

WILL DONOR-ADVISED FUNDS REPLACE PRIVATE FOUNDATIONS?

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Donor-advised funds are among the fastest growing giving vehicles in the United States today, with total assets increasing to more than \$12 billion in 2001.¹ Will they make private foundations obsolete? Probably not, but there's no doubt that the structures people are using for philanthropy are changing, and donor-advised funds are at the forefront of the trend.

"People are increasingly giving through donor-advised funds," says Gregory L. Colvin, a principal attorney with Silk, Alder & Colvin, one of the leading law firms in the country that focuses on representing nonprofit, tax-exempt organizations and people who donate to them. "These funds are growing in popularity because they are easy to administer, provide unique options for privacy protection, and offer a wealth of advantages to donors and charities."

THE ORIGINS OF THE PRIVATE FOUNDATION

So how did private foundations come about? We can thank the creators of the federal income tax for the private foundation concept. The Revenue Act of 1913, which created our federal income tax, exempted organizations that "operate exclusively for religious, charitable, scientific, or educational purposes." Tax deductions for individuals contributing to these tax-exempt organizations were authorized in 1917.

The first foundations—with names such as Rockefeller, Carnegie, and Ford—were funded with the vast wealth created during the industrial boom of the late 19th century, the same wealth boom that led to the income tax. The recent boom of the 1990s created another explosion of growth in private foundations. From 1990 to 2000, the number of foundations in the U.S. grew 75 percent, to more than 56,000.²

In the most recent cycle of growth, however, not all private foundations were established by the ultra-rich. As often as not, they were created by generous people who had less than \$2 million to give to charity and thought a private foundation was the best way to accomplish this goal. Many are rethinking this assumption and converting their private foundations to donor-advised funds.

THE ORIGINS OF DONOR-ADVISED FUNDS

Donor-advised funds have been around for more than 30 years and were first offered through community foundations. Their popularity soared when financial services companies began to offer them to clients in the early 1990s.

Today you can establish a donor-advised fund through some universities, community foundations, and large charities. Strategies, services, and investment choices differ widely, but the tax benefits remain the same—the ability to receive an immediate tax benefit with time to consider future grant making, and equally important, tax-free potential investment growth for contributed assets.

"Donor-advised funds are also popular because they seem to be a catalyst for more strategic giving," says Kimberly Wright-Violich, President of the Schwab Fund for Charitable Giving.[™] "Having a charitable resource set aside, much like a private foundation, seems to encourage families and individuals alike to think about giving in a new way."

THE ROLE OF FINANCIAL SERVICES

Financial services companies such as Charles Schwab & Co., Inc. began sponsoring donor-advised funds about a decade ago and offer numerous advantages, beginning with investment

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CHARITABLE GIVING®

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¹ *Chronicle of Philanthropy*, 5/30/02.

² *Chronicle of Philanthropy*, 2/6/03.

ON A CHARITABLE NOTE



As a donor with the Schwab Fund for Charitable Giving,[™] you are a part of a very generous philanthropic community. A 2002 study comparing grants made by 75 donor-advised funds revealed that national donor-advised funds transferred significantly more assets to charities than donor-advised funds managed by community foundations. And among national donor-advised funds, the Schwab Fund for Charitable Giving ranks high in terms of donor generosity.*

This is extremely gratifying to us because our mission is to increase charitable giving in the United States by providing you with a better way to give. The charities that have received grants from your Charitable Gift Accounts are undoubtedly grateful as well, especially in the current economic environment.

The survey results confirmed our experience working with our donors, whom we talk with frequently about contributions and grant request. Through these interactions, we've learned that our donors represent an incredibly wide range of interests, causes, and communities. However, what unites you is a committed, independent, and strategic approach to philanthropy that is a wonderful expression of who we are as Americans. You like to give, and we admire your desire to make a difference in the world in a meaningful way.

While some of you are building Charitable Gift Accounts that can be used by future generations, many of you see current needs to support. Whatever your philanthropic strategy or timeframe, know that we look forward to helping you achieve your goals for a better world.

Kimberly Wright-Violich, President
Schwab Fund for Charitable Giving

**ANNUAL GRANT DISTRIBUTION
BY CATEGORY**

TYPE OF DONOR- ADVISED FUND	% ASSETS DISTRIBUTED
National Funds (includes SFCG)	23%
Community Funds	8%

*Source: Based on data reported in the *Chronicle of Philanthropy*, 5/30/02, for 2000 and 2001 fiscal years.

YOUR PHILANTHROPY IN ACTION

More than 14,000 grants were made from your Charitable Gift Accounts in 2002, totaling almost \$54 million. Here are just a few of our grant recipients from the Social Justice and Social Services category:

- American Civil Liberties Union of Michigan**
Detroit, Michigan
- The Carter Center**
Atlanta, Georgia
- Center for Voting and Democracy**
Takoma Park, Maryland
- Japanese American Citizens League**
San Francisco, California

- Human Rights Watch**
New York, New York
- Judicial Watch**
Washington, D.C.
- Senior Adults Legal Assistance**
San Jose, California
- Southern Poverty Law Center**
Montgomery, Alabama
- Volunteers of America, Alaska**
Anchorage, Alaska

CHARITY PROPOSALS PASS MAJOR CONGRESSIONAL HURDLE

Legislation to encourage Americans to donate to charities was approved in February by a key committee in the U. S. Senate. The Charity, Aid, Recovery, and Empowerment (CARE) Act of 2003, Senate Bill 476, was approved unanimously by the Senate Finance Committee and now awaits consideration by the full Senate. Key elements of the CARE Act are:

Contributions from retirement accounts. This provision would permit people older than 70 1/2 to withdraw money from IRAs and other retirement accounts and donate the assets directly to a charity (including a donor-advised fund) without being subject to income tax. Individuals would also be able to make tax-free retirement account distributions to "split interest" charitable vehicles such as charitable remainder trusts, pooled income funds and charitable gift annuities beginning at age 59 1/2. In these cases, naming the Schwab Fund for Charitable Giving as the charitable beneficiary provides for maximum donor flexibility (see "Glad You Asked" on page 3).

Lobbying by nonprofit groups. The CARE Act would make significant changes to the way charities account for lobbying expenses, with the goal of reducing record-keeping and simplifying reporting requirements.

Funds for IRS oversight. This provision authorizes \$80 million annually to the IRS for better oversight of charities. The bill would also allow the IRS to share information about charities with state regulators (including notices that the agency is considering revoking a group's tax-exempt status) and require the IRS to increase public disclosure regarding nonprofit organizations.

Charitable deduction for non-itemizers. This provision would allow people who do not itemize deductions on their income tax returns, estimated to be about 70 percent of taxpayers, to write-off some charitable contributions. Individuals would have to contribute more than \$250 (or \$500 for joint filers) to charity in a year to qualify and would then be limited to a maximum deduction of \$250 for individuals, and \$500 for couples.

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choices and financial reporting. In each case, the donor-advised fund consists of a separate, independent nonprofit organization, such as the Schwab Fund for Charitable Giving.

“Financial service companies such as Schwab are highly service-oriented, and they’re familiar with detailed reporting about fees and investment growth,” says Colvin. “Some community foundations do not offer investment choices for donor-advised funds, or they invest very conservatively, and their reporting may not be as frequent or as thorough.”

On the other hand, the strength of having a donor-advised fund with a community foundation, in Colvin’s view, may be that it brings a locally informed, results-oriented philosophy to the process. “National donor-advised funds and community foundations can learn from each other in offering donor-advised funds. They both bring important skill sets to the table,” he says.

Financial advisors also appreciate working with national donor-advised funds, such as the Schwab Fund for Charitable Giving, as a way of ensuring that they can stay informed about charitable giving trends and legal developments. “Charitable Gift Accounts are so easy to administer for clients, and I can offer them with confidence, because Schwab keeps up to date in terms of new legal requirements and other issues,” says Gary Yarus, a Miami-based investment manager.

“Even for clients who give a great deal of money to charity, donor-advised funds offer tremendous simplicity and ease compared to what a private foundation requires.”

A CASE STUDY

Bruce Pretzinger, a Certified Financial Planner and Investment Advisor in Pasadena, California, has worked for many years with a physician who set up a private foundation in the late 1990s. However, as a busy, working doctor, who also travels the world to donate his services in charitable medical clinics, the

client did not appreciate the extra time and effort his foundation required.

Working with Pretzinger and the Schwab Fund for Charitable Giving, the doctor transferred the assets in his private foundation to a Charitable Gift Account in late 2002. His support for philanthropy continues, minus the administrative hassles of running a private foundation, and contributions to his account are deductible up to 50 percent of his adjusted gross income (AGI). For a private foundation, contributions are generally deductible up to only 30 percent of AGI.

“My client appreciates the ease of operation of the Account in comparison to what it took to manage his foundation,” says Pretzinger. “His motivation is about giving, not running an organization, and we both liked the option of being able to contribute and deduct a larger percentage of AGI.”

Pretzinger researched donor-advised funds and recommended Schwab because he appreciated the accessibility of informed client service representatives, “who could not have been more helpful,” and because of our investment choices and granting policies.

“The Schwab program is equal to or better than anything else that’s out there,” says Pretzinger.

HOW DAFs AFFECT CHARITIES

Donors may not realize they are also providing benefits to charities by using a donor-advised fund for their contributions. Let’s say you want to fund a major initiative at a local art museum, perhaps a new building. If you make a contribution through your private foundation, and it represents a substantial portion of the museum’s operating budget, you could jeopardize the museum’s status as a public charity.

“The IRS imposes a public support test on public charities,” says Colvin. “If a large part of a charity’s income comes from a private source—such as a private foundation—the

Q. If I transfer assets from my private foundation to a donor-advised fund, does this create any new tax liabilities?

A. No, it should not. Although tax liabilities vary, transferring assets from a private foundation to a donor-advised fund is not a taxable event because the assets in the foundation are being transferred to a public charity. However, if you choose to close your private foundation, you should consult with a tax advisor about reporting the closure to the appropriate agencies, such as the IRS.

Q. Can I name my Charitable Gift Account as the beneficiary for my IRA?

A. Yes, you can name the Schwab Fund for Charitable Giving as the beneficiary of an Individual Retirement Account or Charitable Remainder Trust, and assets transferred will be credited to your Charitable Gift Account. You may also bequeath cash or securities to your Account through your will or other estate planning instruments.

And remember, your Charitable Gift Account makes it easy for you to leave a lasting legacy. By naming loved ones as successors on your Charitable Gift Account, you’ll give them the opportunity to request grants from your Account throughout their lifetimes and continue your commitment to building a better world.

PROPOSALS *continued*

Additional provisions of the CARE Act would allow for increased deductions for volunteers who use their cars for charitable work and for donations of food, books, and other artistic or scholarly works. Would you like more information? Visit the Legislation and Records section of the U.S. Senate’s Web site at www.senate.gov.

Note: Congressional calendars often change. The information in this article was current as we went to press with this edition of *Giving*.™

Requesting another grant for your alma mater or local museum? Now it's easier than ever before with our new online service, Express Granting.

Beginning in May, the online Donor Center (www.schwabcharitable.org) will feature Express Granting. With this useful enhancement, you will be able to access a list of your most recent grant requests. And if you'd like to request an additional grant to any of your listed charities, all you have to do is click on the charity's name, enter a dollar amount and hit "enter." You will not have to type in any additional information about the charity, and your grant request will automatically be submitted for approval. It's fast, easy, and generous.

Express Granting was developed based on feedback we received from our donors, and is reflective of our commitment to making the grant request process as simple as possible.

So if you've been making grant requests by completing and mailing in a *Nominate a Grant* form, now is an excellent opportunity to make the switch to our improved online service. If you are not yet activated for our secure Donor Center, just give us a call at 1-800-746-6216. We'll be happy to set you up with a password to enjoy Express Granting and our other popular Donor Center features.

To contact us, write to the Schwab Fund for Charitable Giving, 101 Montgomery Street, San Francisco, California 94104. Or send an e-mail to giving@schwabcharitable.org.

charity could fail the test in the eyes of the IRS. I know of several individual patrons who were not aware that their contributions could create a problem of this kind." Because grants from a donor-advised fund are always considered public support, donors can request grants of any amount for public charities without this concern, says Colvin.

Do charities mind that some grants from donor-advised funds are made anonymously, which precludes them from soliciting the donor for future grants? "It's not an issue for them at all, in my experience," says Colvin. "They're happy to receive the support, and it counts fully toward their public support test." While only about 4 percent of Schwab Fund for Charitable Giving grants were made anonymously in 2002, it is a benefit not available through other giving vehicles, such as private foundations.

MORE INTEREST IN PRIVACY

Many donors choose donor-advised funds for their giving instead of a private foundation solely because it allows them to give anonymously if they choose to do so. "There are so many ways to lose your privacy these days," says Kimberly Wright-Violich, President of the Schwab Fund for Charitable Giving. "Especially for the wealthy, privacy has become a very significant concern."

"With a Charitable Gift Account, my clients can opt-out of being on the 'hot list' for the charities they want to support," says Yarus. "It's a very good option because you can personalize your grants or send them anonymously, and you can decide each time you request a grant."

Not only are private foundation grants part of the public record, so are their financial operations. Private foundations are required to provide detailed information to the IRS about their sources of income, budgets, compensation plans, and charitable grants. These disclosure requirements came about through the Tax Reform Act of 1969, which was driven by concern that some private foundations were not focusing on charitable causes but had become ineffectual tax shelters, clandestine

for-profit businesses, or a way to employ relatives and friends with tax-free dollars.

With a donor-advised fund, giving is a much more private matter, in part because it's a very straightforward way to give assets to charity, and nothing else—no board of directors, no staff, no possibility for uncharitable malfeasance.

"There are many reasons why donors may want to have the option of remaining anonymous when they make charitable grants," says Wright-Violich. "If you have a private foundation, you do not have that option. With a donor-advised fund, you do."

It's noteworthy that the Tax Reform Act of 1969 also imposed an excise tax on a foundation's investment income, now at 2 percent, with a minimum required annual payout ratio, presently set at 5 percent of a private foundation's net investment assets. Donor-advised funds pay no excise tax on investment growth and do not have to meet any annual payout requirement.

THE INVOLVEMENT FACTOR

Private foundations will maintain their appeal for some donors, especially those with very large charitable assets. "A private foundation is probably the best option for someone with a large amount of charitable assets, who wants to keep legal control over those assets, and also wants to be very involved with grantees and their programs in a public way," says Colvin. From this perspective, it makes sense that very wealthy philanthropists will continue to use private foundations to structure most of their giving.

"However, there is no reason why we can't open a \$50 million Charitable Gift Account," says Wright-Violich. "If the donor's only goal is to eventually grant out the assets to charity, we can provide them with a very beneficial and cost-effective way to do it. And by allowing the donor to advise us on specific projects to be funded, we can set performance guidelines for grantees."