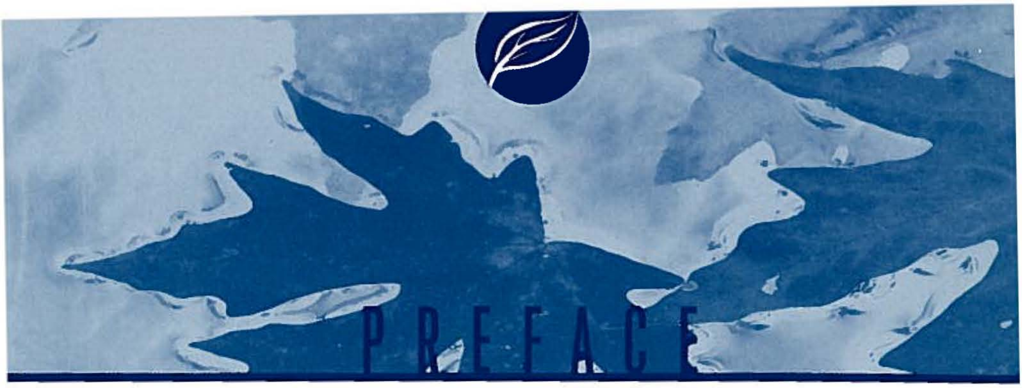

PREFACE

Donor-advised funds are increasingly popular today, but how useful are they to families? Until now, no publication has provided the answer. This monograph, *Family Philanthropy and Donor-Advised Funds,* seeks to do so.

When Virginia M. Esposito, president of the National Center for Family Philanthropy, commissioned the publication, she turned the standard approach around to view the subject from the family perspective.

The result, we hope, is useful to donors and their families who are starting out with a formal giving vehicle, those who are adding to existing structures of giving, and those who have special family giving needs, such as bridging geographic separation. We also discuss the extremely important use of advised funds to train the next generation in the family, who someday will carry on the family philanthropy.

The National Center does not favor any giving option over others, and even points out that advised funds may not appeal to some families. Also, not all host organizations offer all services that are useful to families.

A publication of this sort is only as good as its sources. My thanks to all the people who took time to think about Ginny Esposito's refreshingly original approach to donor-advised funds, and to share their thoughts with us all. They are mentioned by name in the Acknowledgments, Appendix E. I thank my long-time collaborate, Claude O. Norcott, for her invaluable assistance.

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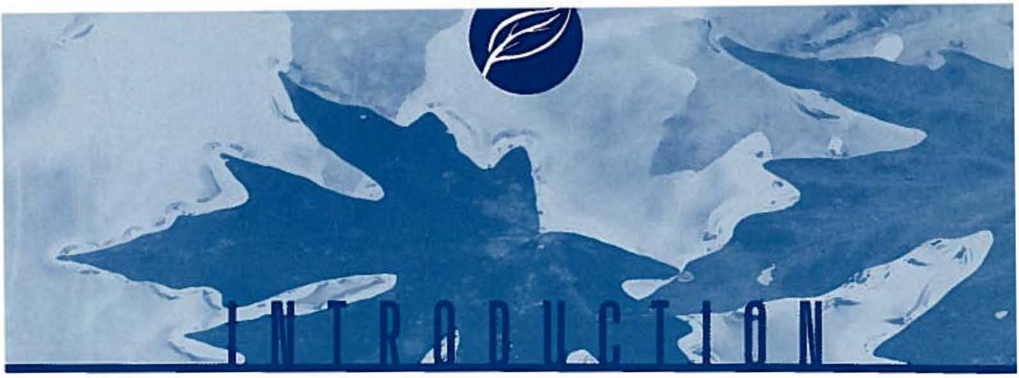

INTRODUCTION

WHY FAMILIES LIKE DONOR-ADVISED FUNDS

When James E. MacVicar retired from ophthalmology in Kalamazoo, Michigan, he and his wife "wanted to show our appreciation. Kalamazoo had been good to us."

The MacVicars established a donor-advised fund—the James E. and Nancy E. MacVicar Fund—at the Kalamazoo Foundation, a community foundation. During the MacVicars' lifetimes, and the lifetimes of their children, the family will recommend how proceeds from the fund can benefit the people of Kalamazoo. The principal will eventually become part of the community foundation's discretionary fund, but it will retain the MacVicar name.

Like the MacVicars, other family donors enter formal philanthropy with the spirit of doing good works, of giving back to the community, of bringing about social change, of memorializing a loved one, and for other reasons. Their decision to give voice to their philanthropic impulse usually comes first, their decision to enter formal philanthropy follows.

Like the MacVicars, other family donors also face choices in formal philanthropy. Some families want a convenient management structure for their giving program. Others already have a private foundation or other fund, but want to expand or broaden their giving options. Still other families want a means of giving that accommodates geographically dispersed family members or helps train the next generation in philanthropy. For each of these families, an advised fund may be a useful giving vehicle.

WHAT ADVISED FUNDS ARE AND HOW THEY WORK

The Internal Revenue Code does not define advised funds, which are a bit of a legal hybrid. The donor sets up a fund with a host organization, usually in a few hours and perhaps even online through the Internet. The donor can give a lump sum to endow the fund, build an endowment over time, or make periodic contributions as the fund needs more money or the donor has funds available. The donor, or a committee the donor designates, recommends grants from the fund. The host organization is not legally obligated to accept recommendations, but usually takes them very seriously.

WHAT IS A DONOR-ADVISED FUND?

An advised fund is a fund established by a donor in a host organization that is recognized as a public charity. Donor-advised funds allow a donor or persons designated by the donor to recommend recipients for grants from the fund. Donor recommendations are advisory—the governing body of the host organization is free to accept or reject them—but are generally given full consideration, provided that the suggested recipient is eligible to receive such a donation.

Advised funds offer some private foundation-like advantages, including a fund in the donor's name. In addition, they provide maximum tax advantages, and flexibility in funding—without the taxes, required payout, and administrative responsibility of running a private foundation.

ADVISED FUNDS ARE GROWING

Donor-advised funds are among the fastest growing segments of formal philanthropy. Community foundations have promoted interest in advised funds. In 1992, donor-advised funds accounted for 25 percent of gifts to permanent funds in community foundations in the United States.[1] By 1998, gifts to advised funds accounted for more than 56 percent of all gifts to component funds.[2] Impetus for growth has also come from the commercial sector, spearheaded by brokerages and other financial institutions. By the end of 1999, the pioneer in this field, Fidelity

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[1] Council on Foundations, *Community Foundations in the United States: 1992 Status*, Washington, DC, 1994, p.49.

[2] Figure based on preliminary data from the *1998 Community Foundation Status Survey* database. Provided courtesy of the Council on Foundations, April 4, 2000.

COMPARING A DONOR-ADVISED FUND WITH A PRIVATE FOUNDATION

MANAGEMENT AND OTHER ISSUES	DONOR ADVISED FUND	PRIVATE FOUNDATION
Control of grants and assets	Donor may recommend grants and investments, but the host organi-zation makes all final decisions.	Donor controls all grantmaking and investments.
Excise taxes	None	Excise tax of 1% to 2% of net investment income annually.
Required payout	None	Required to expend 5% of net asset value annually, regardless of how much the assets earn.
Privacy	Names of individual donors can be kept confidential if the donors wish.	Required to file detailed tax returns on grants, investment fees, trustee fees, staff salaries, etc., which are public records.
Liability and insurance	Covered by the host organization.	Trustees are responsible for any coverage they deem necessary.
Investment, accounting, audit, and tax return	Host organization handles all investment, files annual tax return, obtains annual independent audit, and sends donors regular financial reports; Host organization controls endowment.	Trustees are responsible for ensuring that these functions are performed; trustees control endowments, set policy, and choose managers.
General administration	Host organization handles all financial and administrative management.	Trustees are responsible for ensuring that these functions are performed.
Grant administration	Donor can recommend potential grantees or ask the host organization to suggest them.	Trustees are responsible for ensuring that these functions are performed.
Succession	Some host organizations encourage the continuance of donor-advisors from one generation to the next; many do not. The IRS is still considering succession issues.	Opportunities for board training, succession, and bringing in the next generation are greater.
Perpetuity	Most donor-advised funds revert to the host organization after their original donors or the two succeeding generations die.	Foundation can exist in perpetuity.
Costs	Varies with host organization and level of services.	Depends on how much the trustees wish to spend on administration and other activities.

Investment's Charitable Gift Fund, had accumulated $2.2 billion in advised funds since it was launched in 1992. Public foundations, religious institutions, and colleges and universities have become major host organizations of advised funds.

"This definitely is a growing field," says Stuart Comstock-Gay, director of programs at the New Hampshire Charitable Foundation. "There have always been family funds, but the use of donor-advised funds is definitely building. Both donors and host organizations are learning how to do it better all the time. One key consideration is that donor families don't have to worry about administering a fund. They can turn that over to us. They don't get tied up in the nitty gritty. They can focus on what they want to do, which is to be charitable. And particularly for families, that's a useful thing, because they are trying to pass on charity, not an administrative structure."

FAMILIES SHOULD EDUCATE THEMSELVES ABOUT HOST ORGANIZATIONS

Once family donors have settled on a donor-advised fund, they will likely want to learn about their options for host organizations. Many host organizations provide elaborate literature, website information, telephone access, and in-person counseling.

Commercial brokerages, banks, and many community foundations offer extensive materials designed to educate donors (and professional advisors such as lawyers or financial planners). The Community Foundation for Greater Atlanta, for example, posts excellent materials and guidance for donors on its website (www.atlcf.org). CFGA's site provides technical information and useful case studies.

Many community foundations, public foundations, and commercial host organizations market aggressively to reach both donor families and professional advisors to persons of wealth. The Ms. Foundation for Women, the Peace Development Fund, and hundreds of others publish flyers and post websites that describe the organization's mission, advised-fund program, fee schedule, and policy on donor publicity versus anonymity. Some organizations have special services for families, while others do not. An important consideration is how family-friendly the host organization is.

TYPES OF HOST ORGANIZATIONS

Donors face an exciting and broadening array of choices in host organizations for advised funds. The options include, in no particular order:

- **Community Foundations.** More than 550 of these now operate in communities across the United States. They range in size from a few million dollars to more than $1.7 billion in assets.

- **Banks and Trust Departments.** These traditional custodians of philanthropic dollars are increasingly showing interest in donor-advised funds.

- **Religious Organizations.** All the major denominations appear to offer advised funds, or are planning to offer them.

- **Public Foundations and Special-Interest Funds.** These funds focus on a special interest, such as women's issues, the environment, etc., and offer the opportunity to pool grant recommendations with other like-minded donors.

- **Educational Institutions.** Many colleges and universities now offer advised funds to alumni and friends.

- **Commercial or Proprietary Funds.** Pioneered by Fidelity Investments, these commercial entities now include Merrill Lynch, Schwab, and others and are growing rapidly in size and number. This category also includes noncommercial proprietary funds, such as The National Philanthropic Trust.

"We attempt to educate the donor about philanthropic choices," says Peggy Ross, executive director of the Fund for Charitable Giving, which is affiliated with the brokerage firm Charles Schwab Corporation.

"We concentrate on the philanthropic aspect," says Ross, whose fund is not tied to any particular cause or mission. Among other services, Schwab offers a print and website (www.schwabcharitable.org) publication called the "Seven Principles of Charitable Giving." It also links web visitors to Guidestar.com, which can search all of the approximately 650,000 nonprofit organizations electronically to help donors find potential grantees around the country.

But why, specifically, are donor-advised funds so popular with families? This *Practices* monograph addresses that question by drawing on the views and experiences both of host organizations of donor-advised funds and, more importantly, families who have established such funds. When donors and their families are asked why they chose donor-advised funds as a philanthropic vehicle, they mention one or more of these motives:

- Desire to express their philanthropic impulse;
- Find the convenience and service attractive;
- Benefit from tax advantages;
- Like involvement in grantmaking—at levels right for them;
- Bridge geographic separation;
- Can train the next generation in philanthropy;
- Can choose anonymity—or at least privacy; and
- Make use of a broad range of options.

PROS AND CONS OF AN ADVISED FUND

Pros:

- Quick and easy to set up—can be established in the waning minutes at the end of a tax year, if necessary;
- Donor can determine the amount of time he or she will commit to grantmaking through the fund;
- Donor can often obtain expert advice on potential grantees and grantmaking activities from the host organization for his or her fund;
- Donor can honor a family member, friend, or other individual—including himself or herself—by naming a fund and giving grants in that name or give anonymously;
- Size of the gift can be very small or very large and the gift can be made in one lump sum, in periodic payments to build up endowment, or in periodic payments to replenish the fund for annual giving;
- Host organization has a proven track record, and associating with it may add stature and credibility to an advised fund;
- Donor can establish multiple funds to encourage younger family members to become involved in philanthropy.

Cons:

- Donor gives up control of his or her money—although the donor can recommend grantees, the host organization makes all final decisions on the timing of grants and specific grantees;
- Donor has limited involvement in management and governance roles;
- Duration of donor's philanthropy is usually limited; and
- To ensure compliance with the Internal Revenue Code, grants must fall within the fund host organization's charitable mission for grantmaking.

The following sections examine each of these motives. Where appropriate, the text points out why advised funds may or may not appeal to families and how to explore topics further.