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Efficient And Effective Charitable **Giving**

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Most estate planners enjoy working with charitably inclined clients. There is a vicarious pleasure derived from facilitating our clients' good works. Often the client begins the discussion by stating: "I would like to establish a private foundation." The estate planner will explore the client's more particular goals and objectives, but eventually the estate planner must ask the following question: "How much do you plan to contribute to the foundation?"

If the response is a figure less than $5 million, many estate planners would suggest that the client consider more practical alternatives. One efficient and effective alternative is a donor-advised fund at a community foundation. This article will explain how donor-advised funds at community foundations operate and why they are such good vehicles for achieving the charitable goals of many clients.

Community Foundations

Wherever you practice in the State of Maryland, there is a community foundation near you, and there are community foundations all over the rest of the country as well. Some of America's 700 community foundations have been in existence for almost a century; others have been established more recently. Each community foundation serves a specific city, county or other geographic region.

There are ten community foundations in Maryland with total assets of almost $170 million. Each year, Maryland's community foundations make grants of approximately $17 million to nonprofit organizations both within the communities where they are located and elsewhere.

A community foundation is a public charity, which is managed by a board of directors made up of community leaders. Such foundations often have committees that carry out specific functions. For example, most community foundations have grants committees which approve the disbursement of funds to nonprofit organizations. There may be an investment committee to oversee the management of the foundation's funds; a strategic planning committee to develop long term plans for the foundation; and a marketing (or public relations) committee to inform the general public about the foundation.

A typical community foundation may house and manage several hundred donor-advised funds from which the donors and their families recommend disbursements to nonprofit organizations. A donor-advised fund is a charitable fund established by an individual or family. Such a fund is owned by the community foundation, but the donor or his designee advises the foundation about making grants. If the community foundation board of directors approves the donor's grant recommendations, the community foundation makes the grants to the specified nonprofit organization.

Donor-advised funds range in size from $10,000 to $10 million. The nonprofit recipients may be organizations within the local community, or may be charities of special interest to the donor, such as the donor's alma mater or a national nonprofit organization.

In addition to donor-advised funds, community foundations have common funds or community funds that are distributed among charitable organizations in the community at the discretion of the board of directors. Most community foundations also offer "field of interest" funds. These latter funds provide a donor with the opportunity to specify his or her charitable interest and request the community foundation to distribute money to the most worthy and effective organizations within that field of interest.

Community foundations are ideally suited to meet the needs of many people who might otherwise be interested in creating private foundations. For a modest annual fee (usually 1 percent of the asset value of the fund), the community foundation will manage all of the administrative tasks associated with running a foundation, including tax returns, investments, annual reports and disbursements of funds.

All of the traditional charitable giving vehicles can be used in conjunction with a donor-advised fund at a community foundation. A client can establish a charitable remainder trust and designate a donor-advised fund at the community foundation as the charitable remainderman. Because of the low interest rate environment now prevailing, there is a lot of interest in charitable lead trusts and charitable gift annuities.

A donor-advised fund at the community foundation can be the recipient of the income payments from a charitable lead trust. In addition, most community foundations offer charitable gift annuity arrangements. IRAs and retirement accounts often are subject to substantial taxes (both estate tax and income tax) after death. A client with charitable intent might consider designating a donor-advised fund as the recipient of the death benefit of an IRA or other retirement account, thus eliminating both estate and income taxes that would otherwise be due after the client's death.

Community Foundation Donor-Advised Funds vs. Private Foundations

Unlike community foundations, which are public charities, private foundations are private, nonprofit grant-making organizations that receive the majority of their funding from one source. A private foundation must distribute at least 5 percent of its assets to a nonprofit organization each year. By contrast, there is no minimum distribution requirement imposed on a donor-advised fund. There are many other rules that apply to private foundations, such as a 1-2 percent excise tax on net investment income, strict selfdealing rules and excess business holding rules, which do not apply to donor-advised funds.

A private foundation must file with the Internal Revenue Service an application for recognition of its exempt status and must make the application available to anyone who asks to review the application. A private foundation also must file an extensive information return (Form 990-PF) with the Internal Revenue Service each year, and the return must be made available to the general public at the foundation's principal office. There are no filing requirements imposed upon donor-advised funds at community foundations.

Because the community foundation administers the donor-advised fund for the donor, the overall administrative costs associated with such a fund are far less than the costs involved in managing a private foundation. According to IRS statistics, there are currently 57,000 private foundations in the United States. Only approximately 8,000 of the country's private foundations (less than 15 percent) have assets of more than $2 million, and approximately 30 percent of all private foundations have assets under $100,000. The cost of administering such small private foundations may be an unreasonably high percentage of the asset value.

In addition, the management of a private foundation requires a substantial commitment of time and energy by the donor or the donor's designees. Rather than creating numerous structures for the individual management of foundations, the community foundation offers an umbrella organization for the efficient management of the funds of numerous donors and their families.

According to the Council on Foundations, only 20 percent of all private foundations continue under the management of a family member after the second generation. In many cases, the family members have no interest in assuming the considerable burden of administering a foundation. In these cases, it would have been better for the private foundation to exist as a fund under the management of a community foundation where it could benefit from active oversight in perpetuity.

After a foundation is created, how will the family know how to make truly effective grants? One of the important functions of the staff of the local community foundation is to become familiar with the local nonprofit organizations. The staff members become personally acquainted with the leaders of the nonprofit organizations, and know their track records and results. This knowledge can be very useful in helping families define a mission, develop criteria for grant-making, identify worthwhile grant recipients and decide the amount and timing of grants.

Because community foundations are public charities, the rules applicable to income tax deductions for contributions to community foundations are more generous than the rules applicable to donations to private foundations. Contributions of cash to a private foundation are generally deductible up to 30 percent of the donor's adjusted gross income (AGI), as compared with the 50 percent deduction allowed for cash contributions to a community foundation. The deduction for contributions of long-term capital gain property to a private foundation is generally limited to 20 percent of the donor's AGI.

By comparison the deduction limit applicable to contributions of long-term capital gain property to a community foundation is 30 percent of the donor's AGI. Estate planners should bear in mind that a private foundation can be converted to a donor advised fund within a community foundation. Such a conversion should be considered in the following situations:

- The private foundation does not have sufficient assets to warrant costly ongoing administration
- The family no longer is interested in actively managing the private foundation
- The 5 percent per year distribution requirement and/or the other rules that apply to private foundations are unpalatable to the family
- The family desires to take advantage of the more generous income tax deduction rules that apply to contributions to community foundations
- The family desires to continue active involvement in the grant-making process, but would appreciate advice and recommendations from the staff of the local community foundation

Some Illustrations of the Use of Donor-Advised Funds

(1) A new client contacts you on December 26th and explains that she has just sold her closely held business and, for tax and non-tax reasons, would like to make a substantial charitable contribution before the end of the year. You ask her what organizations she has in mind and she says she is not sure. You suggest to the client that she make the contribution to the local community foundation and establish a donor-advised fund. The contribution can be made and the fund established in as little as 24 hours, thus securing the charitable deduction in the year in which the business was sold, but still give the client unlimited time to decide how to disburse the funds among charitable organizations.

(2) Your client, a retired physician, wants to set aside the sum of $1 million at his death for the benefit of charitable organizations. Having dedicated his working life to the practice of medicine, he wants the funds to be used to support health care programs for low income children and families in the county where he lives. The client is not sure which organizations will be best equipped to carry out his charitable goals after his death and thus wants his three children to decide how to disburse the funds from time to time.

On your advice, the client signs a will that provides for the creation of a donor-advised fund, specifies that the fund is to be used to support health care programs for low income children and families and designates the client's three children as the advisors with respect to the distribution of the funds after his death. The client expresses great satisfaction with this approach because the fund will be easy to establish, he has the peace of mind of knowing that the funds will be used for the specified purpose and it will give his children a role in the philanthropic process.

(3) A beloved teacher at a local high school has died and a group of parents approach you to establish a scholarship fund in the teacher's name. The parents expect to raise substantial funds both from the families of current students and from the many alumni whose lives were enriched by their former teacher. The parents are concerned, however, about the legal, financial and administrative aspects of creating and managing a scholarship fund. You turn to the local community foundation and, with the help of the staff, have the scholarship fund up and running within a matter of weeks.

Private foundations have an important place in the universe of charitable giving. This article is not meant to suggest otherwise. The donor-advised fund at the local community foundation should be considered as a viable alternative, however, when the money and dedication available simply are not sufficient to justify the establishment of a separate legal entity. Simply stated, a private foundation is for the "rich out of sight" (see Paul Fussell, Class") while a community foundation can meet the specific charitable goals of the rest of our clients. ⚖

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