Philanthropy Advisory Group

Key Tips for Starting a Successful Foundation

Tip One: Decide if you want your family's name to be part of the foundation's legal name.

A foundation's name is important to creating a brand. If a foundation becomes known in its community for funding good programs, it can become a leader in its field and offer an imprimatur of legitimacy to the organizations it funds. For instance, in New York City, once the Robin Hood Foundation funds a grantee, other donors recognize its name and are more likely to support that organization.

When selecting a name for your foundation, consider whether or not you want to use your family name. Discussing the name of your foundation upfront helps to address the founders' conceptions of the family's role as philanthropic leaders.

Some families wish their names to be known to honor the originator of the funds. Often, a person or couple has worked extremely hard to obtain sufficient wealth to become philanthropists and by including their names in the foundation's title, the family commemorates their industriousness and their charitable values.

Other families do not want their name used in the foundation's name. Reasons for this vary. Some families want to keep their level of wealth private; often families are concerned that children will be treated differently if the family's wealth is made public.

Our List in a Nutshell

1. Consider foundation name
2. Customize founding documents
3. Adopt a mission statement and funding guidelines
4. Institute grant contracts
5. Run a tight operation
6. Consider unconventional strategies
7. Familiarize yourself with IRS rules

If a family is concerned about privacy or confidentiality, is important to remember that even if a family does not use its surnames in the foundation's name, the tax documents of the foundation will reveal the board members' names. Nevertheless, it is harder for the public to search for board member names embedded in a tax document than the name of a foundation, so a degree of privacy is garnered by using a non-family name for the foundation. If you are searching for complete anonymity, you should consider starting a donor advised fund instead of a family foundation.

Tip Two: Invest in the bylaws and articles of incorporation.

Some advisors try to save families money by encouraging them to use boiler plate language in their bylaws and articles of incorporation, the documents that provide the foundation's principles for governance and operations. While most boiler plate language can serve a new foundation adequately, we strongly encourage families to think together about their particular concerns, dynamics, and philanthropic goals and to reflect them in the foundation's bylaws and articles of incorporation. In particular, we urge families to carefully consider:

- Voting rights for the current generation and how a future generation should obtain voting rights, if at all.
    - For example, some founding board members want only their bloodline descendants to serve as board members while others are open to inviting future spouses or others to join boards.
- Program areas that you intend the foundation to address or areas that you wish the foundation not to fund.
    - For example, some funders are determined to fund religion and religiously-affiliated causes, while others do not want any funds used for religion. If you have strong views on these points, consider codifying your views in the articles of incorporation, which are usually harder to change than bylaws.
- What should happen to the foundation's funds if a board is dysfunctional or if no qualified board members are available.
    - For example, we have seen situations in which the bylaws limit new board members to specific individuals, leaving the foundation with no direction for further appointments years later when the pre-selected individuals are older or not available to join the board.

Tip Three: Initiate strategic giving by adopting a mission statement and funding guidelines.

Sometimes, a funder knows his or her mission from the start. Often, developing a mission is more complicated because (i) either the funder has a variety of causes that are special to him or her or (ii) the funder is including his or her family in the process of developing a mission.

We cannot emphasize enough the importance of developing a defined mission or set of missions, if you have a larger distribution capacity. While initial discussions of mission may cause friction, in the long run funders with articulated missions function with greater harmony and purpose than those without. The mission is also the underpinning of all the grant programs and procedures that you generate; it is the benchmark by which you will measure your philanthropic hurdles and your successes.

Tip Four: Institute grant contracts for all grants of $20,000 or more.

Your foundation should issue contracts for all grants over $20,000. Contracts are a key communication tool. They demarcate the foundation's expectations for how the funds will be used, institute reporting requirements, and name reasons for grant installments to be issued or withheld.

Proposals are often written by development or program personnel who generate aspirational program goals, with good faith and optimism. When it comes time to sign a binding commitment, though, either they or their leadership realize that they should scale back and offer a more realistic version of what can be accomplished in the grant's timeframe.

Crucially, the contract—which need not be complex—promotes better communication between the nonprofit organization and the funder about how performance should be measured and what the challenges are to the grant's success. In the long run, the contract actually helps manage both the funder's and the nonprofit organization's expectations of what it can accomplish.

Some funders worry that contracts will frustrate their grantees and unduly impinge on grantee staff time, especially when the staff has already written an acceptable proposal, provided site visits, and followed up on questions as requested. In our experience, however, the contract process helps align expectations and leads to better working relationships between funders and grantees.

Tip Five: Run a Tight Operation.

Start off operating your foundation with professionalism and care. Keep copies of your proposals, contracts, and reports. Make considered grant decisions. Have board policies in place, including a conflict-of-interest policy and a compensation & reimbursement policy. Take minutes at all board meetings and ensure votes comply with your Articles of Incorporation, Bylaws, and internal policies. Running a well-managed entity will help you be a disciplined grant maker. It will also help you in case you are audited.

A foundation audit can be costly and demoralizing, but if you run your foundation correctly, you will fair well. We know this from experience. One of our clients came to us to learn how to run her foundation, and she took to heart all the nuts and bolts of good foundation maintenance. Just two years into the foundation's existence, the IRS audited the foundation (for no apparent reason). Because the client had run the foundation according to best practices, she could hand over her documents in an organized, expedited fashion. She saved the foundation thousands of dollars in legal fees and months of drudgery.

Tip Six: Consider traditional and lesser known foundation grantmaking tools to pursue your mission.

There are many ways for a foundation to generate important change in its chosen field. A foundation can issue traditional grants for program support, operations, endowments, capital improvements, research, and bridge & seed funding. But your foundation can also make use of many more funding tools. It can make an equity investment in a book on poverty; run a prize competition; assist individuals devastated by a natural disaster; loan money to a school interest free; invest some of its portfolio in social entrepreneurs; or fund an evaluation of a nonprofit organization or field.

Here is another tip – a foundation does not have to give to a nonprofit. It can give to any organization, either in the U.S. or abroad, for a charitable purpose, so long as it follows simple IRS required due diligence procedures. Furthermore, all staff and consultant expenses incurred toward traditional grants or the above-listed creative philanthropic strategies will also count toward the five percent distribution requirement.

Tip Seven: Be mindful of key restrictions against payments from the foundation to family members.

The IRS makes distinctions between foundation and private funds. In order to safeguard funds set aside for charitable purposes and limit self-dealing (i.e., foundation money going back into the private banks of family members and others close to the foundation), there are strict rules governing how a foundation's funds can be invested and disbursed.

The two most commonly violated rules involve foundation rent payments and tickets to fundraisers:

- A foundation cannot pay rent to a family member. It may sound harsh, but if your foundation is housed in the office of a family member, it can pay <u>no</u> rent, *not even fair market rent*, to the family member or that family member's company.
- A foundation cannot purchase tickets to a fundraiser *unless* those purchases are for foundation business. Such business could be overseeing how an event is run, bringing new funders into the fold, or offering the foundation's named support to a long-time grantee. In almost no cases should a foundation pay for a board member's children to attend an event. Moreover, do not permit your foundation to pay for the charitable portion of a ticket while you pay personally for the cost

of the event. The IRS views this as self-dealing because you would not have been permitted to attend the event but for the foundation's purchase.

- ✓ Tip: We recommend documenting – with a short memo to file – the reason your foundation purchased tickets for board members to attend any fundraising event.

Notwithstanding the rules against self-dealing, a foundation can pay a competitive salary to a family member who takes on staff responsibilities. It can also pay market rate fees to board members or professionals who provide services, be they legal, financial, or programmatic. A foundation may also reimburse board members for travel and expenses related to foundation business. We recommend that you adopt a compensation and reimbursement policy, so as to take a uniform, fair approach.