Symbiotic Ways Private Foundations Use Community Foundations and Other Organizations

By Bryan Clontz, CFP

As philanthropic advisors, our job is to recommend the best method to meet our client's charitable objectives. If a direct gift is not appropriate, we generally begin to weigh the pros and cons of public foundations (i.e., community foundations or supporting organizations) and private foundations. All too often, the final recommendation tends to be one vehicle over the other when, in fact, using a combination of vehicles may be the perfect way to meet the client's needs. What follows are 10 planning ideas, with accompanying case studies, that illustrate the synergies created by private foundations utilizing community foundations. Community foundations, in this context, will extend to religious foundations, colleges and universities, healthcare institutions, national donor-advised funds or any nonprofit sponsoring donor-advised funds.

1. Five Percent Payout Solution

To meet the five percent payout requirement, many private foundations establish a community foundation fund (i.e., unrestricted, designated, field-of-interest, donor-advised or scholarship) and then make the appropriate qualifying distribution to it. In many cases, the community foundation may pay out the entire amount of the grant within the allowable period for an out of corpus distribution.

Flexible Grant Payout Management: The Brown Family Foundation had to make a year-end distribution in each of the last three years to meet the five percent payout. In the first year, time simply got away from them, but now the Browns want to be more thoughtful about their grants. In the second year, the underlying investments did much better than projected so the required payout was substantially more than what was planned at the beginning of the year. In the third year, they made a large challenge grant to a nonprofit. Unfortunately, the nonprofit notified the private foundation in December that they would not be able to meet the challenge requirements. In each of these situations, the private foundation made grants to an endowed scholarship fund focusing on "at-risk" youth. The fund was named "The Brown Family Foundation Scholarship Fund."

2. Anonymity Planning

With the advent of scanning and web-based database technology, information is more available than ever. For those individuals or families who created private foundations decades ago, they were comforted that information, for the most part, remained private. Today, however, anyone with a computer can access Guidestar (www.guidestar.org) or the Foundation Center Library (www.fdncenter.org) to gain information on any private foundation. Since all of the information is

pulled from a foundation's 990-PF (or in some instances the actual scanned 990-PF is available), anyone can see the asset balance, the directors, contact information, administrative fees paid, every grant that is made (organization name and amount), investment management fees (holdings are sometimes included), and trustee compensation. Investment advisors use this information to solicit new business and nonprofits use it to find potential matches for their programs. Unfortunately, clearly stating "This foundation does not respond to unsolicited applications" does not tend to work. Ironically, there really isn't a less private charitable structure than a private foundation. Many philanthropists are "millionaires next door" and are not particularly interested in the limelight.

Many are more inclined to give, or perhaps give more, when they can do so privately and using a community foundation can help meet this goal.

Keeping Grants Off the Radar: A family recently realized that their private foundation grant history was public information. They were especially sensitive to some controversial funding that they had planned for the upcoming year. Also, they now realized why they had started to receive so many new requests in the last five years. Each request cited a specific grant and dollar amount that the foundation had funded previously. To ease these concerns, their advisor suggested that they establish a donor-advised fund and flow any potentially controversial grants anonymously through the fund (a community foundation must file a 990 disclosing all grants; however, it does not have to disclose which donor-advised funds support each of the foundation's grants). Further, their advisor suggested that they direct any unsolicited grant applications to their community foundation contact person by saying, "We do any discretionary giving through the community foundation." The family told their contact at the community foundation to save only the grant applications which seemed to match the family's interests.

Stretching Grantmaking Focus Outside the Public View: A very large private foundation had a very specific grantmaking focus: "to improve healthcare for our county." They had received a number of requests in the past for environmental programs which all tweaked the application to highlight the healthcare benefits. The Board of the foundation, however, had denied all the grants because they were not clearly in the healthcare area. One of the Board members had heard about a statewide environmental project with an aim of identifying the primary environmental factors contributing to childcare asthma. Juvenile asthma rates in their county were the highest in the state. Additionally, the project leader happened to be a cousin of one of the Board members. The Board was worried that, if it approved the grant, other environmental groups would continue to apply the foundation. In addition, approving the grant would create ill will among environmental groups that had been denied previously, and would also suggest favoritism toward the Board member's relative. They strongly believed, however, in the merits of the project. The Board established a donor- advised fund and requested that a grant be sent to the applicant with a cover letter stating: "the enclosed grant comes from an anonymous fund at The ABC Community Foundation."

Looking Like a Hero Without Feeling Guilty: Andrea established a private foundation two years ago. At the time she started the private foundation, she accepted the role of capital campaign chair for her synagogue. Andrea was fully aware that she was expected to make a lead gift toward the campaign so her private foundation granted $100,000—ten times her typical annual synagogue gift of

$10,000. She set a goal of completing the campaign within two years but the campaign is still about $100,000 short. Now at the tail end of the campaign, Andrea feels like she is making twice the number of calls for half the results. Frankly, she is getting tired and wants to finish it out. She also wants the congregation to feel like they accomplished a stretch goal within the two-year time period. Andrea has more than enough capital within the private foundation and wants to make another $100,000 grant, but she is worried how it will look and, of most concern, she doesn't want to feel guilty about going back to her $10,000 annual gift after she gives the synagogue $200,000. She plans to use her local Jewish Federation donor-advised fund to make an anonymous gift to accomplish all her objectives.

3. Partial or Complete Termination

A donor-advised fund at a community foundation closely parallels the activity of a private foundation. For a variety of reasons, some families choose to terminate some portion, or all, of their private foundation to establish a donor-advised fund. Frankly, the 2008 market downturn reduced assets to such a level that maintaining a private foundation was no longer efficient or prudent. Also, many families find the private foundation requirements as too constraining and seek ways to simplify the giving process; others cite more subtle issues involving family dynamics.

Maintaining Family Harmony: Joe and Mary created a private foundation some years ago when their children were younger. Everything was going well until their youngest daughter, Betty, was married. While Joe and Mary got along well with Betty's new husband, Betty's siblings did not. Betty and her new husband had become very active in religious causes but the private foundation's purpose was to support healthcare, education and the arts. To ease the intrafamily tension and to encourage Betty's religious work, they decided to partially terminate Betty's pro-rata share of the foundation by making a principal distribution into a national donor-advised fund, with Betty as the fund advisor.

Succession Planning: Lou and Harriet established their private foundation 35 years ago. They could not have been more pleased and actually viewed starting the foundation as one of the most important accomplishments of their lives. What made Lou the most proud was that the foundation was named in memory of his mother. Now that Lou and Harriet are 84 and 82, respectively, they are concerned about who will run the foundation when they are gone. They had one son who has shown no interest and they currently have a close friend who loves the work, but he is 78. In the end, they decided to terminate the entire foundation into a community foundation field-of-interest fund to support pet-assisted therapy programs. The fund will retain the private foundation's name and will offer a staffed, competitive application process to ensure that grants are going to the best programs within the donor-defined two-county geographic area. The fund will exist in perpetuity.

4. Enhanced Tax Benefits for Non-Publicly Traded Assets and Excise Taxes
Donors with existing private foundations sometimes find they need to utilize a public charity's beneficial adjusted gross income limitation (50 percent for public charities vs. 30 percent for private foundations for cash; 30 percent for public charities vs. 20 percent for private foundations

for qualified appreciated assets—under both limitations, there is a six-year period to use the full deduction). Further, donors might have real estate, limited partnership interests, and/or closely- held stock they wish to contribute during life, but if given to a private foundation, the deduction would be limited to the donor's basis. Finally, the private foundation must pay an excise tax on the realized gain when it sells capital assets (generally 2 percent of net income subject to a reduction to 1 percent), even if the asset is publicly-traded.

Unlocking Real Estate's Maximum Income Tax Benefits: Jeremy is currently the President of his deceased father's private foundation. His father funded the foundation with $20 million of real estate at his death. Jeremy currently holds a $6 million parcel of real estate he inherited from his father (with an adjusted cost basis of $60,000). He would like to contribute the real estate into the private foundation to receive a charitable income tax deduction for this year. His adjusted gross income is $3.5 million and he expects it to remain level for the next six years. Jeremy's CPA points out the following: First, he would receive a basis deduction only and, even if he received the full fair market value deduction, he could not use it within the six year period. Second, if he transferred the asset into the private foundation he would have to pay approximately $118,800 in excise taxes at two percent or $59,400 at one percent. By contributing the real estate to a Type I Supporting Organization, with the local hospital as the primary supported charity, Jeremy would eliminate the excise tax, receive a fair market value income tax deduction, and be able to use the entire deduction within the six-year carry forward period.

5. Corporate Foundation "Look-Alike"
Many corporations have contemplated establishing a private foundation; however, using scarce human resources to bring the idea to fruition usually stops the discussion. Corporations also have challenges related to the complexity and administrative burdens of employee matching programs as well as the volatility of net earnings available for charitable contributions.

"Turn-Key" Corporate Responsibility: Christine and Bill own 30 percent of a 1,300-employee textile company with operations in four states. As they have been economically forced to close two mills in the last three years, they were looking for a way to make additional charitable grants into the communities they had left. Further, they wanted to develop a simple employee matching program to encourage charitable contributions where they still had operations.

Christine and Bill had explored the option of creating a private corporate foundation using one of the old mill sites, but their attorney told them they would only receive a cost basis deduction at the corporate level. Christine and Bill also knew that hiring additional foundation staff would not be good for morale after the company had just laid-off 22 corporate office employees.

Their attorney and CPA suggested they donate the real estate to a donor-advised fund. The community foundation could sell the property and then deposit the proceeds into the fund— "The Fabric Corporation Foundation Fund." The Vice President of Community Affairs could be the named advisor so she can recommend grants directly into the communities where the company had closed operations (an additional benefit was access to a local network of community foundations which could help identify the critical community needs as well as the specific charities doing the best work in those respective areas). She could also be the primary contact for a $1-for-$1 employee matching program existing employees can use in their respective communities.

All of the investment management, compliance, administration, and check distribution would be handled by the community foundation so no additional corporate staff would be needed.

6. Increased Grantmaking Flexibility

Sometimes the formality and administrative structure of a private foundation stifles the enthusiasm of the next generation. While some policies and procedures can be developed to ease this strain, the transparency and family history may still get in the way. Additionally, some private foundations want to contribute smaller general grants into a specific community or for a specific cause, but lack the administrative capacity to do it easily. Still others find it difficult to incorporate planned gifts (charitable lead trusts specifically) or to make international gifts.

Creating Charitable Space, Training and Ownership for the Next Generation: Alicia and Susan's parents created a private foundation six years ago. Once a year the family got together to discuss grants from the foundation. The foundation's focus was to give a small number of very large grants one time each year to cancer research projects. The family chose to give such large grants to reduce the amount of required administration. Alicia and Susan were engaged in the process and appreciated their parents including them in their philanthropy.

After a few years, however, the sisters both agreed that while they believed very deeply in cancer research, they felt as though their interests and giving were being crowded out. Susan, for example said, "The private foundation is really my parents', but we enjoy being a part of it. I support healthcare research but I like to give a few gifts each month and they are so small compared with the foundation's giving. I feel like I need to keep it separate." Ironically, while the children viewed the foundation as their parents', the parents' primary purpose was to make the children begin to feel like it was theirs.

They decided to establish donor-advised funds for each child, funded by their private foundation. The foundation matched each child's contributions from these funds two for one. The advised fund at their local community foundation allowed grants to be distributed weekly and for amounts of $250 or more. The parents set aside a part of the annual family meeting to discuss each child's giving over the last year.

Targeting Critical Needs Without Wasting Critical Time: Ben created a private foundation at his death and named his closest friends and advisors to its board. Over the years they received more and more funding requests from smaller organizations. The board had a grant minimum of $25,000 to keep the administration manageable but recognized it was missing a number of very high quality organizations. The board decided to make a $250,000 grant directly into the local community foundation's unrestricted pool from which the community foundation made 25 grants of $10,000. Because the community foundation already had the grantmaking structure and process in place, the private foundation was able to accomplish its goal of supporting small projects without changing grant guidelines or increasing administration.

"Controlling" Charitable Lead Trust Gifts: George and his wife, Nancy, recently met with their estate planning attorney. The attorney advised them to create a charitable lead trust for estate planning reasons. George said that would fit well with his plans to grow their private foundation. The attorney further said that because of gift and estate tax rules, if the trust paid income to a private foundation where he or Nancy, the grantors of the lead trust, also controlled the grant disbursements from the foundation, the assets of the lead trust would be included in their estate if they died before the trust terminated. While there may be ways to segregate the lead trust income from the other assets, the attorney suggested the simpler approach would be to create a donor- advised fund with a national environmental nonprofit. Retaining advisory control only and not legal control of this fund would not violate the grantor trust rules. Accordingly, the lead trust income payment could be made directly to the fund and remain outside their estate.

Minimizing the Administrative Burden of International Grants: Tom's private foundation recently made a grant to an Irish charity. Tom's attorney pointed out that the due diligence requirements for international grants (which included establishing charitable equivalency or expenditure responsibility) had proved more difficult than he expected (affidavits or questionnaires are typically required). His attorney said that a European community foundation with a U.S.-based 501(c)(3) organization may be comfortable doing this due diligence on the charity and then make grants either directly or through a high-quality conduit organization. Under the Pension Protection Act, donor-advised funds are now subject to the same equivalency or expenditure responsibility tests, but for those funds with a specific mission of international grants, they are usually more efficient than a private foundation making occasional one-off grants.

7. Access to Grantmaking Experts

Most local community foundations (or community foundation-like organizations) have a staff of grantmaking experts, or have connections with grantmaking experts, to give objective philanthropic advice. Nationally, only 23 percent of private foundations have paid staff, so many seek assistance in the following areas: strategic mission/focus, application and review process, grant criteria (size, scope, etc.), research reports and post-grant evaluation. Typically, a community foundation will provide these services for a fee. This fee currently comes in three distinct forms. A private foundation can establish a donor-advised fund large enough to generate the necessary administrative fees to pay for the services, or create a fee-for-service arrangement whereby the private foundation simply makes a grant to the community foundation for specific services rendered, or a negotiated basis point fee on the private foundation's assets to encompass a specified range of services. Caveat: Both the range and quality of services provided will vary greatly by community foundation (or community foundation-like entity) so some due diligence will be necessary.

Retaining the Grant Experts to Design a Giving Plan: Todd established his private foundation last year when he sold his business. He always wanted to support teachers but did not know where to begin. After selling the business, he started a new one within three months so his time for other activities was limited. He decided to establish a donor-advised fund large enough to gain access to customized services. In this case, Todd wanted expertise on establishing a mission and clearer focus for his foundation, as well as for specific research reports his board could review.

The community foundation happened to have a program officer with specific expertise on the subject. She was able to provide the board with the inside track regarding the issues and who was doing the best work in the community.

Developing and Implementing a "Junior Board" Plan: Sara and her brother, Bob, are the trustees on a second-generation private foundation. They had only two objectives: to be more disciplined about when they met, and to involve their seven children, ages 8 to 19. They engaged the local community foundation to perform quarterly family meeting services and to share creative ways to involve their grandchildren, and then to give assistance implementing the ideas.

The board especially liked the "junior board" concept where each child was allocated $5,000. They had to give half away based on a consensus group decision and the other half to a nonprofit of their choice based on site visits and detailed reviews. Each child then presented his/her rationale for funding to the full board. The community foundation staff facilitated the process at the full board and “junior board” level for a negotiated basis point annual fee on the private foundation’s assets.

8. Nonprofit Endowment Funds/Real Property

For private foundations that make grants for organizational endowments, there are typically a number of concerns. Will the organization treat the money as an irrevocable endowment in perpetuity? What happens to the money if the organization ceases to exist for management reasons? What happens to the money if the organization ceases to exist because they were successful (e.g., Parkinson’s is cured)? Is the organization going to provide efficient, consistent and prudent stewardship over the assets? Will the organization use the funds according to the donor’s original intent? Will the gift negatively impact future fundraising because of a large asset reflected on their balance sheet? If the grant is used to pay off a building, how can the donor be assured that the organization will not mortgage it at some point and that the building will always be used for the purposes specified? A permanent designated fund at a community foundation generally solves these issues.

Easing Capacity Concerns and Retaining the Option to Change Beneficiaries: A private foundation board wanted to make an endowment grant to a small local food bank sponsored by the Methodist church. The food bank started only three years ago and has quickly developed an excellent reputation. It has a $75,000 endowment fund now but does not have an active investment committee. When considering a $500,000 grant, the private foundation’s board was concerned about the food bank’s investment and administrative capacity. They were also concerned that the current food bank president was the sole reason for its success thus far - they worried what would happen if he left. Also, since the food bank’s current operating expenses were slightly more than $150,000, the president of the food bank knew he would have a more difficult time explaining why the food bank needed additional grants when it had a $500,000 liquid asset. He said that some funders would have a difficult time understanding that they would only spend five percent of the new endowment—$25,000—each year.

To address these concerns, the private foundation established a designated fund at the Methodist community foundation that would be professionally managed and administered. Each year the food bank would receive the same five percent payout and the new endowment would not appear generally as an asset on their books. Should the executive ever leave or the organization ever change its mission, the private foundation board retains the advisory capacity to change the charitable beneficiary of the fund.

Protecting an Asset for a Specific Purpose – Forever: A well-established corporate foundation liked to support small grassroots arts organizations with an emphasis on creating a distinct arts district. Thirty years ago, they made a grant to an arts organization to buy and renovate a dilapidated building in a transitional area. The building was purchased and restored and began putting on performances within the year. The corporate foundation was so pleased with the result it encouraged another arts group to do the same thing with a building just half a block away. Three years later, during the recession of 1974, the first arts group began having financial troubles. Its brand new artistic director wanted to make a mark in the community and "put on a show like no one has ever seen before." Because the arts group did not have a solid cash position, he mortgaged 50 percent of the building to finance the performance with the intent that ticket sales would be more than enough to pay it off. Unfortunately, it did not work out that way nor did the second show financed by more equity. To meet payroll in 1975, the organization had to continue borrowing against the equity until it went bankrupt in 1976. The corporate foundation assumed that the arts group still had the building but was extremely disappointed to learn the truth. The foundation knew the building could be purchased easily by someone who did not share the same arts district vision so it felt compelled to buy it back. They made a grant of the purchase price to the local community foundation to purchase the building, to provide ongoing management, and to provide a $1/year lease to a grass roots arts organization. Over the years, the corporate foundation has purchased 17 more buildings through the community foundation.

9. Scholarship Funds

Most private foundations that support scholarship funds do so directly by supporting a specific school. The necessary tax and legal compliance for a private foundation to administer a scholarship fund can be cumbersome (self-dealing issues, IRS pre-approval, etc.).

Easing Scholarship Fund Compliance Off-Campus and On-Campus: John established his private foundation after selling his engineering firm. The first grant established an engineering scholarship at his alma mater. Subsequent grants to the scholarship fund followed, as well as grants to other nonprofits. Through his volunteer work with his daughter's high school and the local Boys & Girls Club, John started thinking about creating an engineering scholarship fund for local kids that would allow them to go to any school they wanted.

John's attorney said it could be done through the private foundation but he would have to hire an administrator to establish policies and guidelines, advertise, collect applications, review/cull/select applications, coordinate receipt of the recommendation letters and transcripts, staff the final selection committee, notify winning applicants, cut the checks to the schools for the students' accounts, and get IRS pre-approval. Therefore it would be easier to establish a scholarship fund at the local community foundation so its staff could handle the administrative matters.

John's brother, Tim, liked the flexible scholarship idea as well but wanted to restrict it to his alma mater. He established a donor-advised fund with his university because he was concerned that a state lottery funded scholarship program would likely occur in the next five years. He planned on distributing scholarship grants in the interim to a number of the different schools on campus, but if the scholarship need diminished in the future, he would recommend grants to endow a named professorship in his mother's name and suggest additional grants to the athletic program.

Do note that in either scenario, the donors were not participating on the selection committee. Under new Pension Protection Act rules, the donor can only be part of the selection process if the entire process has been pre-approved by the charity's Board. Also note that a donor-advised fund cannot make grants to individuals.

10. Outsourced Administrative Services
After a private foundation has been up and running for about three years, the board members know what responsibilities they like and what responsibilities they don't like. At that point, they can keep the status quo, hire an administrator, or outsource some administrative services to the local community foundation.

Hiring Someone Else to do the "Stuff": Mary used to enjoy doing the little things for her father's private foundation, but after she turned 70, she was looking for someone else to cut the grant checks, follow up on end-of-grant reports, take minutes, make sure the 990-

PF tax return was managed and filed expeditiously, set the board meeting schedule and place, and look at the big picture just to make sure nothing was falling through the cracks. By establishing a fund at the local community foundation (or paying a fee-for-service or asset based fee), she received a personal donor relations officer who performed all of these services.

Conclusion

As I hope these case studies have demonstrated, from a planning perspective, a tremendous amount of creativity and flexibility can be used to leverage the distinct attributes of private foundations, community foundations and other organizations that sponsor and administer donor- advised funds and supporting organizations.

While there are clearly some private foundations that have been created that, in retrospect, should have been donor-advised funds and vice versa, a large number of private foundations could benefit from a synergistic relationship at some level with aforementioned organizations. The next time a client asks you whether he/she should have a private foundation or other type of fund or entity, maybe the answer will be “both.”

I would like to express my sincere thanks to Janne G. Gallagher, Senior Vice President and General Counsel at Council on Foundations, for her helpful comments and critique.

Bryan Clontz, CFP, is president of Charitable Solutions, LLC, a non-cash asset receipt/disposition, CRT/CGA investment management, insurance appraisal, charitable gift annuity risk management and reinsurance brokerage consulting firm based in Jacksonville, Florida. Mr. Clontz is also the founder of Dechomai Foundation, a national donor-advised fund dedicated to non-cash assets and charitable gift annuities.

Mr. Clontz is the former Vice President of Advancement at The Community Foundation for Greater Atlanta and former National Director of Planned Giving for Boys & Girls Clubs of America. He is a frequent lecturer on charitable planning topics and has published in an international insurance textbook, financial services and planned giving journals and a planned giving manual entitled Just Add Water which has sold more than 2,000 copies. He also serves on the Editorial Board of the Planned Giving Design Center.

Mr. Clontz received a Bachelors in Business Administration, a Masters in Risk Management and Insurance, and has earned the Certified Financial Planner, Chartered Life Underwriter, Chartered Financial Consultant and Accredited Estate Planner designations. He can be reached at (404) 375-5496 and bryanclontz@yahoo.com.

Note: This article appeared originally on the Planned Giving Design Center on August 14, 2002 and was updated and republished on October 19, 2010.