

### Private Foundation Start Up Costs

By definition, any tax-exempt charitable entity that does not qualify as a public charity is labeled a private foundation. Startup costs for a private foundation typically rest at a minimum of \$15,000. It is a process that becomes less attractive as the initial endowment shrinks.

### Private Foundation Endowment

Opinions regarding the necessary minimum endowment to start a private foundation are not precisely in agreement. Professionals that specialize in facilitating the creation of private foundations typically only begin the discussion to start one when a client is willing to part with at least \$5,000,000 in assets. Groups or collections of individuals that exist to encourage philanthropic activities suggest a minimum endowment figure well below \$5,000,000 however, the figure suggested by these groups is usually between \$250,000 and \$500,000. Their recommendations do not go below this range.

The reasons for a necessary minimum endowment are many. First, private foundations must distribute a minimum of 5% of their total assets every year. At lower dollar amounts, this minimum distribution is harder for the foundation to support, slowly eroding and consuming its assets each year.

A private foundation is a good vehicle to accomplish charitable giving, but requires significant monitoring and administration to maintain its exempt status and not run afoul of Internal Revenue Code excise taxes. It is not recommended to establish a foundation with anything less than \$5,000,000, because the costs of running the foundation will overtake its charitable purpose and its ability to provide for the community.

### Private Foundation Additional Expenses

Private foundations give rise to a number of responsibilities and administrative concerns, which in turn give rise to further costs. These costs can reach a high of 20% of the value of the assets held by the foundation. The consequence of these additional costs and required distributions is that the private foundation is unable to sustain itself if the endowment does not reach a critical threshold closer to \$5,000,000.

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Running a private foundation also imitates a business, entailing many of the same responsibilities and expenses. Records must be kept, and a tax return must be filed using form 990-PF, which is more complicated than that used by other charitable organizations. Often, staff is hired to address the regulatory and compliance demands of running the foundation. These include professionals in the fields of investment, accounting, tax, and law. Estimates on the cost to a private foundation for its administrative responsibilities hover, on average, between 2.5% and 4% of its assets.

A private foundation is also subject to a number of penalty taxes for prohibited behavior. An additional tax may be imposed on the foundation for any of the following activities: self-dealing, failure to distribute 5% of the foundation assets, holding too great of an ownership interest in a business, participating in certain jeopardy investments (such as trading on margin, selling short), and making grants to political campaigns, lobbyists, and certain non-public charities.

## General Steps Required to Create a Private Foundation

1. Define your organization's charitable purpose and the guidelines for making grants.
2. If you establish the private foundation as a Trust:
  - a. Draft the Trust document.
  - b. Appoint a Trustee.
3. If you establish the private foundation as a non-profit corporation:
  - a. Draft articles of incorporation.
  - b. Draft by-laws.
  - c. Appoint directors and officers.
4. Obtain an Employer Identification Number for the foundation.
5. File Form 1023, Application for Recognition of Exemption under Section 501(c)(3) with the IRS.
6. Apply for tax exempt status with your state.

## Charitable Deductions to Private Foundations

For a donation to a private foundation, a donor is allowed a complete deduction for estate and gift tax purposes. It is an effective means to move wealth out of one's taxable estate. For income tax purposes, a donor is allowed an income tax deduction up to only 30% of his or her Adjusted Gross Income for donations of cash. Any excess contribution over this amount can be carried into future taxable years.

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## **Organizing Your Private Foundation as a Trust or Non-Profit Corporation**

A private foundation can generally take two forms. It can either be established as a trust or as a non-profit corporation. A charitable trust is not different from a private foundation; it is, instead, a type of foundation. Trust Law Counsel would be happy to discuss in more detail the pros and cons of organizing your private foundation as a trust or a non-profit corporation.

### **Additional Option to Private Foundation: Donor Advised Funds**

A feasible alternative to a private foundation, especially when the initial endowment is below the recommended minimum, is to establish a donor advised fund, or DAF, with a supporting organization. A supporting organization is, for all intents and purposes, a public charity. Through a DAF, a donor gives a contribution to the charity with a recommendation or preference as to how it should be distributed. Strictly speaking, the donor gives up control of the proceeds, and the supporting organization does not have to adhere to the donor's recommendation. As a practical matter, however, the supporting organization will almost always follow the donor's wishes, or get as close as possible, because if they generate a reputation for ignoring their current donors people will stop donating to them.

Creating a DAF has the immediate benefit of allowing the donor to take an income tax deduction of up to 50% of his or her Adjusted Gross Income for a cash contribution. Furthermore, the supporting organization takes over the administrative and regulatory requirements of managing the funds, and the cost is shared amongst all the funds the organization manages. As a result, the cost to the fund for administering it is likely to be under 1% of the DAF's assets. At lower endowment amounts, it is a much more efficient means of providing a charitable gift than a private foundation.

