

Weighing the options

Private Foundations and the Donor Advised Fund Alternative

Benjamin Franklin knew the value of money—and time. In 1791, he left \$5,000 to the citizens of Boston to invest for 100 years. In 1891, a portion of the appreciated assets established the Franklin Institute, with the remainder left to grow for another 100 years. In 1991, the balance of the Franklin money—by then \$5 million—was used to benefit the Boston community.

Not everyone has the vision of Ben Franklin, but many philanthropists know that a wise decision today can make a world of difference tomorrow.

What does it take to start a private foundation today? First, it takes commitment. Forming a private foundation is like having a child... giving birth is just the first step. Running a successful, mission-driven foundation requires steadfast vision, strong leadership, and hard work. Second, it takes time. While the investment of time begins with the startup, it will continue for years to come.

Third, of course, it takes money. Just how much money is a matter of debate. Theoretically, any amount is possible. But practically, many underestimate the amount needed to operate efficiently, both in terms of the charitable asset and ongoing operating costs.

Often prompted by year-end tax planning or the influence of peers, a quick decision to establish a private foundation can result in a costly and long-term responsibility. In fact, after the first year or two of operations, some private foundation founders express mild regret, saying they didn't anticipate the magnitude of demands on their time, energy, and resources.

For people like these, practical alternatives are available from the Grand Rapids Community Foundation. Following is a review of perspectives on how much money it takes for a private foundation to operate efficiently, and an overview of the Donor Advised Fund alternative.



“A \$750,000 private foundation might have made sense to me when I was practicing law. But now that I'm managing investments, I understand both the administrative costs and how large a portfolio must be to have enough asset diversification to make it work.”

*Stephanie Prem
Principal, Lowry Hill*



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Money

Gift size. How much is enough? Two hundred years ago, \$5,000 was an ample sum. More recently, \$1 million was considered a sufficient base.

But benchmarks change. Today, private foundations are subject to minimum payout rules... something Benjamin Franklin didn't have to contend with. Legally, a private foundation must pay out five percent of its total assets each year. Ideally, it distributes most of the money to deserving nonprofit organizations. But it can also spend hefty amounts on operations—investigating potential grants, measuring results of grantmaking, paying qualified staff, and just keeping the lights on at the office.

In most cases, these expenses contribute to the effectiveness of a foundation's grantmaking. But for a small foundation, the time and expenses invested may be out of sync with the dollars actually reaching charities. Unless much of the work is done by a volunteer founder, some experts say it takes a charitable gift of about \$5 million to establish and operate a private foundation efficiently.

Operating efficiency. In the world of private foundations, bigger is usually more efficient. First, the most basic level of administrative support is essentially a fixed cost, as are financial and legal services. Regardless of the asset size, few private foundations can operate without minimal administrative services. Sometimes this is provided pro bono by the founder, eliminating the expense from the foundation's balance sheet. In other circumstances, however, the foundation must pay for staff or professional services to handle administrative, financial, and legal work.

Second, the greater the asset, the greater the opportunity to actively manage a diversified portfolio of individual stocks. Given market performance in recent years, most investment experts continue touting the value and necessity of diversification across classes.

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Consider the potential expenses for a \$1 million foundation that wishes to preserve an endowment and pay out 5 percent of net assets:

A larger foundation can operate more efficiently. Assuming incrementally higher administrative costs, consider the potential expenses for a \$10 million foundation:

| EXAMPLE ONE | | |
|--|-----------|--------------------|
| Endowment | | \$1 million |
| Total payout | 5% | \$50,000 |
| Operating expenses | | \$15,000 |
| Available for grantmaking <i>(30% of payout for expenses)</i> | | \$35,000 |

| EXAMPLE TWO | | |
|--|-----------|---------------------|
| Endowment | | \$10 million |
| Total payout | 5% | \$500,000 |
| Operating expenses | | \$100,000 |
| Available for grantmaking <i>(20% of payout for expenses)</i> | | \$400,000 |



Recommended asset size for efficient and effective operations

Private Foundation
\$5 million or more

Donor Advised Fund
\$50,000 or more

In these examples, operating expenses for grantmaking consume a significant portion of the total payout. Increasing the payout for grantmaking is an option, but this would erode the endowment and many private foundations are concerned with preserving principal and generating asset growth.

The Donor Advised Fund Alternative

For those who want to give, but are not comfortable with the demands of a private foundation, a Donor Advised Fund with the Grand Rapids Community Foundation is a practical alternative.

Over the past 15 years, Donor Advised Funds have grown in popularity as a preferred giving vehicle. Donor Advised Funds are highly efficient because administration and investment are pooled with those of other funds at the Community Foundation. The donor can make grant recommendations for approval by the organization’s board of trustees. Contributions to Donor Advised Funds are eligible for a deduction of up to 50 percent of adjusted gross income for gifts of cash, 30 percent for gifts of appreciated stock, and 30 percent for gifts of real estate and closely held stocks. The percentages for a private foundation are 30/20/20, respectively.

Grants are issued in the name the donor chooses for his/her fund (or anonymously). A Community Foundation Donor Adviser can take advantage of information about local needs and opportunities—and even include his/her family or business in recommending grants. It is a simple, personal, highly effective way to give.

| | Direct Gift | Donor Advised Fund | Private Foundation |
|------------------------------------|--|--|---|
| <i>Items to consider</i> | | | |
| Involvement and control | You give a gift directly to a nonprofit organization. Control is limited to initial gift decision. | You give to a public charity—e.g., a community foundation. You recommend grants to qualified nonprofit groups, subject to approval by the public charity’s board of directors. | You appoint a board, which controls investments and grantmaking. |
| Tax status | N/A | Public charity | Private charity |
| Tax deductions | Vary, depending on the status of the recipient organizations. | Up to 50% on cash, up to 30% on appreciated stock, up to 30% on real estate and closely held stock. | Up to 30% on cash, up to 20% on appreciated stock, up to 20% on real estate and closely held stock. |
| Grantmaking support | Your decision is based on your own research and intuition. | In the case of a community foundation gift, professional staff is available to help identify and assess grantees, provide input on community needs, and verify nonprofit status. | You must arrange and support your own grantmaking and monitoring structure. Some community foundations offer grantmaking services to private foundations. |
| Startup costs | N/A | None | Several thousand dollars for legal and accounting expenses and filing fees. |
| Effective/minimum gift size | Any gift size is appropriate. | \$50,000—Legacy Donor Advised Fund (100% endowed) \$250,000—Dynamic Donor Advised Fund (partially endowed) | \$5 million |
| Administrative requirements | You are responsible for tax reporting and recordkeeping. | Administration is pooled and an annual fee is charged. Community foundation handles reporting. | Several thousand dollars for legal and accounting expenses and filing fees. Annual 990 tax form must be filed. |

Today’s high net worth individuals share a lot in common with their predecessors. They want to give. They want to start a legacy. And they want a good value. Private foundations and Donor Advised Funds are attractive giving options—but no one of these options is right for every donor.

From a Private Foundation to a Community Foundation Donor Advised Fund

Wanting to be good stewards of the many gifts bestowed upon them, Arvin and Pearl Tap established a private family foundation. For many years, the couple received great pleasure in supporting specific faith-based organizations. Through their foundation, they could see direct impact on young people at Potter's House, a Christian school they passionately champion.

The Taps soon discovered, however, that administering a private foundation takes time and effort, perhaps more than they wanted to provide at this place in their lives. "The administration of the foundation became burdensome. We're trying to simplify our lives, but wanted to continue with our giving," Arvin said.

The couple's CPA, Bob Schellenberg from Schellenberg and Evers, PC, suggested several reasons for the Taps to consider transferring their private foundation assets to a Donor Advised Fund at the Grand Rapids Community Foundation. He said the Community Foundation has a solid reputation, manages investments well, helps donors find charitable needs that fit their beliefs and frees them from paperwork and form filing.

"The Community Foundation is, above all, objective and impartial about the wishes of a donor, whether conservative or liberal. It is unbiased about meeting the donor's wishes," Schellenberg said.

As the Taps and other families have discovered, other reasons to choose a Donor Advised Fund over a private family foundation include:

- Investments have potential to grow tax free, allowing donors to make additional contributions over time.
- Donors have access to the Community Foundation's professional grant making staff.

- Contributions to a Donor Advised Fund are immediately tax deductible and receive more advantageous tax treatment.
- Recordkeeping is simplified.



- Individuals can avoid incurring capital gains tax by donating appreciated securities directly to the fund.
- There is no required five percent fund distribution.
- Grants can be anonymous.

Terminating their private foundation wasn't complicated. The Community Foundation's development staff worked with the Taps' professional advisors, Ron David and Schellenberg, to transfer assets from the private foundation to the Donor Advised Fund. The couple used shares of Fastco Industries stock to increase the value of their fund.

Through the Arvin L. and Pearl M. Tap Fund at the Grand Rapids Community Foundation, the couple will be able to make gifts to organizations they care about throughout their lifetime. The Tap Fund will provide support in perpetuity to their favorite cause: education.

"We care most about our church and Christian education," said Pearl. "The long-term aspects of the fund are attractive and we hope to have our children involved with it one day," Arvin added.

"God called us to be good stewards of what we've been given. The gifts (we have) can be a blessing or a curse, and it depends on what you do with those gifts. For us it has been a blessing. We've seen the effect of education on students, and that is truly rewarding," Arvin said.

To learn more about the benefits of establishing a Donor Advised Fund, please contact a member of the Community Foundation's development staff at 616.454.1751.



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