GENERATIONS OF GIVING

Leadership and Continuity in Family Foundations

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FAMILY PHILANTHROPY IN NORTH AMERICA

Institutionalized family philanthropy is an American phenomenon. Nowhere else in the world is it practiced on such a broad scale, in such an organized fashion. Foundations have been part of the North American landscape for the past century. In the early years, they were the domain of the spectacularly wealthy, but by the close of the twentieth century the field of organized philanthropy had been profoundly democratized.

Today, donors represent a spectrum of success stories—family business owners, corporate executives, pioneers in new technologies, investors in the stock market and real estate—and their diversity is reflected in the variety of family foundations. The smallest family foundations—by far the majority—have assets of less than $1 million, give primarily in their local communities, and are run by family volunteers, often out of their homes. The largest have assets worth billions of dollars, corporate-sized professional staffs, and grantmaking programs that extend around the world.

Over the past two decades the number of family foundations has increased dramatically, even though donors can choose other charitable options that have more favorable tax benefits, lower start-up costs, and fewer responsibilities. If present trends continue, family foundations will exceed $500 billion in assets over the next decade. There are more than 60,000 private foundations in the United States and Canada, and by some counts, at least two-thirds of them are controlled by families.[1]

Their essential role in so many aspects of society (education, health, arts and culture, economic development, social welfare) and in private wealth management makes it important for us to understand them better. However, in spite of their scope and importance, they are largely unstudied organizations. Like all nonprofits, their functioning and structure have not attracted much analysis from business schools and organizational scientists. In addition, the tendency of families to protect their privacy, especially around financial matters, has helped keep all but the very largest family foundations invisible.[2]

Before we could use the research on this sample to bring family foundations into focus, we needed to understand the history of family philanthropy in general. Current trustees need to see how they fit into the broader economic picture in order to fully understand the particular choices and challenges facing their own foundations. The historical trends in private philanthropy, the ups and downs of public funding for social and cultural services, and the role of families as philanthropic sponsors, all help today's decision makers to understand the context of their stewardship and grantmaking. That context should inform the deliberations about their organization's mission, structure, leadership style, and plans for continuity.[3]

EARLY FAMILY PHILANTHROPY IN AMERICA

Philanthropy stems from a variety of beliefs, impulses, and aims, but history reveals three major motivational themes among founders and donors: the desire to support worthy causes, the quest for relief from taxes, and the wish to create a family legacy. We will examine each of these motivations in turn.

The Charitable Impulse

The impulse to use wealth for social purposes is the first of the core motivations that have driven the development of family philanthropy. Since the American Revolution, individuals have created small, private charitable organizations to care for the needy in their communities, reflecting the belief that private citizens share responsibility with the government to provide for the general welfare.

It wasn't until the late nineteenth century, however, that the concept of an endowed private foundation to provide sustained and systematic assistance took hold. The country had emerged from a period of rapid industrialization in which tremendous wealth was concentrated in the hands of a few bold entrepreneurs. Private foundations provided a means through which these individuals could apply the same resourcefulness and energy to solving social problems that they brought to their business enterprises.

Two pioneers, Andrew Carnegie and John D. Rockefeller, are widely credited for defining organized philanthropy and demonstrating its potential for improving the quality of life. Both set specific goals for their philanthropy, and both backed their projects with the money, talent, and follow-through to ensure their success.

The Role of Tax Policy

The search for tax relief is the second motivational theme in the history of family foundations. Whatever mixture of motives inspired the philanthropy of Carnegie and Rockefeller, avoiding paying taxes was not one of them. Both had been giving away large sums of money long before Congress passed the Sixteenth Amendment in 1913 that established the individual income tax. But beginning in the 1920s, the new income tax and related policies proved to be powerful factors throughout most of the twentieth century.

When federal income taxes were first introduced, taxpayers in the top bracket were assessed 7 percent of their income. Five years later, the top tax rate had jumped to 77 percent. Rates dropped after the stock market crash of 1929 but during the Depression and throughout World War II, Congress raised federal income taxes to what affluent individuals considered confiscatory levels. In 1945, the tax rate for the top bracket peaked at 94 percent and, throughout the 1950s and 1960s, it fluctuated between 70 percent and 92 percent. As tax rates escalated, people of means looked for ways to reduce their tax burden.

Philanthropy presented one answer. In 1917, Congress introduced the practice of allowing tax deductions on personal income for contributions to organizations set up for educational or charitable purposes. Individuals were permitted to deduct up to 15 percent of their adjusted gross income. In addition, in 1940 Congress enacted the federal estate tax. From 1940 to 1979 the largest estates were taxed at 77 percent, which meant that many families had to sell the family business or investments to pay the estate tax. However, there was no limit on the assets donors could transfer to private foundations. As a consequence, private foundations came to be seen not solely as vehicles for charitable giving but also a means for reducing income and estate taxes.[4]

The mid-twentieth century was a period of great prosperity and high taxation. Those family business owners who grew wealthy during and after World War II formed private foundations in record numbers. The Foundation Center report estimates that by the 1940s, close to 44 percent of all new foundations were family foundations. That percentage increased to almost 50 percent in the 1950s and 1960s.

For some of these business-owning founders, one primary motivator was a big tax loophole. In 1924, the Supreme Court ruled that a charitable organization could conduct a business that would be exempt from taxation as long as all the income from the business was used for charitable purposes. In practice, many donors stretched the rules by transferring ownership of their family businesses to their foundations. Donors gave stock in their companies to the foundations they established. They named themselves, family members, and close friends as trustees. In addition to receiving an immediate and full deduction on income tax, donors later saved on estate taxes. The gift of stock or property reduced their equity in their business and thus the value of their estate on their deaths.

Besides offering tax benefits, foundations also permitted donors to retain control of the investment, administration, and distribution of the endowment and income. Private foundations were likened to personal banks that paid high salaries to donors and their families, and gave them a decided advantage in exploiting business opportunities. Not only were foundation assets spared the high taxes that burdened other business owners, they also provided donors with a ready source of funds to draw on for investments—at a time when high interest rates made borrowing money expensive. Moreover, private foundations had the additional advantage of preventing outside takeovers of family corporations.

The benefits of private foundations were so generous that even newspapers and magazines of the day promoted them to readers. A *Fortune* magazine article from 1947 trumpeted the title, "How To

Have Your Own Foundation: Taxation Has Brought the Charitable Instrument of the Rockefellers and the Carnegies within the Reach of Thousands." The message was not whether individuals of moderate wealth should establish foundations but rather why anyone would choose *not* to have one. The advantages were too good to pass up.[5]

In the end, the extraordinary opportunity available to the wealthy for uncontrolled tax relief through foundations was its own undoing. With governmental oversight of foundation administration virtually nonexistent, the situation was ripe for exploitation. Although the opportunities for abuse were plentiful, most family foundation boards carried out their charitable responsibilities. However, some unscrupulous donors paid no dividends from their business to the foundation, thus leaving the foundation with no money to distribute to charities. Others used foundation funds to buy and sell stock and other property at prices beneficial to the trustees, or to make low or zero-interest loans to donors and their families. And in some instances, trustees invested foundation funds so recklessly that they jeopardized the foundation's endowment.

The glaring violations committed by a minority of donors and their families resulted in exposés by the press and investigations by Congress. The Revenue Act of 1950 was Congress's first attempt to regulate the mixture of business and charity in private foundations by requiring foundations that ran businesses to be taxed like corporations. Private foundations had existed for almost half a century without interference from the government. The Revenue Act of 1950 instituted some controls, but more was yet to come.

The most persistent critic of private foundations in the 1960s was Representative Wright Patman of Texas. He was appalled by the abuses that had been uncovered and intent on stopping them. His ten-year investigation of foundations culminated in the Tax Reform Act of 1969, a major restructuring of the U.S. tax code including a strict system of regulations that had significant consequences for private foundations. Congress set limits on the deductibility of gifts, instituted excise taxes, and imposed a penalty tax for self-dealing to stop the misuse of private foundations for noncharitable purposes.

Additionally, private foundations were prohibited from holding more than 20 percent interest in the voting stock of a corporation, and they could lose their tax-exempt status if they speculated with foundation assets. Finally, private foundations were required to make minimum annual payouts and to file information returns with the IRS that would be available to the public.

Some saw the stiff regulations imposed by Congress and the publicity surrounding the hearings as the death knell for private foundations. The number of new foundations formed in the 1970s did decrease, but the historical data suggest that the trend began well before 1969.[6] The Tax Reform Act undoubtedly frightened off some potential donors and created a dampening effect on the formation of new foundations. But the decline may also be attributed to the natural tapering off that occurs after a period of extraordinary growth and to the availability of other charitable instruments that offered savings on taxes without the administrative responsibilities of running a foundation.

Nonetheless, some donors still chose to set up foundations. The difference was that before the Tax Reform Act, the majority of foundations were established by living donors; after 1969, most were created by bequests in response to estate taxes (Boris 1987, 91–92).

Figure 2.1 charts the founding dates of the foundations in our sample, in conjunction with the key tax law changes throughout the century. The pattern of creation fits perfectly with the best data on overall foundation formation across the twentieth century (Odendahl 1987, 9, 83–85, 181).

By the early 1980s, the top federal income tax bracket had dropped to 50 percent, on its way to a low of 28 percent by the end of the decade. The tax incentive for establishing foundations was not as compelling as in the past, and researchers predicted a modest future for private foundations: donors would continue to establish new foundations, although at a slower rate, and most of the new foundations would be small (Odendahl 1987, 92).

However, far from stagnating, the formation of new foundations and, in particular, larger family foundations, soared in the last decades of the twentieth[7] century. Sixty percent of the new foundations established in the 1980s and 1990s were family foundations.

Apparently the analysts had overemphasized tax planning and ignored other factors that were motivating new generations of donors. One such factor was the increasing sophistication of the philan-

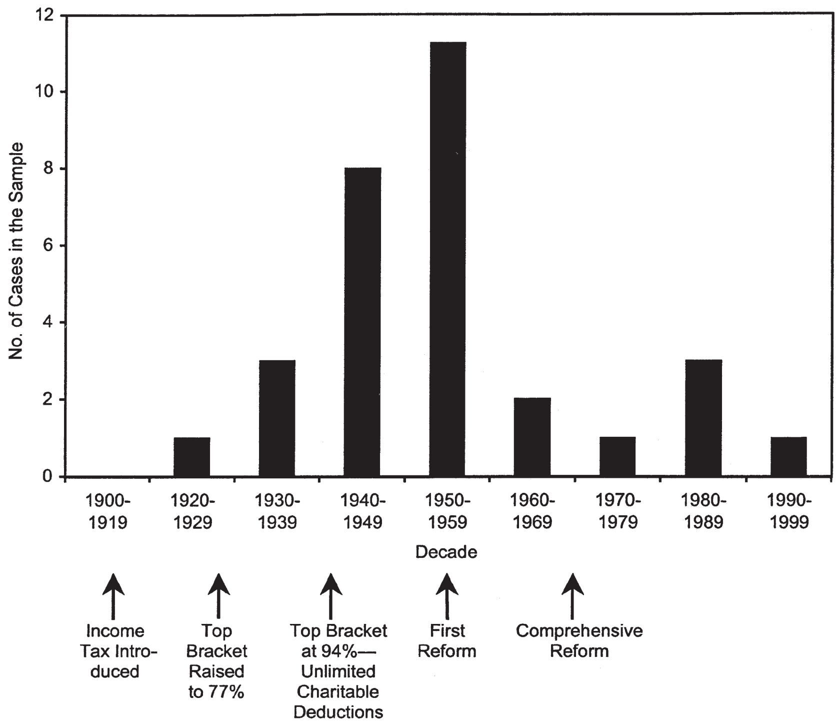

Figure 2.1. Sample Foundations: Year Founded

thropic community. Although the Council on Foundations was formed in 1949, its early membership represented only a small percentage of existing foundations. Most foundations guarded their privacy, operating like islands unto themselves. As a result, there was little sense of community and a limited exchange of ideas and information.

The Tax Reform Act of 1969 gave foundations a compelling reason to come together. Alarmed by the severity of the reforms, foundation executives began to meet informally to discuss the implications of the new regulations. Over time, these groups recognized that they had other interests in common. What began as an emergency response to a new set of circumstances, gradually evolved into meetings of colleagues who came together to explore mutual concerns. Eventually these informal groups evolved into formal affinity groups such as the Regional Association of Grantmakers and many others (Nielsen 1985, 29).

In the mid-eighties, these professional organizations recognized that family foundations had different concerns from other private foundations and that family trustees were eager to learn from one another. They began organizing special conferences and workshops for family foundations and, as part of a family philanthropy initiative, educating financial and legal advisors to wealthy clients about the added rewards that could come from family members working together as grantmakers.

At the same time, the country was experiencing an extended period of unprecedented prosperity. Significant wealth was seemingly created overnight in the high-tech industries and in the soaring real estate and stock markets. The media played up stories of the new rich and made tantalizing predictions of trillions of dollars passing from one generation to the next.

Just as in the 1940s, magazine and newspaper articles promoted the benefits of charitable instruments and foundations in particular. The tax benefits were not as extreme as in earlier decades, but still they offered incentives to potential founders and donors, who could pursue their charitable interests while enjoying deductions against their income and avoiding capital-gains taxes on stock, real estate, and other appreciated investments. According to *Forbes* magazine, three-quarters of the very wealthiest Americans had their own foundations at the dawn of the new century (Barrett 2000, 104).

Philanthropy as a Collaborative Family Activity

The desire to establish a family legacy, or at least a participative family activity, is the third motivational theme. Tax minimization and the charitable impulse help explain the course of philanthropy through the last century, but why family foundations, in particular? Donors could just as easily set up donor-advised funds, charitable trusts, or simply make direct gifts to their favorite charities—as many of them did.

Those who chose to set up foundations often had another aim in mind. They wanted to make philanthropy a family activity and the foundation an enduring family institution. Families had been extolled and taken for granted in the postwar years of the 1950s, and declared "dead" by the end of the 1960s. By the last quarter of the century, there was a dramatic upsurge of attention and discussion about family vitality, and a shared social imperative to strengthen family systems.

This motivation speaks to one of the core family dilemmas of our time. Parents are simultaneously proud of the wealth they have created, and worried about its impact on their children. The role of a privileged aristocracy, inherited from Europe and expressed philanthropically in the American version of noblesse oblige, does not sit comfortably on the shoulders of the entrepreneurial successes of the late twentieth century. Many of the new wealthy fear too little time with their children, too much peer influence and television, too many "things," and too large a generation gap as a dangerous and disheartening poison. For some, family philanthropy is an antidote.

Beneficiaries of new wealth, by establishing family foundations, could simultaneously pursue a number of related goals: demonstrating socially responsible values about wealth to their children, counteracting envy and resentment in the community, and implementing their own vision of human, cultural, and environmental enhancement.

And instead of waiting to set up foundations after their deaths, more and more donors wanted to share the experience of grantmaking with their children and grandchildren. How well or poorly their organizational designs and styles of leadership match these family motivations is a major theme of the remainder of this book.

SUMMARY

The summary lesson from our historical analysis of family philanthropy is that the incentives and rewards of family foundations have changed as the economic and social environment has changed. The earliest foundations were created in an era of easily identified families of wealth, and quickly escalating taxation. Foundations were a convenient and irresistible opportunity to conserve resources within the family, and to protect the economic discretion of the generations in control. The foundations in this sample, which were established before 1950 for the most part reflect those goals focusing on tax-efficient philanthropy and community responsibility, especially connected to successful businesses.

As the century progressed, significant wealth began to emerge in a larger, entrepreneurial class, and reform legislation curtailed the most extreme advantages of foundations. Philanthropy continued to grow, but not necessarily through formal organizations. But by the end of the century, new social dynamics were ascending. The family itself was being challenged, and parents were looking for new ways to strengthen family culture and intergenerational connections. With family members scattered around the country and children growing up far from their grandparents and cousins, family foundations provided the promise of a forum in which family members could collaborate on important work, get to know one another, and deepen their connections to one another and to their shared history.

In addition, the visibility of new wealth was creating an active public dialogue about social engineering, public versus private responsibility for community enrichment, and meaningful citizenship. Among our sample foundations, those created in the later decades paid more attention to their potential as a means of inculcating family values and institutionalizing a sense of stewardship. They were more structured, more intergenerational, and prepared to be more visible.

It is interesting to ponder the current and future environment and its implications for the formation of family foundations. It is easy to predict that there will be expansions and contractions of wealth in the coming decades, and that the availability of surplus wealth for philanthropy will go up and down accordingly.

The trend toward more collaboration in the evolution of the family seems more linear, and irreversible, at least for the foreseeable future. Most sociologists agree that traditional assumptions about hierarchies of authority based on generation, gender, and birth order have been irrevocably altered.

The consolidation and transmission of wealth itself will not be a sufficient reason for collaborative action in family foundations of the future. Family foundations are being formalized as organizations, and families will be faced with the challenge of making them viable through their work and through the interpersonal negotiations among family members about obligations and rewards.

This is the great opportunity of family foundations in the decades ahead—to learn the craft of collaborative governance so that the economic, social, and psychological agendas can all be addressed in an effective and satisfying philanthropic experience.

NOTES

1. According to a recent study by The Foundation Center, even using the most conservative estimates, family foundations now make up 40 to 45 percent of all U.S. foundations (independent, operating, corporate, community). Others have put the figure closer to 70 or 75 percent. In 1998, there were close to 18,300 family foundations in the United States, and more than 5,000 were established since 1980 alone. Family foundations underwent a similar period of rapid growth in the middle of the twentieth century. Between the 1940s and 1960s, almost half the new foundations formed were family foundations. Growth tapered off in the 1970s but resumed again in the 1980s. By the end of the century, the rate at which family foundations were established exceeded even that of the middle of the century.

2. One difficulty in studying family foundations as organizations is the lack of a legal definition for family foundations. The term "family foundation" is popularly understood to denote a grantmaking institution whose policies and practices are guided by donors and/or relatives of donors. However, the government does not distinguish among foundations run by an individual, a family, or a professional staff; all are classified as private foundations. As a result, there is no governmental record of family foundations per se. When the Foundation Center, in cooperation with the National Center for Family Philanthropy, launched its recent study of family foundations, it grappled with the problem of identifying family foundations current and past. In the absence of a legal definition and precise statistical data to draw on, those researchers developed their own criteria to identify family foundations for the study:

independent foundations identified by the National Center for Family Philanthropy as "family foundations";
independent foundations that have self-identified as "family foundations" in Foundation Center surveys;
independent foundations with "Family" or "Families" in their names;
independent foundations with a living donor whose surname matches the foundation name; and
independent foundations with at least two trustees whose surname matches a living or deceased donor's name.

3. The researchers acknowledge the limitations of working with imperfect criteria, especially in identifying family foundations formed in the first half of the twentieth century. Nonetheless, the report, *Family Foundations: A Profile of Funders*

and Trends (2000), provides the most comprehensive summary of family foundations to date and the most complete picture of the "newer" family foundations.

4. Sarason was the premier social scientist on the topic of the impact of history and context in the creation of any organization. See Sarason (1972).

5. Nelson (1987) presents an excellent review.

6. See Rudney (1987).

7. Both Nelson (1987) and Rudney (1987) present data on this point, as does Boris (1987). The patterns described are explored in the broad context of American social history of the twentieth century in Robert Putnam's extraordinary *Bowling Alone* (2000).