



FREQUENTLY ASKED QUESTIONS ABOUT PRIVATE FOUNDATIONS

Investments / Governance / Compliance

ATLANTIC TRUST

PRIVATE WEALTH MANAGEMENT

Foundation // Source

Introduction

For those seeking philanthropic flexibility and impact, the vehicle of choice has always been the private foundation. With its unparalleled financial control, powerful tax advantages and the ability to perpetuate one's family legacy, America's premier philanthropic families consider it the gold standard of charitable giving vehicles.

Unfortunately, private foundations have often been out of reach for those who lack the resources to hire professional staff. The alternative, going it alone, too often results in administrative and compliance issues that threaten to overshadow the joy of giving.

Foundation Source has changed all that, putting this powerful tool in the hands of today's philanthropic entrepreneurs. Our clients supply the funds and vision; we supply everything else.

Foundation Source provides full management and philanthropic services to more than 1,100 family, corporate and professionally staffed foundations, making us the largest independent foundation services firm nationwide. The company's administrative, online, and advisory services provide comprehensive support to private foundations, eliminating the mundane burdens of running a foundation while helping to refine mission, sharpen strategy, and deepen family engagement. The result: better-run foundations with greater social impact.

For those who would like to learn more, the following pages provide answers to common questions that donors, families and their advisors ask about private foundations.

I. General

1. WHAT IS A PRIVATE FOUNDATION?

Technically, a private foundation is a not-for-profit entity that is controlled by, and receives most of its funding from, a single individual, family or business. It is organized exclusively for charitable, educational, religious, scientific or literary purposes under Section 501(c)(3) of the Internal Revenue Code. A foundation must apply to the IRS to obtain official recognition of its tax-exempt status.

In practice, a private foundation is a unique planned-giving vehicle that fosters family involvement, provides significant control over assets and giving, and allows donors to receive an immediate tax deduction for charitable donations made in the future.

2. WHAT ARE THE BENEFITS OF A PRIVATE FOUNDATION?

- **Family legacy:** A private foundation establishes a tradition of giving that can carry on your family name, fund causes that are important to you, and support your favorite charitable activities into the future.
- **Control:** Private foundations provide the greatest control of any charitable giving vehicle. You decide which charities to support, who sits on the board, and how your donated funds are invested. You also have great latitude as to the types of assets you can put in the foundation.
- **Family involvement:** A private foundation enables you to involve your spouse, children and other relatives in philanthropy and pass values on to future generations.
- **Current tax deduction for future grants:** You may take an immediate tax deduction for contributed assets, even if the foundation does not make charitable grants until a later date. You are also able to remove taxable assets from your estate, without incurring capital gains taxes. Consult with your tax advisor about your specific tax situation.

3. HOW DOES A PRIVATE FOUNDATION COMPARE TO A DONOR-ADVISED FUND?

At the most basic level, a donor-advised fund is an account in a public charity. A private foundation is an actual charitable organization. Beyond this, the differences mainly revolve around control and flexibility. Contributors to a donor-advised fund make irrevocable contributions to the public charity that administers that fund and makes decisions regarding its investments. Contributors can recommend eligible charities as grant recipients, but the donor-advised fund's governing body is free to accept or reject any grant recommendation.

With a private foundation, the donor retains control over charitable donations and other disbursements. With a foundation, one can hire staff, reimburse expenses, set up scholarship and award programs, and make grants directly to individuals in times of need. Donors can also contribute a much wider variety of assets to fund the foundation, such as "144" restricted stock, while retaining control over how the assets are invested.

Private foundations are now as easy to set up and run as a donor-advised fund. Thanks to advanced technology and outsourced services that automate and simplify the way private foundations are operated, families can set one up in a matter of days, and enjoy the control and flexibility that only a private foundation can offer without any of the traditional complexities.

II. Compliance

4. HOW MAY FOUNDATION ASSETS BE USED?

Contributions to a private foundation may be used for charitable purposes and certain administrative expenses. Qualifying distributions from the foundation include grants to public charities, administrative expenses and equipment that help achieve the foundation's charitable purpose, direct charitable activities and program-related investments. Investment management fees, custodial fees and salaries or board meeting expenses to oversee investments do not count toward the foundation's minimum distribution requirement.

5. MAY MY FAMILY OR I ENGAGE IN TRANSACTIONS WITH THE FOUNDATION?

The IRS forbids using one's position within the foundation for personal gain ("self-dealing"). Foundation insiders ("disqualified persons") cannot transact with the foundation other than to make donations to it, or under limited circumstances, receive fair market value compensation for personal services. (See #6)

Examples of self-dealing include:

- Purchasing items from or selling items to the foundation.
- Personal use of foundation assets or income.
- Borrowing money from the foundation.
- Retaining foundation assets (e.g., paintings) on private premises.
- Leasing space to or from the foundation.
- Using foundation assets to honor the personal pledge of a disqualified person.

Generally, disqualified persons include: (i) a foundation's officers, directors, trustees, and substantial contributors; (ii) individuals who own a significant stake in a company that is a substantial contributor; (iii) the family members of these individuals; and (iv) certain businesses partially or wholly owned by these individuals. Family members include a disqualified person's spouse, ancestors (e.g., parents, grandparents), lineal descendants (e.g., children, grandchildren) and their spouses.

6. MAY I OR MEMBERS OF MY FAMILY BE EMPLOYED BY MY FOUNDATION?

Yes, in certain circumstances. By appointing children or other family members as officers or directors, you will have the option of making the foundation business a family affair.

However, paying yourself or family members requires strict adherence to detailed IRS rules to avoid legal complications and self-dealing penalties. Before paying compensation to family members, you should have your attorney review your foundation's charter documents and applicable state law to ensure that compensation is permissible. Further, you should take steps to ensure that compensation decisions for foundation insiders are made by disinterested persons based upon an objective benchmarking

analysis to establish and document the reasonableness of their compensation. Foundation Source can assist clients in understanding the relevant regulations and facilitate these procedures.

7. WHO MAY ESTABLISH A PRIVATE FOUNDATION?

Generally, the founder of a foundation wishing to serve as a director or as a trustee must be at least 18 years old.

8. WHAT SORT OF INVESTMENTS MAY A PRIVATE FOUNDATION MAKE?

Subject to certain limitations, foundations may invest in nearly any type of assets (partnerships, real estate, jewelry, closely held stock, hedge funds), and foundation members may follow any investment strategy they want as long as they follow the prudent investor rules (i.e., don't take extreme risks with those funds, diversify the assets and invest the assets prudently).

In order to prevent the taxation of capital gains, dividends and interest at for-profit tax rates, foundations should take care not to purchase investment assets using borrowed funds, such as with a margin account. Also, foundations considering an investment in a partnership similarly should first ask the partnership if it expects its exempt partners to recognize "unrelated business taxable income," which likewise is taxed at for-profit income tax rates.

9. GRANTMAKING: WHAT KINDS OF DONATIONS ARE LEGAL?

Private foundations typically carry out their philanthropy by making grants to recognized public charities. This includes religious, educational, scientific and cultural institutions; poverty relief agencies; or any other organization that qualifies as a 501(c)(3) charity according to the IRS. Federal, state and local governments are treated as the equivalent of a public charity if the donated funds are used strictly for charitable purposes. Private foundations also may provide scholarships and make grants directly to individuals for hardship, emergency assistance and medical distress as long as they meet certain IRS criteria. Foundation Source assists clients in making these types of grants.

Additionally, grants may be made to non-charities (e.g., a for-profit bakery that employs homeless individuals) if those funds are applied solely to charitable purposes and the foundation

adheres to IRS procedures for performing due diligence prior to the grant by entering into a grant agreement with special terms, and by exercising oversight over the expenditure of such funds. Absent careful compliance, a private foundation may be assessed a 20% tax penalty on the amount of the donation by the IRS. Foundation Source can assist clients in understanding these procedures and can facilitate these grants.

Foundation Source provides its clients with an online database of more than a million IRS-approved charities that foundations can use to research potential grantees. We perform due diligence on each grantee, as required by the USA PATRIOT Act and the Office of Foreign Assets Control (OFAC), which preclude organizations and individuals suspected of, or known to be, engaging in criminal, terrorist or other illicit behavior from receiving financial contributions from private foundations. (The USA PATRIOT Act and OFAC sanctions apply to donor-advised funds and individuals as well.)

10. WHAT IS THE TAX DEDUCTION FOR DONATIONS TO A PRIVATE FOUNDATION?

Typically, donations to a private foundation are tax deductible up to 30% of adjusted gross income (AGI) for cash, and up to 20% of AGI for appreciated securities, with a five-year carry forward. Consult with your tax advisor about the deductibility of your contributions. Other types of assets, including real estate, may be donated to the foundation, but are subject to limitations. To avoid self-dealing penalties, care should be taken to ensure that property that is subject to a liability is not donated to a foundation by a disqualified person.

11. IS THERE A MINIMUM OR MAXIMUM AMOUNT A PRIVATE FOUNDATION MUST GIVE AWAY EACH YEAR?

There is a minimum but no maximum requirement for giving. The IRS requires that private foundations pay out at least 5% of the previous year's average net assets for charitable purposes. This may include administrative expenses associated with running the foundation (see #4). Foundation Source calculates the remaining required distribution on a daily basis and posts it on each client's secure, password-protected website.

12. MAY A PRIVATE FOUNDATION REIMBURSE EXPENSES INCURRED BY DISQUALIFIED PERSONS IN CONNECTION WITH FOUNDATION BUSINESS?

Although personal expenses cannot be paid or reimbursed by the foundation, reimbursement of foundation-related expenses incurred by a foundation's insiders, known as disqualified persons (see #5), may be permitted, if such expenses are reasonable and necessary to carry out the foundation's exempt purposes, and if such expenses are not lavish. Foundations that make expense reimbursements should adopt suitable policies and guidelines.

13. MAY A PRIVATE FOUNDATION CONDUCT ITS OWN CHARITABLE PROGRAMS DIRECTLY INSTEAD OF THROUGH A PUBLIC CHARITY?

Yes, definitely. Though most foundations prefer to make grants to nonprofits, a growing number have chosen to get more hands-on in running their own programs. So long as a foundation's program would be regarded by the IRS as charitable—such as a soup kitchen for the needy—a foundation may directly conduct its own program and treat its related expenses (supplies, salary, rent, etc.) as the equivalent of a grant to a public charity. Generally, a foundation should consult its legal advisor to ensure that a program would be regarded by the IRS as charitable for tax purposes.

14. MAY A PRIVATE FOUNDATION MAKE GRANTS FOR POLITICAL ACTIVITIES?

IRS rules generally prohibit private foundations from making grants to political campaigns or to organizations that exist to influence legislation and voting.

15. MAY A PRIVATE FOUNDATION OWN ALL OR PART OF A FAMILY BUSINESS?

Generally, no. The IRS has established rules against excess business holdings to keep a private foundation from owning a significant stake in a family business. We advise you to consult with your legal or tax advisor on any family business issues.

16. MAY I SELL FAMILY ASSETS TO MY FOUNDATION?

No. The IRS prohibits “self-dealing.” Foundation insiders, known as disqualified persons (see # 5), may not engage in transactions with the foundation, except to make donations to it. Under limited circumstances, they may receive compensation for their personal services at fair market value. (See #6)

III. Setup and Operation

17. HOW LONG DOES IT TAKE TO OBTAIN A NEW PRIVATE FOUNDATION?

With our streamlined systems and processes, Foundation Source can deliver a new foundation in as few as three business days, as compared to weeks or months using a conventional setup process. We also provide ongoing support services for foundations set up by your attorney as well as for existing foundations.

18. WHAT IS THE MINIMUM SIZE FOR A FOUNDATION?

The old wealth advisors’ rule of thumb advised that a private foundation did not make sense unless the initial funding was \$2-\$3 million. This was due to the complicated nature of setting them up and the ongoing expenses to keep them running.

Foundation Source has revolutionized the private foundation by developing technology and efficient processes that dramatically streamline the delivery and ongoing administration of private foundations. Foundation Source makes it possible to establish a new foundation with \$250,000, yet provides services that are robust enough for foundations up to \$500 million or more.

19. HOW MUCH PERSONAL TIME IS INVOLVED IN ADMINISTERING A PRIVATE FOUNDATION?

Foundation Source was established to minimize the tasks that you, the donor, don’t want to do. We file taxes, monitor compliance, handle back-office responsibilities and provide each foundation with a team of client advisors who oversee the entire process. Your involvement level is up to you. In short, Foundation

Source never limits your engagement with your foundation; we foster it by enabling you to focus on fulfilling your foundation's mission.

20. WHY DOES FOUNDATION SOURCE INCORPORATE NEW FOUNDATIONS IN DELAWARE?

Regardless of your state of residency, there are many unique benefits to setting up a foundation as a Delaware corporation. First, foundations set up as corporations have much greater flexibility than those set up as trusts.

Second, Delaware allows for sole-director corporations. This means the founder may be the sole individual involved on the foundation, if he or she chooses.

Third, Delaware allows annual meetings to be held electronically via telephone or Internet, which greatly simplifies this requirement—especially when family members live far apart. Foundation Source also works with foundations set up by your attorney as well as existing foundations regardless of state of incorporation.

21. HOW WOULD MY FOUNDATION MAKE DONATIONS USING FOUNDATION SOURCE?

You can make grants quickly and easily through the secure, customized online console provided by Foundation Source. You can also make grants via fax or telephone. Once you decide which charities will receive grants; we then send a check with a grant letter to each charity, or directly to you for personal presentation. Your grant letters are scanned, posted, stored and made accessible to those with viewing rights to your foundation's online console.

22. HOW DO I MANAGE GRANT REQUESTS FROM CHARITABLE ORGANIZATIONS?

Foundation Source provides a comprehensive service for grants management, Foundation Source Requests®, which organizes and manages applicant grant requests and proposals, so you can easily monitor each step and simplify the entire process. This optional service includes a public-facing landing page hosted by Foundation Source, an online eligibility quiz to weed out inappropriate applicants, online applications, proposal and

correspondence management, activity tracking, preparation of grant checks and transmittal letters, customized reports and more.

23. HOW DO I GET INFORMATION ABOUT FOUNDATION ACTIVITIES, ACCOUNT STATEMENTS AND ANNUAL REPORTS?

Foundation Source provides a secure, password protected website for each foundation to access account balances, foundation documents, grant history, pending grants, year-to-date donations and more. Detailed investment account statements will continue to come to you from your financial institution. Foundation Source holds all foundation data in the strictest confidence. Our systems, processes and procedures are designed with privacy and security as primary considerations.

24. HOW DO PRIVATE FOUNDATIONS LEARN ABOUT THE CHARITABLE CAUSES THEY ARE INTERESTED IN?

Foundation Source provides an online database of more than a million IRS-approved public charities that our clients can use to research potential grantees. This database provides information on nonprofit finances and activities, copies of tax returns, mission statements, board members, director's salaries and more. If a client is interested in making a grant to a nonprofit that is not in our database, our legal team will research the charity to verify its charitable status.

25. MAY FAMILY MEMBERS BE INVOLVED IN THE FOUNDATION?

Yes. By appointing a spouse, children and other family members as officers and directors, the foundation can be used to bring the family together and pass on philanthropic values to younger generations.

To help increase involvement by family and friends, Foundation Source has created a unique giving tool called "Grant Certificates" to allow the foundation to give limited granting rights to those not officially on the foundation. There are specific IRS regulations that govern compensation to family members (see #6). To avoid the potential for legal problems and penalties from the IRS, you should consult with your attorney. Foundation Source can assist clients in understanding these regulations.

26. DOES FOUNDATION SOURCE PROVIDE SERVICES FOR FOUNDATIONS THAT ARE ALREADY ESTABLISHED?

Yes, absolutely. Foundation Source provides back-office, online, and advisory services to many of the nation's top private foundations. Whether your foundation has been in existence for one, 10 or 100 years, we lift administrative burdens, deepen family engagement, and provide avenues to leave a lasting philanthropic impact.

IV. Working with Foundation Source

27. DOES FOUNDATION SOURCE MANAGE THE FOUNDATION'S ASSETS?

No, we do not provide financial advice nor do we manage or custody assets. Financial control rests entirely with you, your wealth advisor and your financial institution. At Foundation Source, our goal is to help you get the most from your foundation, in terms of simplicity, impact and family engagement.

28. DOES FOUNDATION SOURCE PROVIDE LEGAL OR TAX ADVICE?

No, Foundation Source does not provide legal or tax advice. We will work with your trusted advisors or provide you with the names of specialists in these areas, if you prefer.

29. MAY I CONTINUE TO WORK WITH MY EXISTING LEGAL, TAX AND FINANCIAL ADVISORS?

Yes, Foundation Source is happy to work with your current legal, tax and financial advisors, as instructed. We can also provide the names of specialists in these areas.

V. About Foundation Source

Foundation Source provides full management and philanthropic services to more than 1,100 family, corporate and professionally staffed foundations, making us the largest independent foundation services firm nationwide. The company's administrative, online, and advisory services provide comprehensive support to private foundations, eliminating the mundane burdens of running a foundation while helping to refine mission, sharpen strategy, and deepen family engagement. The result: better-run foundations with greater social impact.

Administration: Full administrative and support services to keep your foundation running smoothly and compliantly, while you enjoy your philanthropy. Our services include administration, compliance monitoring, transaction processing, tax preparation and filing, and financial and regulatory reporting.

Online Resources: Your foundation's own secure online command center gives you full control, so you can manage your foundation anytime, anywhere.

Advisory: Personalized support from client advisors along with experts on call with extensive knowledge and experience in philanthropy and foundation operations.

ABOUT US

Atlantic Trust has partnered with Foundation Source, the nation's largest provider of comprehensive support services for private foundations, bringing unparalleled knowledge and expertise to clients across the country. The result: better-run, more effective foundations and more enjoyable philanthropy.

Foundation Source provides its services to more than 1,100 family, corporate, and professionally staffed foundations nationwide, ranging in size from \$500,000 to \$500 million. The company's administrative services, online foundation management tools, and philanthropic advisory services provide a total outsourced solution for private foundations, while Atlantic Trust manages the foundation's assets. This combined approach frees donors and families to enjoy their philanthropy with total ease and confidence while we handle the details.

We work with both established foundations and individuals interested in starting a new foundation.

CONTACT ATLANTIC TRUST

Atlanta	404.881.3400	Houston	832.941.5760
Austin	512.651.7800	Newport Beach	949.660.0080
Baltimore	410.539.4660	New York	212.259.3800
Boston	617.357.9600	San Francisco	415.433.5844
Chicago	312.368.7700	Washington, D.C.	202.783.4144
Denver	720.221.5000	Wilmington	302.884.6775

www.atlantictrust.com

ATLANTIC TRUST

PRIVATE WEALTH MANAGEMENT



A CIBC Company

Foundation Source

Foundation Source

55 Walls Drive, Fairfield CT 06824

P 800.839.0054

F 800.839.1764

www.foundationsource.com

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