

## ***Donor Advised Fund, an Alternative to a Private Foundation***

In last month's article, foundations were addressed; however, a donor advised fund is simpler and may be a more appropriate alternative. A donor advised fund is a pool of charitable assets held by a sponsoring charity, such as a community foundation, with the assets managed by a single financial institution. The donor, or contributor, irrevocably transfers property to the fund and then advises the fund on the distribution of those funds to charities. It is critical to understand that the donor may only recommend charitable recipients. The final determination always belongs to the fund.

### *Advantages of Donor Advised Funds over Foundations?*

There are many perceived advantages of a donor advised fund over a private foundation. The first is simplicity. The fund is established so the donor does not need to create a trust or corporation as in the case of a foundation. The downside to this ease is that the donor lacks the control to determine the terms of the charitable entity.

A second perceived advantage of a donor advised fund over a foundation is in terms of the maintenance of the entity. In a foundation, the donor usually retains the right to manage the property although he/she may delegate this responsibility to a professional money manager. The donor is required to complete and file tax returns and other required filings. A foundation often employs an accountant and/or attorney to handle all of these maintenance issues. In a donor advised fund, the fund is responsible for all of these issues to the extent that they exist and the fund pays for the fulfillment of these requirements. Thus, in either case, the charitable entity must pay to have the maintenance issues addressed.

A third perceived advantage of a donor advised fund over a foundation is that the required annual distributions are usually less than for a foundation. This advantage rarely has any practical impact on the operation of the charitable entities because a private foundation is only required to distribute 5% of the foundation property annually.

A final advantage is in the ability to deduct contributions. Both entities are recognized charitable entities (after the foundation obtains a determination letter from the IRS); therefore, the contributions to each are deductible for federal income tax purpose, but the percentage of Adjusted Gross Income (AGI) limitation is less for a foundation than for a donor advised fund if the sponsoring charity of the donor advised fund is a public charity which is most often the case. In such a circumstance, the 50% AGI limitation would apply to cash contributions to the donor advised fund, but a 30% limitation would apply to the cash contributions to the foundation. Given that any contributions not permitted in the year of the contribution can be carried over for a period of five years, even with moderate income tax planning, the distinction in the percentage of AGI limitations will rarely make a difference.

### *Advantages of Foundations over Donor Advised Funds*

The advantages of foundations over donor advised funds all focus on control. In a donor advised fund, the donor only recommends the ultimate charitable beneficiaries. The donor of a private foundation makes the final determination. In a foundation, the donor controls not only the beneficiaries but also the management of the property. Moreover, the donor can name family members to serve as managers. An option not available in a donor advised fund.

The biggest advantage of a foundation over a donor advised fund is that the former can be tailored to meet a client's specific objectives. As set forth in last month's article, foundations are excellent vehicles for clients who wish to champion a specific cause, have a particular mission or a vision for social improvement, in addition to those cases where the amount of property warrants the use of a foundation.

A donor advised fund is a simple charitable vehicle. Sometimes simple vehicles work best, but only if the circumstances are simple. The same can be said for estate planning in general. A simple will works in a simple circumstance.

### *Both a Foundation and a Donor Advised Fund*

In some circumstances, the best approach is to use both a donor advised fund and a foundation. One such case is where the distribution requirements of a foundation are too cumbersome. The foundation can make its required distribution to the donor advised fund which has a smaller distribution requirement which will slow the flow of property out to the public charities. There would need to be rather unique circumstances for the distributions to be so cumbersome because, as discussed above, generally foundations are required to distribute only 5% of the property annually.

A second circumstance when both might work best is where the donor wants to remain anonymous. Again, the foundation can make the distribution to the donor advised fund. The donor can then recommend that a distribution be anonymously made from the donor advised fund to the desired charity. One caveat here though is that the donor only recommends the ultimate charity.

A final circumstance when both may be best is the most common. A client has charitable desires during life but does not want to contribute a substantial sum, less than \$50,000, over the next five to ten years; however, the donor wants to make a substantial contribution at the death of the survivor of the donor and the donor's spouse. In such a circumstance, the donor could create a donor advised fund and foundation currently. The donor would only fund the donor advised fund; therefore, the foundation would stay stagnant and not incur any maintenance expenses. However, the donor would name the foundation as a beneficiary of a portion of his/her trust at the death of the donor and the donor's spouse.

This plan is efficient and flexible. The donor will not incur maintenance expenses during life. However, if the donor has a liquidity event (a sale of a substantial illiquid asset) and desires to offset some of the income tax generated thereby, the foundation is ready to accept the assets and provide the desired charitable contribution deduction while allowing the donor to continue to control the proceeds. Also, when the donor and the donor's spouse pass away, the foundation is ready to accept the property.

This type of plan, like all others, depends entirely on the circumstances. It is important to spend time explaining to your estate planning attorney what you want now, at your death and after your death for yourself and your loved ones. A good estate planner will listen and provide only those alternatives that are appropriate.

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