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A TOOL FOR ALL SEASONS

One of the most exciting and powerful family stewardship planning tools is also one of the least understood and used even though it generates the greatest interest among affluent families—the family foundation. In the first of this two part series we will discuss the family foundation as it relates to two of the three most likely sources of information on the topic (an attorney or a ministry). We will discuss the inherent flaws with each of these traditional sources of information and conclude next edition with the solution to these problems.

In a recent research conducted by Prince and Associates, the philanthropically affluent were asked about their interest in gaining more knowledge about various philanthropic tools. The findings were quite revealing. One hundred percent of those surveyed indicated they wanted more information on family foundations. Less than 42% wanted more information on Charitable Remainder Trusts, and a mere 17% wanted more information on Charitable Lead Trusts. The other eight philanthropic tools listed all received less than a 10% response.

Why is there such an intense interest in family foundations? Why is there such an apparent dearth of information flowing to affluent families on this planning tool? The answer is really twofold and must be considered by looking at the two primary sources from which the affluent would normally receive information on these philanthropic tools.

POSSIBLE INFORMATIONAL SOURCE #1

An Attorney

Discomfort with the Discussion

As far back as August 1996 in issue of *Trusts and Estates* magazine, in his article, "Advisor's Enthusiasm Helps To Shape Client's Charitable Role," Joe Breiteneicher reported on a survey that was conducted with estate planning attorneys in Michigan. The results were most significant.

He reports:
• Few attorneys routinely ask their clients about philanthropic interests in estate or tax planning discussions.
• A majority will only discuss philanthropy if the client raises the issue.
• Discussions regarding philanthropy focus almost exclusively on the tax consequences of giving.
• Many advisors feel that any inquiry into the client's philanthropic interests is unprofessional and could result in the loss of the client's trust and, possibly, his or her business.

With this being the prevailing attitude toward philanthropy among attorneys, it is no wonder that the topic, seldom, if ever comes up. When it does, it is discussed at the most shallow level possible – the tax and financial levels.

Lack of Experience

In light of their clear hesitancy to even discuss philanthropic issues, it should not be surprising that legal counsel is not routinely involved in establishing or administering family foundations for their affluent clients. This infrequent involvement in the discussion and implementation of family foundations limits counsel's confidence and experience in intimately knowing the seven various types of foundations and which ones might be best suited for their respective clients.

POSSIBLE INFORMATIONAL SOURCE #2:

Ministries

Potential Conflict of Interest

The job of the development department is to raise money for their specific ministry. Unfortunately, many, if not most, fundraisers focus their efforts on what we call "Ministry Based Giving" (what is in the best interest of the ministry) instead of "Donor Based Giving" (what is in the best interest of the donor). As a result of this, development personnel often can have a compelling disincentive to encourage donors to make gifts to a family foundation and thereby retain control of all their Kingdom Capital.

If, for example, an affluent family makes a charitable gift of $5 million into their newly formed family foundation, the fundraiser gets no "credit" for this gift because his organization has yet to receive anything. What can be even more unsettling is the reality that the family has the ability to cut off future gifts to that ministry any time they so choose. With a family foundation, the donor is still in total control of his Kingdom Capital. The ministry obviously wants the donor to give those funds directly to them so it can have control of those funds, therefore, making a family foundation a potential fundraising road block and not a means of better achieving the ministry's monetary goals and objectives.

A ministry may not be terribly enthused if their fundraiser comes back to the office and says, "Good news! I helped a family give away $7 million to their family foundation. However, we are going to get $200,000 of it and six other ministries are going to get the other $6.8 million." There may be rather a sense of disappointment over what they did not get instead of rejoicing over what they did get.

The ministry may also be less than thrilled if he says, "I just helped a family give $3 million to us. But instead of giving it to us outright, they set up a family foundation and we will have to annually earn the right to be supported by their foundation each year. And if we don't do a good job, the family could stop supporting us whenever they want!" This leaves the ministry and the development staff feeling like they have only gotten a "phantom" gift.

Herein lies the conflict of interest. The point is not that ministries or their development staffs are unprofessional or unethical in how they work with affluent donors, but even so there is a clear and compelling disincentive for them to discuss with their donors the advantages of establishing and operating a family foundation.

Competition Among Ministries

It is tragic, but true, we have seen the competitiveness between ministries for donors and their gifts many times over the years. Ministries often view other ministries as competitors for the same donors and the same charitable dollars. In fact, the competition and pressure of fundraising is so intense that the average life expectancy of development personnel within the industry is less than three years—shorter than the average life-expectancy of a preacher at a church. Because of this intense sense of competition, the possibility of any kind of mutual fundraising cooperation among ministries is almost unheard. And as a result, the donor and the ministries are both the ultimate losers.

Development personnel also know who is paying their salary and who is evaluating their fundraising performance. Consequently, they do not want to busy themselves showing donors how to spread their giving around to multiple other ministries by establishing a family foundation.

POSSIBLE INFORMATIONAL SOURCE #3:

A Charitable Planning Advisor

Your Best Interest

Possibly the best source for comprehensive information on family foundations ca be found with an advisor who specializes in charitable planning and is familiar with all the different types of family foundations options and will be committed to your best interest

Here is a very brief summary of the many different types of family foundations and the highlights of their similarities and differences. You will very quickly see why choosing the best foundation for your family requires considerable expert counsel.

Private Family Foundations

Private family foundations are clearly the most well-known type of foundation, primarily because attorneys are most familiar with them. Private foundations fall into three distinct categories; (1) *Operating*, (2) *Nonoperating* and (3) *Pass Through*. The overwhelming majority of private foundations are *Nonoperating*.

Private foundations are most commonly chosen because they afford the family "absolute" control over the operation and distributions of the foundation. However, in exchange for retaining this "absolute" control, the Federal Government places a host of onerous restrictions, limitations, and penalties on the foundation in exchange for this "absolute" control. In opting to maintain unrestricted control, the family gives up considerable flexibility that actually limits their control and freedom to operate the foundation as they may choose. The old cliche, "The IRS gives and the IRS takes away" could not be truer than here.

For example, the government puts limitations on how much closely held stock a private foundation can hold and to whom the foundation can sell certain assets. The penalties and excise taxes levied for even unintentional violations of the private foundation rules can be quite substantial; even as high as 50%. It also sets minimum annual distribution requirements along with a host of reduced income tax benefits.

If you were to give a $1 million piece of real estate with a $100,000 cost basis to a private foundation, you would only receive an income tax deduction of $100,000 (cost basis) instead of the $1 million (fair market value) you could normally deduct. Also, you could only deduct up to 20% of your Adjusted Gross Income instead of the normal 30% of the gift in any tax year. In this situation, using a private foundation could cost you as much as $400,000 of cash in pocket for this right to maintain "absolute" control over your foundation.

There are two notable exceptions to these reduced income tax benefits, the *Operating* and the *Pass Through* foundations. An *Operating* foundation is actually an active, operating charity, and it provides full, income tax benefits for its donations. The *Pass Through* foundation is simply a conduit that receives the donations and immediately passes them on to other public charities. Both of these forms of private foundations provide full income tax benefits for the gifts they receive, but all the other restrictions and limitations apply. With the typical private foundation, you can actually end up losing far more than you gain.

The Public Family Foundations

Public Family Foundations are not well understood by most financial advisors and consequently, not well explained or understood by their clients. There are actually two broad categories of public family foundations; (1.) *Donor Advised Funds* and (2.) *Supporting Organizations*. Also there are three types of *Supporting Organizations*.

Donor Advised Funds are segregated accounts under the tax and administrative umbrella of a public charity. It can best be likened to a checking account in a bank. The charity handles all the administration of your foundation, accepts donations, and makes distributions as you suggest. There are literally thousands of public charities and community foundations all over the U.S. that offer *Donor Advised Funds* to potential donors.

Donor Advised Funds are incredibly simple and inexpensive to set up and operate. They are <u>not</u> subject to the private foundation rules and consequently enjoy minimum limitations and maximum tax benefits. The primary drawback to *Donor Advised Funds* is that your foundation is under the ultimate control of the board of the public charity. However, as long as your charitable requests are both legal and in keeping with the charity's mission statement, they will routinely grant your wishes, even though they do have the power to veto them at their discretion. There are several national community foundations that will allow your family to set up and operate your *Donor Advised Fund* into perpetuity and will not expect any part of your donations to go to them. They simply charge a fee for handling your foundation. For families that only want to invest a minimal amount of time and effort into the operation of their family foundation, *a Donor Advised Fund* may be the perfect option.

The second category of public family foundations is the *Supporting Organization*. *Supporting Organizations* are an interesting hybrid between the private foundation and the *Donor Advised Fund*. *Supporting Organizations*, when properly structured, provide the greatest degree of overall control, flexibility and benefits of any type of family foundation. These *Supporting Organizations* are actually private foundations that are treated in every way as public charities. So, with a *Supporting Organization* you retain only a slightly lower level of control as with a private foundation, but with none of the limitations, restrictions, or penalties.

There is a great deal more to choosing a family foundation than you may have originally thought, and it is very important that you not try to create and operate a family foundation without competent professional counsel. But without a doubt, the family foundation is a tool that every affluent Christian family ought to have as part of their overall Stewardship Master Plan.

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Jay Link, Director of Stewardship Planning at Taylor University, spent 35 years counseling Christian families to build customized Master Stewardship Plans. He is an author, a mentor to hundreds of financial advisors and attorneys, and started his career as a pastor. His passion is helping Christian families use all the Lord has entrusted to them for Kingdom-building purposes.