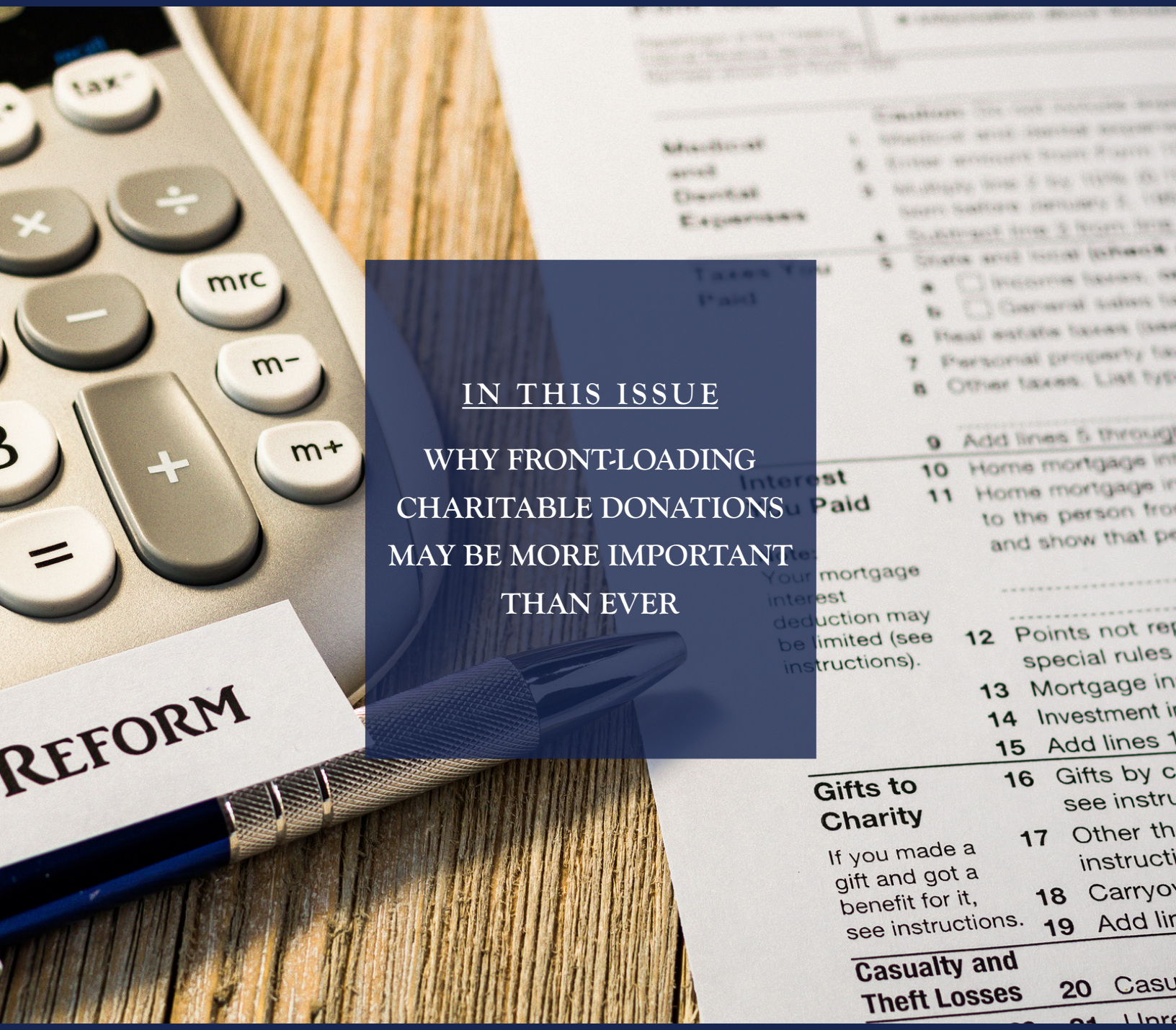
The Siller & Cohen Report

2nd Quarter 2019



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WHY FRONT-LOADING CHARITABLE DONATIONS MAY BE MORE IMPORTANT THAN EVER

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Why Front-Loading Charitable Donations May Be More Important Than Ever

As many of us have seen, the new tax legislation that took affect in 2018 changed our tax situations in more ways than one. One of the most substantial individual tax changes made in this legislation was the limiting of the state and local tax deduction to $10,000, which effectively pushed many families that hadn't taken the standard deduction in years into Standard Deduction territory.

What some haven't considered is how this affects their charitable giving strategies, and in fact, may make front-loading charitable gifts more important than ever. Consider a hypothetical family, John & Mary Smith. John & Mary have high incomes and pay roughly $150,000 annually in State and Local taxes (including property tax). They have no mortgage, but even so, before the recent legislation, they were never anywhere close to the standard deduction and always itemized. They also donate $14,400 per year to their favorite charity.

Example 1: In this first example, assume John & Mary continue making $14,400 annual charitable gifts. Their state and local tax (SALT) deduction is capped at $10,000, giving John & Mary total itemized deductions of $24,400. As the standard deduction for a married couple in 2019 is $24,400, the Smiths would've gotten the same $24,400 deduction without giving anything to charity. In essence, they lose the prior tax benefit of their charitable giving.

Example 2: This time, assume that John & Mary front-load three years of charitable gifts into one tax year, and give $43,200 in that year. Now, their total itemized deductions are $53,200 ($43,200 of charitable gifts plus the $10,000 SALT deduction). This represents $28,800 of additional deduction that the Smith's enjoy. If you assume a 35% effective tax rate, this is an $10,080 savings in tax! In the following two years, the Smiths would simply take the standard deduction of $24,400 each year.

An individual's entire tax situation should be examined in detail to determine whether itemized deductions will benefit that individual in a particular year, but it's clear that in some situations front-loading charitable gifts can make a lot of sense from a tax perspective. However, what if you don't want to give your charity three, five, or ten years of gifts all in one year? Furthermore, what if you're not sure which charity you even want to be giving to three, five, or ten years from now? In the remainder of this issue, we'll explore two vehicles, donor-advised funds and Private Foundations, which are alternatives that may solve these problems. For this article, when discussing Private Foundations, we are referring to nonoperating Private Foundations, and not pass through Private Foundations or pooled fund foundations.

Both of these vehicles allow a donor to gift assets to the fund or foundation and take a tax deduction in the year of the gift (assuming the charitable deduction is otherwise deductible) but delay the donation to the ultimate recipient (the charity of the donor's choice). This can allow charitable minded taxpayers to have their cake and eat it too, by giving them a tax benefit of front-loading gifts, but still allowing them to space out their final donations over the intervals that they choose.

Differences in Operating Cost

A Private Foundation (PF) is a legal entity, in either a corporate or trust form, that a donor establishes and controls. The operating costs of a PF are typically significantly more expensive than a Donor Advised Fund (DAF). When factoring in accounting services, legal services, investment management services, and administrative services, the cost of operating a private foundation can be 1.5% to 2% of the net asset value of the foundation per year.

By contrast, a DAF is an account or fund that a Donor creates at a sponsoring organization that is itself a public charity. The sponsoring organization can be a financial institution, a community foundation, or a religious organization. Administrative and investment fees at DAF sponsoring organizations typically come in under 1% per year, with minimum starting balances of just $10,000 to $25,000 to open an account, depending on the sponsor. Clearly, ease of set up and ongoing administration are directly correlated to cost. In this way, a DAF is not only a turn-key set up, it can be less expensive to operate.

Tax Deductibility Differences

The tax deductibility of donations is typically more generous for DAFs than for PFs. For example, gifts of cash to a PF can be deducted in any year up to 30% of the Donor's adjusted gross income (AGI); the same cash gift to a DAF will allow for a maximum deduction of up to 60% of AGI. Please see the table below for a full summary of the deduction limits of gifts to PFs and DAFs.

PFs may also be subject to a federal excise tax on net investment income of up to 2%.

Additionally, PFs face the burden of a tax filing requirement. The 990-PF, the annual filing for PFs, can be an onerous document. Its details, including a list of grant recipients and amounts, are a matter of public record viewable by anyone. The DAF, on the other hand, has no such tax filing requirement (because the DAF sponsoring organization files annually for all of its DAF accounts). This helps control ongoing administrative costs and, as we will see below, allows the donor, if he or she wishes, to make gifts anonymously.

Table 1: Basic Deduction Limits on Donations

Type of Property Donated	Private Foundation		Donor Advised Fund	
	Deduction Based On	Deduction Limit	Deduction Based On	Deduction Limit
Cash	Cost Basis	Up to 30% of AGI	Cost Basis	Up to 60% of AGI
Ordinary Income & Short-Term Capital-Gain Property	Cost Basis	Up to 30% of AGI	Cost Basis	Up to 50% of AGI
Long-Term Capital-Gain Property *	Cost Basis	Up to 20% of AGI	Fair Market Value	Up to 30% of AGI
Tangible Personal Property	Cost Basis	Up to 20% of AGI	Cost Basis	Up to 50% of AGI

* Assumes no election is made to reduce the amount of deduction and assumes the property is not Qualified Appreciated Stock.

Grant-making and Donor Recognition Differences

By law, each year PFs are required to distribute for charitable purposes a minimum of 5% of the PF's prior year-end non-charitable use assets. While certain PF administrative expenses in the prior year can be counted towards the 5% requirement, failure to meet the calculated minimum distribution can result in a penalty of 30% of the undistributed amount. If the required amounts remain undistributed, additional excise taxes (penalties) may be imposed. If more than the 5% minimum disbursement is made, the excess can be carried forward to reduce the required amount for up to the next five years. By comparison, a DAF has no minimum amount that it must distribute each year.

Another consideration when making grants from a PF is the issue of donor recognition. While publicity for the donor's generosity may be a goal in itself, to increase the donor's standing in the community, or to encourage others to also make charitable gifts, there are times when donors wish to make gifts anonymously. PFs provide no anonymity, as the Form 990-PF is a public document that lists the charities the PF makes grants to each year, and the amount of each grant. On the other hand, most DAFs allow a donor to make a grant without disclosing the donor's identity. As we will later see, the ability to control how much is gifted from a DAF in a particular year, as well as the ability to make anonymous gifts, makes pairing the two vehicles within a donor's philanthropic plan attractive.

Differences in Control

Grants from PFs are permitted to IRC Section 501(c)(3) charitable organizations in the United States, so long as the grant is consistent with the PF's mission and purpose. Directors or trustees of PFs can also create scholarships and make loans to other charitable organizations. Grant-making to non-US based charitable organizations is also permitted.

DAFs, on the other hand, may be subject to refusal of a grant request, depending on the sponsoring organization's policies. For instance, some DAF sponsors will not permit grants to non-US charities. Additionally, the IRS explicitly forbids DAFs from making grants to individuals or conducting their own scholarship programs. However, DAFs may fund scholarship programs that are run and maintained by qualified higher education IRC Section 501(c)(3) organizations. PFs may be attractive for larger gifts, especially for gifts over $2 million, due to the issue of control. Directors or Trustees of a PF exercise total control over investment practices, grantee selection, grant amounts, grant timing, and decisions regarding single or multi-year grant commitments. This level of control may be a primary advantage of the private foundation.

In a DAF, ultimate control over the DAF assets rests with the DAF sponsor. In recent years, to attract new donors and expand their programs, many DAF sponsors have provided donors with the look and feel of control. Despite the reduced level of control, donors to a DAF can treat their philanthropy with the same rigor, thoroughness, and professionalism that they would apply to a PF, creating a board of directors, conducting official meetings, and performing grant due diligence and selections sessions. These decisions can then be communicated to the DAF sponsor, who then decides whether or not to make the disbursements.

A Combination of Both Vehicles

Donors, especially those intending to donate illiquid assets, or those with a low cost basis, may benefit from creating a PF together with a companion DAF. As noted above, a DAF may allow a higher annual adjusted income deduction. Gifts of real estate or closely held securities to DAF, as a complement to a PF, offer other advantages as well. Also, as noted previously, a DAF is not subject to excise tax on net investment income.

The combination of a PF and a DAF can allow a family to make some or all of their charitable gifts anonymously if they wish. While a PF cannot conceal its identity (indeed, all grants from a PF are disclosed on the PF's annual Form 990-PF filing with the IRS), a PF can make a grant to a companion DAF, which can then, in turn, make the grant anonymously.

Creating a PF with a companion DAF can provide a donor with flexibility in the timing of charitable grants. For example, in a given year, a donor to a PF may want to make grants of less than 5% to charities, either because the donor can't identify enough worthy charities to meet the 5% minimum, or because a stock market correction has lowered the value of the foundation's portfolio, and the donor wants to hold onto those assets until markets rise again. With a companion DAF, the PF can make a gift of the shortfall amount to the DAF. This gift to the DAF counts towards the PF's 5% requirement, and the DAF can then hold this money for distribution in later years, at the donor's leisure, because a DAF is not subject to the 5% minimum required distribution. Thus, the donor can view the combined balances of the PF and DAF as a united source of philanthropic capital.

Moving Forward

Clients looking to establish a long-term philanthropic plan clearly have a number of important issues to consider when determining which of these two vehicles, a private foundation or donor-advised fund, is more appropriate for accomplishing their goals. Whether a family chooses one or a combination of both, the recent tax law changes, which greatly benefit taxpayers who front-load their charitable gifts, can make these vehicles even more valuable.

Table 2: Summary - Private Foundations vs. Donor Advised Funds		
Category	**Private Foundation**	**Donor-Advised Fund**
Character of Donations	Irrevocable	Irrevocable
Timing of Charitable Income Tax Deduction	Year of gift to foundation	Year of gift to fund
Operating Costs	May be as high as 1.5% to 2% of net asset value of foundation per year	Typically under 1% of net asset value of fund per year
Deductibility of Donations	See Table 1: Basic Deduction Limits on Donations	
Taxability of Income Earned by Assets Owned	Annual excise tax of as much as 2%	No excise tax
Tax-Filing Requirement	Must file Form 990-PF annually	Sponsoring organization files for all of its DAF accounts
Minimum Distribution	5% annually	None
Anonymity	None - all charities listed on Form 990PF, which is public	Available if desired
Control	Broad control, so long as consistent with PF's mission & purpose, and tax and state law	May be limited by sponsoring organization, cannot gift directly to individuals or conduct their own scholarship program
Perpetuity	Can continue forever based on availability of assets, successor trustees can be appointed	May continue forever, depends on rules of sponsoring organization

What's New At Siller & Cohen: 2nd Quarter 2019

Speaking Events:

• Randy recently co-presented at the New York State Society of CPAs (NYSSCPA) Annual Conference with a prominent Greenwich attorney. Their presentation centered on important Will & Trust provisions for CPAs to understand.

• Jeff Cohen recently presented at The Resource Group's annual meeting. Jeff presented a detailed case study of a high-ranking executive client and outlined how our planning strategies helped him transition into retirement while making the best use of his executive benefits package.

• Josh Marriott recently spoke at a NYSSCPA Estate Planning Committee meeting. His presentation centered on retirement planning and focused specifically on concepts that are important for CPAs to know.

Staff Updates:

• We are excited to welcome two new full-time employees, Domenika Bunjaj and Fran Narkaj, to Siller & Cohen. Both Domenika and Fran had previously been interns for the firm before joining full time.