

The Family Foundation - Breaking up May be Hard to do

By Louis Vlahos

The success of a family business usually requires a lifetime of hard work and leadership by parents and, in some cases, their children. Once they have attained a level of wealth and financial security, many of these individuals seek to share their good fortune with their community.

Often, they will establish and fund a private foundation, possibly in the name of the parents or of the business. Such a foundation may serve a variety of purposes. It enables the family to control and monitor its charitable giving. It provides a receptacle for future lifetime and testamentary charitable transfers. The goodwill generated by the foundation may ultimately benefit the family business. Finally, in some families, it provides a vehicle in which younger family members may learn management, financial and team-working skills as directors and officers of the foundation; thus, it may serve as a training ground for younger family members before they assume greater responsibilities in the family business.

Family squabbles

Unfortunately, things do not always work out as smoothly as the parents may have hoped. Children disagree over matters of business; their personalities and philosophies clash; they fight amongst themselves. So long as the parents are alive, they may be able to exercise enough control, or exert enough pressure, to keep their children in line and together.

But what happens when the parents pass? Businesses may be separated into different entities, each owned and operated by a different branch of the family. If such a separation is not possible or feasible, one branch may buy-out the other, or the entire business may be sold and the proceeds distributed among the members of

the family.

While the business disputes within the family may be resolved by one of these approaches, where does this leave the family's charitable foundation? It would be naive to think that the family feud would end when it comes to charitable giving. The disputants sit on the board of the foundation and act as its officers. Their ability to work together has probably been compromised. Moreover, it is likely that the differences of opinion and personality that caused them to separate in a business setting will also result in their having differing opinions and divergent interests as to the investment of the foundation's assets (which may be substantial) and the charitable disposition of such assets.

Dividing the foundation

Over the years, these situations have been resolved in a number of ways: the foundation may be dissolved and its assets contributed to one or more public charities; a portion of the foundation's assets may be contributed to a public charity (perhaps a donor-advised fund) designated by one branch of the family, with the balance remaining in the foundation to be administered by the other branch of the family; or the foundation may be split into two or more separate foundations, each to be administered by a different branch of the family.

However, in terminating the foundation, or in transferring all or a portion of its assets to one or more other foundations, there are a number of issues, unique to the taxation of a private foundation, that need to be considered. Among those most often encountered in the division of a foundation are the following:



Louis Vlahos

Will a transfer by a foundation of all or part of its assets to one or more other foundations result in the termination of the transferor foundation for tax purposes and, so, result in the imposition of a special termination tax?

Will any transferee foundation succeed to the tax attributes of the transferor foundation?

If the transferor foundation incurred any of the penalty taxes that may be imposed on foundations (covering minimum annual distributions, self-dealing, jeopardy investments, excess business holdings, non-charitable expenditures), either prior to or as a result of the transfers to the other foundations, will the transferee foundation be treated as receiving the transferred assets subject to such liability?

A transferor foundation must meet its minimum distribution requirement for the taxable year in which it transfers all or a part of its assets to other foundations; will the transfer to the transferee foundations be a qualifying distribution for that purpose, and will each transferee become responsible for a portion of the transferor's undistributed income?

Where the transferor has excess business holdings, will the prescribed period for disposing of such excess holdings include both the period during which the transferor held the assets and the period during which the transferee holds them?

Where the transferor foundation has disposed of all of its assets, will the transferee foundations assume and exercise expenditure responsibility for all of the transferor's outstanding grants over which such oversight was required?

What to do?

It should be clear, in light of the foregoing, that the division of a family foundation is not necessarily as simple as just splitting up the foundation's assets among the feuding branches of the family, with each branch going its separate way. There are a number of tax-related concerns which must be considered. There are also a number of investment issues that will have to be addressed in the allocation of assets and liabilities among the transferor and the transferee foundations which, depending upon the transferor foundation's balance sheet, may require a fair amount of negotiating among the different branches of the family. For example, are the assets easily divisible (as in the case of cash or marketable securities)? What about real estate? These negotiations may be further complicated where the transferor foundation and its managers may have engaged in activities for which a penalty tax may be imposed. Until the expiration of the applicable limitations period on the assessment of such a tax, there should be an understanding between the foundations as to how a tax audit will be managed, how any violation will be corrected, and how any resulting tax will be paid.

If the preservation of the family's charitable activities is important to the various branches of the family, the division of the family foundation among such branches may be a viable means for allowing each branch to pursue its own charitable objectives. However, such a division must be approached with an appreciation for, and an understanding of, the various tax pitfalls, each of which should be addressed in advance.

Note: Lou Vlahos, a partner at Farrell Fritz, heads the law firm's Tax Practice Group. Lou can be reached at (516) 227-0639 or at lvlahos@farrellfritz.com.