

Launching a Family Foundation: Pros and Cons

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Giving generously to favorite charitable causes is a long tradition in American culture. Each year, donors in the United States contribute hundreds of billions of dollars for worthy institutions and projects.

Many wealthy individuals, couples, and families make substantial donations directly to established organizations that have received the most favorable – that is, “public charity” – status under the Internal Revenue code’s tax-exemption categories. These charities further a broad range of goals: medical research, education, the arts, alleviation of poverty, historic preservation, and community development – to name just a few.

But some of these high-net-worth people want a more hands-on level of control.

Many – especially on the advice of professional advisers – form private foundations, a popular type of tax-exempt organization that gives them tax benefits along with a greater voice in directing their charitable dollars and activities.

The private foundation vehicle has many advantages, but there are substantial drawbacks. Before going ahead, these taxpayers should seriously think about the substantial commitment of money and time it will take to establish and successfully run a new organization. They should also become aware of the tight restrictions on private foundations and their founders.

And, before taking the serious plunge of creating an entirely new, separate, tax exempt organization, they should consider the available alternatives to the private foundation model.

This post presents an overview of the pros and cons; later posts will examine these points in more detail.

Private Foundations Offer Many Attractive Advantages

There are good reasons why well-to-do people create private foundations. They may have favorite

causes that are not yet addressed by existing charitable organizations. Or they may have unique ideas and vision about how to further these charitable goals. Private foundations are useful vehicles to give people of substantial means the control and creativity they want.

Typically, foundations carry the name of the benefactors. This high-profile connection with worthy charitable endeavors is highly desirable – and families are also ensured that their good works continue even after the founders die.

These are Downsides, Too.

There are prudent reasons as well *not* to go this route. Many experts suggest that a prudent level of funding for a foundation is no less than \$1 million; it is more efficient and viable beginning at around the \$2-million level. And achieving the desired charitable goals can require a more substantial dollar commitment over the long run.

Setting up the foundation can cost money in professional fees, and it may take some time to work its way through the state and regulatory-approval processes.

Running a foundation may cost 1% or more of its assets. At the very least, professional advice and assistance on an ongoing basis will be needed; private foundations are subject to many complicated restrictions, and there are serious financial consequences for running afoul of these rules.

Even if staff are hired to run the organization, the primary founders or families will still have active roles and responsibilities. This can be a large commitment of time and energy. These donors should honestly gauge – in advance – whether this is an obligation they truly want and intend to fulfill over a long period.

Conclusion

Any type of new venture, charitable or commercial, takes time to achieve success in its objectives. If there is an established public charity already supporting a family's favorite cause, the money may be better spent by making an immediate donation to that organization, or taking advantage of an alternative vehicle like a donor advised fund or becoming a supporting organization.

In many cases, a private foundation may be the perfect choice – and a wonderful memorial and tribute – to a family's philanthropic goals. It's a decision, though, that should be carefully considered. There are alternatives that may be a much better fit.