

df DADE COMMUNITY FOUNDATION

Professional Notes

ISSUES IN NEXT SERIES:

APRIL 2000

How a private foundation can use the grant-making expertise of a community foundation.

Transferring a Private Foundation to a Community Foundation

Creating a private foundation can be an exhilarating experience for an individual or family. It is a public affirmation of their philanthropic spirit and a commitment to support worthy charitable activities. But over time, priorities change and family dynamics shift:

l The foundation's original purpose may have become obsolete or need updating to meet changing philanthropic needs.

l Taxes, paperwork, and administrative expenses may become discouraging and even diminish the funds available for charity.

l The donor's family may lose interest, and the foundation may have difficulty attracting suitable new trustees.

In any of these situations, a community foundation such as Dade Community Foundation may be a sensible alternative. The Foundation, an aggregate of more than 300 charitable funds established by individuals, families and businesses, with assets of almost \$59 million, has provided expert philanthropic administration and grant-making for 33 years.

Section 507 of the Internal Revenue Code permits termination of a private foundation in either trust or corporate form and distribution of its assets to a public charity. When the public charity is a community foundation, the private foundation's assets typically form a permanent philanthropic fund with a similar name.

Because the new fund pays no excise taxes, is exempt from private foundation reporting requirements, and operates with minimal administrative costs, the savings can be put to work for charity. Private foundation board members can choose to remain advisors on grantmaking, or may rely on the expertise and knowledge of the community foundation staff.

Private foundations can select Dade Community Foundation to carry on their philanthropy. The following discussion examines the potential benefits and explains the procedures for such a foundation transfer.

WHEN A TRANSFER MAKES SENSE

To Keep the Purpose Current. Over the years, private foundations' purposes can become outdated or unnecessary. Small foundations with limited staff can find it difficult to keep up with changing needs and evaluate new strategies and organizations established to help respond to those needs.

Community foundations can respond to changes as they occur. The extensive grantmaking expertise of an organization such as Dade Community Foundation can maximize the philanthropic impact of both small and large funds.

To Save Time and Money. Many private foundations find that meeting federal and state regulatory requirements drains both human and charitable resources.

The basic operating costs of a private foundation can be significant. Minimum requirements include accounting, auditing, and preparation of federal and state reports; publication of an annual report; and legal counsel to monitor regulatory changes and avoid potential liability for self-dealing, excess business holdings, insufficient distribution of income, or improper grantmaking. Few small private foundations can afford staff, yet their administrative burdens may require such support. In addition, the one or two percent excise tax on private foundation investment income reduces funds available for charity.

Under these circumstances, it can become expensive to maintain a private foundation independently.

(Continued from page 1)

Similarly, a bank trustee may find individual private foundations too small to be efficiently managed as discrete entities.

By transfer to a community foundation, the private foundation enjoys the economies of scale of a large institution while being exempt from excise taxes and numerous costly regulations. A variety of investment vehicles are available and the community foundation handles the accounting, reporting, and grantmaking.

The fee to manage a fund at Dade Community Foundation is modest.

To Ensure Continuing Stewardship.

Private foundation boards evolve unpredictably over the years. Second and third generation family members may not share the donor's enthusiasm for philanthropy. Advisors and friends will age, and new trustees may be needed to help carry on. But some foundations have difficulty attracting suitable replacements willing to undertake the work, particularly since a misstep carries the potential of personal penalties.

When a private foundation is transferred into Dade Community Foundation, it becomes part of a respected permanent institution. The trustees' administrative and fiduciary responsibilities cease, and are shifted to our board of 21 local leaders selected for their knowledge of institutional management and community needs. They are supported by an experienced staff, well versed in all aspects of foundation work. If desired, some or all of the private foundation trustees may continue as advisors.

To Facilitate Ongoing Contributions.

Transferring a private foundation's assets to a fund in a community foundation can be particularly useful where the founder or the family continues to make contributions. As a general rule, a community foundation offers greater flexibility than the conventional private non-operating foundation with respect to the kinds of assets contributed, the income tax ramifications of giving, and annual distribution requirements.

This material was originally developed for the use of professionals by The New York Community Trust, one of the nation's largest community foundations. It was published as of June 1999 with the understanding that neither the publisher nor the authors are engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

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- * Using Charitable Remainder Funds.
- * Reforming a Defective Charitable Remainder Trust.
- * Charitable Lead Trusts.

Transfers That Worked: Some Examples from The New York Community Trust

Innovative Design Fund

Buckminster Fuller was founding trustee of the Innovative Design Foundation in 1981. It encouraged "the impossible dreams of uncommon designers" but suffered from the administrative headaches of a small private foundation. In 1988, the Foundation's newsletter announced an "elegant solution": transfer to a fund in The New York Community Trust, which would "take over all grants administration, legal and investment responsibility and governmental paperwork."

The John and Jane Doe Fund

Two co-executors could not agree on control of a private foundation dedicated to cancer research and care. In 1989, they decided to terminate the foundation and transfer its assets to The New York Community Trust. Each co-executor now advises on grants from one-half of the fund's income.

Maxwell A. Pollack Fund

The New York Community Trust's responsiveness to the needs of New York's elderly has earned it respect throughout the field of aging. In 1986, Mr. Pollack decided to take advantage of The Trust's grantmaking expertise and network of resources by transferring his 14-year old private foundation, the Pollack Foundation for Aging Research, into a fund in The Trust.

The Small Private Foundation

by Louis J. Hector

In the beginning, there are few things as pleasurable 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 bookkeeping and keep the foundation's records. The donor's office or secretary

can 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 investment 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 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 than 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



ABOUT DADE COMMUNITY FOUNDATION

The Foundation is governed by a 21-member Board of Governors composed of community leaders.

Its staff is recognized for experience in grant making, financial administration, and donor services.

In 1999, Dade Community Foundation made grants of over \$6 million and administered \$57 million in assets.

For more information about the Foundation call Joe Pena, Director of Development at 305-371-2711.

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(Continued from page 3)

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 private 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 the 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 transfer 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.

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About the Article: *This article is an excerpt from our Guide to Giving publication, printed in 1997. The content continues to be applicable to this day.*

ABOUT DADE COMMUNITY FOUNDATION

For 33 years, Dade Community Foundation has been the community foundation for Miami-Dade County, an aggregate of funds created by individuals, families, and corporations to benefit the world around them -- especially the people of our community.

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Grants made from these funds meet the changing needs of children, youth, and families; aid in community development; improve the environment; promote health; assist people with special needs; and support education, arts, and the humanities. The Foundation also has taken the initiative in responding to urgent problems -- such as Hurricane Andrew, the AIDS epidemic, and the needs of recent immigrants.



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