Putting the “Family” in Family Philanthropy

How families use philanthropy as a vehicle for transmitting values and working together multigenerationally

Key Points

- Charitable planning involving multiple generations starts with the family’s needs, interests, assets, and goals
- A family needs to think not only about its portfolio of assets, but also its portfolio of interests
- With open channels of communication, you can create a philanthropic legacy for multiple generations, engaging the family and benefitting the causes the family supports

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For many individuals, philanthropy is one of the more gratifying parts of estate planning. Adding in a multigenerational component can make it even more meaningful and compelling. Just as every family is unique, so is their philanthropic approach, and there is no single way to involve a family in philanthropy.

What is multigenerational philanthropy?
In some respects, multigenerational philanthropy is defined by what it is not. It is not the senior generation showing younger generations how to engage in philanthropy, what we might call the “Watch Grandpa Give Wisely and Well” model. Rather, it is the family acting together collaboratively on philanthropy that engages the family as a whole. Because families have complex dynamics, so may family philanthropy.

Like so much of estate planning, multigenerational philanthropy combines the highly personal and the highly technical. From a tax and wealth perspective, for the past few years philanthropic families have had the benefit of the “charitable trifecta”: strong appreciation in the stock market, increased income tax rates, and low interest rates. So for many families, the resources to give were there; the potential tax savings from charitable contributions were greater than in the past; and lower interest rates could also provide benefits to the family.

Of course, in 2017, we are all watching to see whether and how much interest rates will rise and whether income tax reform will affect the charitable contribution deduction or the tax rate. Although generally, lower tax rates bring lower tax savings from deductions, there still may be substantial income tax savings from properly structured charitable gifts. With the new Congress, there is also an increased likelihood of estate tax repeal, which would of course eliminate the estate tax deduction for charitable gifts. Philanthropic families may want to defer major gifts until later in the year when the outlines for tax change are clearer.

Philanthropic giving is about much more than tax savings. From an emotional and family values perspective, many families are looking at issues as complex in their own way as the tax and financial issues: what is the right amount of wealth to leave the next generation? And how can parents or grandparents ensure that the next generation inherits not just assets, but the family’s values? For many families at all wealth levels, charitable planning is an important part not only of managing income and estate taxes, but of resolving these personal concerns about transmitting family wealth and values in a meaningful way.

Where does a family begin?
Like all planning, charitable planning involving multiple generations starts with the family’s needs, interests, assets, and goals. Charitable planning really is like investing: a family needs to think about its portfolio of assets, but also its portfolio of interests. Some assets are more tax-effective than others for funding charitable gifts, and different structures will be more effective for different assets and different philanthropic goals. A family with income needs and highly appreciated securities as their principal asset is going to do something very different from a family that does not need additional income, but whose principal asset is a closely-held business. And a family that wants to benefit a specific charity will be looking for a different solution than a family that wants to create a grant-making entity for the long term. As families develop a family philanthropic portfolio, they need to consider what assets work best for family philanthropy, and which assets may be best for personal philanthropy or kept for family investment. But even as they think about the assets to give, a family also needs to think collectively about its philanthropic interests.

Communication is key
Nothing is sadder than watching a charitable gift unravel, bringing disappointment and loss to both charity and family. In addition to the technical aspects of deciding the right structure and the right assets for funding a multigenerational gift, at the same time, there are enormous
communication needs. More even than with other charitable gift planning, there needs to be communication within the family, as a multigenerational gift entirely structured by the senior generation, and being force-fed to the next, is likely to fail. Donors cannot assume that family members will share their passions or want to be involved in the family’s charitable endeavors. And surprising the family at death can be a big mistake that can lead to hurt feelings, confusion, family quarrels, and perhaps even litigation.

And as with every charitable gift, there is a need for clear communication with the charity. It is important to make sure that a charity is in a position to accept a gift and that it is not surprised by it. For example, a museum that you feel would be the perfect recipient of your prized Picasso may not even be able to accept the painting because it cannot afford to store and insure it. With advance communication, you could seek out a different charity or endow a fund to maintain the gift.

What forms of philanthropy are right for your family?

Successful multigenerational philanthropy is not giving by example, it’s giving by collective family decision making. Together, you need to first determine what level of philanthropy is right for your family now, and also how that might evolve as your family evolves.

Gathering the family around year-end giving and for life cycle events

For some families, simply writing a check to a charitable organization that supports causes the family believes in may be the right level of philanthropy. Attending charity-sponsored fundraising events may also be a good fit. Using a holiday when the family is gathered together, such as Thanksgiving, to hold an annual family philanthropic meeting can help facilitate discussion on what causes to support over the year. Engage your children in the process by encouraging them to use a portion of any financial gifts they receive for birthdays, Bar/Bat Mitzvahs, weddings, and other events to support a charity that they care about. The important part is to encourage children to think about their own causes, creating a culture of giving early on that can extend through multiple generations.

Volunteerism

Volunteering time as a family and making a commitment to a charitable organization can be a great way to integrate philanthropy into a family. Seeing first-hand how contributions help those in need can have a powerful impact on children’s desire to give back to their community. Older family members may also want to volunteer to serve on a board or participate in the operations of a charitable organization.

Planned gifts and philanthropic structures

Some families wish to make a formal philanthropic effort in the form of planned gifts, such as establishing a scholarship fund at a school that has special meaning to their family. Or, you may want to consider vehicles such as private foundations, donor advised funds, and...
charitable lead trusts, which offer opportunities for long-term gifts that engage the family and also provide potential tax-saving benefits.

- **Outright, unrestricted gifts**
  Not all multigenerational gifts need to be complex vehicles. A family can make an outright gift to charity as a multigenerational gift simply by having family members agree on a charity they care about and each making a separate contribution to it. Each contribution can reflect tax planning appropriate to that family member. For example, a parent might make a fairly large gift of appreciated securities held for more than a year, obtaining not only an income tax charitable deduction for the full fair market value of the gift, but avoiding any capital gains tax on future sale of the securities. On the other hand, a young adult child might simply make a gift of cash, and most likely on the Internet.

- **Restricted Gifts**
  Often a family can carry out its values more effectively by making a restricted gift to a charity. For example, a family might support a local community organization but limit its gift to specific programs for local conservation. In some cases a simple restriction can be accomplished just by a cover letter or even a notation on a check. However, sometimes a family may want a fund established at a charity to carry out a specific purpose permanently, for example a scholarship fund at the college or university attended by many family members. Many restricted gifts will require a gift agreement between the donor and the charity, clarifying not only the purpose of the gift, but what will happen in the event that the charity can no longer fulfill that purpose.

- **Private foundations**
  Private family foundations are grant-making entities that provide a way to foster a family's values and provide a focus for charitable giving. They encourage intergenerational involvement by sharing values and decision making within the family while establishing a long-term legacy for the family. They can also create an endowment to fund future giving, while offering income, estate, and gift tax advantages.

A private foundation can be created as a nonprofit corporation or a charitable trust, and it’s important to remember that it is a separate tax-exempt entity. Your family must be motivated enough to accept the complexity of the entity and the responsibility that comes with running it. It’s very easy to fall into the “documents are in the drawer” syndrome and simply write checks as the primary function of your private foundation. Family communication and involvement is key to creating a true endowment that reflects your family’s unique values and engages the family to carry out its philanthropic vision.

A private foundation can also provide a training ground for the next generation on corporate governance, investments, and philanthropy. Families can adopt a trustee or director structure providing the next generation with the opportunity to serve on committees, such as an investment or grant-making committee,

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**Caveat to families: Tax planning is complex**

Gifts to charity are deductible from federal income tax under fairly complex rules, so it is always important to seek tax advice and to run the actual numbers. Under current law, your income tax savings from a particular charitable gift will depend on your adjusted gross income, the kind of asset given, the nature of the charitable recipient, other charitable gifts made during the same year, your tax rate, whether you are in the alternative minimum tax (AMT), and whether any part of your charitable gift will be lost due to the itemized deduction “phase-out.”

Furthermore gifts of more than $250 must be acknowledged to be deductible. Finally, state tax rules may be different from federal rules.
before becoming a full board member with a full vote. Some family foundations allow for fewer votes for younger, less experienced family members.

Of course, the complexity of a private foundation means that it carries several disadvantages as well, such as the time and cost associated with running it. As a tax-exempt charity, it is regulated by the IRS, as well as state charitable law. It must file an exemption application and an annual information return with the IRS, and must pay out at least 5% of the fair market value of its assets annually. Private foundations are prohibited from self-dealing and engaging in certain activities such as lobbying and political campaign activity and are subject to limitations on holding business investments. The deduction rules applicable to contributions to private foundations are also less favorable than those for “public” charities, for example limiting a donor’s deduction for a gift of closely-held stock to the donor’s basis (the initial investment, with some adjustments).

• **Donor advised funds**
Some benefits of a private foundation can be achieved by establishing a donor advised fund (DAF) through a sponsoring charity that offers them, such as a community foundation. By law, donors may only recommend charities to receive distributions of donated funds, but in most cases sponsoring organizations follow those recommendations. DAFs can be a good option for smaller donations as they are simpler and less expensive to establish than private foundations. Some DAFs will also allow the donor to select his or her own investment advisor to manage the funds.

Because a DAF is maintained by a public charity, the deduction limitations and operational restrictions that apply to private foundations generally do not apply to them. And, donors can contribute appreciated property, such as closely-held stock, to a DAF and still receive a full fair market value deduction.

While a DAF can be a very attractive solution for many philanthropic families, it has some disadvantages. First and foremost, the donor does not retain control over the fund. The donor and his or her family will be subject to the policies and procedures of the charity maintaining the fund, including its grant-making and investment policies. If the donor wants the fund to be invested in certain investments, for example, that may not be possible. Further, the opportunity to have family involved as advisors for multiple generations may vary from one DAF to the next. If a family wants to establish a long-term advisory vehicle, it should discuss the DAF’s policy in advance.

Just like a private foundation, a DAF is as good as you make it. Engage the family in the process and communicate regularly about what you hope to achieve from your DAF or it too can become a “document in the drawer.”

• **Charitable lead trusts**
A charitable lead trust (CLT) is a less common vehicle for multigenerational philanthropy, but for some families it can offer the benefits of a structure providing for family collective charitable distribution decisions along with the benefits of long-term wealth transfer to the family.
A CLT is a trust that provides an annual payment to one or more charitable beneficiaries for a period of time, with the remainder interest going to family members. A CLT pays an annuity or unitrust payout, and there is no minimum or maximum payout requirement. The family can be the decision makers for the trust, although the trust creator cannot be, allowing the family to gather annually to make collective decisions on the charities it wants to support.

Unlike a private foundation, a CLT is not a tax-exempt entity. But it can provide estate tax benefits, as it permits the transfer of any appreciation in excess of the IRS benchmark rate to a family, free of estate and generation-skipping transfer tax. These types of trusts are particularly attractive in today’s low interest rate environment. A CLT also provides income tax benefits, as depending on how it is structured, either the grantor or the trust itself will receive a charitable income tax deduction. If the CLT is a “grantor” trust, the grantor will be entitled to a charitable income tax deduction in the year the trust is created, subject to the limitations applicable to all charitable gifts by individuals. However, the grantor must include the trust’s income in his or her taxable income in subsequent years. If the CLT is a “non-grantor” CLT, the trust will have an unlimited charitable contribution deduction for the annual distributions of income to charity.

In some respects a CLT can provide the benefits of a private foundation—annual grant-making to a charity of the family’s choice—with the benefits of family wealth transfer.

The payoff of family philanthropy

Family philanthropy can be hard work, but also immensely rewarding. When a family takes the time to work together to identify its philanthropic goals and to collaborate on where and how to give, it can create a meaningful philanthropic legacy for multiple generations.

Carol G. Kroch
National Director of Philanthropic Planning
Wilmington Trust Company

Carol is responsible for charitable planning for Wealth Advisory Services. She also leads the Wealth Planning and Fiduciary Thought Leadership Team, which develops timely articles and publications on issues related to trust and estate planning, income tax and financial planning, and philanthropic planning.

Carol holds a J.D. from Boston College Law School, where she was a member of the Law Review and the Order of the Coif, and a bachelor’s degree from Wellesley College. She is a Fellow of the American College of Trusts and Estates Counsel and was named by Private Asset Management Magazine in June 2016 and May 2015 as one of the 50 most influential women in private wealth.

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