

PROFESSIONAL TAX & ESTATE PLANNING NOTES

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1 Transferring a Private Foundation to a Community Foundation

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How a Private Foundation Can Use the Grantmaking Expertise of a Community Foundation

Wealthy people have used private foundations for more than a century to carry out their philanthropy, but the recent increase in the number of private foundations has been nothing short of astonishing: from 36,800 in 1996 to 64,400 in 2006. In addition to accelerating tax deductions, foundations can help their donors involve family, focus grantmaking, and get visibility for their giving if they wish.

Giving should be satisfying and fun even though the purpose is often serious, but private foundations can also become a burden. They can be time-consuming and expensive, especially considering these statistics: Of the estimated 37,500 family foundations in 2007, 60 percent reported assets of under \$1 million; 48 percent

reported grants of \$50,000 or less. Even large family foundations run into unexpected problems.

Decisions about who will run the foundation, its grantmaking priorities and strategies, and the details of the grantmaking process may be more work than the family anticipated. The filing requirements are many and the tax rules complicated. Family members may squabble over what causes to support. Over time, the donor's family may lose interest or be unable to administer the foundation; and new trustees may be hard to find. And, in a difficult economy with tumbling markets, the loss of assets and reduction in investment income, along with the high costs of maintaining a foundation, can reduce the amount of money available for grantmaking.

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In any of these situations, transferring a private foundation to a community foundation such as The New York Community Trust may be a sensible alternative. A community foundation is an aggregate of individual charitable funds, and each fund may bear the donor's name or preserve anonymity. It can be endowed or allow for principal invasion. It can be set up for a particular purpose or left unrestricted. In addition, funds in a community foundation benefit from the administrative sophistication of a major institution, and their donors, and any advisors they may name, can call on the expertise and knowledge of the Trust's staff to help them with their grantmaking. In addition, because a community foundation is a public charity, the fund pays no excise taxes, is exempt from private foundation reporting requirements, and operates with minimal administrative costs, leaving more money for charity. And the fund can continue forever, carrying on the family name.

Section 507 of the Internal Revenue Code permits the termination of a private foundation in either trust or corporate form and distribution of its assets to a public charity, including a community foundation. More than 50 private foundations have terminated and transferred their assets to The New York Community Trust. With assets of approximately \$1.5 billion, The Trust comprises more than 2,000 charitable funds established by individuals, families, and businesses, and has provided expert philanthropic stewardship and grantmaking for 85 years. The following discussion examines the potential benefits and explains the procedure for terminating a private foundation and transferring its assets to a fund in The Trust.

When a Transfer Makes Sense

To Save Time and Money

Many private foundations find that meeting federal and state regulatory requirements drains both human and charitable resources.

The basic operating costs of a private foundation can be significant. Minimum requirements include accounting, auditing, and preparation of federal and state reports; publication of an annual report; and legal counsel to monitor regulatory changes and avoid potential liability for self-dealing, excess business holdings, insufficient distribution of income, or improper grantmaking. Few small foundations can afford staff, yet the unique administrative burdens of some foundations may require support. In addition, the 1 or 2 percent excise tax on private foundation investment income reduces funds available for charity.

In the case of a trust-form private foundation, a bank trustee may find it too small to be efficiently managed as a discrete entity and may resign or decline to serve as trustee. When a private foundation is transferred to a fund in The Trust, it has the benefit of expert financial management regardless of its size.

The fund will enjoy the economies of scale of a large institution. A variety of investment vehicles are available and the community foundation handles the accounting, reporting, and grantmaking. The fee to manage a \$1 million fund in The New York Community Trust is modest, \$6,000 to \$12,000 depending on the investment vehicle chosen.

The savings in administrative costs can be used to increase grants to charities, a benefit particularly criti-

cal during economic downturns, when charities typically confront a rise in need with a decline in assets.

To Ensure Continuing Management

Private foundation boards evolve unpredictably over the years. Second- and third-generation family members may not share the donor's enthusiasm for the environment, or arts, or hunger programs. Advisors and friends age, and new trustees may be needed to help carry on. But some foundations have a difficult time identifying replacements because of the time commitment and fiduciary responsibilities involved.

When a private foundation is transferred to The New York Community Trust, it becomes part of a respected permanent institution, along with funds established by Rockefellers, Belmonts, and Astors. The trustees' administrative and fiduciary responsibilities cease and are shifted to a board of 12 New Yorkers selected for their knowledge of philanthropy and community needs. An experienced staff, well versed in all aspects of foundation work, is responsible for operations. If desired, the foundation's assets can be transferred into a donor-advised fund and some or all of the private foundation trustees may continue as advisors.

To Maximize the Effectiveness of Grantmaking

New York City has more than 27,000 operating charities; new ones are established and others close every year. Over time, small foundations with limited staff can find it difficult to keep up with changing community needs and evaluate new strategies and organi-

The extensive grantmaking resources and professional expertise of an organization such as The Trust can maximize the philanthropic impact of both small and large funds.

zations. Private foundations with specific charitable purposes may find that their charitable goals have become outdated or unnecessary.

Community foundations can respond to changes as they occur. A donor can authorize The Trust to allocate charitable funds to recipients either in particular areas of interest or, more broadly, wherever The Trust determines money is needed. Donors can rely on the board of the community foundation to ensure that their generosity is always used to meet contemporary needs, even when circumstances have changed. The extensive grantmaking resources and professional expertise of an organization such as The Trust can maximize the philanthropic impact of both small and large funds.

To Ease Ongoing Contributions

Transferring a private foundation's assets to a fund in a community foundation is also useful when the founder or the family expects to continue to make contributions. As a general rule, a community foundation, as a public charity, offers preferential tax treatment of charitable gifts and greater flexibility with respect to the kinds of assets contributed and annual distribution requirements than do private foundations.

Procedures for Dissolution and Transfer

Section 507(b)(1)(A) of the Internal Revenue Code permits a private foundation to transfer its assets to a fund at a community foundation, if it distributes all of its net assets to one or more organizations described in Section 170(b)(1)(A) [other than in

clauses (vii) and (viii)] of the Code, each of which has been in existence and so described for a period of at least 60 calendar months immediately preceding the distribution.

The New York Community Trust is actually the umbrella name for two organizations: The New York Community Trust, an unincorporated association of charitable trusts, and Community Funds, Inc., a New York not-for-profit corporation; they share a board and staff and together operate as the community foundation serving metropolitan New York. Both The Trust and Community Funds meet the above requirements and are organizations to which a private foundation may distribute its assets under Section 507(b). (Whether a private foundation terminates its status by transfer to a component fund in trust with an authorized bank trustee as part of The New York Community Trust or in Community Funds is determined by the private foundation's board. The service we provide is the same.)

The following section describes the process by which a foundation in New York State, in either corporate or trust form, may transfer its assets to a community foundation, using The New York Community Trust as an example. Foundations organized under the laws of other states should check procedures with local counsel.

Corporate Form Transfers

A Section 507(b) transfer by a corporation that is subject to the Not-for-Profit Corporation Law

(whether originally organized thereunder or under the Membership Corporations Law or pursuant to a special act of the Legislature) is accomplished by dissolution under Article 10 of the Not-for-Profit Corporation Law (N-PCL §1001 et seq.).

N-PCL §1001 provides for the adoption of a Plan of Dissolution and Distribution of Assets by the corporation.¹ N-PCL §1002 requires that the Plan have the approval of a Justice of the Supreme Court and, if the statute creating or authorizing the formation of the corporation required approval by a governmental body or officer for the formation of the corporation, the approval of such governmental body or officer.

Application to the Supreme Court for approval is by verified petition, with certified copies of the approvals attached, and is made upon ten days' written notice to the Attorney General. The Plan must include a statement that the assets held for charitable purposes will be distributed as required by any gift instruments or to one or more charitable organizations engaged in activities substantially similar to those of the dissolved corporation, identify the recipient(s) of such assets, and append the charter documents of each recipient, along with certain financial statements and certification of exempt status. If assets are to be transferred to a component trust in The New York Community Trust, the Plan must also have appended a copy of the proposed instrument under which one of the authorized bank trustees would receive and hold the assets of the corporation to be dissolved. If the trans-

¹ Article 10 of the N-PCL was revised in 2005 to simplify the procedure for dissolving a not-for-profit corporation without assets (other than a reserve of less than \$25,000 to be used for the costs of winding up the affairs of the corporation) and with liabilities of less than \$10,000. However, the Attorney General has taken the position that a private foundation that makes a grant of its assets to a charity in preparation for dissolution under the simplified procedures of Article 10 is required to obtain its approval of such grant under N-PCL §510, which governs the disposition by a corporation of substantially all of its assets. The Attorney General's position is controversial; many practitioners believe that the provision properly applies only to the disposition of assets for consideration and have questioned the extension of its application to charitable grants. Nevertheless, counsel advising a client on the termination of a private foundation with assets and seeking to avoid the more arduous requirements of Article 10 with respect to that termination by making a substantial charitable grant should be prepared to comply with N-PCL §510.

WHEN A TRANSFER MAKES SENSE *Some Examples*

fer is to Community Funds, the Plan must append a form of letter agreement between the dissolving corporation and Community Funds (N-PCL §1001).

If the Attorney General's office finds the Plan satisfactory, it will endorse a waiver of notice and indicate that it has no objection to the granting of judicial approval. The Plan may then be submitted to the Supreme Court.

Once the Plan has been approved, the corporation has 270 days in which to carry it out. It must then submit to the Attorney General evidence that it has disposed of its assets and paid its liabilities in accordance with the Plan. Once the Attorney General has affixed to the Plan an affirmation confirming that it has been carried out in accordance with its terms, a certificate of dissolution bearing the approval of the Attorney General, and any other required governmental bodies or officers, can be delivered to the Department of State (N-PCL §1003). In addition, the approval of the State Tax Commission must be attached to the certificate before submission to the Department of State (N-PCL §1004). The corporation is dissolved when the certificate is filed by the Department of State (N-PCL §1004).

Forms for dissolving a corporate-form foundation organized under the laws of New York State are available on the New York State Attorney General's website, at www.oag.state.ny.us/bureaus/charities/guides_advice.html.

Trust Form Transfers

The procedure for a Section 507(b) transfer by a New York charitable trust (whether established *inter vivos* or under the will of a New York decedent) will vary

DREXEL BURNHAM LAMBERT FUND

In its heyday, the investment firm of Drexel Burnham Lambert established a private foundation to carry out its charitable objectives. When Drexel liquidated, its foundation's board decided to terminate the foundation into a fund in The New York Community Trust, assured that we would carry out their purpose—to help children, youth, and families. Since it was created in 1995, the fund has supported hundreds of programs, from protecting disabled children, to involving their poor parents in their kids' education, to providing mentors for young people in foster care.

THE JOHN AND JANE DOE FUND

Two co-executors could not agree on control of a private foundation dedicated to cancer research and care. In 1989, they decided to terminate the foundation and transfer its assets to The Trust. Each co-executor now advises on grants from one-half of the fund's income.

MAJOR FUND

Cedric Major established a private foundation in 1956. After his death, his widow and the two other remaining trustees decided that the administrative burden was too much and terminated the foundation. They set up a fund that they advised for nearly 30 years, until the last person died in 1998. Today, this unrestricted fund supports legal services, feeding programs, and local environmental projects. It is a key element in The Trust's efforts to protect the safety net for the City's poor residents.

depending on the amount of discretion the trustees of the trust have over the charitable distribution of principal and income of the trust.

(a) Complete discretion over principal and income

If the trustees have complete discretion, an agreement² is prepared for execution by the trustees of the terminating trust and (i) one of the banks or trust companies that have adopted the *Resolution and Declaration of Trust creating “The New York Community Trust,”* if a transfer is to The New York Community Trust or (ii) Community Funds. The agreement should contain basic information with respect to the creation of the trust, its purposes, and a statement that the trustees, in the exercise of their discretion, have determined that a transfer to The New York Community Trust or Community Funds is in the best interests of the charitable trust. If the transfer is to The New York Community Trust, the agreement will take the form of a trust agreement, which The Trust’s president must approve. In some circumstances, it may be desirable to ask the Attorney General to review the agreement before execution.

If the trustees of the terminating charitable trust wish to obtain the protection of judicial approval of their actions, they may do so in the course of a judicial proceeding to settle their final account as trustees. Such a proceeding would be on notice to all creditors, claimants, the Attorney General, the designated corporate trustee or Community Funds, and the Trust’s president.

(b) Incomplete discretion over principal and income

If the trustees of the terminating charitable trust do not have complete discretion with respect to the distribution of a trust’s principal and income, they would bring a proceeding under Section 8-1.1(c)(1) of the New York Estates, Powers and Trusts Law. The procedure generally followed for terminating a charitable trust and transferring its assets to The New York Community Trust under this Section is set forth below³:

- (1) Prepare a petition for execution by the trustees of the terminating trust, containing:
 - (a) Facts with respect to the creation of the trust, its purpose, and a showing that circumstances have so changed since the establishment of the trust as to render it impracticable to continue its present activities;
 - (b) A copy of the *inter vivos* trust instrument or the will of the decedent pursuant to which the charitable trust was established;
 - (c) A statement of account and a statement of assets and liabilities;
 - (d) A showing that the purposes of the trust can be carried on under the auspices of The New York Community Trust or Community Funds; and
 - (e) A copy of the proposed agreement to be executed by trustees of the charitable trust

² Please call us for copies of these forms of agreement.

³ It should be noted that the extent to which the trustees of a charitable trust are required to account or should account for their own protection is not clear with respect to such a *cy pres* proceeding.

and the designated corporate trustee setting forth the terms governing the fund to form part of The New York Community Trust or a copy of the proposed agreement with Community Funds.

By establishing a fund in The New York Community Trust, your clients will regain the satisfaction of supporting the charitable causes that are important to them.

- (2) Present the petition to the Attorney General's office for informal review prior to filing in court.
- (3) An order to show cause or citation would issue to all creditors, claimants, the Attorney General, the designated corporate trustee or Community Funds, and the president of The New York Community Trust, directing them to show cause why an order should not be made providing for payment of all claims, discharging the trustee from further liability, and directing that the remaining assets be transferred to the designated corporate trustee or to Community Funds.
- (4) Interested parties have the right to appear in person or by counsel.
- (5) Unless objections were filed and hearing held, the matter proceeds to judgment following a decision by the court. The judgment releases and discharges the trustees, makes allowances for appropriate counsel fees, and directs transfer of the remaining assets to Community Funds.

If a testamentary trust is involved, the proceeding must be brought in the Surrogate's Court and is gov-

erned by Article 22 of the Surrogate's Court Procedure Act. If an *inter vivos* trust is involved, the proceeding may be brought in either the Surrogate's Court or the Supreme Court, where it is governed by Article 77 of the Civil Practice Law and Rules. Most practitioners prefer to start proceedings in the Surrogate's Court because of its greater experience in handling these matters.

Despite the time involved in transferring a private foundation to a community foundation, it can be well worth the effort. Rather than dealing with the burdens of philanthropy, your clients regain the satisfaction of supporting the charitable causes that are important to them. When a transfer seems to make sense, The New York Community Trust welcomes the opportunity to sit down with you and your client for a full discussion.

For further reference:

- IRC Section 507: Termination of private foundation status.
- Treas. Reg. Sections 1.507-1 and 2.
- N-PCL Sections 510 and 511: Disposition of all or substantially all the assets of a New York corporation.
- N-PCL Article 10: Non-judicial dissolution of a New York nonprofit corporation.
- EPTL Section 8-1.1: Disposition of property for charitable purposes.
- www.oag.state.ny.us/bureaus/charities/guides_advice.html: Charities Bureau of the New York State Office of the Attorney General, Guides and Publications (1/2009).

If you are interested in creating a charitable lead trust with The New York Community Trust as the lead beneficiary, please contact us.

- 2000 Charitable Gifts Using Publicly Traded Securities
Charitable Gifts Using Restricted or Closely Held Stock
Charitable Gifts Using Life Insurance
- 2001 Gifts of Partial Interests in Property
Timing of Charitable Contributions
- 2002 Grants by Private Foundations to Individuals & Foreign Organizations
Grants by Public Charities to Individuals
Grants by Public Charities to Foreign Organizations
- 2003 Investment Standards of Charities
Uniform Principal & Income Act
Endowment Funds of Not-for-Profit Corporations
- 2004 Use of Qualified Disclaimers in Estate Planning
Estate Planning Using Retirement Assets
- 2005 Legislative Proposals to Reform Charity: Chapter I
Legislative Proposals to Reform Charity: Chapter II
Legislative Proposals to Reform Charity: Chapter III
- 2006 Estate Planning for Married Couples
Spousal Right of Election in New York
Estate Planning for Individuals and Non-Traditional Families
- 2007 The Pension Protection Act of 2006: Implications for Charitable Giving
Impact of the Pension Protection Act on Supporting Organizations
Impact of the Pension Protection Act on Donor-Advised Funds
- 2008 Charitable Remainder Trusts
Charitable Remainder Unitrusts
Charitable Lead Trusts

About The Trust

For 85 years, The New York Community Trust has served the needs of donors and nonprofits in the New York area. One of the oldest and largest community foundations, The Trust is an aggregate of funds created by individuals, families, and businesses to support the voluntary organizations that are crucial to a community's vitality.

Grants made from these funds—which now number more than 2,000—meet the needs of children, youth and families; support community development; improve the environment; promote health; assist people with special needs; and bolster education, arts, and human justice.

In addition to reviewing proposals from nonprofit agencies and responding to the grant suggestions of donors, The Trust is alert to emerging issues and develops strategies to deal with them, works collaboratively with other funders and with government, and gets out information to the public. Recent initiatives have included programs that address youth violence, managed health care, immigration, child abuse, and public school reform.

The Trust is governed by a 12-member Distribution Committee composed of respected community leaders. Its staff is recognized for its expertise in grant-making, financial administration, and donor services. Local divisions are located on Long Island and in Westchester. In 2008, The Trust made grants of \$167 million from \$1.5 billion in assets.

For more information call Jane L. Wilton, general counsel, at (212) 686-2563.

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