YEAR-END PLANNING, YEAR-ROUND GIVING : CHECKING IN ON STRUCTURED PHILANTHROPY FOR HIGH NET WORTH INDIVIDUALS

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For high net worth individuals, directing philanthropic efforts is a crucial piece of managing wealth that extends beyond the desire to give back. To make the most of charitable initiatives, donors must ensure that the right vehicles are being used, the most efficient assets are being given, and that donations are being viewed with an eye towards minimizing tax liability. While these efforts may last all year, year-end planning presents the ideal window to confirm that philanthropic goals are well represented and well organized.

Despite an uncertain economic landscape, wealthy donors are not holding back on charity. Trends indicate that high net worth families embrace their role as donors and appreciate the benefits they can enjoy by capitalizing on relevant tax provisions. As *Reuters* noted in a 2011 article, "[During the downturn] there was a segment of wealth and super wealth that still had enough funds to give large gifts, especially with the natural disasters that have happened. Americans have this incredible philanthropic impulse that doesn't seem to be going away any time soon."[1]

Contributing to causes close to their hearts is certainly the primary motivator for donors, but that charitable impulse must be directed and organized in a way that benefits the overall portfolio. If investors do not explore charitable donations by year-end, they are potentially missing out on the ability to accelerate deductions that are designed to encourage money flows into nonprofits. By giving directly to organizations instead of using pass-through charitable entities, they will likely make the process more complex and difficult to track over the long term.

STAYING TAX SAVVY

Identifying the best asset to donate is the first step in a tax-smart giving plan. Depending upon activity across the portfolio, there may be opportunities to capitalize on specific products or provisions. While cash is an "easy" item to give, there may be other assets in a client's portfolio that are better suited for giving from a tax standpoint, such as an appreciated long term public security. In most cases, if a client donates the security, they will receive a deduction for fair market value of the security and avoid paying capital gains, which would be unavoidable if they liquidated the security to raise cash for the donation.

Another method is the use of tax-efficient indexed products, such as separately managed accounts composed of individual stocks that track an index. The client can donate the long term stocks in the portfolio that have gains and have the manager replace them later with an additional contribution or by simply rebalancing the portfolio to an appropriate level. These products are also a good source for harvesting losses; when an equity holding drops, managers can sell the stock at a loss and buy a similar security at a similar price to stay on track with the index. This liquidation strategy minimizes tax exposure without impacting portfolio performance and provides monies free of capital gains that can be used for charitable donations.

Clients should also stay aware of charitable carryforwards as they consider year-end donations. Donations that exceed a percentage of a taxpayer's adjusted gross income (depending on AGI and the receiving charity) result in a carryforward deduction, just as Private Family Foundations have carryforwards when grants exceed the annual required distribution. In both cases, carryforwards must be used within five years of the initial donation; individuals or Foundations with carryforwards will want to balance them with any current donations or grants in order to use them before they expire.

PICKING THE RIGHT PHILANTHROPIC VEHICLES

With a complete understanding of the portfolio, advisors can match the right asset with the right vehicle to create best case charitable giving scenarios for clients. Donor Advised Funds (DAFs) are a popular choice, as they are easy to manage with no tax returns or minimum required distributions. DAFs also have no excise taxes and donors receive the maximum deduction upon gifting to the Fund, regardless of when monies are disbursed. The downside is less investment flexibility and potentially higher investment fees, as the donor is typically limited to one of the investment options offered by the DAF. Further, once the donation is made to the DAF (which is considered a public charity), the funds are no longer the client's. The client can then only recommend grants to the DAF sponsor, which is not legally required to approve every recommendation.

For those with private equity and venture capital investments, appreciated stock distributions are an ideal fit for DAFs. Distributions can be donated to the DAF and individuals avoid recognizing gains for which they would otherwise be responsible.

Perhaps for this reason, DAFs have become a favored option in Silicon Valley. As *The Wall Street Journal* reports, "donor-advised funds [run by Silicon Valley Community Foundation] have experienced growth in assets and in the grants made from the funds. Total assets in the funds rose to $893 million at the end of last year, up 16% from 2009, according to the Community Foundation. Meanwhile, grant-making out of the funds increased to nearly $120 million in 2010, up 46% from around $82 million in 2009."[2]

In some cases, the potential tax benefits go even further. Clients with concentrated public stock that is undervalued but has low basis can donate their holdings to a DAF and then replace the stock through a cash purchase. The donation is taken for tax purposes at fair market value and when the client purchases the stock back, they have increased their basis in the position while avoiding capital gains.

For clients with gifting accounts in excess of $5 million, Private Foundations may be a better fit due to the increased control of funds. Such control comes at a cost, however, as Private Foundations demand more administrative attention and are accompanied by legal fees and a small excise tax.

Wealthy families may also want to consider the degree of privacy each vehicle provides. Ironically, Private Foundations yield very little in the way of privacy: a publicly filed Form 990 shows precisely how much was given to which charity and who made contributions to the Foundation. However, because DAFs are responsible for disbursement, there is no such public record that tracks back to individual donors.

Leaving a public trail can open wealthy families up for unwanted solicitation. *The New York Times* chronicled the mishap of a family that made a grant of $100,000 to one child's school, and upon enrolling a second child at a different school was immediately approached by the development office for a gift of the same amount. "The client was taken aback," the article notes, "because the size of the gift was consistent with what he had given to schools his other children had attended. The client had not realized how easy it was to get the information online."[3]

If a client has a Private Foundation, but still wants to give anonymously, they can do so by using both a Foundation and a DAF. The Foundation would simply give to a DAF, and then the DAF would grant the funds to the charity. For purposes of the Foundation's 990 filing, the grant would simply be recorded as a grant to the DAF.

ORGANIZED APPROACH SUITS MULTI-GENERATIONAL GIVING

Staying organized and informed should be a mainstay of wealth management, but these elements come into especially sharp focus during year-end planning. When it comes to charitable giving, well-organized data that tracks family activities year over year can paint a clear picture of how much has been donated to which charity and when.

This helps to quickly measure solicitations from new charities against past giving habits. With effective vehicles established, families can keep pace with regulatory demands with a minimum of paperwork. A lump sum contribution to a DAF, for example, only requires that the family keep record of the initial contribution but does not call for tracking of subsequent disbursements from the DAF.

These administrative issues may seem trivial, but staying organized makes it easier to share philanthropic and overall financial priorities within the family. Managing charitable funds can serve as a valuable arena in which families can work together and introduce the younger generation to investing, taxes, and budgeting. They can then apply those lessons to their own financial lives and be more prepared to manage the family wealth. Clear tracking and ready explanations of how giving is balanced with tax exposure are excellent first steps toward this goal.

Year-end brings to mind any number of planning goals, from checking on long-term investments to rebalancing portfolios to ensuring that charitable donations are in line with expectations. All of these elements should be viewed through the lens of tax exposure. There may be opportunities to improve the way philanthropy is approached, be it by moving away from cash gifts to more tax efficient assets, or staying ahead of the curve for families with concentrated positions. In all scenarios, families must have the right vehicles, assets, and guidance to support their philanthropic ventures.

ENDNOTES

[1] Charitable giving jumps despite slow recovery, Reuters, June 20, 2011

[2] Donor-Advised Funds Show Rise in Giving, Pui-Wing Tam, Wall Street Journal, September 22, 2011

[3] Weighing the Best Vehicles For Philanthropic Giving, Paul Sullivan, New York Times, January 29, 2011