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Charitable Giving: Donor-Advised Funds vs. Private Foundations

By: Nick Breit

While private foundations date back as far as the early 1900s, the advent of donor-advised funds goes back less than 20 years. In fact, chances are good that you may have never even heard of a donor-advised fund. A Fidelity survey of more than 500 individuals with at least \$100,000 in assets found that 86% reported that they either had not heard of or knew very little about donor-advised funds. While private foundations may offer more control with regard to investment selection and distributions, they certainly come with their set of limitations; as a result, donor-advised funds may represent a viable alternative for charitable giving.

According to the National Philanthropic Trust, assets in donor-advised funds exceeded \$21.6 billion as of 2006. Today, Fidelity (\$4.9B), Schwab (\$2.2B), and Vanguard (\$1.9B) offer the three largest donor-advised funds; collectively, they account for 35% of assets in donor-advised funds. As account minimums have decreased over the past several years, these funds now represent a great avenue for the average individual to organize and maximize their giving potential.

A donor-advised fund is a charitable account funded by an irrevocable, tax-deductible charitable contribution (cash, securities, etc.). Because the contribution is considered a completed gift, the donor can take an immediate charitable tax deduction. The donor can then advise the fund or foundation to make distributions to a qualified charity as they see fit, whether that be the current year of the contribution or at a later date. While the charitable fund or foundation is not required to follow the donor's distribution request, it generally processes the request so long as the entity is a qualified charity.

Minimum contributions for such an account start as low as \$5,000 though they may be as high as \$25,000 or more. While an individual may elect to gift cash, stock, or real property, appreciated securities are largely behind the growth in donor-advised fund assets. Fidelity Charitable Gift Fund estimated that appreciated securities accounted for 77% of the fund's total contributions for 2006 (January through October) and 69% for 2005. The benefit behind gifting appreciated securities is avoiding the capital gains tax on the embedded gain while receiving a deduction for the full fair market value, subject to AGI limitations (as noted below). It should be noted that any gifting of appreciated securities should be limited to long-term holdings (held for more than 1 year), as the tax deduction for gifting short-term securities is limited to the lesser of the security's basis or fair market value.

A donor-advised fund charges an administration fee for the account, typically ranging from 0.5% to 0.7%. The donor then elects how the account is to be invested, choosing among the various investment options offered on the platform. Investment fees can range from 0.07% for an indexed option to as much as 1.00% for an actively managed investment mix.

The table below summarizes some of the key differences between donor-advised funds and private foundations.

DONOR-ADVISED FUND vs. PRIVATE FOUNDATION

	Donor-Advised Fund	Private Foundation
Set-up Costs	None, typically	Various legal, accounting, & operational start-up costs
Tax Deduction – Cash	Limited to 50% of AGI	Limited to 30% of AGI
Tax Deduction – Stock	Limited to 30% of AGI	Limited to 20% of AGI
Tax Deduction – Property	Limited to 30% of AGI	Limited to 20% of AGI
Taxes	None	Excise tax of 1% - 2% of net investment income
Payout Requirements	Generally none, depends on donor-advised fund	Must pay out 5% of asset value regardless of income
Reporting Requirements	None	Annual tax returns and IRS tax filings
Investment Options	Generally limited to fund chosen, though more may be available depending on contribution to the fund	Almost no limitations on investments options
Grant Disclosure	Grants may be made anonymously or publicly	Grants are a matter of public record
Grants to Individuals?	Not permitted	Permitted, but must avoid self-dealing

The decision of opening a donor-advised fund versus creating a private foundation can be complicated, with many variables to consider. While donor-advised funds currently hold certain advantages over private foundations, speculation exists that Congress could propose regulations for donor-advised funds over issues ranging from donor control to payout requirements. Time will only tell if such donor-advised funds will continue to benefit from such advantages.

Notes:

- Asci, Sue. "Donor-Advised Funds Gaining." [Investment News](#). November 19, 2007.
- Asci, Sue. "Donor-Advised Funds Gaining." [Investment News](#). November 19, 2007.
- Asci, Sue. "Donor Fund Inflows Track Volatile Market." [Investment News](#). June 23, 2008.

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