

Wealth Management: Writing Off the Myths

By **Benjamin Pierce**

Donor-advised funds (DAFs) have captured headlines since the millennium changed, often for their meteoric rise in popularity. According to the Chronicle of Philanthropy, there was an estimated \$5.5 billion in DAFs nationwide in 1995. The estimate for 2005 is nearly \$20 billion.

These giving vehicles have existed for more than 70 years. Despite their longevity and impressive growth, numerous misperceptions about DAFs persist. These common "myths" underplay the real value a DAF can have in helping you meet your clients' philanthropic needs.

Myth #1. Donating assets directly to a charity is better than paying fees to a donor-advised fund. Your clients may believe that fees paid to an organization that sponsors DAFs are assets taken away from their favorite charities. But, until any donation is put to work, a recipient charity (hopefully) invests the money-and therefore, pays investment fees. So in either case, fees are paid until the money is used.

Obviously, the fees charged impact the final amount that is available for granting. If the DAF organization has low fees and quality investment options, chances are good that more money will be available at the time it is needed for granting. Direct giving can have other drawbacks as well. If your client favors a small local charity, would that charity handle a large gift responsibly? It may be wiser to recommend smaller annual grants from a DAF for the charity's specific needs or projects.

If your client wishes to donate appreciated stock or more complex assets such as hedge fund shares in order to avoid capital gains tax, is the animal shelter or community theater equipped to handle those securities? Many DAF organizations have some experience with assets like these, and can liquidate your client's contribution so that the shelter or theater receives a grant in cash (assuming that they qualify).

Again, costs do make a difference. If a DAF could benefit your client, be sure to understand the applicable investment and administrative fees. When choosing a DAF organization, also note what investment options are used and how often they are changed. Accessibility of current financial reports is also a sign of fiscal responsibility and organizational transparency.

Myth #2. A donor-advised fund won't help my clients because they already have a private foundation or a charitable remainder trust. We sometimes read that private foundations become cost-effective somewhere between \$1 million and \$5 million in assets, and DAFs are good for those with less. But DAFs can be effective for donors with tens of thousands of dollars or hundreds of millions. And the two vehicles have differing advantages that allow them to work well together, or in succession.

For example, DAFs allow anonymous grants while private foundations do not. DAFs usually allow recurring grants that are automatically reviewed and issued (if approved). This can save research and reporting time for the foundation's staff because the DAF organization handles these tasks, freeing the foundation's staff to focus on specialized grants that may not fit well with a DAF.

Sometimes private foundation boards find it difficult to convene-or to agree when they do convene! Foundations can be closed by distributing their assets to one or many DAFs, which do not require such board meetings. In some cases, a portion of the foundation's assets is used to create a DAF advised by one board member who lives far away or doesn't get along with the others, allowing him to pursue his giving goals separately.

Professional advisors have been enthusiastic when they learn about the possibilities of using a DAF as a successor to other charitable vehicles. For example, if your client is interested in a charitable remainder trust, a DAF organization can be named as the charitable beneficiary. The trust remainder would then be used to set up a DAF advised by your clients' heirs-a quick and simple way to create a giving legacy. Or, if the benefactor of a private foundation is concerned that the successor trustees may change its mission, he may be able to arrange to have the foundation terminated into a DAF upon his death. Many DAF organizations allow for recurring grants to public charities in the name of the deceased benefactor (assuming that the charities continue to qualify under IRS guidelines).

Myth #3. Your client's donor-advised fund account must distribute five percent of assets each year. There is a rule that private foundations must distribute five percent of their assets per year. A similar rule exists at the aggregate level for organizations that sponsor DAFs. The following scenario illustrates how this rule might play out. Suppose that your client and another individual both have DAF accounts at the same organization, with equal balances. If 10 percent of the other account's assets is distributed in a given year, this would cover the necessary five percent distribution for your client's portion of aggregate assets, in addition to the other donor's portion. Recent statistics show that the average DAF organization actually distributes more than 15 percent of its aggregate assets each year.

Be aware, however, that the IRS does not favor "hoarding" of charitable assets in any account. Most DAF organizations require at least nominal distributions from an account every few years.

Myth #4. A donor-advised fund is like a "charitable checkbook." Our program representatives regularly receive calls from people preparing to establish a DAF who ask, "When will I receive my checkbook for writing checks to charities?" The IRS does not permit DAFs to operate this way. Donations to a DAF organization are immediately deductible because the DAF organization is a charity and gifts to it are irrevocable. As with other charitable donations, deductibility is based on loss of ownership and control. Issuing a checkbook would place that control right back in the donor's hands, nullifying the deduction. This is why DAFs offer advisory privileges to donors and allow them to make grant recommendations.

In fact, if the DAF behaves like a checking account there will eventually be negative consequences. There are IRS guidelines that govern grants from DAFs, and prudent DAF organizations vet each recommended recipient as well as the stated purpose of each grant.

Grant recipients, with few exceptions, must be U.S.-based public charities, and grants cannot benefit any specific individual. Grants that result in more than an incidental benefit to the donor (e.g., tickets to sporting events) are prohibited. One DAF donor spent time in prison for recommending a grant that was meant to cover his child's tuition.

Sometimes donors express frustration when a recommended grant takes longer to issue than they expect. But that is a difference between charitable giving from your pocket and from a DAF. In the latter scenario, the DAF organization owns the assets and, as a prudent steward, should properly research all grant recommendations. Doing so protects the DAF organization's tax-exempt status-

and the continuing viability of each donor's DAF.

Myth #5. Donor-advised funds and charitable giving fall outside the advisor/client relationship. Many professional advisors are reluctant to handle charitable giving because it usually involves assets leaving the client's portfolio, which can mean lower advisory fees. By taking this view, these advisors lose an opportunity to deepen a client's trust by addressing that client's core convictions. Philanthropy also offers important opportunities to develop relationships with a client's heirs.

DAFs offer a unique possibility for professional advisors to remain involved with charitable assets. The representatives at the DAF organization should be equipped to answer any professional advisor's questions. And they can communicate directly with the donor or work with the advisor, keeping the advisory relationship intact.

The professional advisor can usually access DAF account information and even request transactions if so authorized by the donor. Some DAF organizations allow approved advisors to manage the donated assets. Note that the DAF organization must retain ownership and ultimate control of the assets. Conversations about charitable giving can open doors to client loyalty and add value to the advisor/client relationship. And a DAF is a flexible tool that can help.

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