

**OAK STREET**  
**GROUP, PLLC**

## **PRIVATE FOUNDATIONS**

A private foundation is a tax-exempt entity under IRC §501(c)(3), meaning it is organized and operated exclusively for charitable, religious, scientific or educational purposes. A private foundation may be formed as either a trust or corporation. Corporations have added flexibility in that they can be amended easily; whereas, trusts are irrevocable. One of the major benefits of a private foundation is that the clients establishing the foundation can exercise substantial control over it; that is, they have complete investment control and complete control as to what charitable organizations will ultimately receive its funds. The ability to distribute the foundation's funds over an extended period of time allows generations of family members to become involved in the foundation's philanthropic legacy.

### **GIFT AND ESTATE TAX DEDUCTIONS**

Contributions to qualified charities, which include private foundations, qualify for unlimited gift and estate tax deductions.

### **INCOME TAX DEDUCTIONS**

From an income tax standpoint, a donor will receive an immediate income tax charitable deduction for contributions to a private foundation, regardless of when the foundation ultimately distributes the donated funds to other charities. The income tax deduction is, however, more limited than gifts made directly to private charities. For example, cash gifts to private foundations are subject to a deduction limitation of 30% of a donor's adjusted gross income, whereas cash gifts to public charities are subject to a deduction limitation of only 50% of the donor's adjusted gross income. Additionally, there are other limits that apply to foundations depending on the nature of the foundation and the character of the contributed property. The client's accountant should always be a part of this important planning.

### **CHARITABLE REMAINDER TRUST**

Property owned by a charitable remainder trust ("CRT") can be distributed to a private foundation, as the designated charity, upon the CRT's termination. This is a popular strategy when the donor owns highly appreciated assets and would like to sell such assets to convert them to income-producing property. Because a CRT is a tax exempt entity, the CRT can sell appreciated property without having to pay tax on the gain. Therefore, by contributing appreciated property to a CRT, a donor can receive a higher income stream, qualify for a charitable income tax deduction and reduce his or her estate that will be subject to estate tax. Additionally, a portion of the increased income stream can be used by the donor to pay premiums on a "wealth replacement" life insurance policy for the donor's family.

For more information contact:

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## **SPECIAL RULES RELATED TO PRIVATE FOUNDATIONS**

One of the major complications of private foundations is the many rules that apply to foundations in order to deter abuses. These rules are somewhat complicated, and, failing to comply with the rules can result in the imposition of taxes and penalties against the foundation and the foundation's manager. For example, there is a 2% tax on the foundation's net investment income (which may be reduced to 1% if certain distribution requirements are met). There is also a prohibition on transactions between the foundation and donors, foundation managers, and family members of donors. Additionally, the foundation must distribute an amount equal to at least 5% of its assets each year.

## **STEPS TO CREATE A PRIVATE FOUNDATION**

1. Establish a nonprofit corporation or trust.
2. Prepare a mission statement describing the foundation's activities.
3. Prepare a detailed statement as to how the foundation will meet its mission (i.e., "How, What, When, Where and How").
4. Prepare a conflict of interest statement.
5. Prepare a five-year financial projection for the foundation.
6. Consider the special rules that apply to private foundation, such as issues of self-dealing, excess business holdings and jeopardizing investments.
7. Determine who the Directors of the foundation will be. List their current addresses, current or historical employment and history of community/civic/philanthropic involvement.
8. File a Form 1023 with the IRS to apply for the foundation's tax exempt status. The Form must be filed within 27 months from the end of the month when the private foundation was formed.

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