

FAMILY FOUNDATION *Advisor*

Ju.y/August 2010 • Volume 9 / No.5 • ISSN 1537-9485

Is Perpetuity Too Long? Family Foundations Can Increase Impact With Sunset Dates

by Mark Neithercut

Introduction

Recently, a number of studies have looked at the benefits of establishing a termination or sunset date for foundations. Most of these studies have considered the benefits of a “spend-down” or “spend-out” policy (as opposed to operating in perpetuity) for staffed private foundations that may or may not have involvement from the founder’s family. Yet, family foundations, especially the smaller variety, are distinctly different enterprises than their large, professionally staffed, private foundation cousins. This article reviews the sunset-vs.-perpetuity issue and considers the potential benefits of a sunset date, with the special considerations of small family foundations in mind.

Family foundations comprise roughly half of all American foundations. The Foundation Center reports that there were more than 38,000 family foundations in 2008. While some of these family foundations are large and staffed by professionals, many of them are not. For example, nearly half of all family foundations distributed less than \$50,000 in 2008, and 64% had assets totaling less than \$1 million.

Many philanthropy professionals subscribe to what has been dubbed the “sanctity of perpetual endowment.” The emergence of perpetuity as a sacred concept may well be linked to the debate over preserv-

ing (or changing) the requirement that private foundations distribute 5% of the market value of their assets each year. If a foundation chooses perpetuity, then preserving the buying power of its assets over time can be an important core issue. Foundation executives may believe that they have the responsibility to ensure that the buying power of the institution’s assets do not erode while they are at the helm. Thus, they are inclined to emphasize the importance of perpetuity.

Yet for smaller foundations, perpetuity may be less appropriate. A recent study by the Foundation Center casts a helpful light on the treatment of sunset dates by family foundations. This study found that nearly 63% of the responding foundations had chosen perpetuity, nearly 12% had chosen limited-life, and the remaining respondents were undecided (see Table 1).

The study found that smaller, unstaffed foundations were more likely to limit their life span, while the larger family foundations with professional staff were more likely to have chosen perpetuity. In addition, foundations with a living donor were three times more likely to choose the spend-down option. Among smaller foundations, the proportion choosing sunset dates is likely even higher, as only 9% of the study’s sample came from foundations with under \$1 million in assets, while The Foundation Center estimates that 59% of family foundations had assets of this level in 2008.

The Benefits of Establishing a Sunset Date

We see four primary benefits of setting a sunset date: focus, impact, fulfillment, and proximity.

Focus. Many founders choose to establish a sunset date for their foundation because of a concern that the foundation may stray from his or her original vision in the decades (or centuries) that follow. News media accounts of foundations that have gone astray have no doubt influenced some founders in this regard. In addition, some of America’s larger foundations have changed in character after a generation or two, as the family became less involved and as professional managers and outside board members gained greater influence.

By establishing a sunset date, a donor can be assured that the foundation’s trustees will have known him and be familiar with his vision and values. It is quite common for small family foundations to end up, years later, being managed by a bank trust department or an attorney at the firm that helped set up the foundation—with no involvement from the descendants of the founder.

Impact. Donors who establish a sunset date for their foundations often indicate that they feel they can have a stronger impact on an issue by concentrating the full strength of the financial resources of the foundation over a finite amount of time. Rather than distribute the traditional 5% each year, these foundations spend out the entire corpus over a set period, with the goal of having the greatest impact possible. Furthermore, a sunset date can enhance the impact of a foundation because the board and its staff are not focused on creating and perpetuating a permanent institution. That is, a sunset date allows the foundation to focus on achiev-

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ing its maximum impact without being distracted by the care and feeding of the institution. Because small family foundations have, by definition, limited resources, a sunset date can allow these few resources to be used in a more focused—and possibly more forceful—manner.

The recent financial crisis has caused some foundations to increase their grant-making and set a sunset date. These foundations have felt that the financial crisis has created a period of greater need, and they wanted to respond with greater resources.

Fulfillment. Personal philanthropy should bring a rewarding sense of joy and fulfillment to a donor, and a sunset date for a small family foundation can help achieve this. Because a sunset date can lead to greater impact, a donor will likely see greater results during his or her lifetime—and this can lead to a much greater sense of accomplishment and fulfillment than if the impact had been spread over a much longer time period. In addition, although some of the impact may occur after the founder's passing, the children and grandchildren of the founder can gain a valuable sense of pride and fulfillment in achieving their parent's (or grandparent's) vision.

Table 1. Family Foundation Life Span (N = 1,074)

Perpetuity	62.94%
Limited Life Span	11.64%
Undecided	25.42%
	100.00%

Proximity. Most donors establish foundations because they want to “give back” in some way. This is a strong American philanthropic tradition dating back to Messrs. Carnegie and Rockefeller. A fundamental principle of our tax law is that assets set aside for charitable purposes can avoid various taxes, with the understanding that these assets will be used in the future for charitable purposes. Yet, if taxes are avoided today, when should this public benefit occur? Many donors who want to give back are attracted to the notion that they can give back to the communities where the profits that funded the foundation were earned. A sunset date can also provide a more direct link between the time that the assets were earned and the place. A sunset date can ensure that the “giving back” occurs within a limited time after the charitable deduction is taken (when the taxes are avoided).

Some donors who have chosen the limited-life option have pointed to the large

transfer of wealth expected in the next few decades, and thus concluded that many new donors will set aside additional assets for charity to benefit future generations. These donors believe that their assets can be better put to use today, while other assets will be available in later generations.

How Long?

The life span of a “spend-down” foundation can vary widely. Some donors have chosen a life span of as little as a few years, while other foundations may close after 100 years or more. The goals and strategies of the foundation should drive this decision. Because many donors seek to use their foundation as a tool to transfer their values to the next generation(s) and to give these generations a reason to meet together to achieve a common purpose, a life span of 20 to 50 years after the founder's passing may well serve this purpose while avoiding many of the common pitfalls of perpetuity.

Concerns

Despite the many benefits of sunset dates, foundations that set a closing date should be cognizant of a number of issues. First, foundations that have a set of grantees that receive regular annual funding should plan many years ahead to ensure that the transition is not disruptive to the grantees. In some cases, terminating foundations have made final endowment grants to their long-time grantees to help with this transition. These endowment grants could be made directly to the nonprofit, or to a local community foundation for the benefit of the nonprofit. Implementing a termination process can be challenging, but fortunately there are a number of helpful guides available.

Second, a foundation without a clear

Reader Resources

Allan R. Clyde, “A Conversation With Irene Diamond,” *Foundation News and Commentary*, March/April 1998.

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David Cay Johnston, “As Foundations Close, Anxiety for Charities,” *N.Y. Times*, November 11, 2009.

Key Facts on Family Foundations, The Foundation Center, April 2010.

Ruth Masterson, *Closing Shop: When Small Foundations Get Out of the Foundation Business*, Association of Small Foundations, 2009.

Loren Renz & David Wolcheck, *Perpetuity or Limited Lifespan: How Do Family Foundations Decide? Intentions, Practices, and Attitudes*, The Foundation Center in collaboration with the Council on Foundations, April 2009.

Stephanie Strom, “An Environmental Charity Expires, as It Always Planned,” *N.Y. Times*, May 29, 2009.

John R. Thelin & Richard W. Trollinger, *Time Is of the Essence: Foundations and the Policies of Limited Life and Endowment Spend-down* [Program on Philanthropy and Social Innovation], The Aspen Institute, 2009.

Heidi Waleson, “Beyond Five%: The New Foundation Payout Menu,” A joint project of the French American Charitable Trust, the Northern California Grantmakers, and the New York Regional Association of Grantmakers.

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strategy to achieve its goals will not achieve its desired impact or a sense of fulfillment, whether it has a 30-year life or a 500-year life. A sunset date can result in greater impact, but there is no guarantee. This is especially true of a small, all-volunteer foundation where the trustees have many other responsibilities.

Options

While many family foundations, especially the smaller ones, would benefit from choosing a limited life, all family foundations would benefit from discussing the sunset vs. perpetuity issue. No matter what the final decision, this discussion will help a foundation align its time line, goals, and resources. Those family foundations that choose a limited life may do so at the time of the foundation's creation, and thus this decision may be part of the foundation's founding documents. Others may arrive at this decision later in the life of the foundation.

In addition to sunset dates, donors and the trustees who are interested in philanthropy with a limited life have other options available depending on their philanthropic goals and strategies.

Community Foundations. Donors may find that working with their local community foundation offers a flexible set of tools to achieve their philanthropic goals while avoiding many of the pitfalls of perpetuity that small, stand-alone foundations face. Donors may choose to establish a fund or a support organization at

Gone Astray?

Dan Maddox founded the Maddox Foundation in Tennessee in 1968, but his involvement in the foundation was cut short by a freak boating accident in 1998, which took the life of Mr. Maddox and his wife, Margaret. Within a few years, the two remaining trustees (an employee and a stepdaughter) of the foundation voted to move the foundation to Mississippi, without seeking approval of the Tennessee Attorney General, where the foundation purchased a minor-league hockey team and an arena football team. Mississippi state law allowed one of the two remaining trustees to make all decisions without consulting the other. Some Maddox family members objected to the foundation's direction, and the State of Tennessee sued the foundation in 2004. A subsequent settlement in 2007 required the Maddox Foundation to pay \$55 million to the newly established Dan and Margaret Charitable Trust in Nashville.

their local community foundation as an alternative to a family foundation, or the trustees of a family foundation may create a fund at a community foundation with the remaining assets at the end of the foundation's life.

Lead Trusts. Like a sunset date, a lead trust avoids the pitfalls of perpetuity. A lead trust can provide many tax advantages to a donor while, at the same time, setting aside assets for charitable use for a limited time. At the end of this period, the assets return to private hands—usually the donor's children or grandchildren. Jacqueline Onassis used the lead trust in her estate planning, which gave this vehicle a good deal of publicity.

Commercial Gift Funds. Like community foundations, many of the large investment houses and banks now offer donor-advised funds. These funds offer many of the benefits of a family foundation, while avoiding many of the pitfalls of perpetuity. Donor-advised funds typically

allow one or two generations of advisors, after which any remaining assets are spent out to a designated charity or become a permanent unrestricted endowment fund of the sponsoring charity.

Perpetuity Can Be a Sound Strategy

Perpetual endowment is a wonderful and powerful tool for many institutions. Many of America's greatest educational, arts, and medical institutions are sustained, in part, by strong endowments. These institutions are among the most important in our society, and preserving them in perpetuity makes eminently good sense.

Large permanent foundations of any type typically have sound strategic reasons for managing their assets for perpetuity. A founder may have a long-term vision that will require many generations to achieve—such as nuclear disarmament, reducing global warming, or erasing rural poverty. Other foundations may simply want to provide flexible capital (“community capital,” if you will) for future generations. Community foundations have often adopted this view; they seek to grow permanent endowment that will act as venture capital for future community initiatives. For these permanent foundations, the power of compounded interest can result in significant growth in both assets and the 5% payout after 40 or 50 years. Thus, after many decades, the cumulative amount of grant-making by the foundation can exceed the grants that would have been made under a spend-out scenario.

Finally, some families are simply inter-

Successful Implementation of a Sunset Date

Julius Rosenwald Foundation. Founded by Julius N. Rosenwald, who served as president and later chairman of Sears and Roebuck (1908–1932), the Rosenwald Foundation focused, in part, on educational deficiencies in the poor and rural South. The foundation helped build more than 5,000 schools for poor African Americans before it closed in 1948.

The Beldon Fund. Founded in 1982 by John Hunting, Beldon received significant funding in 1998—at which time Hunting decided to spend down the fund within 10 years. Beldon awarded a total of \$120 million for environmental causes before it closed its doors in May 2009.

Aaron Diamond Foundation. Best known for funding AIDS research, the Aaron Diamond Foundation closed in 1996.

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ested in preserving the name and the legacy of a family member in perpetuity. In this case, a permanent foundation is an excellent option.

Conclusion

Small family foundations are increasingly adopting a sunset date for a variety of reasons. Some founders are concerned that the foundation will stray from its original vision after a few generations. Others realize that they can have significantly more impact by concentrating their grantmaking over a finite number of years. Although this article has focused on small family foundations, many of the very largest family foundations have also cho-

sen to establish sunset dates, as well, including the Bill and Melinda Gates Foundation and The Atlantic Philanthropies.

By adopting a sunset date (typically 20 to 50 years), a donor can be assured that the board will always be composed of known advisors and family members who are aware of the founder's original vision and values. The board can focus more on

achieving the foundation's strategic goals and less on perpetuating the institution.

While many family foundations would benefit from establishing a sunset date, all family foundations would benefit from discussing the benefits of perpetuity versus a sunset date, no matter what the final decision. The "spend-down" trend is simply one alternative strategy to perpetuity, which can be a very long time. ■

Foundations That Have Chosen a Sunset Date

The Bill and Melinda Gates Foundation is scheduled to close within 50 years of the founders' passing.

The Atlantic Philanthropies is scheduled to close in 2017.

The Paul Rapoport Foundation is scheduled to close in 2015.

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Current Developments, Cases, Analysis, Planning Advice

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