

COMMUNITY FOUNDATIONS -
INFORMATION FOR LAWYERS, FINANCIAL PLANNERS, AND DONORS

I. Community Foundations - formation.

- A. A community foundation may be organized as a trust or a non-profit corporation.
 - 1. The consensus is that a non-profit corporation is more flexible and adaptable to most foundation purposes.
 - 2. The new Iowa non-profit corporation statute is Chapter 504 of the Code.

II. Charitable Gift Annuity (CGA)

- A. A charitable gift annuity program is an important offering for community foundations. Colleges, universities and religious organizations have used CGAs for years.
- B. The concept is simple.
 - 1. The donors make a cash gift or gift of other asset;
 - 2. There is a contract signed between the donor and the community foundation that provides for fixed annual (or more frequent) payments to the donor (and, if desired, for another beneficiary's lifetime). Quarterly payments are normal.
 - 3. Upon the death of the beneficiary(s) the funds remaining are available for the use of the foundation, if unrestricted, or for the use stipulated, if restricted.
 - 4. The tax aspects depend upon the age of the donor and the subject of the gift.
 - 5. The gift, however, is always a partial charitable gift because of the payback element of the contract.

6. Essentially, the tax breaks are as follows: the charitable deduction is usually 40 to 50% of the gift. The "income" payback is only partially taxable (say 50-70%), at least until one's life expectancy is achieved and the amount of the gift is immediately removed from one's future estate.

7. If a donor contributes capital gain property the donor will report the gain portion of the gift over the donor's life expectancy.

8. The American Council on Gift Annuities (acga-web.org) has an excellent website which will provide you with forms, suggested gift annuity rates, and several key links.

9. Current recommended rates are as follows:

	One Life	Two Lives	
Age	Rate	Age	Rate
60	5.7	60/65	5.5
65	6.0	65/70	5.7
70	6.5	70/75	6.1
75	7.1	75/80	6.6
80	8.0	80/85	7.3

10. Some pointers:

a. The contract is not a legal document as such. A lawyer doesn't have to prepare it like a trust agreement.

b. Don't issue CGA's for persons under age 60 or for less than \$10,000. (This is a policy recommendation not a legal point).

c. Check with the Iowa Commissioner of Insurance Office. You need to do a filing with that office to legally issue CGAs.

d. Don't issue CGA's to out of state persons without complying with the registration laws of the state of their residence.

e. If you take real estate for a CGA, delay the start date and reduce the value to what you think you will net on the sale of the real estate.

III. Donor Advised Fund (DAF).

- A. Many community foundations receive the majority of their gifts in the form of donor advised funds.
- B. A DAF permits an individual or organization to choose the most advantageous time for charitable gifts with optimum tax planning.
- C. Appreciated assets can be given and capital gain taxes avoided.
- D. DAF assets are invested in the foundation investment pool and appreciation goes to the DAF.
- E. Most community foundations provide quarterly accountings and investment reports.
- F. Most community foundations will also send recommended gifts directly to the charity selected (recommended) or to the donor for actual delivery to the charity.
- G. Most community foundations charge one percent per year, but the fee can be negotiated for larger DAFs.
- H. Most community foundations allow successor advisors for one generation.
- I. Federal legislation designed to restrict activities in DAFs may be coming.

IV. Charitable Split Interest Trusts are an important part of charitable giving.

- A. They can be in the form of a remainder trust (CRT) or in the form of a lead trust (CLT).
- B. The two most common forms of remainder trusts are the annuity trust (CRAT) and the unitrust (CRUT).

V. Like all trusts, an important planning decision is who should be the trustee.

- A. With proper drafting an individual, including the grantor, can be the trustee of a CRT. Iowa Code § 633.63(1)(2004).

- B. A bank or trust company can also be a trustee of a CRT. Iowa Code § 633.63(2)(2004).

VI. May a non-profit corporation (such as a community foundation) be a trustee?

- A. In this regard the Iowa Code provides no guidance.
- B. However, Iowa Code section 633.63(3) allows a private non-profit corporation organized under Chapter 504 to act as a guardian or a conservator in certain circumstances. Iowa Code § 633.63(3)(2004).
- C. The implication is that a non-profit corporation can not serve as a fiduciary (except as a guardian or a conservator).

VII. Service as trustee by a State University.

- A. May Iowa, Iowa State, or UNI serve as a trustee?
- B. Iowa Code Chapter 262 establishes the State Board of Regents, and sets forth its power.
- C. Code Section 262.9(8) provides expressly that the Board may: “Accept and administer trusts and may authorize non-profit foundations acting solely for the support of institutions governed by the Board to accept and administer trusts deemed by the Board to be beneficial. Notwithstanding the provisions of Section 633.63 the Board and such non-profit foundations may act as trustee in such instances.” Iowa Code § 262.9(8)(2004). (emphasis added).

VIII. Can a community foundation manage a CRT for a trustee?

- A. It would appear that a community foundation may, by contract, serve as a manager of a CRT.
- B. In this regard, note that new Iowa Code Chapter 504 specifically authorizes a non-profit subject to the Act to manage a trust. See Iowa Code § 504.302.9 (2004).
- C. The Act states: “Be a promoter, partner, member, associate or manager of any partnership, joint venture, trust or other entity. Iowa Code § 504.302.9 (2004). (emphasis added).
- D. A management agreement should probably address the following points:
 - 1. The community foundation would agree to calculate the required distributions.

2. The foundation would account for all trust earnings and expenses as required by the trust and by applicable laws and provide all necessary accountings.
3. The foundation would provide all tax forms including the 1041's, any required 8282 and the form 5227 as well as any K-1.
4. The foundation would coordinate appraisals if needed .
5. It would handle all disbursements as authorized by the trustee.
6. It would coordinate with investment advisors, but not serve as an advisor. (securities law issues).
7. It would be reimbursed for all reasonable expenses, but would not charge a fee. (caution: a fee could be unrelated business taxable income; (UBTI))

E. A recent private letter ruling is instructive (PLR200352017):

1. Harvard University received a favorable letter ruling from the IRS National Office to allow charitable trust funds to be invested with its endowment. (emphasis added).
2. The University's endowment is invested in public equities, bonds, private equity and real estate.
3. The endowment has significantly outperformed the investments of the trusts for which Harvard serves as trustee.
4. Allowing the school to commingle the assets would achieve greater economies of scale and potentially generate a higher return for the trusts.
5. Harvard proposed a contractual arrangement in which the trusts would receive units in its endowment. The value of the units would be tied to the value of the endowment. Trusts would receive payments based on the number of units owned. A trust could reinvest part of the payout or redeem units, depending upon its cash requirements. Payouts received by the trusts would be treated as ordinary income, regardless of the character of the underlying income of the endowment. Redemptions of units will generate short- or long-term gain, depending upon the holding period.
6. Harvard uses the unit system for the endowments of various departments and schools within the University. The units owned by the trusts would have the same value as used for internal University accounting purposes.

7. The trusts would have no interest in the underlying assets of the endowment and could not control, direct, supervise, recommend or review Harvard's business operations with respect to the endowment.

Trusts would also be prohibited from vetoing or opting out of any underlying investment in the endowment.

8. Harvard's governing board establishes the annual payout from the endowment, based on the investment performance. The goal is to maintain the purchasing power of the endowment while providing a reliable stream of income for the school's operations.

- F. Charities are subject to tax on unrelated business taxable income (UBTI) for income received from a trade or business regularly carried on that is not substantially related to the organization's exempt purpose (I.R.C. § 511).
- G. In Rev. Rul. 69-528, 1969-2 C.B. 127, the IRS ruled that an organization that provided investment services to charities for a fee is in receipt of UBTI under Code § 512(a)(1). However, because Harvard does not intend to charge for its investment services, it will not receive UBTI.
- H. Only those trusts of which Harvard is the sole charitable beneficiary will be eligible to participate in the unit program. Priv. Ltr. Rul. 2003-52-017.

- IX. **It may be appropriate for new Iowa Code Chapter 504 and Code Section 633.63 to be amended to expressly authorize a non-profit corporation to serve as a trustee of a charitable trust. Issues with respect to UBTI will continue to exist, however, unless the fee is waived.**