The Small Private Foundation

Louis J. Hector is a partner in the law firm of Steel, Hector & Davis

In the beginning, there are few things as pleasureable as the creation of a small private foundation. The foundation quickly brings a new sense of order and purpose to the donor's charitable giving. The board meets regularly; there is a systematic review of giving programs; a total grant figure for the year is established; and a plan is developed to achieve the maximum impact from the gifts. All this is much more satisfying and productive than responding to appeals one by one on an ad hoc basis as most individuals do.

And there are, of course, more tangible immediate benefits; a large tax deduction, and the ego satisfaction that comes from seeing "Gift of the John Doe foundation" in a list of donors. In time, indeed, the donor may see the name of his foundation engraved in granite in the lobby of some building. Such satisfaction may not be the most laudable of motivations, but seeking it is certainly very human, harmless and often very productive of substantial benevolence.

In the new foundation's early years, the donor and the donor's spouse are usually the guiding force on the board. In most cases, the donor's lawyer, a close friend or two, perhaps a bank trust officer and perhaps one or more of the donor's children, make up the rest of the board, and they all work cooperatively to carry out the donor's purposes.

After the donor dies, the surviving spouse and the board usually maintain the momentum of charitable programs which were of particular interest to the donor, and the arrangement works reasonably well for a decade or so after the donor's death.

Meanwhile, it must be admitted, the pleasures of the foundation have usually been somewhat soured by the morass of technicalities which surround private foundations. These revolve mostly around various restrictive provisions of the Internal Revenue Code. The restrictions were adopted over the years to prevent genuine abuses at a few foundations, but they have in the process become a formidable set of requirements and prohibitions applying to all foundations and they often necessitate expensive legal and accounting services. In some states, private foundations must register with the state and file annual state reports, as well as federal tax returns. Someone must be found to do the bookeeping and keep the foundation's records. The donor's secretary or his office can often do this, but in that case, great care must be taken to comply with all the IRS restrictions against prohibited transactions with unqualified persons. The trustees also discover early on that foundations cannot just go out and "do good". They cannot, for instance, grant scholarships to worthy local students without setting up a selection procedure with the approval of the IRS to insure that there is no favoritism or nepotism. Many groups and causes, no matter how worthwhile, cannot be helped by the foundation because they are not organized as recognized public charitable institutions under IRS code regulations.

All these technicalities can become very burdensome. This is not to say that donors and trustees cannot learn to live with them. They can and do -- but it is always more complicated than they expected.

More serious problems appear when the donor and the surviving spouse have both died. It is often just about this time that the family lawyer and the close friends who have served as trustees begin to die; the trust officer at the local bank who handled the investments retires; and the donor's office which handled the paperwork and files is being dismantled. The donor's children have often moved away or become disinterested in the causes of their parents. And now the trust often becomes a real nuisance to the surviving trustees and the donor's children.

The Small Private Foundation
CONTINUED

The only way to keep a private foundation functioning effectively at this point is to find new, younger, dedicated trustees and to put a professional staff in place; both of these may be difficult. Unless the trust is of substantial size, it is hard to persuade responsible people to devote the necessary time as trustees. A less substantial trust cannot afford the expense of a professional staff able to conduct the affairs of the foundation effectively and responsibly.

In short, the trust must now acquire an independent life of its own, and if it is not big enough, this is really not practicable. How big is "big enough"? Some years ago, I thought the figure was $10 to $15 million; now I would put it closer to $50 million. Running a private foundation today is simply too big a job to justify the effort and expense over the long run for anything smaller.

What then can a small foundation donor do? One device used surprisingly infrequently is a provision that the trust principal will be distributed within a certain number of years after the death of the donor and spouse to the same type of charities which the foundation had previously assisted. Another is to provide that upon the deaths of the donor and spouse, the principal may be transferred to a larger private foundation or to a community foundation such as the Dade Community Foundation. In this way, the donor insures that the funds will be properly managed and invested, that all tax and other technical requirements will be satisfied, and that the purposes of the foundation will be carried out by an organization large enough to give careful study and consideration to appropriate giving programs.

I know an elderly couple who recently transferred their $30 million foundation to a much larger professionally-managed private foundation because they felt they could not personally oversee their own foundation any longer. Transfer to a community foundation can serve the same purpose, and in many cases, do so more effectively.

We seldom realize that a community foundation like Dade Community Foundation is not one large monolithic pool of charitable money, but rather a collection of many different funds from many different sources for many different purposes. A well-run community foundation is meticulous in carrying out these individual purposes, and the intent of the individual donor thus carries on. Even if the donor has not provided in advance for transferral to a larger foundation, the surviving trustees for whom the management of the foundation has become too burdensome may well be able, under the powers of the trust instrument, to make an appropriate arrangement with a community foundation.

A small private foundation does indeed afford many pleasures in the beginning, but unless there is a time limit or a provision for transfer to a larger foundation, the pleasures ultimately get lost in the hard practicalities of administration. Fortunately, community foundations provide a ready means to avoid these problems, while at the same time insuring that the purposes of the donor are carried out under competent, professional management.