



Terminating a Private Foundation

Addressing clients' motivations for terminating a private foundation, and reviewing the alternatives—such as a donor advised fund or public charity—can help ease the transition.

The number of private foundations has increased dramatically over the past several decades, but so have the number of families wishing to terminate them. Recent clarifications in the tax code have simplified the termination process.

Between 1990 and 2000, the number of foundations increased by 75 percent, to almost 57,000, compared to an increase of 47 percent in the 1980's, according to The Foundation Center, a provider of information and research about philanthropy in the U.S. By far the largest surge was in foundations with less than \$10 million in assets.

In 2000, the last year for which figures are available, private foundations were shutting down at a rate of 6 percent per year, according to the Association of Small Foundations.

Philanthropy experts believe that some private foundations are terminating simply because too many were created in the first place. "In the IPO-era of the 1990's, many baby boomers saw their stock portfolios rise, and at the same time, they came into the age of inheritance, a transfer of over \$200 trillion," says Philip Flynn, of Philanthropic Focus, LLC, in Vero Beach, Fla., an administration office for family foundations.

A recent article in Bloomberg Wealth Manager picked up the potential trend, and sparked much interest in the philanthropic and advisor communities. [*Meltdown* by Deborah L. Jacobs, Oct 2004.] The article stressed that advisors can ease the transition by arming themselves with at least a working knowledge of clients' motivations for termination, relevant compliance issues, and charitable alternatives, such as public charities or donor advised funds.

Why Foundations Terminate

Family foundations choose to terminate for three reasons, according to Daniel Moisand, CFP, a financial planner with Spraker, Fitzgerald, Tamayo & Moisand, LLC, in Melbourne, Fla., and president-elect of the Financial Planning Association. "Basically the family loses interest, the money dries up, or the administration becomes so burdensome that the family opts for a donor advised fund where they can focus on grantmaking without the hassles."

The administration of a private foundation can be a significant burden. Running a \$3 million foundation may be harder than running a \$30 million one because

smaller foundations cannot afford to pay staff to handle daily operations or to consult on issues such as succession planning. At the same time, the small foundation must find resources to pay for expert outside assistance on legal and accounting issues.

The Costs of Maintenance

For individuals who are not totally dedicated to their foundation, the work can be drudgery, from a personal and financial point of view.

The personal costs of doing business include researching charities, educating younger family members, reading grant proposals, retaining advisors, and disbursing grants.

From a financial point of view, costs often outweigh benefits. "Private foundations can be financially prohibitive to set up and maintain," says Susan C. Kaplan, MBA, CFP, of Kaplan Financial in Newton, Mass. In her experience, starting a foundation costs between \$2,000 and \$5,000, mostly in legal and accounting fees, which will cover, in addition to counsel, a required submission to the IRS requesting charitable (501(c)(3)) status.

In subsequent years, Kaplan says, private foundations can pay \$1,500 to \$3,000 a year for professional tax filing, which is not difficult, but can result in excise taxes or even stricter penalties if done incorrectly. Foundations must show on their annual tax returns (990-PF) that they have met the IRS's requirement that they disburse five percent of their assets annually, and that foundation money was not used to enrich its insiders or otherwise jeopardize its tax-exempt status.

Succession Issues

Regardless of whether a foundation has \$10 million or \$30 million in assets, the most common motivation for termination is the family succession issue.

"The original donor is getting old, and the children or grandchildren don't share his values, the family is scattered across the country, or the family loses interest in running the foundation," says Robert Thalhimer, associate director of The Community Foundation Serving Richmond and Central Virginia. "These few reasons capture the great majority of terminations."

Thalhimer describes one client, an elderly man with strong Christian leanings, who wanted to ensure that his money would never go to support certain causes. He worried that his descendants would not honor his wishes; by setting up a donor advised fund, he assured his legacy in perpetuity, and captured his wishes precisely in the Fund Agreement.

Sometimes the reason for termination can be quite emotional, says Judy Shine, CFP, president of Shine Investment Advisory Services in Englewood, Colo. "In some cases, a couple starts a foundation together, so that when one spouse dies, this activity that they so enjoyed doing together suddenly becomes almost painful for the surviving spouse."

Often family members simply disagree on the direction of their philanthropy. Family friction—whether bridling over each other's choice of charities or facing long-standing family dynamics—can cause a communication meltdown.

"I have one group whose private foundation meetings always degenerate into arguments," Kaplan says. One contingent, she explains, wants to focus its philanthropic efforts on so-called primary needs, such as medical research and nutrition in Third World countries. The other is more interested in political causes such as gay rights. "Their goals just differ tremendously."

In a surprising number of cases, the generational issue is whether to give money to people or animals, Shine says in all seriousness.

Avoiding Mistakes

Because of the costs and potential headaches involved, advisors should do sufficient upfront work with clients to clarify that a private foundation is right for them.

Advisors can help by working with clients to prioritize their giving goals and review the benefits and drawbacks of each giving vehicle option. Bringing multiple generations into these planning sessions ensures that everyone gains insight into the process, and the choice ultimately becomes a family decision. The more clients know in advance about the opportunities and pitfalls of each type of charitable vehicle, the easier the transition will be.

For more information on how to work with the Community Foundation on your charitable giving, please contact us.

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