

Start Your Own 'Mini-Foundation' & And Save a Bundle in Taxes! (12/00)

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Do you regularly contribute more than \$3,000 to charities each year? Are you holding stocks or mutual funds that have appreciated over the past few years? If you answered 'yes' to both of these questions, you could save a substantial amount in taxes by having your own Donor Advised Fund (which we informally refer to as a 'mini-foundation').

How It Works:

- 1) You open a separate account through one of the many public charities offering this service ([see table](#)). Your Cambridge Advisor can help you with the paperwork.
- 2) You transfer stocks or mutual funds that you have held for more than a year, and preferably ones that have appreciated substantially, to this account. Note that this is an irrevocable transfer; you cannot get the stocks, mutual funds or other investments back.
- 3) You request that the fund make the contributions you would like to have made to your favorite charities, such as places of worship, universities, hospitals, museums, or any other non-profit charitable organizations meeting the requirements of IRC 501-c(3). Contributions cannot be gifted to individuals.
- 4) You can name this fund whatever you like, e.g. the "Jane and John Smith Family Charitable Foundation." All contributions will be made in the name of your foundation, with a letter from the public charity sponsoring the fund.

The Benefits:

- 1) You save capital gains tax. By transferring the appreciated stock, you avoid paying capital gains tax on the profit from the stock, while receiving a charitable deduction for the full market value of the stock at the time it is gifted. To illustrate:
 - A. You invested \$5,000 in XYZ stock five years ago, and it is now worth \$20,000. You choose to sell the stock and give the proceeds to a charity. You have to pay capital gains on the \$15,000 in profit, which would be \$3,000 plus state tax.
 - B. Instead of selling the stock, you transfer it to your 'mini-foundation'. You still get the full \$20,000 deduction, but you save the \$3,000+ in capital gains tax!
- 2) It makes it more convenient to give to multiple charities. You could, without a 'mini-foundation', gift a portion of your shares to each of your charities, but then you would have to have multiple stock certificates issued, or have each of the charities open an account at the brokerage where you hold the stock. This represents a lot of paperwork! Having a 'mini-foundation' allows you to gift the stock once, and then contribute in even small amounts to variety of charities (as long as the minimum contribution of \$250-500 required by the public charity is met).
- 3) The money left invested in your 'mini-foundation' is professionally managed by the public charity, and so it grows tax-free until it is used for contributions.

A Strategy for Retirement: If, after retirement, you plan to continue your personal philanthropy at your current level, it is astute to save the taxes now on future contributions and at the same time protect your post-retirement cash flow.

We suggest that clients start a 'mini-foundation' 2-5 years before they retire, and then aggressively fund it until it has accumulated about ten times their annual contributions. E.g. if you usually contribute \$5,000 per year to charity, during the last five years of your working career you could contribute \$15,000 in appreciated securities each year. Since \$5000 each year is gifted out, the foundation will grow at the rate of \$10,000 per year (plus investment earnings) and so will likely be worth over \$50,000 upon retirement in five years.

After retirement, assuming the fund is earning an average of 10% per year, you can continue making your customary contributions for the rest of you life without having to use any of your cash flow!

The two advantages of this strategy is that it enables you to accelerate your tax deduction for these contributions, and save more taxes now by taking the deduction when you are in a higher tax bracket.

Is, Ands, and Buts:

1) Upon your death, you can appoint another person to continue advising the fund on bequests. Upon the death of that person, however, the funds remaining are distributed to the public charity holding the funds, or to a specific charity you have designated. They cannot go to your heirs. The plus is that these assets will not be included in your estate for probate or estate tax purposes.

2) You only receive a deduction for the assets contributed to the trust; i.e. you do not get to take another charitable deduction when the fund dispenses the funds to the charity. You can, however, make additional contributions to your 'mini-foundation' over time and you do get a tax deduction for all new money contributed.

3) The 'public charity' which holds and invests the funds files all the tax returns etc. which are required of a qualified foundation. They are required to make sure that all charities contributed to are properly registered as tax-exempt charities. Thus, there can be a 4-6 week delay after requesting a contribution to a charity has not previously been investigated.

4) Technically you cannot have any control over the assets once they are gifted to the foundation, in order for you to be able to get a tax deduction. That is why they are termed "Donor Advised Funds" since you do not legally have the right to direct the contributions, but only to advise. To my knowledge, in practice, no public charity has ever refused to make a contribution as requested from a donor, as long as the charity was a bona-fide 501-c(3) organization.

5) Charitable deductions for appreciated securities held more than one year are limited to 30% of your AGI, but any unused deduction may be carried forward for five years.

6) Donor Advised Funds are a low-cost alternative to a private foundation. There is no charge for setting these up, subject to the required minimum funding ([see table](#)). The public charities which manage the funds do charge an administrative fee, which is taken out of the remaining assets, usually less than 1.0% ([see table](#)).

7) Due to space limitations, this article only highlights the advantages of Donor Advised Funds. You may want to ask your Cambridge Advisor about the benefits of alternatives such as charitable gift annuities, charitable remainder trusts, charitable lead trusts, or your own private foundation.

PUBLIC CHARITY	MINIMUM FUNDING (Initial/Additional)	MINIMUM CONTRIBUTION	EXP%	INVESTMENT OPTIONS
Schwab http://www.schwabcharitable.org/programs.html 1-800-746-6216 (M-F, 11am-8pm ET)	\$10,000/\$1,000	\$500	1.0%	Growth Money-Market Balanced
Fidelity http://www400.charitablegift.org/daf/index.shtml#gifting 1-800-682-4438	\$10,000/\$1,000	\$250	1.0%	Growth Equity Income Interest Income Money Market
Vanguard http://www.vanguardcharitable.org 1-888-383-4483	\$25,000/\$5,000	\$500	.65% - .75%	Total Equity Gift Preservation Moderate Growth Growth Pool

You may also want to check with various community foundations and other charities.

Charitable Gift Comparison

Gift Method	Description	Family Receives	Charity Receives	Limitation	Income Tax Consequence	Gift Tax Consequence	Estate Tax Consequence
Cash	Outright while giver is alive	N/A	Cash	50% of AGI, 5-yr carry forward for excess	Current deduction	Deduction	Out of taxable estate
Cash	On death from estate	N/A	Cash	None	None	None	Deduction
Capital Assets	Outright while giver is alive	N/A	Capital assets to keep or sell	50% or 30% of AGI; 5-yr carry forward for excess	Current deduction	Deduction	Out of taxable estate
Capital Assets	On death from estate	N/A	Capital assets to keep or sell	None	None	None	Deduction equal to fair market value
Outright Remainder Interest	Giver keeps income and use of property for life	Use of property for life	Property on death of giver	Personal residence or farm only	Deduction equal to value of remainder interest	Deduction	Out of taxable estate
Remainder Trust	Giver puts property in trust	Family retains income for their lives or term of years	Exclusive control of property on death of all beneficiaries to keep or sell	50% or 30% of AGI depending on type of property put in trust; 5-yr carry forward on excess	Current deduction equal to value of remainder interest	Gift to family members equal to value of their income interest	Out of taxable estate
Lead Trust	Giver puts property in trust	Property goes to family beneficiaries when trust terminates	Income from trust for giver's life or term of years	20% of AGI; 5-yr carry forward for excess	Deduction limited to first year if taken at all	Gift to family members equal to value of remainder interest they will receive	Out of taxable estate