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On Watch

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Foundation or Donor Advised Fund:

Which is Right for You?

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Private foundations (PFs) have been a long-favored charitable vehicle for philanthropic families. Indeed, having one of your own gives a sort of caché to the family. However, donor advised funds (DAFs), a relative newcomer to the charitable scene, are increasingly gaining traction. According to The National Philanthropic Trust, PFs held $614 billion in assets in 2013, up 5.7% from 2012. DAFs held $53 billion in 2013, but that represented a 20% increase from the prior year. Those numbers and relative growth rates may allude to significant differences that you should consider in determining which may be best for your needs.

Story continued inside.

At their cores, both PFs and DAFs allow an individual to set aside money or other assets to get a current tax savings (income tax for lifetime contributions or estate tax for testamentary bequests), but delay the decisions as to which charities or causes ultimately benefit from those funds. The ability to be involved in subsequent decisions about disposition of the money allows the family to use the structure to help develop family members' philanthropic interests and skills.

The distinctions between the two structures are substantially driven by the tax law. Since DAFs are public charities, contributions to them are most highly incentivized and the organizations are subject to fewer restrictions. Although PFs are charitable entities, they are much more highly regulated. The chart below illustrates some of the differences.

Cost and Set Up

A DAF is simply a recordkeeping account within a public charity. DAFs are sponsored by many community foundations, large national charities and investment organizations (like Fidelity Investments and Vanguard). There is no cost to set up your DAF and the sponsoring organization bears the ongoing administrative hassles and costs. Grant making can be as simple as a few clicks on a webpage.

On the other hand, setting up a private foundation requires substantial up-front costs for legal and accounting fees. Ongoing recordkeeping and tax return filing costs are significant. Many advisors suggest that these costs, combined with the hassle factor, require a minimum of perhaps a $1 million contribution (and ongoing balance) to justify creating a foundation.

PFs must distribute at least 5% of their net asset value for charitable purposes annually. Some families have trouble complying with this annual commitment. There is a 1% excise tax on investment income and potentially substantial excise taxes on any business or "debt-financed" income, which may arise unintentionally if the PF invests in hedge funds, publicly traded master limited partnerships or other "pass-through entities" like partnerships or limited liability companies. DAFs don't have these requirements or taxes.

Private Foundation vs. Donor Advised Fund

	PF	DAF
Limitation on deduction for cash contribution	30% of adjusted gross income (AGI)	50% of AGI
Limitation on deduction for marketable securities contributions	20% of AGI	30% of AGI
Excise tax on investment income	1%	None
Transactions between fund and donor (and other related persons)	Generally prohibited and subject to potentially confiscatory excise taxes	Generally not regulated
Ownership of closely held business interests	Generally prohibited and subject to potentially confiscatory excise taxes	Generally not regulated
Required annual distribution for charitable purposes	5% of net asset value	None

Control

A major advantage of a PF is the level of control that can be given to the family, both currently and in perpetuity. Organizational documents specify the process for selecting future leaders (e.g., trustees, directors, officers, etc.) and all may be family members. As such, the family can exercise complete control over investment and grant making decisions. However, there are major constraints on using PFs to directly or indirectly benefit donors, their families and employees, and other "prohibited parties." Investments in family enterprises or with family members generally are strictly limited.

DAFs technically are not controlled by the donor or family members. Instead, the donor makes grant "recommendations," which must be approved by the sponsor's governing board. As a practical matter, it is highly unlikely that a recommended grant will be denied. The sponsor organization won't risk the damage to its reputation and future fund-raising ability if word gets out. However, some DAFs restrict the type or geographical area of acceptable charities, so ask before opening an account.

The DAF typically offers only a limited menu of investment options for your fund, although you usually get to choose and change your selections periodically. PFs are not restricted in their investment options or selection of managers (although caution is required for the above prohibitions and excise taxes).

Most importantly, there is no limit on the life of a private foundation, while most sponsor organizations limit the time period of a family's control over their DAF – often to only one or two generations.

Privacy

Private foundations are not "private." The foundation must file an annual tax return which includes information on grants made, salaries, fees and expenses, and balance sheet information. These filings are public and are available online. The filings are a great resource of information for fund raisers and others seeking information about the controlling family.

DAFs publish no information about their contributors or their grant requests. You have the choice of being recognized for specific grants from your fund or you may remain totally anonymous.

Legacy

Many wealthy families view philanthropy as a mechanism to build moral and social values and, perhaps, investment skills. A charitable legacy can be a focal point of family pride and community recognition. However, the charitable structure (formalistic for a PF or informal for a DAF) is, at most, peripherally relevant to these goals. Rather, it is how the structure is used and how family members interact with it that will accomplish or defeat those goals. However, the sponsoring organization's constraints on the duration of your DAF could be a disadvantage over the perpetual nature of a PF if you want a legacy lasting many generations.

Although donor advised funds offer a clear advantage in terms of avoiding cost and complexity, private foundations provide somewhat greater control, potentially for many more generations. Both can be used as focal points for a family's philanthropy and development of moral and social values.

Which is best for you and your family?

The answer might not be one or the other. Some families use both structures, perhaps with the PF distributing money to multiple DAFs, which in turn are "managed" by different family members. Talk with your advisors to determine the approach that will best accomplish your near and long term objectives.

Teaching My Children About Money

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President

Teaching young kids how to spend, save, give charitably, and live within their means is a daunting task. In an attempt to get my six and seven year olds thinking more critically about earning it, saving it, growing it, sharing it and spending it, we started giving them allowances over the summer. Here is what happened ...

My spouse and I agreed on the following rules of engagement:

- At this age (6-12 years), children really have no way of dealing with complex decisions to allocate funds. So, we decided to give them each three dollars per week to be divided equally into save, spend and give accounts.
- This prescribed division of funds would apply to all money - even windfalls (like birthday checks from Gramma).
- The allowance was a tool to learn about money, not a tool for behavioral control. Accordingly, they would receive it regardless of chores rendered or temper tantrums thrown.

We're more than six months into it and, while it hasn't been a totally smooth process, we've had overall good results. Their ability to count money has sky-rocketed because, it seems, I never have correct change. They have begun to understand the concept of interest because, it seems, I have been late a few times in making their allowance "deposits" and they have inquired as to how much my tardiness should cost me.

Delayed Gratification

The kids have tussled with delayed gratification – waiting to buy the better, less expensive NERF™ gun online instead of in the store. This was a real struggle for my son as he watched his sister buy her toy, in-store, same-day, but he succeeded. They are wrapping their minds around resource allocation. Recently, while shopping, my son asked for silly string but when he realized it was his to buy he decided against it, preferring instead to "save up and buy something big."

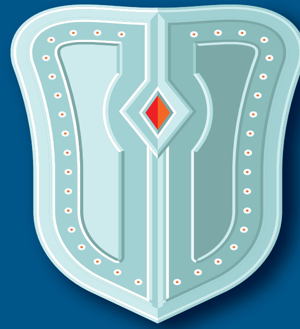
One day, we took a family field trip to the bank, opened savings accounts and peeked in the vault. I am unclear whether they understand that all of their money isn't held in a safe deposit box, but we'll leave the details of the monetary system for another day.

Dogs and Cats

They chose to donate their charitable funds to a local animal shelter. I have to say this was one of my favorite days as a parent – they were incredibly proud to shove $12 in coins and small bills into a Plexiglas donation box and spend the rest of the morning playing with the animals whom they had just helped. We are lucky we didn't come home with a fourth cat!

All-in-all, "the allowance project" as it has come to be known, has been a good one that, unlike previous endeavors, we haven't abandoned. I can imagine a day when three dollars per week will not be sufficient. Perhaps that will be when we seriously explore work ethic. As they enter their teen years, they might want more independence as it relates to fund allocation. I'm not at all sure when we will delve into the intricacies of the banking system and sophisticated investing. For now, however, the allowance project has been an excellent platform to address the responsibilities and privileges of money.

Protecting Yourself Online



Clients often ask, “What steps can I take to protect my personal information online?” The news flow about corporate data breaches, private email and photo account intrusions, and social media fraud causes us all to be nervous about our online security. Fortunately, there are some simple steps you can take to make your digital information more secure.

1 Use a Passcode on Your Cell Phone

A staggering amount of our personal information is commonly stored on our cell phones. If you don’t have a pin or swipe passcode on your cell phone, you should immediately create one. It is worth the effort when you consider what someone could access if you forgot your phone at a restaurant or on a plane. Many people have their personal or work email accounts, shopping and banking applications, and photos and other digital keepsakes on their phones. This easy step makes your digital data much less vulnerable.

2 Install Anti-Virus Software on Your Mobile Devices

Most people use anti-virus software on their desktop computers; however, mobile devices, including cell phones and tablets, are often overlooked. Cyber criminals are increasingly exploiting this weakness. Fortunately, there is a burgeoning industry of security software providers for mobile devices. Two popular programs for Android or Apple operating systems are Lookout (owned by a private company) and 360 Security (NYSE: QIHU). These programs offer basic protection for free. In addition to constantly scanning for viruses, they allow you to disable and locate your device if it is lost or stolen.

3 Create Passwords That Are Difficult to Crack

The longer your password is, the more difficult it is to hack. An easy way to form a long password is to create a memorable phrase or sentence. For example, you could use a child’s name and birth month, such as “JohnWasBornInJanuary2015.” Since it is recommended that we use a different password for each device and website, you could vary the password based on the first letter of the website name. For example, using the password above, you might use “GJohnWasBornInJanuary2015G” for Gmail or “CJohnWasBorninJanuary2015C” for Chase. Even better, use a “password manager,” which is a program that remembers your passwords for websites and inputs them after verifying that you are the authorized user. Examples include LastPass, RoboForm and Norton Identity Safe. They can create virtually unbreakable passwords and remember them for you. You just remember one password (hopefully a complex one) to launch the program.

4 Don’t Trust Public WiFi

Free WiFi is ubiquitous in the United States. Restaurants, hotels, airports, stadiums and stores commonly provide this service. These networks are frequently unsecured and any data you send is unencrypted and easily intercepted by criminals. You should only connect your computer or cell phone to internet networks you trust. You preferably should use small networks that are password protected. Never send personal information over networks you don’t trust.

5 Do Not Overshare on Social Media

In addition to using strict privacy controls on your social media accounts, it is advisable to avoid providing personal information that criminals can use to your detriment. For example, never publish information on social media that a hacker could use to reverse engineer your website passwords. For example, many websites ask you what city you graduated high school or where you were born as security questions to recover a forgotten password. Upon resetting your password using this information from your social media, a bad actor can access your private data. Avoid providing sensitive information like this on social media or other online platforms.

These suggestions, combined with a little common sense, represent some of the simplest actions that provide an immediate benefit to your privacy.

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Sentinel Trust Company provides custom integrated planning, investment, fiduciary and administrative solutions to affluent families and their closely held businesses and entities.

Founded in 1997 as the successor to two 40-year old, investment-focused family offices, today Sentinel offers the stability of an institutional firm, the entrepreneurial spirit of a young firm, the personal feel of a family office and the in-house technical skills of independent planning and investment management firms.

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