



Building Future-Proof Foundations: Insights for Family Offices and Corporate Foundation Managers

Publication Date: December 4, 2024

Learning Objectives

KNOWLEDGE



Review key regulations and laws governing private foundations.



Identify major IRS enforcement issues, including self dealing and reputational risks.



Explore strategies to enhance financial management and tax benefits for foundations.



Discuss the future trends and compliance for aligning foundations and charitable missions.

CPE INFORMATION

Program Level: Basic

Field of Study: Specialized Knowledge

Delivery Method: Group Internet Based

Recommended CPE: 1.0

Audience: All

Program Prerequisite: None

Advanced Preparation: None

WELCOME

Today's Presenters



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Nonprofit Tax

EXPLORING NEW AREAS

Agenda



Why Set Up a Foundation?



History of Legislation for Foundations and IRS Enforcement



Financial Planning



Hot Topics and Trends in the Zeitgeist

WHY CREATE A FOUNDATION?

Understanding Motivations Behind Private Foundations

WHAT IS A PRIVATE FOUNDATION

A private foundation is a tax-exempt charitable organization

KEY CHARACTERISTICS

- **Funding Source:** Usually funded by a single individual, family, or corporation, as opposed to public charities, which receive broad public support.
- **Control:** They are controlled by a small group of individuals, often the donors or their family members, who retain significant authority over decision-making, including grant distributions and investments.
- **Purpose:** Their primary goal is philanthropy. Foundations either provide grants to public charities or directly engage in charitable activities.
- **Legal and Tax:** Recognized as tax-exempt under 501(c)(3), but subject to additional rules: Must pay an annual excise tax of 1.39% on net investment income.
 - Required to distribute at least 5% of their net investment assets annually for charitable purposes.
 - Must adhere to restrictions on self-dealing, political lobbying, and business ownership.
- **Flexibility:** Private foundations offer flexibility in how funds are used, whether through grants, direct charitable work, or investments aligned with charitable goals.
- **Longevity:** They can be set up to operate indefinitely or for a finite period, depending on the founder's intent.

DIFFERENT TYPES OF PRIVATE FOUNDATIONS

All share certain regulatory characteristics, but they can be categorized into different types.



Grant-Making Foundations

Purpose: These foundations primarily provide funding to public charities, nonprofits, or individuals for specific purposes such as scholarships or research grants.

Example: The Bill & Melinda Gates Foundation, which awards grants to support health and education globally.



Operating Foundations

Purpose: Operating foundations use the majority of their resources to run their own programs and initiatives rather than providing grants to other organizations.

Example: The Getty Trust, which operates museums and cultural initiatives.



Corporate Foundations

Purpose: These are established by corporations to support charitable activities aligned with corporate values or community engagement goals.

Example: The Coca-Cola Foundation, which funds programs related to water sustainability, community well-being, and education.



Hybrid Foundations

Purpose: These foundations combine grant-making and operational activities, funding external charities while also running their own programs.

Example: The Rockefeller Foundation, which provides grants and operates initiatives in health and economic equity.



Family Foundations

Purpose: Family foundations are created and funded by a family, often to engage in multigenerational philanthropy.

Example: The Ford Foundation, initially funded by the Ford family, although it has since evolved into a broader grant-making foundation.



Community Foundations (Hybrid Structure)

Purpose: While technically classified differently under IRS rules, some private foundations serve localized purposes similar to community foundations, pooling resources to benefit specific regions or communities.

Example: A local private foundation funding community parks or education programs.



Pass-Through Foundations

Purpose: These foundations distribute all their income (or principal) to charitable activities within a set period, rather than building an endowment.

Example: A foundation established to fund a one-time initiative like disaster relief.

WHY WEALTHY PEOPLE CREATE FOUNDATIONS

Wealthy individuals establish private foundations for several reasons, ranging from philanthropy and legacy-building to strategic tax planning

Philanthropy and Social Impact

- ✓ Structured Giving: Enables focused and strategic philanthropy
- ✓ Long-Term Impact: Supports initiatives over time and beyond lifetimes
- ✓ Catalyst for Change: Concentrates resources on societal challenges

Family Legacy and Values

- ✓ Legacy Building: Leaves a lasting impact on cherished causes
- ✓ Passing Values: Instills charitable principles in future generations
- ✓ Family Cohesion: Strengthens bonds through shared philanthropic activities

Tax Benefits

- ✓ Immediate Tax Deductions: Contributions are tax-deductible.
- ✓ Avoiding Capital Gains: Donations of appreciated assets bypass capital gains tax.
- ✓ Estate Planning: Reduces estate tax liabilities.



Control And Flexibility

- ✓ Control Over Grants: Decide where and how funds are distributed.
- ✓ Customizable Goals: Focus on specific issues or regions.
- ✓ Innovative Philanthropy: Experiment with unique or risky initiatives.

Anonymity and Privacy

- ✓ Shielding Identity: Support causes privately.
- ✓ Controlled Public Narrative: Shape perceptions of charitable activities.

Influence and Advocacy

- ✓ Advocacy Work: Support policy initiatives within legal limits.
- ✓ Thought Leadership: Fund research and influence social issues

MANY WEALTHY PEOPLE HAVE PRIVATE FOUNDATIONS

Here are some notable examples:

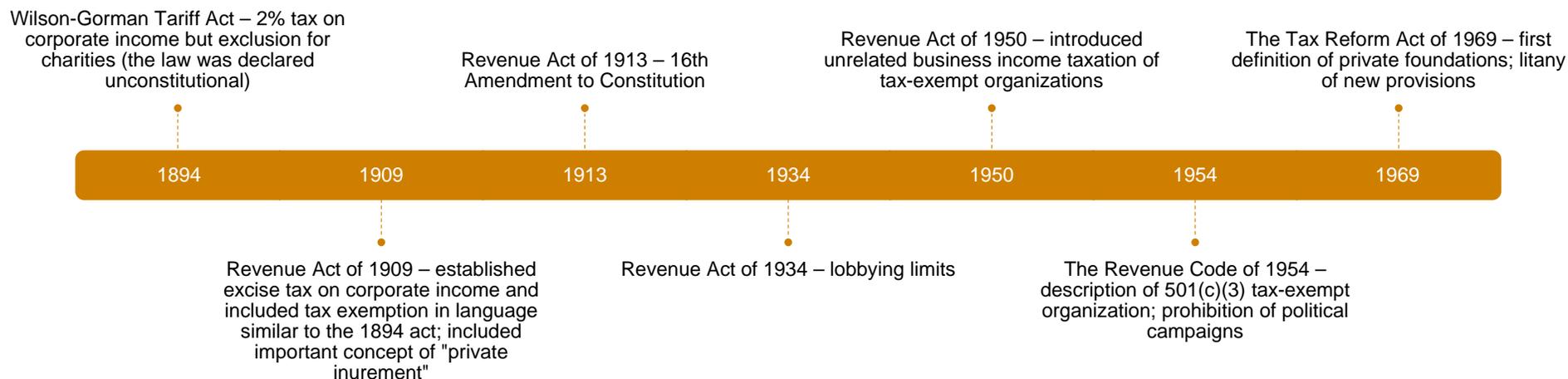
- **Bill Gates:** Co-founder of Microsoft, Gates established the Bill & Melinda Gates Foundation, one of the world's largest private charitable foundations, focused on global health, education, and poverty alleviation.
- **Mark Zuckerberg:** Founder of Facebook, Zuckerberg, along with his wife, Priscilla Chan, leads the Chan Zuckerberg Initiative (CZI), which aims to advance education, cure diseases, and reform criminal justice systems.
- **Dustin Moskovitz:** Co-founder of Facebook and Asana, Moskovitz and his wife, Cari Tuna, founded Good Ventures, a philanthropic foundation committed to effective altruism and impactful global causes.
- **Jeff Bezos:** Amazon founder Bezos created the Bezos Earth Fund to combat climate change and the Day 1 Families Fund to support homeless families and early education initiatives.
- **Elon Musk:** CEO of Tesla and SpaceX, Musk operates the Musk Foundation, focusing on renewable energy, STEM education, and space exploration projects.
- **Sergey Brin:** Google co-founder Brin co-leads the Brin Wojcicki Foundation, which supports Parkinson's disease research, education, and disaster relief efforts.
- **Larry Page:** Google co-founder Page established the Carl Victor Page Memorial Foundation, funding environmental conservation, education, and technology to improve societal outcomes.
- **Reid Hoffman:** Co-founder of LinkedIn, Hoffman supports causes through the Hoffmann Collaborative Fund, focusing on AI ethics, economic inclusivity, and civic engagement.
- **Steve Ballmer:** Former CEO of Microsoft, Ballmer and his wife, Connie, established the Ballmer Group, which invests in improving economic mobility and addressing systemic inequities in the United States, focusing on early childhood, education, and workforce development.
- **Jack Dorsey:** Twitter co-founder Dorsey leads #StartSmall, a foundation addressing COVID-19 relief, universal basic income (UBI), and global education initiatives for girls.
- **Marc Benioff:** Salesforce founder Benioff created the Salesforce Foundation and the Benioff Ocean Initiative, championing education, ocean health, and public health.
- **Patrick Collison:** Co-founder of Stripe, Collison focuses on funding scientific research and technological innovation through his philanthropy, rooted in effective altruism principles.

MISSION DRIVEN

Legislation Around Foundations and IRS Enforcement

HOW DID WE GET HERE?

A Brief History of the Tax-Exempt Sector to Private Foundations



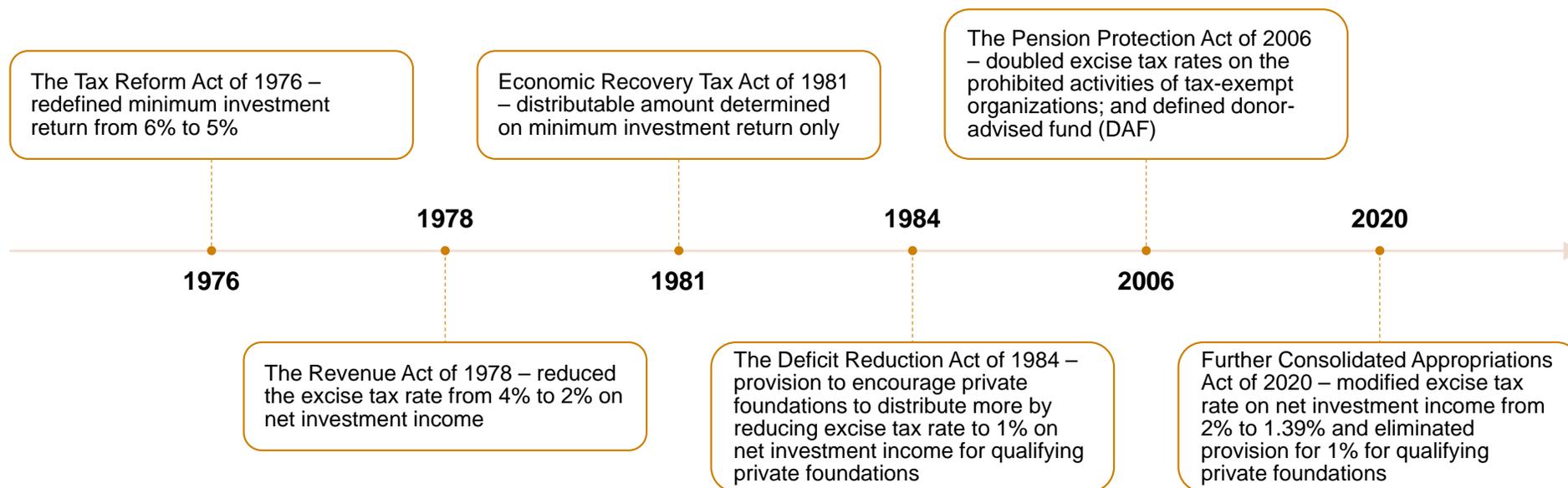
HOW DID WE GET HERE?

Private Foundation Tax Provisions

- 1969 – The Tax Reform Act of 1969 – first definition of private foundations; taxes imposed on the following:
 - Net investment income
 - Failure to distribute for charitable purposes
 - Self-dealing activities
 - Excess business holdings
 - Jeopardizing investments
 - Taxable expenditures

HOW DID WE GET HERE?

Changes to Private Foundations



PRIVATE FOUNDATIONS

Disqualified Persons

- Substantial contributor (SC)
- Foundation manager
- Owner of >20% of entity that is a SC
- Family member of the above individuals
- Entity >35% owned by one of the above
- PF with in-common controlling individuals (For excess business holdings)
- Government officials (For self-dealing only)

PRIVATE FOUNDATIONS

Excise Taxes on Prohibited Transactions

Prohibited Transaction	Liable Party	First-Tier Tax Rate	Limit	Second-Tier Tax Rate	Limit
Self-dealing	Self-dealer	10%	None	200%	None
Undistributed Amount	Private Foundation	30%	None	100%	None
Excess Business Holdings	Private Foundation	10%	None	200%	None
Jeopardizing Investments	Private Foundation	10%	None	25%	None
Taxable Expenditure	Private Foundation	20%	None	100%	None
Self-dealing	Foundation Manager	5%	\$20,000 per act	50%	\$20,000 per act
Jeopardizing Investments	Foundation Manager	10%	\$10,000 per act	5%	\$20,000 per act
Taxable Expenditure	Foundation Manager	5%	\$10,000 per act	50%	\$20,000 per act

PRIVATE FOUNDATIONS

First-Tier and Second-Tier

If a prohibited transaction takes place, then first-tier tax rates are imposed

Second-tier tax rates are triggered by the failure to make a correction

Correction means:

- Self-dealing: undo the transaction to the extent possible. Restore the foundation to the same or better financial position than it would have been had the transaction not occurred
- Failure to distribute - reduce the undistributed amount to zero
- Excess business holdings - dispose of the excess holdings
- Jeopardizing investment - remove the investment from jeopardy by either selling or disposing (other than exchanging for another jeopardizing investment)
- Taxable Expenditure - recover as much of the expenditure as possible; obtain or make a report on the use of the grant

PRIVATE FOUNDATIONS

Self-Dealing

- Sale, exchange, or leasing of property between a private foundation and a disqualified person
- Lending money or other extension of credit between a private foundation and a disqualified person
- Furnishing of goods, services or facilities between a private foundation and a disqualified person
- Payment of compensation (or payment or reimbursement of expenses) by a private foundation
- Transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation
- Agreement by a private foundation to make any payment of money or other property to a government official

Exceptions to Self-Dealing

- ❑ Leases by disqualified person to private foundation without charge
- ❑ Lending of money by a disqualified person to a private foundation, if the loan is without interest or other charge and if the proceeds of the loan are used exclusively for charitable purposes
- ❑ The furnishing by a disqualified person to a private foundation is without charge and if the goods, services, or facilities are used exclusively for charitable purposes
- ❑ The furnishing by a private foundation to a disqualified person is made on a basis no more favorable than to the general public
- ❑ Payment of compensation for personal services which is reasonable and necessary to carry out the exempt purpose of the foundation
- ❑ Certain transactions occurring during the administration of a decedent's estate

PRIVATE FOUNDATIONS

Other Prohibited Transactions

- Failure to Distribute
- Excess Business Holdings: 2% rule; 35% rule (if controlled by third persons) or 20% rule
 - Grace period of gifted holdings
- Jeopardizing Investments: scrutiny on speculative investments
 - Exception: Program Related Investments (PRI)
- Taxable Expenditures: lobbying; political; grants to individuals for travel study or other similar purposes; grants to non-domestic public charities
 - Exception: grants to individuals which are pre-approved by the IRS
 - Exception: grants to non-domestic public charities over which the granting PF exercises "Expenditure Responsibility" (ER)

PRIVATE FOUNDATIONS

Abatement of Excise Taxes

- The taxpayer qualifies for abatement of first-tier tax if the taxable event:
 - Was due to reasonable cause
 - Wasn't due to willful neglect
 - Was corrected within the correction period
- If correction hasn't occurred or doesn't occur, then abatement is unavailable.
- The taxpayer qualifies for abatement of second-tier tax if correction is timely made

Prohibited Transaction	First-Tier	Second-Tier
Self-dealing	No	Yes
Failure to Distribute	Yes	Yes
Excess Business Holdings	Yes	Yes
Jeopardizing Investments	Yes	Yes
Taxable Expenditures	Yes	Yes

MISSION DRIVEN

Financial Planning

BEST PRACTICES

Highly functional foundations incorporate multiple elements into a concise articulation of purpose, methods, implementation and governance

Mission Statement	<ul style="list-style-type: none"> • Why the organization exists • Who you serve 	<ul style="list-style-type: none"> • Why the organization serves them
Governance	<ul style="list-style-type: none"> • Board of Directors • Executive team • Administrative management 	<ul style="list-style-type: none"> • Grant-making committee • Investment committee charter – empowers IC • Investment Committee
Grant Making Policy	<ul style="list-style-type: none"> • Areas of focus • Criteria for grants recipients 	<ul style="list-style-type: none"> • Allocation across recipient type
Spending Policy	<ul style="list-style-type: none"> • Permanent or self-liquidating fund informs gifting and spending policies 	<ul style="list-style-type: none"> • Generally, 5% minimum distribution requirement • Consider economic sensitivity of key components
Investment Policy	<ul style="list-style-type: none"> • Mission and governance • Roles and responsibilities • Grant making policy and spending policy 	<ul style="list-style-type: none"> • Investment philosophy and portfolio construction methodology • Portfolio guidelines and monitoring procedures
Management and Monitoring	<ul style="list-style-type: none"> • Effectiveness of grants • Status of granting making related to spending policy • Spending policy review with reference to asset performance 	<ul style="list-style-type: none"> • Portfolio and manager level performance • Fiduciary process and regulatory filings

It's hard, if not impossible, to have good financial planning without these things.

WHAT IS FINANCIAL PLANNING?

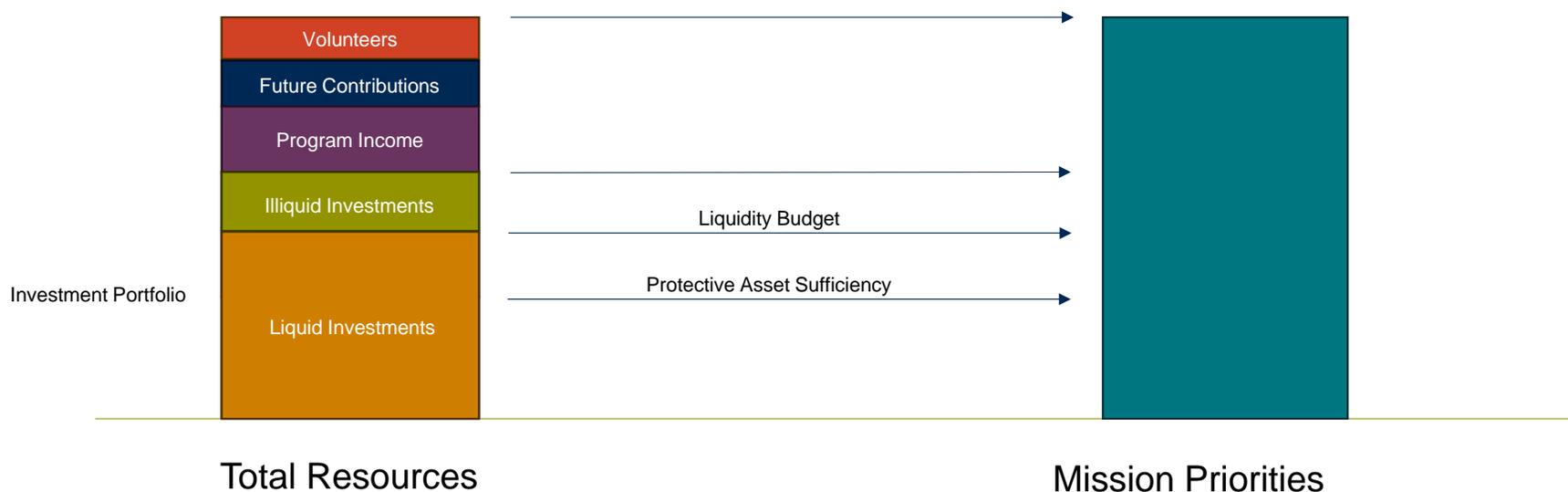
Financial planning is the process of aligning your total resources with your mission's total expenditures



While simple on the surface, it does require thoughtful introspection and decision-making.

WHAT IS AN INVESTMENT POLICY

An investment policy is the guidelines given to an investment professional that ensure alignment between the investment portfolio portion of total resources and the mission



WHAT IS THE STRUCTURE OF THE MISSION?

The Mission is a set of priorities that can be classified into three categories



Each foundation is different, and how it categorizes its priorities will be different.

WHAT IS ESSENTIAL?

Essential expenditures are a foundation's non-negotiable near-term commitments

- **Minimum Operating Budget**
 - Minimum salaries (if any)
 - Compliance costs (tax, legal, etc.)
 - Rent, utilities, or other keep-the-lights-on type of expenditures
- **Contractual obligations**
 - Grant and vendor agreements
 - Excise taxes
 - 5% distribution requirement
- **Near-term grants or services that, if missed would jeopardize the entirety of the mission**
 - Next semester's tuition for a scholarship award
 - Rent, insurance, and salaries for a shelter or other essential program element
 - Grants or services to mission-critical economically vulnerable recipients

WHAT IS IMPORTANT

Important: expenditures that the foundation will make unless it is in financial distress

- **Normal Operating Budget**
 - Normal salaries
 - Other essential operating expenditures
- **Annual Charitable Gifts and Services**
 - Normal recurring gifts
 - Normal services operation
 - Normal ad-hoc gifts

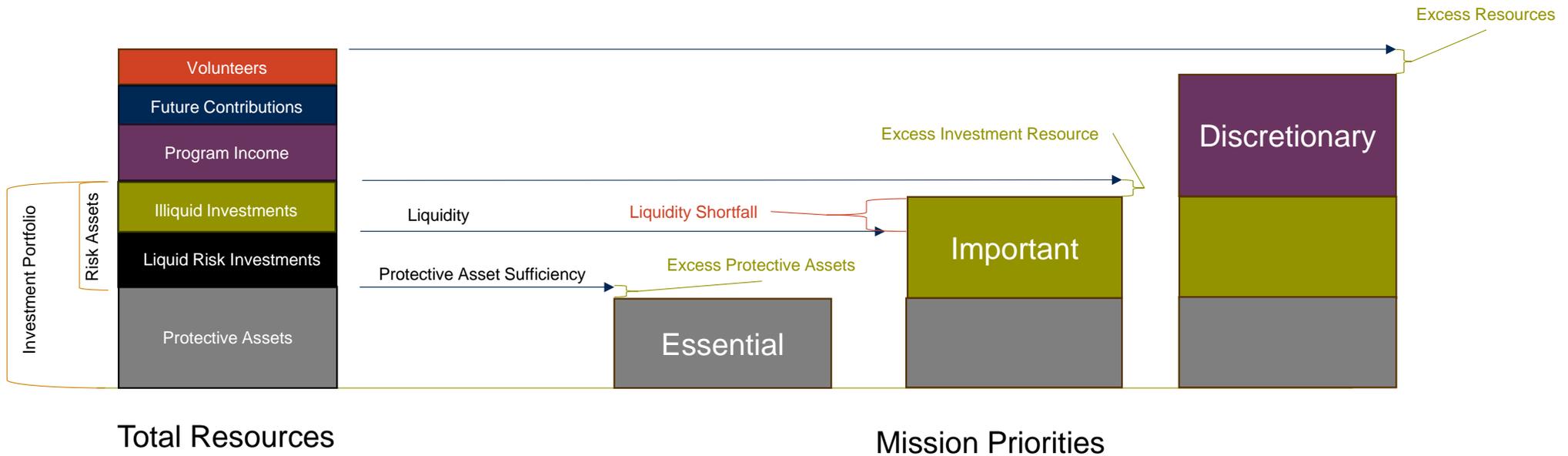
WHAT IS DISCRETIONARY

Discretionary: expenditures that the foundation will make if it has excess resources

- **Excess Annual Charitable Gifts and Services**
 - Extended or expansion of services
 - Additional reoccurring gifts
 - Growth in ad-hoc gifts
 - Self Sustaining Fund

PUTTING IT ALL TOGETHER

Now that you have all the expenditures categorized, compare them to the resources stack



The alignment helps determine the specific calibration of the investment, grant-making, and spending policies.

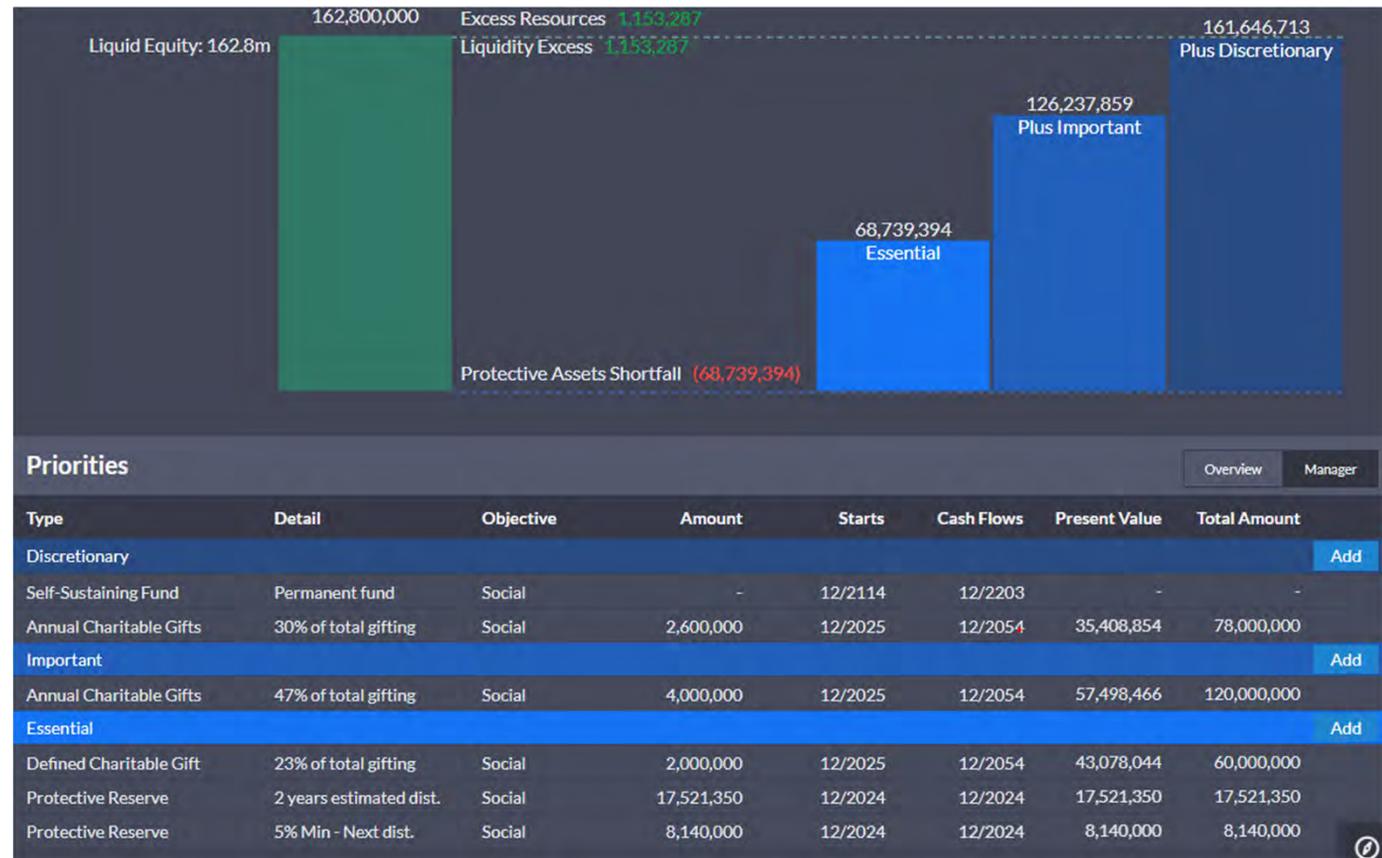
ILLUSTRATIVE EXAMPLE – WARREN BUFFETT’S CHILDREN

Situation

- Total Resources \$162.8B of Berkshire Hathaway Stock
- Warren would like his three children to give it away in their lifetimes
- Warren’s children are in their late 60s and early 70s

Suggestions

- Prudent to convert \$68.7B of stock into Protective Assets to ensure:
 - Sufficient reserves to make this year’s 5% required distribution
 - Sufficient reserves to make the next two years of required distributions
 - Sufficient reserves to make \$2B/year for 30 years defined charitable gift
- Bulk of assets allocated to Annual Charitable Gifts for grant-making ease
- Discretionary gifts minimized as this is not intended to be permanent



MISSION DRIVEN

Hot Topics and Future Trends For Aligning Foundations and Charitable Missions

WHAT ARE WE KEEPING AN EYE ON?

Hot Topics

-  Apparent interest by ultra-wealthy philanthropists from 501(c)(3) charitable private foundations to 501(c)(4) social welfare organizations
-  Interest in "working charities" needing funds now over perpetual warehousing of funds by donor advised funds (DAFs) and private foundations
-  Proposed legislation in the ACE Act
-  Proposed regulations regarding taxable distributions by DAFs
-  Potential developments by President-Elect Trump and Vice President-Elect Vance

HOT TOPICS AND TRENDS

501(c)(3) to 501(c)(4)

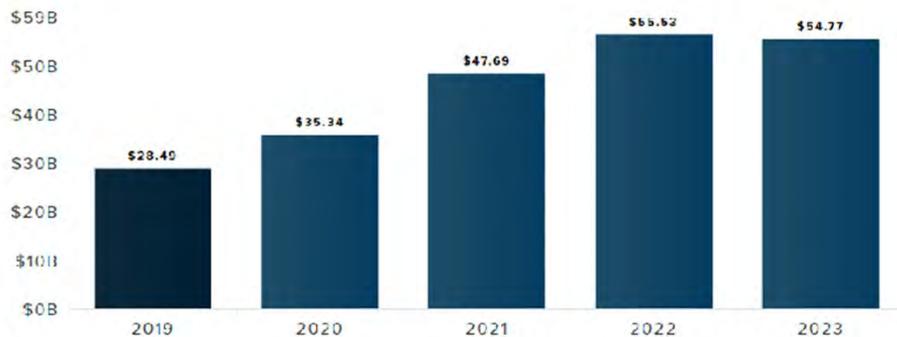
- Ultra-wealthy philanthropists are showing increasing interest in shifting their focus from traditional 501(c)(3) charitable private foundations to 501(c)(4) social welfare organizations.
- This shift allows philanthropists to engage in more direct political advocacy and lobbying efforts to bring about social change.
- The flexibility provided by 501(c)(4) organizations allows increased involvement in influencing public policy and addressing broader social issues.



HOT TOPICS AND TRENDS

Immediate Funding Needs

FIGURE 1: TOTAL VALUE OF GRANTS MADE BY DONOR-ADVISED FUNDS
\$ IN BILLIONS



National Philanthropic Trust: The 2024 DAF Report

- There is a growing emphasis on supporting "working charities" that require immediate funding to address pressing societal needs.
- Donor advised funds (DAFs) and private foundations are facing scrutiny due to the perceived warehousing of funds, leading to increased interest in supporting organizations that have an immediate impact.
- Philanthropists are looking for opportunities to make a tangible difference by supporting initiatives that provide direct assistance and resources to communities in need.

HOT TOPICS AND TRENDS

ACE Act

- The Accelerating Charitable Efforts (ACE) Act is proposed legislation aimed at incentivizing increased charitable giving and simplifying the donation process.
- The ACE Act seeks to provide tax benefits to donors and remove barriers to charitable giving, encouraging individuals to contribute more to philanthropic causes.
- This legislation could potentially have significant implications for private foundations and family offices, creating new opportunities for charitable giving and streamlining the charitable donation process.
- Proponents of the bill: proposed policies increase transparency necessary to build public trust and improve the timely flow of resource to working charities
- Opponents of the bill: resources already flow at rates higher than the proposed policies and changes may negatively impact the administrative flexibility needed to thoughtfully invest in communities

HOT TOPICS AND TRENDS

Donor Advised Fund (DAF) Regulations

- Proposed regulations issued in Notice of Proposed Rulemaking on November 14, 2023
- Significant changes to regulations governing donor-advised funds potentially impacting existing funds
- Redefines eligible funds, donors, and donor-advisors
- Implications include potential excise taxes on distributions managed by investment advisors and expanded eligible distributions

HOT TOPICS AND TRENDS

Post-Election Uncertainty

- The incoming administration has expressed interest in making changes to tax policies that could impact philanthropic efforts.
- Potential developments may include revisions to tax deductions for charitable contributions and other tax incentives aimed at encouraging charitable giving by increasing minimum distribution requirements from PFs and DAFs.
- These changes could have a significant impact on private foundations and family offices, necessitating careful financial planning and consideration of potential implications.



THANK YOU

Questions?

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OUR PROMISE TO YOU

Reimagine Your Potential



Unconventional Approach

We're a vested, entrepreneurial partner who sees your organization through a 360 lens and finds opportunity at every stage



Comfort in Change

Our experts provide guidance and support while quickly facilitating transformation that gives you a competitive advantage.



Focused on You

Our integrated teams and solutions deliver tailored insights to bring you more value and clarity throughout your journey.

A new and better way for today and tomorrow

Equipping you with the insights and tools needed to redefine what's possible



COMPLIANCE

- UBIT Tax Planning
- Form 990
- Nonprofit Formation
- Construction Cost Advisory



TRUST

- Financial Audit
- Benefit Plan Audit
- Internal Audit
- Single Audit
- Cybersecurity
- Restructuring
- Revenue Recognition



STRATEGY

- Operational Strategy
- Management Consulting
- Benchmarking
- Business Transformation
- Technology Roadmaps and RFPs



STAFFING

- HR Outsourcing
- Payroll
- Policies and Procedures
- Health and Benefits
- Executive Search
- Interim Placement



TECHNOLOGY

- ERP
- CRM
- FP&A
- Business Intelligence
- Managed Support and Services
- Automation



OUTSOURCING

- Bookkeeping
- Budgeting/Forecasting
- Account Receivable
- Accounts Payable
- Strategic Fundraising Development

WRAP UP

Thank you
for participating!

Be on the lookout for a
survey (via email) to give us
your feedback for this
training event

Additional questions? Reach out to us at
elevatelearn@armanino.com



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