TAX BENEFITS OF CREATING A PRIVATE FOUNDATION

Reduced Income Tax Is Just the Beginning.

In addition to the many philanthropic reasons a donor might have for establishing a private foundation, there are also short-term and long-term tax benefits to consider. A donor may be able to take advantage of four main tax benefits when he or she gives to a private foundation:

1. Reducing the donor's income tax for each year in which a contribution is made;
2. Income-tax-free growth of assets which have been contributed to the foundation;
3. Avoiding capital gains taxes depending on the characteristics of property contributed; and
4. Reducing or eliminating potential estate taxes.

A foundation can help your client avoid capital gains liability and reduce or eliminate estate and gift taxes.

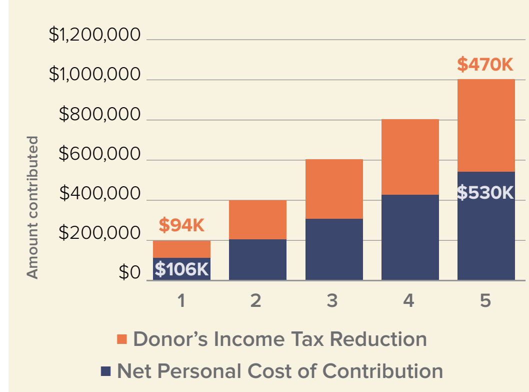
INCOME TAX SAVINGS

One of the more immediate tax benefits is that a donor will receive an income tax deduction for any amount contributed to a private foundation of up to 30% of the donor's adjusted gross income (AGI).

Consider the case of Jack, a successful businessman working in finance in a high-tax state like New York and earning an adjusted gross income of $1,000,000 each year. His combined federal and state income tax rate is approximately 47%. Jack 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. Jack 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.

Jack will owe nearly $470,000 a year in income taxes based on his adjusted gross income. 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). Based on a taxable income of only $800,000, if his income tax rate remains approximately the same, he will now owe $376,000 a year.

Cumulative Income Tax Savings



By making this yearly contribution, Jack will save nearly $94,000 per year in income taxes over the course of the five year period. In addition, if he continues making donations each year, after five years he will have contributed $1,000,000 to his foundation at a net personal cost of $530,000. Thus, the immediate income tax deduction Jack receives by contributing to the foundation annually lowers his cost of giving to charity.

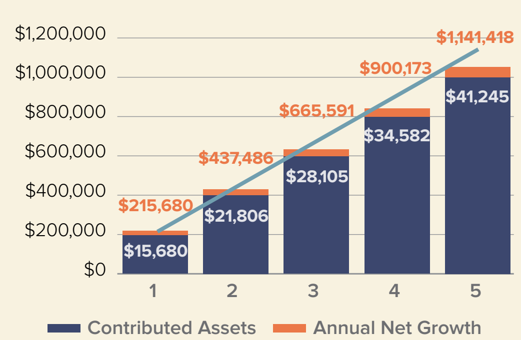
INCOME-TAX-FREE GROWTH OF ASSETS

Consider the example from the previous section where Jack contributed $200,000 to his private foundation every year over the course of five years. Because Jack's 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 2% excise tax, the private foundation's assets will have grown by nearly $150,000. This income-tax-free growth is despite also having made over $110,000 of charitable grants in satisfaction of the Minimum Distribution Requirement (MDR) during these years. By the time Jack retires, his foundation will have a substantial endowment, and he can focus on creating a lasting charitable legacy.

2%

Instead of capital gains taxes, private foundations pay a nominal excise tax on the sale of appreciated assets.

Income-Tax-Free Growth of Assets



(This chart assumes an 8% growth rate net of the 2% excise tax & the 5% MDR)

	YR. 1	YR. 2	YR. 3	YR. 4	YR. 5
Year Beginning	$200,000	$215,680	$637,486	$865,591	$1,100,173
8% Growth	$16,000	$33,255	$50,999	$69,247	$88,014
2% Excise Tax	-$320	$-665	$-1,020	$-1,385	$-1,760
5% MDR	$0*	$-10,784	$-21,806	$-33,280	$-45,009
Net Growth	$15,680	$21,806	$28,105	$34,582	$41,245
Year End	$215,680	$437,486	$665,591	$900,173	$1,141,418

*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 gifts to a private foundation, donors may also be able to avoid paying capital gains taxes by donating highly appreciated assets to a private foundation.

Jack's sister, Christine, founded her publicly traded technology company on the West Coast and became very successful. Her adjusted gross income each year is $3,000,000. Because Christine lives in a high-tax state like California, her combined federal and state tax rate is 47% (a combined rate of 29% on capital gains). Christine has seen Jack's personal satisfaction and philanthropic success with his private foundation and is interested in establishing a foundation 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, Christine wants to make one initial gift at the outset. She has $2,000,000 in stock in her company with a cost basis of $500,000. She does not want to incur high capital gains taxes.

If Christine sells the stock, she will owe $435,000 in combined state and federal capital gains taxes. 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 ($2,000,000). Although this exceeds 20% of her AGI, she can carry this deduction forward for five years and, over time, she will save $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% or 2% on the net capital gains. By participating in the foundation, Christine's children will learn about smart philanthropy.

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.

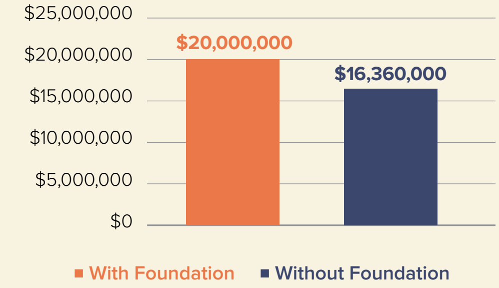
Consider Jack and Christine's parents, Mr. and Mrs. Abbott, who are proud to see that both of their children have been not only financially successful, but have also developed strong charitable interests. Mr. and Mrs. Abbot have combined assets of $20,000,000 and want to leave a portion of their wealth to their children and grandchildren, but are also interested in leaving some of their assets to charity. Mr. and Mrs. Abbott are retired and have moved to a state like Florida that has no state-level income tax or estate tax. Their assets are largely tied up in real estate and art such that their adjusted gross income is not large enough to justify a charitable gift simply for income tax reduction.

If Mr. and Mrs. Abbott decide to pass all of their assets to their family, their combined estates will owe over $3,600,000 in estate taxes (assuming a federal estate tax exemption of $5.45 million).
If instead the Abbotts decide to leave the federal exemption amount ($5.45 million) to each of their children ($10.9 million total) and the balance of their estate ($9.1 million) to a private foundation that is funded when the second of them 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 these values in future generations of Abbotts who will have the opportunity to come together over their common philanthropic goals. If their children have already established their own foundations, the Abbots could instead simply leave the taxable portion of their assets to those foundations.

Other advantages of a private foundation:

- **Tax-advantaged asset growth**
- **Five-year income tax deduction carry forward**
- **Exist in perpetuity**

Amount Available to Family for Personal & Charitable Goals



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Now in our second decade, Foundation Source provides its services to more than 1,300 family, corporate, and professionally staffed foundations, of all sizes, nationwide. We work in partnership with wealth management firms, law firms, accounting firms, and family offices as well as directly with individuals and families. Foundation Source is headquartered in Fairfield, Connecticut.

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