hadn't presented evidence supporting his claim that Dennis breached the standard of care in drafting the estate-planning documents. The district court ruled there was no evidence the Cooks breached any fiduciary duties owed to Gerald, and if they had, he failed to present any evidence showing he was damaged by their actions. The Supreme Court affirmed all of these findings.

Even if Gerald had presented sufficient evidence to support his claims, his attempt to modify the trust eliminated his beneficial interest, shooting himself in the foot.

PHILANTHROPY

Advising Business Owners Who Want To Establish a Private Foundation

By Andrea L. Kushner, senior vice president and director of the Wealth Strategies Group at AllianceBernstein based in Los Angeles, and Jennifer R. Ostberg, associate director of AllianceBernstein's Wealth Strategies Group based in Boston

Business owners know that part of their success is attributed to the communities where they interact and operate. Because of those community ties, many feel both a desire and an obligation to give back. Some may volunteer their time, while others may make significant contributions to local organizations or even offer scholarships to local residents. They may show their appreciation through a single, one-time gesture or decide they would like to establish a longer term philanthropic program. For those business owners who like to give back over time, establishing a private foundation (PF) might make sense.

A PF offers many benefits that business owners can take advantage of, but there are also restrictions. Business owners who have a PF, for instance, may want to donate shares of their company. But, there are several rules with which business owners must become familiar and with which the PF must comply to maintain its tax-exempt status.

Giving Shares to the PF

A PF doesn't depend on the general public for charitable or financial support; instead, it relies on the individuals who created and funded it. Because of this self-funding, the Internal Revenue Service limits the tax benefits available to a PF and seeks to regulate certain activities in which a PF may engage.

An owner of a closely held business who would like to donate shares of stock in the business to his PF can only deduct for charitable income tax deduction purposes up to the adjusted basis in the stock. The owner would be entitled to a charitable income tax deduction equal to the stock's fair market value if instead the shares were donated to a public charity.

"Pre-Transaction Planning," p. 11, illustrates the potential federal tax savings of giving private shares of the company to either a public charity, such as a supporting organization (SO), or a PF prior to a liquidity event. The dual benefit of receiving a charitable deduction and avoiding capital gains tax (otherwise taxed on the sale of the security) would provide potential federal tax savings of $380,000 per $1 million gift (with 10% basis) to an SO or other public charity, whereas tax savings would be only $200,000 for the gift to a PF.

The prohibition on excess business holdings is an additional limitation. A PF can hold up to 20% of the voting stock of a corporation, partnership or trust, including stock owned by disqualified persons.[1] If a PF receives more than 20% of a business interest by gift, the PF has five years to dispose of the excess business holding to avoid excise taxes, which can be significant.[2]

Thus, if a business owner donates shares in the business to his PF in anticipation of selling the business and the sale falls through, then subject to limited exceptions,[3] the PF must dispose of the shares within five years to avoid excess business holdings liability. The PF isn't permitted to hold the interests indefinitely and benefit from the business' growth and distributions. Consequently, the excess business holdings limitations

may discourage the owner from contributing business interests to his PF because the interests will eventually have to be sold to a third party.

The Newman's Own Exception

What if a business owner wants the PF to own 100% of the active business following his death? Luckily, an exception was recently enacted as part of the Bipartisan Budget Act of 2018 and is the result of a bill advocated by the Newman's Own Foundation (the Foundation). Today, the Foundation owns 100% of the for-profit company No Limit LLC (which sells Newman's Own food products). All profits of the company benefit charity.

The Foundation received the holdings by bequest on the 2008 death of actor Paul Newman. In 2013, the Foundation was faced with having to divest at least 80% of its ownership of No Limit LLC to avoid excess business holdings excise tax liability under Internal Revenue Code Section 4943. The Foundation was granted a 5-year extension, and in 2018, President Trump signed the new law (IRC Section 4943(g)).

The exception provides that the tax on excess business holdings of a PF shall not apply to philanthropic business holdings that are independently operated. The Foundation therefore didn't have to divest its ownership of No Limit LLC and could continue to operate the business while all profits of the company would ultimately benefit charity.

While Section 4943(g) creates a new planning opportunity for business owners who want to leave their businesses to a PF, it only fits a very specific situation in which the following conditions must be met:[4]

1. The PF must own 100% of the voting stock;
2. The ownership interests were acquired in a manner other than by purchase (for example, gift or bequest);
3. All net operating income of the business for a tax year is distributed to the PF within 120 days of the end of the tax year;
4. No substantial contributor to the PF (or any family member of the contributor) serves as an officer, director, manager or employee of the business enterprise;
5. A majority of the PF's board of directors consists of individuals who aren't officers or directors (or family members of such officers or directors) of the business enterprise; and
6. There are no outstanding loans from the business to a substantial contributor to the PF or to any family member of the contributor.

Donor-advised funds, charitable remainder trusts, and Type III SOs, however, can't take advantage of Section 4943(g) and are still subject to excess business holdings limitations. And, given that many family foundations and their underlying businesses are run by the contributor's children, the majority may not meet these requirements. That is, children can run the business or the PF, but not both. But, in certain situations, such as a philanthropist who intends to leave everything to charity, there's an opportunity for a PF to receive business interests that will provide ongoing financial support.

An Alternative Option

What if a business owner is charitable but doesn't want to leave the entire privately held business to charity? And, how can a family use its privately held business to benefit charity without giving up charitable income-tax deduction benefits or running afoul of the excess business holdings limitations? One consideration is to establish an SO.

An SO is a public charity that fulfills its charitable purpose by supporting another public charity. There are three types of SOs:

- Type I: Must be operated, supervised or controlled by its SO(s), usually by giving the SO(s) the power to appoint or elect a majority of the directors or trustees of the SO.
- Type II: Must be supervised or controlled in connection with its SO(s). This is customarily accomplished by having a majority of the directors or trustees of the SO(s) serve as a majority of the trustees or directors of the SO.
- Type III: Must be operated in connection with one or more publicly supported SOs.

SOs are considered public charities even though they can be funded by a single donor or family. Accordingly, gifts to an SO are eligible for more favorable charitable income tax deductions than gifts to private nonoperating foundations. In addition, most SOs aren't subject to the 5% payout requirement or

excess business holdings limitations applicable to private nonoperating foundations. Thus, SOs can be an attractive option for a family who wishes to give closely held business interests to charity so that the charity can benefit from the business' continued success.

But, there are some drawbacks. A donor who establishes an SO will have less control than a donor who creates a PF. Furthermore, certain Type III SOs will be subject to the 5% payout requirement and excess business holdings limitations. SOs can be complex to establish and maintain. A donor who's interested in creating an SO should be aware of the intricacies surrounding these vehicles.

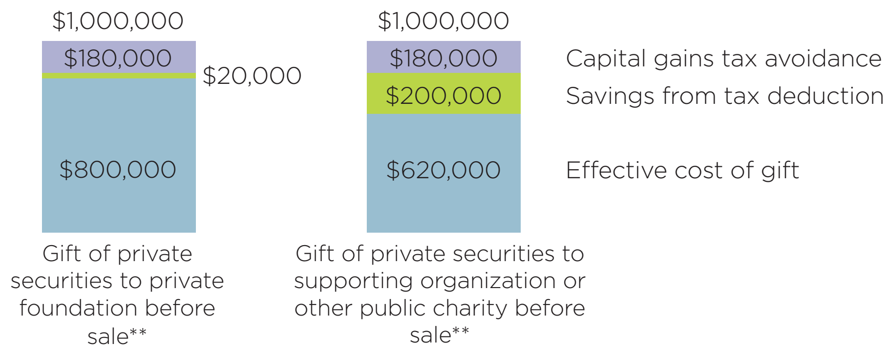
Optimal Structure

Business owners who want to give back to their communities or other causes can do so in several ways. But, there might be an optimal way to structure their philanthropic efforts. Both a PF and an SO can be advantageous, but one may have parameters that are better suited for the owners' desires and interests. While a PF may grant the owners more control over distributing charitable gifts, an SO may be a more interesting strategy for families who wish for some, but not all, of the family business to provide for charity. There are many intricacies that should go into charitable planning for a philanthropically inclined family whose primary asset is a closely held

Pre-Transaction Planning

Gift to private foundation versus gift to supporting organization or other public charity

Per $1 Million Gift to a Private Foundation or Supporting Organization/Public Charity*—10% Cost Basis



Gift of private securities to private foundation before sale** | Gift of private securities to supporting organization or other public charity before sale**

	Gift to private foundation	Gift to supporting organization or other public charity
Income tax savings	**$200,000**	**$380,000**

* A $1 million gift to a private foundation (PF) or public charity is assumed to be made with private securities prior to a liquidity event. The tax deduction assumes the donor is able to fully use the deduction in the year the gift is made, which will be used to offset capital gains income. The units owned aren't subject to capital gains taxation at the sale. The effective cost of the gift is after accounting for the federal tax savings from the deduction.

** The pre-transaction charitable deduction is limited to the cost basis of the private securities on the contribution date for the gift to the PF or is based on the fair market value of the private securities on the contribution date for the gift to supporting organizations or other public charity, as determined by a qualified independent appraisal (Internal Revenue Code Section 170(e)(1) and Treasury Regulations Section 1.170A-1(c)(1)). The appraisal value may be subject to valuation discounts, reducing the value of the deduction. Additionally, these vehicles may earn income that's taxable to the charity as unrelated business taxable income. Furthermore, the Internal Revenue Service may deem the capital gains tax unavoidable to the donor, depending on the timing or the pre-transaction contribution. A post-transaction contribution of cash or appreciated marketable securities avoids these potential issues.

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— AllianceBernstein (AB)

business to ensure that the most optimal plan is created for each circumstance. Charitable planning for a closely held business owned by a philanthropically inclined family involves many considerations to ensure that the planning maximizes the family's charitable objectives.

Endnotes

1. If your client is a substantial contributor to a private foundation (PF) or acts as a director, officer or trustee of one, he's considered a "disqualified person" who can't engage in certain acts of self-dealing, including selling items to the PF, borrowing money from it or leasing space to or from it.
2. The initial excise tax on excess business holdings is 10% of the value of the holdings. If the PF continues to own the excess holdings at the close of the taxable year, then an additional tax equal to 200% of the excess business holdings is imposed. *See* Internal Revenue Code Sections 4943(a) and (b).
3. *See* IRC Section 4943(c)(7). A PF may apply for a 5-year extension to dispose of the holdings.
4. Section 4943(g); *see also* The Philanthropic Enterprise Act of 2017.

TIPS FROM THE PROS

Assessing the Proper Role of Portability

By Charles A. Redd, partner at Stinson LLP in St. Louis and a fellow of The American College of Trust and Estate Counsel

One of the most important aspects of the 2012 Tax Act[1] for estate-planning professionals is that it made portability permanent (to the extent anything emanating from Washington can be said to be "permanent").[2] The term "portability" is shorthand among estate planners for the ability of a predeceased spouse's executor to transmit to the surviving spouse the predeceased spouse's deceased spousal unused exclusion amount (DSUEA). As a result, measured by 2020 numbers, spouses with an aggregate net worth of up to $23.16 million, without having to reallocate ownership of assets between them before either of them has died, would be able to transfer all of their assets to any one or more persons, whether through judiciously timed gifts during life or testamentary transfers at death, and pay no federal gift or estate tax.

Among the significant limitations of portability are: (1) the DSUEA, unlike the basic exclusion amount, isn't adjusted for inflation; and (2) any income and appreciation accruing after the predeceased spouse's death aren't sheltered by the DSUEA. That said, a major advantage of portability is that all assets that, at the death of the first spouse to die, would've passed under that spouse's estate plan, in the absence of portability, to a credit shelter trust (CST) using the traditional approach, instead pass to the surviving spouse and will be included in the surviving spouse's estate at his subsequent death—thereby generating a step-up in basis of the assets to their then fair market value[3] and minimizing future capital gains taxes when they're sold[4]—perhaps without subjecting the surviving spouse's estate to estate tax liability.

Portability vs. CST

If portability is used in place of the traditional CST model, and if the surviving spouse doesn't have a taxable estate (for example, because the spouses' combined net worth was relatively modest to start with or due to poor investment results and/or consumption by the surviving spouse), the beneficiaries will save, at some point in the future when they decide to sell inherited assets, 20% in federal capital gains tax they would've paid on the spread between the basis immediately before the surviving spouse's death and the sale price had a CST disposition been implemented. In this case, using portability is obviously the better course of action. A basis step-up with respect to the assets that had composed both spouses' estates is secured at no tax cost.

If portability is used in place of the traditional CST model, and if the surviving spouse ends up with a taxable estate (for example, due to positive investment results and/or reduction in the basic exclusion amount during the surviving spouse's life): (1) the amount of the estate exceeding the surviving spouse's applicable exclusion amount[5] will generate an immediate federal estate tax burden of 40%; and (2) the beneficiaries will save, at some point in the future when they decide to sell inherited assets, 20% in federal capital gains tax they would've paid on the spread between the basis immediately before the surviving spouse's death and the sale price had a CST disposition been implemented. Whether portability turns out to be advantageous in this case depends on: (1) the amount of federal estate tax payable; (2) the amount of federal capital gains tax