CICF PROFESSIONAL ADVISOR LEADERSHIP COUNCIL

CHARITABLE GIFT PLANNING WITH DONOR-ADVISED FUNDS

BEYOND THE BASICS

Central Indiana Community Foundation

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Charitable Gift Planning with Donor-Advised Funds
Beyond the Basics

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Charitable Gift Planning with Donor-Advised Funds
Beyond the Basics

I. Donor-Advised Fund Fundamentals

A. Introduction: According to the *IRS Donor-Advised Funds Guide Sheet* (Internal Revenue Manual 7.20.8, dated August 6, 2008), donor-advised funds have been a part of the charitable landscape in the United States "for nearly a century, and have long been a staple of community foundations." Donor-advised funds at community foundations took root just after private foundations begun by the likes of Carnegie, Rockefeller, Ford and Eli Lilly came to prominence in the early to mid-1900s. The first donor-advised fund is reported to have been created at the New York Community Trust around 1931—"and the popularity of this charitable giving vehicle has been growing ever since." Report to Congress on Supporting Organizations and Donor-Advised Funds, Department of Treasury (Dec., 2011) (hereinafter "Treasury Report"), p. 21. In the 1990s, "commercial donor-advised funds" came onto the scene when financial institutions began creating "sister" 501(c)(3) public charities for the sole purpose of housing donor-advised funds. In addition, a variety of religious-based and national donor-advised fund charities have emerged, as well as many colleges and universities that now offer donor-advised funds, but which generally restrict the grant making to university projects or purposes. As explained by the Department of Treasury in the Treasury Report, donor-advised funds "have become increasingly relevant in the charitable sector, in terms of both their numbers and their assets." Treasury Report, p.1.

In its "*2017 Donor-Advised Fund Report*," the National Philanthropic Trust reported that in 2016, assets under management in all donor-advised fund accounts totaled $85.15 billion, annual contributions to donor-advised funds were $23.27 billion, and grants recommended by donors from donor-advised funds totaled $15.75 billion. The total number of donor-advised funds in the United States grew by 39.2% from 2012 to 2016. Donor-advised funds now outnumber traditional private foundations by more than three to one. *"2017 Donor-Advised Fund Report*," National Philanthropic Trust.

B. The Basics: Generally, donor-advised funds allow individuals, families, businesses and other entities to establish a separate charitable account at a host charity, the "sponsoring organization," with irrevocable gifts of cash, stock or other assets, and take a charitable income tax deduction in the year the account is established (and each year in which additional contributions are made to the fund). A fund agreement or other instrument of transfer is executed. The donor, the donor's family, or other donor advisor or advisory committee appointed by the donor can then recommend to the sponsoring charity qualified charitable recipients to receive grants from the donor-advised fund, either right away, over any number of months or years, or as long as there are assets in the fund. Some donor-advised funds will be fully expended during the donor's lifetime, whereas others are set up as permanent endowment funds. Successor advisors such as children and grandchildren may be identified, depending on the policies of the various sponsoring organizations. Subject to sponsoring organization policy, donors may or may not retain the right to advise the sponsoring organization on investment matters. The sponsoring organization must review all grant recommendations to ensure that proposed grants are for a qualified charity or charitable purpose, and generally heeds the recommendations from the donor-- but is not compelled to do so, as it is the legal owner of the assets in the fund.

A donor-advised fund represents an alternative option to the establishment of a private foundation. Like private foundations, donor-advised funds can be created during the donor's lifetime or through his or her estate plans. Whereas the general rule of thumb for creating a new private foundation is that one should be able to devote at least $1 million and perhaps as much as $5 to $10 million or more to justify the legal time and expense, including annual federal and state reporting requirements, a donor-advised fund can be established for $25,000 at many community foundations and for as little as $5,000 at most of the commercial donor-advised funds, with no annual reporting required. Lest one jump to the conclusion that a private foundation is more appropriate for assets of *more* than $10 million, myriad donor-advised funds are established with far more than that, including several that have been funded with more than $10 million at Central Indiana

Community Foundation. Practical considerations in selecting one charitable vehicle over the other, as well as selecting a particular donor-advised sponsoring organization are considered in Section II below.

C. Pension Protection Act: With the popularity of donor-advised funds, of course, also came abuses and, eventually, Title XII of the Pension Protection Act of 2006 ("PPA). While the PPA enacted certain rules around donor-advised funds to ensure against abuses, as a practical matter, it served more importantly as a milestone in further "legitimizing" donor-advised funds. It also provided a first ever statutory definition, and hence more clarity and comfort for advisors in recommending and utilizing this significant charitable tool. According to the Council on Foundations, the number of donor-advised funds increased by 15 % in 2007 alone, the year following enactment of the PPA.

1. PPA Definition of Donor-Advised Fund: The PPA added Internal Revenue Code Section 4966(d)(2), which provides a three-pronged definition of donor-advised fund:

- a fund or account that is separately identified by reference to contributions of a donor or donors,
- is owned and controlled by a "sponsoring organization," and
- with respect to which the donor, or any person appointed or designated by such donor ("donor advisor"), has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund by reason of the donor's status as a donor.

The Joint Committee Report, which serves as the legislative history of the PPA, expands upon each of these prongs:

Separately identified by reference to contributions of a donor or donors. This prong requires that the sponsoring organization reference the contributions of a donor or donors to the particular fund or account on its books and records by, e.g., naming the fund after the donor or by attributing contributions to a specific donor or donors.

Owned or Controlled by a Sponsoring Organization. A “sponsoring organization” is defined under Section 4966(d)(1)as a Section 170(c)(1) organization that is not a governmental organization or a private foundation and maintains one or more donor-advised funds.

A Donor or any Person Appointed by the Donor has Advisory Privileges. The PPA does not define “advisory privileges,” other than to refer to advisory privileges as to distributions or investments. The Joint Committee Report notes that the presence of advisory privileges may be evidenced by a written agreement or through conduct of the donor or fund advisor and the sponsoring organization. The Joint Committee Report also distinguishes between advisory privileges and legal rights or obligations.

2. **Excise Tax on Taxable Distributions.** The PPA also imposed a few of the "private foundation rules" on donor-advised funds, including the 20 percent tax on taxable distributions. Pursuant to Code Section 4966(c), distributions from a donor-advised fund to an individual are prohibited, as are distributions to any organization that are not for a charitable purpose. Other distributions, e.g., to a private foundation or certain types of supporting organizations, may require the sponsoring organization to exercise expenditure responsibility.

3. **Excise Tax on More-Than-Incidental Benefits.** Code Section 4967 imposes a penalty tax on a donor advisor who recommends a grant from a donor-advised fund that results in more than an incidental benefit being received from the grantee by a disqualified person. The definition of “disqualified person” applicable to donor-advised funds includes any donor, donor advisor, or member of the family of a donor or donor advisor or a 35% controlled entity of which a donor or donor advisor owns more than 35% of the combined voting power, profits, interests, or beneficial interest. Code Sections 4976(d), 4958(f)(7), and 4958(f)(4). For donor-advised fund disqualified person purposes, family members include a spouse, ancestors, lineal descendants (down to great-grandchildren), and siblings (whether whole or half), as

well as their spouses. In addition to prohibited benefits from grantees back to donor advisors and other disqualified persons, the PPA also introduced the “excess benefits transactions” rule to donor-advised funds. An excess benefit transaction for donor-advised fund purposes is one in which a disqualified person receives an economic benefit, directly or indirectly, that exceeds the value of the services provided to the charity. This is more liberal that the flat out prohibition applicable to private foundations.

4. **Excess Business Holdings Rules:** The PPA also extended the private foundation excess business holdings rules to donor-advised funds. In general, if a donor-advised fund receives a gift or bequest of an interest in a business enterprise, it has 5 years to divest itself of any excess holdings, with a possibility of an additional 5 years under limited circumstances if approved by the Secretary of the Treasury. The holdings of a donor-advised fund in a business enterprise, aggregated with the holdings of disqualified persons with respect to the fund, will be subject to penalties on the excess holdings if the aggregate holdings exceed: (1) 20 percent of the voting stock in a business enterprise in corporate form (35 percent if persons who are not disqualified persons have effective control of the business); (2) 20 percent of the profit interest in a partnership; or (3) 20 percent of the beneficial interest of a trust or estate. Code Section 4943. A *de minimus* exception applies when a donor-advised fund, together with its disqualified persons (as defined in Code Section 4943), owns not more than 2 percent of the voting stock of a business enterprise. Code Section 4943 (c)(2)(C). "Business enterprise" is defined as the active conduct of a trade or business and does not include a business that derives at least 95 percent of its income from passive sources such as dividends, interest, royalties and capital gains. Interests in family limited partnerships generally will come under this exclusion.

5. **Department of Treasury Report:** Section 1226(a) of the PPA mandated that the Department of Treasury conduct a study on the organization and operation of both supporting organizations (as distinguished from donor-advised fund sponsoring organizations) and donor-advised funds. PPA Section 1226(b) mandated that the

Secretary of the Treasury submit a report on the supporting organization and donor-advised study to Congress. That report, the Treasury Report, *infra*, was submitted to Congress on December 5, 2011. With respect to DAFs, Treasury was directed by the PPA to specifically consider:

1. Whether the existing deduction rules for contributions to donor-advised funds are appropriate (Treasury answer: yes);
2. Whether donor-advised funds should be subject to a distribution requirement like private foundations (Treasury answer: no); and
3. Whether an advisory role in the investment or distribution of donated funds is consistent with a completed gift and consequent qualification for a deduction from income, gift and estate tax purposes (Treasury answer: yes)

No new legislative changes or reforms are recommended by the Department of Treasury in the 109-page Report. Among other findings, the Treasury found:

- The fact that donor-advised funds have high approval rates for donor recommendations is not in itself indicative of donors' exerting excessive control over their donated assets. Approval is not automatic.
- The PPA appears to have provided a legal structure to address abusive practices and accommodate innovations in the sector without creating undue additional burden or new opportunities for abuse.
- The issue of the lag between contribution and final use of assets is no different at donor-advised fund sponsoring organizations than it is for other public charities that may operate charitable funds or maintain endowments. "Thus, it is appropriate that the contribution deduction rules faced by donors to donor-advised funds are the same as those applicable to donors to other public charities." Treasury Report at 7.
- It would be premature to recommend a distribution requirement for donor-advised funds at this point. As more years of data become available, analysis of trends with respect to donor-advised fund distributions will be possible.

- As is the case with gifts to other charities, if all existing tax and other legal requirements are met, donations to a donor-advised fund may be completed gifts and become the property of the donee organization. Although donee organizations may feel an obligation to use donated funds in a manner preferred by the donor, especially when subsequent contributions may be desired, "there is nothing unique about donor-advised funds... in this regard and, in fact, they have no legal obligation to follow the preference of the donor." *Id.* at 9.

Senator Grassley was not satisfied with the Treasury Report, as reported in the unpublished Congressional Research Service Report on Donor-Advised Funds, dated July 11, 2012 (CRS Report), p.1. The CRS Report takes issue with several findings of the Treasury Report, including the Treasury finding that the average payout rate for donor-advised funds in 2006 was 9.3 percent of assets. CRS also concluded that donors have effective control over donor-advised fund grantmaking, as contrasted with the Treasury Department's conclusion that legal control of donor-advised fund assets is vested in the sponsoring organization's board of directors, and that approval of grant recommendations from fund advisors is not automatic. When a congressman or congressional committee does not agree with the conclusions of the appropriate federal agency in a statutorily mandated report, what is the effect of an unpublished Congressional Research Service "rebuttal" prepared by a Specialist in Public Finance and a Senior Specialist in Economic Policy? Suffice it to say that sponsoring organizations will need to be vigilant in assuring that donor-advised fund assets are not being squandered and that fund advisors are not in control of donor-advised fund assets.

D. Tax Cuts and Jobs Act: With the passage of the Tax Cuts and Jobs Act, Public Law No. 115-97 (Dec. 22, 2017) (the “TCJA”), in December of 2017, many have speculated about its impact on charitable giving, which remains to be seen. While the TCJA does not specifically address donor-advised funds, certain provisions will likely impact charitable giving generally and donor-advised funds in particular.

1. **Doubling the Standard Deduction:** Section 11021 of the TCJA nearly doubles the standard deduction from $12,700 to $24,000 for married couples filing jointly and from $6,350 to $12,000 for single individuals. While the charitable income tax deduction remains intact, with more people opting for the standard deduction instead of itemizing, donors taking the standard deduction have no incentive, from a tax perspective, to give charitably. The Tax Policy Center projects that only 11 percent of households will continue to itemize, down from 26 percent under the prior law.

2. **Additional Incentives for High Net Worth Donors:** For those that will continue to itemize under the TCJA, some donors will have greater incentive to give. Section 11023 of the TCJA increases the adjusted gross income limitation for charitable gifts of cash that can be deducted in any particular year from 50 percent to 60 percent. Section 11046 of the TCJA suspends the Pease limitation, where itemized deductions are limited when adjusted gross income exceeds a specific amount, through 2025. And Section 12003 of the TCJA expands the exemption amount for the individual alternative minimum tax, meaning that fewer wealthy taxpayers will be subject to alternative minimum tax, which makes charitable giving less advantageous than the non-alternative minimum tax structure. Finally, the doubling of the estate tax threshold to more than $22 million for a married couple may make giving at death less advantageous for donors who previously included charitable giving in their estate plans to avoid estate tax liability. Rather, these donors may now prefer to start a donor-advised fund during life to take advantage of the continued charitable income tax deduction. Donors benefitting from these provisions of the TCJA may find that they have even more capacity to give in light of these changes. With the charitable income tax deduction remaining unchanged, charitable giving from itemizing donors should stay constant or possibly even increase.

E. Treasury Notice 2017-73: The Department of Treasury issued a notice in December of 2017 that set forth proposed regulations in Treasury Notice 2017-73 that would directly affect donor-advised funds.

1. **Proposed Prohibition on Bifurcated Distributions:** The proposed regulations more clearly prohibit distributions from donor-advised funds to "pay for the purchase of tickets that enable a donor, donor advisor, or related person under § 4958(f)(7), to attend or participate in a charity-sponsored event" as such purchase results "in a more than incidental benefit to such person under § 4967." This will not affect the practices of many sponsoring organizations, including CICF, which, out of an abundance of caution, have not permitted "bifurcated" distributions from donor-advised funds (where a donor pays the fair market value of the ticket and the DAF pays the additional cost of the ticket as a "charitable contribution").

2. **Pledges May Be Paid from DAFs:** The proposed regulations also recommended the loosening of a prior prohibition on pledges being paid from donor-advised funds. The Treasury proposed that distributions from a donor-advised fund to a charitable organization not be considered to result in "more than an incidental benefit to a donor, donor advisor, or related person" merely because such person has made a charitable pledge to the charitable organization, regardless of whether that organization treats the distribution as satisfying the pledge. Sponsoring organizations should, however, remind donors that any distribution from a donor-advised fund, whether in fulfillment of a pledge or not, is not eligible for a charitable income tax deduction, as donors take the full amount of the charitable income tax deduction at the time the funds are deposited into the donor-advised fund. Unlike the other two proposed regulations which place greater requirements on donor-advised funds and sponsoring organizations and therefore do not go into effect without further action from the Department of Treasury, this regulation loosening the rules around pledges went into effect immediately.

3. **Proposal to Require DAF Grants to Meet 2% Requirement of Public Support Test:** Finally, the Treasury Department and the IRS are considering whether, with respect to determining whether a public charity meets the public support test, grants from a donor-advised fund should be subject to the two percent public support limitation and not be treated as grants from a public charity.

4. **Request for Comments on the Relationship between DAFs and Private Foundations:** Although not a part of the proposed regulations, the Treasury and IRS requested comments regarding whether a transfer of funds by a private foundation to a donor-advised fund should be treated as a “qualifying distribution” only if the sponsoring organization of the donor-advised fund agrees to distribute the funds for charitable purposes within a certain time frame.

F. Outlier Cases: Although there is not a great body of donor-advised fund-related case law, a couple of interesting cases highlight the need to do one's homework in advance of making an irrevocable donation to a sponsoring organization to establish a donor-advised fund. In 2009, the Federal Bankruptcy Court for the Eastern District of Virginia approved a reorganization plan for the National Heritage Foundation which wiped out donor-advised funds at the foundation totaling $25 million. The dollars in the donor-advised funds were determined to be assets of the bankruptcy estate and were used in part to make a lump sum payment to 107 people with charitable gift annuities. Although National Heritage Foundation described itself as "the gold standard of donor-advised funds" on its website, it had apparently had a long history of run-ins with the IRS and with practices that eventually were outlawed by the PPA. See, "*Charity Bankruptcy Leaves Many Donors in Distress*", New York Times**,** Nov. 12, 2009.

Another cautionary tale points to the necessity for the donor to conduct due diligence not only on the sponsoring charity, but also on the charitable tax planning advisor--especially, perhaps, if the advisor recommends a particular charity established by the advisor. In *Styles v. Friends of Fiji,* No. 51642 (Nev. 2011), the Nevada Supreme Court, in an unpublished opinion, upheld a Nevada district court ruling that although a sponsoring organization "failed to attempt in any way" to satisfy its donor's charitable goals and breached its implied covenant of good faith and fair dealings, the donor, Mr. Styles, suffered no legal damages because "once he made the unrestricted gifts into his fund, he no longer had any interest or control over the donation." Although charitable experts agree that the Court correctly rejected Styles' argument that he was entitled to a return of the donation (for which he had taken an income tax charitable deduction), they disagree as to the absence of equitable remedies in connection with the breach of the charity's duty of good faith. The underlying fund or gift agreement provisions were not discussed, but what happened with Mr. Style's fund assets is genuinely unfathomable in the community foundation world, in which fulfilling donor intent underlies all that we do.

According to an article written about this case by esteemed charitable gift planning lawyer Richard L. Fox, who was tangentially involved, the underlying facts were unbelievable. See, http://www.quatloos.com/2009/03/ray-styles-v-friends-of-fiji-big-winner.html. Mr. Styles, from Wichita Falls, won $8 million at a slot machine in Lake Tahoe. The tax planning "expert" he turned to in his abundance steered him to Friends of Fiji to make a $2.5 million contribution to establish a donor-advised fund. The advisor had created the charity *and* served as an officer and director. Mr. Styles' contribution was the only contribution *ever* made to Friends of Fiji, which of course is long since defunct. Monies from the fund also were used for celebrity golf tournaments and to pay outlandish annual compensation to the officers of the organization. (Thankfully, per notation at the top of the opinion and pursuant to Nevada Supreme Court Rule 123, unpublished orders "shall not be regarded as precedent and shall not be cited as legal authority.")

II. Considerations in Choosing to Establish a Donor-Advised Fund

A. Questions for the Client Who Wants a Private Foundation:

1. What are the charitable purposes of the foundation? I.e., does the donor have a clue what to support, an idea of charitable mission, ideas about how to accomplish the purposes?
2. What is the level of personal financial commitment to the foundation?
3. Will the anticipated foundation assets justify the expense of establishing and operating the foundation?
4. Who will serve on the board of directors? Indiana nonprofit law requires at least three.

5. What kind of time commitment will the founder and individual board members give to the foundation business? Will the foundation hire staff or will volunteers manage all operations?
6. Will there be family interested in continuing the foundation when the original donor or donors are deceased?

B. Benefits of a Donor-Advised Fund: Some advantages of donor-advised funds over private foundations and other charitable giving vehicles include:

- **Simplicity**. Donor-advised funds have no start-up costs. The sponsoring organization already exists, so setting up a fund is easy, whereas establishing a new private foundation, supporting organization or charitable trust is both time consuming and expensive.
- **Elimination of Administrative Hassles**. Donor-advised funds are not required to file IRS Form 990s. The sponsoring organization handles all record keeping and ensures compliance with regulatory requirements.
- **Flexibility**. The donor may support multiple charitable organizations with one fund--and one asset, if desired.
- **Experience and Service**. Depending on the sponsoring organization, the donor obtains the services, knowledge and expertise of a professional grants and philanthropic services staff for a comparatively low fee (often one percent or less of the fund balance.) With community foundation sponsoring organizations, the research and knowledge of the community foundation is shared with donor-advised fund donors, and the foundation can assist with identifying and fulfilling the donor’s personal charitable goals, researching specific charities, facilitating site visits, etc.
- **Available Ongoing Philanthropic Planning**. Most community foundation sponsoring organizations, including CICF, offer strategic charitable planning and family philanthropy facilitation.
- **Minimal Expense/Required Investment**. The minimum amount required to start a donor-advised fund is much less than the minimum amount recommended to

establish other charitable vehicles such as a private foundation, supporting organization or charitable trust

- **Ability to "Take a Test Drive."** Most sponsoring organizations offer pass-through donor-advised funds (whereas the more traditional endowment type funds are available less frequently). Thus, a donor could open a donor-advised pass-through fund for the minimum required amount with the assurance that the donor could recommend grants from the fund out to charities of the donor's choice and spend out the entire amount of the fund. For donors concerned about whether the ability to serve as fund advisors to their fund provides them sufficient input over the distribution of their charitable capital, the pass-through alternative could provide a great introduction to charitable giving through donor-advised funds. It also could be a great introduction and learning experience prior to the establishment of a private foundation.
- **Immediate Tax Deductibility**. Donor-advised funds are especially attractive for donors with sudden and/or one time increases in income. The amount donated to establish a donor-advised fund is tax deductible for the year the transfer to the fund is received from the donor, even though the donor may need additional time to recommend or advise grants to be made from the fund. The availability of an immediate income tax deduction without first having to determine all of the charitable recipients can prove very helpful to donors.
- **Bunching**. A popular strategy gaining popularity since the enactment of the TCJA is the concept of "bunching" through the use of a donor-advised fund. Bunching permits a donor to (1) contribute two or more years' worth of donations to a donor-advised fund, (2) itemize his or her tax deductions for that year and receive the charitable income tax deduction for the full amount contributed, and then (3) grant money from the fund out to the donor's favorite charities over the desired number of years. In subsequent years after the initial contribution is made, the donor then takes the standard deduction. Bunching is one way that donors affected by the doubling of the standard deduction can continue to be charitable in a tax-smart way.

- **Greater Tax Deductibility**. Gifts to establish donor-advised funds constitute gifts to public charities and are deductible up to 60% of adjusted gross income for cash and 30% of adjusted gross income for publically traded securities, as opposed to the 30% or 20% limit for gifts to private foundations. Donors also can deduct the full fair market value of appreciated long-term capital gain property contributed to a donor-advised fund—whereas the deduction for inter-vivos gifts of long-term, non- marketable assets to private foundations generally is limited to cost basis.
- **Anonymity if Desirable**. Donors have the opportunity to give anonymously, which is nearly impossible with private foundation reporting requirements. The entire fund can be anonymous or certain grants made from the fund can be anonymous.
- **Recognition if Desirable**. The donor can choose to name the donor-advised fund after the donor or the donor's family and call it a family foundation with associated name recognition and prestige. The donor also could establish a fund as a memorial to honor someone.
- **Legacy**. Through donor-advised funds, donors can build lasting legacies to their families and the causes or charitable organizations they support. Depending on fund size, most donor-advised funds allow for successor generations to continue to advise the fund.
- **No Excise Tax on Earnings**. Earnings from donor-advised fund assets can be devoted to charitable causes of the donor's choosing, rather than the government's (through the investment earnings excise tax applicable to private foundations.)
- **No Required Payout.** Donors can choose to not grant every year and have the opportunity to build up their endowment fund over time if desirable.
- **Centralized and Streamlined Charitable Giving**. Donors can make a single charitable contribution, take the tax deduction for that one gift, and make distributions from the fund at a later time to myriad charities without the need on the part of the donor to keep track of multiple charitable substantiation letters and tax years. For estate planning purposes, a donor-advised fund can be named the beneficiary of wills, trusts, retirement plans, life insurance policies and/or other estate plans. The fund agreement entered into to establish the future fund can name

specific charities to receive specified amounts and, unlike some other aspects of estate plans, can easily be updated to add or eliminate charities, change amounts, etc.

- **Protection from Solicitation**. The sponsoring organization receives all mail on behalf of the fund. Donors' addresses and other contact information remains protected. Depending on the sponsoring organizations policies, donors can refer all requests for funding to the sponsoring organization and thus avoid having to respond affirmatively or negatively themselves to specific requests.
- **Corporate Foundation Ease**. For corporations considering private foundations, donor-advised funds offer 'turn-key" operation with no or minimal additional staff time required. All investment, compliance, administration, check distribution, etc., can be handled by the sponsoring organization in the name of the corporation, e.g., the ABC Corporation Foundation, thus freeing up staff to focus on the business of the corporation.

C. Using Donor-Advised Funds with Private Foundations: Many times the most appropriate vehicle to meet a client's charitable objectives is not an either/or, but a both/and. There are many situations in which private foundations could benefit from the establishment of a companion donor-advised fund to more effectively accomplish the donor's objectives. Examples of utilizing both vehicles for more effective giving include:

- **Meeting the Required Five Percent Distribution Requirement.** Donor-advised funds offer private foundations greater flexibility in grant payout management. Through a grant from a private foundation to a donor-advised fund, the private foundation can obtain additional time to meet its annual five percent payout requirement. Time might simply have gotten away from the private foundation board or family, they may be waiting on a potential grantee to obtain requisite charitable status or accomplish certain objectives or conditions precedent to intended funding, or they may want to open a donor-advised fund in order to strategically accumulate rather than pay out charitable assets for a certain period of time.

It should be noted that Treasury Notice 2017-73 requested public comments on the relationship between donor-advised funds and private foundations, particularly with respect to whether "a transfer of funds by a private foundation to a DAF should be treated as a 'qualifying distribution' only if the DAF sponsoring organization agrees to distribute the funds for § 170(c)(2)(B) purposes (or to transfer the funds to its general fund) within a certain timeframe." In its Comments Regarding Notice 2017-73, in part opposing any change to the treatment of distributions from private foundations to donor-advised funds, the Council on Foundations cited multiple examples of how and why a private foundation might legitimately seek to make its required distribution to donor-advised fund. It further requested that the Treasury Department and the IRS "avoid any regulations that would discourage private foundations from utilizing the resources at community foundations." "Comments Regarding Notice 2017-73", Council of Foundations, March 5, 2018.

- **Making Anonymous Grants.** All of the information included in a private foundation's IRS Form 990-PF is readily available online, including asset base, the names and contact information of the officers and directors, and grants paid by grantee organization and amount. Donor-advised funds, on the other hand, can keep donor names and grants completely confidential. Thus, a private foundation could establish a donor-advised fund to make potentially controversial grants or to expand its interest area without opening up the foundation to additional stacks of grant requests from other nonprofits serving the new interest area.
- **Utilizing Donor-Advised Funds as Recipients of Charitable Lead Trusts.** From an estate planning perspective, private foundations often do not work well as the charitable recipient of income from charitable lead trusts. A similar, but much simpler approach for grantors of charitable lead trusts would be to establish a donor-advised fund to be the recipient of the charitable lead interest. This also is an easy method to essentially benefit multiple charitable organizations through one trust, as discussed in more detail in Section III. A. 3.

- **Obtaining Enhanced Tax Benefits.** As public charities, sponsoring organizations' more favorable income tax deduction limitations often are more attractive than those afforded to donors of charitable gifts to private foundations. A donor may wish to ensure more charitable assets are available from a particular asset by donating it to a donor-advised fund sponsoring organization, even though the donor also has a private foundation, due to income tax deductibility factors.
- **Disclaiming to a donor-advised fund rather than a private foundation.** A problem arises if a parent names a child as a beneficiary of an estate and through the child's disclaimer the property passes to a private foundation where the child is a director. The child's participation in the private foundation's selection of charitable grant recipients could prevent the disclaimer from being a "qualified disclaimer," because the child's involvement in selecting the recipients to receive grants from the disclaimed property could violate the requirement for a qualified disclaimer that the property pass "without any direction on the part of the person making the disclaimer". Code Section 2581; Treas. Reg. Sec.25.2518-2(d)(1) and (2); 25.2518-2(e)(1)(I).

  Although one solution for the private foundation would be for it to amend its bylaws so as to prohibit the child and child's spouse from participating in the selection of grant recipients from the disclaimed property, with the disclaimed assets being isolated from other foundation assets in a separate account, this is a cumbersome and clumsy solution that interferes with the parent's intention to involve the child in the work of the foundation. (PLRs approving/upholding disclaimer with similar facts: 200802010 (Sept. 12, 2007), 200744005 (June 28, 2007), 200649123 (Aug. 23 2006), 200616026 (Dec. 22, 2005), 2004420007 (Jan. 23, 2004), 9317039 (Feb. 2 1993) and 9141017 (July 10, 1991)).

  A better solution might be to have a child disclaim property to a donor-advised fund at a community foundation. The IRS concluded that the advisory nature of a child's or grandchild's grant recommendations did not pose a problem. PLRs 200518012 (Dec. 17, 2004 (disclaimers by grandchildren) and 9532027 (May 12, 1995)(disclaimers by children). (This recommendation is from the presentation materials prepared by Christopher Hoyt, *"Charitable Giving Implications of the 2012-2013 Income and Estate Tax Environment and Gifts and Bequests of Retirement Assets*," Council on Foundations Advanced Legal Seminar, Sept. 9, 2012 ("Hoyt Presentation")).

D. Choosing a Donor-Advised Fund Sponsoring Organization: The "outlier cases" serve as ample warning: not all donor-advised "programs" and sponsoring organizations are the same! Some issues to consider in determining whether a donor-advised fund at a particular sponsoring organization will suit a donor's current and future needs include:

1. What assets may be contributed to the fund? (More than cash and publically traded securities? Real estate? Business interests? Tangible personal property?)
2. Are there geographical or interest area limitations on grantmaking? (CICF and affiliated community foundations do not impose geographical restrictions—grants from donor-advised funds may be made to any U.S. 501(c)(3) public charity.)
3. Services beyond the basics? (Will the sponsoring organization host advisory committee meetings, perform research on interest areas or specific charitable organizations, assist with mission or purpose statement development, goal setting and impact assessment?)
4. Online access?
5. Investment choices? By law, the sponsoring organization has ultimate authority and control over the investment of donor-advised fund assets and must establish investment policies concerning the fund. But can the donor recommend an outside investment manager to manage his or her fund? Commercial sponsors generally limit investments to their mutual fund offerings. CICF allows a donor to recommend an outside investment manager, provided the manager abides by CICF's investment policy statement.
6. Investment performance—even if outside investment manager selection recommendations are allowed, it might make more sense to let the sponsoring organization invest the assets of the fund.

7. What is the sponsoring organization's policy regarding successor advisors and multi-generational involvement in the fund?
8. What is the financial picture and reputation of the sponsoring organization? Are there references who can be contacted regarding their experience with the organization? What is the amount of unrestricted assets versus liabilities of the organization? What is its history?
9. What are the fund minimums? Will an "acorn fund" be allowed?
10. What are the fees, and what will the fees cover? E.g., consider the difference between funds that come with a local philanthropic advisor and family philanthropy education and involvement versus a 1-800 number.

III. Creative or "Advanced" uses for Donor-Advised Funds

A. Use a Donor-Advised Fund as the Charitable Recipient When Drafting Defined Value Formula Clauses. Consider an estate plan in which an individual states in his or her will and trust instruments: "Give to my family the federal estate tax threshold in the year that I die, e.g., $11.2 million, and give the rest to charity." The intent is to avoid estate tax, and although this is not difficult when the estate or trust consists of liquid assets with undisputable valuations, a potential problem arises there if there are illiquid assets with a wide potential range of values e.g., real estate, limited liability company, partnership interests, etc. A defined value clause can be very helpful for such situations.

1. Drafting language: In *Estate of Petter V. Commissioner*, 653 F.3rd 1012 (9th Cir. 2011) affirming T.C. Memo. 2009-280 (Dec. 7, 2009) (gift tax), one of the better known defined value formula clause cases, the niece of the founder of United Parcel Service ("UPS") put UPS stock in a limited partnership and, among other complex gift and estate plans, made inter vivos gifts of the partnership units through two long-term trusts to her two adult children and two donor-advised funds at the children's respective community foundations, the Seattle Foundation and the Kitsap Community Foundation. The relevant sections from the *Petter* gift documents, as set forth in the 9th Circuit's opinion, provide:

1.1 Subject to the terms and conditions of this Agreement, Transferor:

1.1.1. assigns to the Trust as a gift the number of Units described in Recital C above that equals one-half the maximum dollar amount that can pass free of federal gift tax by reason of Transferor's applicable exclusion amount allowed by Code Section 2010(c). Transferor currently understands her unused applicable exclusion amount to be $907,820, so that the amount of the gift should be $453,910; and

1.1.2. assigns to The Seattle Foundation, as a gift to the A. Y. Petter Family Advised Fund of The Seattle Foundation, the difference between the total number of Units described in Recital C above and the number of Units assigned to the Trust in Section 1.1.1.

1.2 The Trust agrees that, if the value of the Units it initially receives is finally determined for federal gift tax purposes to exceed the amount described in Section 1.1.1, Trustee will, on behalf of the Trust and as a condition of the gift to it, transfer the excess Units to The Seattle Foundation as soon as practicable.

1.3 The Seattle Foundation agrees that, if the value of the Units the Trust initially receives is finally determined for federal gift tax purposes to be less that the amount described in Section 1.1.1, the Seattle Foundation will, as a condition of the gift to it, transfer the excess Units to the Trust as soon as practicable.

The fair value of the membership units as of the transfer date in 2002 was determined by a qualified appraiser to be $536.20 per unit. Following IRS audit in 2005 of the 2002 gift tax return, the parties settled the valuation issue stipulating to a $744.74 value per unit at the time of transfer. As a result of the stipulated value and the reallocation clauses of the transfer agreements, the community foundation donor-advised funds received additional units from the adult children. The tax court allowed the taxpayer (Mrs. Petter) to amend her 2002 gift tax return to take an additional charitable deduction based on the value of the additional LLC units the community foundation donor-advised funds received.

2. Practical tips for selecting and planning for a charitable recipient. As a result of the reallocation approved in *Petter*, the Seattle Foundation received over \$3.3 million worth of *additional* partnership units into the donor-advised fund advised by the daughter of Mrs. Petter. This amount is likely more than many charitable organizations would be able to handle and more than most donors would intend to give to any single charity. A donor-advised fund would be a great choice of public charity in such cases because it would allow for future grants to more than just one charity, or for a donor who wants to “endow” their annual gift to one charity, where the fund makes grants to the charity every year forever (and avoids the issue of giving a huge lump sum to a single charity, particularly a small or even mid-size charity, that may not be prepared for such a sizeable gift).

Whereas donor-advised funds were used as the charitable recipients in *Petter* and *Hendrix.* (See also, *McCord v. Commissioner,* 461 F. 3rd 614 (5th Cir. 2006), also using a donor-advised fund), a private foundation was used as the charitable recipient in *Christiansen, supra.* With both private foundations and donor-advised funds, it is important to “plan an exit strategy” for the business interest donated to the charity due to the excess business holdings rules discussed above. Private foundations are subject to harsher self-dealing tax if the property is sold to a disqualified person, which is often a desired part of the plan. A private foundation’s sale of an asset to a donor or to a related family member will likely trigger the tax. Section 4941 (d)(2)(F). Donor-advised funds, on the other hand, are only subject to the usual rule that property must be sold for a reasonable price. There is no self-dealing penalty for a sale transaction with a donor-advised fund. Nor would there be problems with a potential failure to meet the private foundation 5 percent distribution requirement that could be imposed retroactively to the date of gift (which was several years earlier in *Petter*).

B. Use a Donor-Advised Fund to Accelerate Donations or "Pre-fund" Charitable Giving into Desired Tax Year: A donor-advised fund allows for the decoupling of the timing of the charitable contribution that provides the deduction and when the actual donations (grants from the fund) are made to specific charities. Thus, a donor-advised fund could offer your clients the opportunity to "have their cake and eat it too," meaning that they can act this year to lock in the deduction for charitable gifts this year to a donor-advised fund that they can then grant out from the fund in future years. For clients with larger income tax events in one particular year, a donor-advised fund will allow the desired increased income tax deduction in the year of the income event, but allow for the smoothing out of charitable contributions consistent with the client's usual charitable giving. This is essentially the "bunching" strategy, which may become a charitable giving trend in light of the enactment of the TCJA, as donors without a large taxable event may also benefit from bunching in a donor-advised fund.

C. **Use a Donor-Advised Fund to Accept Complicated or Unusual Assets (while simultaneously avoiding capital gains tax):** With the current top capital gains tax rate at 20% along with the 3.8% Medicare investment surcharge, both of which are still applicable post-TCJA, the incentive to donate appreciated property remains high. Not only does the donor get a charitable deduction (in most cases) for the current fair value of the gift, but also avoids paying capital gains tax on the unrealized gain. Needless to say, charitable gifts of appreciated property are now more attractive than ever.

Although cash and appreciated, publically traded securities are the most common assets utilized to make charitable gifts, including establishing donor-advised funds, a donation of a more complicated asset, such as privately held business interests, also might make sense--especially if the donation occurs in connection with the sale of the business and a substantial income (and consequent income tax) event to the donor. When illiquid business interests, or other long-term capital gain interests such as real estate, are donated to a *public charity* (as distinguished here importantly from a private foundation) in the optimal manner, the donor eliminates potential capital gain on the donated portion and generally is entitled to the full fair market value for charitable income tax deduction purposes. Even if a particular public charity is sophisticated enough to accept such a complex asset, the donor may rather split that gifted asset among several charities—which is difficult if not impossible to do through the donation of one asset, unless that asset is donated to a donor-advised fund. By utilizing a donor-advised fund at sponsoring organization that accepts complicated assets, the donor is able to benefit myriad charitable recipients through one gift and only one charity to work with in connection with the transfer.

D. Convert IRA Assets to a "Philanthropic Inheritance" through a Donor-Advised Fund: Retirement plan assets constitute the largest asset holding of many Americans. IRA beneficiary designations could potentially affect the transfer of several trillion dollars. Unfortunately, plan assets left to individuals are heavily taxed and consequently "expensive" to inherit. Not surprisingly then, many are predicting a dramatic increase in the number of individuals who choose to leave IRAs to charity. *See, e.g.*, Gift Law (Jan. 7, 2012). Donor-advised funds can be the beneficiary of an IRA or qualified pension plan. Depending on how the decedent sets up the fund, his or her adult children can receive a sort of "philanthropic inheritance" consisting of an inherited fund from which to make charitable grants, saving their own income or assets for other purposes. A large donor-advised fund (or private foundation) can increase the children's prestige as a significant contributor in the community. The idea of philanthropic inheritance can be attractive to clients who worry about "affluenza." An "inherited" donor-advised fund is a shift from the traditional "it's yours to spend freely" to "it's yours to support charity" for some share of the family wealth.

E. Don't Forget the Obvious—Using a Donor-Advised Fund to Receive a Bequest. This too can be a "beyond the basics" proposition! Bequests are the MAJOR gift of the middle class. There is a tendency of even the wealthy to defer gifts of assets until death during more volatile economic times—based on a study going back to 1931. When the net worth of people shrinks, they are less likely to give substantial amounts in their lifetime. The relative importance of bequests is greater in uncertain times when people are feeling less secure.

Donor-advised funds likely are most commonly thought of in connection with formalizing a donor's "giving while living." One school of thought is, "why leave the fun of charitable giving to someone else after you've gone"? However, myriad charitably inclined donors choose to create or add to donor-advised funds through their estate plan--for myriad reasons. Perhaps they plan to donate a complicated asset that they need the use or enjoyment of during their lifetime. (In this case, advise your client to notify the sponsoring organization to ensure the organization will accept the asset.) Perhaps they have a private foundation during their life, but they decide to plan for a post mortem donor-advised fund to receive the assets of the private foundation in order to ensure their intent is carried forward or to ease the burden on future generations. Many donor-advised fund sponsoring organizations provide extensive philanthropic services, so a donor could decide that a donor-advised fund is a better match going forward with the successor generations being hosted and administered by the sponsoring organization.

A bequest of art work, collections, jewelry, coins or other tangible personal property could be a wonderful way in which to leave a charitable legacy --that "philanthropic inheritance"--while simultaneously relieving your clients' heirs of the worry about how to effectively and fairly dispose of the meaningful item or items. The "related use" requirement does not apply to charitable estate gifts, so the estate will be able to deduct the full fair market value of the bequest. Beware of the possible need, however, for qualified appraisals in order to claim charitable tax deductions for contributions of noncash property valued at more than $5,000. Code Section 170(f)(11) (C).

F. Transfer a Private Foundation to a Donor-Advised Fund: An increasing number of private foundations have been terminated in recent years. According to a 2010, article in the Journal of Accountancy, the precipitous drop in wealth in the U.S. during the 2008-2009 financial melt-down accelerated a trend of many private foundations' considering closing their doors. McCallister, B., "*Closing Up Shop: How to Successfully Shut Down a Private Foundation,"* Journal of Accountancy, July, 2010. Because of the increased interest in private foundation termination, the IRS issued Publication 4779, *Facts about Terminating or Merging Your Exempt Organization*, in May, 2009.

Private foundation termination can happen by choice for any number of reasons. Private foundations can become a burden. They can be time consuming and expensive. Filing requirements and tax rules are complicated. Family members may differ as to grantmaking priorities. Decisions about who should run the foundation, details of the grantmaking process, etc., may be more work than initially anticipated. In volatile economic times, the amount of money available for grantmaking based on asset base and investment income can be reduced perhaps to the point where it does not make sense for the private foundation to continue as an independent entity.

Many individuals, families and corporations head down the private foundation path without any awareness of simpler, less costly, turn-key alternatives available through community foundations. Running a $1 million (or less) private foundation could prove more difficult to the donor than running a $10 or $100 million private foundation because the smaller foundation cannot afford to hire staff. If the asset base has been reduced or was never sufficiently large to begin with, or if managing the private foundation becomes too burdensome for whatever reason, it may make sense to consider transferring the private foundation assets to a donor-advised fund.

The board of the private foundation can choose to continue on in a very similar capacity as the advisory committee of the donor-advised fund to recommend charitable uses of the private foundation-turned donor-advised fund assets. Code Section 507 (b) (1) (A) permits the termination of a private foundation in either corporate or trust form and a distribution of its assets to a public charity, provided the charity has been in existence for five years preceding the distribution. Community foundations quite frequently accept the transfer of private foundation assets into a donor-advised fund. No advance IRS approval or notice is necessary. Pursuant to IC 23-17-22-1 *et seq*., dissolution is straightforward and relatively simple. No court or attorney general approval is required.

IV. Donor-Advised Fund Case Studies

Here a few sample case studies demonstrating how CICF's charitable gift planning and philanthropic services teams have helped them help their clients accomplish their charitable goals:

A. Professional Advisor A:

1. Highly Engaged Client Resulting in Multiple Iterations of a Charitable Fund: High net worth clients were initially interested in a future fund as part of their estate plans. They wanted to ensure that they could control multiple facets, including: (1) successor advisor qualifications, (2) naming charitable beneficiaries, (3) identifying and describing charitable interest, (4) allowing for pass-through charitable beneficiaries "off the top," and (5) naming Advisor A as the outside investment manager, as the clients have a very long, close relationship with him and trust him implicitly. Though it started out as a future fund, the clients decided to fund the fund in 2014 to allow for grantmaking during their lifetimes and have worked with Ruthie to make grants from their fund.

The fund agreement has been amended, most recently in late 2017, to add the pass-through beneficiaries that would receive money "off the top" once the fund was funded with assets in the clients' estate plans as well as to add a donor interest area endowment portion of the fund, in addition to the donor-designated and donor-advised portions of the fund that will be created at the death of the survivor of the two clients. After the clients' lifetimes, the "off the top" charitable donations will go out first, and the fund will be converted to five separate but affiliated funds: a donor-designated endowment fund, a donor interest area endowment fund, and three donor-advised funds, to be advised by each of their three children.

Most recently, the clients are in the process of donating closely held business interests, shares of an LLC, to their fund. The LLC owns commercial real estate that the entity will be selling this year. Upon the sale, the proceeds will come into the clients' fund at CICF and The Indianapolis Foundation.

B. Professional Advisor B

1. Appreciated Real Estate Donated to a Donor-Advised Fund: A long-time client with unimproved water front lot on reservoir had a real estate tax problem. The client was weary of real estate taxes and leery of the hassle of a sale. Advisor B suggested that the client use the land to make a charitable donation to Legacy Fund and create a donor-advised fund. Even before Legacy Fund sold the property, the client received an income tax charitable deduction for the full fair market value of the property and avoided capital gains. Real estate taxes were no longer the client's concern. Sales proceeds (less carrying costs) were added to the client's newly created donor-advised fund. Ruthie is the client's philanthropic advisor, and the client has made a variety of grants: some large in size and some smaller, often in memory of a loved one. Because the client had such a seamless experience, there may be additional real estate he wants to use for charitable purposes.

2. Private Family Foundation Terminated and Assets Transferred into Scholarship Fund at CICF: A private foundation with an aging board and the next generation in different states and not interested in awarding scholarships to the local high school (which was the foundation's purpose) sought help from Advisor B. Advisor B recommended terminating the foundation into a scholarship fund at CICF. The client was not interested in his county's community foundation, due to the "back fence" syndrome. We always encourage prospects to use their county's community foundation, but in this case the client knew what he was looking for and it was not a community foundation that would "know his business." He also was very particular regarding investments, economies of scale, etc. Our scholarship program fit with the private foundation's purposes. Marissa and our entire Scholarship Team meet with him regularly and ensure that his scholarship runs smoothly. This is an exacting donor who keeps us on our toes!

3. Estate Plan Interest Area Endowment Fund. Advisor B assisted his client to create a future fund in honor of her deceased husband to be funded upon her death. This donor interest area endowment fund, which was funded last year, will perpetually provide funding to organizations in Marion County that benefit children and youth, with preference being given to faith-based organizations in the Christian tradition. Our Community Investment staff is so grateful to have additional resources in our community endowment fund, as faith-based organizations benefitting children and youth in Indianapolis abound!

C. Professional Advisor C

1. Post-Business Sale Donor-Advised Fund. Advisor C recommended a donor-advised fund to address the tax issue associated with the sale of a client's business as well as the client's philanthropic desires. The fund was created as a pass-through donor-advised fund for the client with a subsequent conversion to an endowed donor-advised fund upon the client's death with two successor generations. Rather than having the adult children advise the fund together as a committee, the client provided for one half of the annual endowment distribution to be advised by one son (and then his designees) and one half of the annual distribution to be advised by the other son (and his designees). At the end of the advisory period of the fund, it will be converted to a donor-designated endowment fund to perpetually benefit the client's church and missionary work. Advisor C serves as the outside investment manager.

2. Donor-Advised Fund as Lead Beneficiary of Charitable Lead Trust. This is another post-business sale for a client with many charitable interests, seeking to avoid the associated tax liability. Advisor C suggested creating a donor-advised fund to be the beneficiary of a 10-year charitable lead trust to be advised by the client and two successor generations. In this case, in the first generation of successor advisors, the two daughters specifically each must give their consent to each grant. Although a short initial year caused the fund to start small, because the fund would ultimately and irrevocably hold over $1M, CICF has elected to assess a 1% fee, which applies to pass-through funds starting with over $1M.