

COMERICA CHARITABLE GIFT PLANNER INSTITUTE

Grantmaking Considerations for Family Foundations

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Family foundations are often started to accomplish the donor's charitable objectives and to establish a family legacy of giving. In order to maximize its philanthropic impact, the foundation must define and articulate its mission, long- and short-term objectives, spending and investment policies, and grantmaking priorities and guidelines. These interrelated considerations are the subject of this article.

Family/Private/Independent Foundations

The IRS classifies family foundations as private foundations (which receive funding from limited sources, such as an individual, a family, or a small group of donors) rather than other public charities (which receive their major support from the general public) that are not private foundations. Private foundations are governed by different legal regulations than other public charities and are required to pay a tax on investment income and make charitable expenditures that equal or exceed five percent of their asset value. The bulk of their budgets is usually made up of grants to other charitable organizations.

Note: The IRS also recognizes private *operating* foundations, which directly operate their own charitable programs (for example, running a museum) instead of making grants to other charitable organizations. These foundations offer more liberal charitable deduction rules to the donors, and the foundations generally must spend at least 85 percent of investment income directly for the operation of their charitable activities.

Trust or Corporate Form

A private foundation can be established as a trust or as a corporation. There are advantages and disadvantages to both forms.

Many donors choose to establish a charitable trust because it is simple to create, and it allows the donor to establish irrevocable provisions that ensure that their philanthropic interests will be adhered to *in perpetuity*. The law of trust is based on common laws and is therefore more flexible than the laws of incorporation. Trusts also have more flexibility in receiving and disposing of real property than nonprofit corporations. In order to change the purpose of the foundation in the future, the governing body must obtain approval in a court of law.

If the trust is not structured properly, then the corporate form may provide greater protection from liability for members of the board of directors. The directors of a nonprofit corporation are held to less stringent fiduciary standards than trustees of a trust. However, if the donors select a corporate trustee to assist them, then they can insulate themselves from fiduciary liability similar to the protection they are afforded in the corporate form.

Enlarging the governing board, replacing board members, and revising the purpose of the foundations may be handled more efficiently in the corporate form. Many purpose clauses in the articles of incorporation are drafted in general language to allow the governing body flexibility to modify the purpose in the future. If the donor wants to assure the future continuation of the charitable purpose for which the foundation was established, the trust form provides greater protection.

Some donors decide to establish a named fund at the local community foundation, rather than a private foundation—often donors who care about many local causes and organizations, or the community as a whole. Donors who have specific fields of interest or organizations that they want to support long-term often prefer to establish a private foundation.

Management of the Foundation

The foundation's governing body must make provisions for the five primary management areas:

1. Custody of the assets
2. Investment management
3. Federal and state compliance and taxes
4. Organizational management
5. Grant management

Each foundation will consider its own purposes, internal strengths, financial wherewithal, and comfort level in weighing management options. Most foundations hire outside help for custody of the assets, investment management, and federal and state compliance and taxes, while many handle organizational and grant management internally with hired staff, consultants and expertise on the board.

In trust form, the board of trustees or the trust advisors have the authority to decide which nonprofit organizations receive distributions based on the original trust document, and the corporate trustee bears the fiduciary liability to ensure that the trust is used for charitable purposes. The foundation must receive the approval of a court of law in order to change the purpose of the foundation.

In corporate form, the board of directors has the authority to make distributions to

nonprofit organizations and bears the fiduciary liability to ensure that the corporation is used for charitable purposes. Each state's corporate laws spell out specific rules for amending the articles of incorporation and changing or enlarging the corporation's purpose, now and in the future.

Mission and Objectives

All foundations are legally required to have a statement of purpose in their founding documents. The mission goes beyond the legal requirement to clarify the foundation's purposes and the philosophy and values that guide it. The mission includes the grantmaking goals and priorities, establishes the geographic focus for giving, and declares the types of organizations it wants to support.

The grantmaking goals and priorities will help the governing body decide whether to accept grant proposals from a wide variety of nonprofit organizations or whether to distribute grants to one or more predetermined organizations. If its focus is to channel funds to specific charities or institutions, it will not need to advertise the availability of grants or review applications. On the other hand, a foundation with broader purposes must be prepared to seek, receive and evaluate funding proposals in a competitive environment.

Investment and Spending Policies

The foundation's governing body defines a desired charitable impact—its grantmaking goals and priorities—and the investment manager helps the foundation achieve it. For example, some foundations want to make an immediate impact on a particular project and may choose to distribute principal as well as earnings. Other foundations may want to assure the long-term viability of the foundation and will make more modest annual grants while protecting the foundation's assets. The investment manager establishes a spending policy to meet the foundation's impact objectives, both short- and long-term.

Once the spending policy has been established, the foundation's governing body, in consultation with the investment manager, will determine investment policies and guidelines. These policies typically include asset allocation, asset classes within the allocation, and any excluded asset classes. Thus, the foundation's investment and spending policies directly reflect the foundation's grantmaking goals.

Grantmaking Guidelines

Guidelines set the parameters for grantmaking. They are essential whether the foundation makes grants to predetermined nonprofit organizations or through a competitive application process. Each foundation must decide for itself the size and number of its grants, as well as whether to make annual grants or multi-year grant commitments. The two kinds of grantmaking formats require different guidelines.

Non-competitive format – In the non-competitive format, the governing body has determined that the foundation will make grants only to selected organizations, as long as they continue to meet certain criteria (such as maintaining their 501(c)(3) charitable status, providing services to certain client classes, etc.) determined by the board. The board should notify the selected organizations of the board’s criteria and the foundation’s plans for periodic site visits and program evaluation, as appropriate.

Competitive format – In the competitive format, the foundation must establish a grantmaking process including an application form, submission deadlines, grantmaking priorities and restrictions, a system for proposal review, a timeline, and grant evaluation requirements. There are nearly as many grantmaking policies and procedures as there are foundations, although in recent years many foundations have adopted the Common Grant Application Form distributed by the Council of Michigan Foundations. It is important that the foundation’s grantmaking process is clearly described and widely distributed.

Changing Grantmaking Focus

The donor must decide whether to give successor boards the freedom to change the charitable focus of the foundation in the future or whether to perpetuate the charitable purpose(s) by making such changes possible only when the original purpose becomes impossible or impractical to carry out. In other words, who has the focus—the founder or successors? The donor may give general or specific charitable directions in the foundation’s trust documents, and successor trustees are bound by the provisions of that document. In the corporate form, state laws usually grant more authority to the current boards of directors to revise or change the charitable focus. Donors may want to institutionalize their philanthropic vision through the form they choose for their family foundation.