The Foundation of Philanthropy

An Introduction to Gifting Methods

John W. Bateman, President, JB & CO PHILANTHROPIC ADVISORS, LLC

"I want to contribute."

Often, philanthropy starts with an idea. A desire to make a change and make a difference. But the idea is only the beginning of a journey that requires planning, creativity, time and labor. And money. Although volunteer efforts are tremendously valuable for charities, financial resources are also a critical component of planning in order for charitable ideas and desires to transform into reality. So, how does a philanthropic-minded person know where to start giving?

Knowing where to start only arises after consideration of a number of choices and options and assessing the ultimate end-game. This includes understanding the initial motivation behind the charitable desire as well as the long-term goals. Is it inspired by events that reveal a need in the community? Or, is the charitable motivation primarily tax-oriented? Does the philanthropist want to involve family or friends in the charitable mission? Or, does the philanthropist want to act alone?

All of these questions can lead someone in very different directions. There are many ways to give to charity, and each has its own benefits and limitations. For example, one of the easiest ways to finance a charitable idea is for an individual to give directly to charities with similar goals and missions. This often requires little more than writing a check or volunteering time at a local shelter. However, what if the philanthropist has unique ideas to address a community need? What if these ideas do not match an existing charity's mission? This may be an opportunity to start a new charitable entity. This new charity can then fund a specific project at a church, school or other charitable organization, conduct its own charitable program, or award discretionary grants to other charities and, in some cases, individuals. Subject

to various tax requirements, the new entity can be tailored in the fashion most suited to accomplishing donor intent.

"What if I don't want to just write a check? What exactly are my options?"

Now that you have an idea, the first step in undertaking a charitable endeavor may be finding an experienced advisor who can guide you through various options. This could be a tax attorney, accountant or consultant with experience in the nonprofit market sector. However, be aware that, as with any field or market sector, experts are as varied as the organizations themselves. This is no less accurate with nonprofit entities, many of whom must depend upon fund-raising, program experts, and volunteers, in addition to competent tax counsel in order to function.

Thus, seek an advisor with experience relevant to your circumstances: not all advisors in the nonprofit market sector may be able to assist your specific needs. Are you primarily motivated by tax planning, and, if so, are your tax concerns related to income or capital gains, lifetime giving, or testamentary and estate planning? Or, are you simply looking for the best way to accomplish a charitable mission, motivated primarily by philanthropic goals? Do you want to include others? Or, do you want to generate resources and contributions from others and need to know how to best garner the most support for your charitable idea?

Once you have found an advisor that suits your needs and that has earned your trust, then you will be able to start the process toward a rewarding endeavor. As suggested above, giving financial support to a philanthropic mission can be accomplished through basic donations or through sophisticated gifting techniques, depending upon your precise needs. Common considerations will include:

1) *Do I have a specific idea?*
2) *How much control do I want over where the money goes?*
3) *Do I want to encourage others to participate?*

4) What are my tax and income planning needs?

An overview of more well-known techniques will help you decide what direction may be best for you. These are discussed in no significant order.

1. Individual, direct gifting (i.e., church collection plate)

Nothing may be easier than writing a check to your favorite cause. And it may be as simple as leaving money in a collection plate. However, in that context, your impact stops there. No strings, no suggestions, no purpose on the funds, except how the recipient charity wishes to use the funds. A hat may be passed for a specific purpose; however, the choice in the use of the funds is ultimately decided by the charity. If substantial sums of money are to be given, or if you have a specific desire for the use of your donations in mind, you may find other options more suitable for your needs.

2. Charitable Gift Annuities

Charitable gift annuities are essentially contracts between the donor and a charity. You make a gift to a specific charity and, in exchange, the charity agrees to pay you an annuity for a specific term (whether for years or for life). The annuity amount is a percentage, based upon your life expectancy and amortization tables. The gift annuity agreement will outline whether or not the donation to the charity must be used for a specific purpose. Otherwise, the gift should be viewed as an unrestricted gift. Charitable gift annuities are not always offered, and thus may not be an option in some instances.

3. Pooled Income Funds

A pooled income fund ("PIF") is very similar to a charitable gift annuity. You, as donor, make a gift pursuant to a "life income agreement" to a charity that pools the gift with other similar donations (called the fund). In return, the charity (called the sponsor in this arrangement) agrees to pay you the income that is attributable to your portion of the entire pool. Once your income interest ends, generally at your death, the remainder of the gift is paid out of the pool and over to the sponsoring charity. As you may image, these have lost popularity given that charitable gift annuities often pay an annuity amount that is much higher than the income-only payout from a PIF.

4. CRATS / CRUTS

Charitable remainder trusts are advanced techniques that come in two forms: charitable remainder annuity trust (CRAT) and charitable remainder unitrust (CRUT). Under these circumstances, a donor makes a gift into a trust which then pays out either an annuity or unitrust amount to an individual. The individual can be the donor, a spouse, family member or any other person. The trust may be for a term of years (up to 20 years) or for life of the individual receiving the annuity or unitrust payout. At the end of this term, the remainder of the trust (whatever amount is left) goes to a charity. The remainder portion does not have to go outright to the charity, but may remain in trust in accordance with the donor's wishes. Thus, this form of gift can allow the donor to enforce a particular purpose on the gift.

There are a number of restrictions on these trusts, and many of the technical rules that apply to private foundations (discussed below) apply to CRTs. Fortunately, the IRS has provided guidance through published forms that practitioners may use in drafting these trusts that help outline some of the prohibitions that apply to CRTs.

5. CLATS / CLUTS

Charitable lead trusts are a cousin of the charitable remainder trust. However, the annuity / unitrust recipient is the charity and the remainder is paid out to benefit an individual or a trust for the benefit of an individual. Because CLTs eventually benefit one or more individuals, these vehicles may not suit your long-term philanthropic goals although they may be quite useful.

As with CRTs, there are a number of restrictions on these trusts. Fortunately, the IRS has provided guidance through published forms that practitioners may use that help outline some of the prohibitions.

6. Private Foundation

Perhaps the ultimate method that allows control over your charitable mission, private foundations can be complex legal entities that require oversight in order to maintain tax-exempt status. In short, a private foundation is generally funded by donations from a single source, whether a

family, an individual, or a business. The foundation is required to pay out a minimum amount each year in the form of "qualifying distributions." Generally, this is accomplished by making payments to public charities, although, subject to strict adherence to IRS guidelines, distributions may also be accomplished in other ways, such as the award of scholarships, achievement awards, or direct aid to disaster victims. Additional rules impose restrictions on investment activity, transactions with certain persons, and prohibit certain lobbying and political activities.

However, because this legal entity charity can be perpetual, it may be a method through which a donor can have a lasting impact.

7. Donor Advised Fund

A donor advised fund ("DAF") is often described as an alternative to private foundations, although, legally, they have very stark differences. A donor contributes funds into a DAF at a sponsoring charity and then directs distributions from his or her contribution. Sometimes, the donor may also provide input on various pre-selected investment options. Generally, there is a minimum contribution required by the charity in order for the donor to establish a DAF. Under current law, however, there is no minimum amount that must be paid <u>out</u> of the DAF.

An important factor to recognize is that, under the terms of the agreement creating the DAF, the donor has legally given the money <u>outright</u> to the sponsoring charity. Thus, when the donor is "directing" distributions and investments, he or she is legally doing so in an <u>advisory</u> <u>capacity</u>. Furthermore, the sponsoring charity may require distributions to be made in a specific region or area of focus. Thus, the relationship between the donor and the sponsoring charity, when a DAF is used, may require not only mutual interests, but also a level of trust and partnership to ensure donor intent is effectively satisfied.

These may be excellent vehicles for a donor who does not have or intend to dedicate significant resources to an endeavor, yet wants to make a difference and provide some level of input.

8. Supporting Organization

Supporting organizations are precisely what their name suggests: organizations that support a specific public charity (on rare occasion the supported entity may be another type of nonprofit entity). Supporting organizations are treated as public charities, and are not subject to the same restrictions as private foundations. Lately, these entities have become more difficult to establish. The supporting organization must satisfy one of several tests, all of which generally require a level of interaction between the supporting organization and the supported entity. If these tests are not satisfied, but the IRS still views the entity as a proper charitable organization, then the charity may be considered a private foundation.

Frequently, these entities are used to hold endowment assets separate from the charity, such as with hospitals and schools, which may help with liability concerns. Or, perhaps there are other reasons to keep assets separate from the supported charity, such as when planning to fund a specific department or unit within an organization.

9. Endowments

The word "endowment" can be a misnomer, because it is used to describe a number of relationships. An endowment may simply describe a restricted gift. Funds are given directly to a charity (such as a university) with restrictions or for a specific purpose: the chemistry department or naming rights to a building. Many universities have "endowment funds" that are used for various fundraising purposes.

This term has also been used to describe permanent funds that maintain or support charities or public institutions. Legally speaking, that "permanent fund" might be any number of charitable entities discussed above: charitable remainder trusts, private foundations, or supporting organizations.

A key focus when using the term "endowment" is to identify who will own the gift and what legal restrictions govern how the gift will be used. The answer may not be clear at first to the average donor, so be certain to ask questions and understand the context in which this term is used. An

organization may add your donation to its "endowment fund," but that alone will not indicate what rights the donor has to enforce any restrictions or purposes intended for the gift.

How do I know what method is right for me?

Discuss the options with your advisor to see what meets your needs. You may find that a combination of gifting tools will accomplish your goals, whether tax-oriented or mission-oriented. How you structure the various techniques may also depend upon whether you want to include children or family members or friends in your charitable endeavors. Once you have identified and prioritized your goals and needs, then your advisor may be able to assist you in determine what charitable gifting method is most appropriate for you.

For questions on how JB & CO PHILANTHROPIC ADVISORS, LLC, may partner with your team to assist you, please contact us at:

JB & CO PHILANTHROPIC ADVISORS, LLC
john@jbphilanthropicadvisors.com
Post Office Box 190977
Dallas, Texas 75219-4129
214.559.2947 (office)

www.JBPhilanthropicAdvisors.com

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