# FUNDAMENTALS OF PLANNED GIVING

## PART TWO: BASIC PLANNED GIVING METHODS

PG CALC WEBINAR

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Presented by:

Craig C. Wruck
Senior Advisor
PG Calc
(617) 497-4970
cwruck@pgcalc.com

## INTRODUCTION

No doubt the simplest and most straightforward gift is an outright contribution for the unrestricted use of the charitable organization … preferably in cash. However, there are a great number of other ways in which a contribution can be made. Some charitable gift plans can provide an income or stream of payments to the donor or others. Some allow significantly greater tax advantages than a simple outright contribution. Others can allow a donor to meld complex financial and estate planning goals with charitable objectives.

Why pursue these alternatives, especially given all their added complexity? First, the charity will provide a valuable service to its most loyal donors by working with them to create charitable gift plans that meet the donors' needs as well as those of the organization. In addition, by offering the full range of charitable giving opportunities the organization will appeal to a much wider audience. Finally, other charitable organizations will offer alternatives and so, if only as a matter of keeping current, your charitable organization should be familiar with these more sophisticated methods of charitable giving.

## TESTAMENTARY GIFTS

A testamentary charitable gift is simply a formal direction or instruction to transfer money, property, or other assets to a charity at death. The testamentary gift is usually made by executing a formal legal instrument during lifetime. Typical tools for making testamentary gifts include charitable bequest provisions in wills and trusts as well as beneficiary designations on all manner of financial instruments and accounts.

What is the appeal of testamentary charitable giving?

For the donor there is an intuitive appeal. A testamentary contribution is a logical extension of one's lifetime accomplishments and ambitions. It is a way to make a final statement about their visions and beliefs. Testamentary giving also provides the donor with an opportunity to accommodate various contingencies and conditions specific to his or her circumstances, i.e. ensuring that financial resources are available for a surviving spouse. Finally, a testamentary gift, unlike other kinds of charitable gifts, preserves flexibility for the donor in that it can be changed, modified, or deleted completely, if the need arises.

Testamentary gifts appeal to charitable organizations because they provide an opportunity to seek support for long-term needs without disrupting fundraising for current needs. In addition, testamentary gifts provide an opportunity to identify and address entirely new groups of constituents. Even those who are either maximizing their current giving or who are unable or unwilling to give currently can be asked to consider a testamentary gift. Indeed, testamentary gifts can be a key prospecting and cultivation step in pursuit of additional gifts of all kinds.

Finally, there is a large potential audience for testamentary giving. Research by the National Association of Charitable Gift planners indicates that only 5% of the population has included a charitable bequest in their estate plans, which suggests as many as 95% of your constituents are

 

potential charitable bequest prospects. A Giving USA survey found that one in three donors would consider a charitable bequest *if they were asked*.

Yet, even given this low participation rate, data compiled by Giving USA show that 10% of individual giving each year is in the form of charitable bequests, and that those who include a charitable bequest actually increase their lifetime giving overall. What is more, a charitable bequest gift is often the largest gift of a donor's lifetime, often significantly larger.

## The Probate Process

Prior to considering specific types of testamentary contributions, let us first briefly review "probate," the process by which an estate is administered and settled. Although the term "probate" has specific legal meaning, it is frequently used by non-lawyers to describe all of the steps and processes involved in gathering, administering, and distributing an estate following the death of an individual.

The rules governing estate administration vary from state to state, and the process is usually carried out under some level of court supervision. In broad strokes, these are the steps that must be taken to settle and distribute an estate:

1. The estate administrator – the one responsible for managing and administering the estate, sometimes referred to as the "Executor" or "Personal Representative" in state laws – must locate the will (or other testamentary documents) and submit it to the court for certification and appointment as estate administrator. An opportunity is provided for others to object to the appointment of the estate administrator or question the validity of the will.
2. Once appointed, the estate administrator has legal authority over the estate and its assets and is responsible for locating, preserving, and maintaining property and assets of the estate.
3. The estate administrator must take an inventory and value all of the assets and property in the estate, and account for all expenditures and income during administration of the estate.
4. The estate administrator must attempt to identify all creditors or others who may have a claim against the estate. This usually includes advertising to notify those who believe they may have a claim so that they have an opportunity to come forward and seek payment.
5. Then the estate administrator pays the valid claims and denies others. At this point a court hearing may be held to allow those who have not been paid to have an opportunity to object.
6. The final income tax return and estate tax return are prepared and filed.
7. In most cases the estate administrator must provide the court with a final accounting and inventory and seek permission to make distributions according to the will.
8. Finally, distributions are made to the beneficiaries named in the will.

The entire estate administration process can easily take a year or more following the death of the donor. Charities should monitor the process and, while exercising patience, be vigilant to make

 

certain that the process is moving along and to ensure that the donor's charitable wishes are carried out.

## Charitable Bequests

The most straightforward way to make a testamentary gift is by a charitable bequest – a provision included in a will or trust directing a gift to charity upon the death of the donor. There is an almost endless variety of ways in which a charitable bequest can be structured. Some of the most common forms are:

**Specific bequest** – an exact amount, or a specific item, is left to charity

- "I bequeath the sum of $100,000 to..."
- "I direct my Executor to distribute my collection of barbed wire to…"

**Percentage bequest** – a percentage or fraction of the estate is left to charity, often used with a remainder or residue provision

- "I bequeath 50% of my estate to …"
- "I direct my Executor to distribute one-half of the remainder of my estate to…"

**Bequest of remainder or residue** – directs that what is left (if anything) after other distributions should be given to charity, often expressed as a percentage

- "I bequeath all of the rest remainder and residue of my estate to..."
- "I direct my Executor to distribute one-third of the remainder of my estate to…"

**Contingency bequest** – a contribution is to be made only if certain other things happen first (e.g., my spouse dies before I do)

- "If I am suffocated when a door plug catastrophically fails on the starboard side of a west-bound Boeing 737, then I bequeath..."

## Beneficiary Designations

Beneficiary designations, sometimes called a "POD" or "TOD,"[1] can be an effective and simple way for donors to make a testamentary gift without having to write or re-write their will or trust.

The process of writing or updating a will or trust can be daunting. Understandably, donors may procrastinate. While there is no substitute for a good up a good up to date will to ensure the estate is distributed exactly as intended, designating a charitable organization as a beneficiary of certain financial accounts or assets is an easy way to make a legacy gift without the hassle of making changes to a will or trust.

[1]) "POD" stands for Pay on Death and "TOD" stands for Transfer of Death. The important distinction is that a POD will cause the account to be liquidated and the proceeds sent to the charity while a TOD will cause whatever assets are in the account (for example a portfolio of securities) to be transferred to the charity. The donor's advisor and financial institution are in the best position to help determine whether a POD or TOD is most appropriate.

 

Accounts and assets that can be given via a beneficiary designation include bank and investment accounts, life insurance policies and annuity contracts, and retirement accounts including IRA, 401(k), 403(b), and most other "Qualified Retirement Plans" (see below.)

The process is straightforward and often as simple as filling out a form directing the account to be distributed to the charitable organization at the end of the donor's lifetime. Beneficiary designations can name the charity as the sole beneficiary of the account or as one of several beneficiaries, for example leaving a portion of the account to charity and the rest to provide for surviving family members.

Beneficiary designations offer several benefits for the donor, including:

- Simplicity: no need to write or change a will or trust
- Flexibility: accounts remain under the donor's control and can be easily changed

From a tax standpoint, a beneficiary designation can be very tax-wise even for estates of modest size. This is especially true for retirement accounts. In general, income taxes that have been deferred will come due when retirement accounts are left to heirs. However, these taxes can be eliminated if the account is left to charity via a beneficiary designation.

**Restrictions**

Donors often wish to provide instructions or restrictions as to how their charitable bequest should be used. These restrictions can become problematic if the direction is unclear, or if it is impractical. Ultimately, the charity may be forced to decline the bequest if the restriction is unacceptable. In fact, the charity should not accept a charitable bequest unless it intends and can reasonably expect to use the funds as directed by the donor.

In order to avoid these complications, charities often suggest that the donor set forth the restrictions in a memorandum or other written document negotiated with the charity. Then, the provision in the will can direct that the bequest "...be used in accordance with the most recent memorandum that I have placed on file with Charity." Of course, the donor should seek the advice of his or her legal counsel as to what details should be included in the will.

In addition, it is prudent to ask donors to include "safety valve" language, such as:

> "If the Board of Directors determines that it has become unwise or unnecessary to use this gift for the purposes I have specified, then I direct that this gift be used for other purposes the Board of Directors may designate, bearing in mind my original intention."

It may take a bit of explaining, but a provision such as this should be reassuring to the donor. If, in the future, circumstances change so that it becomes impossible to use the gift exactly as the donor intended, this provision directs the governing board to use its best judgement to redeploy the gift as the donor intended. In the absence of this, the organization could have to seek court action or, in the worst case, be prevented from using the gift at all.

## QUALIFIED RETIREMENT PLANS

There are a number of retirement plans under current tax law. "IRA," "Keogh," "401(k)," and "403(b)," are just a few of the "qualified retirement plans." The key differences among the plan types have to do with how the plan is funded and by whom.

In general, a qualified retirement plan offers the opportunity to set aside pre-tax income and invest that money on an income tax deferred basis. Since no taxes are paid on the money as it is earned, nor as it is invested and grows, withdrawals from a qualified retirement plan are subject to income tax when the money is withdrawn. Contrary to a common assumption, qualified retirement plans do not eliminate – or even necessarily reduce – income taxes. A qualified retirement plan merely postpones when the income tax must be paid.

The public policy purpose behind qualified retirement plans is to encourage individuals to save money to be used as a source of income in their retirement years. For this reason qualified retirement plans are subject to rules that make it unattractive to use them for other purposes.

- There is a minimum age (generally 59½) before which withdrawals are subject to a 10% penalty for early withdrawal. This discourages use of a qualified retirement plan as a tax-deferred savings account.
- There is also a requirement mandating minimum annual withdrawals generally beginning at age 73. This "Required Minimum Distribution" (or "RMD") discourages the use of qualified retirement plans to accumulate estate wealth. The penalty for failure to take the RMD is 25%.

With the exception of Qualified Charitable Distributions (see below) qualified retirement plans generally are *not* a good source of funds for lifetime charitable gifts because the donor will have to recognize as taxable income any amounts withdrawn from the account. Even though the charitable deduction can offset the additional taxable income, the complexities involved – including the likelihood that the administrator will be required to deduct standby withholding – make lifetime gifts from qualified retirement plans unattractive to donors.

However, qualified retirement plan assets make an *excellent* testamentary gift for a donor considering a charitable bequest. The reason is, a carefully planned testamentary gift of a qualified retirement plan can eliminate the deferred income taxes on money coming from the retirement account.

- If left to heirs, any amount in a qualified retirement plan at death will be subject to income tax paid either by the estate or the heir who eventually receives the distribution. Although the heir may be able to defer the withdrawal for years, sooner or later the income tax must be paid. Effectively, the total amount left in a qualified retirement plan at death is subject to income tax.
- However, transfers at death from a qualified retirement plan directly to charity escape the income tax completely!

### *Example:* Testamentary Contribution from Qualified Retirement Plan versus Charitable Bequest

A donor has a modest sized estate worth $500,000 including a home, life insurance policies, other assets and a qualified retirement plan account worth $100,000. The donor has decided to make a charitable bequest of $100,000 to charity and wants the rest of his estate go to heirs. In order to accomplish this, the donor plans to write a will that directs $100,000 to charity and the rest of the estate to heirs. Here are the effects of a gift of the qualified retirement plan account to charity versus the simple charitable bequest provision:

| | Regular charitable bequest | Retirement Account to Charity |
|---|---|---|
| Total value of estate | $500,000 | $500,000 |
| Retirement account transferred to charity | n/a | (minus) $100,000 |
| Income tax due on retirement account (assuming 30%) | (minus) $30,000 | -0- |
| Charitable bequest | (minus) $100,000 | n/a |
| Remainder to heirs | $370,000 | $400,000 |

By naming the charity as the remainder beneficiary of his retirement account the donor could save $30,000 in income taxes that would be due on the retirement account if it were to pass into the estate, money that would reduce the amount available for heirs.

Note that this example illustrates income tax savings only. For larger estates there are potential estate tax savings too.

In order to avoid the income tax, the qualified plan must be directed to charity upon death. The donor must work with the administrator of the retirement plan to name the charity as the remainder beneficiary of the account. If the donor simply provides a direction in her or his will to use retirement plan assets, the IRS will conclude that the retirement plan first distributed to the estate and then to the charity, and the distribution to the estate will be subject to income tax.

Similar to the flexibility of a charitable bequest provision, the donor can direct the plan administrator to distribute all or part of the qualified plan or make the contribution contingent upon other circumstances, for example only if the donor's spouse is no longer living.

Note that, since it is impossible to know exactly how much the retirement plan will be worth at the moment of the donor's death, the donor may wish to consider including a coordinating provision in her or his will to make up the difference should the balance available in the retirement account fall short of the amount the donor wants to give to charity.

Finally, the rules surrounding IRAs and other qualified retirement plans are complex. Donors should be encouraged to work with their retirement plan administrators and other advisors to ensure that their charitable plans do not produce unintended consequences for their heirs.

### Qualified Charitable Distribution – the "Charitable IRA Rollover"

Certain donors can use their IRA accounts to make contributions during lifetime via a "Qualified Charitable Distribution" (or "QCD") without incurring income tax on the withdrawal from the IRA. The Qualified Charitable Distribution is subject to several limitations:

- The donor must be age 70½ or older at the time the gift is made.
- The account must be a traditional Individual Retirement Account (IRA) or Roth IRA.
- The contribution must be outright, with the exception of certain limited transfers for a life income plan (see Part 4).
- Total qualified charitable distributions cannot exceed $111,000[2] for the year.
- The transfer must be from the IRA administrator directly to the charity (the donor cannot withdraw the money and then make a contribution to the charity).
- Contributions must be to a public charity. They cannot be to a donor advised fund, supporting organization, or private foundation.

Note that the donor does not receive an income tax deduction for a qualified charitable distribution but does not pay income taxes on the withdrawal as would be the case otherwise. In addition, the Qualified Charitable Distribution counts toward the Required Minimum Distribution, which allows donors to meet their required withdrawals without generating taxable income.

The qualified charitable distribution appeals to donors for reasons that include:

- It is relatively simple to complete, just contact the plan administrator.
- Counts toward the donor's Required Minimum Distribution which can be especially appealing to donors who are forced to withdraw and pay taxes on income they may not need in the current year.
- Does not increase the donor's taxes, and can save income taxes even if the donor's other charitable contributions have exceeded the AGI limits or if the donor does not itemize deductions.

## GIFTS OF LIFE INSURANCE

Life insurance is a powerful and flexible financial and estate planning tool. For charitable giving purposes, the value for the charity lies in receiving the "death benefit" which is paid upon the death of the insured. In this sense, a gift of a life insurance policy is much like a charitable bequest.

However, the financial viability of a policy can be tenuous and the value of the eventual gift to charity might be significantly affected by policy loans, withdrawals, and other obligations. In addition, life insurance can seem shrouded in mystery, making it difficult to evaluate a proposed

[2] The $111,000 limit is for QCD contribution in 2026. It is adjusted for inflation each year.

 

contribution. This synopsis is intended to provide an understanding of the basic workings of a life insurance policy and how a contribution of life insurance can work.

## Life Insurance Basics

Before we discuss the practical applications of life insurance as a charitable gift, a brief review of the basics of life insurance:

- **Policy** – Life insurance is a legal contract (the "policy") promising to pay a certain amount (the "death benefit") upon the death of an individual (the "insured").
  - The insurance company seeks a large number of people to insure in order to spread the risk of having to pay a specific policy's death benefit in any one year.
  - The company charges a fee (the "premium") for the policy and uses this money to pay death benefits to the beneficiaries of those insureds who die.
- **Term Life Insurance** – "all life insurance is term insurance"
  - The policy covers one life for a specified period of time (usually one year).
  - The amount of the premium increases each year as the likelihood of paying the death benefit during that year increases because the insured is older.
  - **Annual renewable term** – The insurance company promises to renew the coverage each year—but at a higher premium for the same death benefit.
  - **Decreasing term** – The insurance company promises to renew the coverage each year for the same premium, but with a smaller death benefit.
- **Whole Life Insurance** – The premium stays the same and the coverage stays the same for the life of the insured.
  - In the early years the premium for a whole life is significantly higher than for the same coverage under a term insurance policy.
  - The extra premiums collected in the early years are accumulated and invested to be used to pay the higher cost of insurance in later years when the insured is older.
  - The insurance company guarantees that a specific value in death benefit will be paid as long as premium payments are made on time regardless of investment performance, mortality experience, or other vagaries during the life of the insured.
- **Universal or Variable Life Insurance** – Both the premium amount and the value of the death benefit may be adjusted during the course of the policy.
  - Similar to whole life policies, excess premiums are accumulated to be invested and used later to pay the cost of insurance.
  - Most of the variables, including the cost of insurance, mortality assumptions, investment return and value of death benefit, are not guaranteed and can be adjusted from time to time.

  - The policy owner may be provided some opportunity to select the investments owned by the policy.

- **Limited Payment or "Vanishing Premium" Plans**
  - A limited number of annual premiums are projected, after which a sufficient policy value is expected to have accumulated in order to pay the cost of insurance for the lifetime of the insured.

- **Single Premium or "Paid Up" Life Insurance**
  - One very large premium is paid at the time of purchase, most of which is set up as an investment account to pay the cost of insurance for the lifetime of the insured.

**Life Insurance Vocabulary**

Life insurance employs a very specific and technical vocabulary. An understanding of several key terms will be helpful in the evaluation and comparison of charitable life insurance proposals:

| | |
|---|---|
| Account value | The sum of all premium payments adjusted by periodic charges, credits and partial withdrawals |
| Annuity | A contract issued by an insurer that promises to pay periodically an amount to a beneficiary (the amount of the annuity can be fixed or variable and continue for the lifetime of the insured or last for a shorter period depending upon the terms of the contract) |
| Beneficiary | The individual or entity to whom the death benefit or periodic annuity is to be paid |
| Cash surrender value | The cash value available upon surrender of the insurance contract |
| Death benefit | The amount paid upon the death of the insured (the amount of the death benefit can be guaranteed and fixed at the time the policy is issued or it can vary depending upon the terms of the contract, the net amount available may be reduced by loans or withdrawals made before the death of the insured) |
| Guaranteed value / guaranteed rate | Policy illustrations usually include certain minimum or guaranteed rates of investment return as well as assumed rates of investment return; guaranteed policy values are those projected based upon the guaranteed rates while values based upon the assumed rates are not guaranteed |
| Insured | The individual upon whose life a policy or annuity is issued |
| Insurer | The insurance company that issues the policy or annuity |

| | |
|---|---|
| Owner | The individual or entity that owns and controls the policy |
| Policy | A contract issued by an insurer which promises to pay a death benefit to the beneficiary upon the death of the insured |
| Policy year | The "fiscal year" of the policy, generally beginning the first day the life insurance coverage is in place; premium payments and other outlays are usually assumed to be made at the beginning of the year while cash values are usually shown as of the end of the policy year |
| Premium | The amount paid to the insurer in exchange for the contractual promises of the policy (insurance policies usually require periodic payment of premiums during the lifetime of the insured, annuities usually require a single premium payment when the contract is issued) |

### Outright Contributions of Life Insurance

If a charity is named as the "beneficiary" of the policy, the charity will receive the death benefit amount when the insured dies.

If, instead, the donor assigns "ownership" of the policy to charity (in addition to naming the charity as the beneficiary), the donor receives a current income tax deduction for "interpolated terminal reserve value" (basically the "cash value," subject to certain adjustments) of the policy. In addition, if the donor makes premium payments on the policy after it has been contributed to the charity, he or she can receive an income tax charitable deduction for those amounts too.

**Note:** Policy loans, withdrawals, and other obligations may decrease, sometimes significantly, the value of the policy to the charity.

Donors should be advised that the charity, as owner of the policy, has sole discretion to make decisions that will affect the dollar value eventually received by the charity:

**Further premium payments** – the charity is *not* obligated to make any further premium payments on the policy

**Policy loans** – the charity can borrow the cash value from the policy

**Paid-up insurance** – the charity may elect to accept a smaller death benefit and eliminate the need for further premium payments

### "Wealth Replacement" Life Insurance

Since planned gifts often remove estate assets that would otherwise have gone to surviving heirs, life insurance naming the heirs as the beneficiary can provide a cost-efficient way to replace the assets given to charity.

 

Those donors who are concerned about estate taxes can work with their financial advisors to ensure that wealth replacement policies are owned by the heirs. Ownership by the heirs can avoid estate taxes on wealth passed to the next generation.

### Evaluating Life Insurance Contributions

It seems there is a never-ending array of programs promoting creative applications for life insurance in charitable giving. Before engaging in any life insurance program, the charity should engage in a careful review of the proposal to ensure that there is real value for the charity.

The National Association of Charitable Gift Planners has published guidelines for the evaluation of life insurance. These guidelines are available from the Association's Web site https://charitablegiftplanners.org/standards/charitable-life-insurance-evaluation-guidelines. The key elements of the recommended review are:

**Complete Analysis** – Careful analysis of both the subjective and objective factors is key. Some aspects of charitable life insurance programs lend themselves to quantitative analysis, while other aspects are more qualitative in nature. A worthwhile charitable life insurance program will meet both subjective and objective criteria.

**Value and Values** – The analysis should guard both the value and the values of the charitable organization today and in the future. Even though a charitable life insurance program may be financially viable, it may still present unwarranted risk to reputation and/or consume unreasonable amounts of valuable staff time and resources.

**Nothing is Free** – Nothing of value comes without a price. All of the costs of the charitable life insurance program, including the costs of insurance, borrowing, commissions, and on-going administration, must be paid by someone at some point. The charity should have a clear understanding of all of these costs and the sources of the funds to pay these expenses, as well as the ultimate source of the value the charitable organization expects to receive.

**Charitable Interest** – The charitable life insurance program must respect and serve the charitable interests of the donor.

**Obligations and Commitments** – Charitable organizations should fully understand the obligations involved in a proposed charitable life insurance program and the impact should the program not unfold as planned. Interest rates, mortality assumptions, and the cost of insurance are all variables that may increase or decrease the charity's out-of-pocket expenses over time.

## BARGAIN SALE GIFTS

A "bargain sale" occurs when a donor sells property to a charity for less than its full fair market value. For tax purposes, the transaction is viewed as having two elements: a sale and a gift. The donor is allowed an income tax deduction for the difference between the sale price and the fair market value of the property.

Under certain circumstances, a bargain sale can be advantageous to both the donor and the charity. For example, a donor may be willing to "contribute the appreciation" he or she has earned on an asset but determined to retain his or her initial investment in the asset. Although, as we will see below, the capital gains tax rules make it impossible to separate the appreciation from the cost basis, a donor can use a bargain sale to effectively share a specific portion of an asset's value with a charity. In another example, a donor may wish to contribute only some of the value of an asset that cannot be easily divided.

Bargain sale gifts that should be approached with special caution include appreciated short term property, ordinary income property, mortgaged property, stock redemption plans, and tangible personal property. Although a bargain sale is possible in these situations – and can even be mutually advantageous to both the donor and the charitable institution – the guidance of qualified counsel should be sought before proceeding.

**Note:** The donor of a bargain sale gift will owe capital gains tax on the portion of the property that was sold. For example, if a donor owns a property now worth $50,000 with a cost basis of $20,000, the donor has a $30,000 gain in the property ($50,000 sale price minus $20,000 basis). Put another way, 60% of the total value of the property is capital gain, which means that 60 cents of each dollar received in a sale would be capital gain and the remaining 40 cents would be recovery of cost basis. The same ratio applies to the portion sold by the bargain sale donor. If the donor sells the property to charity for $10,000, he or she will be liable for capital gains tax on $6,000 of capital gain (60% of $10,000).

The bargain sale can become even more complex if the property is mortgaged or if the donor has taken accelerated appreciation deductions related to the property. Under the appropriate circumstances such gifts can be acceptable, however in some cases the donor will incur taxable income in addition to capital gain. Donors should be urged to consult their own tax advisors before completing a bargain sale.

Finally, the charity should carefully evaluate the implications before accepting a bargain sale gift. Two considerations should be paramount:

- Is the property usable and valuable to the charity in its mission? If not, is it readily marketable so that the charity can use the proceeds for its charitable work? Since the charity will be committing financial resources to the purchase, there should be a reasonable likelihood that the transaction will result in additional support for the mission of the charity.
- Does the charity have sufficient resources to engage in the purchase? The initial cash purchase may be only the beginning. There may be expenses and costs if the property cannot be sold quickly.

# FAMILY FOUNDATIONS

The notion of a "family foundation" can be very appealing to generous individuals. A family foundation is a way to have an impact on an array of organizations over an extended period of time and to provide family members and others with opportunities to influence charitable giving now and in the future. Interestingly, there is no legal definition of "family foundation." Most often a private foundation is the vehicle used to establish a "family foundation." Increasingly, however, donors are using a donor advised fund as an alternative way to establish a family foundation.

## Private Foundation

A private foundation is a separate tax-exempt entity, created either as a non-profit corporation or in the form of a trust. The private foundation accepts contributions from one or more donors. The governing board of the private foundation manages and administers its assets and makes distributions, or grants, for charitable purposes.

Private foundations are subject to a number of restrictions – the private foundation rules – that prohibit transactions between the private foundation and its founders, donors, or individuals or parties related to them. As a separate legal entity, a private foundation must provide for its own administration, accounting, and investment management. It must also complete and file its own tax and information returns each year, which must be made available to the public on request.

## Donor Advised Fund

Donor advised funds are among the fastest growing vehicles for personal philanthropy. Although donor advised funds are most often created through community foundations, other public charities sometimes sponsor donor advised funds. Several financial institutions, including Fidelity Investments, Vanguard, and Charles Schwab, operate very large donor advised funds.

Through a written agreement with the sponsoring charity, a donor creates a specially named fund account to which contributions are made. The terms of the agreement allow the donor (or others) the privilege of making non-binding recommendations regarding charitable distributions that the sponsoring charity makes from the fund.

Since the donor makes contributions directly to the sponsoring charity, contributions to the fund are charitable contributions to a public charity rather than gifts to a private foundation. Because a charitable contribution must be irrevocable and complete in order to qualify for a tax deduction, the donor's recommendations as to the use of the contribution must be advisory only and the governing body of the sponsoring charity must have final control over all distributions.

The table below compares several aspects of a donor advised fund and a private foundation.

| | **Donor Advised Fund** | **Private Foundation** |
|---|---|---|
| Tax-exempt status | Fund account held by established public charity | Must separate tax-exempt status as private foundation |
| Charitable deduction AGI limit | 60% cash / 30% appreciated property | 30% cash / 20% appreciated property |
| Donor control over distributions | Donor may recommend distributions, but sponsor makes final decision | Donor can retain significant control subject to IRS private foundation rules |
| Minimum payout requirements | None (except by policy of sponsoring charity) | At least 5% of asset value each year |
| Donor privacy | Can be anonymous | Requires significant public disclosure including grants |
| Start-up | Established by agreement with sponsoring charity | Create non-profit entity and secure tax-exempt status |
| Annual taxes | None | Excise tax of up to 2% of net investment gain |
| Annual tax filings and returns | None required, reported as part of sponsoring charity's annual return | Separate tax return must filed annually along with required schedules |
| Administration and investment management | Provided by the sponsoring charity | Must establish or secure its own services |

(Text adapted from the book *Planned Giving in a Nutshell* and used with permission of the author.)