

## **SHOULD I MAKE MY FOUNDATION GO AWAY, AND IF SO, WHERE SHOULD IT GO?**

**By Claudia B. Sangster**  
**Director, Philanthropy Services**  
**Harris myCFO, Inc.**

During the “go-go” days of the 1990s, many of the newly wealthy decided to share their good fortune and established private foundations at a greater rate than ever before, according to The Foundation Center, a New York-based philanthropy research center. There are currently over 55,000 private grant-making foundations in the United States today, according to the latest estimates from The Foundation Center.

But the 90s have come and gone and with the decade’s passing, foundation asset values have in many cases plummeted over the past 2-3 years, which is now having an impact on grant making. In fact, The Foundation Center found that three years of stock market declines, a year-long recession and a slow economy led to a nearly 4 percent drop in the value of U.S. foundation assets in 2001. Asset levels were estimated to have declined up to 12 percent last year, meaning – especially among the largest endowed foundations – giving will probably fall this year. This has caused many families to reconsider whether a foundation is the best way to carry out their philanthropic efforts.

There is and has always been a certain cache in creating a foundation for charitable giving by a few individuals or a family. Individuals are drawn to establishing private family foundations for many reasons: such as to give focus their giving, to involve their family members and ensure family values are passed down through the years, to turn a family’s affluence into influence in the community and to realize certain financial benefits such as tax advantages. Just as there are many faces of philanthropy, there are diverse motives for establishing family foundation.

However, many individuals are finding that the maintenance of these entities can rob them of much of the joy of grant making. The rules governing private foundations are numerous and complex. Founders must carefully wend their way through the private foundation minefield of rules – constant vigilance is key to crossing safely to the other side.

One of the most common pitfalls is the ban on self-dealing, meaning a founder or other “disqualified person” benefits from the foundation. For example, many foundations willingly purchase tickets to a gala event, recognizing that the charity will receive a portion of the proceeds because the value of the tickets exceeds the costs of the event itself. However, if the foundation purchases the table and a founder or other “disqualified person” actually attends the dinner, an act of self-dealing has occurred since a benefit has been received by such individual. Even if the disqualified person does not attend the event and gives the tickets to friends or colleagues, the fact that the disqualified person has the right to control the use of the tickets is still an impermissible benefit.

Another example is where a disqualified person wants to sell an asset to the foundation and will do so at a very reduced price. Even if the price is extremely favorable to the foundation, such a transaction constitutes self-dealing under the private foundation rules. These are two of the more commonly violated rules – there are many more.

In addition to complex operational rules, there are other mandates: the foundation must file an annual return (Form 990PF) with the Internal Revenue Service and in some states as well. Each state has its own requirements as to other filings that also must be followed.

Each year, the IRS requires a private grant-making foundation to distribute a minimum of 5 percent of the value of its investment assets. Foundations that fail to make the requisite distribution are penalized. Each year the foundation must pay an excise tax of 2 percent (in certain special circumstances the tax is 1 percent) on the foundation's income to the federal government. The IRS uses excise tax revenue to police the operations of private foundations.

Finally, for some foundations, the foundation will pay other administrative, legal and accounting expenses that can further deplete the foundation assets leaving less available for making grants.

Many foundations are operated effectively and efficiently, the family is well informed about the various rules and is not intimidated by the compliance issues. But, many foundations are not operating within the parameters imposed and founders and/or their families are surprised to realize that their actions can result in economic penalties and, in some cases, can jeopardize the exempt status of the foundation.

All of this – plus the recent drop in asset value – may lead some individuals to conclude they are not really cut out to be “charity operators” and cause them to look for a way out.

#### **THE GOOD NEWS IS THAT THERE ARE ALTERNATIVES.**

Outsourcing operational aspects is one solution. Large family foundations have been “hiring it done” for years and there now is an entire industry that has emerged for just that purpose. But if the family is looking for a clean break, the best option is to consider terminating the foundation and transferring the foundation assets to a charity that sponsors donor-advised funds. Establishing a donor-advised fund allows the family to participate in the grant-making process without the same level of costs associated with foundation management. Donor-advised funds also allow for anonymous grants, something not permissible with a foundation. There is nothing “private” about a private foundation. All contributions (as well as contributor names) and all grants are listed on the foundation's annual tax return filed with the IRS.

Finally, many of the intangible benefits of family giving sought in operating a family foundation can still be achieved through donor-advised fund giving. Family members can work together to determine which nonprofit organizations to support. Younger family members can be brought into the family philanthropy by allowing joint participation in the recommendation of grants. Family members can still make site visits, review investment reports and analyze charitable proposals. The skills associated with grant making can, and many times do, translate into those needed for managing individual wealth.

What is lost is the absolute control over the funds. The family can recommend to the sponsoring charity which pre-selected investment pools the family would like for investment of the family's account assets and can recommend as to the recipient charity for grants from the account. But, the final decision for investments and grant making is in the discretion of the sponsoring charity and not the donor.

In summary, it is never too late to reassess the family's philanthropy structure and determine if another vehicle is better suited to the family's needs. Whether the family should continue as a charity operator or not depends on many factors – size of foundation, family involvement both now and in the future, desire to exercise absolute control over investments and grant making, cost of administering the foundation and tolerance for complexity. If the family decides to turn to a different model, then creating a donor-advised fund is certainly an alternative worth exploring. In

the final analysis, it is all about doing good and making a difference. How best to accomplish those objectives in the most meaningful and strategic manner is the task at hand for the family.

