Morgan Stanley

PRIVATE WEALTH MANAGEMENT

Insights for Entrepreneurs

Part Six: Philanthropic Strategies and Structures

Working as part of an integrated advisory team, your Morgan Stanley Private Wealth Advisor can help you make well-informed personal wealth management decisions at every stage of your company's development. Our goal is to provide you with the information, insight and resources needed to help you reach your personal and professional goals. We are here to help you answer the key questions that arise at the intersection of your business strategy and your personal wealth management.

How Do I Integrate Philanthropy Into the Plans I Have for My Business?

One of the great pleasures of building a successful business is the platform it provides to create the change you want to see in the world. There is a broad range of approaches that you may wish to consider, providing a great deal of flexibility to implement your philanthropic strategy. The choices range from direct gifts to community or private foundations, donor-advised funds or perhaps even establishing your own nonprofit organization. Each option also has unique characteristics, from various forms of donor control to varying degrees of flexibility, cost and complexity. There are also varying amounts of tax deductibility. While most of these strategies can be deployed at any point in the development of your business, there can be considerable efficiencies to be gained by implementing certain strategies in advance of an IPO, or the sale of your business. Some strategies available are:

- Establishing a Charitable Remainder Trust
- Forming a Private Nonoperating Foundation
- Contributing to a Donor-Advised Fund

How Do Charitable Remainder Trusts Work?

Charitable Remainder Trusts (CRTs) are flexible structures that allow you to provide for a valued cause while creating a stream of income for a a defined number of years. To fund a CRT, you transfer property into the trust, which then pays you an annual annuity for a set period of time, up to twenty years or measured by the life of one or more of the trust's individual beneficiaries. The annuity rate can be a fixed percentage of the initial value, or a fixed percentage of the value of the trust property predetermined annually, subject to certain percentage payout requirements. Whatever remainder interest is left after the period of the annuity ends will pass to one or more charitable organizations. This remainder interest must be at least 10% of the initial gift, determined at the time of the funding of the trust. If the assets increase in value, any excess will inure to the benefit of charity.

There may also be opportunities for additional federal income tax benefits using a CRT. First, the initial gift of a remainder interest can generate a federal income tax deduction. Second, CRTs are tax-exempt entities. So, if your CRT is funded with shares of your business pre-liquidity event, there is no immediate federal capital gains tax upon the sale of the business. Each annual annuity payment to the donor will carry out a portion of the imbedded capital gain. As a result, additional wealth may be created via the federal income tax deferral. In this case, the donor can achieve both tax planning and charitable goals simultaneously.

How Do Private Nonoperating Foundations Work?

Private nonoperating foundations, also known as grant-making foundations are nonprofit organizations that are typically created with endowments from individuals, families or corporations. They make grants from the income earned off of that initial investment. Private, or family, foundations are often governed by members of the donor's family. Corporate foundations may be funded from some combination of an endowment and periodic contributions from the donor company's profits. With Private nonoperating Foundations, a minimum percentage, generally 5% must be distributed annually in support of charitable purposes.

How Do Donor-Advised Funds Work?

A donor-advised fund (DAF) is a fund held by a public charity for which the donor may recommend to the charity what qualified non profit to make grants from the DAF. While DAFs and private foundations are similar in some respects, the administrative burden is far lower for a DAF, which isn't subject to the rule that requires private nonoperating foundations to pay out an annual 5% distribution of investable assets.

What Is the Advantage of Implementing a Philanthropic Strategy Ahead of a Major Liquidity Event?

While a decision to engage in philanthropy is inherently personal, there are good tax reasons to transfer pre-liquidity stock to charity rather than waiting for a liquidity event. Timing, however, is key to success. Compare the following scenarios:

- An executive holds appreciated stock in his or her private company for at least one year. All the stock in the company, including the executive's stock is sold in an all-cash transaction. The executive incurs long-term capital gain tax on the sale of the stock and then makes a gift of $1 million to charity. They receive a $1 million charitable income tax deduction.
- An executive holds appreciated stock in their private company. Well before any sale of the company, and at a time when a sale of the company is uncertain to occur, the executive transfers $1 million worth of their stock to a public charity willing to accept the stock. Upon sale, the charity pays no tax and receives $1 million. The executive receives a $1 million charitable income tax deduction. Under this fact pattern, the executive may avoid long-term capital gain tax on the gifted stock, since they did not own the stock at the time of sale.

In the sale of a company scenario, the timing and other facts are important. The executive would like to maximize the value of the stock upon transfer to charity while avoiding the tax when a sale occurs. A transfer too close to the sale or with other facts connecting the transfer to the sale of the company, however, could result in the executive being attributed the capital gain on the stock even though the charity owned it at the moment of sale. The tax results will therefore depend on your individual facts and circumstances; consult with your tax advisor.

There are advantages to giving private stock to a public charity rather than to a private nonoperating foundation. A gift of private stock to a private nonoperating foundation generally results in a charitable income tax deduction limited to the lesser of cost basis or than fair market value. A gift of the same stock to a public charity results in the deduction being valued at fair market value. It can be difficult, however, to find a public charity to accept such stock. In such a case, the executive may wish to consider a gift to a donor-advised fund.

THE INSIGHTS FOR ENTREPRENEURS SERIES COVERS THE FOLLOWING ADDITIONAL TOPICS:

Choosing a Business Structure

Early-Stage Trust and Estate Planning

Overview of Wealth Planning Structures

The Public Sale of Privately Held Businesses

Family-Owned Business Succession Strategies

Understanding Equity Compensation

FOR FURTHER INFORMATION

If you wish to discuss philanthropic strategies in the context of your personal and professional goals, please speak to your Private Wealth Advisor. He or she can schedule a meeting with a Morgan Stanley Philanthropy Management specialist.

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