Please Note:

Issues of *Futures* appear as they were originally published. Information in these publications has not been updated to reflect changes that could affect calculations given in case examples.

Newsletter begins on next page.

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Futures

Spring 2004

A no-nonsense newsletter for estate planners and financial advisors from The Dayton Foundation

Endowed Funds Generate Gifts that Keep on Giving

By Attorneys Frederick J. Caspar and David R. Wickham, Chernesky, Heyman & Kress PLL

Endowed funds offer our clients the opportunity to meet their current charitable objectives and to meet anticipated future objectives in a very tax-efficient manner.

For purposes of this article, "endowed funds" refer to charitable donations that: 1) are dedicated permanently to charity, 2) provide the donor with a charitable deduction in the year of contribution and 3) allow the donor (or donor's representative) some level of control over the ultimate charitable disposition of such donated funds for years to come.

Endowed funds are available from many different sources, including The Dayton Foundation, which offers an entire menu of endowed options. This article first will describe the times when an endowed fund can be useful in meeting charitable objectives, and then describe the various types of endowed funds that are available.

"Endowed funds are an integral part of our checklist for meeting our clients' income tax, charitable and estate planning needs."

FREDERICK J.CASPAR

DAVID R. WICKHAM

Typical Fact Patterns

A typical, but not exclusive, fact pattern for use of an endowed fund could involve the following. 1) The donor desires a charitable deduction in a particular taxable year (a prospective donor may have sold stock at a capital gain or, better yet, may be considering such a sale), and 2) the donor has general charitable objectives and has either not identified the specific charity or charities that he or she wants to benefit, or has identified those charities but wishes to use the contemplated funds to meet his or her current and future charitable obligations. Other fact patterns are discussed below.

Solution: Create an endowed fund and contribute appreciated property (or cash) to the fund prior to year end. The donor will receive a full fair market value charitable contribution deduction for federal income tax purposes (depending upon the type of property contributed) and will avoid the tax on the long-term capital gain, if the donation of the property occurs before the sale is complete.

In addition, the donated funds are excluded from the donor's taxable estate. The donor then can investigate potential charitable recipients and make distributions from his or her endowed fund to public charities at the donor's leisure, subject to the terms of the fund. It is important to remember that virtually any charitable technique (e.g., lead trust, remainder trust, direct gift) can utilize an endowed fund at a community foundation as the charitable recipient, and such recipient has public charity status for the donor's income tax purposes.

We also are seeing many clients who have large retirement accounts and want to leave a portion of such accounts to charity. Endowed funds offer flexibility in planning for such accounts.

We recently had a client who was forced by his employer's plan requirements to take a distribution of employer stock (publicly traded). Because of a special tax provision (which would have been lost if the distribution had been rolled into another retirement plan), he will only be taxed on the basis of employer stock distributed from the plan. He nevertheless will have significant taxable income in the current year as a result of the distribution.

By contributing a portion of this stock (which has a very low basis) to an endowed fund, however, he can reduce the tax in the year of distribution by claiming a deduction equal to the full fair market value of the stock and use these contributed assets to meet his future philanthropic objectives. He also is considering a charitable remainder trust with the endowed fund as the remainder beneficiary.

Other Factors Leading to Endowed Funds

There are many variations of the typical fact pattern that would lead a donor to pursue an endowed fund. Additional factors include:

- The donor would like to create a fund for annual charitable giving, because income, tax or other circumstances are changing.
- The donor would like to teach his or her children the art of philanthropy.
- The donor would like to create a receptacle that will be available to receive funds from a retirement account, trust or estate at death (a deferred gift).
- The donor needs time to investigate several charities.
- A private foundation is terminating due to administrative costs or must dispose of a closely held business interest due to the excess business holdings excise tax, and the foundation trustees want a receptacle where they continue to influence the disposition of the property.
- The donor wants the administrative services, such as recordkeeping and investment management services, offered by The Dayton Foundation or organization holding the endowed fund.

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Endowed Funds Generate Gifts that Keep on Giving

Continued from page 1

Private Foundations

In the past, private foundations often were used in order to meet the circumstances described above. The administrative costs and potential excise taxes involved in private foundations, however, make endowed funds an attractive alternative. This is especially true, given the increased flexibility to *direct* such funds now offered through certain donor services of The Dayton Foundation.

"The administrative costs and potential excise taxes involved in private foundations… make endowed funds an attractive alternative."

– Frederick J. Caspar and David R. Wickham

Menu of Endowed Funds

The Dayton Foundation has been very creative in developing the following menu of endowed funds, all of which are long-term in nature.

- *Unrestricted Funds* – The donor cedes control of the funds to The Dayton Foundation for use in the community, where need is greatest.
- *Field-of-Interest Funds* – This is similar to the unrestricted funds, except that the donor restricts the use of the funds by The Dayton Foundation to a particular area of interest.
- *Donor-Advised Funds* – The donor *recommends* the charitable recipients.
- *Donor-Designated Funds* – The donor designates the specific charities that will receive ongoing support from his or her fund, today and in the future.
- *Scholarship Funds* – The donor determines the criteria students must meet to receive scholarships from his or her fund.
- *Donor-Directed Funds* – The donor *directs* the timing and recipients of his or her distributions to charities.
- *Family Foundation* Plus – This is a type of donor-directed fund, offering multigenerational control and longevity similar to a private foundation, plus additional tax, administrative and other benefits.

Many of the endowed funds offer the opportunity for family involvement, both during the lifetime of the donor and following the donor's death. In addition, nearly all of the funds allow for investment of the fund's assets, with an investment return being added to the fund. Each fund type has its own restrictions and fee structure, but there are options available to meet the needs of our clients.

Advantages for Organizations

In addition to use of endowed funds by individuals, businesses may utilize endowed funds to establish gift-matching programs for employees and for their corporate giving. Charitable (tax-exempt) organizations, churches and schools among them, also may benefit from establishing an endowment fund with The Dayton Foundation. Such a fund can provide the benefits of separate, restricted access and protection from liability exposure, but at a low administrative and financial cost. An endowment fund with The Dayton Foundation can furnish other benefits, including long-term, professional money management and stewardship, technical expertise to receive different types of assets as gifts, and the financial strength to underwrite charitable gift annuities.

Conclusion

Endowed funds are an integral part of our checklist for meeting our clients' income tax, charitable and estate planning needs. Such funds offer flexibility at a reasonable cost. They allow our clients to give a current gift that keeps on giving. ❧

Note: Solutions will differ from case to case. The above does not constitute professional financial or tax advice.

Frederick J. Caspar and David R. Wickham are attorneys with Chernesky, Heyman & Kress, PLL. Caspar concentrates his practice in the area of federal income, gifts and estate tax planning. Wickham's practice focuses on federal and state tax law, exempt organizations and estate planning.

Futures Takes Top National COF Award for Outstanding Newsletter

The Dayton Foundation's *Futures* was named a Gold Award winner for excellence in communications by the national 2004 Wilmer Shields Rich Awards Program. The program is sponsored by the Council on Foundations, the premiere professional organization for all foundations in the U.S. and abroad, and the Communications Network. The Dayton Foundation's competition involved community and public foundations from across the nation. The *Futures* award was one of three Wilmer Shields Rich Awards presented to The Dayton Foundation at the 55th Annual Conference of the Council on Foundations in Toronto, Canada.

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