CHILTON TRUST

Family Office Bulletin:
Insights Into Donor-Advised Funds
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Insights Into Donor-Advised Funds

Donor-advised funds are third-party charitable funds set up by a sponsoring organization that accept contributions from donors and then facilitate those contributions to various charities at the direction of the donor. Contributions can be made in the form of cash, securities, or even complex assets such as real property or a piece of artwork. These contributions are treated as gifts by the donor to 501(c)(3) public charities. The largest, nationally recognized sponsoring organizations for these funds include Fidelity Charitable Gift Fund, Schwab Charitable Services, Vanguard Charitable, and National Philanthropic Trust. Many high net worth individuals and families who are heavily involved in charitable giving, including many of our clients here at Chilton Trust, can utilize these vehicles as an option to their current form of charitable gifting. We are often asked the question, why choose a donor-advised fund as a vehicle for charitable giving as opposed to direct giving? Why not open a private family foundation and process donations from there? The answers ultimately depend on the client's specific needs and/or circumstances, and the outline below will help provide further information on these donor-advised funds.

Tax Advantages

One of the primary tax benefits of a donor-advised fund is the ability to deduct contributions to the fund immediately. In a high income year, the individual can use the concurrent contributions, regardless of when donations are actually made to the end charity or charities, to offset gains made or income received. The donor-advised fund contribution is treated as a gift to a 501(c) (3) public charity and deductible in full based on fair market value (FMV) with limits of up to 50% of adjusted gross income (AGI) for cash gifts and 30% of AGI for appreciated securities. Alternatively, the thresholds for similar contributions to a private, non-operating foundation are lower, only up to 30% and 20%, respectively.

Another specific tax advantage of contributing to a donor-advised fund, over setting up a personal private foundation, is the ability to invest the charitable contribution without incurring tax liabilities. A donation to a donor-advised fund would circumvent the current 2% (maximum) excise tax that is assessed on net investment income in private foundations. Because the contribution to the donor-advised fund would not be subject to that excise tax, the contribution could grow tax-free and potentially result in a larger donation.

One final tax advantage of a donor-advised fund worth noting is the ability to donate securities and other "non-traditional" assets, specifically those that have appreciated in value (such as artwork and real estate). Although most of the larger public charities have the ability to receive such assets, we have come across some smaller charities that do not have the means to accept even a stock donation. For example, Mrs. Smith wishes to donate $100,000 to a small, local non-profit and she holds stock in ABC, Inc. valued at $100,000 (with a cost basis of $20,000). If Mrs. Smith sold this stock and donated the cash proceeds of $100,000 she would have to pay taxes on the capital gain of $80,000 ($100,000 - $20,000 = $80,000) which ultimately reduces the tax benefit from the donation! However, if Mrs. Smith donated ABC, Inc. securities directly to the donor-advised fund, there would be no capital gains tax implication. It is important to note that in this example, the donation would still be subject to Mrs. Smith's AGI limitations. Thus, a donor-advised fund has allowed many individuals to donate securities and alternative assets and enjoy the accompanying tax benefits.

Strategic Considerations

In addition to the tax advantages a donor-advised fund has to offer, there are several strategic advantages to consider as well. For instance, a donor-advised fund receives the benefit of investment expertise from the respective sponsoring organization. This is especially relevant if the donor is not particularly investment savvy. The fund will charge some type of administrative and investment fee; however, those fees may be significantly less, in most cases, than the investment management and administrative fees involved with creating a private foundation and running donations through that entity.

Another motivating aspect of a donor-advised fund has to do with the actual charitable goal. Some of our families are drawn to one specific charitable cause; however they may not have a specific charity in mind. As an example, the Smith family strongly supports "children & youth activities." A donor-advised fund is beneficial because it will allow the family to advise on the specific cause they support and the fund will then go ahead and identify like-minded charitable organizations, if requested. The funds can work with the family to help narrow and select from various organizations, and also confirm their non-profit status. In this case, the fund may donate to Boys & Girls Clubs of America, Make-A-Wish Foundation, Toys for Tots, etc. That said, it should be noted that the donor legally has no control over assets once acquired by the sponsoring organization for the donor-advised fund. This is one of the reasons using a well-established donor advised fund makes sense – they have a long history of following the donor's guidance on either how to invest the funds, or about where to donate. Furthermore, the fund allows you to "pool" your money with other donors. The collaboration of like-minded donors pooling their money can make a greater impact in charitable endeavors than smaller, one-off gifts from a single donor.

"I couldn't find a worthy recipient of my philanthropic giving, so I'm funneling it all through Grandma."

Another strategic consideration, especially when comparing a donor-advised fund to a private foundation, has to do with the annual minimum payout requirement. Private foundations, unlike donor-advised funds, are required to distribute at least 5% of the value of its non-charitable-use assets on an annual basis. (The purpose of this requirement is to prevent foundations from investing contributions without subsequently processing charitable donations). This may seem like a simple task, but, we have been privy to a few instances in which individuals with smaller foundations have difficulty adhering to the 5% requirement. The most common explanation is the individual simply does not want to take the time to provide a list of organizations and amounts that meet the calculated donation thresholds, nor do they want to verify the 501(c) 3 status. Contributions from a private foundation should only be made to organizations which are public charities and best practice is to obtain documentary evidence of that organization's tax exempt status. To this end, working with a donor-advised fund could be less of an administrative burden than attending to the details that are required to run a minimally-efficient personal private foundation.

Finally, perhaps one of the greatest and most relevant benefits to our clients relates to the concept of anonymity. High net worth individuals and their families are susceptible to endless solicitations from a plethora of charitable organizations, many of which have quite extensive donor information databases. Private foundations have no such flexibility when it comes to public anonymity. Private foundations file a tax Form 990 with the Internal Revenue Service which is required to include items such as key officers/ employees and their related compensation, top contributors, schedules of major grants, etc. These forms are subject to public inspection and available online in many cases. Donor-advised funds are also subject to certain filing requirements. However, they provide greater privacy, especially in terms of their individual donors and those donors' specific contributions and charitable causes. If a client is truly looking for anonymous gifting, only contributions to a donor-advised fund or anonymously through a public charity will suffice.

Scenario: Donor-Advised Fund or Private Foundation?

Mr. and Mrs. Smith are an older, high-net-worth couple looking to contribute towards causes near and dear to their hearts, specifically their love for animals, but do not have any specific charitable organizations to which they would want to contribute in mind. Mr. and Mrs. Smith are directors on a personal private foundation in their family, but have a few questions regarding whether or not they should continue to donate through their foundation: What is their most efficient and tax-strategic option? How can they make the maximum charitable impact? To whom should they give?

To answer the first question from a tax perspective, the proportion of their gift in relation to their AGI is important. If, in this hypothetical case, the couple's AGI for the year is **$240,000** and they want to donate appreciated securities with a FMV of **$60,000** to qualified charities this year, the following 2 outcomes can be modeled:

Smith Private Foundation	
Donation of securities (FMV)	$60,000
Maximum charitable deduction (20% of AGI)	$48,000
Total charitable deduction (lesser of donation or 20% of AGI)	**$48,000**

Donor-Advised Fund	
Donation of securities (FMV)	$60,000
Maximum charitable deduction (30% of AGI)	$72,000
Total charitable deduction (lesser of donation or 30% of AGI)	**$60,000**

In this case, there's a clear tax benefit for the couple to donate to the donor advised fund rather than the private foundation because of the difference in AGI phase-out limits.

However, if the couple's AGI was $**3**40,000 rather than $**2**40,000, the donor advised fund would no longer have a tax benefit as the donation of this size ($60,000) would fall short of either option's phase-out limits.

If tax modeling renders any tax advantages neutral, the Smith's second question becomes more important. Making the maximum charitable impact means different things to different people, so other strategic options could come into play here. For this example, the couple doesn't really have a specific plan as to how to make their maximum charitable impact. Therefore, donating to a donor-advised fund might be a more fluid and efficient option. This will allow the Smiths to take the tax benefit in the current calendar year and afford them the time to either research which charities they want to donate to or completely offshore the decision-making process to the donor-advised fund. They could express their wishes to have the donor-advised fund pool their contribution with other contributions earmarked for animal welfare needs, thus giving the administrative burden to the donor-advised fund *and* preserving their charitable mission.

Conclusion

Donor-advised funds can be greatly beneficial to high-net worth individuals and families depending on their tax needs and/or charitable inclinations. Donor-advised funds are now one of the more popular philanthropic channels for those aiming to establish an enduring giving legacy. They are an alternative method of charitable giving for individuals whose charitable endeavors go far beyond smaller donations to a handful of charities, but also do not want to be burdened with the cost, administration, and maintenance of a private foundation. Donor-advised funds can be a compelling case for some individuals and families and should be included in one's overall discussion as it relates to charitable gifting.

At Chilton Trust, we believe it is our duty to not simply assist clients in reaching their philanthropic goals, but to guide them in identifying and understanding the necessary steps to reach those goals. We stand ready to help in assessing what charitable strategy may be appropriate for you and your family, whether it be a donor-advised fund, private foundation, direct giving, or other charitable vehicle .

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