foundation is only viable for individuals who intend to make periodic gifts in excess of $5 million.

Certainly, the private foundation allows today's philanthropist the opportunity to manage substantial charitable gifts and to actually become involved in charitable work if he or she so chooses. It also affords the donor the opportunity to be recognized for charitable giving, while solidifying his or her philanthropic legacy. As with all advanced estate and tax planning, consult with your team of qualified legal, estate, and tax professionals to help ensure that you meet the goals and objectives of all involved parties.

A Savings Plan That Pays for More than College

If you're thinking about ways to fund your child's education, the Federal government has provided an incentive—the **Coverdell Education Savings Account (Coverdell ESA)**, formerly known as the Education IRA. Contributions are not tax deductible, but withdrawals for eligible education expenses are tax free.

If you're a parent who wishes to open a Coverdell ESA for your child, keep in mind that there are income eligibility limits. Contributions phase out for single taxpayers with adjusted gross incomes (AGIs) between $95,000 and $110,000, and for married couples filing jointly with AGIs between $190,000 and $220,000 in 2016.

You may contribute up to a maximum of $2,000 annually per child until the designated student reaches age 18. Contributions are subject to the gift tax; the **annual gift tax exclusion** limits are $14,000 for singles and $28,000 for married couples in 2016. Remember, if you also contribute to a 529 plan for the same child during the same year, you will need to add these gifts together to determine your gift tax filings.

There is no limit to the number of accounts that may be held in a child's name or the number of people who may make contributions to a Coverdell ESA—as long as total contributions remain within the $2,000 annual limit per child.

If multiple accounts are established and the total contribution exceeds $2,000, the excess is subject to a 6% excise tax penalty. You can, however, eliminate the penalty by withdrawing the excess contributions (and any earnings) before the due date for the beneficiary's tax return for that year. The withdrawal would be considered income, and it would be subject to taxation.

Coverdell ESA funds can be used to pay for more than just college expenses. Funds can also be used to pay for elementary and secondary school expenses, including the purchase of computer systems, educational software, and Internet access for the child.

A Few Holds Barred

The beneficiary must spend a Coverdell ESA by his or her 30th birthday. If the designated beneficiary does not use the funds for educational purposes by that age, the account may be rolled over to another family member who is under age 30. Withdrawals from a Coverdell ESA that are not used for qualified education expenses may be subject to both income taxes and a 10% penalty.

Finally, if you're hoping your child will qualify for financial aid for college, you may want to think twice about setting up a Coverdell ESA, as such an account must be set up in the child's name. When determining how much a family can afford to contribute to the cost of college, assets held in a child's name count more heavily than those held in the parents' names. Therefore, it may be more difficult to obtain financial aid.

To learn more about funding college costs through a Coverdell ESA or other financial sources, including financial aid, visit the US Department of Education at www.studentaid.ed.gov.

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