



Philanthropic Estate Planning

By Janet Nava Bandera

Private Foundation vs. Donor Advised Fund

Within the next 50 years, charitable giving will be drastically changed by an estimated \$41 trillion transfer of wealth between generations. Conservative estimates assume that more than \$6 trillion will be donated immediately, with the remainder of the assets transferred to the next generation.

Today's donor, whether he or she has significant wealth or more modest means, needs guidance on the most efficient method of transfer. Two methods that allow a donor to establish a legacy and perpetuate the family's giving are a private foundation and a donor advised fund.

Private Foundations

There are primarily four types of private foundations: an operating foundation, a nonoperating foundation, a passthrough foundation, and a quasi-private foundation called a supporting organization

A private foundation allows a family flexibility to operate an organization in accordance with special preferences, purposes and predilections. It also allows the founding grantor to specify directors or trustees, including the grantor and his or her family members. The foundation is able to carry on its charitable activities without the approval of an independent institution.

- An **operating foundation** is one that carries on its own specified purposes, invests in projects, as opposed to stocks and bonds, and has a staff.
- A **nonoperating foundation** acts as a conduit to fund other charitable endeavors. Such foundations are required to annually distribute not less than five percent of their investment holdings to public charities.
- A **passthrough foundation** is a private grant-making organization that distributes all of the contributions it receives each year (not just five percent of its assets). The passthrough option may be made or revoked on a year-to-year basis.
- A **supporting organization** is created and funded by one or more family members. Although not

supported by the public, it is typically structured as a trust whose purpose is to support one or two designated "public charities." The organization cannot be controlled, directly or indirectly, by the donors and/or family members. "Control" is defined as veto power or voting power equal to 50 percent or more of the governing body.

Donor's Income Tax Deduction. The income tax deductions vary according to the type of organization and the asset gifted. They are shown in Table 1.

Disadvantages of a Private Foundation. Although foundations provide flexibility, there are also disadvantages, some significant, including the following:

- There is a cost to establish and operate a private foundation. There are attorneys' fees to draft the required documents. These include the founding trust or corporate document, IRS Form 1023, specifying what the foundation will do, its budget and other relevant documents and the form to obtain the employer identification number.
- IRS Form 990PF must be filed annually, incurring ongoing tax preparation fees.
- Record keeping is critical as an accurate summary of capital gains and losses, dividends and interest. This type of record keeping is required.
- There is a two-percent excise tax on private foundation investment income. This tax is imposed on the aggregate of dividends, rents, royalties and capital gains.

Janet Nava Bandera, J.D., is the Managing Principal of the Bandera Law Firm, P.C. Ms. Bandera is engaged in the practice of law specializing in estate planning, charitable giving and asset protection for high-net-worth individuals. She serves on the boards of several charitable organizations and is a regular speaker for local and national financial planning firms. She can be reached in St. Louis, Missouri at (314) 691-4386 and in Lake Ozark, Missouri at (573) 365-9779 or at www.banderalawfirm.com.

- There are restrictions on “self-dealing” between the foundation and “disqualified persons” (officers of the foundation, the donor, the corporation whose shares are owned by disqualified persons, etc.).

Advantages and Disadvantages of a Supporting Organization. The advantages of a supporting organization over a typical private foundation are that it is not required to make the annual five-percent distribution and it is not subject to the two-percent excise tax on net investment income or to any other private foundation excise tax.

The primary disadvantages are a loss of control and lack of flexibility. Charitable recipients of a supporting organization can be changed only if the supported organization ceases to exist, loses charitable status or no longer conducts supported activity.

Donor Advised Funds

For those who do not want such a complex structure or the limitations, there are other options. Additionally, “Philanthropy is no longer just for the very rich, it is everybody’s business now,” according to Robert H. Bremner, Professor Emeritus of History at Ohio State University. A donor advised fund provides a way for people of modest wealth to manage their charitable investments.

A donor advised fund is a fund managed by a third party that has qualified as a public charity. Through a written agreement with the charity, a donor creates a specially named fund to which contributions are made. The fund can be a permanent endowment or a provisional fund that distributes principal. The terms of the agreement provide the donor, or others specified by the donor, with the privilege of making nonbinding recommendations regarding charitable distributions and investment decisions. The charity typically allows the donor

to name the account as desired. Thus, a donor may establish the “Smith Family Fund” and charitable recipients acknowledge the gift accordingly.

Such a fund allows a donor to remain involved without the annual tax on investment income, minimum annual payout requirements and other restrictions that apply to private foundations. Additionally, the charity that holds the fund takes responsibility for all administration including filing annual returns and preparation of financial statements and professional staff is available to help donors pursue their individual charitable interests and identify charities that can use grants in efficient and effective ways.

Donor’s Income Tax Deduction. Gifts to a donor advised fund are deductible at up to 50 percent of the donor’s adjusted gross income and as with gifts to a public charity, contributions of appreciated securities that are not publicly traded can be deducted at their full fair market value.

How to Compare Donor Advised Funds. There are a variety of organizations that offer donor advised funds, including Community Foundations, universities and financial services firms such as Schwab, Fidelity and Vanguard. Each fund will vary and the donor should find a fund that suits his or her giving style and goals. Some key points of comparison for donor advised funds are:

- Minimum initial investment
- Minimum subsequent contributions
- Investment options
- Assets manager
- Minimum grant
- Maximum grants per year
- Are distributions restricted to type, location or specific organization?
- Fees and expenses
- Recordkeeping

Table 1

Donor’s Income Tax Deduction	Direct Gift to Charity	Private & Nonoperating Foundation	Passthrough Foundation	Operating Foundation	Supporting Organization
Tax deduction limitation for gifts of cash (percent of adjusted gross income that may be deducted)	50%	30%	50%	30%	50%
Tax deduction limitation for gifts of stock or real property (percent of adjusted gross income that may be deducted)	30%	30% for “qualified” securities 20% for non-“qualified” securities	30%	30%	30%
Valuation of gifts of stock other than publicly traded stock	Fair market value	Cost basis	Fair market value	Fair market value	Fair market value

Conclusion

Through either a private foundation or a donor advised fund, a donor can leave a legacy that continues for generations and involves his or her children and grandchildren in giving.

The primary advantage of a private foundation over a donor advised fund is that the family of the donor can be paid reasonable compensation for acting as trustees/officers. Donor advised funds do not allow this. However, if the donor intends to contribute small

amounts and/or is willing to give up a small degree of control, a donor advised fund can accomplish the same result as a private foundation with less complexity and cost.

Whatever method may be appropriate for the donor, one thing to emphasize is that this planning can be accomplished in the donor's will or living trust. It is not necessary for the donor or his or her spouse to give up assets during their lifetime and the limits on contribution deductions for gifts to private foundations do not apply to estate or gift tax charitable contributions.



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