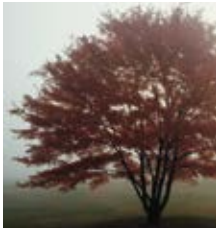
THE DIVERSITY OF GIVING: PHILANTHROPIC SOLUTIONS



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You have attained a level of financial security that allows you the freedom to devote resources to causes that are important to you and to make a difference in the lives of others. But with opportunity comes challenge. Having made the decision – and commitment – to contribute to charity, you are now faced with determining how best to ensure your desired legacy is achieved.

At Northern Trust, we recognize that philanthropic giving is unique to every individual. Working with you and your other advisors, we can help you determine the course of action that will best accomplish your objectives and work with you to implement your charitable strategy, ensuring that you and your family have as much – or as little – involvement in the day-to-day activities as you desire.

MAKING INFORMED DECISIONS

When you first consider making contributions to charity, there are more questions than answers:

- What do you hope to accomplish through philanthropy?
- What charity or type of charities would you like to benefit?
- Do these activities or charitable organizations reflect your values and goals?
- How will family members be involved in making gifts?
- How involved do you wish to be in the causes that you wish to support?

Not surprisingly, the answers to these questions are a springboard for further conversations about choosing philanthropic solutions that fulfill your wealth transfer and charitable objectives. As always, careful consideration of personal factors leads to a disciplined choice.

EXHIBIT 1: CHOOSING A GIVING VEHICLE[1]

	NUMBER (2014)	TOTAL ASSETS (BILLIONS)
Charitable bequests	23% of all estates for which estate tax returns were filed in 2014	$18.40
Charitable remainder unitrusts	88,262	$78.71
Charitable remainder annuity trusts	12,459	$5.52
Charitable lead trusts	6,414	$28.20
Private foundations	82,045	$695.30
Donor-advised funds	238,293	$70.70

ONE SIZE DOES NOT FIT ALL

For many donors, it is a surprise to learn that charitable gifts can be structured in many different ways (see Exhibit 1) – and that the size of the gift may or may not influence the choice of charitable vehicle. For example, for individuals wishing to make an immediate impact, direct contributions to charity may range from a modest check at one extreme to very substantial asset donations at the other. Similarly, one donor who wants to involve her family in philanthropy may choose to make a sizeable contribution to a donor advised fund, while another chooses to establish a substantial family foundation. From the donor's viewpoint, it is important to recognize that many factors are involved, including motivations, objectives and financial situation. When considering particular philanthropic vehicles, donors typically find that the best choices emerge after a thorough evaluation of the relevant alternatives.

TAXES AND CHARITABLE GIVING

While typically not the primary reason for philanthropy, an evaluation of charitable giving options would be incomplete without a discussion of the income and transfer tax benefits of giving. An understanding of how charitable giving can ease your tax burden will likely encourage consistent and long-term giving.

Federal Tax Consequences

The federal tax law provides incentives for charitable giving, in the form of generous deductions under the income, gift and estate tax. In general, the same charitable techniques that qualify for deductions under the income tax also qualify for gift and estate tax charitable deductions. That being said, donors should remember that the gift and estate tax charitable deductions are unlimited; in contrast, the income tax charitable deduction is limited by a number of factors, including the donor's adjusted gross income.

The Income Tax Charitable Deduction

With current federal income tax rates ranging up to 39.6%, the after-tax cost of contributing a dollar to charity during life can be as low as 60.4 cents. In addition, if appreciated assets are contributed to charity during life in a properly structured transaction, capital gain is either avoided or deferred. As Example 1 illustrates, even with capital gains rates at historic lows, the tax savings can be substantial.

EXAMPLE 1: INCOME TAX SAVINGS CAN BE SUBSTANTIAL

SCENARIO	ALTERNATIVE	
Sarah, age 50, donates $600,000 of highly appreciated securities with $0 tax cost to a public charity in 2014, when her AGI is $200,000.	Maximum available income tax charitable deduction in year of contribution ($200,000 x 30%): Capital gains avoided:	$60,000.00 $600,000.00
	Tax Benefits: From charitable deduction From capital gain avoided	 $17,482.50 $120,000.00
	Total Tax Savings:	$137,482.50
	After-tax cost of gift in year of contribution*	$462,517.50

**Charitable contribution carryover is available for use in the five succeeding years.*

The income tax charitable deduction is limited to a percentage of the donor's adjusted gross income, with a generous five-year charitable contribution carryover for excess contributions – allowing you to carry over the contributions that you are not able to deduct in the current year because they exceed your adjusted gross income limits. In other words, you can deduct the excess in each of the next five years until it is used up, but not beyond that. As Table 1 illustrates on the next page, the applicable percentage limitation depends on the charitable vehicle selected by the donor – and on the nature of the contributed asset. For example, cash is deductible up to 50% of adjusted gross income if contributed to a public charity.

TABLE 1: INCOME TAX CHARITABLE DEDUCTION		
TRANSFER TO	AGI LIMITATION	DEDUCTION BASED ON
Public charity	50% for cash 30% for long-term capital gain property	Fair market value
Private foundation	30% for cash 20% for long-term capital gain property	Fair market value for cash and publicly traded long-term appreciated stock; tax cost for other long-term capital gain property, including closely held stock and real estate
Charitable remainder trust with public charity as remainderman	50% for cash 30% for long-term capital gain property	Fair market value
Charitable remainder trust with private foundation as remainderman	30% for cash 20% for long-term capital gain property	Fair market value for cash and publicly traded long-term appreciated stock; tax cost for other long-term capital gain property, including closely held stock and real estate
Non-grantor charitable lead trust	n/a	n/a
Supporting organization	50% for cash 30% for long-term capital gain property	Fair market value

The Gift Tax Charitable Deduction

As noted above the gift tax charitable deduction is unlimited. The exact amount of the deduction depends on the fair market value of what is transferred.

The Estate Tax Charitable Deduction

In 2016, the estate tax rate is 40%, imposed on aggregate transfers (during life and at death) in excess of the $5.45 million estate tax exclusion. In other words, each dollar of estate tax charitable deduction has the potential to save 40 cents of tax. In addition, as noted above, the estate tax charitable deduction is unlimited (so long as the transfer is properly structured). This means that an otherwise taxable estate can avoid taxation through strategic use of the estate tax charitable deduction. As Example 2 illustrates on the next page, it is possible to include charity in an estate plan without substantially diminishing the portion of the estate that flows to individual beneficiaries.

EXAMPLE 2: ILLUSTRATION OF THE ESTATE TAX CHARITABLE DEDUCTIONS		
SCENARIO		
Sam passes away in 2016, leaving an estate of $10 million.		
	$0 LEFT TO CHARITY	$1 MILLION LEFT TO CHARITY
Estate Tax:	$1,820,000	$1,420,000
Net to Daughter:	$8,180,000	$7,580,000
Estate Tax Savings:	n/a	$400,000
After-tax Cost of Charitable Gift:	n/a	$600,000

OUTRIGHT GIFTS TO PUBLIC CHARITIES

For some donors, making an outright gift is as simple as writing a check or arranging for the transfer of selected securities, real estate or collectibles. Others, however, desire a greater degree of control. As a result, their gifts may be documented by written agreements that:

- Restrict the use of the gift,
- Specify how gift proceeds are to be invested, or
- Direct the recipient to produce annual reports detailing how gifted monies are used.

In either situation, donors are best served when they engage both their financial advisors and the planned giving office of the recipient charity before making firm plans. For example, the charity may have a particular funding opportunity that will uniquely match the donor's interests. Planned giving officers also can advise which types of gift restrictions are acceptable – or not acceptable – to the institution. Financial advisors are able to initiate or review relevant documentation and help with related compliance and funding issues.

Endowments

One important distinction for donors is the distinction between endowed funds, on the one hand, and non-endowment funds, on the other. When funds are given as an endowment, the parties agree that only the income from donated monies may be used for current purposes; the donated principal typically must remain intact. As a result, an endowed gift – whether for maintenance of capital assets or for scholarships – can continue in perpetuity. An endowment may take the form of a separate fund on the charity's books or may be structured as a separate entity altogether.

Restricted Gifts

Endowments are one example of the broader category of restricted gifts. Because restricted gifts are targeted to particular areas of need, they work best when the donor and charity collaborate. For example, a gift restricted to capital costs might be counter-productive for a charity struggling to meet current operational needs. Conversely, a charity working to build its endowment might be very grateful to receive a donation earmarked for this purpose.

From the donor's standpoint, much will depend, as always, on the motivation for making the gift. For example, if there is a desire to honor a family member in perpetuity, an endowed scholarship may be a better choice than a bricks and mortar facility with a limited lifespan.

To avoid future controversy about restricted gifts, the agreement of the parties should be in writing, with full consideration of contingencies. For example:

- What happens when a named building becomes obsolete?
- What happens when the program for which funds are earmarked ceases to exist?
- Is there an opportunity for the donors and their descendants to work with the institution in the future to determine to what use funds should be designated?

QUALIFIED CONSERVATION CONTRIBUTION:
A special type of outright transfer of property.
A charitable deduction is allowed (for income, gift and estate tax purposes) for "qualified conservation contributions" of real estate, defined broadly to include both transfers of full title and easements in perpetuity. A "contribution" will qualify only if it preserves outdoor recreation areas, open space, natural habitat or historically important land areas and structures. Contributions of real property to governmental agencies or charities may qualify under this provision, subject to a host of highly technical requirements.[2]

Tax Consequences

As Table 1 illustrates on page 3, the Internal Revenue Code looks with favor on outright transfers to public charities during life. Such lifetime transfers also qualify for an unlimited gift tax charitable deduction. Similarly, if an outright transfer is made at death, the unlimited estate tax charitable deduction will be available.

BARGAIN SALES

Sometimes donors find themselves torn between their philanthropic intent on the one hand and their cash flow needs on the other. This is particularly true of collectors, who may have a large percentage of their net worth invested in their collections of art, antiques or jewels. One solution is to engage in a bargain sale,[3] a strategy that benefits both the charity (with a below-market sales price) and the donor (with a cash infusion from the sale). In this situation, the charitable deduction (for income, gift and estate tax purposes) will be calculated based on the "bargain" element of the sale, i.e. the difference between the actual fair market value of the property and the below-market sale price.[4]

DONOR ADVISED FUNDS

Donor advised funds have become increasingly popular in recent years because of their versatility and ease of operation, particularly in contrast to private foundations. The latest statistics show total donor advised fund assets at more than $70.7 billion in 2014.[5]

***A donor advised fund** will appeal to individuals who want to establish a tradition of giving by involving their family members in the grant-making process. And compared to family foundations, donor advised funds are less complex for the donor.*

Definition of a Donor Advised Fund

In simple terms, a donor advised fund is a separate account over which the donor and his designees have the power to recommend grants and investments.[6] The account is owned and held by a sponsoring charity, which may or may not receive a certain percentage of grants made.

Often, the sponsoring charity is a community foundation; less frequently, it is a large public charity such as a hospital or educational institution. Major financial institutions also offer associated donor advised funds. For these, the sponsoring charity is generally a newly created charitable organization. There are exceptions, however: the sponsoring charity for the Northern Trust Charitable Giving Program is an affiliate of a major community foundation.

How They Work

The charitable transfer occurs when the donor transfers assets to the donor advised account, either during life or at death. Grant-making from the account then occurs over the succeeding months and years. A key element is the ability of the donor and/or his designees to name family members and friends as "account advisors." In this way, a donor advised fund may be used to promote family philanthropy or create a giving circle.

Considerations

There are important differences among donor advised funds, differences beyond fee structure and available investment options. Depending on your situation and your charitable objectives, among the most important factors to consider are:

- Whether the fund will accept non-traditional assets such as closely held stock or partnership interests,
- The number of individuals who may serve as advisors during your lifetime or after your death,
- The presence or absence of a requirement to make distributions to the sponsoring charity,
- The ability to designate multiple charities to receive distributions at your death,
- Whether expert advice on grant recommendations is available from the sponsoring charity, and
- Minimums for contributions and additions.

Income and Gift Tax Consequences

A lifetime transfer to a donor advised fund is treated, for both property law and tax purposes, as a direct transfer to the sponsoring public charity. For this reason, the applicable income tax limitations are those for transfers to public charities: a 50% limitation for gifts of cash and a 30% limitation for gifts of long-term capital gain property. As noted previously, the gift tax charitable deduction is unlimited and will be equal to the fair market value of the cash and property transferred.

Because the sponsoring organization owns the donor advised fund account, all earnings of the account appear on the tax return of the sponsoring organization. Unlike those who establish private foundations or supporting organizations, a contributor to a donor advised fund does not need to file a separate tax return for the new entity. The gift tax rules are equally benign: currently, donors are not required to file a gift tax return solely because they have transferred cash or property to a donor advised fund.

Planning Tip:
Donors can maximize tax efficiencies by establishing a donor advised fund in a year when they expect a spike in income. Triggering events may range from an unusually large bonus to stock option exercises to the sale of a closely held business.

SITUATION	SOLUTION
A "triggering" event Mary and her husband Ted have two daughters. Their usual AGI is $200,000; in 2016, however, Mary also will receive a bonus of $50,000.	**Value: Mary and Ted perpetuate philanthropic values.** By contributing her bonus to a donor advised fund and naming her family members as fund advisors, Mary begins to develop a family tradition of giving. Because her contribution grows tax-free, the potential for future grant-making increases. From a tax perspective, Mary and Ted offset their 2016 taxable income with a $50,000 income tax charitable deduction. Longer term, Mary has removed the $50,000 – as well as any associated future earnings – from her taxable estate.

Transfers at Death

Transfers to donor advised funds can be made at death as well as during life, so long as the appropriate language is included in the donor's will or trust. For example, if Mary wished to include her family's donor advised fund in her estate plan, she could include a bequest of a fixed dollar amount to the "The Mary Donor Advised Fund, established as Donor Advised Account #123456 with Northern Trust Charitable Giving Program." As discussed above, an unlimited estate tax charitable deduction would be available to reduce estate tax in an otherwise taxable estate.

CHARITABLE TRANSFERS TO TRUSTS

Several different types of trusts qualify for the charitable deduction, ranging from qualified wholly charitable trusts to qualified "split-interest" charitable trusts. In this context, "split-interest" means that the trust benefits both individual beneficiaries and designated charities. Including a qualified split-interest charitable trust in your estate plan can enable you to maximize after-tax transfers to both individuals and to your favorite charity. This flexibility can be very useful when addressing a wide range of family situations.

Beneficiaries of a charitable trust may hold a variety of interests. In a *wholly charitable trust,* all interests in the trust are held by one or more charities. In a *split-interest charitable trust,* some beneficiaries hold a current interest (e.g. a current right to fixed distribution) while others hold a *future* interest (e.g. a right to receive the principal of the trust when it terminates).

Types of Charitable Remainder Trusts

As illustrated in Table 2 on the next page, there are four main types of approved charitable remainder trusts, each appropriate for a different type of donor situation. The fixed payments made by a charitable remainder annuity trust may suit those wanting steady cash flow. For donors funding with non-marketable assets (such as real estate or closely held stock) – or donors who wish to defer cash flow until retirement – a flip unitrust (that changes its payout when a trigger event occurs) may be the right answer. Regardless of the type of charitable remainder trust chosen, the present value of the remainder interest must be at least 10% of the initial fair value of the contributed property.

TABLE 2: COMPARISON OF CHARITABLE REMAINDER TRUSTS		
TRUST TYPE	TRUST PAYMENT FOR BENEFICIARY	COMMENTS
Charitable Remainder Annuity Trust	Fixed	Least flexible No additions permitted
Straight Percentage Unitrust	Fluctuates, based on trust value	Most popular Annual valuation required Additions permitted
Net Income Alternative Unitrust	Lesser of net income or unitrust amount "Make-up" may be permitted if income exceeds unitrust amount	Income beneficiary may be disappointed with distributions Annual valuation required May define income to include post-contribution capital gain Additions permitted
"Flip" Unitrust	On trigger event, flips from net income alternative unitrust to straight percentage unitrust	Sample trigger events: sale of real estate, retirement Annual valuation required Additions permitted

Benefits of Charitable Remainder Trusts

Well-established. In 1969, Congress enacted Internal Revenue Code Section 664, which lays out the requirements for a properly structured charitable remainder trust. As a result, donors can enjoy a comforting certainty: so long as their charitable remainder trust is drafted and operated in a way that complies with the tax rules, their charitable deduction is assured. Put somewhat differently, charitable remainder trusts are a well-established, fully approved wealth transfer strategy: the Internal Revenue Service even publishes charitable remainder trust forms to make life easier for donors and their drafters.[7]

Flexible. A second endearing quality of the charitable remainder trust is its flexibility. Charitable remainder trusts can be hand-tailored by a skilled drafter to fit a variety of situations. The beneficiary of a charitable remainder trust may be the donor, another individual(s), a trust(s) for the benefit of individuals, a corporation or a partnership. Individual beneficiaries often include the donor, the donor's spouse and/or the donor's children. Equally importantly, charitable remainder trusts are valuable estate planning tools for unmarried couples and the LGBT community, with each partner's documents creating a charitable remainder trust at death for the benefit of the other.

Tax Efficient. A third advantage of a charitable remainder trust is that it is tax efficient if properly structured. When used during life, it defers capital gains, while at the same time facilitating portfolio diversification and enhancing cash flow. The tax savings from gain deferral can be very significant.

SITUATION	SOLUTION
Family member with limited income Sam's daughter Sara is unmarried with no children and a limited income. Sam wants his estate plan to 1) provide additional cash flow to Sara over her lifetime and 2) fund a scholarship in his family's name at his alma mater.	**Value: Provide income to daughter and support to favorite charity.** Working with his team of advisors, Sam creates an estate plan that establishes a large charitable remainder unitrust that will provide cash flow to Sara for her life. At Sara's death, the balance of the trust will distribute to create a scholarship fund at Sam's college honoring Sam's family. Sam's estate is entitled to an estate tax charitable deduction equal to the present value of the remainder interest in the trust.
Two Goals: Increased cash flow and funding the arts Jennifer, age 61, desires increased cash flow but also wants to support the local art museum. She currently has a concentrated position of closely held stock, valued at $500,000 with a zero tax cost.	**Value: Provide retirement income to donor and support a special charity.** Using her closely held stock, Jennifer funds a charitable remainder unitrust with a unitrust percentage of 7%. When the trustee sells the $500,000 concentration, no gain is currently recognized: the trustee can reinvest the entire proceeds – unreduced by tax – creating a well-balanced portfolio. In year 1, Jennifer receives $35,000 in income from the unitrust ($500,000 x 7%); 7% payments (based on the annual value of the unitrust) continue for Jennifer's lifetime. From a tax perspective: ■ Jennifer's maximum available income tax charitable deduction (available in the year of contribution, with five-year carryover) is almost $143,500. ■ The $500,000 capital gain is deferred over the period that payments are made to Jennifer. Moreover, the tax character of the payments made to her by the charitable remainder unitrust depends on the composition of the trust's earnings. Assuming $5,000 interest income and $8,000 qualified dividends from the trust in the first year, the $35,000 unitrust payment is taxed to Jennifer as $5,000 ordinary income, $8,000 qualified dividends and $22,000 capital gain. Should Jennifer die before the entire $500,000 gain is taxed to her, the untaxed capital gain escapes tax forever.

Like Jennifer, many donors establish charitable remainder trusts during life to enhance their own cash flow and to facilitate diversification. Others, like Sam, establish a charitable remainder trust at death to provide cash flow for loved ones.

Types of Charitable Lead Trusts

In a charitable lead trust, the current interest is held by charity, and the future interest is held by family members. Like charitable remainder trusts, charitable lead trusts were created by Congress in 1969 and are an estate planning staple.[8] As Table 3 indicates, there are four different types of charitable lead trusts, with the charitable lead annuity trust working best for transfers not otherwise subject to the generation-skipping transfer tax. In today's low interest rate environment charitable lead annuity trusts are particularly powerful.

TABLE 3: COMPARISON OF CHARITABLE LEAD TRUSTS

TRUST TYPE	INCOME TAX DEDUCTION?	GOOD FOR GENERATION-SKIPPING TAX (GST) PLANNING?
Non-grantor Charitable Lead Annuity Trust	At trust level only (trust is taxable)	No
Non-grantor Charitable Lead Unitrust	At trust level only (trust is taxable)	Can allocate GST exemption at inception to achieve totally GST exempt trust Alternately, can reduce value of remainder to zero so no allocation is needed
Grantor Charitable Lead Annuity Trust	Donor gets income tax deduction at inception Trust income taxed to grantor	No
Grantor Charitable Lead Unitrust	Donor gets income tax deduction at inception Trust income taxed to grantor	Can allocate GST exemption at inception to achieve totally GST exempt trust Alternately, can reduce value of remainder to zero so no allocation is needed

Benefits of Charitable Lead Trusts

Charitable lead trusts are very useful in situations where family members have no immediate need for cash flow. The gift to individuals is deferred – allowing the donor to leverage her estate, gift or generation-skipping tax exemption to the fullest. The key here is the time value of money: a gift of a future interest has less current value than a gift of a present interest. Moreover, the present value of the remainder interest is calculated using the current "applicable federal rate," which is typically low compared to returns on strong investments. This means that, to the extent that individual enjoyment is deferred, the amount of a gift, estate or generation-skipping tax exemption needed to protect the non-charitable remainder from transfer tax is minimized. Likewise, to the extent the assets appreciate at a rate higher than the applicable federal rate, they have escaped gift and estate tax and may have also escaped generation-skipping tax. As noted above, in today's low interest rate environment, charitable lead annuity trusts are particularly appealing.

SITUATION	SOLUTION
Desire to encourage personal achievement Sam has three young children, David, Alex and John. Sam would like to share some of his considerable wealth with the three boys at his death. At the same time, he is concerned that early access to extensive funds will be a disincentive to personal achievement.	**Value: Provide cash flow to charity with remainder to children when they're older.** Sam establishes a charitable lead annuity trust that will provide cash flow to his favorite charity for 40 years. At the end of that term, the trust will distribute outright to the children, who by then should all be mature adults.

As illustrated in Example 3, if the charitable lead trust is established at death, an unlimited estate tax charitable deduction is available to a donor's estate for the present value of the cash flow to be received by charity. This deduction will reduce estate tax otherwise due from the donor's taxable estate. In addition, a properly structured charitable lead trust will avoid the separate generation-skipping transfer tax otherwise due on transfers that skip a generation, such as transfers to grandchildren. The generation-skipping transfer tax is a flat tax, imposed at a 40% rate, in addition to the gift or estate tax.

EXAMPLE 3: ILLUSTRATION OF ESTATE AND GENERATION-SKIPPING TAX SAVINGS

SCENARIO	CURRENT ESTATE PLAN	PHILANTHROPIC SOLUTION
Margaux, a widow in her 80s, has an estate currently valued at $10 million and passes away in 2014. She leaves one son, who is independently wealthy, and five grandchildren.	Estate distributes to Margaux's grandchildren	$10 million, 5% charitable lead unitrust 14-year term Initial beneficiary is Margaux's donor advised fund Remainder beneficiaries are Margaux's grandchildren
Estate Tax:	**$1,864,000**	**$0**[1]
Generation-skipping Tax:	**$798,857**	**$0**[2]
Net to Grandchildren:	**$7,337,143**	**$10,000,000**[3]

[1] *Due to $4,660,000 estate tax charitable deduction plus $5,340,000 estate tax exemption.*
[2] *Present value of future distribution to grandchildren is $4,660,000, which is covered by GST exemption.*
[3] *Expected future value of the remainder interest at the end of 14 years, assuming a constant 5% rate of return on investment.*

FAMILY FOUNDATIONS

By the end of 2014, there were more than 82,045 grant-making family foundations in the United States.[9] Unlike public charities, private foundations are supported not by the general public but by a very limited number of donors – typically a corporation or a high-net-worth family.

Establishing a Family Foundation

Some family foundations are organized as wholly charitable trusts; others are wholly charitable not-for-profit corporations. Most are grant-making foundations that make grants to public charities selected by their trustees, board or grant-making committees. A smaller number are operating foundations that directly fulfill a charitable function, typically by providing some type of service to the public, e.g. operating a museum or a soup kitchen. Most private foundations are family foundations, controlled by individual donors and their descendants, advisors and friends;[10] the balance are corporate-sponsored.

Tax Consequences

Although private foundations are exempt from income tax, most pay a 2% excise tax on their net investment income, including capital gains.[11] Private foundations are also subject to a variety of penalty taxes designed to ensure that donors do not benefit, directly or indirectly, from their assets and income.[12]

The income tax charitable deduction for lifetime transfers to private foundations is limited by the "percentage of adjusted gross income" rules summarized previously in Table 1. Gifts of cash are subject to a 30% limitation; gifts of long-term capital gain property are subject to a 20% limitation. Importantly, the income tax charitable deduction for transfers to a private foundation of long-term appreciated assets other than publicly traded stock (such as real estate or closely held stock) is generally further limited to tax cost. For this reason, most lifetime transfers to private foundations are funded with cash or long-term publicly traded stock.

In contrast, if a transfer to a private foundation is made at death, the unlimited estate tax charitable deduction is available, whether the asset being transferred is cash, publicly traded securities, real estate or closely held stock.

Administrative Complexity

One downside of a private foundation is its administrative complexity. For example, the tax rules require annual distributions equal to at least 5% of average monthly asset value, with a 30% penalty tax on late payments. There are also Byzantine rules on self-dealing, excess business holdings, jeopardizing investments and excess expenditures, all with associated penalty excise taxes. Finally, there is the 2% tax on net investment income – which must be paid in estimated quarterly installments. To keep their foundation on the straight and narrow, donors typically to their accountants or a financial services provider who will serve as agent or trustee.

Family Philanthropy

Administrative complexities notwithstanding, many donors conclude that a private foundation is the ideal vehicle to promote family philanthropy. A typical expectation is that the foundation will unite the family as it works together toward common goals. This expectation is more likely to be fulfilled if the foundation is established during the original donors' lifetimes, so that family members can share first-hand the donors' passion and vision. Conversely, it is not likely that a deeply divided family will find itself united through a family foundation, whether or not the donors are alive.

What if your finances will allow you to establish a significant private foundation at death but not during life? Many advisors suggest "test-driving" the concept with a pint-sized private foundation while you are alive. Depending on what you learn about family dynamics, you may decide to create separate family foundations for each family member at your death – or to establish a donor advised fund for the entire family, with each family member as an advisor.

SITUATION	SOLUTION
Desire to instill a family legacy of giving Hal and Martha are the parents of three school-aged children – Kendra, Jason and Holly. Their estate has a current value of $10 million. They feel strongly about giving back to the community and want to pass this passion on to their children.	**Value: Hands-on involvement in philanthropy.** After evaluating their options, Hal and Martha decide to establish a $1 million grant-making family foundation, the mission of which is to broaden educational alternatives in the local community. Hal and Martha will serve as board members, with Kendra, Jason and Holly as junior board members. By being actively involved in the grant-making process, the children learn not only about philanthropy, but also are introduced to portfolio management and the importance of budgeting and cash management. From a tax perspective, a $1 million income tax charitable deduction is available in the year of contribution, with a five-year charitable contribution carryover. The applicable income limitation is 30% for gifts of cash and a 20% for gifts of publicly traded stock. Furthermore, assets grow income tax free in the foundation, subject only to a 2% excise tax on net investment income.

Family Foundation or Donor Advised Fund?

As suggested by Table 4, donor advised funds share two of the most appealing characteristics of private foundations: donor involvement and family participation. However, donor advised funds are more tax efficient for lifetime gifts – with a 50% income limitation for gifts of cash and a 30% limitation for gifts of publicly traded stock.

The trade-off is that private foundations offer the donor more control. With a donor advised fund, the donor makes recommendations about grants and investments with final approval coming from the sponsoring charity; with a private foundation, final approval comes from the donor and her board. On the other hand, donor advised funds are far less administratively complex than a private foundation, with no taxes on net investment income and no separate tax return. In the end, donors choose the appropriate philanthropic solution based on a variety of factors, including their available time and their tolerance for complexity.

TABLE 4: COMPARISON OF PRIVATE FOUNDATIONS AND DONOR ADVISED FUNDS

PRIVATE FOUNDATION	DONOR ADVISED FUND
Wholly charitable trust/corporation	Not a separate entity Funds belong to sponsoring charity
Grant recipients are generally public charities	Grant recipients must be public charities
Designated individuals choose charities	Designated individuals recommend charities
Opportunity for donor/family participation	Opportunity for donor/family participation
Tax-exempt, but pays 2% federal excise tax	Part of tax-exempt sponsoring public charity

CONCLUSION

Whatever your age, income level or family situation, there is an appropriate philanthropic solution. For some, outright gifts will remain the vehicle of choice. For others, searching for a higher level of personal involvement, the answer is a family foundation – or even a private operating foundation. For still others, the flexibility of a charitable remainder trust or a donor advised fund is most appealing. Whatever your final choice, we believe that you will be most satisfied if your choice is an informed one, reached by considering the full diversity of the available philanthropic solutions.

ABOUT THE AUTHOR

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Prior to joining Northern Trust, Suzanne spent 26 years as a partner at Chapman and Cutler LLP in Chicago, ultimately leading the firm's trusts and estates practice, representing individuals, charitable organizations and corporate fiduciaries in a full range of wealth planning and fiduciary matters, including philanthropy, domestic and international wealth planning, and fiduciary administration.

Suzanne is an adjunct professor in the Master of Laws in Taxation Program at Northwestern University Law School and also a frequent speaker and author. She has been quoted in publications such as The Wall Street Journal and Bloomberg and has received numerous professional honors and recognitions, including selection for inclusion in Best Lawyers in America in Trusts and Estates. Suzanne earned her bachelor's degree with distinction in economics and sociology from the University of Michigan. She received her law degree, cum laude, from the Loyola University Chicago School of Law and a master of laws in taxation from the DePaul University College of Law.

In the civic community, Suzanne supports diversity and education initiatives. She has been involved with the executive committees and boards of directors of Gads Hill Center, and the Chicago Coalition of Women's Initiatives in Law. Suzanne is chairperson of the board of directors of Chicago Scholars, a college access program for high potential urban students, and a trustee of Hope College.

Suzanne is a fellow of the American College of Trust and Estate Counsel and a member of the Chicago Bar Association, Chicago Estate Planning Council, American Bar Association, International Bar Association and the International Society of Trust and Estate Practitioners.

ABOUT NORTHERN TRUST

Northern Trust Corporation (NASDAQ:NTRS) is a leading provider of investment management, asset and fund administration, fiduciary and banking solutions for corporations, institutions and affluent individuals worldwide. A financial holding company headquartered in Chicago, Northern Trust serves clients in more than 40 countries from offices in 18 U.S. states and 16 international locations in North America, Europe, the Middle East and the Asia-Pacific region.

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FOOTNOTES

1. *National Philanthropic Trust, 2015 Donor-Advised Fund Report, Tables 2 & 3 (2015).*
2. *Internal Revenue Code Section 170(h).*
3. *IRC Sections 170 and 1011(b).*
4. *For a discussion of the "related use" test that applies to tangible personal property for income tax purposes, see "Diversity of Philanthropic Funding Alternatives."*
5. *National Philanthropic Trust, 2015 Donor-Advised Fund Report, Tables 2 & 3 (2015).*
6. *Internal Revenue Code Section 4966(d)(2).*
7. *See, e.g., Rev. Procs. 2005-53 through 2005-59, 2005-34 I.R.B.*
8. *See Rev. Procs. 2007-45 and 2007-46, 2007-29 I.R.B., for sample charitable lead annuity trust provisions; Rev. Procs. 2008-45 and 2008-46, 2008-30 I.R.B., for sample charitable lead unitrust provisions.*
9. *National Philanthropic Trust, 2015 Donor-Advised Fund Report, Tables 2 & 3 (2015).*
10. *Id.*
11. *Internal Revenue Code Section 4940.*
12. *Internal Revenue Code Sections 4941-4945.*