NORTHERN TRUST

DIVERSITY OF GIVING: PHILANTHROPIC SOLUTIONS

You have attained a level of financial security that allows you the freedom to devote resources to causes that are important to you and to make a difference in the lives of others. But with opportunity comes challenge. Having made the decision — and commitment — to contribute to charity, you are now faced with determining how best to ensure your desired legacy is achieved.

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MAKING INFORMED DECISIONS

When you first consider making contributions to charity, there are more questions than answers:

- What do you hope to accomplish through philanthropy?
- What charity or type of charities would you like to benefit?
- Do these activities or charitable organizations reflect your values and goals?
- How will family members be involved in making gifts?
- How involved do you wish to be in the causes that you wish to support?
- Who in addition to you and your family should be involved in implementing your gifts?

Not surprisingly, the answers to these questions are a springboard for further conversations about choosing philanthropic solutions that fulfill your wealth transfer and charitable objectives. As always, careful consideration of personal factors leads to a disciplined choice.

At Northern Trust, we recognize that philanthropic giving is unique to every individual. Working with you and your other advisors, we can help you determine the course of action that will best accomplish your objectives. We partner with you to implement your charitable strategy, ensuring you and your family have as much — or as little — involvement in day-to-day activities as you desire.

TABLE 1: CHOOSING A GIVING VEHICLE[1]

	NUMBER (2015)	TOTAL ASSETS (in billions)
Charitable bequests	22.1% of all estates for which federal estate tax returns were filed in 2015	$20
Charitable remainder unitrusts	86,824 (est.)	$74.98 (est.)
Charitable remainder annuity trusts	11,228 (est.)	$4.97 (est.)
Charitable lead trusts	6,380 (est.)	$29.73 (est.)
Private foundations	81,902 (est.)	$781.6 (est.)
Donor-advised funds	269,180	$78.64

ONE SIZE DOES NOT FIT ALL

For many donors, it is a surprise to learn that charitable gifts can be structured in many different ways (see Table 1) — and that the size of the gift may or may not influence the choice of charitable vehicle. For example, for individuals wishing to make an immediate impact, direct contributions to charity may range from a modest check at one extreme to very substantial asset donations at the other. Similarly, one donor who wants to involve her family in philanthropy may choose to make a sizable contribution to a donor-advised fund, while another chooses to establish a substantial family foundation. From the donor's viewpoint, it is important to recognize that many factors are involved, including motivations, objectives and financial situation. When considering particular philanthropic vehicles, donors typically find that the best choices emerge after a thorough evaluation of the relevant alternatives.

TAXES AND CHARITABLE GIVING

While typically not the primary reason for philanthropy, an evaluation of charitable giving options would be incomplete without a discussion of the income and transfer tax benefits of giving. An understanding of how charitable giving can ease your tax burden will likely encourage consistent and long-term giving.

Federal Tax Consequences

The federal tax law provides incentives for charitable giving, in the form of generous deductions under the income, gift and estate tax. In general, the same charitable techniques that qualify for deductions under the income tax also

EXAMPLE 1:INCOME TAX SAVINGS CAN BE SUBSTANTIAL

SCENARIO	
Sarah, age 50, donates $600,000 of highly appreciated, long-term capital gain securities with $0 tax cost to a public charity in 2019, when her adjusted gross income is $200,000.	
SOLUTION	
By using the income tax charitable deduction, Sarah was able to reap substantial savings.	
Maximum available income tax charitable deduction in year of contribution ($200,000 x 30%)*:	$60,000
Capital gains avoided:	$600,000
Tax Benefits:	
From charitable deduction**	$19,200
From capital gain avoided***	$90,000
Total Tax Savings:	$109,200
After-tax cost of gift in year of contribution	$490,800

*Charitable contribution carryover is available for use in the five succeeding years.
**Assuming federal income tax rate of 32% and no state income tax.
***Assuming federal long-term capital gains tax rate of 15% and no 3.8% net investment income tax.

Even with capital gains rates at historic lows, the tax savings can be substantial.

qualify for gift and estate tax charitable deductions. That being said, donors should remember that the gift and estate tax charitable deductions generally are unlimited; in contrast, the income tax charitable deduction is limited by a number of factors, including the donor's adjusted gross income.

The Income Tax Charitable Deduction

With current federal income tax rates ranging up to 37%, the after-tax cost of contributing a dollar to charity during life can be as low as 63 cents. In addition, if appreciated assets are contributed to charity during life in a properly structured transaction, capital gain is either avoided or deferred. As Example 1 illustrates, even with capital gains rates at historic lows, the tax savings can be substantial.

The income tax charitable deduction is limited to a percentage of the donor's adjusted gross income, with a generous five year charitable contribution carryover for excess contributions — allowing you to carry over the contributions that you are not able to deduct in the current year because they exceed your adjusted gross income limits. In other words, you can deduct the excess in

each of the next five years or until it is used up, but not beyond that. As Table 2 illustrates, the applicable percentage limitation depends on the charitable vehicle selected by the donor — and on the nature of the contributed asset. For example, cash is deductible up to 60% of adjusted gross income if contributed to a public charity.

The exact amount of the deduction depends on the fair market value of what is transferred.

TABLE 2: INCOME TAX CHARITABLE DEDUCTION

TRANSFER TO	AGI LIMITATION	DEDUCTION BASED ON
Public charity	60% for cash 30% for long-term capital gain property	Fair market value
Supporting organization		
Charitable remainder trust with public charity as fixed remainderman		
Charitable remainder trust with private non-operating foundation as fixed remainderman	30% for cash* 20% for long-term capital gain property*	Fair market value for cash and minority stakes in publicly traded long-term appreciated stock; tax cost for most other appreciated long-term capital gain property, including closely held stock and real estate
Private non-operating foundation		
Non-grantor charitable lead trust	n/a	n/a

*Could be reduced if taxpayer makes other gifts, such as cash or long-term capital gain property to a public charity.

The Gift Tax Charitable Deduction

As noted above, the gift tax charitable deduction is not limited by adjusted gross income. The exact amount of the deduction depends on the fair market value of what is transferred.

The Estate Tax Charitable Deduction

In 2019, the estate tax rate is 40%, imposed on aggregate transfers (during life and at death) in excess of the $11.4 million estate tax exclusion. In other words, each dollar of estate tax charitable deduction has the potential to save 40 cents of tax. In addition, as noted above, the estate tax charitable deduction is not limited by adjusted gross income.

This means that an otherwise taxable estate can avoid taxation through strategic use of the estate tax charitable deduction. As Example 2 illustrates, it is possible to include charity in an estate plan without substantially diminishing the portion of the estate that flows to individual beneficiaries.

EXAMPLE 2: ESTATE TAX CHARITABLE DEDUCTION

SCENARIO		
Sam passes away in 2019, leaving an estate of $20 million and a daughter as sole heir.		
SOLUTION		
	$0 LEFT TO CHARITY	**$1 MILLION LEFT TO CHARITY**
Estate Tax	$3,440,000	$3,040,000
Net to Daughter	$16,560,000	$15,960,000
Estate Tax Savings	n/a	$400,000
After-tax Cost of Charitable Gift	n/a	$600,000

OUTRIGHT GIFTS TO PUBLIC CHARITIES

For some donors, making an outright gift is as simple as writing a check or arranging for the transfer of selected securities, real estate or collectibles. Others, however, desire a greater degree of control. As a result, their gifts may be documented by written agreements that:

- Restrict the use of the gift,
- Specify how gift proceeds are to be invested, or
- Direct the recipient to produce annual reports detailing how gifts are used.

In either situation, donors are best served when they engage both their financial advisors and the planned giving office of the recipient charity before making firm plans. For example, the charity may have a particular funding opportunity that will uniquely match the donor's interests. Planned giving officers also can advise which types of gift restrictions are acceptable — or not acceptable — to the institution. Financial advisors are able to initiate or review relevant documentation and help with related compliance and funding issues.

Endowments

One important distinction for donors is the distinction between endowed funds, on the one hand, and non-endowment funds, on the other. When funds are given as an endowment, the parties agree that only the income from donated monies may be used for current purposes; the donated principal typically must remain intact. As a result, an endowed gift — whether for maintenance of capital assets or for scholarships — can continue in perpetuity. An endowment may take the form of a separate fund on the charity's books or may be structured as a separate entity altogether.

Donors are best served when they engage both their financial advisors and the planned giving office of the recipient charity before making firm plans.

Restricted Gifts

Endowments are one example of the broader category of restricted gifts. Because restricted gifts are targeted to particular areas of need, they work best when the donor and charity collaborate. For example, a gift restricted to capital costs might be counter-productive for a charity struggling to meet current operational needs. Conversely, a charity working to build its endowment might be very grateful to receive a donation earmarked for this purpose.

From the donor's standpoint, much will depend, as always, on the motivation for making the gift. For example, if there is a desire to honor a family member in perpetuity, an endowed scholarship may be a better choice than a bricks and mortar facility with a limited lifespan.

To avoid future controversy about restricted gifts, the agreement of the parties should be in writing, with full consideration of contingencies. For example:

- What happens when a named building becomes obsolete?
- What happens when the program for which funds are earmarked ceases to exist?
- Is there an opportunity for the donors and their descendants to work with the institution in the future to determine to what use funds should be designated?

Tax Consequences

As Table 2 illustrates, the Internal Revenue Code looks with favor on outright transfers to public charities during life. Such lifetime transfers also qualify for an unlimited gift tax charitable deduction. Similarly, if an outright transfer is made at death, the unlimited estate tax charitable deduction will be available.

BARGAIN SALES

Sometimes donors find themselves torn between their philanthropic intent on the one hand and their cash flow needs on the other. This is particularly true of collectors, who may have a large percentage of their net worth invested in their collections of art, antiques or jewels. One solution is to engage in a bargain sale,[3] a strategy that benefits both the charity (with a below-market sales price) and the donor (with a cash infusion from the sale). In this situation, the charitable deduction (for income, gift and estate tax purposes) will be calculated based on the "bargain" element of the sale, i.e., the difference between the actual fair market value of the property and the below-market sale price.[4]

If there is a desire to honor a family member in perpetuity, an endowed scholarship may be a better choice than a bricks and mortar facility with a limited lifespan.

QUALIFIED CONSERVATION CONTRIBUTION

A special type of outright transfer of property.

A charitable deduction is allowed (for income, gift and estate tax purposes) for "qualified conservation contributions" of real estate, defined broadly to include both transfers of full title and easements in perpetuity. A "contribution" will qualify only if it preserves outdoor recreation areas, open space, natural habitat or historically important land areas and structures. Contributions of real property to governmental agencies or charities may qualify under this provision, subject to a host of highly technical requirements.[2]

DONOR-ADVISED FUNDS

Donor-advised funds have become increasingly popular in recent years because of their versatility and ease of operation, particularly in contrast to private foundations. The latest statistics show total donor-advised fund assets at more than $110 billion in 2017, an all-time high and a 27% increase from 2016.[5]

Definition of a Donor-Advised Fund

In simple terms, a donor-advised fund is a separate account over which the donor and his designees have advisory privileges with respect to the distribution or investment of amounts in the fund.[6]

The account is owned and held by a sponsoring charity, which may or may not receive a certain percentage of grants made.

Often, the sponsoring charity is a community foundation; less frequently, it is a large public charity such as a hospital or educational institution. Major financial institutions also offer associated donor-advised funds. For these, the sponsoring charity is generally a newly created charitable organization. There are exceptions, however: the sponsoring charity for the Northern Trust Charitable Giving Program is an affiliate of a major community foundation.

How They Work

The charitable transfer occurs when the donor transfers assets to the donor-advised account, either during life or at death. Grant-making from the account then occurs over the succeeding months and years. A key element is the ability of the donor and/or his designees to name family members and friends as "account advisors." In this way, a donor-advised fund may be used to promote family philanthropy or create a giving circle.

Considerations

There are important differences among donor-advised funds, differences beyond fee structure and available investment options. Depending on your situation and your charitable objectives, among the most important factors to consider are:

- Whether the fund will accept non-traditional assets such as closely held stock or partnership interests,
- The number of individuals who may serve as advisors during your lifetime or after your death,
- The presence or absence of a requirement to make distributions to the sponsoring charity,
- The ability to designate multiple charities to receive distributions at your death,
- Whether expert advice on grant recommendations is available from the sponsoring charity, and
- Minimums for contributions and additions.

DONOR-ADVISED FUND

A donor-advised fund will appeal to individuals who want to establish a tradition of giving by involving their family members in the grant-making process. And compared to family foundations, donor-advised funds are less complex for the donor.

Income and Gift Tax Consequences

A lifetime transfer to a donor-advised fund is treated, for both property law and tax purposes, as a direct transfer to the sponsoring public charity. For this reason, the applicable income tax limitations are those for transfers to public charities: a 60% limitation for gifts of cash and a 30% limitation for gifts of long-term capital gain property. As noted previously, the gift tax charitable deduction is unlimited and will be equal to the fair market value of the cash and property transferred.

Because the sponsoring organization owns the donor-advised fund account, all earnings of the account appear on the tax return of the sponsoring organization. Unlike those who establish private foundations or supporting organizations, a contributor to a donor-advised fund does not need to file a separate tax return for the new entity. The gift tax rules are equally benign: currently, donors are not required to file a gift tax return solely because they have transferred cash or property to a donor-advised fund.

Unlike those who establish private foundations or supporting organizations, a contributor to a donor-advised fund does not need to file a separate tax return for the new entity.

Transfers at Death

Transfers to donor-advised funds can be made at death as well as during life, so long as the appropriate language is included in the donor's will or trust. For example, if Mary wished to include her family's donor-advised fund in her estate plan, she could include a bequest of a fixed dollar amount to "The Mary Donor-Advised Fund, established as Donor-Advised Account #123456 with Northern Trust Charitable Giving Program." As discussed above, an unlimited estate tax charitable deduction would be available to reduce estate tax in an otherwise taxable estate.

EXAMPLE 3: A TRIGGERING EVENT

SCENARIO

Mary and her husband Ted have two daughters. Their usual adjusted gross income is $600,000; in 2019, however, Mary also will receive a bonus of $50,000.

SOLUTION

Mary and Ted perpetuate philanthropic values.

- By contributing her bonus to a donor-advised fund and naming her family members as fund advisors, Mary begins to develop a family tradition of giving. Because her contribution grows tax-free, the potential for future grant-making increases.
- From a tax perspective, Mary and Ted offset their 2019 taxable income with a $50,000 income tax charitable deduction. Longer-term, Mary has removed the $50,000 — as well as any associated future earnings — from her taxable estate.

PLANNING TIP

Donors can maximize tax efficiencies by establishing a donor-advised fund in a year when they expect a spike in income. Triggering events may range from an unusually large bonus to a stock option exercises to the sale of a closely held business.

CHARITABLE TRANSFERS TO TRUSTS

Several different types of trusts qualify for the charitable deduction, ranging from qualified wholly charitable trusts to qualified "split-interest" charitable trusts. In this context, "split-interest" means that the trust benefits both individual beneficiaries and designated charities. Including a qualified split-interest charitable trust in your estate plan can enable you to maximize after-tax transfers to both individuals and to your favorite charity. This flexibility can be very useful when addressing a wide range of family situations.

Beneficiaries of a charitable trust may hold a variety of interests. In a wholly charitable trust, all interests in the trust are held by one or more charities. In a split-interest charitable trust, some beneficiaries hold a current interest (for example, a current right to fixed distribution) while others hold a future interest (for example, a right to receive the principal of the trust when it terminates).

Types of Charitable Remainder Trusts

As illustrated in Table 3, there are four main types of approved charitable remainder trusts, each appropriate for a different type of donor situation. The fixed payments made by a charitable remainder annuity trust may suit those wanting steady cash flow. For donors funding with non-marketable assets (such as real estate or closely held stock) — or donors who wish to defer cash flow until retirement — a flip unitrust (that changes its payout when a trigger event occurs) may be the right answer. Regardless of the type of charitable remainder trust chosen, the present value of the remainder interest must be at least 10% of the initial net fair market value of the contributed property.

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TABLE 3: COMPARISON OF CHARITABLE REMAINDER TRUSTS

TRUST TYPE	TRUST PAYMENT FOR BENEFICIARY	COMMENTS
Charitable Remainder Annuity Trust	Fixed	– Least flexible – No additions permitted
Straight Percentage Unitrust	Fluctuates, based on trust value	+ Most popular + Additions permitted
		– Annual valuation required
Net Income Alternative Unitrust	Lesser of net income or unitrust amount	– Income beneficiary may be disappointed with distributions – Annual valuation required
	"Make-up" may be permitted if income exceeds unitrust amount	+/– May define income to include post-contribution capital gain
		– Additions permitted
"Flip" Unitrust	On trigger event (such as sale of real estate or retirement), flips from net income alternative unitrust to straight percentage unitrust	+ Additions permitted
		– Annual valuation required

Benefits of Charitable Remainder Trusts

Well-established. In 1969, Congress enacted Internal Revenue Code Section 664, which lays out the requirements for a properly structured charitable remainder trust. As a result, donors can enjoy a comforting certainty: so long as their charitable remainder trust is drafted and operated in a way that complies with the tax rules, their charitable deduction should not be challenged. Put somewhat differently, charitable remainder trusts are a well-established, fully approved wealth transfer strategy: the Internal Revenue Service even publishes charitable remainder trust forms to make life easier for donors and their drafters.[7]

Flexible. Charitable remainder trusts can be hand-tailored by a skilled drafter to fit a variety of situations. The beneficiary of a charitable remainder trust may be the donor, another individual(s), a trust(s) for the benefit of individuals, a corporation or a partnership. Individual beneficiaries often include the donor, the donor's spouse and/or the donor's children. Equally importantly, charitable remainder trusts are valuable estate planning tools for unmarried couples, with each partner's documents creating a charitable remainder trust at death for the benefit of the other.

Tax-Efficient. A charitable remainder trust is tax-efficient if properly structured. When used during life, it can defer capital gains, while at the same time facilitating portfolio diversification and enhancing cash flow. The tax savings from gain deferral can be very significant.

EXAMPLE 4: FAMILY MEMBER WITH LIMITED INCOME

SCENARIO

Sam's daughter Sara is unmarried with no children and a limited income. Sam wants his estate plan to:

- Provide additional cash flow to Sara over her lifetime
- Fund a scholarship in his family's name at his alma mater.

SOLUTION

Provide income to daughter and support to favorite charity.

Working with his team of advisors, Sam creates an estate plan that establishes a large charitable remainder unitrust that will provide cash flow to Sara for her life. At Sara's death, the balance of the trust will distribute to create a scholarship fund at Sam's college honoring Sam's family.

Sam's estate is entitled to an estate tax charitable deduction equal to the present value of the remainder interest in the trust.

Many donors establish charitable remainder trusts during life to enhance their own cash flow and to facilitate diversification.

TABLE 4 : COMPARISON OF CHARITABLE LEAD TRUSTS

TRUST TYPE	INCOME TAX DEDUCTION?	GOOD FOR GENERATION-SKIPPING TRANSFER TAX (GST) PLANNING?
Non-grantor Charitable Lead Annuity Trust	At trust level only (trust is taxable)	No
Non-grantor Charitable Lead Unitrust	At trust level only (trust is taxable)	Can allocate GST exemption at inception to achieve totally GST exempt trust Alternately, can reduce value of remainder to zero so no allocation is needed
Grantor Charitable Lead Annuity Trust	Donor gets income tax deduction at inception Trust income taxed to grantor	No
Grantor Charitable Lead Unitrust	Donor gets income tax deduction at inception Trust income taxed to grantor	Can allocate GST exemption at inception to achieve totally GST exempt trust Alternately, can reduce value of remainder to zero so no allocation is needed

Types of Charitable Lead Trusts

In a charitable lead trust, the current interest is held by charity, and the future interest is held by family members. Like charitable remainder trusts, charitable lead trusts were created by Congress in 1969 and are an estate planning staple.[8] As Table 4 indicates, there are four different types of charitable lead trusts, with the charitable lead annuity trust working best for transfers not otherwise subject to the generation-skipping transfer tax. In a low interest rate environment, charitable lead annuity trusts are particularly powerful.

Benefits of Charitable Lead Trusts

Charitable lead trusts are useful in situations where family members have no immediate need for cash flow. The gift to individuals is deferred — allowing the donor to leverage her estate, gift or generation-skipping transfer tax exemption to the fullest. The key here is the time value of money: a gift of a future interest has less current value than a gift of a present interest. Moreover, the present value of the remainder interest is calculated using the current "Section 7520 rate," which typically is low compared to returns on strong investments. This means that, to the extent that individual enjoyment is deferred, the amount of a gift, estate or generation-skipping transfer tax exclusion or exemption needed to protect the non-charitable remainder from transfer tax is minimized. Likewise, to the extent the assets appreciate at a rate higher than the applicable federal rate, they have escaped gift and estate tax and may also have escaped generation-skipping transfer tax. As noted above, in a low interest rate environment, charitable lead annuity trusts are particularly appealing.

As illustrated in Example 6, if the charitable lead trust is established at death, an unlimited estate tax charitable deduction is available to a donor's estate for the present value of the cash flow to be received by charity. This deduction will reduce estate tax otherwise due from the donor's taxable estate. In addition, a properly structured charitable lead trust will avoid the separate generation-skipping transfer tax otherwise due on transfers that skip a generation, such as transfers to grandchildren. The generation-skipping transfer tax is a flat tax, imposed at a 40% rate, in addition to the gift or estate tax.

EXAMPLE 5: DESIRE TO ENCOURAGE PERSONAL ACHIEVEMENT

SCENARIO

Sam has three young children, David, Alex and John. Sam would like to share some of his considerable wealth with the three boys at his death. At the same time, he is concerned that early access to extensive funds will be a disincentive to personal achievement.

SOLUTION

Provide cash flow to charity for set time with remainder to children.

Sam establishes a charitable lead annuity trust that will provide cash flow to his favorite charity for 40 years. At the end of that term, the trust will distribute outright to the children, who by then should all be mature adults.

Charitable lead trusts are useful in situations where family members have no immediate need for cash flow.

FAMILY FOUNDATIONS

In 2017, there were an estimated 82,516 grant-making family foundations in the United States.[9] Unlike public charities, private foundations are supported not by the general public, but by a very limited number of donors — typically a corporation or a high-net-worth family.

Establishing a Family Foundation

Some family foundations are organized as wholly charitable trusts; others are wholly charitable not-for-profit corporations. Most are grant-making foundations that make grants to public charities selected by their trustees, board or grant-making committees. A smaller number are operating foundations that directly fulfill a charitable function, typically by providing some type of service to the public, such as operating a museum or a soup kitchen. Most private foundations are family foundations, controlled by individual donors and their descendants, advisors and friends; the balance are corporate-sponsored.

Tax Consequences

Although private foundations are exempt from income tax, most pay an excise tax of up to 2% on their net investment income, including capital gains.[10] Private foundations also are subject to a variety of penalty taxes designed to ensure that donors do not benefit, directly or indirectly, from their assets and income.[11]

EXAMPLE 6: ESTATE AND GENERATON-SKIPPING TRANSFER TAX SAVINGS

SCENARIO

Margaux, a widow in her 80s, has an estate currently valued at $20 million and passes away in 2019. She leaves one son, who is independently wealthy, and five grandchildren. Her plan was to leave her estate to her grandchildren.

SOLUTION

By using a $20 million, 14-year term 5% charitable lead unitrust, Margaux's estate is able to benefit from substantial savings. The initial beneficiary is Margaux's donor-advised fund and the remainder beneficiaries are Margaux's grandchildren.

DIRECT DISTRIBUTION TO GRANDCHILDREN		CHARITABLE LEAD TRUST	
Estate Tax:	$3,440,000	Estate Tax:	$0
Generation-skipping Transfer Tax:	$1,474,285	Generation-skipping Transfer Tax:	$0*
Net to Grandchildren:	$15,085,714	Net to Grandchildren:	$22,051,725**

*Assumes that, at the time the charitable lead unitrust is funded, there is gift and generation-skipping transfer tax exclusion and exemption amount that is allocated to cover the present value of the amount that is projected to go to the grandchildren.
**Assumes 6% rate of return and no income taxes.

The income tax charitable deduction for lifetime transfers to private foundations is limited by the "percentage of adjusted gross income" rules summarized previously in Table 2. Gifts of cash are subject to a 30% limitation; gifts of property are subject to a 20% limitation on capital gains. Importantly, the income tax charitable deduction for transfers to a private foundation of long-term appreciated assets other than publicly traded stock (such as real estate or closely held stock) is generally further limited to tax cost. For this reason, most lifetime transfers to private foundations are funded with cash or long-term publicly traded stock.

In contrast, if a transfer to a private foundation is made at death, the unlimited estate tax charitable deduction is available, whether the asset being transferred is cash, publicly traded securities, real estate or closely held stock.

Administrative Complexity

One downside of a private foundation is its administrative complexity. For example, the tax rules require a private non-operating foundation to expend at least 5% of the net value of its investment assets for charitable purposes annually. Undistributed income can be taxed at 30% or even 100%, depending on the amount of time that the income remains in the foundation. There are also Byzantine rules on self-dealing, excess business holdings, investments that jeopardize charitable purpose, and taxable expenditures, all with associated penalty excise taxes. Finally, there is the 2% tax on net investment income — which generally must be paid in estimated quarterly installments. To keep their foundation on the straight and narrow, donors typically designate an accountant or financial services provider to serve as agent or trustee.

Family Philanthropy

Administrative complexities notwithstanding, many donors conclude that a private foundation is the ideal vehicle to promote family philanthropy. A typical expectation is that the foundation will unite the family as it works together toward common goals. This expectation is more likely to be fulfilled if the foundation is established during the original donors' lifetimes, so that family members can share first-hand the donors' passion and vision. Conversely, it is not likely that a deeply divided family will find itself united through a family foundation, whether or not the donors are alive.

What if your finances will allow you to establish a significant private foundation at death but not during life? Many advisors suggest "test-driving" the concept with a pint-sized private foundation while you are alive. Depending on what you learn about family dynamics, you may decide to create separate family foundations for each family member at your death — or to establish a donor-advised fund for the entire family, with each family member as an advisor.

60%
INCOME LIMITATION FOR DONOR-ADVISED FUNDS ON GIFTS OF CASH

30%
LIMITATION FOR DONOR-ADVISED FUNDS ON GIFTS OF PUBLICLY TRADED STOCK

TABLE 5: PRIVATE FOUNDATIONS AND DONOR-ADVISED FUNDS

PRIVATE FOUNDATION	DONOR-ADVISED FUND
Wholly charitable trust/corporation	Not a separate entity; funds belong to sponsoring charity
Grant recipients are generally public charities	Grant recipients must be public charities
Designated individuals choose charities	Designated individuals recommend charities
Opportunity for donor/family participation	Opportunity for donor/family participation
Tax exempt, but may be subject to federal excise tax	Part of tax-exempt sponsoring public charity

Family Foundation or Donor-Advised Fund?

As suggested by Table 5, donor-advised funds share two of the most appealing characteristics of private foundations: donor involvement and family participation. However, donor-advised funds are more tax efficient for lifetime gifts – with a 60% income limitation for gifts of cash and a 30% limitation for gifts of publicly traded stock.

The trade-off is that private foundations offer the donor more control. With a donor-advised fund, the donor makes recommendations about grants and investments with final approval coming from the sponsoring charity; with a private foundation, final approval comes from the donor and her board or trustees. On the other hand, donor-advised funds are far less administratively complex than private foundations, with no taxes on net investment income and no separate tax return. In the end, donors choose the appropriate philanthropic solution based on a variety of factors, including their available time and their tolerance for complexity.

SELECTION OF FIDUCIARIES

Many philanthropic solutions will require the selection of a fiduciary — an agent under a power of attorney, the trustee of a trust, the executor of an estate or the trustee or director of a foundation. These choices can be as important as the decision regarding the selection of the philanthropic solution itself. When choosing an individual or a corporation to act, there are a number of criteria to take into account. What is their prior experience? How much time do they have available to dedicate to the responsibilities associated with the role you are asking them to assume? Do they have any competing or conflicting interests? After spending considerable time, effort and energy making the decision to give and deciding how to give, do not be tempted to take shortcuts selecting those who will be instrumental in implementing your gifts.

CONCLUSION

Whatever your age, income level or family situation, there is an appropriate philanthropic solution. For some, outright gifts will remain the vehicle of choice. For others, searching for a higher level of personal involvement, the answer is a family foundation – or even a private operating foundation. For still others, the flexibility of a charitable remainder trust or a donor-advised fund is most appealing. Whatever you decide, we believe your choice should be reached by considering the full diversity of the available philanthropic solutions.

FOR MORE INFORMATION

As a premier financial firm, Northern Trust specializes in Goals Driven Wealth Management backed by innovative technology and a strong fiduciary heritage. Our Wealth Planning Advisory Services team leverages our collective experience to provide financial planning, family education and governance, philanthropic advisory services, business owner services, tax strategy and wealth transfer services to our clients. It is our privilege to put our expertise and resources to work for you. If you would like to learn more about these and other services offered by Northern Trust, contact a Northern Trust professional at a location near you or visit us at northerntrust.com.

ENDNOTES

1. National Philanthropic Trust, 2016 Donor-Advised Fund Report, Table 1 (2016).
2. Internal Revenue Code Section 170(h).
3. Internal Revenue Code Sections 170 and 1011(b).
4. For a discussion of the "related use" test that applies to tangible personal property for income tax purposes, see Northern Trust's "Diversity of Giving: Funding Alternatives."
5. National Philanthropic Trust, 2018 Donor-Advised Fund Report, Figure 3 (2018).
6. Internal Revenue Code Section 4966(d)(2).
7. See, e.g., Rev. Procs. 2005-52 through 2005-59, 2005-34 I.R.B.
8. See Rev. Procs. 2007-45 and 2007-46, 2007-29 I.R.B., for sample charitable lead annuity trust provisions; Rev. Procs. 2008-45 and 2008-46, 2008-30 I.R.B., for sample charitable lead unitrust provisions.
9. National Philanthropic Trust, 2018 Donor-Advised Fund Report, Table 2 (2018).
10. Internal Revenue Code Section 4940.
11. Internal Revenue Code Sections 4941 through 4945.

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