

Wealth Manager

■ ENDOWING WEALTH ■ CREATING THE LEGACY

IF THE SHOE NO LONGER FITS

When a private foundation no longer makes sense, there are alternatives.

■ **KIM WRIGHT-VIOLICH**

While investors and retirement accounts have felt the pain of the past year's massive stock market losses, non-profits have experienced a perfect storm with depreciating endowments, shrinking contributions and reduced access to lines of credit. Private foundations, a vital source of funding for many charities, are also struggling with depreciated assets.

Such foundations have long been a visible and popular vehicle for charitable giving by affluent Americans—particularly affluent American families. In fact, it is believed that approximately two-thirds of the estimated 44,000 private foundations in this country are family managed, with most run by family members who serve as trustees or directors on a voluntary basis—receiving no compensation. Almost half are worth less than \$250,000, according to the Foundation Center, and 95% have no professional staff, according to the study, “Looking Out for the Future: An Orientation for Twenty-first Century Philanthropists.”

Many of these families have effectively utilized foundations to facilitate multi-generational giving and to accomplish very specific philanthropic objectives. Those most satisfied with their decisions tend to be families who want to retain substantial control over the governance of their foundation—including hiring and paying staff—again, often family members; who are willing to either live

with the complexity of managing a highly regulated organization or to pay for advisors capable of doing so; and who enjoy the perceived caché that comes with having a private foundation. Yet, while the number of private foundations has increased dramatically over the past decade, recently the number of families wishing to terminate them has also increased. Data from the Association of Small Foundations shows that roughly 6% of small private foundations terminate each year.

Since we are in what many believe will be a deep and potentially prolonged recession, some families are beginning to question whether a private foundation is the right charitable vehicle for the times. With average operating costs exceeding 100 basis points—and closer to 500 bps. for those with less than \$1 million in assets—and privacy concerns on the rise, directors of family foundations are pondering the question with renewed significance. Would they be able to donate more money to charity if they could reduce the costs and complexity inherent in a foundation? Do they really want all of their grants to be a matter of public record? Are there less time-consuming and less-expensive alternatives that still provide a vehicle for strategic philanthropy? What are the procedures to wind up a foundation and transfer the assets to a qualified charitable organization or donor-advised fund? Increasingly, many are turning to their investment advisors to help guide them through this process.

Alternative Procedures for Winding Up a Private Foundation

For directors of a private foundation who are considering whether to wind up its operations, a few options exist. If the directors have no desire to continue their philanthropic activities, they can terminate the foundation and transfer the assets to any number of public charities (such as churches, hospitals, schools) that are supported by donations from the general public and have been in existence for at least 60 months.

If foundation directors wish to continue philanthropic engagement, but want to use a lower cost and simpler charitable vehicle, then transferring the foundation's assets to a donor-advised fund (DAF), may be an attractive option.

Some DAFs allow donors to recommend RIAs to manage the assets; some offer a list of mutual funds that donors can select from.

Donor-advised funds are designed to be a straightforward, accessible and less expensive alternative to private foundations. Typically, donors contribute assets to the sponsoring charity; the charity invests the assets for potential growth; and donors (or persons they designate) may recommend grants from their accounts to charitable organizations of their choice over time. The sponsoring organization performs the recordkeeping and due diligence, makes the grants, and—unlike private foundations—can protect a donor's identity if that is desired. Both vehicles have similar constraints on fulfillment of pledges and receipt of personal benefit. DAFs are better able to protect an individual donor's privacy because sponsoring organizations report their grants in aggregate, without individual donor details. Administrative fees and investment management options do vary significantly among sponsoring organizations. Some allow donors to recommend investment advisors to manage the assets; some offer a list of mutual funds and allow donors to make investment recommendations consistent with their philanthropic goals; and some manage the assets collectively.

Advisors should be aware that the termination of a private foundation and the distribution of its assets to qualified organizations are relatively straightforward procedures, but that there are legal requirements at both federal and state levels. A private foundation's

federal tax status must be terminated so as to avoid costly penalties. IRC Section 507 outlines the requirements for voluntary termination, and IRS Revenue Rulings 2002-28 and 2003-13 simplified and clarified many issues that once made terminating a private foundation a headache. While each state has its own procedural particularities, the general process of winding up a private foundation and distributing its assets to qualified charities remains much the same, regardless of the state of incorporation.

The Five-Step Termination Program

The five-step process for winding up a private foundation and distributing its assets to qualified public charities or DAFs :

- 1. Adopt a plan of dissolution and (if necessary) notify state authorities.** The dissolution plan must be in accordance with the laws of the state in which the foundation was established. While directors may need to notify the state's Attorney General, it may be possible to distribute the assets to charity while waiting for approval to dissolve the foundation.
- 2. Distribute the assets of the foundation.** As noted above, the easiest way for a private foundation to terminate is by transferring all of its assets to one or more 509(a)(1) public charities that have been in existence for at least 60 months. This type of termination requires no IRS notification, and the foundation is not liable for termination tax.
- 3. File appropriate documents with the Secretary of State.** Following any necessary approvals by the state Attorney General or other state authorities, the directors must follow their state's process for dissolving a corporation.
- 4. File the final 990-PF.** The foundation must file Form 990-PF for the taxable year in which the final distribution is made and check the box for "final return" at the top of the form
- 5. Submit any final state regulatory and tax filings.** This step varies by state, but typically the state Attorney General will require a copy of the final 990-PF.

In these harsh economic times, philanthropic individuals are re-evaluating their giving strategies with the same rigor as their investment strategies. Wealth managers are in a unique position to help their clients change their charitable vehicle or provider if the fit is no longer perfect.

Kim Wright-Violich is the president of Schwab Charitable (www.schwabcharitable.org), one of the nation's largest facilitators of charitable giving through its donor-advised fund.