Heritage financial

Where Wealth and Management Meet

Enhancing Generosity To Support Not For Profits Through Donor Advised Funds

(Not-for-Profit Leadership Edition)

Mark G. Cooke and J. Robert Moon

Persons who wish to generously support their favorite not for profit organizations are often cautious to carry out this wish because of three challenges. They want some assurance of accountability from the charity leadership that the charity will live up to the donor's reason for the gift. They want good independent advice from sources other than the not for profit on where to give, what to give, and when to give. They also want the option to remain anonymous so that they do not become a target for other charitable solicitations. This white paper explores how not-for-profit leaders can promote the use of Donor Advised Funds to address these concerns and increase the probability of the charity receiving gifts now or later.

Heritage Financial LLC partners
Mark Cooke, J. Robert Moon, and David Morton
HeritageFinLLC.com

7001 Heritage Village Plaza, Suite 190
Gainesville, VA 20155
(703) 754-1233 Fax (703) 754-2122

Miss Toni, a widow with no heirs and a life-long volunteer with the Auxiliary, passes away and leaves her entire estate to the Free State Lodge. In a few private meetings with the Lodge president in the year before her death, Toni expressed her wish regarding this gift. Tina and the Lodge president, with the help of a general practice attorney who is also a board member, prepared a very simple will that she signed and was witnessed. After a few months passed, the Lodge president with the attorney who is also the named executor of the will, present this information to the Lodge Board of Directors. Soon, word spreads that Miss Tina left her home and a significant bank account to the Lodge. Some folks are eyeing Tina's home and hope it goes up for sale at a bargain that will make it attractive for them to purchase. Others more acutely aware of the financial stress of the Lodge with a burdensome mortgage and an aging declining membership, see this 'Lodge inheritance' from Miss Tina as a windfall -- a quick solution to balance the operating budget and perhaps reduce the mortgage principal. The president is aware that one of Miss Tina's confessed passions for the Lodge was its support of the visually impaired. In subsequent business meetings of the Lodge membership, there are multiple opinions expressed about how to use Miss Tina's money. The president is keenly aware that this current crisis in how to honor Miss Tina's memory and her generosity will be carefully watched by most of the other senior members of this aging organization. What happens now will determine how these aging members, many of them just like Miss Tina with no living heirs, will consider the Lodge in their estate planning. They are watching to see how accountable the Lodge will be to Miss Tina's intentions and what they observe will determine how the Free State Lodge will benefit from their estate planning.

THREE MAJOR CHALLENGES FOR THE GENEROUS

What the Free State Lodge is experiencing are common challenges among organizations that depend on current donations and estate level gifting. This white paper addresses three very common challenges to generosity, namely, accountability, advisory roles, and anonymity. We begin by examining these specific challenges and then explore how Donor Advised Funds (DAFs) can meet these challenges for the benefit of the benefactor as well as the recipient of large donations. For the purposes of this paper, a large donation can be anywhere from $5,000 to several million dollars.

Accountability

Most charities would welcome a large contribution. Even better would be large contributions to endow and use the earnings from the principle to sustain the charity or special project. It would be a way for large gifts to 'keep on giving'.

However, general support for giving large sums to a single institution for perpetual gifting is encountering challenges. One of those challenges is the accountability of the charity to the donor. Take any local charity for example. How do members honor their loyal support of their local charity and address some of the other needs and worthy causes in the community and world? Why should the charity expect to be the primary and sometimes only recipient of someone's ability to be generous? In many cases, the level of giving is in direct correlation to the relationship between the donor and the charity's leadership. Large donations can be solicited by a well-liked executive director, only to have that executive director promoted, transferred or terminated and the project for which the funds were solicited collapse or stall indefinitely. Donors are becoming wise to the growing possibilities that what is promised in the use of a donation may not always be delivered by the recipients of the gift. The major challenge for the significant donor is making the charity accountable for the promises made for the donation. Major challenge number one: How does the generous give with any assurance that the charity will be accountable?

Advisory Roles and Generosity

There are frequently at least two good outcomes when the generous share their resources with worthy causes. The generous donor usually becomes more engaged in the charity or special cause. Engaged donors are more likely to encourage others to join them in that support. And frequently the generous give more than their money -- they often eagerly give of their time and wisdom as well. Legacy is more than about the money. It is about the values and passions of the donors, the wisdom of their experiences and their education from life. In many cases, donors would like to be perceived as more than a checkbook. They would like to have some ownership in the progress and changes that might occur in the causes they wish to support. They have more than money to give. They have advice and experiences to offer. They can offer an advisor role officially, e.g. via board membership or other formal structure, or unofficially, as in directing more funding toward specific projects and opportunities that surface over time.

Sometimes the generous desire guidance in where and when to expand their generosity. They appreciate a second or third opinion, sometimes from friends, sometimes from professionals, regarding the worthiness of a cause or organization. Does this project make the best use of my donation?

The generous will benefit from the advice and collaboration with their financial advisor. Ideally, the same advisor who works with them continuously regarding their wealth management can also be involved in using that same trust and competence to manage the assets that have been given. If good management and advice can prepare for a good retirement, that same good management can be applied to investing the donations of the generous so that those donations can achieve their highest long-term potential. Imagine a regular meeting between a generosity focused investor and his or her wealth manager where one half of the meeting is reviewing the client's portfolio regarding retirement and estate planning, and the other half of the meeting is spent reviewing how a generous donation is being invested to fund the client's favorite causes. The second challenge of generosity: How does the donor remain engaged in the asset he has given and the cause he supports beyond the initial gift? What are the possible advisory roles of the donor, the organization, and the client's wealth manager?

Anonymity

Some time ago, Lester shared with Roger how irritated he had become when he began to be perceived as the solution to every financial crisis for every worthy cause (and some not so worthy) in their community ever since he made a challenge gift to the Rock Hill Community Chest. He felt that whenever a financial crisis was being discussed, all eyes and thoughts were consciously or subconsciously turning to him for a bail out donation. Lester shared how he never regrets giving to the Community Chest and other worthy causes, he loves being generous, but he certainly wishes there had been a way to be generous without the expectations for him to be the savior every time the Chest gets in a financial jam. Because he likes being generous, he hates to say, "No." Unfortunately, the publicity of his generosity is requiring an overwhelming volume of the latter to the point that it has begun to diminish the joy of his generosity. Lester confesses to Roger that this un-spoken but evident expectation has started to eat away at his enjoyment of giving and participation at Rock Hill. Roger has tucked away in his mind Lester's conversation as he ponders how his wife Lorene and he might share their own good fortune with the Hillsborough Free Clinic and its various services.

When it comes to sizeable contributions there are usually two distinct tracts regarding how the generous wish to make known their contributions. We are most aware of the first, those who seek recognition for their donation to varying degrees of announcements or awareness. We know these benefactors are generous because <u>they want us to know they are generous</u> people. We might see the donor's name on a building, or listed as a sponsor in a specific donor category at a fund raising event. It might be more subtle but just as important for the leaders of a cause or organization to know from whence the money is coming and for that to be recognized not in public announcements but in private 'thank you' dinners. Sometimes all a donor wants is for someone important in the organization to know the name of the donor and to privately thank him or her. For example, if Roger donates what he considers to be a sizeable contribution, he expects not a simple note from the Community Chest treasurer or financial bookkeeper, but a personal call from the executive director.

There is an opposite category of the generous, i.e., those who prefer that their gifts (or the donor source) remain anonymous. There can be several reasons for this affinity for anonymity. The donor might be shy. The donor might not want to be identified because they fear once the source is identified, they will become the target for funding every project of every organization connected with the Community Chest. The preference for privacy could be to protect the donor from future heirs who might feel the donor's generosity is cutting in on their inheritance (or the charity is drawing down their shares of a future estate). Sometimes the generous just take special delight in being a mystery donor, someone who gives when and where he or she pleases.

Not knowing which track the donor prefers and responding in a supportive manner will have a major impact on future donations. If either the donor or the recipient is presenting confusing signals, disappointment and possibly disaster awaits. If the expectations for publicity or privacy are clear from the beginning and who is to play what role in protecting the privacy or publicity of the donor and donations, there will be ample opportunity for more frequent and larger generosity. Challenge number three when it comes to generosity to charities: some donors want privacy and others thrive on publicity. How do you meet both needs?

The answer to these three challenges, *accountability, advisory, and anonymity*, can be adequately met through the use of Donor Advised Funds.

What is a Donor Advised Fund?

According to the American Endowment Foundation, *a Donor Advised Fund (DAF) is a family foundation alternative that provides a simple, flexible, efficient way to manage a person's or family's charitable giving with immediate and maximum tax advantages. Through a Donor Advised Fund, a generous person is able to make specific grants on a flexible timetable, build a charitable legacy, and increase that person's philanthropic funds for future grant making. In recent years, the benefits of Donor Advised Funds have become more apparent to many of those wishing to*

Donor Advised Funds are now one of the fastest growing vehicles for giving in the U.S., having been proven as a simple, practical, and tax effective means for donors to achieve charitable goals.

American Endowment Foundation

channel their charitable giving in the most effective and efficient ways possible.

As a substitute for a private family foundation, Donor Advised Funds allow a gift to be tax deductible and to be capitalized (i.e. invested) so that its future earnings can be contributed to a variety of charitable causes. How does this work?

Suppose Roger and Lorene have a sizable investment portfolio consisting of stocks, bonds, mutual funds, private participation programs, and shares in their employer's business. Their investments are spread across several types of accounts, including IRAs, 401Ks, annuities, life insurance policies, brokerage accounts, jewelry, art, and real properties. They have analyzed their retirement needs. With the help of their wealth manager they have a very high probability they will conclude their lives with significant assets to fund a reasonable estate to their family heirs while still having a large sum they can contribute to their favorite causes. They have determined they want to be generous now, while they have the chance to enjoy the results of sharing their blessings. In this example, they have $500,000 more than they need and would like to give this to a variety of charities in a way that will address the three challenges that concern them, namely, accountability of the recipients, good advice to give and receive in the management of this sizeable contribution, and protecting their privacy (anonymity).

The Free Clinic is a big part of their lives. They want to continue to be supportive in the ongoing operations of this special health care program. And they want to be able to support special events or projects and perhaps donate significantly to a future building campaign or a medical equipment purchase. They also want to give to some special charities such as the Special Olympics to honor their grandchild and to the homeless shelter in memory of Lorene's uncle.

For many years, Roger and Lorene carefully held their course in their investment strategy, taking the long-term approach rather than seeking a quick and risky return. This $500,000 investment represents an original investment of only $100,000 several years ago. If they cash out $500,000 in investments, they will encounter a taxable event, i.e. they will owe the IRS and any state or local income tax on the $400,000 gain. In other words, they have a cost basis of $100,000 and a taxable capital gain of $400,000. They want to be generous, but they don't want to pay long-term capital gains tax, in their case over 45% of the $400,000. After paying $180,000 of income taxes, they could only contribute $320,000 to any or a number of favorite charities. To avoid this tax bite, they seek the advice of their professional financial advisor who will work with their account, help them coordinate this contribution and transfer of assets and then help them manage the assets as investments.

Roger and Lorene, using legal documents, transfer these assets equaling $500,000 to the Donor Advisor Fund managed by a reputable Endowment Foundation established for this purpose. Roger and Lorene immediately claim the full $500,000 as a tax-deductible charitable contribution on this year's tax return or spread the deduction over the next five years depending on the advice of their accountant. The $500,000 in assets now in the DAF are held or reinvested in other appropriate holdings as advised by the wealth manager in consultation with Roger and Lorene. Let's suppose the fund in the first year has had a modest growth of 6% after expenses, or $30,000[1]. Roger and Lorene decide that they would like to donate $10,000 this year to the Special Olympics, $6,000 to the local homeless shelter, and $1,000 per month to the Free Clinic. By keeping the principle of the donation invested, each year they are able to direct the endowment to make one or multiple contributions from the earnings of the principle. They can also elect to spend down the account in one or multiple donor advised contributions.

Furthermore, Roger and Lorene can so construct their gift to the Donor Advised Fund and estate plans to allow their heirs or designees to carry on the management of the investment decisions and the directives of where the donated earnings might go, as long as they are to a 501(c)3 organization. They suspect Tim, their oldest child, will want to direct his share to his church in Kentucky, and that daughter Elizabeth, who is currently studying for a physical therapy degree, will want to support the local Special Olympics chapter.

What are the Advantages of a Donor Advised Fund?

One of the major benefits of a Donor Advised Fund is its flexibility on several matters, including the amount needed to establish a DAF, the timing for taking the taxable deduction for the original donation to the DAF, lower overhead costs, reduced responsibilities for reporting to the IRS, choices in current and future recipients of donations from the DAF, increased management of invested funds with lowered costs, and screening for potential solicitors for donations from the DAF. The following table outlines the major differences and advantages in a Donor Advised Fund vs. a Private Family Foundation.

[1] This is only an example and does not suggest any promise or guarantee of any return on any investment. Furthermore, it is possible that the entire investment could be lost. Nevertheless, the initial contribution remains tax deductible regardless of the future performance of the Donor Advised Fund.

	Private Foundation	Donor Advised Fund
Valuation for charitable deduction: closely held stock or real estate	Cost Basis	Fair Market Value
Valuation of publicly traded securities	Fair Market Value	Fair Market Value
Income tax deduction -percentage of AGI, with 5 year carry over	30% for cash, 20% for appreciated assets	50% for cash, 30% for appreciated assets
Excise tax on investment income	1-2% of income	No excise tax
Set up expense	Costly	No set-up fees
IRS approval process	Time consuming	DAF can be established in less than a day
Annual distribution requirement	5%	None
Investment options	Wide range	Wide range
Preparation of tax returns, IRS compliance, accounting, grants management, fiduciary oversight, legal and audit	Donor must arrange for these services	Provided by endowment manager
Confidentiality	*None - All information is publicly available via form 990-PF	Donor has flexible options: Full recognition, or partial, or full anonymity
Who can receive donations from the Donor Advised Fund?	501(c)3 organizations or public charities, and in special cases, scholarships to individuals	Only organizations that have a 501(c)3 not-for-profit status with the IRS.

What Are the Advantages to the Not-for-Profit Organization in the Promotion of a DAF as a Vehicle For Generosity?

There are two major advantages that a not-for-profit organization can realize when promoting the Donor Advised Fund model over the traditional focus on giving solely to the current charity fund-raising agenda. The DAF model is accessible to most potential donors because the entry level for establishing a DAF is only $5,000 and can be expanded to accommodate several million from an individual or family. This makes it possible to hold a charity sponsored workshop or seminar presenting the benefits of the DAF as a model for generous giving. No one needs to feel excluded or called out regarding her level of wealth. Additionally, the DAF can be the beneficiary or partial beneficiary of a charitable remainder trust, an IRA, or a life insurance policy. A business owner contemplating the sale of a business can delegate before the sale all or a portion of the business toward a DAF.

Most not-for-profit leaders and development directors are familiar with the concept of a charity having or considering its own endowment fund, memorial fund, or fully established formal foundation. Those who have been involved in attempting to administer these methods of designated giving know too well the headaches they can cause in record keeping, balancing the donor's wishes with the needs of the charity, transparency to both the donor and the directors, not to mention the regulatory requirements demanded by the IRS. The DAF in many cases is able to by-pass the administrative headaches and potential public relations risks often associated with charity based foundations, endowments and memorial funds.

In summary, the DAF model sends a signal to the generous that the charity is not just looking out for its own selfish agenda when it is encouraging generosity among its membership and the community. When a charity promotes a DAF approach to generosity, it is in effect blessing the individual donor's choices of how they choose to disburse their generosity.

What Are the Restrictions of a Donor Advised Fund?

There are three noteworthy restrictions on the use of Donor Advised Funds. First, the Internal Revenue Service requires that the recipient of any contribution channeled through a Donor Advised Fund must be recognized by the IRS as a 501(c)3 charity eligible for tax-deductible contributions. Most charities, churches and religious organizations easily meet this threshold requirement.

The second restriction is that once the donation has been made to the Donor Advised Fund, it cannot be reversed without serious complications in tax accounting. The donor always retains the option of moving the Donor Advised Fund to any endowment set up to manage a Donor Advised Fund.

The third restriction is more a matter of clarity regarding actual control and ownership of the Donor Advised Fund. The Donor Advised Fund is viewed as the charity or not-for-profit entity which is receiving a contribution. Once an asset or contribution is made to the Donor Advised Fund, the contributor no longer owns or controls the funds. The contributor may provide requests, preferences, and recommendations regarding the distribution of the fund to other charities and how the fund is managed, but the ultimate responsibility for the fund, including its filings and compliance with IRS regulations resides with the fund, not the donor. To be clear, the donor can advise, but not control the fund. Of course, it makes sense for the management of the Donor Advised Fund to accommodate reasonable considerations from the original donor for determining charitable gifting and fund management.

Action Steps for Charities Interested in Promoting DAFs as a Vehicle for Generosity

The first step probably begins with the primary leader of the not for profit, i.e. the executive director (ED). The ED must decide if the charity wishes to bless generosity in general without being in control of the potential gifts or the recipient of the generosity. If the ED can embrace that level of comfort, i.e., generosity in general is a better place than promoting giving only to one charity, the largest obstacle to overall promotion of generosity is overcome. From that openness, the ED can begin a discussion with a reliable source, i.e., a financial advisor familiar with the DAF concept and focused on generosity among the affluent. In collaboration with the organization's leader(s) and the financial advisor, an approach can be designed that will be applicable to the situation. Several examples of how that might unfold include the charity's sponsorship of a generic seminar on DAFs that is led or presented by a third party who is not intended to be a direct recipient of a donation. The financial advisor might serve as that third party presenter. The leadership in charge of a fund-raising campaign can add DAFs as an option for capital giving or annual support for the charity budget. The executive director or development director can reference DAFs in ongoing communications with the targeted audiences via newsletters, illustrations, and conversations. EDs can initiate dialogue by soliciting feedback from donors to the charity regarding the use of DAFs.

SUMMARY

Generosity can change our lives for the good of others and ourselves. Generosity is the life-blood for institutions that allow them to do good work in the local and global community. There is a growing frequency in persons who have been fortunate and blessed with assets they wish to share and to benefit others. Yet, there is a reasonable air of caution in acting on that generosity. In order to maximize the efficiency and effectiveness of their generosity, the generous need to be wise. There are many channels by which generosity can be expressed and managed. Donor Advised Funds is one of those channels growing in popularity because it addresses some of the major concerns of those who wish to be generous. Donor Advised Funds could be the ideal channel for your donors and volunteers as a vehicle to promote generosity now and for generations to follow.

About the Authors

Mark Cooke is the senior partner of Heritage Financial, LLC. He has over thirty-two years of experience helping people acknowledge their spirituality in the course of living life on purpose. For the past twelve years, his ministry has been formed around the delivery of wealth management services. The earlier part of his life he served as an ordained minister on the staff of several churches in Virginia, West Virginia, and Maryland.

In each of these careers, Mark has been keenly aware of the role one's faith and values play in the pursuit of personal dreams and the application of one's resources. He practices this weaving of faith, work and enjoyment of life by serving clients, active engagement in his family and church, and professional trumpet performances for which he has earned a master's degree. He takes great delight in working with clients who want to be generous and working with local charities in their development programs.

Mark founded Heritage Financial based on his commitment to offering the highest level of service to those who appreciate quality service and trusting relationships that build over time. He is an investment advisor representative licensed with Acorn Financial Advisory Services. As president and CEO of Heritage Financial, LLC, he leads a team of dedicated investment advisor representatives and staff members to deliver services and solutions to affluent clients. Mark and his wife Cyndi, reside in Manassas, VA.

Robert Moon has extensive experience in the intersections of wealth and matters of faith. Since 2006 he has focused on helping individuals, families and businesses articulate their highest values in the decisions and management of their resources. He serves as the Chief Operations Officer at Heritage Financial and carries a full-time load of advisory clients. He is an investment advisor representative licensed with Acorn Financial Advisory Services. Prior to assisting Mark in the launching of Heritage Financial, Robert provided eleven years of executive leadership to not-for-profit organizations, and seventeen years as senior pastor to churches in Georgia, Florida, and Virginia. He holds an earned doctorate in ministry, a master in divinity, and a master in business administration. As opportunities are presented, he serves as guest pastor in area churches and presentations to local charity groups. He and his wife, Mariann, reside in Broad Run, VA.

About Heritage Financial, LLC

Heritage Financial, LLC is a partnership of three investment advisor representatives, including Mark Cooke, Robert Moon, and Dave Morton. Heritage Financial specializes in assisting affluent clients with the management of their wealth, customized according to each client's distinctive goals, values, and comfort level. Each member of the Heritage Financial team contributes a combination of experiences that help to bring clarity in the use of assets.

If you or someone you know need a consultation with a trusted advisor please contact us

Heritage Financial, LLC
7001 Heritage Village Plaza, Suite 190
Gainesville, VA 20155
Phone: 703-754-1233 Fax: 703-754-2122
Email: MCooke@HeritageFinLLC.com

www.HeritageFinLLC.com