

Shaking The Foundation

THE FINANCIAL CRISIS HAS MADE THE popular donor-advised fund an attractive alternative to the venerable private foundation. “When the market beat up the asset values in foundations, people really began to look at their cost and how much time they require,” says Kimberly Wright-Violich, president of Schwab Charitable, the donor-advised fund sponsored by the house that Chuck built.

The average foundation’s assets dwindled 28% in 2008, according to the Council on Foundations, a non-profit association in Arlington, Va. It is now less palatable to pay foundation expenses such as the annual federal excise tax on investment income, accounting fees to have IRS Form 990-PF prepared, staff salaries and other costs.

Moreover, explains Wright-Violich, “in this environment many people can’t devote the time they once did to charitable activities. They’re having to spend a lot more time running their companies or managing their investments.”

These vectors have led to record levels of conversions from foundations at Schwab Charitable. Ditto at Fidelity Charitable Gift Fund, the donor-advised entry from Fidelity Investments that has quietly grown into America’s third-largest charity, behind United Way and the Salvation Army.

Whether your client should abandon his private foundation for a donor-advised fund, or utilize one instead of a foundation in the first place, is driven by his objectives, says Pittsburgh advisor Chris Roe. “Understand all the reasons why the client wants to give to charity and address it on that front. Know thy client,” advises Roe, senior wealth counselor at Waldron Wealth Management, an independent LPL Financial affiliate. It really comes down to understanding the benefits each vehicle can yield the client.

Giving Account

A donor-advised fund is an account established at a sponsoring charity. The donor contributes cash, securities or other assets to the giving account, then recommends which charitable organizations should receive distributions out of it. Though the donors cannot by law dictate themselves where the money goes, their recommendations are denied only when implementing them would violate regulations. The sponsoring charity handles all due diligence, tax filing, compliance and administration.

“All donor-advised funds are independent non-profits,” explains Wright-Violich. Some are sponsored by financial-services concerns. Others are administered by community foundations. Both genres evolved their offerings considerably in the ’00 decade. Today, for example, advisors can manage the client’s donor-advised fund assets, possibly without being restricted to the sponsor’s investment products.

That said, donor-advised funds vary widely in their features, in the size of client that’s eligible for special features and in cost. For instance, the minimum asset requirement for an advisor-managed giving account can be anywhere from \$250,000 to \$1 million, observes Tim Freundlich, a Calvert Foundation senior vice president. You’ll have to canvass the marketplace to determine whether there’s a product that meets your client’s needs.

The Advantages Of Donor-Advised Funds

Giving accounts cost less than foundations and thus stretch the client’s charitable dollars. There is no excise tax or costly return to file, just a modest annual administration charge. One family now pays Schwab Charitable 22 basis points after transitioning its \$12 million foundation, which had

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Eric L. Reiner

had a small staff and annual expenses of roughly 120 basis points. Depending on the complexity of a foundation's administrative needs, the Fidelity Charitable Gift Fund indicates that potential savings can range from 20% to 50% annually on administrative and investment expenses, according to its president, Sarah Libbey.

Simplicity is perhaps equally attractive. The sponsoring charity handles everything. The donor avoids dull administrative chores and wrestling with the cobweb of regulations that governs private foundations. With some of today's donor-advised funds, clients can simply go online to view their account balances, analyze their giving and research charities, in addition to recommending grants. "They've made it pretty easy for people," says John Poulton, head of the Strategic Advisory Group at Brown Advisory in Baltimore.

Privacy is yet another benefit. "Donors can make gifts anonymously with a giving account," Libbey says. Contrariwise, a private foundation's 990-PF is readily available to the public (see www.GuideStar.org) and discloses who the donor and board members are, the foundation's level of assets, the recipients of grants, and more.

For the client who might add to his charitable pot in the future, consider the larger income tax deductions that gifts to donor-advised funds produce. For contributions of cash and public securities, the donor is entitled to deduct up to 50% and 30% of adjusted gross income, respectively, compared with 30% and 20% when these assets go into a foundation. Contributions of real estate and other property are deductible at market value, versus at cost basis if donated to a foundation.

A final difference is that with a giving account, there are no mandatory annual distributions, Roe points out. "That gives the client some flexibility in the timing of his charitable giving" compared to a private foundation, which must give 5% of net assets out to charity annually, he says.

Favoring Foundations

Paramount prestige comes with one's own foundation. So does unfettered control. Attorney Sally Venverloh tells her clients, "With a private foundation you are

running the show. You have maximum flexibility regarding how the assets are invested and where the money goes," says Venverloh, who is president of NGE Philanthropic Advisors, a division of Chicago-based law firm Neal, Gerber & Eisenberg LLP.

Foundations may make grants to individuals if strict rules are followed, whereas donor-advised funds can't at all. And even though private foundation money cannot be used to fulfill the pledge obligations of the founders, directors or officers, the foundation itself may make a pledge with strings attached to another charity payable over several years. "It's harder to accomplish that in the context of a donor-advised fund," Venverloh says.

The client likewise needs a foundation if his goal is to pay staff (perhaps a young family member) or to create a philanthropic legacy within the family. "When structured and operated properly," says Venverloh, "a private foundation can be a platform for uniting the family for a common purpose and bridging communication gaps."

Giving accounts don't offer that. Even if the account can be passed to successor advisors that the donor named while he was alive, the successors act independently. The sponsoring charity might even split the account among the designated parties and literally send them their separate philanthropic ways.

Lean toward a foundation if the client aims to make gifts with complex arrangements. Suppose he wants to help construct a building but wishes to pay for it in stages, to make sure the project makes adequate progress. "A private foundation is better equipped to monitor the charity and make sure it's meeting the target requirements," Venverloh says.

But some donor-advised funds handle unusual, customized gifts. Calvert Giving Fund is among the more adventurous in this regard. Applying "heightened levels of fiduciary oversight," Freundlich says, "we will approve grants to non-profits other than 501(c)3s and to for-profit enterprises to accomplish very carefully scoped charitable purposes."

As an example of the latter, he proudly points to a documentary about Native American rights that one donor wanted

to fund. "We hired a production company and paid for it out of his giving account. We can administer projects with expenses, although we are very, very careful about it," Freundlich says.

International gifting also requires extra administration. While private foundations are free to engage in giving to charities abroad, some donor-advised funds prohibit it. Others don't.

The Advisor's Role In Conversions

If the client decides to abandon his foundation, the advisor's job is to quarterback the transaction, says Roe, the Pittsburgh planner. Dissolving the foundation and moving the money has to comport with a lot of arcane IRS and state rules. The donor-advised fund might have Web site information explaining the process, or even an entire foundation-conversion service like Schwab Charitable does. But still, the advisor ought to oversee the transition. Left unmonitored, a well-intentioned but blundering client could make costly mistakes.

One of the first things Roe does is help the client locate competent legal counsel. It's guidance more folks could use. At Fidelity, "we frequently see people realize a little late in the game that they should have had an attorney advising them," Libbey says. Look for a lawyer experienced in terminating private foundations similar in size and complexity to the client's, and in the same state.

Look, too, for someone helpful at the donor-advised fund. Ask for assistance from a staff member with experience processing conversions from foundations, Roe suggests. Having the right person on the other end smoothes the transaction and eliminates headaches, he says.

Somewhere along the way, make sure the family's wills get checked for potential updating. Venverloh says, "If Grandpa left his entire estate to the foundation, that would be important to know before you kill it off."

When it's time to migrate the assets, don't transfer all the money to the donor-advised fund at first. Keep enough in the foundation to cover its final expenses, such as legal and accounting fees. "After all the final expenses are paid," Roe says, "distribute whatever remains in the foundation to the donor-advised fund." 