Morgan Stanley

Topics in Wealth Strategies:

Philanthropic Toolkit

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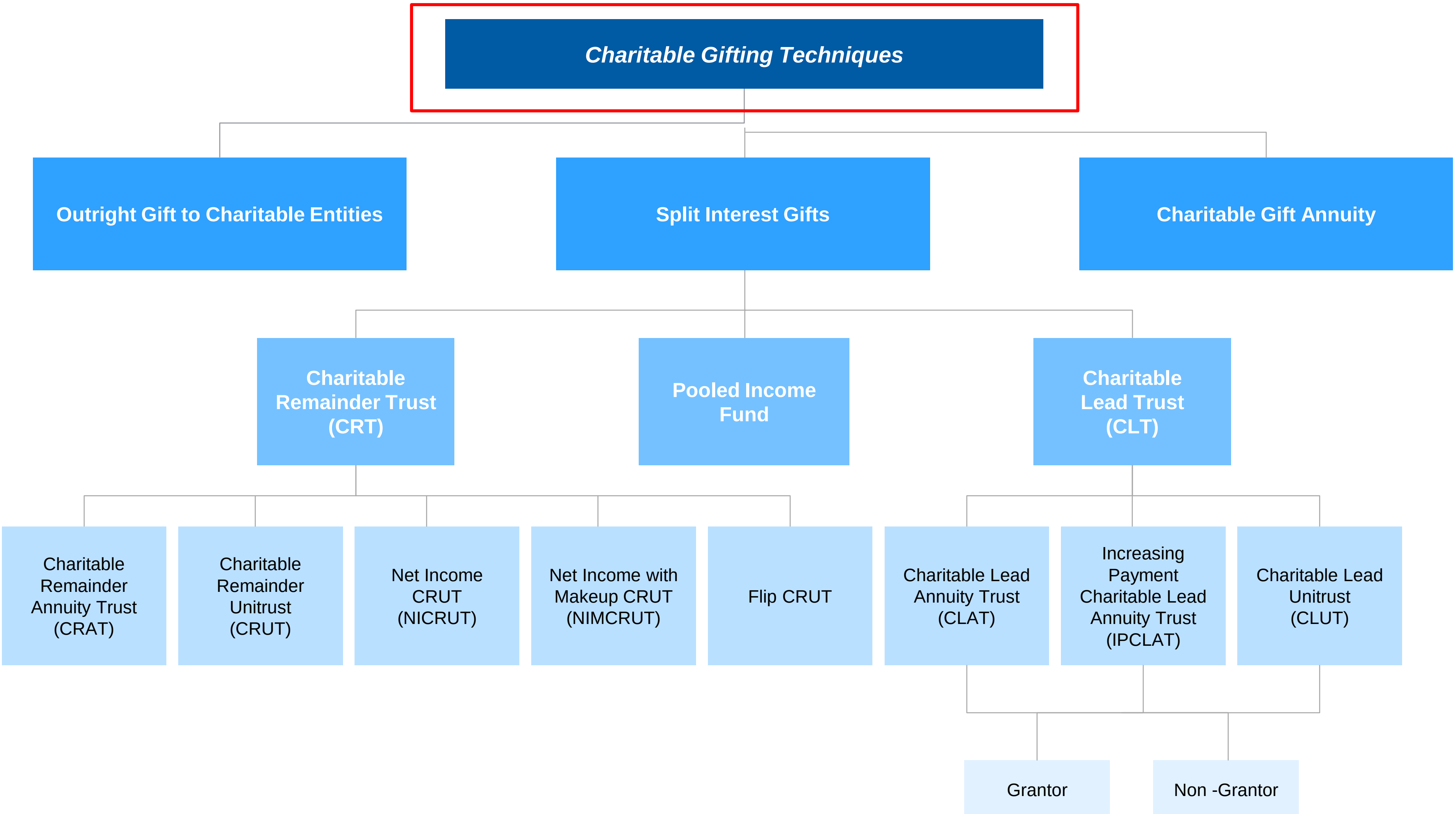
PHILANTHROPIC TOOLKIT

Overview

Many clients value philanthropy and thereby utilize various gifting structures while giving to different types of charities. In order to help you prudently invest, we need to grasp the salient features of client situations, including their philanthropic endeavors. While we do not give tax and legal advice, we work with our clients' lawyers and accountants to understand the complete framework under which you can then make sound investment decisions.

The following information is meant to give context of the gifting techniques and charitable entities, which surround client investments.



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Charitable Gifting Techniques: Characteristics and Considerations

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Charitable Gifting Techniques Notes

[1] Fixed Annuity distribution must be between 5% - 50% of fair market value of trust's assets at time of trust's establishment

[2] Variable Annuity distribution must be between 5% - 50% of fair market value of trust's assets; annuity amount is calculated annually using a constant percentage

[3] Beneficiary of NICRUT receives lesser of the specified unitrust amount or the trust's net accounting income; NIMCRUT allows deficiencies owed to the beneficiary to be made up in future years

[4] Upfront federal income tax deduction is based on the present value of the remainder interest, which is determined by subtracting the present value of the life income interest (based on the section 7520 rate) from the value of the transferred assets at the time of transfer (must be at least 10% of initial value of trust's property for CRTs)

[5] Upfront federal income tax deduction is equal to the present value of annuity payments to charity determined by the section 7520 rate

[6] Upfront federal income tax deduction is based on the present value of the remainder interest, which is determined by subtracting the present value of the annuity interest (based on the section 7520 rate) from the transferred assets at the time of transfer

[7] Annuity distributions to the beneficiary are taxable on a worst-first basis meaning that interest and dividends are taxed first, then short term capital gains, then long term capital gains, and then municipal income

[8] May be subject to certain of the private foundation rules that impose excise taxes on acts of self-dealing between the entity and persons considered related to it, owning too much of a business, investments that jeopardize the entity's charitable purpose and certain expenditures deemed inappropriate for federal income tax purposes

[9] Federal income tax may be imposed on the UBTI (unrelated business taxable income) from an investment unrelated to the exempt purpose

[10] Beneficiaries include distribution amounts in their gross income during their taxable year

[11] A portion may be considered a tax-free return of basis and the remaining portion is taxed as ordinary income

[12] With a non-grantor CLT, donor does not get an upfront charitable income tax deduction and is not taxed on trust income. The trust is a separate taxable entity and can take a charitable income tax deduction, without limit, for the amount paid to charity each year.

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Charitable Remainder Trust (CRT) Structure

- Donor transfers property to a trust that makes taxable annual distributions to the donor and/or other non-charitable beneficiaries for a period of time
- Property remaining in trust at the expiration of the non-charitable beneficiaries' interest is paid to charity
- Tax exempt
- Annual distributions to non-charitable beneficiaries are taxable
- Can be used to defer federal income taxes and benefit charity
- Assets in a CRT may be included in the donor's estate on donor's death, depending on whether donor was an income beneficiary and/or retained certain rights
- Subject to excise taxes and federal income tax on UBTI
- Should not be funded with stock options, encumbered property, S corp stock, or the donor's personal residence
- Upfront tax deduction based on present value of remainder interest, determined by subtracting present value of the life income interest (based on the section 7520 rate) from transferred assets at the time of transfer
- Donor can maintain control of investments if he or she serves as trustee
- May last for the lifetime of one or more individuals, or fixed term of up to 20 years

CRT Qualifications/Types

- **Type 1 – Charitable Remainder Annuity Trust (CRAT):** Pays the income beneficiary a fixed dollar amount each year, which must be at least 5%, but not more than 50% of the initial market value of the assets contributed to the trust; may last for the lifetimes of one or more individuals, or a fixed term of up to 20 years

- **Type 2 – Charitable Remainder Unitrust (CRUT):** Pays the income beneficiary a fixed percentage of at least 5% but not more than 50% of the fair market value of the trust's assets as redetermined each year (the unitrust amount); may last for the lifetimes of one or more individuals or a fixed term of up to 20 years

There are variations of CRUTs…

- **Type 3 – Net Income Charitable Remainder Unitrust (NICRUT):** Pays the income beneficiary the lesser of the trust's net income for that year or the fixed percentage of the trust's assets as redetermined each year. Distributions will not draw from principal amount of trust

- **Type 4 – Net Income With Makeup Charitable Remainder Unitrust (NIMCRUT):** This is a NICRUT with a makeup provision, whereby in years that net income exceeds the fixed percentage, this excess is used to makeup for past deficiencies in years that net income was less than the fixed percentage. Distributions will not draw from principal amount of trust

- **Type 5 – Flip CRUT:** Initially pays the income beneficiary the lesser of the trust's net income for that year or the fixed percentage of the trust's assets as redetermined each year AND after a specific date changes (flips) to paying a fixed percentage (like a typical CRUT)

CRT Advantages and Disadvantages

- **Advantages**
  - Appreciated property contributed to a CRT can be sold without the current payment of any federal income tax
  - CRT produces steady distribution stream, which may be greater than the income of the asset contributed/sold
  - Donor may benefit from tax deferred compounding within CRT
  - The settlor receives an income tax charitable deduction
  - The settlor creates a stream of income for the non-charitable beneficiary

- **Disadvantages**
  - If CRT has UBTI, it is subject to an excise tax equal to 100% of the UBTI in that taxable year
  - Early death can diminish return from the CRT to the donor

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Pooled Income Fund Structure

- Trust that is established by public charity with similar structure to a Charitable Remainder Trust
- Individual donors contribute to the fund, contributions are commingled and each donor receives “units of participation” (variable annuity) in the fund based on his/her contribution value
- Corpus flows to charity
- Taxed as complex trusts (but rarely need to pay any tax)
- Fund’s entire net investment income is distributed to fund participants for their lifetime; taxable distributions to beneficiaries; after a participant’s death, his/her portion is used by the charity for charitable purposes
- Contributions qualify for charitable income, gift, and estate tax deductions (will be subject to federal estate or gift tax if income interest is given to someone other than donor or donor's US citizen spouse)
- Subject to certain excise taxes and federal income tax on UBTI
- Upfront federal income tax deduction based on the present value of the remainder interest
- Donor does not maintain control of investments
- Useful to defer taxes from appreciated assets
- May last for the life of individual(s) living at time property is transferred to fund

Pooled Income Fund Advantages and Disadvantages

- **Advantages**
    - Donations to a pooled income fund can qualify for gift and estate tax charitable deductions for the present value of the remainder
    - May exist in perpetuity
    - Donor can secure payment stream for life

Disadvantages

- Will be subject to federal estate or gift tax if the retained income interest is given to someone other than the donor, the donor’s US citizen spouse, or charity

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Charitable Lead Trust (CLT) Structure

- Donor transfers property to trust that makes annual distributions to one or more charities for a period of time
- May last for the lives of 1 or more individuals or a fixed term of years
- Property in trust at expiration (death/time-period) is paid to one or more designated non-charitable beneficiaries
- **Grantor:** Donor is taxed on income produced in the trust
  Non-grantor: Donor is not taxed on income produced in the trust
- Assets in a non-grantor CLT are generally not included in donor's estate on donor's death unless the donor retains certain rights. Assets in a grantor CLT are generally included in the donor's estate at death
- Subject to excise taxes
- Grantor CLTs are not subject to federal income tax on UBTI; non-grantor CLTs are subject to federal income tax on UBTI
- **Grantor:** Upfront charitable income tax deduction equal to the value of charity's annuity interest discounted using the IRS discount rate
  Non-grantor: No up-front charitable income tax deduction
- **Grantor:** Trust is not tax-exempt, but taxes are paid by the grantor and not from the trust principal
  Non-grantor: Trust is separate taxable entity; unlimited annual federal income tax deduction for amounts paid to charity
- Donor can maintain control of investments if he or she serves as trustee
- Cannot be used to defer federal income taxes from appreciated assets

CLT Qualifications/Types

- **Type 1 – Charitable Lead Annuity Trust (CLAT):** Pays one or more qualified charities a fixed dollar amount not less often than annually for a certain term of years or for the life of one or more individuals; annuity amount may change during the term of the trust in accordance with trust's terms; a. may be a fixed percentage of the initial net fair market value of the trust assets (as a fixed sum), or b. may be determined by a formula to produce a certain tax outcome; unlike a CRT there are no percentage constraints (greater than 5%, less than 50%) on the amount of the annuity

- **Type 2 – Charitable Lead Unitrust (CLUT):** Pays one or more qualified charities a fixed percentage of the fair market value of the trust's assets as redetermined each year (the unitrust amount) for a certain term of years or for the life of one or more individuals; unlike a CRT (greater than 5%, less than 50%) there are no percentage constraints on the unitrust amount.

- **Type 3 – Increasing Payment Charitable Lead Annuity Trust (IPCLAT):** Pays one or more qualified charities an initial fixed dollar amount that increases during the annuity period. Assets can accumulate more quickly with lower distributions early in the life of the trust

Note: Each of these can be grantor or non-grantor

CLT Advantages and Disadvantages

- **Advantages**
  - A CLT can produce gift and estate tax savings if the trust produces an annual return in excess of the IRS discount rate over the term of the annuity
  - The donor effectively shifts all of the return on the trust property in excess of the benchmark IRS discount rate to the remainder beneficiaries without making an additional taxable gift

Disadvantages

- No estate or gift tax savings if the trust underperforms the IRS discount rate
- Not a useful tool if the grantor wants to benefit grandchildren (or more remote descendants) or individuals two or more generations below the grantor and subject to generation-skipping transfer tax

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Charitable Gift Annuity (CGA) Structure

- Donor transfers property to a charity in exchange for charity's promise to pay donor a fixed amount annually for life
- Upfront federal income tax deduction based on present value of remainder interest, determined by subtracting present value of the annuity interest (based on the section 7520 rate) from transferred assets at the time of transfer
- Donor can defer income taxes when appreciated property is exchanged for annuity
- Upfront federal income tax deduction; annuity is taxable to beneficiaries
- Not subject to excise taxes or federal income tax on UBTI
- Donor does not maintain control of investments
- Entity is tax exempt
- Annuity may last for two lives with restrictions
- A portion of each annuity payment may be a federal income tax-free return of basis; the balance will be taxed as ordinary income
- If appreciated property is used to purchase the annuity, it will be treated as a bargain sale. If the purchaser is an annuitant, the gain will be recognized over the purchaser's life expectancy as part of each annuity payment. If the purchaser is not an annuitant, the gain will be recognized upon the purchase of the annuity.

CGA Advantages and Disadvantages

Advantages

- Donor can secure payment stream for life
- Charity legally obligated to make annuity payments
- When appreciated property is used to acquire annuity and purchaser is an annuitant capital gain is spread out over time

Disadvantages

- With fixed annuity, no hedge against inflation
- Type of assets that may be contributed may be limited by state laws
- Not all charities offer a gift annuity program

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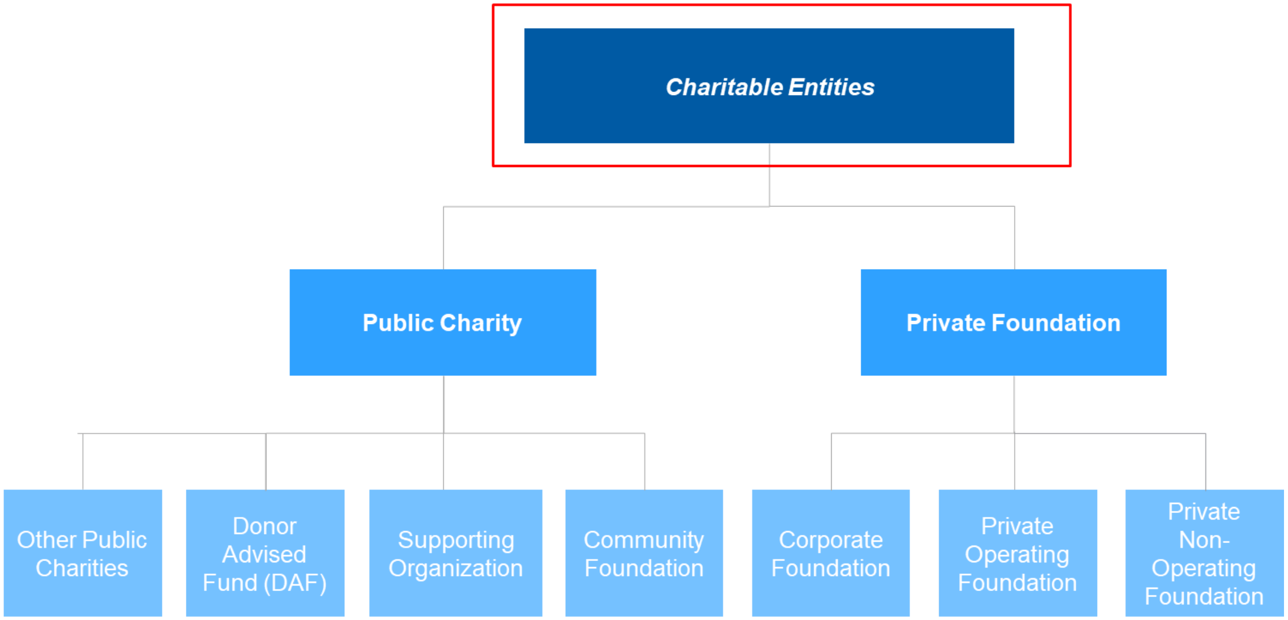

Description of 501(c)3 Entities

Recipients of charitable gifts are **501(c)(3) entities** and have the following characteristics:

- US legal entity organized and operated exclusively for religious, charitable, scientific, literary and/or educational purposes
- One of the most common types of nonprofit organizations exempt from most federal income taxes
- May be either a public charity or a private foundation
  - A public charity receives a substantial portion of its funding from the broad public and/or the government and largely disburses grants or provides services directly in furtherance of its charitable purposes
    - Examples of public charities include donor advised funds (DAFs), supporting organizations, and community foundations
  - A private foundation receives a substantial portion of its funding from a few private individuals and largely disburses grants to other non-profit organizations, including public charities and other private foundations (subject to additional oversight)
    - Private foundations can be operating or non-operating foundations
      - Operating foundations conduct charitable activities
      - Non-operating foundations make grants to other 501(3)(c) organizations

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Charitable Entities: Characteristics and Considerations

	Charitable 501(c)(3) Entities	Number of Accounts	Tax Deductible Limits for Donations			Donor Retains Control of Investments	Donor Retains Control of Donations	Distribution Requirements	Excise Taxes	UBTI	Burdensome Paperwork for Donor	Allows Many Donors	Time Horizon	Entity Tax Exempt
			Cash	ST Capital Gain Assets	LT Capital Gain Assets									
Public	Donor Advised Funds (DAF)	Many	60% AGI	50% AGI Lower of Cost Basis Or Fair Market Value	30% AGI Fair Market Value[6]	No[4]	No[7]	None	Some[1]	Yes	No	Yes	Perpetuity	Yes
	Supporting Organizations	Pooled (one)				No	No	Varies depending on the type of supporting organization	Some[1]	Yes	Yes	Yes		
	Community Foundation	Pooled (one)				No[4]	Some[5]	None	Some[1]	Yes	No	Yes		
Private	Private (Non-Operating) Foundation	One	30% AGI	30% AGI Lower of Cost Basis Or Fair Market Value	20% AGI Fair Market Value If "Qualified Appreciated Stock" otherwise lower of FMV or Cost Basis	Yes	Yes	At least 5% of assets must be distributed to charity each year	Yes[1]	Yes	Yes	Yes		
	Private Operating Foundation	One	60% AGI[6]	50% AGI lower of FMV or Cost Basis	30% AGI Fair Market Value	Yes	Yes	Must spend the lower of: • 85% of its net income on direct charitable expenditures[2] • 85% of the 5% minimum distribution requirement applicable to non-operating foundations	Yes[1]	Yes	Yes	Yes		
	Corporate Foundation	Pooled (one)	Same as other private foundation (Based on classification: Operating or Non-Operating)			No[8]	Yes[8]	Same as private foundation (Based on classification: Operating or Non-Operating)	Yes[1]	Yes	No[3]	Yes		

[1] May be subject to certain of the private foundation rules which impose excise taxes on acts of self-dealing between the entity and persons considered related to it, owning too much of a business, investments that jeopardize the entity's charitable purpose and certain expenditures deemed inappropriate for federal income tax purposes

[2] Direct charitable expenditures are expenses directly related the running the foundation (e.g. rent, salaries, …); does NOT include grants to other charities

[3] Corporate parents will undergo the paperwork

[4] Can make recommendations from set menu of options

[5] Community foundations offer donors a choice of funds, several of which allow them some ability to affect the disposition, such as unrestricted funds, memorial funds, field of interest funds, advised funds, designated funds, agency endowments, and pooled income funds (https://www.irs.gov/pub/irs-tege/eotopick94.pdf)

[6] Limit is 50% of AGI if asset is appreciated and if donor elects to limit deduction to basis

[7] Donor can make non-binding recommendations

[8] Corporate parent can retain control

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Non-Operating Foundation (“Non-OF”) Structure

- Donor can maintain control of investments and donations if donor controls the foundation
- Donor may receive a lower federal income tax deduction than for a comparable donation to a public charity
- Tax exempt
- May exist in perpetuity
- Allows many donors to one account
- Burdensome paperwork for donor

Non-OF Qualifications/Types

1. Annual Distribution Requirement

- A private non-operating foundation, the more common type of private foundation, must make annual qualifying distributions of roughly 5% of the foundation’s net asset base (except for in the first year). Qualifying distributions include grants to other 501(c)(3) entities, program related investments and administrative expenses.
  - Program-related investments are investments which would not have been made except for their relationship to the foundation’s charitable purpose and must be made with the primary purpose of accomplishing the foundation’s charitable goals, and no significant purpose of which is the production of income or the appreciation of property.
  - Program-related investments not only reduce the base upon which the 5% distribution requirement is computed but are themselves counted towards meeting the 5% requirement. Program related investments can, therefore, greatly impact the liquidity requirements of a portfolio.
- A Qualifying distributions in excess of the minimum amount are carried forward for 5 additional tax years.

2. Unrelated Business Taxable Income (UBTI):

When a non-profit benefits in commercial activities that are unrelated to the purpose of the non-profit, the income resulting from such activities constitutes UBTI and is subject to federal income tax. The concept of UBTI was introduced in 1950 to penalize non-profits for engaging in such activities. If the commercial activity generating UBTI is substantial, a non-profit may lose its tax exempt status.

3. Public Disclosure

Form 990-PF must be filed annually and is publically available. Available information includes: asset values, names of directors and employees with their compensations, names of recipients of grants with the dollar amounts distributed

4. Global Reach

There are restrictions and heightened scrutiny of charitable donations outside the US

5. Future Growth

While investment returns are mostly tax-exempt, future asset growth is limited to contributions from few donors and investment performance

6. Deductibility

Contributions generate an federal income tax deduction for the donor; however, deductions for contributions to private foundations are limited, generally to 30% of adjusted gross income (for cash and short-term capital gain property). Further limitations apply depending upon the type of property contributed. For example, the deduction for long-term capital gain property is generally limited to cost basis and 20% of adjusted gross income. However, qualified appreciated stock (generally long-term appreciated publicly traded stock) is deductible at fair market value at 20% of adjusted gross income.

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Non-OF Qualifications/Types (continued)

7A. Excise Taxes – Mandatory Distributions

- 1.39% excise tax on foundation's net investment income, such as dividends, interest, royalties, rents, and capital gains
- Net capital losses may not be used to offset other investment income for the foundation such as dividends or interest and capital losses must be utilized in the year realized
- Donor's federal income tax basis generally carries over to the foundation
- "Net investment income" is generally the sum of gross investment income and net capital gains, minus the ordinary and necessary expenses incurred by the foundation for the collection of such income or for the management, conservation, or maintenance of income-producing property

7B. Excise Taxes – Prohibited Act

In addition to the excise tax, two-tier punitive excise taxes are imposed on certain prohibited acts

Self Dealing	Undistributed Income	Excess Business Holdings	Jeopardizing Investments	Taxable Expenditures
Certain direct or indirect financial transactions between a private foundation and "disqualified persons" (defined generally as substantial contributors, substantial owners, related entities, foundation managers and directors, and their family members) trigger multiple taxes (from 5% to 200% of the amount involved) on the disqualified person and any other foundation manager or director who participated in the self-dealing transaction	A 30% excise tax will be imposed on the amount of undistributed income if the foundation fails to meet the minimum distribution requirement referred to earlier	If the foundation owns greater than 20% of the stock of a corporation or greater than a 20% interest in a partnership (this percentage is increased to 35% if certain conditions are satisfied), the foundation is subject to a tax equal to 10% of the value of the excess business holdings. If the excess business holdings are not disposed of within a certain period of time, a 200% tax (based on the value of the excess business holdings) will be imposed	An excise tax of 10% of an investment's cost will be imposed on any jeopardizing investment (i.e., an investment that jeopardizes the carrying out of a foundation's exempt purpose) in each year and an additional 25% tax may be imposed if the investment is not sold within a certain timeframe. While no investment is improper per se, the IRS has suggested transactions that will be closely scrutinized including trading in securities on margin, trading in commodities futures, investments in working interest in oil and gas wells, trading in options, the purchase of warrants, and selling short	An excise tax will be imposed on expenditures that are not in furtherance of the foundation's exempt purposes, for example, lobbying and political activities, and grants to individuals or non-exempt organizations. An initial tax of 20% of the improper expenditure is imposed on the foundation and an additional 5% on any foundation manager who participates knowingly in the improper payment

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Non-OF Advantages and Disadvantages

Advantages

- Donor and his/her family may retain control
- Donor and his/her family may be employed by the foundation for reasonable compensation
- Can be used to teach family members fiscal responsibility and encourage philanthropy
- Can memorialize name of donor forever and advance philanthropic goals of donor after death
- Tax deductible to donor

Disadvantages

- Paperwork filing can be burdensome
- Ensuring the abidance by private foundation rules can be burdensome
- May be taxed on net income from a business unrelated to its charitable purpose (UBTI)
- Not efficient for gifting long-term private stock with low cost basis because of low taxable limit
- May be subject to excise tax

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Operating Foundations Structure

- Actively carries out its own charitable purpose rather than providing grants to public charities or other private foundations
- Created by a donor as either a charitable trust or a not-for-profit corporation
- Donor can retain control of investments and donations if donor controls the foundation
- Multiple donors permitted
- Distribution requirement: must spend lower of 85% of net income on direct charitable expenditures or 85% of the 5% minimum distribution requirement applicable to non-operating private foundations
- Burdensome paperwork for donor
- Subject to excise taxes
- Subject to federal income tax on UBTI
- Treated like a public charity for purposes of figuring the donor's charitable income tax deduction
- Treated like a private non-operating foundation in many other respects as it is subject to many of the same excise taxes
- May exist in perpetuity
- Tax-exempt

Operating Foundations Qualifications/Types

- **1. Income Test:** In connection with its tax exempt purpose, it must make distributions of at least 85% of the lesser of (i) its adjusted net income or (ii) in general, 5% of the fair market value of the foundation's assets not used directly in carrying out its exempt purpose
- 2. In addition, the foundation must meet one of three alternative tests
  - **A. Asset Test:** at least 65% of the foundation's assets must be used in the active conduct of its exempt purpose, a functionally related business or a combination of the two
  - **B. Endowment Test:** the foundation must make contributions spent directly on the active conduct of its exempt purpose that exceed 2/3 of the minimum investment return
  - **C. Support Test:** at least 85% of the foundation's support (other than gross investment income) must be normally received from a combination of the general public and five or more unrelated exempt organizations and not more than 25% of its support (other than gross investment income) may be received from one related exempt organization and not more than 50% of the support may be received from gross investment income

Operating Foundations Advantages and Disadvantages

Advantages

- Carries out charitable purpose actively, not indirectly through grant-making
- Donor and his/her family may retain control
- Donor and his/her family may be employed by the foundation for reasonable compensation
- Can be used to teach family members fiscal responsibility and encourage philanthropy
- Can memorialize name of donor forever and advance philanthropic goals of donor after death
- Tax deductible to donor

Disadvantages

- Paperwork filing can be burdensome
- Ensuring the abidance by private foundation rules can be burdensome
- Donor cannot remain anonymous
- Treated like public charity for donor tax deductions and private foundation for excise tax laws and federal income tax on UBTI

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Corporate Foundation Structure

- Private foundation created by a corporation to carry out philanthropic endeavors
- Federal income tax deductibility rules are the same as for private foundations (operating vs. non-operating)
- Distribution requirements are the same as for private foundations (operating vs. non-operating)
- Subject to excise taxes
- Subject to federal income tax on UBTI
- Multiple donors to one account
- Corporate parent can maintain control of investments; individual donors cannot
- Tax exempt
- May exist in perpetuity
- No burdensome paperwork for donor

Corporate Foundation Advantages and Disadvantages

Advantages

- Tax deductible to donor
- Can be set up as operating or non-operating private foundation
- Allows corporation to engage in charitable activities that would otherwise not be tax deductible (like scholarship programs or individual grants)

Disadvantages

- Corporate parent can maintain control of investments and donations; individual donors cannot
- May be subject to excise taxes
- May be subject to federal income tax on UBTI

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Donor Advised Fund (“DAF”) Structure

- Gift held in a segregated fund that the donor can recommend grants from to other public charities
- Account is opened and funded with cash, securities, or other assets
- Donor can receive immediate income tax charitable deduction and then recommends grants from the fund to qualified nonprofit organizations over time
- May receive a higher income tax charitable deduction than comparable gifts to a private foundation
- Low-cost relative to private foundation
- Federal income tax deductions are generally the same as for other public charities
- Tax exempt
- Allows multiple donors to multiple accounts
- Subject to some excise taxes; subject to federal income tax on UBTI
- No distribution requirements
- Donor may make investment recommendations, typically subject to menu of investment options
- No burdensome paperwork for donor
- May exist in perpetuity

DAF Qualifications/Types

- DAF must be separately identified by contributions of the donor
- DAF must be owned and controlled by a sponsoring organization
- Donor or donor's designee must have, or reasonably expect to have, advisory privileges with respect to the distribution or investment of the amounts in the DAF by reason of the donor's status as donor

DAF Advantages and Disadvantages

Advantages

- Donor can receive federal income tax deduction up front in the year of contribution to the DAF
- Donor makes “suggestions” as to distributions, which the custodian of the DAF generally follows
- There are no minimum annual distribution requirements
- Donor can name the account and any successor advisors
- Can be established with reduced cost to donor
- Little administration required of donor
- Can be used to teach family members fiscal responsibility and encourage philanthropy

Disadvantages

- Donor surrenders ultimate control over the investment, management, and disposition of assets
- Investment options often limited to mutual funds

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Supporting Organization ("SO") Structure

- Charitable entity that supports one or more public charities
- Supporting organization and the public charity share responsibility for carrying out charitable purpose; donor does not retain control of donations
- Individuals may be subject to excise taxes if they benefit from or participate in "excess benefit transactions" including non-fair-market-value transactions and the receipt of unreasonable compensation
- Certain Supporting Organizations are subject to excise taxes on "excess business holdings"
- Federal income tax deductions are the same as for public charities
- Subject to federal income tax on UBTI
- Multiple donors to one pooled account
- Donors do not retain control of investments
- Distribution requirements vary depending on the type of supporting organization
- May exist in perpetuity
- Tax-exempt
- Burdensome paperwork
- Not subject to certain excise taxes

SO Qualifications/Types

- **Type 1 - Parent-Subsidiary Relationship:** Supporting Organization is "operated, supervised, or controlled by" the supported public charity. The supported public charity must appoint a majority of the Supporting Organization's governing body. The relationship between entities is like that of parent-subsidiary.
- **Type 2 - Brother-Sister Relationship:** Supporting Organization is "supervised or controlled in connection with" the supported public charity. The supported public charity and the Supporting Organization must be controlled by the same individuals.
- **Type 3 -** Supporting Organization is "operated in connection with" the supported public charity and passes two tests:
  - **1. Responsiveness Test:** Supporting organization must be responsive to the needs or demands of the supported public charity. Test can be met by satisfying either the relationship prong or the significant voice prong:
    - The relationship prong is satisfied if at least one of the following elements is present.
      - The supported organization may appoint at least one officer, director or trustee of the supporting organization.
      - At least one member of the supported organization's governing body also serves as an officer, director or trustee of the supporting organization.
      - The officers, directors or trustees of the supported organization and the supporting organization maintain a close and continuous working relationship.
    - **Significant voice test:** The officers, directors, or trustees of the supported organization have a significant voice in the use and management of the supporting organization's assets, including investment and grantmaking policies.
  - **2. Integral Part Test:** Supporting Organization must perform a charitable function which directly furthers the exempt purpose of the supported public charity and that the supported public charity would otherwise carry out itself, or the Supporting Organization must pay at least 85% of the greater of its income and its minimum asset amount for the use of the supported public charity.

SO Advantages and Disadvantages

- **Advantages**
  - Supporting organization may employ any individuals, including the donor and his/her family and pay them reasonable compensation
  - Donor can use Supporting Organization to teach family members fiscal responsibility and encourage philanthropy
  - Supporting Organization can memorialize the name of the donor forever or the donor can remain anonymous
  - Supporting Organization can advance the philanthropic goals of the donor after his/her death
  - Tax deductible to donor

Disadvantages

- Donor does not retain complete control
- Supporting Organization and public charity share responsibility for carrying out the charitable purpose of the Supporting Organization
- Burdensome paperwork

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Community Foundation Structure

- Charitable entity that pools donations from many individuals dedicated to the social improvement of a specific geographic location
- Public philanthropic organization – receives support from general public
- Tax-exempt
- Governed by board of directors comprised of community leaders
- Federal income tax deductions are the same as for public charities
- Not subject to certain excise taxes
- Subject to federal income tax on UBTI
- Multiple donors allowed
- No distribution requirements
- May exist in perpetuity
- Donor does not retain control of investments
- No burdensome paperwork for donor

Community Foundation Advantages and Disadvantages

Advantages

- Donor may remain anonymous
- Tax deductible to donor
- Inexpensive to establish
- No distribution requirements

Disadvantages

- Donor cannot retain complete control

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Glossary of Terms

Donor: Person who gives assets to the charitable entity

Beneficiary: Person who receives funds from the charitable entity

Unrelated Business Taxable Income (UBTI): Income that comes from engaging in business activity that is unrelated to the tax-exempt purpose of an organization

Excise Taxes: Taxes imposed on certain prohibited actions, such as self-dealing between the entity and persons considered related to it, owning too much of a business, investments that jeopardize the entity's charitable purpose and certain expenditures deemed inappropriate for federal income tax purposes

Grantor Trust: Trust where powers or rights in the trust instrument cause the income of the trust to be taxable to the grantor rather than the trust

Non-Grantor Trust: Trust where the income of the trust is taxable to the trust rather than the grantor

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Important Disclosure

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