NAPIER'S NOTES:

A Couple Minutes Is All It Takes.

SPRING 2014, VOL. 22, NO. 2

PRIVATE FOUNDATIONS AND DONOR ADVISED FUNDS

"My father used to say, 'You can spend a lot of time making money. The tough time comes when you have to give it away properly.' How to give something back, that's the tough part in life."
— Lee Iacocca

A longer version of this article was published in the June 2014 issue of Trusts and Estates magazine.

Private foundations (PFs) and donor advised funds (DAFs) are often compared and contrasted. PFs and DAFs are typically the charitable vehicles our clients use to explore the tax and philanthropic highways. Because advisors frequently refer to both PFs and DAFs as charitable planning vehicles, it is helpful to look a little more closely under the hoods of both options.

PFs seem like the cars America produced in the 1960s and 1970s. While these vehicles were meant to be driven and enjoyed, they also dripped some oil and guzzled a little too much gas.

Eventually, smaller, more fuel-efficient cars became popular and toured the highways of America. These cars are much like the modern DAF. Although very different from their predecessors, their fuel economy and engineering were impressive.

So which charitable planning vehicle is right for which client? Today, many financial advisors are all but eliminating PFs from consideration, almost predetermining DAFs as the only viable option.

Does this mean that PFs are an option whose time has passed now that DAFs are being driven around the neighborhood? Certainly not. In fact, PFs have several attributes that should make them the first choice for many.

For example, it can be less expensive to operate a PF than a DAF. The breakeven point is probably slightly below $1 million. The average account size of a DAF is about $225,000. So, strictly on operating expenses alone, clients making sizeable charitable gifts may prefer PFs.

There are other advantages PFs enjoy. Operating a PF can substantially benefit the donating family. While running a PF requires some management, the positive and charitable dialogue required among family members involved in the PF creates an opportunity to foster family harmony.

Moreover, the economic reality of the modern world may mean that not every member of a family that wants a job has one. Perhaps not every member of that family is necessarily mentally or physically capable of retaining a job. While a DAF will not hire the family member, a PF that needs staff can employ family members.

Now let us address some of the perceived disadvantages attributed to PFs. PFs must give away at least five percent of their assets each year, while DAFs do not have this condition. (There are rumblings that minimal distributions from DAFs may be required.) However, distributing five percent seems like an insignificant disadvantage when you consider that investment returns historically exceed this modest threshold.

Note also that PFs must pay an excise tax, typically one percent of earnings, while DAFs have no such requirement. I look at this small tax like the few oil drops my bright orange 1972 Oldsmobile - the "*Orange Crate*" - left on the driveway. Do I wish the crankcase was tighter? Of course. On the whole, was the car a joy to own and operate? Without question.

So, when the rubber hits the road, perhaps advisors could better serve their clients by helping them understand which charitable vehicle best fits their driving style. Some clients may even choose both vehicles. After all, both planning vehicles can co-exist comfortably in our clients' estate planning garages.

The Orange Crate