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Helping donors cut down red tape

By Todd Mason
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Simplicity was the issue as a wealthy Haverford College benefactor considered gifts to the school and separate charities several years ago, recalled Steven Kavanaugh, the college's director of gift planning.

Rather than set up his own foundation, the donor asked, "Can't I just give the money to you, and you take care of it?"

Well, yes. Haverford's answer was to create a donor-advised fund, which allows donors to park money, claim an immediate tax deduction, and decide later how to give it away.

Such funds borrow a nonprofit organization's tax-exempt status to cut down on the red tape that creating a foundation would involve.

More and more, brokerage firms and mutual-fund families compete with individual charities for donors. But donors should not mistake the investment firms for charities themselves.

Money given to investment companies' charitable programs often does not leave their management, as it would if donors had given directly to a charity. Not only do the firms continue to earn fees, the clients' financial advisers often do, too.

"I think they're doing it because they make a lot of money," Kavanaugh said. "There are a lot of vested interests and conflicts."

Even Haverford's fund, launched in 1998, has strings. The donor must agree to give 50 percent of donations to Haverford programs.

Choosing a donor-advised fund is not simple at all. Costs matter to donors setting up funds for the long haul, said Russel Kinnel, director of mutual-fund re search for Morningstar Inc., the Chicago fund-ranking firm.

Subtracting 2 percent in fees rather than 1 percent from a $50,000 fund earning 9 percent a year would trim assets by $16,000 after 20 years, assuming annual distributions to charities of 5 percent a year.

Costs can vary widely, even when two funds are associated with the same nonprofit administrator. The Merrill Lynch Community Charitable Fund, offered in Philadelphia in partnership with the Philadelphia Foundation, charges annual fees in a range of 1.40 percent to 1.75 percent of assets in the fund. Merrill cut the fee from a flat 2.1 percent in the last two weeks.

But donors who set up a fund directly through the Philadelphia Foundation pay fees of just 1 percent, which cover the foundation's in-house investment management, according to the foundation. Community foundations have been sponsoring donor-advised funds for decades.

Donor-advised funds allow investors to separate tax planning from giving.

The Merrill program costs more because "in the real world, everyone has to have a piece of the action," said Andrew Swinney, the foundation's president. "The more people involved, the more it costs."

Even so, Swinney credits commercially sponsored charities for expanding philanthropy's reach, through marketing, to donors who think first about tax considerations.

Merrill's advisers earn annual fees equal to 0.3 percent of fund balances, said David E. Ratcliffe, a Merrill executive vice president. They are paid for "their advice and recommendations," he said.

Donor-advised funds allow investors to separate tax planning from giving. The initial gift to donor-advised funds is irrevocable, and tax-deductible immediately. The funds' gifts to charities can be made at any time.

Donors must ask nonprofit administrators to make grants to specific charities. As a practical matter, administrators do not ignore legitimate requests.

As donor-advised funds proliferate, the philanthropic world is wrestling with the implications.

Fees create incentives for financial advisers to steer donors to fund sponsors that are lucrative for the advisers, said Bruce Makous, planned giving officer for the American Association for Cancer Research, of Philadelphia.

In a recent article in Trusts & Estates, a professional journal, Makous called on charities and investment firms to end "blatantly unethical" arrangements that let firms retain investment assets and pay fees to advisers.

Fees represent payment for advice, countered William Marshall, a Doylestown financial planner and charitable-giving specialist. "I have yet to find a client who didn't think it was worth it," Marshall said in an interview.

Donor-Advised Funds

What is a donor-advised fund? A donor-advised fund is a tax-sheltered investment fund held for charitable purposes by a qualified tax-exempt organization.

How does it work? While donors must surrender control of the gift in order for it to be tax-deductible, administrators of donor-advised funds allow donors to appoint advisers to request distributions to working charities. These requests can be a month later, a year later, or every year.

What are the benefits? Donors can meet the Dec. 31 deadline for tax-planning purposes and parcel out the money later. Donor-advised funds also can serve as a family foundation on the cheap.

What are the pitfalls? While charities' endowments are invested at inexpensive institutional rates, donor-advised funds often cost more than comparable retail investment accounts.

Do brokerage and fund-family sponsors have capabilities that charities don't? No, despite frequent claims that they are better-equipped to handle gifts of securities, real estate or other assets. Even small charities can accept gifts of assets if they enlist the aid of a community foundation. This question comes up often. Longtime investors get two tax breaks when they give appreciated assets rather than cash. They avoid paying taxes on capital gains, but they deduct full market value on their tax returns. *— Todd Mason*

Charities prefer outright gifts to funds that disburse money in installments, as donor-advised funds often do, he said. "A charity loves that because then they are getting control of the money," he said.

Congress, meanwhile, has a skeptical eye on donor-advised funds. The IRS complained in a report this year to a Senate committee that some funds made inappropriate gifts, or did not make gifts at all.

Fund advisers have "given to scholarships for their sons and daughters," said Pablo Eisenberg, a senior fellow at the Georgetown Public Policy Institute.

Fidelity Investments, which has the oldest and largest commercial charitable program, already polices grants, spokeswoman Jennifer Engle said. Donors gave out 27 percent of the charity's assets as gifts in the 12 months ended June 30, she said.

Half of new donations are disbursed in the first year, Engle said. "It doesn't make a strong case for us sitting on assets," she said. Fidelity's program held $3 billion as of June 30.

The Vanguard Charitable Endowment Program is gaining ground rapidly, according to the Chronicle of Philanthropy, a professional journal. Its assets grew 37 percent to $958 million in the 12 months ended June 30. It grew 46 percent in the previous fiscal year.

For accounts of $5 million or less, donors at Vanguard pay a maximum annual fee of 0.83 percent.

Vanguard is not the area's price leader. Haverford College's fund is free, like many operated by individual organizations. But the college's investment costs trim annual returns by 0.5 percent.

The Costs of Giving

Fees can vary widely among donor-advised funds. The following fees are for selected funds.

Name	Minimum gift	Administrative fee[1]	Investment expenses	Overall fees and expenses[2]
Vanguard Charitable Endowment Program	$25,000	0.57%	0.19-0.26%	0.76-0.83%
Fidelity Charitable Gift Fund	10,000	1.00	0.10-1.17	1.10-2.17
Merrill Lynch Community Charitable Fund	25,000	1.05	0.55-0.70	1.60-1.75
Schwab Fund for Charitable Giving	10,000	1.00	0.46-0.76	1.46-1.76
Bank of America Charitable Giving Program	25,000	1.50	0.15-1.25	1.65-2.75

SOURCE: The companies

1 Firms offer a series of discounts as fund size increases

2 Overall fees and expenses on small funds, without administrative fee discounts

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