WEALTH MANAGEMENT ARTICLE

When a private foundation has run its course

Recognizing important transition points

With more than 1,000 private foundations established each year, it's a sure bet that not every one of them will endure in perpetuity. How do you know when a private foundation has run its course?

"Circumstances change, that's a fact of life," said Pamela Jones Davidson, J.D., gift planning expert and president of Davidson Gift Design. "When people establish private foundations, they want to give back, make a difference, change some small corner of the world. But then death, divorce, retirement, or other family changes… you name it… intervene. Sometimes other charitable options offer greater advantages."

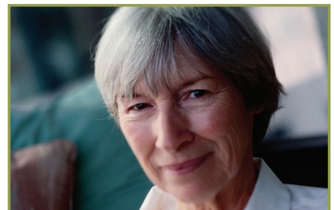
The process for terminating a private foundation varies from state to state, but is always guided by Section 507 of the Internal Revenue Service Code. The IRS permits termination of a private foundation in either trust or corporate form and the distribution of its assets to a public charity.

Alternatives to private foundations

Community foundations are gaining favor as the public charity of choice for such terminations. One of the most popular funds available is a donor advised fund, which allows the contributor to recommend charitable grants from the fund. "Transferring assets to a community foundation donor advised fund allows donors to have their cake and eat it too," said Davidson. "The donor advised fund can retain the name of the private foundation, and the family can continue to participate in grantmaking. But the community foundation takes on all the investment, administrative, and reporting work."

In the scenario at right, Sally Gibson took this route. She used the private foundation assets to create an endowed donor advised fund at her local community foundation, and named her children as the donor advisors. Now, the community foundation development staff brings them all together once a year to review fund performance, grantmaking options, and grant recommendations. (Because of its public charity status, the community foundation board must approve the recommendations.) With the community foundation managing the logistics of the fund, the family can focus its time and energy on making grants that honor the values and memory of John Gibson.

Most community foundations in the United States now offer donor advised funds, although fund minimums and terms vary widely. Minimums range from $2,000 to $50,000, with $10,000 a common benchmark.



An unexpected loss

When entrepreneurs John and Sally Gibson established their family foundation, they were flying high. The college bills were history. The business was thriving. The house and cottage were both paid for. Retirement income was secure.

So with a great sense of gratitude for their success, the Gibsons set aside $1 million in appreciated securities to form the Gibson Family Foundation. They asked their four adult children to serve on the board, and they were in business. John enjoyed managing the foundation's investments, and for several years, the family made annual grants to support the community that had helped them prosper.

Then, at age 57, John lost his life in a tragic accident. Suddenly and unexpectedly alone, Sally was faced with managing the finances, maintaining two homes, and running the foundation on her own. Something had to give.

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Another option available through many community foundations is a supporting organization. A supporting organization affords more involvement than a donor advised fund, but less paperwork than a private foundation. It is kind of a hybrid of the two: an operating unit of the community foundation, but with its own board and separate accounting system. Board members are selected by the community foundation and by the donor, balancing control over financial decisions.

"Supporting organizations provide a high degree of control and independence," said Davidson. "But they still allow the donor to leverage the processes and efficiencies of the community foundation."

In the scenario at right, the sons of Harold Jackson chose this option. By converting the private foundation into a supporting organization, they kept operating costs to a minimum and secured the future of their father's legacy. They still attend quarterly board meetings and make annual grants, but the day-to-day administration of investments, finances, and solicitations is handled by community foundation staff.

Community foundation minimums for supporting organizations are typically in the $1 million to $2 million range.

"Most private foundations are solid and strong, and will be in business for a long time," said Davidson. "But when circumstances change, it's nice to know other options exist that offer simple, powerful, and highly personal ways to give."

When it might be time to make a change

Each expression of philanthropy is unique. It begins for different reasons, and for different reasons, it changes over time. Despite differences, there are several cross-cutting "transition points." At these times, a philanthropist might be ready to end the private foundation experience and move on to something new.

Death of the founder. One of the most common reasons for terminating a private foundation, the death of the founder can leave an organization without leadership, energy, or focus. Sometimes the surviving family members don't share the founder's passion or skills for foundation work.

Costs exceed benefits. Of all the charitable options, a private foundation affords the greatest control, but at the greatest cost. If the family no longer values maximum control over its charitable assets, it may be time to go to something easier and more efficient.

Shift in focus. The original cause may no longer be an urgent need. Or, as the foundation's charitable mission evolves, private foundation regulations may be too constraining. If the board decides to award scholarships, for example, it will need prior IRS approval.

Confidentiality. Although some families value the recognition and status that come with a private foundation, foundation finances are public information. Families may find themselves inundated with requests for assistance, or the subject of public criticism for their grantmaking decisions.

Tax savvy. One of the ironies of tax-exempt organizations is that they must manage tax regulations and reporting. It is not work for amateurs or the faint of heart. Unrelated business income transactions, business holdings, jeopardy investments, and expenditures all require a careful eye and clear understanding of current laws and regulations.

Building a legacy

When banker Harold Jackson established his foundation, he hoped to build a legacy for future generations. He had lost his wife to cancer, and was looking for a way to pass their philanthropic values on to their two sons. In his solitary retirement, managing the foundation gave him a great sense of purpose.

After Harold's death at age 82, his sons took over management of the $2.7 million foundation. Although they were committed to preserving their father's legacy, neither had the time or the interest to manage the investments, administration, and grantmaking of the Jackson Foundation. When they evaluated options for hiring staff to do the work, they were dismayed to see that operating costs were almost equal to grants paid.

Public scrutiny. The spending of charitable organizations and their leaders has become the subject of intense public scrutiny. The misdeeds of a few have cast suspicion over the entire philanthropy field, and investigative journalists continue to search for new transgressions.

Deductibility limits. Tax benefits for gifts of cash or appreciated property to private foundations are capped at 30% and 20% of adjusted gross income, respectively. Some find it easier to accomplish their charitable objectives with the 50% and 30% caps that apply to public charity gifts.

Changing regulations. Death and taxes may be universal constants, but the tax code is always changing. Restrictions on self-dealing, new interpretations of what constitutes lobbying, and additional reporting requirements can all affect the bottom line.

Lack of time. Despite a strong interest and desire to engage in philanthropy, some individuals and families simply do not have enough time to attend to the essential tasks of running a private foundation. Even with professional advisors to handle much of the work, the demands can still be a burden.

Loss of advisor. When a trusted and experienced professional advisor retires, private foundation trustees are faced with adjusting to, and perhaps training, new counsel. At that point, some might choose instead to transition to a simpler giving solution.

Family life. As generations unfold, extended families can become geographically dispersed. In addition, values and priorities often shift and evolve. When space and time become barriers to handling the work of a foundation, it may be time for a change.

Slim pickings. Without a request for proposal process, private foundations may have a hard time finding prospective grantees whose projects and program align with their funding objectives. It may be easier to leverage the community foundation's expertise in this area.

Fun is gone. Like anything else, running a private foundation can lose its appeal after any number of years. If administrative burdens and time requirements deplete the joy of giving, some families may choose a less demanding way to give.

"The only thing constant in life is change."

François de la Rochefoucauld