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Intelligent Investing

Finding The Right Vehicle For Charitable Giving

Betsy Brill, 06.09.10, 5:00 PM ET

Despite the recession, the amount donors contributed to donor-advised funds last year increased by more than 2%--reaching a record \$9.1 billion. The number of new donors creating DAF accounts also increased dramatically (by over 10%) reaching nearly 148,600 accounts holding more than \$28 billion in assets.

At the same time, the rate at which donors are establishing private foundations has slowed considerably, due in no small part to the economic crisis. In 2009 the number of active foundations rose only a marginal 0.5%--the slowest annual rate of growth tracked since 1981. Although the media has tended to focus on the slow rate of foundation growth as a sign of diminishing popularity, the fact remains that private foundations are the most prominent and influential charitable giving vehicles in the philanthropic sector, giving out over \$30 billion in 2009 and managing over \$580 billion in assets.

While private foundations and donor-advised funds are by no means the only options for managing charitable giving, they are the most frequently discussed and, quite often, the most misunderstood. As donors become more sophisticated and hands-on in their approach to charitable giving, it is critical that they understand the advantages and limitations of these two popular giving vehicles. With help from colleagues Rick Sevcik, partner in the law firm K&L Gates who has extensive experience in the representation of private foundations, and Sarah C. Libbey, president of the Fidelity Charitable Gift Fund, I hope to dispel some of the myths surrounding both vehicles as well as to outline their comparative advantages and limitations.

Donor-Advised Funds (DAFs)

Originally pioneered by community foundations as an alternative to the relative inefficiency of checkbook giving and the more complicated private foundation establishment, DAFs are now offered by a range of sponsoring organizations from financial institutions that operate independent nonprofit organizations (e.g., Fidelity Charitable Gift Fund) to universities to religious organizations. Because DAFs are housed by public charities, donors receive the maximum tax deduction available at the time of their gift. Those assets are then invested with the potential to grow tax-free, with the possibility of generating even larger donations to donors' charities. Libbey explains that "most donor-advised funds then allow donors to research charities, recommend grants and manage how their charitable contributions are invested at any time through their DAF provider's website."

According to Sevcik, one of the most attractive features of the DAF is that "clients can focus on what assets they would like to donate and on what charities to support" since the DAF's sponsoring organization manages daily administration and processes all contributions. Sevcik believes that "for clients who want a vehicle through which to make grants to other organizations, a donor-advised fund may be the most attractive option."

Libbey observes that donor-advised funds allow people to streamline their charitable giving, providing a "one-stop vehicle that combines the convenience of technology with lower administrative burdens and maximum tax advantages." DAFs allow donors to take a federal income tax deduction up to 50% of adjusted gross income (AGI) for cash contributions and up to 30% of adjusted gross income (AGI) for appreciated securities; vs. 30% of AGI for cash contributions and 20% of AGI for appreciated securities for a private foundation.

"The simplicity and convenience of DAFs, which allows donors to give spontaneously, through a planned strategy and to carry on their charitable legacy beyond their lifetime, is catching on."

Indeed, Fidelity Charitable Gift Fund's first-quarter results show that contributions to Giving Accounts(Fidelity's DAF

product) rose 109% compared to the same period last year from \$129 million to \$270 million and grants from giving accounts to charities were up 35% from \$199 million to \$269 million.

The relative low cost of operating a DAF has certainly contributed to its popularity, especially in these troubled economic times. DAFs can often be established with as little as \$5,000 and do not charge start-up fees for opening an account. For example, Libbey explains, "The FidelityCharitable Gift Fund charges donors via an annual administrative fee which is based on a sliding scale that decreases as the account balance increases. Fees can range from \$100 for smaller accounts to several thousand dollars for accounts with balances over \$1 million. The annual administrative fee covers all aspects of the donor-advised fund experience, including account record keeping of investment balances and grant allocations, the processing of grants and due diligence of recommended charities."

In addition, many donors choose DAFs because they allow them to give to charities anonymously. In fact, according to Libbey, some donors with private foundations also use donor-advised funds specifically because of the anonymity they offer. In contrast, private foundations are required to file the IRS Form 990-PF, which is a public record of assets, contributors and grants.

Libbey says that many private foundation owners also see DAFs as a strategic way to complement their private foundation. DAFs allow donors to give grants outside of the core mission of their private foundations and maximize charitable tax deductions in a given year. Many DAFs also can easily facilitate the donation of special assets, and provide families a way to introduce new generations to philanthropic giving before they are ready to manage the family foundation.

Private Foundations

Sevcik explains that the most common reason for choosing a private foundation is the donor's desire "to maintain control over the use and expenditure of his/her charitable assets and the beneficiaries of those assets." He also cites the desire for "direct engagement in charitable activities, venture philanthropy and an interest in maintaining a greater sense of philanthropic or family legacy" as the top motivations for establishing a private foundation.

Indeed, private foundations provide donors with an array of options for supporting charitable causes, from engaging in cross-border giving, to setting up a scholarship program to providing funds directly to an individual (although these activities require additional paper work and monitoring). Foundations also allow donors more control as far as directing the investment of their charitable assets beyond grant making. Sevcik has noticed, for example, that his foundation clients are increasingly turning to program-related investments as ways to aid needy nonprofit organizations without necessarily giving away the corpus. These investments may take the form of loans, loan guarantees and equity investments. Because foundation endowments aren't as large as they were pre-recession, these program-related investments allow foundations the possibility of generating some income, thus allowing money to potentially funnel back into the corpus for support of other organizations' work.

It's true, however, that private foundations are expensive to establish and operate, and there are administrative duties such as filing 990-PF tax returns and holding regular board meetings that must be undertaken to ensure compliance with the tax code. However, in Sevcik's experience, "clients who want to be actively engaged in their philanthropy will make the determination that the time and resources are worth spending."

Part of the expense of operating a private foundation covers the cost of legal, financial and philanthropic advisors that help to guide and manage all foundation investments--charitable and otherwise. Assembling the right advisory team is crucial for ensuring adherence to best practices and compliance with the law. Advisors are especially helpful to donors who are interested in giving to organizations overseas. Sevcik notes, for example, that legal counsel is necessary to address the various rules that apply to grants to foreign organizations.

Other expenses can come in the form of paid full-time staff who provide issue expertise, administrative support and conduct research on and follow up with grant recipients. While the desire to hire a professional staff is one of the reasons some donors choose to establish foundations, only about 14% of private foundations have paid full-time staff (not counting legal, investment and philanthropic advisors). In fact, most foundations in the U.S. are small family foundations, with over 60% having less than \$1 million in assets. Rather than serving as tax havens for the ultra rich as is often alleged, foundations provide a way for families to shape their legacies and serve as venues for passing on family values from one generation to the next.

Questions to Consider:

Regardless of the type of charitable giving vehicle donors may choose--be it a donor-advised fund, a private foundation or

another entity--the following questions can help to guide their decision-making process:

--What values do you plan to express through your giving?

--To what extent do you wish to involve your family?

--What is the geographic scope of your philanthropy?

--How much time do you have to devote to administering your philanthropy?

--Do you want to extend your giving to other forms of support, e.g. loans or scholarship awards?

--How long do you want your philanthropy to operate? Several years? Forever?

--Is anonymity important to you?

The decision about which vehicle to choose depends on what clients hope to accomplish with their philanthropy, a decision as important and as personal as which organizations, issues and populations donors plan to support with their charitable dollars.

Betsy Brill is founder and president of Strategic Philanthropy, Ltd., a philanthropic advisory firm based in Chicago serving clients worldwide.

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