



IV. Starting a Family Foundation

WHY FORM A FAMILY FOUNDATION?

There are many reasons why an individual, a couple or a *family* might decide to establish a family foundation. In most cases, the motivations arise from one or a combination of the following reasons:

- to respond to the charitable impulse by returning to society some measure of the successful accomplishments of the donor,
- to promote and pass on to children and future generations a family tradition of commitment to philanthropic efforts,
- to serve as a means of maintaining family unity.
- to provide a fitting and lasting memorial to a family member (or members),
- to establish an organized, systematic vehicle for charitable giving that avoids last minute, ad hoc and unfocused charitable checkwriting,
- to serve as a buffer for on-the-spot solicitations (those seeking funds will need to follow the established application procedures),
- to reduce current income tax obligations while at the same time removing assets from one's estate and thus also reducing future estate tax liabilities,
- to make use of tax deductions for payments that are otherwise not deductible. Tax deductible contributions to a family foundation can be used for:
 - making grants to individuals (such as scholarships),
 - paying staff salaries and other necessary and reasonable expenses to run a grantmaking program,
 - making grants to non-U.S. charities (see page 53),
 - making grants to noncharitable organizations for a charitable purpose (see page 50).

If a donor were to make any of these payments directly, no charitable deduction could be claimed.

HOW LONG DOES IT TAKE TO SET UP A FAMILY FOUNDATION?

Completing all the paperwork to establish a family foundation takes approximately six months. If created in the trust form, the legal entity is complete when the trust agreement is signed. If created in the nonprofit corporation form, the entity's articles of incorporation must be submitted to the appropriate state authority for approval and stamping. Depending on the state, the process varies from one day to three or four weeks.

Once the creating document is complete, Form 1023 needs to be submitted to the appropriate IRS office to obtain Section 501(c)(3) status (see page 8). On average, IRS review and approval takes four to six months.

IS THERE A RECOMMENDED MINIMUM SIZE?

IRS estimates that there are at least 14,000 private foundations with assets of less than \$100,000. Whether such a small foundation makes sense or not is another question to which there is no simple answer. Appropriate minimum size depends on several factors.

How much volunteer help is available? A number of issues arise here. Will a family member provide the legal assistance in establishing and operating the foundation? Will others volunteer to do the paperwork, answer the mail, write the checks, complete the tax return, submit estimated tax payments and serve on the governing board? The more volunteer and *pro bono* help available, the fewer staff required. But be sure to think through the long term. Will the same degree of volunteer help be there in 10 years, 20 years or 50 years? The operating expenses will not go away.

Will the foundation depend on ongoing Lifetime gifts? The size of the annual budget is more important than the size of the endowment. If the donor or family members intend to contribute frequently to the foundation to fund the grant-making and other expenses, the size of the endowment is basically unimportant. This "pass-through" approach is not uncommon, particularly when the donor expects to endow the foundation with significant assets at death.

How long will the foundation last? If ongoing gifts are not likely and a significant bequest is not designed a small foundation endowment of \$100,000 or more may still be effective, as long as the intent is to operate the foundation for a limited number of years paying out principal as well as income.

However, *if* the intent is for the foundation to be permanent, *if* the amount of volunteer help available is minimal and *if* there are no ongoing contributions anticipated, what is a good rule for minimum size of the endowment?

For a *nonstaffed* family foundation with volunteer board members, a suggested minimum size is \$1 million. The income from such an endowment should provide \$50,000 to \$55,000 for expenses and grants while still keeping the foundation's endowment even with inflation (see page 56). Under this scenario, expenses should be in the \$5,000 to \$15,000 range, leaving most of the budget for grants.

However, if the intent is to hire a full-time executive director, the annual costs of salary, benefits and office expenses are likely to reach the \$80,000 to \$100,000 range. In this case, a suggested minimum size is much closer to \$10 million, which provides an annual budget of \$500,000 to \$550,000.

If minimum size is a problem, the donor should look into the services available at the local community foundation. Many donors find the many options and assistance at community foundations preferable to setting up and operating a separate legal entity. Contact the Council on Foundations for the name of the community foundation in your area.

WHO SHOULD SET UP THE FAMILY FOUNDATION?

Although it is perfectly feasible for a nonprofessional to set up a private foundation, there are several drawbacks to the do-it-yourself approach. First, it will take longer. The donor or family member assigned the task will need to locate the correct documents and do considerable reading to learn how to complete them. The occasional technicalities involved in filling out the various forms increase the likelihood that they will be returned for additional or revised information. There is also some potential for filing an incorrect submission, which could lead to classification in the wrong category.

Using a professional well versed in the application process is strongly recommended. Law firms and accounting firms (that frequently have lawyers on staff) are the best bet. If you are contemplating the establishment and operation of a family foundation without seeking appropriate legal guidance, you should reconsider. There are many potential pitfalls. Initial and ongoing legal assistance should be built into your budget. If you cannot afford such assistance, you should consider other options. Legal fees can be significantly reduced when the family members are familiar with the rules. For example, the initial discussions with counsel can be shortened if the person starting the foundation is fully prepared. By reading this book and other resources, you will avoid having counsel bill you for time for simply explaining the rules.

***Other Resources**

First Steps in Starting a Foundation

The Handbook on Private Foundations

Operating Basics for Small Foundations

HOW DO YOU FIND AN EXPERIENCED FOUNDATION ATTORNEY?

Many attorneys familiar with private foundations are tax and/or estate planning lawyers. Beyond the general practice of tax or estate law, they have carved out a specialty or designated a significant portion of their practice to representing all kinds of tax-exempt organizations (churches, museums, hospitals and trade associations). Many local agencies may be able to refer you to firms that represent exempt organizations. Good sources to contact are local city or state bar associations, your local regional association of grantmakers or other local private foundations or major charities that regularly use outside counsel. In addition, the Council on Foundations will be glad to assist you in recommending counsel. If an experienced local lawyer is not available, you may be better served by retaining counsel in another city or state who knows exempt organization law, and foundation law in particular, rather than by hiring a local tax lawyer who will need to learn the field from scratch (possibly at your expense)