Giving Like a Zuckerberg or a Regular Joe: Alternatives to Private Foundations

~ E. John Wagner II

Private foundations typically appeal to charitably minded individuals who plan to make large, recurring, immediately deductible charitable gifts into an entity over which they and future generations can retain significant control. However, private foundations bear significant restrictions in the form of mandatory annual distributions, limitations on the percentage of income and value eligible for full charitable income tax deductions, and heightened scrutiny from the Internal Revenue Service (IRS). For donors who require less control, one of the alternative approaches described in this article may prove more efficient.

Public Charities

A public charity is a tax-exempt organization that is not classified as a private foundation. Public charities are not subject to the mandatory annual distribution rules that apply to private foundations. Most public charities must receive donations from a diversity of donors, governmental grants, charitable programs, or a combination of these. As a donor, you may consider forming a public charity if you expect to solicit and receive significant donations from such other sources. Alternatively, you can contribute to an existing operating public charity or to a supporting organization designed to manage the public charity's endowment fund.

Public charities are subject to fewer restrictions on the deductibility of donated assets and on the percentage of annual income a donor may deduct upon contributing to the organization. As a practical matter, however, if you want to form your own charitable vehicle, you may find it difficult to solicit enough non-family donations to satisfy the requirements to become a public charity while also retaining practical control over the organization. A public charity, therefore, is most appropriate for a donor who has a vision for a long-term operating charity rather than a portal through which to make donations to other charities.

Community Foundations

Community foundations are tax-exempt organizations qualifying as public charities. They pool donations from many people, but they offer donors varying levels of direct and indirect control while providing oversight for further contributions to operating tax-exempt organizations. Donations to community foundations qualify for an up-front income tax deduction to a public charity, which is more favorable under the tax laws than donations to a private foundation. A community foundation may focus its efforts on supporting operating tax-exempt organizations in the geographic area where it is located, while other community foundations operate on national platforms. There are many national community foundations that are sponsored by national or international investment management firms. Community foundations focused upon supporting tax-exempt organizations in a particular geographic area, however, usually feature local governance.

For most donors, the cost of giving and maintaining funds for future repeat contributions to operating tax-exempt organizations at a community foundation is substantially lower than the cost of creating and maintaining a private foundation. This cost savings, combined with the greater flexibility in income tax deductions and the absence of restrictions on the timing of redistributions to other tax-exempt organizations, often makes giving through community foundations a more desirable option. Depending upon the level of control you wish to retain and the amount of independent authority you want the community foundation itself to provide with respect to future giving to other tax-exempt organizations, you and other donors can select from different giving vehicles. Although different community foundations use varying terminology, we may classify the primary community foundation giving alternatives into four groups: unrestricted donations, designated funds, field of interest funds, and donor-advised funds.

Unrestricted donations to a community foundation are not subject to future control by donors. These donations allow the community foundation's governing body to choose the best place to redirect those funds. The lack of control and future involvement by the donor make this form of donation comparatively rare. It does, however, sometimes occur when a donor with broad philanthropic intent recognizes that a particular community foundation has a track record of effectively managing and redistributing donations in meaningful ways in the community it serves.

A designated fund is a segregated fund consisting solely of the donor's donations, which the community foundation must distribute to certain, specified, operating tax-exempt organizations in the future. The donor may relinquish control as to the exact amount and timing of those contributions from the designated fund; however, the pool of eligible recipients is limited to the designated organizations. Donors may establish designated funds when they have particular charitable recipients in mind but do not want to oversee the actual distribution of funds.

A field of interest fund is similar to a designated fund, except that it is not restricted to a predefined set of recipients. Instead, donors may designate particular philanthropic areas to which their resources should be dedicated, such as education, fighting homelessness, or the arts. The community foundation then decides the best way to distribute the funds and determines the timing of distributions to recipient tax-exempt organizations. Scholarship funds are a common field of interest fund.

A donor-advised fund is a segregated fund within a community foundation consisting solely of assets designated by a particular donor. The community foundation technically controls the timing and amount of the contributions of funds within a donor-advised fund; however, the community foundation openly solicits suggestions from the donor and designated donor advisors to the fund as to the timing and amount of such contributions. As a practical matter, assuming that the advisors' suggestions are consistent with the community foundation's tax-exempt purposes recognized by the IRS, community foundations almost always follow the recommendations of their donors.

Community foundations streamline the system of recommending and approving donor-advised fund donations to other tax-exempt organizations through a form application or Internet portal process whereby their donors submit information regarding the donations, the community foundation reviews the submitted information within a few days or hours, and the community foundation then promptly disburses approved donations in accordance with the donor advisors' recommendations.

When a donor contributes to the donor-advised fund, the donor still receives an up-front income tax deduction that is exempt from the private foundation deduction limitations, even though the ultimate distributions to operating charities may occur over a period of many years. This has made donor-advised funds a popular charitable giving tool. The low cost of giving to a donor-advised fund has added to its popularity. Although a donor-advised fund's investment management and maintenance fees usually exceed those of a non-charitable (i.e., personally held) investment account, the cost for most donors is significantly lower than that of creating and maintaining a private foundation, particularly for persons considering routine gifts of thousands, tens of thousands, or hundreds of thousands of dollars, rather than millions of dollars. Given these benefits, we expect donor-advised funds to remain a popular option for planned charitable giving.

Giving Through For-Profit, Benefit, and Social Purpose Entities

In 2015, Mark Zuckerberg and his wife, Priscilla Chan, pledged to transfer 99 percent of their Facebook shares over the course of their lives to the Chan Zuckerberg Initiative. While other billionaires have pledged to donate their fortunes for charitable purposes, Mrs. Chan's and Mr. Zuckerberg's announcement drew extra attention in the estate planning world because of the unique structure of their gift. The Chan Zuckerberg Initiative is a for-profit Delaware limited liability company, not a tax-exempt public charity or private foundation. They explained that they did not intend to receive an up-front charitable income tax deduction for donating Facebook shares for charitable purposes. Rather, they seek to achieve their philanthropic goals free of the myriad regulatory restrictions placed on tax-exempt organizations. They value control over the donated shares and flexibility more than the current income tax benefit of an up-front income tax deduction derived from more traditional income tax planning.

Mrs. Chan's and Mr. Zuckerberg's creation of the Chan Zuckerberg Initiative is a prominent example of a trend to use for-profit entities, or quasi-for-profit entities, to undertake activities traditionally associated with tax-exempt organizations. While these organizations may or must pay income tax on profits from their activities and cannot freely deduct expenditures (which may be classified as non-business, non-charitable personal expenditures of the earners in many circumstances), these organizations provide a vehicle free from the governmental regulations imposed upon tax-exempt organizations through which individuals may pool their efforts to accomplish charitable purposes. It will be interesting to see whether other entrepreneurs will consider this new option for giving.

Some states have statutorily recognized a form of corporation or limited liability company that is not solely for not-for-profit or for-profit purposes. Rather, these organizations may serve a hybrid purpose, which may include for-profit goals, as well as achieve a specific social purpose. Alternatively, such an entity may be required to take into consideration the needs of constituencies, which are typically ignored in the purposes of for-profit corporations and limited liability companies. For example, an entity benefitting one or more constituencies, sometimes called a "benefit" entity, may take into consideration the needs of the environment, employees, or other broad constituencies in determining how the company will operate an otherwise for-profit enterprise traditionally undertaken through a purely for-profit business organization that would make decisions solely based on maximizing the profitability of that organization.

Florida recognizes two forms of such organizations: The *social purpose corporation* is organized to serve a particular social goal in addition to any for-profit motivations. A Florida *benefit corporation's* governance takes into account a broader set of goals and constituencies, in addition to its for-profit purposes, in making decisions. These hybrid-purposed entities are a relatively new phenomenon in the United States and in Florida. It remains to be seen whether they gain traction, given that they do not offer an immediate income tax deduction and are not exempt. For donors with intentions similar to Mrs. Chan and Mr. Zuckerberg, though, such organizations may prove useful in differentiating the purposes and uses of capital from that of either purely for-profit or not-for-profit organizations.

For you, choosing the right form of giving depends on your personal goals. Setting those goals in advance will help simplify and streamline the selection of the legal tool to help you make the difference you want to make in the world.

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