

## **Thinking about Forming a Private Foundation? Let's Run The Numbers**

Prospective donors often contact the Council on Foundations to ask if they have enough money to start a private foundation. While the amount of assets available to endow the foundation is important, it is by no means the sole, or even the most important, factor in your decision. Therefore, the Council does not recommend a monetary threshold for forming a private foundation.

Determining whether a private foundation is right for any individual or family involves a host of additional questions such as:

- What values do you plan to express through your giving?
- Do you wish to involve your family and to what extent?
- What is the geographic scope of your philanthropy?
- How long do you want your philanthropy to operate? Years? Decades? Forever?
- Do you prefer supporting others' work or hands-on participation?
- To what degree are you comfortable delegating tasks (such as investment management or correspondence)?
- How much time do you have to devote to administering your philanthropy?
- What are the tax consequences?

The decision is one you'll want to make only after doing some research, talking with family and getting some sound advice from a trusted philanthropic advisor.

### **Options for Administering a Private Foundation**

You will know the assets you can afford to put into a private foundation when starting it, but what will the annual administrative expenses be? That will depend on how you choose to administer your private foundation. There are many options for managing private foundations. Some of them include management by:

- volunteer board of directors
- paid staff
- consultant
- attorney
- bank trust department
- community foundation

(Consult the Council on Foundations' *Guide to Small Foundation Management: From Groundwork to Grantmaking* for an exploration of the various options. To order, go to [www.cof.org](http://www.cof.org) then click on "Publications")

### **Can you afford to hire staff?**

The Council on Foundations has developed three basic examples to help you think through just one of these management options, whether you can afford paid staff. The scenarios below roughly demonstrate the relationship between asset amounts, grant distribution and staffing expenses.

The formulas are based on the following assumptions:

- You want a permanent endowment.
- Your charitable budget is going to be in the range of 5 to 6 percent of assets.
  - The IRS mandated minimum annual charitable expenditure is 5 percent of assets (this includes grants and administrative expenses, but does not include investment management expenses).
  - In the formulas below, we use the median foundation expenditure percentage of 5.5 percent for your charitable budget.
- No more than 15 percent of your annual charitable budget will be used for administrative expenses.
  - Research by the Council on Foundations shows the median charitable administrative expense level in

relation to the total charitable budget for all private foundations is 8.6 percent. However, smaller foundations don't have the same economies of scale as larger foundations. Therefore, for smaller foundations we suggest that for the purpose of the scenarios below assume that your administrative expenses will be about 15 percent of your annual charitable budget.

- Annual legal and accounting fees will total \$5,000.

Depending upon the assets you have available, you may want to think about alternatives that can help you maximize your charitable dollars and choices for giving (see the "Additional Options" section below).

### **\$1 Million Foundation (No staff)**

Because of the small amount of money that should be devoted to administrative expenses (usually no more than 15 percent of your annual charitable budget), the option of hiring part-time staff is not financially prudent with a foundation of this size.

#### ***Total Annual Charitable Budget***

$$\mathbf{\$1,000,000 \times .055 = \$55,000}$$

Assets x 5.5 percent = total annual charitable budget (grants + expenses)

#### ***Administrative Costs***

$$\mathbf{\$55,000 \times .15 = \$8,250}$$

Total annual charitable budget x 15 percent = administrative budget

Without paid staff, your administrative costs will reflect only your legal and accounting fees (estimated at \$5,000), which in this case is 9 percent of your annual charitable budget.

### **Volunteer Responsibilities**

Because in this scenario the foundation can not realistically afford staff, it will be the responsibility of the donor and volunteer board to review all grant requests, go on site visits (as necessary) and handle all grantee correspondence, grantmaking investigations, and governance responsibilities of the foundation. If your grantmaking is focused and the grants are few in number, these responsibilities will be easier for you. These responsibilities can be extremely fulfilling when willingly undertaken. In preliminary responses to the Council's 2002 Foundation Management Survey, 93% of family foundation respondents reported that they feel inspired by their philanthropy.

### **\$5 Million Foundation (Half-time CEO)**

Council on Foundations research shows the majority of private foundations with assets of \$5 million to \$9.9 million have part-time staff only. The following calculations assume your half-time CEO salary and benefits is \$38,750<sup>1</sup> and your annual legal and accounting fees are \$5,000:

#### ***Total Annual Charitable Budget***

$$\mathbf{\$5,000,000 \times .055 = \$275,000}$$

Assets x 5.5 percent = total annual charitable budget (grants + expenses)

#### ***Administrative Costs***

$$\mathbf{\$275,000 \times .15 = \$41,250}$$

Total annual charitable budget x 15 percent = administrative budget

In this case, because your total charitable budget is significantly larger than the previous example, you might consider the option of a half-time staff person. With your half-time CEO salary and benefits at \$38,750 and your legal and

accounting costs at approximately \$5,000, administrative costs total \$43,750.

This exceeds the recommended 15 percent administrative ceiling. Therefore, you might consider hiring a lower-compensated staff person such as a program officer or administrative assistant, with the board retaining many responsibilities, or hire a CEO with legal or accounting skills, so that the \$5,000 fee is reduced.

## **\$10 Million Foundation**

*(Half-Time CEO and Half-Time Administrative Assistant)*

In this case, your annual charitable budget is an amount that realistically allows you to consider the option of hiring a half-time CEO and a half-time administrative assistant. Assuming that your half-time CEO and half-time administrative assistant salary/benefits are \$68,750<sup>2</sup> and your annual legal and accounting fees are \$5,000:

### ***Total Annual Charitable Budget***

$$\mathbf{\$10,000,000 \times .055 = \$550,000}$$

Assets x 5.5 percent = total annual charitable budget (grants + expenses)

### ***Administrative Costs***

$$\mathbf{\$550,000 \times .15 = \$82,500}$$

Total annual charitable budget x 15 percent = administrative budget

Adding personnel and legal and accounting costs gives you a total of \$73,750 for administrative costs. In this example, your administrative costs will be 13.4 percent of your annual charitable budget, which is below the 15 percent recommended ceiling.

As noted above, there are many options available to manage a private foundation. Our research indicates that many families opt for more than one philanthropic tool, each fulfilling a different philanthropic goal.

For example, in preliminary data from the 2002 Foundation Management Survey, 11% of the family foundations responding also had donor-advised funds at community foundations.

## **Additional Options**

### **Donor-Advised Funds**

Donor-advised funds make philanthropy administratively simpler if one of your goals is to lessen your day-to-day obligations. In a donor-advised fund, donors make an irrevocable contribution to a fund, claim a charitable deduction on their income tax returns and then recommend how the money in the fund should be distributed to charity. Public charities (e.g. community foundations such as The Community Foundation for the Twin Tiers) take the responsibility of managing such funds. Most accept gifts of cash, publicly traded stock, real estate and other assets like closely held stock and life insurance. The donated funds are invested in the financial market, so they can keep growing. You can take the tax deduction-typically up to 50 percent of your adjusted gross income for cash gifts and 30 percent for appreciated properties, such as stock-for the tax year in which the donation was made.

One advantage of creating a fund through a community foundation is that community foundation staff know and live in the community they serve and can work closely with you to fulfill your charitable goals. To find a community foundation in your area, visit [www.cflocate.com](http://www.cflocate.com).

### **Supporting Organizations**

A supporting organization (SO) is a tax-exempt entity that supports a public charity. To be a supporting organization, the SO must meet one of three complex legal tests that assure, at a minimum, that the organization being supported has some influence over the actions of the supporting organization. The use of this form is common in connection with community foundations. While supporting organizations are distinguishable from donor-advised funds because they are

distinct legal entities, they share many of the same favorable deduction limitations.

### **Planned Gifts**

Planned gifts include bequests, charitable remainder trusts, charitable lead trusts, pooled income funds and charitable gift annuities. These usually involve a split income arrangement where the donor receives an income stream during his or her life and the charity receives an outright gift after a term of years or the donor's death. You can make these planned gifts through community foundations and other charities.

### **Writing Checks**

You also may decide to simply continue making direct donations. If you are contemplating increasing the size of your gifts, development (fundraising) professionals at your favorite nonprofits will be happy to work with you to honor specific wishes you may have.

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<sup>1</sup> Based on the Council on Foundations' 2002 *Grantmakers Salary and Benefits Report*, the median salary for a half-time CEO of a private foundation with \$5 million to \$9.9 million in assets is \$31,000. The same report showed that benefits paid are roughly 25 percent of their salary. \$7,750 (25 percent) plus \$31,000 = \$38,750.

<sup>2</sup> Based on the Council on Foundations' 2002 *Grantmakers Salary and Benefits Report*, the combined median salary for a halftime CEO (rounded off at \$40,000) and half-time administrative assistant (\$15,000) at a private foundation with \$10 million to \$24.9 million in assets is \$55,000. Benefits (roughly 25 percent of their salary) would be \$13,750. Therefore, \$55,000 + \$13,750 = \$68,750.