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2013 Edition

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2013 Edition

by Jerry J. McCoy and Kathryn W. Miree

The *Family Foundation Handbook* provides ongoing practical advice on how to operate a family foundation. It helps the foundation director set and meet personal goals, learn how to avoid liability, and make the most effective grants. This book provides forms, checklists, questionnaires, training forms, and other items to help provide the professional assistance every foundation needs.

Highlights

This 2013 Edition of the *Family Foundation Handbook* incorporates the changes in tax law and practice that have occurred in this complex and constantly changing field. Highlights include:

- Amendments to the regulations, providing additional examples of qualifying program-related investments.
- New IRS Form 8940 for requesting miscellaneous determinations.
- Updated disclosure and filing requirements.
- Latest private letter rulings on important issues, including increasing-payment charitable lead annuity trusts and the estate administration exception for self-dealing transactions.
- A report on the *Cooperman* case, in which the Tax Court upheld disallowance of a $43 million deduction for contribution to a family foundation of investment property that was not a "publicly traded stock."
- The most recent statistics of family foundation trends and profiles from The Foundation Center, the Council on Foundations, the Association of Small Foundations, the Giving USA Foundation, and the Internal Revenue Service.
- The latest data on salaries and guidelines.
- A updated list of states that have adopted UPMIFA, statutes governing volunteer liability, and resources for family foundations.
- Expanded and updated coverage of other issues, including:
  - ☐ Private letter rulings approving foundation scholarship programs
  - ☐ The long-delayed Treasury Report on supporting organizations and donor advised funds
  - ☐ Choice of form (corporation versus trust) for family foundations

To Alex, Maddy, Alli, and Jon
—JJM

To my family—Ben, Kyser, and Harry—
the most patient people on the planet

I greatly appreciate the help of my colleagues and clients in this field who continue to teach me more about the world of family foundations. This book contains the results of many collaborative efforts over the years.

I would also like to thank Marty Carter of Baton Consulting and David Hobbs of Hilb, Rogal & Hamilton Company of Alabama for their review of and input on segments of the manuscript.

—KWM

About the Authors

Jerry J. McCoy, Esq. is an independent attorney in Washington, D.C., specializing in charitable tax planning, tax-exempt organizations, and estate planning. He holds law degrees from Duke University and New York University.

A member of the American Law Institute and a fellow of both the American College of Trust and Estate Counsel (ACTEC) and the American College of Tax Counsel, Mr. McCoy is listed in *Who's Who in America, Who's Who in American Law,* and *The Best Lawyers in America.* A frequent presenter at planned giving, tax, and estate planning seminars, he serves on the adjunct faculties at the Georgetown University Law Center and the University of Miami Law School. He is chairman of the Charitable Planning and Exempt Organizations Committee of ACTEC.

Mr. McCoy is co-founder and co-editor of *Charitable Gift Planning News,* a monthly newsletter.

Kathryn W. Miree, Esq. is president of Kathryn W. Miree & Associates, Inc., a consulting firm that works with nonprofits to develop planned giving programs. She received her undergraduate degree from Emory University and her law degree from The University of Alabama School of Law. She spent 15 years in various positions, including manager of the Personal Trust Department, in the Trust Division of a large southeastern bank. During her tenure with the bank, Ms. Miree handled the foundation administration and grant administration for more than 40 foundations. She joined a regional brokerage firm in 1994 to start its trust company. She established Kathryn W. Miree & Associates, Inc. in 1997.

Ms. Miree is a past president of the National Committee on Planned Giving, the founding president of the Alabama Planned Giving Council, a past president of the Estate Planning Council of Birmingham, Inc., and a past member of the Board of the National Association of Estate Planners & Councils. In addition to those professional associations, she currently serves on a number of foundation and nonprofit boards. She is a graduate of both Leadership Birmingham and Leadership Alabama.

Ms. Miree is a frequent lecturer on nonprofit management and fundraising. Her clients include a variety of nonprofit organizations across the nation.

Preface

Like most children, neither of us grew up hoping to work with foundations. We both ended up there by accident, following different routes to a similar destination. Here are our stories and how we hope this book may make the reader's journey a bit easier.

Kathryn's Story:

> *I became a foundation administrator by accident—like so many of us find our roles in life. I was an attorney, involved in estate and trust administration, and was asked to take a management role administering charitable trusts and foundations. It seemed like a great idea (because it was a step up), but I had no idea of how to define, much less manage, a charitable foundation. So I asked a simple question: What books can I read to help me learn how to make grants, manage finances, invest money, and keep the foundations on track? I was referred to the Internal Revenue Code and the regulations.*
>
> *I spent weeks reading the Code and regulations and was as lost at the end of the exercise as when I began. I felt that there must be better resources, so I called my friends who practiced in this area and asked them to refer me to an English version of the rules. They also referred me to the Code and the regulations. I kept reading the Code, and still do so today. But the best advice I received came through talking with other foundation administrators and combining their wisdom with resources found in the for profit sector.*

Jerry's Story:

> *Like Kathryn, I likewise became involved in foundation matters by accident, even involuntarily. Congress began work on the Tax Reform Act of 1969 in February of that year and, as the newest attorney in a Washington tax boutique law firm, I was sent off to Capitol Hill to watch the proceedings. The firm had a number of charitably inclined clients, including a number of private foundations, and my assignment was to let them know through overnight bulletins just what was going on in the hearings. This turned out to be a historic time for private foundations, as Congress put together what remains almost unchanged as our federal law on this subject over the course of that year. A few years later I was privileged to serve on the staff of the Commission on Private Philanthropy and Public Needs, named the "Filer Commission" after its chairman, John H. Filer. This landmark study of the nonprofit sector included a detailed review of the law governing private foundations.*
>
> *With these two experiences under my belt, my fate was sealed. Like it or not, I was a specialist in charitable tax planning, with a subspecialty in private foundations. My practice in this area brought me into contact with a number of lawyers around the country who sought assistance in this increasingly specialized field. Along the way I was surprised over and over to see how many people,*

lawyers and clients alike, got so caught up in the many complications and complexities in this area that they missed the bigger and more important part of the picture—how useful a family foundation can be and how those complications often don't matter at all. In many cases, these complications discouraged the advisers so much that they in turn discouraged their clients from creating foundations.

Family Foundation Handbook is designed to save you from some of the struggles we encountered by giving you answers to the most frequently asked questions and practical solutions for both common and uncommon problems. It will be a valuable tool for advisors and clients and will help them harness the tremendous potential that the family foundation offers. While the Code and regulations are available, there are few practical resources that provide quick, understandable answers to these questions. This book is designed to bring practical, understandable answers and solutions to these commonly asked questions. We have taken our 45 (plus) years of hands-on experience, combined it with the technical directives of the Internal Revenue Code, and reduced it to practical guide for the professional.

The questions are practical but require precise answers:

- Should I create a family foundation, or is there a more effective way to involve my family in charitable giving?
- How does creation of the foundation impact my estate plan?
- How do I handle grant administration? Do you have a sample form?
- What are the administrative obligations of a family foundation?
- Am I required to file tax returns?
- Can I pay myself or a member of my family a salary for foundation work?
- Can I lease my property to the foundation?
- How do I manage foundation investments?

Foundation boards may answer these questions in different ways. Founders establish foundations with different goals, varying levels of assets, and diverse objectives. This book provides the tools to help the professional coach the foundation board through the steps to find the answers.

Moreover, as our experience has too often shown us, the creator of the family foundation is left at the starting line with a new foundation and little direction about how to move forward. The accountant analyzes the tax impact of creating the foundation and gives the go-ahead. The financial planner helps fit the foundation into the family's overall financial picture. The attorney prepares the documents and qualifies the foundation with the Internal Revenue Service. But no one is there to provide ongoing, practical advice on how to operate the new entity. The new foundation director needs help to set and meet personal goals and to learn how to avoid liability, how to make the most effective grants, and how and when to hire an executive director. This book provides forms, checklists, questionnaires, training forms, and other items to help you provide the professional assistance that the foundation needs.

July 2012

Kathryn Miree
Jerry McCoy

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Introduction

§ 1.01 THE PHILANTHROPIC IMPULSE

[A] Growth of U.S. Philanthropy

Despite some appearances to the contrary, Americans are at heart a generous, caring people who have for centuries routinely put aside their self-interest to provide assistance and relief to others who need it. They enthusiastically support the greatest network of schools, colleges and universities, cultural institutions, and other non-profit organizations the world has ever known. This enthusiasm is backed up with annual contributions amounting to $298.42 billion in 2011, an amount 4 percent higher than the revised 2010 total of $286.91 billion.[1]

From the earliest times, a spirit of community helping and cooperation has been a characteristic of North American residents and immigrants alike. The first explorers to arrive here were aided by the generous Native Americans they found already in residence. Later, of necessity, a culture of cooperation and mutual assistance grew up. Early settlers left their homes in Europe and elsewhere in search of not just a different life here, but a better one as well. They arrived in America to find a heavily forested, sparsely populated continent, with harsh living conditions that forced them to help

[1] *Giving USA* (2012), Giving USA Foundation, *www.givingusa.org*.

one another build homes, schools, houses of worship, and other public facilities. This acceptance of mutual interdependence continued as Americans moved across the prairies and mountains to settle this new nation. Many vignettes of early American life bear out a spirit of cooperation and common efforts aimed at providing a better life for all; from the Minutemen rushing to the defense of their villages, to the pioneers attending barn-raising parties on the prairies, to the residents forming volunteer fire brigades, our traditions are steeped in this spirit.

Although born of necessity, community helping soon became a basic feature of the American way of life. The initial help provided directly by one resident to another soon became institutionalized, with the growth of mutual entities to undertake such help on a larger scale. Alexis de Tocqueville, in *Democracy in America,* his insightful report of observations as a visitor from Europe in the early nineteenth century, noted this tendency:

> Americans of all ages, all conditions, and all dispositions constantly form associations. They have not only commercial and manufacturing companies, in which all take part, but associations of a thousand other kinds, religious, moral, serious, futile, general or restricted, enormous or diminutive. The Americans make associations to give entertainments, to found seminaries, to build inns, to construct churches, to diffuse books, to send missionaries to the antipodes; in this manner they found hospitals, prisons, and schools. If it is proposed to inculcate some truth or to foster some feeling by the encouragement of a great example, they form a society. Wherever at the head of some new undertaking you see the government in France, or a man of rank in England, in the United States you will be sure to find an association.[2]

Modern Americans have continued to participate in these endeavors up to the present time through contributions and volunteer activities. Some have gone even farther and made charitable activity a family priority through the creation of family foundations.

[B] Growth of American Foundations

Although participation in collective activities has always involved a commitment of financial resources as well as time, the United States has perfected a new type of nongovernmental institution designed primarily to help distribute funds toward the solution of societal problems and other charitable and religious undertakings. Ironically, this altruistic form of organization grew out of the seemingly self-centered and acquisitive age of the Robber Barons—industrialists who amassed huge, unprecedented amounts of wealth in the late nineteenth century. Philosophically, these fortunes were not always deployed to charitable purposes out of a spirit of providing aid to those less fortunate, who were the traditional objects of charity. Rather, they

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[2] A. de Tocqueville, *Democracy in America* 2d pt., 2d bk., ch.V, at 106 (Knopf 1994).

resulted from the various personal motivations that moved the early leaders of that age.

For Andrew Carnegie, who had come to this country as a penniless immigrant in his childhood and had struggled to better himself, the objective was to provide a helping hand to youths who, like himself, evidenced a willingness to work toward personal improvement. Carnegie felt it was a disgrace to die rich and in his essay entitled "Wealth," published in the *North American Review* in June 1889, proposed that millionaires should administer their fortunes as a public trust during their lifetimes, rather than amassing a fortune to pass along to heirs, or even to benevolent causes, upon their deaths.

The modern private foundation was advocated by John D. Rockefeller, the first American billionaire, as a means of more effectively organizing what he called "this business of benevolence." Although skeptics speculated that he was moved to charitable endeavors by some combination of guilt over his business methods and a desire for positive public relations, the truth is that deep-seated religious beliefs played a larger role in leading him to this service. Rockefeller believed that his wealth was the result of divine influence and that the wise application of it to the betterment of humanity was his solemn duty. He had benefited from the use of business combinations, including the use of corporations, in amassing his wealth, and it was only natural that he would turn to similar tools and techniques in order to give money away more effectively.

Thus was born the first corporation aimed at providing an orderly and business-like approach to philanthropy. Rockefeller attempted without success to obtain from Congress a federal charter for what would become the Rockefeller Foundation and in the end settled for a New York corporation, which he formed in 1913. Given the important role of taxes as an incentive to modern U.S. philanthropy, it is interesting to note that efforts to form the Rockefeller Foundation were under way several years before the modern federal income tax was enacted. Other foundations created at about this same time, well before the enactment of the federal income tax, were the Rockefeller Institute for Medical Research (1901), Carnegie Foundation for the Advancement of Teaching (1905), Russell Sage Foundation (1907), and Carnegie Corporation of New York (1911).

The suspicious and distrusting attitude of Congress in denying Rockefeller's efforts to secure a federal charter reflects a recurring theme in the attitude of the U.S. public toward charitable undertakings and philanthropists—the social reformers' antipathy toward the wealthy and skepticism about their motivations in giving money away. Initially, there was a reluctance on the part of many church groups and other elements in society to accept foundation grants on grounds that this was somehow tainted money that should not be welcomed, lest the recipient be deemed to acquiesce in the giver's acts in earning the fortune wherein it originated.

Similar waves of suspicion and adverse public reaction to organized philanthropy occurred periodically in the twentieth century, and it was such a sentiment that led to consideration and passage of our modern tax rules for private foundations in the Tax Reform Act of 1969. The leadoff witness at the initial hearings on that Act was Texas Congressman Wright Patman, who had held a series of investigative hearings through the 1960s depicting various actual and perceived abuses by foundations and sounding a populist call for restrictions reining in these agents of wealth.

[C] Private Foundations Today

The Foundation Center estimates that there were 38,671 family foundations in the United States in 2010 (the latest year for which there are statistics), representing 63 percent of the independent foundations operating in the United States.[3] Indeed, the restrictions imposed under that legislation have proved to be a good thing for foundations in general in that they have eliminated most of the practices that generated legitimate criticism of foundations. This is borne out by Internal Revenue Service (IRS) personnel, who have reported that private foundations have by and large become the model citizens of the exempt organization community, rather than its bad boys. Virtually all of the widely reported charitable abuses and scandals of the 1980s and the 1990s involved public charities, rather than private foundations. Examples include the televangelist abuses, the excesses of the Bishop Estate trustees and the Adelphi College administration, and the Ponzi scheme of the Foundation for New Era Philanthropy. In more recent times, however, there have been a growing number of private foundation abuses that are attracting Congressional attention focusing on excessive compensation and benefits, distributions for non-charitable purposes, and self-dealing.

The booming economy of the late 1990s and its new technology wealth created a climate eerily evocative of the time a century earlier when new industrial fortunes gave rise to a new age of private philanthropy. Increasingly, the holders of this new wealth turned to the same sorts of outlets for their personal passions and concerns as their counterparts of a hundred years earlier. This passion has continued—as evidenced by the continued strong growth of private foundations—through the more economically perilous first decade of 2000.

§ 1.02 THE PURPOSE OF THE BOOK

The number of family foundations in this country is growing rapidly as families amass wealth, understand options in disposition of wealth, and focus on values. As interest in foundations grows, professionals must be able to offer advice to clients about the role of foundations in estate planning and wealth transfer planning. More important, the professional must be able to support the client in the ongoing management of the foundation, including administration, tax filings, grantmaking, and investment management.

Foundation management, like any area of tax practice, is detailed and unforgivingly exact. Many professionals do not have the tax training or practical experience to move through the issues easily. This book is designed to fill the gap.

The goal of the handbook is to provide forms and checklists to guide the most important activities, provide warnings for the most dangerous activities, add effectiveness to grantmaking, and answer common questions. The authors understand that most administrators and managers are less interested in understanding the

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[3] *Key Facts on Family Foundations,* The Foundation Center (February 2012), *http://foundationcenter.org/gainknowledge/research/pdf/key_facts_familyfdns2012.pdf.*