

Maintain Control of Donated Assets

Private Foundations and Supporting Organizations Combine Tax Benefits With Some Control

Do you have charities you would like to support while retaining a degree of control over your gifts? Two entities can help you accomplish this objective: a private foundation (PF) or a supporting organization (SO). Both of these alternatives have advantages and disadvantages, and the organization that is right for your situation depends on your particular goals.

Before you can decide whether a PF or an SO is better for your situation, you must understand the two basic categories of charitable organizations: the public charity and the private foundation. “Charity” is used in its broadest sense here to include most qualified exempt organizations such as scientific, religious and educational entities. All charitable organizations are PFs unless a specific exception applies under the Internal Revenue Code (IRC) to treat an organization as a public charity. The distinction is important.

Contributions to a public charity qualify for more favorable income tax deductibility than contributions to PFs. For example, contributions of appreciated property to a public charity generally are deductible at full fair market value in an amount up to 30% of your adjusted gross income (AGI), and cash contributions are deductible up to 50%. In contrast, contributions of qualified appreciated property to a PF are deductible only up to 20% of your AGI, and cash contributions up to 30%.

SOs Offer More Tax Benefits

An SO qualifies as a public charity rather than as a PF. It is designed to support one or more other charitable organizations. Certain types of SOs have become popular because they allow substantial donors to exercise considerable control over the gifted property and its investment, while also obtaining the maximum income tax charitable deduction available for contributions to a public charity.

There are basically three types of SOs, and each must meet specific requirements prescribed by the IRC and related regulations:

1. One type requires the manager of the supported organization to sit on the SO’s board.
2. Another type requires the supported organization’s board to appoint the managers of the SO to their board.
3. The third type doesn’t require commonality of management, but does require the SO to be highly responsive to the needs of the supported organization.

This third type of SO is the most popular because it allows its benefactors to retain indirect control. However, this type of SO must meet a number of stringent tests in order to qualify as a public charity. For example, the SO may have to distribute at least 85% of its income to one or more of the supported organizations annually.

PFs Offer More Control

A PF is often used in a family context and allows family members to exercise complete control over its charitable grant making activities. Further, in its organizational documents a PF doesn't have to specify, either by name or type, the charitable organizations it wants to benefit.

On the downside, as a donor to a PF you won't enjoy the more favorable deductibility limits available for donations to public charities. Also, a PF may be subject to a number of excise taxes that public charities -- SOs included -- avoid. For example, a PF must distribute to certain qualified charitable organizations at least 5% of the fair market value of its investment assets every year.

Also, PFs are subject to excise taxes if certain disqualified persons, such as substantial contributors and close family members, engage in self-dealing. For example, if a substantial contributor sells or leases property to the organization, this is an act of self-dealing that subjects the contributor, and possibly the manager of the PF, to a high excise tax.

Which Is Right for You?

A PF will almost always provide absolute investment control to those creating it, but limits the type of investments and prohibits self-dealing. In contrast, rules prohibit an SO from being controlled directly by disqualified persons, including substantial contributors.

Therefore, if you create an SO and donate a substantial amount of money to it, you are considered a disqualified person and may not have 50% or more of the voting control over the SO. You can indirectly maintain control by electing "confidants" to the managing body, but such control is never as absolute as in a PF.

SOs and PFs both have advantages and disadvantages. The rules are complex, and professional advice in structuring either of these organizations is strongly recommended. We would welcome the opportunity to be of assistance. Please call us to discuss the merits of the entities for meeting your charitable objectives.