Establishing a Family Foundation: What Donors Need to Know

Even as donor-advised funds become more popular with donors, there remain compelling reasons for donors to consider setting up a family foundation. These are foundations that are not only endowed by a particular family's wealth but also have boards largely or entirely composed of family members. Establishing a family foundation communicates a family's long-term dedication to engaging in philanthropy as a family and provides a vehicle for thoughtful grantmaking. Like any nonprofit, however, such an enterprise requires serious administrative attention that is not to be undertaken lightly.

Foundations take work. They are subject to government regulations, and there is significant paperwork and administration required. If you establish a foundation, you'll need to decide who is going to do this work. Larger foundations are often operated by professional staff. For a smaller foundation, like many family foundations, family members might do the work themselves, or outsource it to a foundation management company like Foundation Source. However you do it, running a foundation will cost time and money.

Foundation Source advises that it used to take $5 to $10 million to make it worth setting up a foundation, but with services like theirs, running a foundation is easier and less expensive, and it can be practical to start a foundation with as little as $250,000.

A wide range of financial or legal advisors can help prepare the necessary government paperwork to obtain 501(c)(3) status and register with state charity officials. As with DAFs, you get a tax deduction when you make contributions and can then give to charities over time.

A foundation has to pay out at least 5% of the fair market value of its assets every year. This 5% includes both grants and the foundation's operating expenses. A foundation can be set up to exist in perpetuity or to spend down by a certain date. Private foundations are exempt from federal income tax but do pay a 1.39% excise tax on assets annually. Foundations are

required to disclose all grantees and grant amounts in a yearly 990-PF form. The IRS prohibits self-dealing, or personal gain, from foundations.

You can establish a foundation and also have a DAF and/or an LLC. You can also just write checks directly as an individual. But keep in mind that giving as an individual and giving from the foundation are not the same thing, and it's important to keep the lines clear.

Key Considerations

Even if a donor makes their foundation a time-limited operation instead of perpetual, creating a family foundation is inherently a long-term commitment, and that's at the heart of its appeal for many donors who want to leave a legacy. Here are some of the tradeoffs associated with establishing a family foundation:

- **Commitment to distributing funds**. Unlike DAF accounts, in which you can legally let the principal grow without distributing any charitable funds, family foundations are not a parking lot. Private foundations must give at least 5% of the organization's average fair market value of assets held for investment annually toward the foundation's declared charitable purpose. Funds used to further the exempt purpose of the foundation — salaries, travel, etc. — qualify toward the annual giving requirement.

- **More control over giving**. In addition to giving to qualified charitable organizations, a foundation can provide scholarships and make grants directly to individuals. Private foundations can give to 501(c)(4) organizations (social welfare organizations often associated with issue advocacy and political organizing), whereas most DAF managers prohibit giving to such organizations. Like all nonprofits, private foundations must have a board of directors of at least three people, which means in theory that an individual donor gives over some control to two other people. In the case of a family foundation, these are often family members.

- **More control over assets.** A foundation also gives funders more control over managing the investment of the endowment. DAF fund managers perform this function, though you can often choose between a few portfolios. If you are keen to manage your investments directly or to hire investment managers yourself, a foundation might be the way to go. With a foundation, you'll have more options for impact investing, including providing loans. In addition to impact investing with the foundation's corpus, you can use program-related investments (PRIs) in the form of loans, loan guarantees and equity investments.

- **Increased family connections and a family legacy of philanthropy**. A family foundation can be a vehicle to connect your family over the course of generations and create a family legacy. Within each generation, it can bring family members together to collaborate on a joint effort to do good and give back. With a family foundation, the board will likely be composed mostly or entirely of family members, and family members can be hired to do work relating to the foundation.

- **Effort to engage participants**. You can't assume family members will naturally want to be involved and take on the work of running a foundation, especially as time passes. Donors considering setting up a family foundation will want to think about what it might entail to keep generation after generation engaged in the foundation. Also, keep in mind that family dynamics can be challenging to manage.

- **Decreased anonymity compared to a DAF**. A private foundation must file a 990-PF form annually, which includes reporting on the names and amounts given to nonprofits. That becomes public information and appears on sites like Candid. That has pluses and minuses. It means grantseekers may try to connect with your foundation, and it also means that the giving priorities of your foundation are open to public scrutiny. But this obligation also means that you are contributing to public knowledge of philanthropy and how those with wealth are doing good with their resources.

- **Time and expense**. Even if you hire legal help or hire staff for grantmaking and administration, a foundation will still require your attention to remain in compliance with laws. Like any nonprofit, family foundations should keep regular meeting minutes, especially where grant and investment decisions are made. Tax filings required by the IRS and most states require four to eight hours of work for an accountant or attorney to complete each year (according to one law firm specializing in helping foundations).



- **Opportunity to run charitable programs**. Most foundations primarily operate to give grants, but private foundations can also create and manage their own charitable programs. Direct charitable activities (DCAs) are IRS-approved programs that permit foundations to directly fund and carry out their own projects. This could mean direct service operations like providing meals to vulnerable families or it could mean funding convenings of grantees to increase collaboration in a field where more partnerships could lead to greater impact.

Taking Action

Establishing a family foundation is not a hugely complicated affair, but most donors will want to enlist the help of a CPA, lawyer or other advisors. That said, don't hand over all the thinking to others.

- **Think about your philanthropic goals**. How would establishing a family foundation help you reach those goals? Could you reach those goals with a simpler structure, like a DAF, or by simply writing checks, or using a more flexible vehicle like an LLC? Or is a foundation the best vehicle for you? How do the pros and cons of setting up a foundation versus other types of philanthropic vehicles translate to your priorities?

- **Think about family and board composition**. Think about your philanthropic goals in relation to your family and their priorities. How would establishing a family foundation help you reach those goals? Are your relatives already excited about family philanthropy? How will you get your family engaged in the foundation? How will future generations be engaged to continue the foundation's work? Do you and your family have shared values? How easy or difficult do you think it will be to agree on a philanthropic mission or vision? How will the foundation deal with conflict? Do you want to staff the board with experts on the issues you intend to fund? Do you want to set directions about how the board will be composed in the future?

- **Consult experts.** If you do want to establish a foundation, you'll want to have an attorney or foundation management organization set it up.

- **Stay engaged**. Once it's set up, will you run the foundation yourself? Hire a qualified family member to run it? Outsource the work to a foundation manager or consultants? If you start a family foundation, you are creating a real nonprofit. Treat it like the serious social change endeavor it is.