Financial Parenting Through

A Family Foundation

By Paul L. Comstock

Instructing children on the proper role and responsible management of financial resources is a difficult task and requires effort and creativity on the part of already busy parents. Children raised in an environment of affluence are generally educated at the best institutions and are provided with financial security as a means of giving them the "edge" they will need to compete as adults. Without the proper training from parents, however, these children often find themselves having little understanding of how to deal with their current and anticipated affluence.

Parents who earned their own wealth sometimes fail to recognize that their feelings of self-worth came from the satisfaction of having a dream and working hard to achieve it. Children who do not learn to associate reward with effort often fail to develop those same feelings of satisfaction and self-worth. These children may be labeled "wealth consumers" or "spendthrifts" and are less likely to earn the respect of their peers. They often feel a sense of guilt for having their financial advantage.

With the proper training from parents, however, these children can find themselves with an understanding of how to deal with their privileged status. A family foundation created while the children are young and used as a financial parenting tool can be invaluable in assisting parents achieve that end.

The following scenario illustrates this and other benefits that can come from the proper use of a family foundation as a financial parenting tool.

Case Background

Mary and Mark are involved in their community on various charity boards and volunteer projects. They find a good portion of their social life centered around attending fund raising functions. Their roles keep them busy and away from home more than they or their children would like.

In order for them to pursue their active lifestyles, they have engaged full time staff to handle the domestic responsibilities and care for the children. Time spent with the children generally involves expensive recreational events and travel.

Mary and Mark would like to find a way to be more involved with their children as they enter their pre-teen and teenage years. The children are very advanced educationally and in their social maturity. Mary and Mark have begun to notice in them, especially in the teenager, increasingly independent behavior with desires to make their own decisions as to their future. While such desires are normal, Mary and Mark have been trying to find an activity that will provide an outlet of expression for their children that also allows them to accomplish their own agenda of more meaningful parental involvement.

While meeting with their financial advisor, Mary and Mark are introduced to the concept of using a Family Foundation as a tax planning tool to help reduce a substantial capital gain that they are anticipating upon the future sale of an investment asset. During the conversation with their advisor, Mary and Mark begin to explore some of the non-benefits offered to those who create their own foundation.

Case Dialogue

M&M: At a recent conference we attended, a family psychologist discussed the emotional issues surrounding children of privilege. She suggested that we work on providing experiences that assist our children in developing their self-esteem and feelings of competency. With that in mind, how might we involve our children in this foundation to accomplish those objectives?

ADVISOR: First of all, while you are inquiring about how to involve your young children in a family activity, the principles and benefits I will describe apply equally as well to adult children or grandchildren. In addition, it is important to always remember as we explore the ancillary benefits of a family foundation to its members that foundations receive their special tax treatment only if they are established and maintained for the "public good."

To that end, most family foundations are organized to give away money in the form of grants to publicly supported charitable organizations. If your foundation limits its activity to making such grants, it must distribute at least 5 percent of the value of its assets each year.

Occasionally we have a family that would like to actually conduct a specific charitable program such as organizing and/or conducting medical research or providing direct services to those in need. This type of family foundation is referred to as an "operating" foundation.

Regardless of the structure of your foundation -- "grant-making only" or "operating" -- the lessons to be learned from the management of the various activities associated with it are substantial. The opportunities for financial parenting are unlimited. As a forum for positive family interaction, either foundation format provides an invaluable setting.

Problem Solving

For example, children are generally more sensitive than we realize to the issues that confront our society. Schools often place emphasis on the environment, the homeless or hungry, education of inner city children, drug abuse, etc. Rarely, however, do children have an opportunity to actively participate in providing solutions to these issues. A family foundation offers your children the chance to use family wealth as a tool for solving such problems. This experience should help them develop a more healthy understanding of the advantages of wealth that goes beyond just an increased ability to consume it.

Including the children on visits to organizations that have made requests for funds places a new dimension on the meaning of a "family outing." Touring the facility, meeting recipients of the organization`s efforts, seeing the needs of individuals being met first hand, and actively participating in the decision of whether to positively or negatively respond to a grant request can provide meaningful opportunities for teaching, learning, and communicating with one another.

Fiscal Responsibility

Reviewing the financial policies of the organization requesting a grant will help your children to understand the importance of fiscal responsibility. There will be a limit on how much your foundation will give away each year, therefore, once a decision has been made to assist an organization, the next step is to determine the amount to be given, what restrictions and/or accountabilities are to be required, and what follow-up the family should do subsequent to the gift being made. This process of "due diligence" and budgeting will be of great value to your children as they are asked to evaluate and determine their level of participation in the myriad of investments that will be presented to them in the future.

As you can see, the opportunities for input and decision making on the part of all family members working together utilizing fiends that are no longer for their personal benefit can provide quality parenting experiences and family member involvement. At the same time this can help meet the various social and emotional needs of both you and your children and bring the family closer together. This benefit will continue as your children reach adulthood and provide them with a tool for training their children.

The family foundation experience also allows you and your children to view each other in a positive way as you make decisions that have impact on the community. All participating family members will experience the pride of community recognition for the good works done through the foundation and will receive respect and admiration from outside sources that are credible. Again, having financial resources takes on a new meaning other than consumption for one`s own benefit.

As parents you will be able to witness the varied interests and talents of your children that you may not have had the opportunity to experience in other family activities. A family foundation provides your children and you with communication experiences that are not as threatening as those that involve academic performance, athletic abilities, choice of friends, etc.

I advise parents to allow each child the opportunity to research and decide on two to four grant requests each year. This activity should not be overburdening but will provide your children with a sense of involvement in both the family and the community. In addition, it provides positive reinforcement to both your children and you that they are able to make competent decisions and have a meaningful role in the family.

Providing a Forum

Your children should be active participants in the management of the family foundation. They will have the opportunity to discuss how assets are to be invested. They can participate in reviewing how to hire an outside money manager. They can experience reviewing reports of how the manager is performing.

This learning opportunity is a very important feature of a family foundation since most children are not involved in family financial decision-making. Many wealthy parents have decided not to be involved in that process themselves and use staff or outside advisors to handle all of their financial affairs. In addition, regardless of their personal involvement, parents are generally reluctant to discuss family financial matters with children who might not have the maturity to maintain the necessary confidentiality. Since the family foundation and its corresponding finances are a matter of public record such privacy concerns are eliminated.

As mentioned previously, your family foundation will have minimum distribution requirements set by the government as well as family imposed policy outlining maximum annual distributions both of which will require the children to be involved in budgeting. They can witness the performance of various investment classes. How advisors are involved and how their effectiveness is monitored will be invaluable lessons for your children when they assume responsibility for their own finances and wealth that is either earned or given to them.

Building Self-Esteem

M&M: We have been concerned with the impact our wealth will have on our children since work is such an important source of our happiness and feeling of self-worth. While our children may never have to work, we have been trying to find ways to encourage them to be anxiously engaged in meaningful activities. How can we use this family foundation to encourage our children to work as productive members of society?

ADVISOR: That is a very good question. It has been my experience that enough wealth to provide an income sufficient to meet all one`s needs should only be available after an individual has had the opportunity to experience that they are able to provide for themselves through their own labor. For the majority of the population this generally occurs as an individual matures and reaches the day when capital replaces the need for employment. We refer to this time in one`s life as retirement. Even then, after years of feeling needed and productive, many retirees feel left out and often return to work even when financial independence has been achieved.

Children who are able to prove their worth as productive members of society before becoming financially independent generally have greater self-esteem. These individuals are able to see themselves as producers rather than just consumers of family wealth and thus develop self-respect and the respect of their peers.

Parents can employ this productivity philosophy when structuring the transfer of their estate to their children by utilizing a trust with "incentive" provisions. Distributions from such a trust are based on various performance requirements placed on each beneficiary.

For instance, if you would like your children to spend time serving the community in which they live, you may provide for compensation to them for serving on the board of directors of an exempt organization or for work done on behalf of the family foundation. You might also stipulate that the trust cover your children`s expenses to board meetings and conferences designed to enhance their role as volunteers. Incentive payments or bonus distributions tied to such activities and made part of a regular trust provide financial advantage to children but also encourage work.

By compensating your children or grandchildren`s efforts made on behalf of the family foundation from a taxable trust rather than directly from the foundation, you eliminate the exposure of such compensation to regulatory scrutiny. While a family foundation may compensate family members for services actually rendered, prudent levels may be well below the income requirements that you feel your children will need as a supplement to their personal earnings in order to maintain a reasonable lifestyle.

Operation and Maintenance

The family foundation will require work. It must be maintained and operated according to government rules and regulations. Certainly the children may elect to hire management from outside the family, but as members of the board of directors they are ultimately responsible for the foundation.

In addition, there will be fairly substantial peer pressure exerted from those that your children will be associated as they are involved with exempt organizations. Perhaps some of the most motivated and hard-working individuals are involved with the non-profit sector of our society. This influence for good impacts most lives around it. In the nonprofit world money is not the measure of success; meaningful programs are. This environment allows your children, regardless of their wealth, to compete in a different way than the for-profit commercial enterprise requires.

Funding Your Foundation

M&M: If we establish a family foundation, we will need to determine how much we want to put in it both while we are alive and at our death. Do you have any suggestions that you could give to us as to each of these amounts?

ADVISOR: To determine how much of your wealth you would like to ultimately place in the family foundation, you must first address the very basic issue of how much wealth do you intend for your children to receive both while you are alive and at your death. Remember, resources earmarked for the family foundation reduce the amount your children will ultimately receive unless asset replacement is established through the use of a life insurance trust or other planning options. The difficult choice of how much and under what distribution plan to transfer wealth between generations has always been a problem for privileged families regardless of tax laws.

The best way I have found to answer this question is to actually determine a dollar amount, such as $1,000,000, for each child. The taxes due can be calculated and the remaining value of the estate placed in the family foundation free from all gift or estate taxation.

In addition you must determine the initial commitment you are willing to make to the project. My suggestion would be to begin your calculation with the amount that you are currently giving to charities. You can "endow" that level of annual giving by placing 20 times that amount into your foundation.

This would allow the minimum annual distribution requirement of 5 percent to meet your current philanthropic goals. For example, if you give $25,000 per year to various organizations, you would need to fund your foundation with $500,000 in order for the minimum distribution to meet your annual gift objectives. If this amount is initially more than you would like to fund the foundation with, we have found that as little as $100,000 placed in a family foundation will allow $5,000 to be distributed during the following year to public causes. This is an amount sufficient to allow your children to have a real sense of the importance of their effort.

While the funds placed in a family foundation are not available for consumption by family members, current and future heirs do experience social mobility and influence afforded any individual responsible for the distribution of funds to community organizations. This advantage to heirs provides a continued position of community status and maintains both business and social contacts, but does not rob them of the need for personal effort to achieve a portion or all of their own financial support. The setting of personal goals and the opportunity for success or failure based on personal achievement may still be part of your children`s dreams and realizations.

Foundation Administration

M&M: It sounds like the family foundation can be very time consuming and requires complicated regulatory compliance. Do you think we should really be involved with such activity?

ADVISOR: Family foundations require record keeping that can be done by your CPA or a trust company and paid for by the foundation. In addition, you must distribute at least 5 percent of the value of the assets each year to public charities. Other than that, it can be as simple or involved as you would like.

M&M: What will happen to the family foundation at our death?

ADVISOR: First of all, the assets in the foundation are not subject to estate taxation. The benefits derived from the foundation pass without dilution from one generation to the next. Secondly, you will, more than likely, know the answer to that prior to your death. Establishing your family foundation now while you are alive allows you to witness the involvement and interest of your children. It will also allow you to see first hand how your children are prepared to handle wealth that will be transferred to them at your death. The family foundation allows a preview of your children`s ability to deal with finances in a different way than just watching them manage their allowance.

If things do not work out the way you would like, the family foundation may be terminated and its assets distributed to one or more public charities. Any provisions you have made for additional testamentary contributions to the family foundation may be changed to allow those contributions to be made directly to various public charities or to your children on an after-tax basis. Such feedback prior to death is essential in proper estate planning for parents concerned about how wealth will impact the lives of their children.

In the future, your children may decide that they would like to be on the board but not be involved in the day-today management of the foundation. They will most likely do as many family foundations do, hire staff on either a full or part-time basis to attend to the various administration requirements. This staff may be comprised of members of the family or non-family members.

Permanent Family Ties

M&M: We have been concerned about how we can encourage the family to stay close to one another after the children have left home and especially after our deaths. How can a family foundation help accomplish this?

ADVISOR: Studies recently conducted by various organizations concerned with such issues have found that a family foundation can provide a continued source of family unity. Structured properly, a family foundation can serve as a focal point of family gatherings for generations to come. One family I advise has decided to hold its annual meeting each Thanksgiving at the family homestead. The directors of the charity (the parents and children) are brought in for the meeting and grants are discussed and distributions determined. Plenty of time is then available for the family to be together in a social setting. The parents felt that this tradition would set a pleasant tone for the reunions as well as assist in ushering in the holiday season with the spirit of giving rather than just receiving.

Surveys of children who have had parents establish a family foundation indicate that often times the foundation is the only forum for meaningful family communication once the parents are no longer alive. In addition, several families have reported that the communication links between members were almost nonexistent prior to the family foundation being established. The foundation proved to be the last opportunity for the family to reopen a dialogue with each other in a positive way.

In summary, a family foundation allows a wonderful opportunity for you to be involved with your children in meaningful teaching experiences that allow your children to express themselves individually and demonstrate their competency in the decision making process with funds that were, more than likely, earmarked for the public sector anyway. However, like with every other teaching opportunity that you as parents have at your disposal, you must take initiative and provide the time necessary to make the experience meaningful.

Family foundations offer the unique opportunity of combining the increased social awareness interests of your children with your community involvement, a chance for common ground that does not threaten the ego or financial welfare of any one participant.

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