



## Family Wealth Institute

### *The Family Foundation... Opportunities – Challenges - Traps*

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#### **A growing trend**

One of the most significant trends in wealth management and estate planning is the creation and funding of private foundations, especially those controlled by families. In 1978, there were 22,484 foundations identified in the United States with a combined value of \$37 billion. By 2005, there were over 71,000 foundations in the country and the assets had grown to \$551 billion nationally. It's estimated that over 60% of the foundations, not including community and company foundations, consider themselves "family foundations".<sup>1</sup>

There are many reasons for this rapid growth. Of course, tax planning plays an important part. Contributions are income tax deductible and pass estate tax free. Appreciated assets contributed to a foundation and then sold by the foundation avoid personal capital gains taxes.

But beyond the tax implications, one of the most common motivations is that, contrary to the perceptions of many estate planning advisors, wealth creators often choose to cap or limit the inheritance of their children and grandchildren. Many estate owners have come to the conclusion that their heirs need only so much wealth to assure their security and maximize their opportunities and personal achievement. They have determined that too much inherited wealth may be counter-productive, distracting the beneficiary from completing his or her education or pursuing a career, undermining his or her determination to become self-sufficient, and actually impeding the beneficiary's self-esteem.

Equally important is the ability to preserve capital and to maintain family power over the accumulated wealth. If the family cannot or should not inherit all this wealth, it can, at least, retain control over it.

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<sup>1</sup> "Key Facts on Family Foundations", published by the *Foundation Center*, January 2007



Economics are only part of the story. As families grow in size and spread out geographically, it becomes increasingly difficult for the members of the various branches to really know one. The foundation offers an opportunity to bring the extended family back together. It creates a platform to work together and to learn important life skills B leadership, responsibility, accountability, community service, compassion, and financial acumen.

The foundation is an important vehicle to build and perpetuate through the generations a heritage of family philanthropy and community service, reinforcing this important family value. Contrary to the view of many observers, family philanthropy is not typically intended to memorialize the founder, but to remind future generations of the core values of the founder.

### **The challenges ahead**

A foundation is like any other business. It has a purpose, a product or service, governance and management, financial resources, compliance and tax reporting responsibilities. Unlike most businesses, however, the foundation is intended to continue for generations to come. Relatively few of the new foundations are prepared for these responsibilities. As a consequence, many of the goals of the founder, from making a difference in the lives of others to strengthening and connecting the founder's own family, are unlikely to be realized. These, then, are the challenges ahead.

### **Vision of the founder**

No one establishes a foundation and then hopes to see the resources squandered. What would success look like to the founder over the next 25-50-100 years? If the wealth of the foundation accomplished exactly what the founder would have wanted, what would that be? A foundation without a clear vision and stated mission is like a ship without a rudder. The founder's wealth was not created without focus. It should not be distributed without focus.

### **The business of the foundation is grant making**

The business of the foundation is grant making. How will grants be determined and by whom? This process will change over time – during the founder's life, during the management of the children, and through the generations. What is the role of the children and future issue in this process after the founder is gone? Will they need to make up new rules? Must they follow the old rules? Have they been involved in setting up these rules?

Among the most common reasons for the failure of a family foundation is the inability to engage younger generations, prepare them for their responsibilities, and respond to their own passions and concerns.



### **How will the foundation be run?**

Governance and management will also change over time. During the founder's lifetime, will decisions be made by dictatorship? Democracy? Anarchy? Will there be shared leadership? Is there a process in place for preparing the next generation of leadership?

After the founder is gone, who will choose the successor leadership or what process has been established to choose the successors? Is it the oldest child entitled to run the foundation? The smartest? The closest to home? The one who took care of the founder during his or her final days? Must it actually be a family member, or might it be a non-family friend or professional foundation manager?

Is the younger generation being prepared to assume responsibility? Since the future leaders of the foundation should have experience and skill in managing a family enterprise, you should consider a program to train and prepare these younger members of the family in these tasks. The foundation provides an opportunity to mentor the younger generation through the efforts of other older and more experienced family members. This achieves several objectives, including preparing future leaders, teaching important life skills, and building family relationships.

### **How will the assets of the foundation be managed?**

Is there a written policy on how the assets are to be managed? This type of policy is essential to assure that the investment advisors adhere to the goals of the founders and board members, and avoid inappropriate or impermissible investments for a tax-exempt entity like a foundation. Will family members be entrusted to manage the assets, or will outside experts be engaged to do so?

### **How long will the foundation continue?**

Does the founder intend the foundation to last forever? What if future generations decide that forever is too long? Is there a plan in place should the foundation terminate? How should such a decision should be made and by whom?

### **What are the traps that could jeopardize the foundation, founder and family?**

With increasing scrutiny from Congress, the IRS, and the state attorneys general, foundations must be careful to avoid the tax traps. Self-dealing – paying compensation or rent to family members or purchasing tickets at galas – all raise serious issues. Using foundation grants to satisfy personal pledges, investing foundation assets in family owned business and projects – these and others could cost the foundation and its directors significant penalties and even jeopardize its exempt status.



**In other words**

A foundation that is formed without a comprehensive plan, clear focus, prepared management and careful governance, will never achieve the vision of its founder. As noble as it may be to do the right thing, it's essential to do things right.

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At the First Foundation Inc., we are concerned not just with the tax and economic consequences of wealth planning, but with the impact of that planning on the lives of those for whom the wealth was intended to benefit. Our planners, investment advisors, bankers, and trust officers see the results of both effective and ineffective planning. We are pleased to offer you our insight, experience, and perspective.

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