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## **P** LANNERS' FORUM

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### **Donor Advised Funds: The Philanthropic Swiss Army Knife**

Many planners are aware that a donor can make a contribution of property to a donor advised fund of a community foundation<sup>1</sup> and then request distributions to other charitable organizations that the donor wants to support. A donor advised fund is a planned giving tool that is as flexible as a Swiss Army knife. A creative planner can solve almost any philanthropic problem with a donor advised fund much the way McGyver can crack a safe with a pack of matches, chewing gum and a strand of his hair.

The donor advised fund is so flexible because of two characteristics. First, the donor has given up all legal control over the funds in the donor advised fund. The Tax Court has accepted that the disposition of the funds in a donor advised fund is an independent act of the community foundation.<sup>2</sup> Thus the donor has no legal connection to the expenditure of funds from the donor advised fund. Second, the donor advised fund is held by a public charity. Contributions to the fund are deductible in the same manner as contributions to any other public charity.<sup>3</sup> The private foundation self-dealing rules and taxable expenditure rules do not apply to the donor advised fund. The funds in a donor advised fund can be spent or distributed in any manner or for any purpose that a public charity may make distributions of its funds.

The donor advised fund has these characteristics because legally the funds belong to the charity, and the charity is free to use the funds as it sees fit. There is a legal risk that the community foundation will ignore the donor's suggestions. If a donor is working with a reputable community foundation, however, and making suggestions for legitimate charitable purposes, there is little risk that the organization will disregard the donor's suggestions. Any community foundation that violated a donor's trust would soon be out of donor advised fund donors. If the donor is concerned about a particular suggestion, the donor should discuss his or her intentions with the community foundation before making the gift.

### **Pry Out a Deduction for a Procrastinator**

Though procrastination may not be desirable, it is a reality for many donors. The donor advised fund is a great tool to accommodate procrastination. When a donor is facing an imminent sale or needs to generate a deduction within a specified time frame but is procrastinating or otherwise unable to decide how he or she ultimately wishes to distribute charitable

dollars, the donor can make the contribution in a donor advised fund. After contributing to a donor advised fund, the donor can take a year or more to select the charities to ultimately receive the funds. While this type of planning may involve only a five or ten thousand dollar end of year contribution, this plan should be considered for the largest of donations as well, even into the tens of millions of dollars. Placing a large contribution in a donor advised fund leaves open virtually all philanthropic possibilities including the creation of a support organization. In fact, the only philanthropic alternative that is foreclosed by the creation of a donor advised fund is the creation of a private foundation.<sup>4</sup>

### **Cut Through Trading Restrictions**

A donor advised fund may be helpful to sell a block of publicly-traded stock for the philanthropic interests of a corporate insider. The donor advised fund may be able to liquidate the position more easily than the donor because the donor who is the insider no longer has legal control or any beneficial interest in the shares.<sup>5</sup> A sale of stock by the donor advised fund also may generate less publicity than a sale by the insider because the community foundation may not be obligated to report the sale.

### **Pick Scholarship Recipients**

Donors who wish to provide scholarships will find that the donor advised fund is a flexible vehicle for running such a program. Unlike a private foundation, the donor advised fund is not required to make the detailed disclosure to the IRS of its scholarship programs and policies in advance of awarding those scholarships.<sup>6</sup> Furthermore, the donor advised fund is not required to resubmit information to the IRS any time there is a material change to the scholarship program. Another benefit of

using a donor advised fund for scholarships is that a community foundation will have application forms and review procedures for scholarships. Furthermore, the community foundation likely will be in contact with high school counselors and others who would be able to widely disseminate information regarding the availability of scholarships to insure the best applicant pool.

## **Uncork a Fundraiser**

A donor can use a donor advised fund to host a fundraiser for a particular organization or multiple organizations, or any other charitable purpose. The donor can pay for the expenses of the fundraiser such as renting a room and hiring a caterer and may claim a deduction for those expenses. The community foundation would be responsible for providing donation acknowledgments to the fundraiser donors. The fundraiser donors would have the benefit of making a gift to a public charity. A donor should obtain the permission of the community foundation before embarking on the fundraiser and coordinate the details of the fundraiser with the community foundation.

## **Magnify a Life**

After the death of a respected member of the community, family members or business associates sometimes wish to establish a memorial fund in honor of that person. Many memorial funds often are created hastily, and it can be unclear how the memorial fund is to be taxed or for what purposes it should be used. The memorial fund may be taxable, and donations to it may be subject to gift tax. If a memorial fund is established as a donor advised fund, the tax issues are clear and favorable. The donors to the donor advised fund are entitled to charitable income and gift tax deductions, and the donor advised fund is not subject to tax. The community foundation will send a receipt to

donors for the contributions to the memorial fund. The family members or business associates who initiated the fund can direct it to charitable purposes in memory of the person that the fund honors.

## **Serve Assistance to Disaster Victims**

A donor advised fund can be used to aid victims of a disaster. This type of fund can be established for the victims of a local disaster such as an apartment fire or other natural disaster. When there is a large group of victims of a disaster, creating a fund for their benefit is fairly straight forward, and many local disaster relief organizations will establish such funds. The issues become more challenging when there is a particularly compelling tragedy that befalls a single person or family. This might be the tragic death of a child or family that is a victim of crime that generates a lot of public concern. If a fund is set up exclusively for the benefit of that person or family, contributions to that fund are gifts to that family and are not tax deductible as charitable gifts. To the extent that a person contributes more than \$11,000 for a beneficiary of such a fund, the contribution is a taxable gift.

A donor advised fund can be used to help a single person or family that has been a victim of hardship with certain limitations. Contributors to the donor advised fund must be told that the particular victim or family will receive benefits from the donor advised fund to the extent that the community foundation determines that the family has needs that qualifies them to receive support from a charitable organization. In the event that the contributions to the donor advised fund exceed the needs of the victim or family who inspired the fund, the balance of the contributions to the fund will be retained for victims of similar tragedies or disasters in the future. Under these conditions, contributors to the donor advised fund are then entitled to a charitable contribution income tax

deduction because they are making a gift for charitable purposes rather than a gift to a particular family or individual. Furthermore, gifts of any amount to the donor advised fund will be free of gift tax.

## **Cut a Path for Any Charitable Project that You Can Dream Of**

A donor advised fund can be used by a donor who wants to complete virtually any charitable project. For example, the fund might be used to pay for the creation of an educational video that is distributed to schools. A donor advised fund also can pay for the bona fide work of a researcher. The project must be a legitimately charitable endeavor and it should not involve family members or related business entities. The community foundation will have ultimate control and ownership of the project. Using the donor advised fund allows the donor to focus on the charitable project rather than on the legal structure to support the project. Since the community foundation will be legally responsible for the project, the donor should discuss the project with the community foundation prior to making the contribution to the donor advised fund to insure the community foundation is willing and able to oversee the endeavor.

## **Spark Another Charity**

The donor advised fund can be useful to a charitable organization that is newly formed (or yet to be formed). The donor advised fund can receive contributions from donors like private foundations that are sensitive to whether or not the organization has received its determination letter. In addition, if the organization is concerned that a particular contribution might tip the new organization into private foundation status, the contribution could go to an associated donor advised fund. The new

organization does not need to wait until it has its determination letter to use the funds in the donor advised fund. As noted above, the donor advised fund can be spent for any charitable purpose. Accordingly, expenses of the organization for charitable purposes can be paid directly by the donor advised fund. These expenses can include materials for charitable activities, consulting fees or even salaries of staff carrying out the charitable mission of the new organization. These types of payments should be made under an agreement limiting the funds to a particular purpose. The community foundation should receive documentation confirming the funds were used for the intended purpose.

## **Charitable Collaboration**

When two or more charities or other types of organizations are working together on a charitable project, the organizations may wish to work through a donor advised fund for the collaboration. This can be particularly helpful for collaborations involving unincorporated groups or organizations that are not charitable organizations such as business leagues. The fund agreement should set out clear rules regarding how the collaborators will determine distribution recommendations. The funds can be used for any charitable purpose.

## **Gift of Giving for Others**

A donor can designate children, grandchildren or others as advisors for a donor advised fund. This allows the donor to give the gift of giving to others with the comfort of knowing that the community foundation will assure that the ultimate recipients are qualified organizations. The donor can give the advisors total choice over distributions or can build distribution guidelines and limitations into the fund agreement. A donor whose estate plan

calls for distribution of the estate to charities selected by the trustee or executor may wish to consider distribution to a donor advised fund with the fiduciary named as the advisor to the fund. Distribution to a donor advised fund will assure the estate of the estate tax charitable deduction and will give the fiduciary time beyond the normal period of administration to identify the charitable organizations to receive the distributions.

## Anonymous Gifts

The donor advised fund is an excellent tool for a donor who wishes to make an anonymous gift to an organization. The donor can create a donor advised fund with a name that does not identify the donor. Some community foundations simply create numbered anonymous funds, e.g. "Anonymous Fund Number 25." The donor then requests distribution to the charity he or she wishes to support anonymously. The selected charity receives a check from the community foundation described as coming from the anonymous fund. The donor's support of the community foundation is not public information because the community foundation is a public charity and is not required to publicly disclose the names of its donors. Accordingly, unless the donor discloses his or her identity to the recipient charity, there is no way for the organization to trace the donation back to the donor.

## Donor Advised Funds Come With Different Numbers of Tools

Just as there is a wide array of sizes of Swiss Army knives, some of which are only basic cutting tools and others, which can be used to disassemble a nuclear reactor, community foundations will differ with respect to types of activities that the organization is willing to accommodate in a donor advised

fund. Depending on the staffing level, sophistication and depth of experience of the community foundation, not all community foundations will be willing to accommodate all of the activities described in this article in a donor advised fund. In particular, donor advised funds associated with banks and mutual fund managers are unlikely to be able to accommodate some of the more creative uses of a donor advised fund. Accordingly, a donor should discuss any intended activities with the community foundation to ensure that the organization and the donor will be able to work together to meet the donor's objectives.

A donor advised fund is an extremely flexible planning tool. It accommodates a wide range of sizes of gifts, types of gifts and charitable activities. For those reasons, it may be the philanthropic tool that a planner should reach for first. Planners who consider the donor advised fund will find that they do not need to use other more specialized and expensive tools like support organizations and private foundations nearly as often as they had been using them in the past.

<sup>1</sup> Organizations other than community foundations sponsor donor advised funds, but the majority are sponsored by community foundations [which] are the primary charities offering these funds, and this article will refer to a community foundation as the sponsor throughout.

<sup>2</sup> [Laphna] Family Foundation, Inc. v. Commissioner, T.C. memo 2002-293; Treas. Reg. § 1.170A-9(e)(11)(V)(CB). 3 I.R.C. § 170; Treas. Reg. § 170A-9(e)(10).

<sup>4</sup> This author is aware of at least ten reasons that a client would not want to form a private foundation in any event.

<sup>5</sup> See Section 16 of the Securities Exchange Act of 1934 and 17 C.F.R. § 230.144. A complete discussion of the securities laws and gifts is beyond the scope of this article. Competent securities counsel should be consulted when making a gift of restricted stock to charities.

<sup>6</sup> See I.R.C. § 4945(d)(3); 4945(g).