FOUNDATION Source®

Making More Foundations *Great* Foundations™

FOUNDATIONS & DONOR-ADVISED FUNDS: Can Foundation Management Be Done Smarter?

The rise of outsourced philanthropic support solutions

Page Snow
Chief Philanthropic Officer
FOUNDATION SOURCE

The dizzying economic downturn may have sowed second thoughts about charitable giving, but it certainly hasn't eliminated the philanthropic impulse.

Indeed, those who have reached a certain level of personal and material success may view this tumultuous time as all the more reason to give back. And even in a cratering economy, there are those looking for the tax benefits that charitable giving can provide. But which giving mechanism is most suitable?

Of all the charitable giving vehicles that exist for donors to accomplish good works, the private foundation is widely considered to be the most effective, flexible and enduring. From the Rockefellers, Carnegies and Fords of previous generations to Bill Gates, Jeffrey Skoll and Gordon Moore of the present era, a defining mark of financial achievement is the ability to make a difference in people's lives through one's own private foundation.

Private foundations

Many advisers resist recommending the private foundation model to clients who could benefit from them because they think it is beyond their client's monetary reach. (Conventional wisdom holds not starting a foundation unless a client has $3-5 million in expendable assets). But you don't have to be a Buffet or a Gates to have a private foundation: the vast majority of all private foundations – nearly 70 percent – have assets under $1 million. What is more, the cost of operating a modern foundation is now on a par with – and, in many cases, is less expensive than – the cost of maintaining an equivalently sized donor-advised fund.

More than just tax advantages. Initially, the impetus to establish a private foundation may be motivated by a desire to protect or maximize one's estate through an immediate income tax deduction and the reduction of taxable assets. But the financial benefits of a private foundation go far beyond the initial tax advantages. By maintaining control of their donated assets, donors and their families can direct the investment to ensure that the charitable dollars are put to good use for generations. With effective money management, what begins as a wealth-management strategy becomes a working foundation that binds family members together and creates real philanthropic value over time.

Beyond the tax advantages, a private foundation serves myriad purposes for high-net worth families while, at the same time, improving the lives of others. It exerts a unifying force, similar to a family business, by erecting a formal structure that links several generations working together toward a common philanthropic goal. By providing a reason to meet and converse, it is the glue that holds together family members who are geographically dispersed. It is the clear statement of purpose that transmits the family value system from generation to generation. And, if the foundation is set up in perpetuity, it becomes a time capsule preserving the memory and interests of the founders to generations of their family that they may never meet.

Training ground for heirs

A family foundation also functions as a kind of training ground to prepare the next generation for the responsibilities of wealth. Many affluent parents, particularly first-generation wealth-holders, are preoccupied with the impact of their wealth on their children. (The specter of seeing their offspring turn into a Paris Hilton clone gives them pause.) Being involved in a foundation sparks meaningful conversations about issues that matter (beyond "so what did you do today?"). It can teach their offspring some of the skills they will later need to land a job, including leadership, communications skills and reading financial statements. Watching their sons and daughters make decisions on foundation investments also offers parents a window on how they will manage their inheritance.

> *"Many advisers are unaware that private foundations give donors significantly more options for giving than other modes of charitable giving."*

Of course, the advantages of a private foundation don't solely benefit the family; society profits as well. Many advisers are unaware that private foundations give donors significantly more options for giving than other modes of charitable giving. With other ways of giving, clients are often limited to donating to U.S. nonprofits. With a private foundation, they can engage in international giving, set up their own scholarship program and even provide funds to a for-profit business, so long as it's for a charitable purpose. In addition to making grants, they can make loans to nonprofits enabling the funds to circle back to the foundation for future giving. Moreover, families with foundations can provide funds directly to individuals who are experiencing an emergency, hardship or medical crisis.

Yet despite the varied benefits that private foundations offer affluent families, advisors often resist recommending them to clients because of the perceived difficulty of setting one up and managing it. While this once may have been true, today there are many options available to help families establish and run their foundations.

The requirements of time and expense were often disincentives to establishing a private foundation. Filling this gap, donor-advised funds became the default recommendation of advisers, especially if the initial funding was less than $2 million. In the mid-1990s, many financial institutions launched a turn-key approach to donor-advised funds, marketing them as a new financial "product" and an attractive alternative to private foundations. With the advent of these turn-key services, setting up and making charitable donations through a donor-advised fund became as simple as making a phone call.

DAF limitations

Donor-advised funds' limitations. While donor-advised funds are excellent vehicles for many people, they have their drawbacks. Donor-advised funds may limit the type of assets they will accept, restrict investment options and sometimes put geographic or other restrictions on the types of grants donors can make. And, at the human level, having an account at a donor-advised fund can rarely match the visceral sense of ownership and satisfaction that comes from establishing one's own charitable organization.

All things being equal, many donors would prefer to establish a private foundation over a donor-advised fund. It's all about the inherent powers a private foundation conveys: Donors can nominate their own board members, establish their own organizational guidelines and bylaws, act as the final authority in making their own investment and grant-making decisions, reimburse expenses related to their philanthropy and hire family members as staff to assist in pursuing their philanthropic mission, provided family members are qualified and their compensation is reasonable and necessary. Donors also have greater flexibility in the types of assets they can donate to their foundation. But given the traditional complexities associated with starting and managing a foundation, many advisors retreat to safer ground by recommending donor-advised funds because they seem easier to manage. So let's take a look at the care and feeding of a private foundation.

Making it work

Five key functions of foundations. There are five primary functions of a smoothly operating foundation:

Administration

Like any financial organization, foundations must set up thorough accounting and bookkeeping systems. And the record-keeping requirements for foundations are considerable: an annual 990-PF form to the I.R.S., quarterly excise taxes, state filings (sometimes) and a range of transactions, including contributions, grants, legal correspondence, fees, expenses, nominations and voting.

> *Professional foundation management companies, such as Foundation Source, have leveled the playing field by greatly reducing the administrative responsibilities and costs associated with private foundations.*

Compliance

Private foundations must follow specific rules and regulations set by the Internal Revenue Code, primarily to ensure that the foundation's assets are being used for charitable purposes. Failure to do so may result in additional taxes being imposed on the foundation.

Governance

Proper governance of foundations requires a carefully constructed board with clear roles and responsibilities. Each board member must be fully engaged in the oversight of the foundation. Board service by family members provides a terrific opportunity to engage in the inner workings of the foundation's philanthropy.

Fiscal Management

Foundations have great control and discretion over the investment of their assets. They are free to invest in a broad range of income-producing entities – publicly traded securities, real estate, art work – with few restrictions as long as they exercise fiduciary stewardship and accountability. The I.R.S. prohibits speculative investments that entail high risk that could compromise a foundation's long-term viability. Any investment strategy that jeopardizes the foundation's exempt purpose is also prohibited.

Grantmaking

Finally, there is the primary business of the foundation – having an impact on social issues or problems. This is the area of foundation management where donors usually prefer to spend their time. To achieve their philanthropic objectives, the donor and family members must establish the foundation's mission; identify needs and opportunities in their area of interest; and seek and evaluate grant requests from worthy organizations.

Coordinating all of these aspects of running a foundation can seem daunting. And, traditionally, it was up to the donor to assemble the entire team of advisors and staff required to keep the foundation running and in compliance. That was then, this is now.

Emergence of service providers

Fortuitously, companies have emerged that provide the same sort of turn-key services that were once only available with donor-advised funds. Thanks to advanced technology and the outsourcing of services that automate and simplify the way private foundations operate families can now set up a foundation in a matter of days and enjoy the control and flexibility that only a private foundation can offer without any of the traditional organizational complexities standing in your way.

Professional foundation management companies, such as Foundation Source, have leveled the playing field by greatly reducing the administrative responsibilities and costs associated with private foundations. Now, philanthropically-minded families have real choice—donor-advised fund or foundation?—that doesn't hinge on cost or complexity. Many donors start a foundation for around $250,000 and add assets over time—road testing their charitable interest and gauging family involvement—before making a larger financial commitment.

This handful of major national foundation administrators provide a menu of outsourced administrative services for the philanthropically inclined. For a fee, companies like Foundation Source and others shoulder all the legal, accounting and compliance issues so that the donors can focus on the deeply satisfying part of their philanthropy – changing people's lives for the better. Typically, each foundation is provided with a Web site, accessible remotely and securely from virtually anywhere, to keep tabs on taxes, distribution requirements and compliance rules. These online systems also streamline the giving process. With a click of a mouse, donors can research charities, make grants and pay expenses.

Transacting philanthropy with password-protected online systems also ensures one of philanthropy's essential qualities: transparency. Everyone involved with the foundation – family, board members and wealth advisors – is able view the entire range of its philanthropic activities: donations, grants, expenses (even review applications online). It also keeps family members engaged, with mom and dad vacationing overseas, young adults in college or grandparents in retirement locales. All it takes to meaningfully participate is access to a computer.

Keeping everyone connected

Running one's own family foundation can be one of life's most rewarding experiences. And with the advent of services that ease the administrative burdens historically associated with private foundations, financial advisers no longer need to hesitate in recommending them to clients. When clients experience the tax advantages, the family impact, the social benefits, the lasting legacy and, now, the relative ease with which they can operate a family foundation, they will realize that the advisor was thinking about much more than just numbers. Being seen as a facilitator of family philanthropy can solidify the wealth manager's position as a trusted adviser to clients and their children, offering an opportunity to manage their assets over successive generations.

Page Snow is Chief Philanthropic Officer at Foundation Source, where she leads the Client Services division for over 850 foundation clients and oversees the company's team of Philanthropic Advisors. This provides her with a birds-eye view of the administrative, compliance and philanthropic issues family foundations encounter daily.