OLD NORTH STATE TRUST, LLC

Two Approaches to Charity: Tax-Exempt Trust or Charitable LLC?

A new approach for high-wealth individuals to support charitable causes is getting a lot of attention. It's known as a *Charitable LLC*, and has one very sharp difference from traditional charitable trusts: It's taxable. What that also means is that, unlike the far more common tax-exempt trusts, its founders can do virtually anything they like with its assets and its income – and even benefit from any losses.

The best known of these new entities is a limited liability corporation that Mark Zuckerberg, the founder of Facebook, created at the end of 2015. He and his wife Priscilla Chan have announced that they will donate all but 1 percent of their Facebook stock to this new organization.

That's in keeping with the example set by another multi-billionaire, Warren Buffet, who has promised to give away 99 percent of his wealth within ten years after his estate is settled. He began the process ten years ago, giving away about 5 percent of his Berkshire Hathaway stock each year. Most recently, Buffet gave almost $2.9 billion worth of stock to five charitable foundations. Four of them were in the family, so to speak: one set up in his late wife's memory, and three created by his three children. The bulk of the gifts, though, went to the Bill & Melinda Gates Foundation.

Buffet and Bill Gates got a lot of attention for challenging their fellow billionaires to give at least half of their assets to charity, the so-called "Giving Pledge."

Zuckerberg's possibly profit-making charitable LLC seems to fall under the standard of the Giving Pledge. But questions have been raised about his organization's unusual status, and its ultimate purpose.

So why would anyone want to forego the tax benefits of a true charitable trust?

Among the reasons we've heard are that the taxable structure gives the owner much more day-to-day control over how the entity invests its assets, and frees it from any restrictions on what qualifies as "charity." So a charitable LLC might choose to invest in a political movement, for example, something that's not permissible for a tax-exempt foundation.

This structure also allows for so-called "charitable entrepreneurship," by which a profit-making company measures its success both in dollars and in benefits to society or to the environment, or in other non-monetary ways. Doing well by doing good, in other words. But should such an entity lose money, those losses can offset the founders' tax liabilities, just like other business losses.

But the downsides are considerable, which is why we don't recommend this approach to our clients. First and most important, of course, is tax liability. For somebody like Zuckerberg, a billionaire many times over, that may be a minor consideration. But for most people with more "ordinary" levels of wealth, sheltering assets from taxes is an important goal.

A second issue, which has surfaced with creation of the "Chan Zuckerberg Initiative," is that the founder's motives may be called into question. Because a charitable LLC can be run any way its founders choose, with no oversight and no public accountability, there's no real proof that it will, in fact, do what it claims to do. In other words, it could be seen, rightly or wrongly, as a public-relations vehicle rather than as a legitimate charitable institution.

By contrast, we have found that our clients have had great success with several types of tax-exempt charitable accounts that we've helped them set up. These individuals were obviously charitably inclined, but they also enjoyed the tax benefits of these types of trusts.

One group of clients had taxable estates that they wanted to shelter, and as a result their heirs ended up paying no estate tax after their deaths. Others set up trusts purely for the charitable and/or personal benefits their loved ones would also receive.

This isn't the place to get into the technical aspects, but a charitable trust can be set up in a couple of different ways. For instance, you can design it so your designated charity or charities benefit first, and your beneficiaries inherit second. But it can be done the opposite way, too: Family benefits first, and charities receive the estate's residue. How the estate is divided up can be specified as a set amount for each beneficiary, personal or charitable. Or the distribution can be designated on a percentage basis.

Here's how a charitable trust can benefit its founder right away: When you contribute assets, you can receive a deduction. If those assets are likely to appreciate, thus potentially imposing future tax liabilities, taking them out of your estate makes that appreciation moot for tax purposes.

It's also possible to set up a trust so your preferred charity, your heirs or both get the benefit of your gift prior to your death. We have accounts like these that have continued for years and years after the grantor's death. They have increased in value, to benefit both the surviving family members and the charities many years later. That has met the original clients' desires, taking care of all the folks involved but also doing well in the wider community.