

Trusts & Estates

Feature: Philanthropy

By Roger D. Silk

Lifetime Versus Testamentary Giving

Contemplating three non-tax implications

Self-made people are often conflicted about philanthropy. Many of them work very hard for their wealth and, to a certain extent, measure their self-worth by the size of their pile.

If a client's goal is to not only build his pile but also be philanthropic, it can seem like a contradiction. And to some extent, it is. But, for the advisor, there's also plenty of room for effective planning. And that often involves getting the client involved in philanthropy while he's alive. James Cody, director of estate and trust advisory services at Harris myCFO, a multi-family office in Palo Alto, Calif., observes that good philanthropic planning and the related tax benefits can actually help a client grow his overall pile. But there are other good reasons to engage in philanthropic planning. According to Cody:

Rather than simply leaving behind a testamentary plan that creates a huge philanthropic fund at death, wealth creators should be encouraged to become actively involved in shaping their philanthropic legacies during their lifetimes in the same way that they actively grew and shaped

the business ventures that created their wealth. Many find active engagement in philanthropy during their lifetimes to be as stimulating and challenging as their business ventures. Involving children and grandchildren in the giving process, especially through a family charitable foundation, can strengthen family bonds and instill a sense of charitable purpose in future generations.¹

In our role creating and managing charitable entities, we've encountered three non-tax benefits of lifetime giving: personal satisfaction, the ability to shape a legacy and the ability to exert control both during and after life.

Personal Satisfaction

One reason donors give while they're still alive is that they enjoy the gratitude people express to them for their generosity. Donors who wait until they die to make contributions won't see the effects of their generous gifts and certainly won't be able to acknowledge the thanks from those they've helped. Of course, receiving kudos isn't the only reason for making donations while still alive, but it can be an enjoyable one, even though donors rarely mention it out loud or in public.

Create a Legacy

Some people care about being remembered after



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death and some don't. But, if being remembered is important to your client, as it is for many donors, starting a giving program early gives your client a chance to explore a rewarding second career as a philanthropist and create a legacy.

Here's a trivia question for a cocktail party: What do John D. Rockefeller, Sr., Andrew Carnegie and Julius Rosenwald have in common? If you don't know, you're not alone. In the 1930s, Rosenwald, Rockefeller and Carnegie were the "Big Three" of philanthropy. Rosenwald was a philanthropist on the same scale as Rockefeller and Carnegie. So what happened to Rosenwald? His foundation spent itself out of existence, as he wished, and now it's not making any contributions to anything. But, while virtually everyone

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recognizes the names of Rockefeller and Carnegie, few people today have ever heard of Julius Rosenwald.

Rosenwald required that his foundation spend itself out of existence within a relatively short period following his death in 1932. He most likely chose to eliminate his foundation because he didn't trust those who would be running it after he died. He once said, "It is easier to make \$1 million honestly than to give it away wisely."² Rosenwald's foundation spent all its money rapidly. Concentrating on the education of poor black children, mainly in the South, the foundation built many schools. In Prince Georges County, Md., for example, it built 23 schools. Just nine survive.

In addition to forgoing a legacy, another problem with Rosenwald's method of assigning the foundation an expiration date is the perverse incentive it creates to spend the funds quickly, but not necessarily intelligently. If you've got to shovel money out the door, it's tough to do it well. While some foundations seek to spend themselves out of existence, the more common course—and in the long run arguably the more prudent and beneficial course for both donors and charities—is to spend only the required 5 percent of assets each year. Because long-term investment returns tend to be above 5 percent, this allows both assets and annual giving to grow. Note that because of the mathematics of investment returns and the effects of inflation, if a foundation doesn't grow, it's doomed to give less and less after inflation, every year, until it finally vanishes.

The Problem With Waiting

A donor who fails to develop a sufficient pattern of giving during his lifetime faces the challenge of developing an explicit and appropriate mission for his charity, one that's specific enough to guide family members or trustees, but flexible enough to allow for social and economic changes.

Donors' missions range from specific to vague. James B. Duke, who earned his fortune through the American Tobacco Company and Duke Power, is perhaps best known for the university that now bears his name. The university is only one of the many institutions he helped create by being tremendously specific. He created a foundation and funded it with shares of Duke Power that could only be sold with unanimous consent of the trustees. He went on to specify how the foundation's income should be distributed: 32 percent to Duke University, 32 percent to hospitals in the Carolinas, all the way on down to a requirement that the foundation spend 2 percent on supporting retired preachers and their families.

Other philanthropists, such as John D. MacArthur, who earned his fortune in the insurance

industry, left minimal guidance. When he died in 1978, MacArthur left his foundation no instructions other than the legal requirement that the money be used for qualified exempt purposes.

When the donor leaves no clear pattern of lifetime giving, even instructions he leaves, such as in a will, can be too vague and his intentions easily misconstrued. But being overly specific creates the risk that conditions will change enough after a donor's death to make his directions impractical. Some philanthropists believe they can avoid such problems by having their charities spend their money within one generation after the founder's death. For other founders, this is unacceptable, especially if they want the charity to continue to do good for many generations to come.

Control From the Grave

Sometimes, in the early stages of thinking about charitable giving, clients will be concerned about specifying exactly what their philanthropy should and shouldn't do, particularly after they're gone. This is one of those initially attractive ideas that can turn out to be a mistake.

Often clients don't realize the limited framework of their assumptions when they specify rigid missions for their charities. It's impossible to accurately predict a century's worth—or more—of social and economic trends and technological innovations. Yet some donors build a highly detailed plan for giving without taking into account the unforeseeability of the future. A donor today, for example, could plan to have his foundation help find a cure for a specific debilitating disease. But once that cure is found, due to the rigidity of the mission, there's no longer an outlet for the foundation's largesse.

Consider the case of Bryan Mullanphy, mayor of St. Louis in the late 1840s. In the early 1800s, many homesteaders heading west in their covered wagons became stranded in Missouri without enough money to return home or to continue westward. A St. Louis resident, Mullanphy

established an endowment in 1850 to help worthy travelers in covered wagons continue west. Failing to anticipate that technology might make the covered wagon obsolete, Mullanphy didn't see that he was creating a problem. As the number of covered wagons declined, opportunities to carry out the foundation's mission became scarce. With grants down, the endowment grew. Eventually, Mullanphy's will was challenged and, after extensive litigation, the court ruled that the endowment could be used to assist all travelers, not just those in covered wagons.

These examples illustrate some pitfalls of overly specific instructions for charity. But what of the other extreme—simply telling your trustees to do good things with your money, as Rockefeller did when he directed his foundation to “promote the well-being of mankind throughout the world”?³

Too Little Direction

There are a number of famous philanthropists who left vague instructions upon their deaths. The subsequent successes or failures of their charities can be attributed to one factor: the track record of their philanthropic involvement.

Rockefeller's instructions about the “well-being of mankind” must be among the most general ever left. Yet his successors were hardly in the dark. The elder Rockefeller, having devoted so much of his life to active philanthropy, left an extensive track record. It seems certain that Rockefeller would, on the whole, be pleased with the great achievements of his foundation since his death.

The same may not be said of John D. MacArthur and Henry Ford, both of whom left major fortunes in foundations to be administered after their deaths. MacArthur and Ford left very little in the way of either lifetime examples or of clear instructions. As a result, their foundations have at times been accused of funding programs actually antithetical to their founders' interests and desires. For example, when Henry Ford created

the Ford Foundation, he made clear that he had no interest in philanthropy; the foundation was simply a way to avoid estate tax and retain family control of the Ford Motor Company. After he died, the first trustees of the Ford Foundation searched in vain for some guidance from the donor. And because Ford had no track record, conflicts among the foundation's trustees and Ford family members eventually ensued. The Ford Foundation sold the last of its Ford Motor Company stock in 1974, and in 1977, Henry Ford II resigned, accusing the foundation of an anti-business bias through the projects it funded. Today, there's little connection between the Ford Foundation and either the automobile company or the family.

There's no better way for a donor to assure his charity's future than starting that charity now.

William E. Simon, a well-known conservative who was Treasury secretary in the Nixon administration, served briefly on the MacArthur Foundation's board. Simon found the experience to be "the most frustrating of his life"⁴ because as a conservative aware of MacArthur's traditional views, he couldn't convince the board to advance conservative causes. MacArthur preferred to concentrate almost entirely on business during his lifetime, but his failure to develop a philanthropic tradition himself meant that the current mission of the MacArthur Foundation didn't reflect its founder's beliefs.

Simon was himself an important philanthropist, and his own actions shed light on the difficulty of gauging the philanthropic desires of someone without direct evidence. In addition to

serving as Treasury secretary, Simon was a very successful businessman. His son, William E. Simon, Jr., credits his father with developing the leveraged buyout. The elder Simon gave away an estimated \$30 million during his lifetime and in 1998 announced his intention to devote his fortune, estimated at \$350 million at his death in 2000, to various charities, including AIDS hospices and education for low-income communities. How many people, knowing that Simon was a political conservative, would, if placed on the board of the William E. Simon Foundation and given no guidance as to Simon's preferences, have allocated funds to AIDS hospices and education for the poor?

Between the Scylla of being too restrictive and the Charybdis of being too vague, how is a donor to specify what his charity should do after he dies? That depends largely on a donor's goals and wishes. If a donor's mission is vague, he should make sure that his philanthropic goals are specified during his lifetime, either by developing a track record or by spelling out a few general principles in the founding documents and appointing his children or trusted (and younger) friends as directors. But if a donor's mission is quite specific, the donor needs to find directors who share his passion or at least can be trusted to carry out his wishes.

Who Gets Control?

It's extremely important that a donor consider his relationship with his family or with his trustees when deciding how specific his charity's mission should be. For example, if the family has a close, harmonious relationship and the donor trusts his descendants' judgment, he may simply want to appoint them as directors, with no restrictions on what they may do after his death. This approach avoids the pitfalls of over-restriction, since any constraints will not only bind children, but also could bind generations to come.

However, if a donor's family isn't close, the children don't get along with each other or the

donor has no children or other close relatives and doesn't intend to disburse the charity's money before death, then the donor will need to give more thought to who the successors will be.

When choosing a charity's successors, a common assumption is that good business associates will be good board members. Randy Richardson, who spent 20 years as president of the Smith Richardson Foundation (created out of the Vicks VapoRub fortune), a major supporter of higher education and a variety of think tanks, warns against making this assumption. He offered the following advice in *Philanthropy Magazine*:

You doubtless have bright business associates. Resist the urge to decorate your beginning board with such folk unless they share your objectives and match your enthusiasm for whatever philanthropic endeavor you choose. There are many business executives whose conduct on charity boards betrays an apparent belief that activities outside business do not merit the full use of their brains. These men and women frequently join a foundation board for the sole purpose of having it fund their favorite charities, thereby enhancing their reputation as fund raisers.⁵

Best Approach

The best approach is for donors to take an active role in philanthropy while still alive and leave the funds relatively unrestricted after death. This approach gives the charity's directors flexibility to respond to changing conditions, while still following the example set by the founder.

It's always a good idea for founders to state their missions clearly and to spell out values and principles. The trick is to be specific about the vision and yet flexible about how to achieve it, so that the successors can carry that vision forward despite changes in society and technology.

For the donor who cares about how his philanthropic legacy is implemented after his death, the only realistic approach is to establish a coherent body of precedents by giving during his lifetime. Too often, individuals have waited until

their death to create their charities, only to leave family members and descendants wondering how they should use the money to best honor the deceased. How can the successors know for sure? They can't, unless there were prior actions behind the deceased donor's words.

An established pattern of philanthropy during a donor's lifetime becomes a guide for his family. There's no better way for a donor to assure his charity's future than starting that charity now, building a solid history of giving and involving family, others or both—so that they're prepared for their eventual role in advancing a foundation's mission and goals.

This strategy will not only develop patterns of behavior to guide heirs after a founder is gone, but also will build good working relationships among the successors. These steps will ensure that a charity's legacy is one of which the family—and especially the founder—can be proud.

*Note: This article is based on a chapter from the book *Managing Foundations and Charitable Trusts: Essential Knowledge, Tools, and Techniques for Donors and Advisors*, by Roger D. Silk and James W. Lintott (John Wiley & Sons 2011).*

Endnotes

1. Interview with James Cody on July 28, 2011.
2. Roger D. Silk and James W. Lintott, *Managing Foundations and Charitable Trusts: Essential Knowledge, Tools, and Techniques for Donors and Advisors*, (John Wiley & Sons 2011) at p. 63.
3. The Rockefeller Foundation, "Moments in Time 1913-1919," www.rockefellerfoundation.org/who-we-are/our-history/1913-1919/.
4. Roger D. Silk and James W. Lintott, *Creating a Private Foundation: The Essential Guide for Donors and Their Advisers* (Bloomberg Press 2003) at p. 60.
5. Randy Richardson, "Letter to an Aspiring Philanthropist, Advice on starting a foundation from someone who has been there," *Philanthropy Magazine*, April 1, 1997, www.philanthropyroundtable.org/article.asp?article=1388&paper=1&cat=147.