THE WALL STREET JOURNAL.

Tax-Smart Philanthropy Made Easy

Many Donors Should Consider a 'Charitable Gift Trust' or 'Donor Advised Fund'

August 22, 2014

By
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Charitable-gift trusts can be an easy, low-cost and tax-favored way to make donations. *iStock*

What do the bull market, booming mergers and acquisitions, and possible changes to the tax laws have in common?

They all signal that it is a good time to open a charitable-gift fund—or add to one that already exists.

Also called donor-advised funds, the accounts offer charitably-minded investors an easy, low-cost and tax-favored way to manage their giving—and even to maximize it.

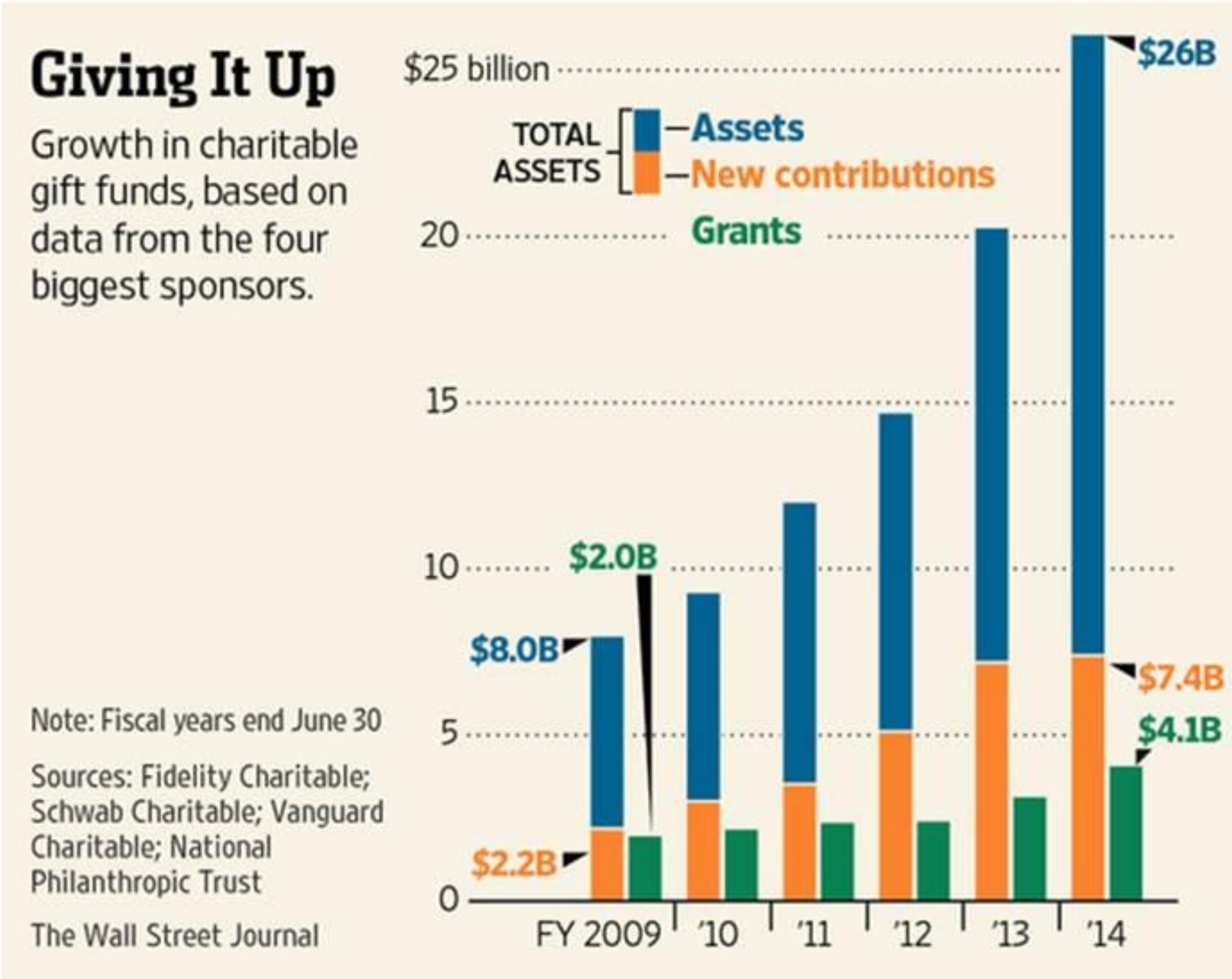
"My donations have been 10 times what they would have without this fund," says Chanchal Samanta, a tech executive who lives in the Boston area and has a six-figure charitable-gift account he started 20 years ago.

Charitable-gift funds enable investors to earmark funds for gifts and get an immediate tax deduction, while allowing them to postpone making decisions about specific recipients. Meanwhile, the money is invested and grows tax-free until it's disbursed.

While other charitable vehicles have waxed and waned, charitable-gift funds have grown in popularity ever since Fidelity Investments Chairman Edward C. "Ned" Johnson III recast an old charitable arrangement in the early 1990s. The move enabled investors whose donations range from several thousand to several hundred thousand dollars a year to reap many of the benefits of a private foundation without their high costs and hassles.

Now, more than 200,000 donors have accounts with some 2,300 sponsors of charitable-gift funds, according to the most recent survey by National Philanthropic Trust, an administrator of these funds.

Grants made from donor-advised funds still amount to less than 5% of total giving in the U.S., though such funds are by far the fastest-growing charitable vehicle. New contributions to them at the four largest sponsors, which account for half the total, rose to $7.4 billion for the fiscal year ended June 30, more than triple the amount for 2009.



Last year Fidelity Charitable's gift fund by itself ranked as the second-largest U.S. charity by contributions, after the United Way, according to the Chronicle of Philanthropy.

At Schwab Charitable, the fund affiliated with Charles Schwab Corp. SCHW +1.16% , accounts range from $5,000 to more than $800 million, and recent gifts funneled to tax-exempt charities range from $50 to more than $10 million.

For people who are charitably inclined, the advantages of donor-advised funds boil down to their ease of use, especially in capturing tax benefits.

Here is how they work: A person opens an account with a fund sponsor and makes an irrevocable gift of an asset, which can range from cash to stock to a "complex" asset such as shares of a private business or an ownership interest in a racehorse (which the Fidelity fund once accepted). Because the donor can't get the asset back, he gets an immediate tax deduction for the gift.

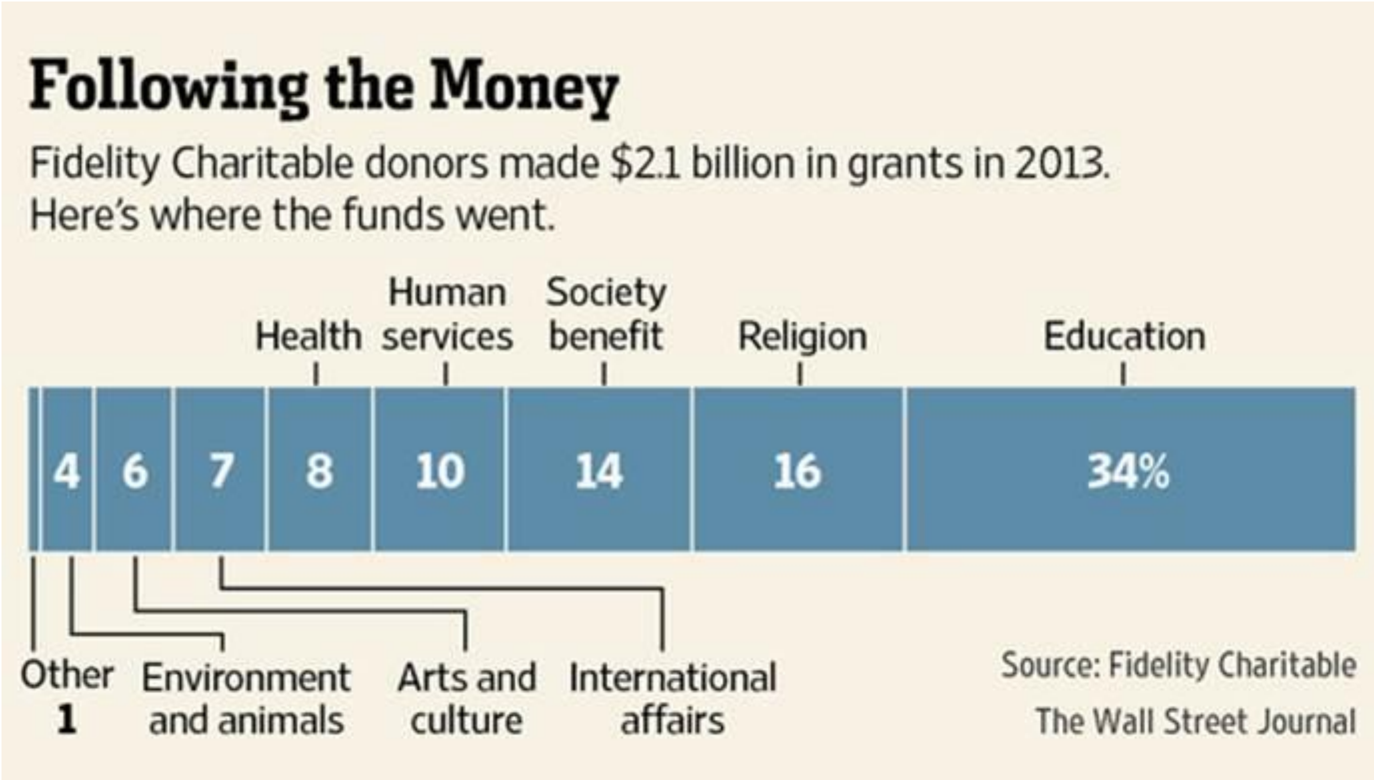
The cash or proceeds from an asset's sale go into the donor's account, where the money is invested as he directs. There it grows tax-free until the donor "recommends" (translation: designates) one or more tax-exempt charities to receive grants of specified amounts, which the sponsor sends to the groups. There isn't any additional tax deduction, even if the account has grown in value.

The ability to postpone decisions about specific gifts enables many donors to concentrate on boosting the value of their gifts with smart tax planning. One of the tax code's most generous provisions allows people who donate some types of assets that have risen in value—such as traded securities—to write off the full market value of the gift, up to certain limits, while bypassing capital-gains taxes.

Consider an investor who wants to make an annual gift of $10,000 to charity and owns 100 shares of a highly appreciated stock with a tax cost of less than $1 each and a current value of $55—as some do.

If the investor sells at the current price, he could owe tax at rates as high as 23.8% on $5,400, leaving him with about $4,100 to donate. But if he donates his shares directly to a charitable-gift fund, he can take a deduction for the full $5,500, assuming other limits don't kick in.

To be sure, this donor also could give his shares directly to his favorite charity, reap the same tax benefit and skip the account fees of a charitable-gift fund. But some groups, such as a local food pantry, might not be able to handle noncash donations. The giver also might want to pay out a single large gift over several years, or to combine one year's gift with others to make a single large donation.



Many donors to charitable funds are already aware of the tax benefit of giving appreciated assets.

Steve Peterson, a software engineer in Bloomington, Minn., set up a charitable account earlier this year to make five-figure donation of long-held shares that had a tax cost of $20 each and a current price of $44. So far, he has made only two small gifts from the fund.

Jay Tabor, a corporate lawyer based in Dallas, is more systematic with his six-figure giving account. Every year he and his wife empty it, or nearly so, and in December they refill it by donating shares of stocks that have appreciated. Right away they repurchase the stocks they favor, resetting their tax cost higher.

"We channel all our giving through this fund, and we have gotten substantial tax benefits," he says.

Messrs. Samanta, Peterson and Tabor say their accounts have been easy to work with. Mr. Peterson set up his online and was able to transfer specific lots of stock into it. It's also possible to set up recurring grants from an account and to give anonymously—which some people appreciate because it prevents a barrage of mail from charities.

In addition, people with these funds dispense with onerous paperwork, because the sponsor is responsible for getting proper acknowledgment from charities for specific grants. This is a good feature for people who tend to lose their letters from charities before tax-filing time, say experts.

If you are thinking of opening or adding to a donor-advised fund, here are other points to consider.

Consider donating before tax laws change. Tax changes are difficult to handicap, and charities are formidable advocates. But some proposals in play would curtail charitable deductions—increasing the incentives to make donations under current law. The Obama administration has several times proposed limiting the value of charitable write-offs for upper-bracket taxpayers.
The sweeping reforms proposed by outgoing House Ways & Means Committee Chairman Dave Camp (R., Mich.), which could survive his retirement, would lower the value of charitable write-offs, or deny them, for millions of taxpayers.

The plan would also allow full deductions for appreciated assets only if they are publicly traded securities, so it could make sense give other types of assets before a change.

Conversely, a different provision in Rep. Camp's plan would require assets in donor-advised funds to be distributed within five years of their contribution, though so far it has attracted little support.

Know the different types of sponsors. The sponsor is the umbrella group holding the donor-advised funds, and there are distinct types. Investors looking for a charitable-gift fund need to determine which type best suits their needs.
Among the oldest are "community" trusts or foundations, which focus on a geographic area such as a city or region. Often they work closely with local nonprofits and offer extensive hand-holding and advice to donors who want to give locally.

The fastest-growing providers are the charitable funds affiliated with financial firms such as Vanguard Group, Fidelity, Charles Schwab and T. Rowe Price Group. Typically they impose fewer restrictions on donors and may offer lower fees, but donors often have to do more of their own research.
Other donor-advised fund sponsors have a special focus. Some are universities or religious groups, such as the National Christian Foundation or the UJA. A few, such as the King Baudouin Foundation United States, concentrate on aiding groups outside the U.S.

Keep an eye on account minimums, fees and other terms. They vary widely. For purposes of comparison, the minimum to open an account is $5,000 at Fidelity and Schwab, $10,000 at T. Rowe Price and $25,000 at Vanguard.

Annual fees typically include a basic administrative fee of about 0.6% of assets, plus an investment fee that can range from 0.1% for index funds to many times that. As with other investments, fees often decrease as account size increases; a common breakpoint is $500,000.

Also determine the maximum number of grants to charities allowed each year and the minimum for grants to specific charities. For example, the latter is $50 at Fidelity and Schwab, $100 at T. Rowe Price and $500 at Vanguard.

Another issue to be considered: What assets can the sponsor accept as donations? All usually take cash and securities, but some have recently expanded their ability to take nontraded assets such as shares in a private business or even gold coins—as long as there's a clear exit strategy for the sponsor.

In addition, find out whether the account is "portable"—meaning it can be moved to another sponsor if the donor should want to. Several of the largest funds allow such moves, and they have made good on this promise.

Consider a private foundation. Although such vehicles can be burdensome and expensive to administer, they do allow donors to do things that charitable funds can't—such as hire family members, make grants to individuals (as opposed to charities) and have a greater say in investing the foundation's funds.
How many millions does it take for a private foundation to make sense? That varies, says Beth Kaufman, an estate-tax lawyer at Caplin & Drysdale in Washington, but the minimum is generally considered $5 million—some advisers say $20 million—because of the expenses involved.

"Most people giving away single-digit-million amounts choose donor-advised funds," she says.

Understand the endgame. What happens to a donor-advised fund if the person who set it up dies or becomes unable to advise it? It's a question donors need to address.
Some sponsors allow the original owner to name one or more people to make grants if the account holder is unable to, while others ask for remaining funds to revert to the sponsor's general charitable account for it to dispense. If you name a successor, be sure to communicate your wishes.

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