FOUNDATIONSOURCE

Tax Benefits of a Private Foundation

REDUCED INCOME TAX IS JUST THE BEGINNING

There are many philanthropic reasons for establishing a private foundation, but there are also attractive short-term and long-term tax benefits to consider. Donors may be able to take advantage of four key benefits when contributing to a private foundation:

1. **Reduction of income tax liability.**
2. **Tax-advantaged growth of assets contributed to the foundation.**
3. **Avoidance of capital gains taxes for appreciated assets; and**
4. **Reduction or elimination of potential estate taxes.**

Income Tax Savings

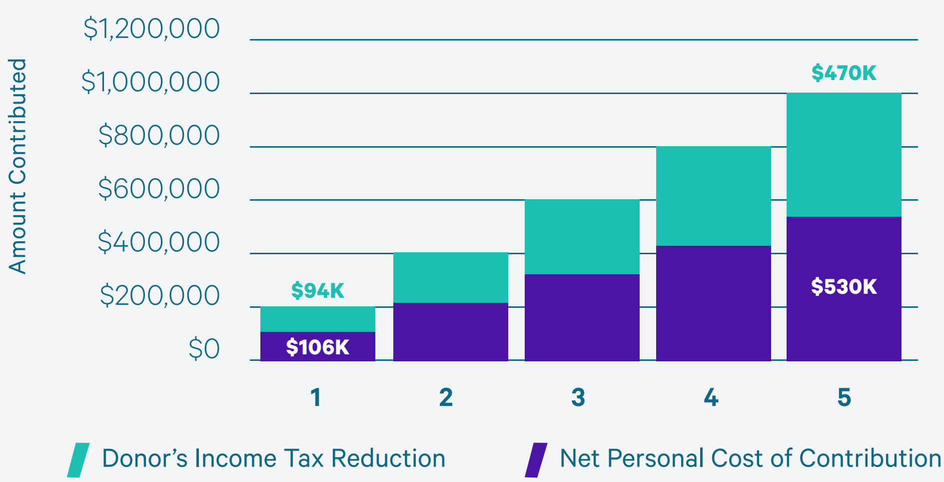
One of the more immediate tax benefits donors would see is an income tax deduction for any cash amount contributed to a private foundation of up to 30% of their adjusted gross income (AGI). The deduction is up to 20% of AGI for many non-cash contributions.

Let's take a hypothetical donor named Lucas. He works as a healthcare executive and has taxable income of $1 million each year. His combined federal and state income tax rate is approximately 47%. He plans to retire in five years but wants to establish a private foundation now and contribute $200,000 to it each year until he retires. Lucas is single and has no children but sees an opportunity to make his retirement productive by spending it managing a private foundation and pursuing his charitable interests.

Lucas will owe nearly $470,000 a year in income taxes. If he establishes a private foundation and contributes $200,000 to it, he will get a tax deduction for the full amount of the contribution (since it is less than 30% of his AGI), reducing his taxable income to $800,000. If his income tax rate remains approximately the same, he will now owe $376,000 a year in taxes.

A FOUNDATION CAN HELP YOU AVOID CAPITAL GAINS LIABILITY AND REDUCE OR ELIMINATE ESTATE AND GIFT TAXES

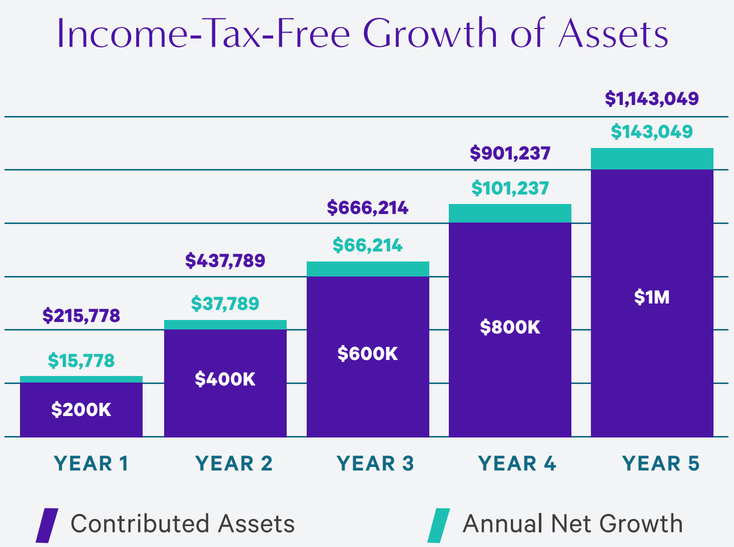
Cumulative Income Tax Savings



By making an annual contribution of $200,000, Lucas will save nearly $94,000 per year in income taxes over a five-year period. After five years, he will have contributed $1 million to his foundation at a net personal cost of $530,000, saving $470,000 in taxes.

Income-Tax-Free Growth of Assets /

Let's assume that Lucas follows through with his plan to contribute $200,000 to his private foundation every year over the course of five years. Because his assets will be able to grow in the tax-advantaged environment of the private foundation, after assuming an 8% growth rate and taking into account a 1.39% excise tax, the private foundation's endowment will have increased by nearly $150,000 despite having made over $111,000 of charitable grants in satisfaction of the minimum distribution requirement (MDR) during these years. By the time Lucas retires, his foundation will be worth more than $1.1 million and he can focus on creating a lasting charitable legacy.



(This chart reflects an 8% return on investment less 1.39% excise tax & the 5% MDR)

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
Year Beginning	$0	$215,778	$437,789	$666,214	$901,237
Annual Contribution	$200,000	$200,000	$200,000	$200,000	$200,000
8% Growth	$16,000	$33,262	$51,023	$69,297	$88,099
1.39% Excise Tax	-$222	-$462	-$709	-$963	-$1,225
5% MDR	$0*	-$10,789	-$21,889	-$33,311	-$45,062
Net Growth	$15,778	$22,011	$28,425	$35,023	$41,812
Year End	$215,778	$437,789	$666,214	$901,237	$1,143,049

*Foundations are not required to satisfy an MDR in their initial tax year.

Capital Gains Tax Savings

In addition to a deduction for income taxes on contributions to a private foundation, donors may also be able to avoid paying capital gains taxes by donating highly appreciated assets to a private foundation.

Let's say Lucas has a sister, Theodora, who founded a publicly traded technology company and holds a lot of highly appreciated, unrestricted stock. Her adjusted gross income each year is $3 million. Theodora's combined federal and state tax rate is 47% (with a combined rate of 29% for capital gains). Theodora has seen her brother's personal satisfaction and philanthropic success with his private foundation and is interested in establishing one of her own. She's particularly interested in instilling philanthropic values in her children and providing them and her husband with a worthwhile activity. Instead of making annual gifts to the foundation, Theodora wants to make one initial gift at the outset.

1.39% INSTEAD OF CAPITAL GAINS TAXES, PRIVATE FOUNDATIONS PAY A NOMINAL EXCISE TAX ON THE SALE OF APPRECIATED ASSETS.

She happens to own $2 million in stock in her company with a cost basis of $500,000. If Theodora sells the stock, she will owe $435,000 in combined state and federal capital gains taxes – not a tax she wants to incur. But if she establishes a private foundation instead and donates the stock to it, she will receive an income tax deduction for the full fair market value of the stock ($2 million). Although this exceeds 20% of her AGI, she can carry this deduction forward for five years and, over time, she will save around $940,000 in income taxes. In addition, she will not pay any capital gains taxes.

When the foundation decides to sell the stock in the future, it will pay only the nominal excise tax rate of 1.39% on the net capital gains. In fact, if the foundation uses the appreciated stock to make grants instead of cash, the foundation can avoid the excise tax on the stock's built-in gain entirely. Additionally, because Theodora can pass the foundation down to her children, they can become stewards of a significant charitable legacy and further her good works well beyond her lifespan.

Estate Tax Savings

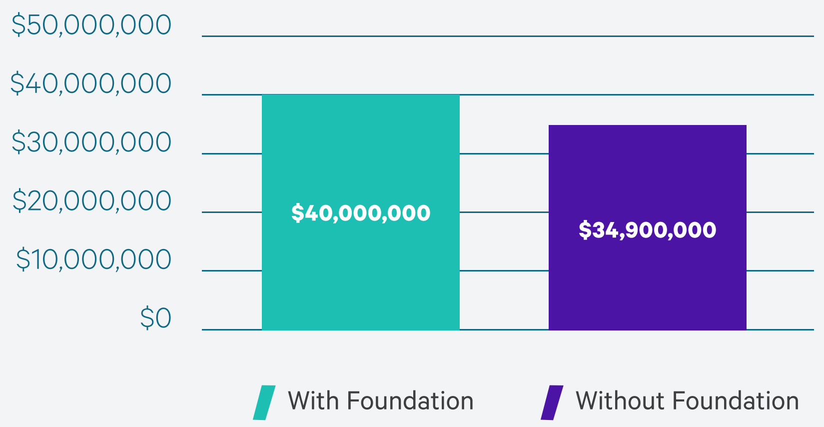
When assets are contributed to a private foundation, they are excluded from the donor's estate and, as a result, are not subject to either federal or state estate taxes. For high-net-worth individuals who have a strong charitable interest, private foundations offer an opportunity to avoid paying estate taxes while simultaneously creating a lasting philanthropic legacy.

Consider Lucas and Theodora's parents, who are proud to see that both of their children have been financially successful and have also developed strong charitable interests. The parents have combined assets of $40 million and want to leave a portion of their wealth to their children but are also interested in leaving some of their assets to charity. They are retired and have moved to a state that has no income tax or estate tax. Their assets are largely tied up in real estate and art, so their adjusted gross income is not large enough to justify a charitable gift simply for income tax reduction.

If the parents decide to pass all of their assets to their family, the estate receives a combined federal estate tax exemption of $27.22 million ($13.61 million for each spouse), and their combined estates will owe over $5.1 million in estate taxes based on 2024 federal tax rates.

Instead, if the parents decide to leave the combined federal exemption amount ($27.22 million) to their children and the balance of their estate ($12.78 million) to a private foundation that is funded when the surviving spouse dies, they can entirely avoid paying federal estate taxes. In addition, they will have created a foundation that will preserve and promote the family's charitable legacy and will instill their values in future generations. The family will have the opportunity to collaborate over common philanthropic goals, enhancing the family's bond and engagement. Because their children have already established their own foundations, the parents could instead simply leave the taxable portion of their assets to those foundations.

Usable Assets Available for Personal or Charitable Goals



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