

Common Misconceptions Regarding Donor Advised Funds

Though the popularity of donor advised funds continues to grow, there are still some common misconceptions about establishing a donor advised fund at a community foundation.

For decades, community foundations have given charitably inclined individuals and families the chance to create donor advised funds. More recently, commercial financial services firms, backed by heavy marketing campaigns, have attracted billions of dollars in donor assets to their national gift funds. Despite this rapid growth, commercial donor advised funds are not necessarily the best choice for every client. In fact, for many high-net-worth individuals, a donor advised fund at a community foundation would be the better option. Some professional advisors steer clients toward commercial funds on the basis of misconceptions about the two kinds of funds—misconceptions this article sets out to correct.

That said, both types of funds do have their place. Although they inevitably compete for client assets, donor advised funds at community foundations and at commercial firms serve a common purpose: raising the profile of philanthropy and bringing needed resources to worthwhile nonprofits. And given the tremendous amount of marketing undertaken by the national gift funds—and with that, the popularization of donor advised funds—some community foundations feel this actually increases their market for new donors.

Misconception 1: Charitable giving is just a matter of writing checks.

We are all familiar with the ritual of writing checks to our alma mater or the Red Cross. But for serious donors, philanthropy means a good deal more. They want to accomplish a specific objective; they want to know they are having an impact; and they want to see results firsthand. A commercial donor advised fund might be a perfectly reasonable way for an individual to give money to her college, but it wouldn't be much help if she decided to set up a scholarship program there for children of homeless families. A community foundation, by contrast, has the philanthropic expertise and experience to guide a donor with a complex objective. "The primary goal of a community foundation is to provide assistance where it's needed in the community," says Howard Zaritsky, estate planning lawyer at Pitcairn Financial Group in Vienna, Va. "The community foundation focuses on distribution—on maximizing the value of the dollars where they're used."

Misconception 2: Commercial donor advised funds generate superior investment returns, which can lead to larger philanthropic gifts.

While commercial brokerage firms and mutual fund companies have made their names in the investment world, community foundations are holding their own here. Most community foundations receive institutional investment management services at very low fees. "People often assume that our investments are very conservative—and there

was some truth to that in the past when our assets were in trust form,” notes Ruben Orduña, Vice President for Development at the Boston Foundation. “But today, we have an investment policy designed to build long-term charitable capital for Greater Boston. We use very sophisticated investment vehicles. As a percentage of our assets, for example, we expect our alternative investments to reach the 40 percent range.” And when it comes to maximizing gift impact, community foundations give donors the opportunity to leverage their gifts with the foundation and other donors who share their interests.

Misconception 3: Community foundations give solely to local charities.

Community foundations are named for the cities or counties where they are based, so it’s natural that many advisors and donors assume that their focus is exclusively local. Although they do have hands-on knowledge of local needs and of the local nonprofit organizations addressing them, community foundations are fully prepared to make gifts to national charities and to nonprofits in other communities or regions. Some even make gifts to organizations overseas. “The reality is that if community foundations didn’t give proper consideration to grantors’ wishes, they wouldn’t receive any assets,” explains Jeffrey Daniher, CFP, of Ritter Daniher Financial Advisory in Cincinnati. By contrast, commercial financial firms may be less knowledgeable about local affairs and less committed to educating donors about social needs—whether on the local, regional, national, or international level.

Misconception 4: The income tax deduction is the same, whether the donor advised fund is established at a commercial firm or at a community foundation.

Commercial firms may be fully conversant with federal tax law, but they may be less knowledgeable about state income tax law regarding charitable donations. States such as Montana, for example, offer an endowment tax credit (not a deduction) that is not widely understood by outsiders. “A local community foundation is aware of the state’s particular income tax laws relative to charitable donations and can tailor the donor advised funds to maximize state-level tax benefits for the donors,” explains Stephen Hample, a financial planner in Bozeman, Mont., who also founded the Bozeman Area Community Foundation. “At least in this state—and I suspect in a few others—the local community foundations have an advantage with regard to state income tax.”

Commercial funds have their uses

Setting these misconceptions aside, you may, of course, have good reasons for guiding clients toward commercial donor advised funds. Community foundations are not for everyone. For example, a commercial donor advised fund might be a reasonable choice for a donor with limited ties to any specific community. It might also make sense for someone simply wanting to donate money now, take a tax deduction this year, and distribute gifts to a few large, well-established recipients over the next year or two.

But for anyone with longer-term and more specific philanthropic goals, the community foundation would likely be the better choice.

While community foundations and commercial funds have yet to collaborate in any serious way, both kinds of funds encourage and facilitate charitable giving, according to Dr. Thomas Peters, President and CEO of the Marin Community Foundation. Commercial funds have made great strides in publicizing donor advised funds through national marketing campaigns, and this has led to greater interest in donor advised funds at community foundations. "I'm of the philosophical and practical perception that all boats have been rising," Dr. Peters notes. "The only thing that's occurred since Fidelity entered this business is that all our assets have increased. And a lot more people are thinking about giving back. This is not a zero-sum game."

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