Glue to bind generations

Managing a private foundation can be an exciting and fulfilling experience—for the right families.

By Deanne Stone

In the public's mind, private foundations are billion-dollar money machines funded by America's super-rich families. In reality, most of the estimated 20,000 family-managed foundations have assets of less than $5 million.

The misconception is understandable. The government originally created tax-exempt private foundations to encourage wealthy industrialists to set aside some of their fortunes for the public good. The hope was that by giving them unrestricted freedom to run their foundations, the wily tycoons that masterminded the industrialization of America would be equally imaginative in finding swift cures for society's ills.

Some families, like the Rockefellers and Carnegies, rose to the occasion. Others subverted the tax-savings benefits to their personal advantage by speculating with the foundation's assets and paying themselves exorbitant fees. During the mid-1950s and '60s, some newly rich families also discovered private foundations. Operating on a smaller scale, they funneled their charitable donations through a foundation to reap substantial savings on taxes.

The passage of the sweeping 1969 Tax Reform Act curtailed the most flagrant abuses of private foundations. Although it preserved their exemption from gift and estate taxes and virtual unaccountability in grant making, it instituted new demands: Foundations were required to distribute 5 percent of their assets annually, file reports of their investments and activities that the Internal Revenue Service makes available to the public, and pay an excise tax of 1 to 2 percent a year.

The new requirements discouraged the formation of private foundations primarily as a tax dodge. Meanwhile, the creation of several other new gifting vehicles—charitable remainder trusts, charitable lead trusts, and donor-advised funds through community foundations—provided attractive alternatives to foundations. Many wealthy individuals discovered that these vehicles offered similar personal and tax benefits without the time demands of running a foundation.

In recent years, family foundations have undergone a remarkable democratization. Once the privileged domain of America's wealthiest families, foundations are currently being promoted by legal and financial advisors as an estate-planning tool appropriate even for those with modest excess wealth. Their new popularity is in part a response to the booming '80s, which created new fortunes, and to the estimated $8 trillion transfer of intergenerational wealth predicted to occur over the next half century.

The trend also says something about the state of the American family. In the past, legal and financial advisers recommended their clients consider forming foundations because they offer personal satisfactions as well as tax benefits. Today, there is a new twist: the equally important and legitimate benefits families can derive from working together toward a common good.

At a time when families at all economic levels are unraveling, the private foundation holds the promise of gluing a family together over generations. Besides providing a forum in which family members can work together as equals, foundations present an unrivaled educational training ground for parents and children to develop valuable skills.

The cliché about the difficulty of giving away money wisely is true. Serious grant makers need a large repertoire of skills to make intelligent decisions in the face of overwhelming need. For starters, they require an investigative mind to ferret out what the community that they serve really needs, what is already available and working well, and what is lacking. They also need financial sophistication to oversee the foundation's investments, to read an organization's balance sheet, and to evaluate grant proposals. Finally, they must communicate clearly among themselves and with community leaders, and have the modesty to know when to ask for help.

The government makes it surprisingly easy for inexperienced families to test the philanthropic waters. Private foundations can be established with a relatively small initial endowment—say, $250,000 (legal and administrative expenses may not justify a smaller asset base). Another option is to operate the foundation as a pass-through entity; donors can contribute small amounts annually until they feel comfortable and competent to grant large amounts. Or, if donors discover they don't have the talent or temperament for philanthropy, they can spend the foundation out of existence without incurring any penalties.

For all the advantages private foundations offer, enthusiasts sometimes oversell them as a cure-all for troubled families. Families mired in long-brewing resentments and rifts will inevitably create new battlegrounds within the foundation. And those with histories of never doing anything together and going their separate ways are unlikely to meld into a harmonious team. Some warring families have chosen to spend their foundation out of existence rather than serve together, and others have divided the foundation's assets and formed separate foundations.

In more than a few instances, tensions within the family foundation have exploded publicly in litigation. One widely publicized case was that of the Kirby Foundation of Morristown, New Jersey, in which a brother ousted his three siblings from the board of directors and replaced them with his wife and four children. The courts upheld the brothers, ruling that he had violated the law.

Operating a successful foundation is similar to running a family business. Family members must be passionately committed to their work, like one another reasonably well, and share similar goals and values. For the right families, foundations can provide one of life's most fulfilling and exciting experiences. But even those families must be willing to plan carefully and work on a long timeline.

A good example is the Payne family. Roslyn and Lisle Payne own Jackson Street Partners Limited, a real estate investment company in San Francisco. Several years ago Roslyn attended a conference at which Paul Comstock, a Houston financial planner, discussed the personal and tax benefits of establishing family foundations. For the past 20 years, Comstock has helped families and nonprofit organizations develop wealth-transfer programs.

Comstock assumes that his clients want to maintain influence over their money. Yet each time the wealth passes from one family member to another, estate taxes reduce the amount by as much as 55 percent—an act tantamount to appointing the government as their charitable adviser. Comstock advises clients to consider giving 100 percent of their excess wealth to the public good. That way, the family and not the government determines how it will be used.

"It was a totally new concept for me," says Roslyn. "We have two young sons, and I was excited by the possibilities of creating something in which the whole family could work together to benefit society. The next time Paul spoke I took my husband along. Not long after, we began rethinking our estate planning."

Their first step was to find good legal counsel on rewriting their will. Roslyn interviewed five lawyers before she found one knowledgeable about both estate planning and foundations. Like Paul Comstock, the lawyer asked them to consider how much money they wanted to leave to their children and how much they wanted to go to charity. The Paynes decided that their obligations to their sons included paying for their educations and putting aside money for them to buy houses. Beyond that, they expected them to be self-reliant.

"Once we started thinking along these lines," says Roslyn, we wanted to have something in place, in case of a family tragedy. The lawyer suggested we follow a two-stage process to give ourselves time to learn about foundations. As a temporary measure, we put an initial lump sum into a charitable remainder trust and drafted language to allow for the transfer of funds to the foundation when it was established."

Because the Paynes had a clear idea of what they hoped to accomplish, they had no trouble defining their foundation's mission: supporting sports and youth. Their sons are active in sports and Lisle volunteers as a coach for games around the city. Both the parents and children believe that sports promote the habits and values most important in life—discipline, focus, commitment to win, and the chance to make deep connections with peers and mentors.

The Paynes' goal is to have the foundation up and running within the next year. In the meantime, Roslyn and Lisle are continuing to educate themselves by talking with experienced grant makers, and especially those knowledgeable about programs in their funding area. “We’re setting up a foundation with the same time and care we would give to starting a business,” says Roslyn. “Right now we think the best use of our time is to learn from others and to check out programs we may want to fund in the future.”

Like most donors, the Paynes plan for their foundation to exist in perpetuity rather than for a limited time. They had two reasons for setting it up indefinitely. For one, they have willed the bulk of their estate to go to the foundation upon their deaths. For another, they view the foundation as a training ground for their sons to become future board members and, one day, their successors.

“We want our kids to be equal partners in making decisions when they come of age,” says Roslyn. “Once we begin making grants, we intend to talk over the funding choices with the boys as part of their informal training in how to evaluate organizations.”

Although the boys are only 15 and 11 years old, they have already absorbed their parents’ values. After the 1989 San Francisco earthquake, Matthew, then 10, spearheaded an effort to create a haunted house in the family garage to raise funds for the Red Cross. Then, last year, both boys decided they wanted to raise money for a program in which star athletes worked with kids. Roslyn found one in San Jose, and Matthew instructed his younger brother, Andrew, on how to organize a successful fundraiser.

Before the foundation is established, the Paynes must make other financial decisions: How large should the initial endowment be? Which assets should they donate? What are the best ways to transfer their assets, and when? They also must make far-reaching decisions about governance.

Because of recent well-publicized cases of successor trustees attempting to alter the mission of a foundation set by the original donor, legal advisers are cautioning new donors to carefully spell out their philosophy and objectives. Donors who want to determine the foundation’s future direction are counseled to set up the foundation as a trust, requiring their successors to get court approval to change the mission. Those who prefer to give future board members broader discretion in amending the bylaws to meet changing social needs can set up the foundation as a corporation.

The Paynes have still more governance issues to resolve. For example, who will serve on the board and for how long? “We know we want to include nonfamily members,” says Roslyn, “but we haven’t specified their qualifications. Nor have we decided on term limits, other than that we want our boys to be permanent members. Working out all these details takes a lot of soul-searching, but it’s a small price to pay if it helps us become better funders.”

The Paynes are clearly on the right track in planning their family foundation. Their mission is an extension of their family’s interests; they have strong values which they are passing on to their children through shared activities; they have educated themselves about the legal and program aspects of running a foundation; and they have begun preparing their children for their responsibilities at early ages.

A long-range succession planning approach to foundations always works best. But families with adult children need not be discouraged from forming foundations. With good will and patience, the right families can surmount most obstacles. They can also benefit from the experiences of other family foundations. A case in point is the Lawson Foundation, whose nine-member, third-generation board—ages 38 to 76—assumed their grant making responsibilities without the benefit of training.

The foundation was established in 1956 by Ray Lawson with proceeds from a large, family-managed printing business, Lawson Mardon in Toronto, Canada. Beginning with an endowment of $2.5 million, the foundation's assets have surged to $41 million through additional contributions from the family.

Lawson single handedly ran the foundation as an extension of his personal charity until 1972, when he handed the reins to his son, Tom. Tom also ran the show alone, operating with a nominal three-person board. A few years before his death in 1990, Tom Lawson drew up a confusing legal agreement mapping out the future of the foundation and naming four of his six children as trustees. "Although my father showed us the completed agreement, we didn't understand it or its implications," says Joan Vanduzer, current president of the foundation. "He would say, 'I know you'll respect my wishes,' and nobody dared speak up."

Vanduzer says her father's death left the family without a rudder. The family hoped the foundation would become its new center, but when the foundation agreement proved unworkable the family was thrown into turmoil. "We were out of our depth, and needed expert help," Vanduzer recalls. Over the past four years, they have worked out a new structure and expanded the foundation's mission to include all of Canada. The Lawson Foundation assists education, child, and family programs and also supports the development of community foundations throughout the country. The new model better reflects the reality of their family—their trustees are scattered across the country—and the communities they serve. Although the board is beginning to feel more sure of its direction, the process has been stressful.

Says Vanduzer: "After my father's death, my mother decided that for the sake of peace in the family all six children should serve as trustees. We created an all-family board and included two cousins. I personally think this was a mistake. All-family boards are risky and need nonfamily members to balance the family dynamics. Another weakness is that board positions are inherited when they should be earned. I also believe that families have to take an honest look at themselves. Not all family members can work together; sometimes the personalities are too different."

Vanduzer says that many foundation problems could be avoided if the donors set the same high standards and clear guidelines for family members in foundations as they do in running their businesses. She recommends two-year rotating board terms and specific qualifications for service. "Before coming on to the family board, the candidates should learn about nonprofit organizations by working as volunteers, serving on other boards, or sitting on the family foundation's grant committee. The donor and family members should also attend family foundation meetings sponsored by the Council on Foundations to hear from other funders. In these ways, they can demonstrate their interest, curiosity, and suitability for the work and know the responsibilities that go along with being part of this community."

The third-generation Lawson trustees are just answering those questions for themselves. At the same time, they are beginning to think about which members of the next generation might make the best trustees. Luckily, the very nature of a foundation can make it easier for the family to make those hard choices. As Paul Comstock is fond of pointing out, the family foundation is the only estate-planning tool he knows of that allows parents to see how it works while they are still alive. Functioning as a virtual laboratory for leadership development, the foundation allows the older generation to observe their children's progress. How well they meet their responsibilities as board members, says Comstock, can be a gauge of how well they will manage their personal affairs when they are on their own.

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How a family foundation is governed

The Council on Foundations in Washington, D.C., defines a family foundation as one in which the donor or donor's relatives play a significant role in governing the foundation. A 1992 survey of 227 family business foundations by the council described trends in their governance, staffing, and management.

Family foundation boards tend to be run informally and to meet an average of five days a year. Succession training tends to occur on-the-job rather than in formal board orientation. Family foundations are also less likely to list formal board qualifications or set limits on the number of directors or the length of their terms. The chief drawback to limiting board size or letting trustees serve as long as they wish is that the members of the younger generation won't have a voice until they reach middle age. But if the size of the board isn't limited, it can become unwieldy as it enlarges with each new generation. Today, most family foundations prefer to have a few nonfamily members on the board, too—individuals invited for their expertise, relationship to family (often a lawyer or accountant), or because an outsider is needed to keep a check on family emotions.

Smaller family foundations rarely have paid staff and typically rely on one family member to act as volunteer administrator. Generally, only the larger foundations compensate directors for service, although about half of family foundations reimburse directors for board meeting expenses. A popular perk is to give directors discretionary funds which they can donate to their favorite charities, often without board approval. -*D.S.*

Help for forming a foundation

First Steps in Starting a Foundation, by John Edie, 1989. Council on Foundations, 1828 L Street, N.W., Washington, D.C. 20036. $30.

Starting a Private Foundation: Carrying out the Donor's Intent, by Paul Rhoads and Stephanie H. Denby, 1993. The Philanthropy Roundtable, 32 North Meridian Street, Indianapolis, IN 46204-1725. $7.50.

Building Family Unity Through Giving: The Story of the Namaste Foundation, by Deanne Stone, 1992. The Whitman Institute, P.O. Box 2528, San Francisco, CA 94026. $5.

Family Foundations Now—And Forever? The Question of Intergenerational Succession, by Paul Ylvisaker, 1991. The Council on Foundations, Washington, D.C. $8.

Trends in Family Foundation Governance, Staffing, and Management. Council on Foundations, 1993. Washington, D.C. $10.