Can I Really Do *That* with a Donor-Advised Fund?

Creative Uses of DAFs for Planning &

the Impact of Proposed Tax Law Changes

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Overview of Donor Advised Funds

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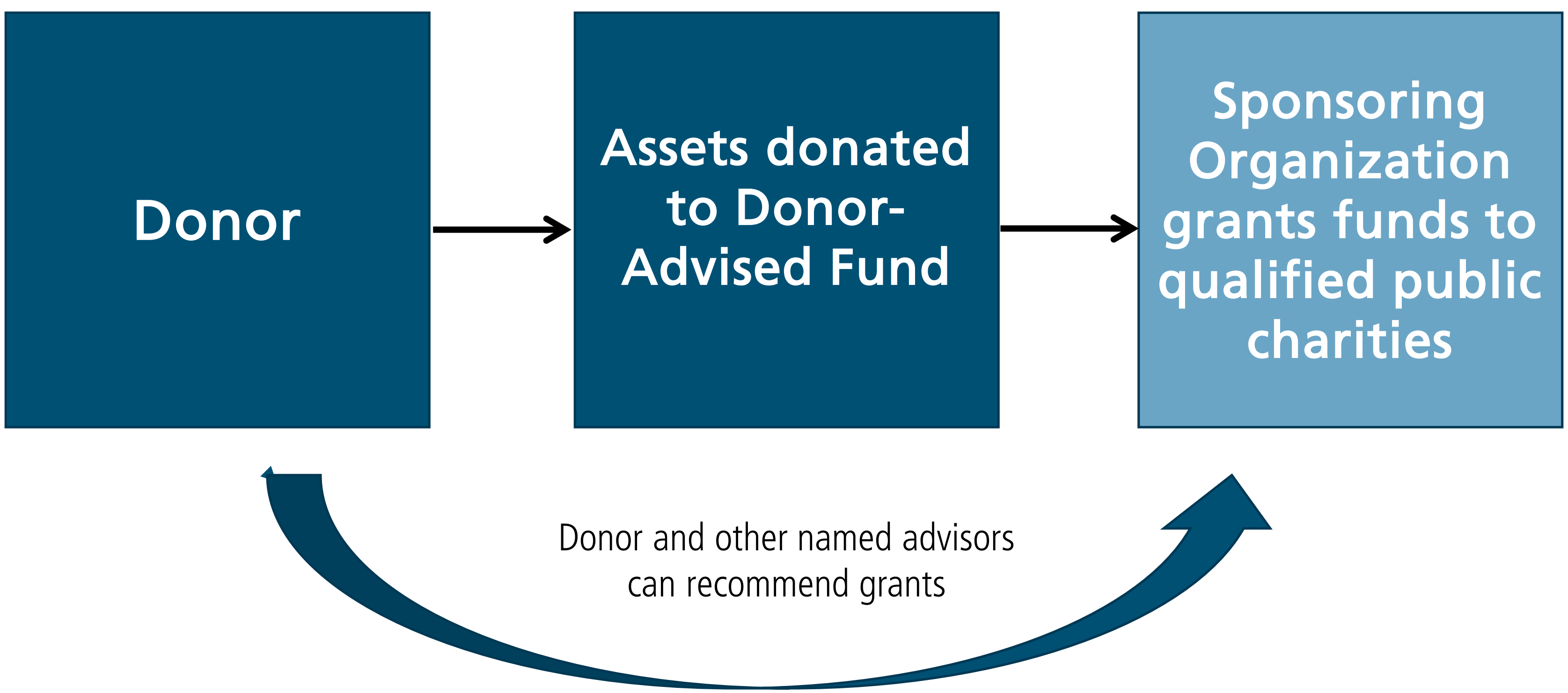
Donor Advised Fund Overview

What is a DAF?

- A charitable account within a pre-existing public charity called a sponsoring organization. A sponsoring organization may be connected to a community foundation, a financial institution, or another public charity such as a church or a university.
- Donor has advisory privileges to recommend grants and can name additional advisors, such as younger family members to encourage their participation.
- Once a contribution is made to a DAF, the gift is complete and the donor receives an immediate income tax charitable deduction. For deductibility purposes, DAFs are considered public charities.
- Donor gives up all legal control of the funds and can only serve as an **advisor**, the sponsoring organization holds all authority with respect to final grant making decisions.
- No required annual distributions (for now) or tax return.
- Fund name may include "Foundation" and may omit family name to protect privacy.

How Does a Donor-Advised Fund Work?

Donor receives immediate tax deduction subject to AGI limits for gifts to a public charity (see slide 10).



Donor Advised Fund Overview

Advantages of DAFs

- Allow for greatest deductibility (FMV) of cash, stock and real estate.
- Can easily convert contributed stock or alternative assets to cash before granting to your favorite charity, simplifying gift acceptance for the charity, while avoiding capital gains tax.
- For stocks donor wants to keep in a personal portfolio, consider a “charitable swap:” donating low basis stock to a DAF and immediately using other cash to buy the same stock at a higher basis.
- Some DAFs are perpetual – they allow donors to name unlimited successor advisors, creating a more flexible alternative to community foundation DAF platforms.
- Contributions to charity through a DAF can be made anonymously.
- Trend is for donors to open DAFs alongside their private foundations to achieve various goals, and provide greater flexibility for donating certain assets and offering anonymity in grantmaking (more on this in next section).

A Word of Caution about Donor-Advised Funds

DAFs are not all created equal!

- Community Foundations, while usually well-connected to the nonprofit communities they serve, often have undesirable provisions in their agreements with donors:
    - Layered fees
    - Limitations on naming successor advisors
    - Unused funds may roll over to the Community Foundation's general fund
    - Limited amount of philanthropic support (usually for additional fee)
    - Limited (or no) control over choice of investments

- Institutional DAF platforms
    - While they may have excellent online capabilities and low fees, service is minimal and designated advisors rare

Why Whittier's DAF is Better for our Clients

We built our DAF platform to do more for our high net worth clients than any other. As far as we know it is unique in the industry.

Our flexible platform allows clients to:

- Name unlimited successor advisors
- Use customized grant agreements
- Rely on meticulous attention to accuracy
- Hold alternative assets such as private equity and real estate (for 3-5 years and must be marketable, unencumbered and an undivided interest)
- Access all of our administrative services available to foundations
- Establish the fund in a matter of days with minimal paperwork
- Pay less in fees than most community foundations or institutional DAF platforms charge (standard fee is 100 bps)
- As always, there are no hidden fees; our quoted fee covers asset management, administration and access to our philanthropic services.

Grant Payout for Donor-Advised Funds

	2017	2018	2019
National DAF sponsoring organizations	23.0%	22.6%	24.2%
Community Foundations	19.8%	16.2%	16.4%
Single Issue Charities	29.7%	29.4%	28.8%

Source: National Philanthropic Trust – 2020 Donor-Advised Fund Report

Is a DAF right for me?

	Private Foundation	DAF
IRS Classification	501c3 Private Foundation	A fund or account established for charitable contributions that is owned and controlled by a sponsoring organization (a large public charity, and allows donors advisory privileges
Required tax filings	990-PF (disclosure required), state returns, AG and/or Sec of State filings	None
Required Annual Distributions	5% of average asset value (less 1.5% cash reserve & expenses)	None
Required Compliance	Directors/trustees, annual meeting, minutes, bylaws, possible audit	None
Deductibility Limits: 1. Cash 2. Publicly traded securities (long term) 3. Private securities, real estate	1. 30% AGI 2. FMV up to 20% AGI 3. Cost basis up to 20% AGI	1. 60% AGI 2. FMV up to 30% AGI 3. FMV up to 30% AGI
Ability to grant to other than public charity or pay stipend or expenses for board service	Yes	No
Ability to influence investments?	Yes	Maybe
Subject to excise tax?	Yes, 1.39% of investment income	No
Can modify structure?	Yes	No

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Pros & Cons of DAFs

Why Choose A DAF?	Why NOT Choose A DAF?
Donor plans to fund initially with a relatively small amount.	Donor gives up ultimate control of grant making and perhaps investment management decisions.
Simplicity is desired (fewer administrative responsibilities).	Fund may not be allowed to last in perpetuity with named successors.
Donor seeks lowest overhead cost for charitable giving vehicle.	Fund may have restrictions on accepting and/or holding certain asset classes (read the fine print!).
Donor wants highest available tax deduction for contributions.	Funds can only go to other public charities (which includes private operating foundations).
Donor plans to gift non-publicly traded assets or real estate.	Cannot employ or compensate family members.
Donor wants privacy related to grant making.	Cannot pay vendors or any other non-charitable organizations other than supporting organization for administration.
Donor is not yet sure of what organization(s) to fund, or who should be involved in grant making.	
Donor is major supporter of an organization and is worried about tipping rule (*careful with this one).	
Donor wants fund set up as quickly as possible.	

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Creative Uses of Donor Advised Funds

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Creative Uses for a DAF

Pairing a DAF with a Foundation (for now)

- Eliminate the stress of hitting the 5% payout.
- Provide a pressure relief valve for warring family factions

  (allow for anonymous grants or those that don't align with foundation's mission)
- Avoid "tipping" your favorite charities (at least for now)
- Simple way to train younger family members about grantmaking before "graduating" to Foundation board service
- Provide a tax-preferred option to receive gifts of appreciated assets and real estate (FMV deduction for gift to DAF, rather than cost basis for a foundation, and up to 30% of AGI, rather than 20% of AGI for foundation).
- Pooled funds allow for collaborative grantmaking and attract other donors to the cause

Creative Uses for a DAF: Pairing with a CRT

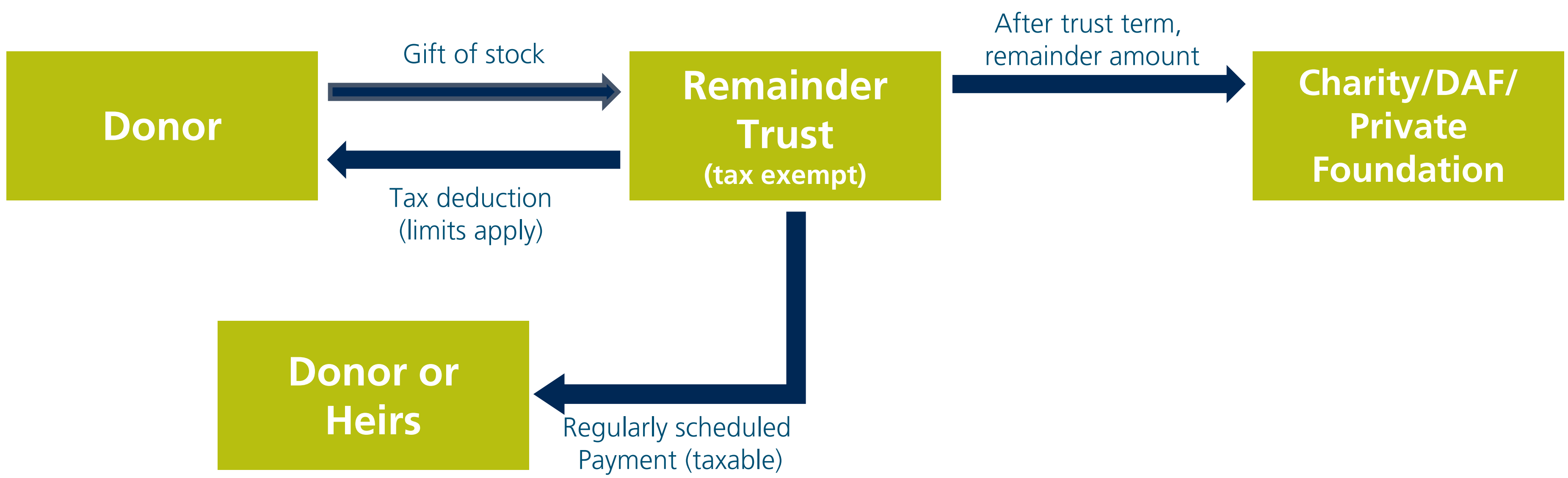
What is a Charitable Remainder Trust?

- An irrevocable agreement in which a donor transfers assets to a tax-exempt trust in exchange for an income interest. A public charity or private foundation receives the remainder interest after a term of years or life of the donor/spouse. Income can be paid to any individual, corporation or trust.

Clients are realizing that designating their own DAF as the remainder beneficiary, rather than an operating charity, has some distinct advantages.

Creative Uses for a DAF: How do CRTs Work?

- You or your heirs receive an **income stream** for the rest of your life or a term of up to 20 years
- Potential income, estate and gift tax and capital gains tax advantages (*may be changing*)
- The balance, or "remainder interest," is paid to one or more designated charitable beneficiaries at the end of the trust term



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Creative Uses for a DAF: Pairing with a CRT

Benefits to **Clients** of Naming a DAF as remainder beneficiary

- Client retains more control – if the remainder interest passes directly to a charity, there is no ability to change course if desired. Naming a DAF as charitable beneficiary allows the donor to retain advisory rights. S/he can restrict the flow of funds to the charity over time and even stop distributions altogether if desired.

- Client retains flexibility – with a DAF, donor is not locked into a single charity as beneficiary and can even change from one charity to another.

- Client can involve future generations – children and grandchildren can enjoy the ability to advise on donations for years to come.

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Benefits to Clients' **Charities** of Using a DAF

- Supported charities can receive stable funding over time. If funds are received as one lump sum, it can jeopardize their public charity status, may need to be professionally managed at a high cost
- Holding the funds in a DAF and releasing to the charity over time gives the organization the benefit of professional investment of the funds paid for by the DAF and protects the organization from potential creditors
- Charities are incentivized to stay connected with the family over time
- Repeat funding can be used as matching/challenge gifts, which enables the charities to leverage the funds they receive to attract additional funding from other sources

Creative Uses for a DAF: Contributions of S-Corp Shares

Clients with S-Corp shares who are looking to sell their interests and shelter the gain from taxes might consider contributing those shares to a DAF.

- On the one hand: DAFs are a better choice than private foundations (which are subject to excess business holdings rules) and CRTs (which are not qualified shareholders and will defeat the S-Corp election).

- On the other hand: There is no escaping the tax hit. (1) Income tax deduction is less than FMV because deduction is reduced by ordinary income that would have been realized from a sale. (2) Capital gains must still be paid when S-Corp shares are sold inside a DAF. And (3) A DAF must also pay unrelated business income tax (UBIT) on ALL S-Corp share income, even passive investment income.

Creative Uses for a DAF: S-Corp Shares

Creative Solution # 1:

- Consider putting S-Corp shares into an LLC and donating the LLC interests to the DAF as a means of avoiding UBIT.

Creative Solution # 2:

- Sell the S-Corp shares first, pay the capital gains tax, then donate the remaining proceeds to a DAF for a full FMV deduction. CPA should do the math to see if it makes sense.

Creative Solution # 3:

- Donate the S-Corp shares to the DAF, which holds it for a year or so (paying UBIT). The company then converts to a C-Corp and the DAF sells the shares for no recognized capital gain.

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Creative Uses for a DAF: S-Corp Shares

Creative Solution # 4:

- Assuming a sale to a C-Corp, construct a stock swap where the donor gets C-Corp shares for his S-Corp shares, then donates the C-Corp stock to the DAF for a full FMV deduction.

Creative Solution # 5:

- Company could convert to a C-Corp prior to the sale, IF all shareholders agree. RISKY: (a) There can be no sale contract in place at time of conversion. If the IRS concludes that the conversion was only effectuated to avoid paying gain on the sale it will defeat the deduction. However, (b) If the company converts but no sale takes place, then shareholders are stuck paying the higher C-Corp tax rate for the full 5-year waiting period before they can convert back to S-Corp.

Creative Uses for a DAF: S-Corp Shares

Creative Solution # 6:

- Donor contributes S-Corp assets rather than stock.

Creative Solution # 7:

- If S-Corp shares must be donated, then establish a Type I support organization structured as a charitable trust and have the S-Corp shares flow into the trust. The trust, which pays long term capital gains tax at the lower 20% rate, rather than the higher 35% corporate rate, sells the shares and contributes the proceeds to the DAF. Then the trust gets a tax deduction to offset its UBIT obligations. And the trust isn't subject to the excess business holdings tax.

Summary of Proposed Tax Law Changes

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Impact of Proposed Legislation on Donor-Advised Funds

The proposed legislation would establish three new categories of DAFs, each with its own rules concerning the deductibility of contributions:

1. **Qualified DAFs**
2. **Qualified Community Foundation DAFs**
3. **Nonqualified DAF**

If the ACE Act becomes law, it would be effective as of January 1, 2022.

Qualified DAFs

A Qualified DAF would be created with a fund agreement providing that advisory privileges to recommend distributions to charities would end before the last day of the 14th tax year beginning after the year in which the contribution is made.

The DAF sponsor would be subject to a 50% excise tax on contributions into the DAF (along with associated earnings) after 15 years, with a 6-month grace period.

The ACE Act would impose expanded requirements for the contemporaneous written acknowledgement (CWA) to be issued to the donor.

Non-publicly traded assets will be treated differently than publicly traded ones. No charitable deduction would be allowed of assets other than cash or marketable securities until those assets are sold by the DAF sponsor.

Qualified Community Foundation DAFs

This type of DAF would need to be organized and operated to serve the needs of a particular geographic community no larger than four states.

At least 25% of the assets would need to consist of assets other than DAF assets.

Would generally need to hold less than $1 Million in assets.

5% of the fund's value much be distributed annually.

Same deductibility rules as a Qualified DAF with same CWA requirements.

Nonqualified DAF

Nonqualified DAF = any DAF that is not a Qualified DAF or a Qualified Community Foundation DAF.

No charitable income tax deduction would be allowed until (1) the property is sold for cash and (2) the sponsoring organization makes a qualifying distribution to a charity. The donor's deduction is equal to the amount of the charitable distribution.

Distributions treated as made from contributions using first-in/first out accounting.

The DAF sponsor would be subject to a 50% excise tax on contributions into the DAF (along with associated earnings) after 50 years, with a 6-month grace period.

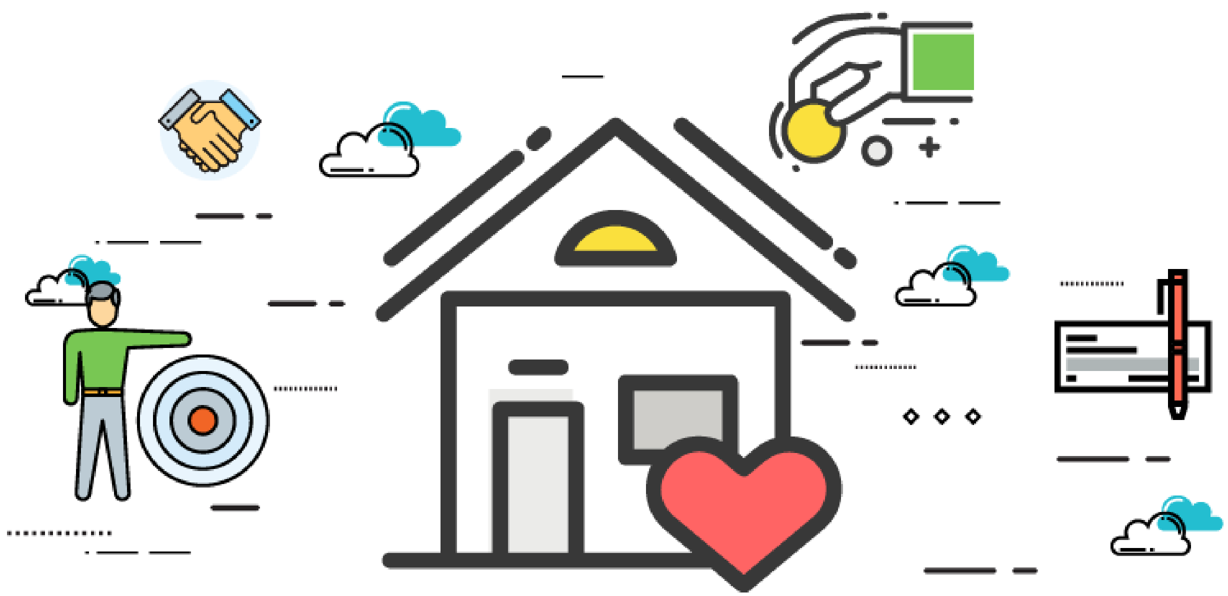
Sponsors of Nonqualified DAFs would be subject to more complex CWA requirements

The Public Support Test

The current Public Support test requires that the organization receive more than one-third of its support from contributions from the general public and/or from gross receipts from activities related to its tax-exempt purposes.

The ACE Act would subject grants from a DAF sponsor to a charitable organization to a 2% limitation.

The ACE Act provision would aggregate grants from the X Fund with contributions by Mr. X, within a single 2% limitation, meaning that none of the DAF grant funds may be counted toward the Agency’s public support test.



Estate Tax Changes in 2025

Today, the lifetime exemption for gifts and estates is the highest it has ever been — $11.7 million for individuals and $23.4 million for married couples.

In 2025, the increased exemption amounts provided under the Tax Cuts and Jobs Act are set to expire and revert to previous levels ($5 million, indexed for inflation).

The Washington State estate tax exemption remains at $2,193,000 per individual in 2021.

One of the easiest ways to reduce your taxable estate is to maximize the annual exclusion limit, currently $15,000 a year per gift to an individual or trust.

Another is to donate cash and/or appreciated assets to charity.

Superfund 529 plans for children and grandchildren for 5 years of contributions at one time. ($75,000 for a single donor or $150,000 for a married donor)

The CARES Act

For individuals who are charitably inclined, the CARES Act makes qualifying contributions in 2021 deductible up to 100% of Adjusted Gross Income (AGI), which can be carried over for up to five years. This is a meaningful temporary increase over the traditional limit of 60% of AGI for cash contributions to public charities. Gifts to Donor Designated Funds are fully qualified.

Cash is donated to a Whittier Trust Designated Fund.

Qualifying gifts made before 12/31/21 are deductible up to 100% of AGI and may be carried over for up to five years.

Cash is invested in a custom portfolio, managed by Whittier Trust.

One charity is named by donor as beneficiary of the fund.

Donor, or named advisors, requests the amount and frequency of distributions to the charity.

One designated charity per fund. Multiple funds can be set up for multiple charities.

Unlimited Successor Advisors may be appointed by donor to advise distributions after s/he is no longer able.

Thank you!

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BIOGRAPHIES

Pegine E. Grayson

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Pegine is a Senior Vice President in Whittier Trust's Philanthropic Services department, providing philanthropic advisement to our high net worth clients and management services for their foundations and donor-advised funds. Pegine advises clients on issues such as formalizing their philanthropy, strategic grantmaking and involving the next generation in charitable giving. She also provides turn-key, comprehensive foundation and DAF management services, shouldering all of the administrative responsibilities so clients can simply experience the joy of giving and the positive impact it has on their families.

Pegine brings a wealth of experience to Whittier Trust as an attorney in both private practice and nonprofit legal services. She previously served as the Executive Director of the Western Center on Law & Poverty, a well-respected, state-wide poverty advocacy organization, and as a management and Board consultant to nonprofit organizations throughout California. Pegine has extensive experience with private foundations, grants management, board development, nonprofit governance and administration, nonprofit financial management, organizational development, strategic planning, retreat facilitation and program evaluation.

Pegine received her law degree from the University of Southern California Law School, her Chartered Advisor in Philanthropy designation from The American College, and her Bachelor's degree from Middlebury College. She is also trained as a mediator through the Los Angeles County Bar Association. Pegine serves on the Endowment Board of the Western Center on Law & Poverty and on the Advisory Board of Casa Treatment, a Pasadena-based residential and outpatient treatment center for women in recovery.

RAJPAL GIBSON
SENIOR MANAGER

Rajpal Gibson, CPA, MBT, IAR, is GHJ's High Net Worth Practice Leader. She has more than 10 years of public accounting experience in providing tax and planning services to high-net-worth individuals and families. Rajpal has extensive experience in estate and wealth planning, family offices, partnerships, S-corporations, individual taxes, closely held businesses and multi-state clients.

She is certified as an Investment Advisor Representative (IAR) and offers holistic portfolio review and investment advice using tax-efficient strategies. She also holds a Series 65 License and is a member of the American Institute of Public Accountants.

Rajpal is also actively involved in GHJ's Women's Empowerment and BIPOC cohorts. In 2016, Rajpal was named, "Women to Watch" by CalCPA and CalCPA Education Foundation.

Prior to joining GHJ in 2020, Rajpal worked as a controller of a single family office. Previously, she was a tax manager in the High Net Worth and International Tax Practice at a large, national accounting firm in Los Angeles.

Rajpal is a graduate of the University of California, Los Angeles where she received dual Bachelor of Arts degrees in political science and history and a specialization in business administration. She also received a master's in Business Taxation from the Marshall Business School at the University of Southern California.

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