What's next for you?

Building your legacy with a Donor Advised Fund (DAF) or a Private Foundation.

Many owners find it difficult to part company with the business they have nurtured and developed into a successful enterprise. Having devoted so much time to their business it becomes a part of their identity, and it can be hard to replace the sense of purpose and fulfillment it represents. When the exit phase of the business life cycle approaches, many business owners will ponder what is next for them and for the business that has been their life's work.

After transitioning away from their business, many business owners struggle to manage their newfound freedom, and may experience a sense of loss of the identity and community that their business once provided. It can be a disappointing end to a venture that gave the owner pride and a sense of accomplishment. A thoughtful transition should be a multi-year process that provides ample opportunity to focus on how to use that freedom to provide purpose and community, and to transform the business into a lasting legacy.

The key to this process is to find activities that match your values and interests. One way to provide identity and community post-business—and to enhance your legacy—is to explore charitable giving.

Do you want to have a sustained impact on your community or in an area that interests you? Would you like to take a strategic approach to your giving? Do you want to involve other family members in your giving, or to pass on your philanthropic values to your children and grandchildren? There are many ways to give meaning and structure to your philanthropy and a DAF or a private foundation are two such ways.

The key to this process is to find activities that match your values and interests.

What is a DAF?

A DAF is a giving vehicle established at a public charity (these include national charities, community foundations, and single-issue charities). It allows donors to make a charitable contribution, receive an immediate tax deduction and then recommend grants from the fund over time. Donors can contribute to the fund as frequently as they like, and then recommend grants to their favorite charities whenever it makes sense for them. You may name your DAF account, its advisors and successor advisors, and manage the underlying investments.

What is a Private Foundation?

A private foundation is a philanthropic vehicle that is constituted and operated exclusively for charitable purposes, and can be structured as a trust or a not-for-profit corporation. It fulfills its charitable purposes through the controlled disbursement of its assets to listed tax exempt organizations or other "eligible donees."

Private foundations have restrictions on self-dealing between the foundation and their substantial contributors or other disqualified persons. Violations can give rise to taxes and penalties against the foundation and, in some cases, its managers, substantial contributors, and certain related persons.

Continued

Choosing between a DAF and a Private Foundation

Below are some high-level guidelines to help you compare a DAF and a private foundation.

- Making a minimum contribution of approximately
- $5,000–$50,000 (account minimums differ by sponsoring charity and/or DAF program)
- Seeking a simple, fast and inexpensive way to form a charitable giving vehicle
- Looking to maximize your charitable giving income tax deductions
- Contributing closely held stock, publicly traded stock, real estate or cryptocurrency that has appreciated in value, especially if you want a larger tax deduction
- Seeking greater flexibility in the annual amount of your grant making, including the ability to forego making any grants in some years
- Looking for greater privacy in your grant making, including keeping the balance of your charitable giving vehicle private

Although a DAF offers lower administrative and management fees, more favorable deduction limitations and asset valuations, and no excise tax on investment income, a private foundation provides greater control in the areas of grant making and investing. This is because a donor to a DAF must surrender final discretion and control over contributed assets, retaining solely advisory privileges.

A charitable sponsor of a DAF typically offers several investment pools into which you can allocate funds for investment (although most charitable sponsors will permit independent and active management of a DAF account if it has a minimum balance determined by the charity—typically $250,000 to $1 million). On the other hand, you may retain complete control of the investment of funds in your private foundation within the foundation's documented rules; private foundation investments are not limited to a selection of investment pools. In addition, as a donor to a private foundation, you can exercise full control over grant making. With a DAF, the charitable sponsor has the legal right to approve or deny a grant and makes all the final decisions. However, it's important to note that you can make recommendations, and in practical application, the charitable sponsor generally approves recommendations for grants to 501(c)(3) public charities.

Finally, as a donor to a private foundation, you may appoint its board members, including family members, providing the opportunity for your family's future generations to participate in its legacy through philanthropy. A private foundation may operate in perpetuity, and successive generations may serve on the board. A private foundation exists until its board votes to dissolve and unwind its operations.

Giving back

There are many ways to give back as you near the exit phase of your business.

While starting a donor advised fund (DAF) or private foundation are popular methods to create a legacy for your family, other strategies may better fit your needs and situation. Aside from the benefit of helping others, a major benefit of charitable giving can include tax deductions that may be claimed for up to 60% of your adjusted gross income for the year (and carried forward for five years after that). Generally, almost any property of value can be contributed as a charitable donation, with some restrictions around non-cash gifts.

Donate directly

Donate cash or other assets to a charity's general fund for unrestricted use, or to a restricted fund for a specific project.

Donate through your Will or Trust. Make testamentary gifts to charities in your Will or Trust by giving a set dollar amount or a portion of your estate or trust.

When you donate qualifying publicly-traded appreciated securities directly to a charity, tax on any capital gains can be eliminated. The tax that would have incurred on the eventual sale of the security would be avoided.

Life insurance

Donating a life insurance policy to a charitable organization is another popular strategy for giving back. Common options to do this are:

- **Make the charity the beneficiary.** Upon death, the charity would receive the death benefit proceeds and the insured's estate would receive a tax deduction for the full amount of insurance proceeds. If you have a taxable estate, this may be tax inefficient.
- **Make the charity the owner and beneficiary.** A donation receipt based primarily on the cash surrender value of the policy is issued and all future premiums paid by the insured are considered charitable donations eligible for a charitable deduction.

Life annuity

Donating a life annuity is a good way to make a significant gift without impacting your income needs. The benefactor would use a portion of his/her capital to buy a life annuity to provide a lifetime stream of income, and the remaining capital could be donated to a charity.

How is a DAF or Private Foundation established?

A DAF can usually be established immediately by filling out an application, having it approved by the sponsoring charity and making a deposit. In addition, there are typically no start-up fees.

With a private foundation, an attorney drafts articles of incorporation and bylaws (or a trust document), and registers the foundation with the state. The foundation must also apply to the IRS for recognition as a tax exempt organization. Legal fees and other start-up costs can be several thousand dollars and typically takes several weeks to create. As a result a private foundation is best suited to those willing to fund it with at least $2 million.

Giving back, *continued*

Designate a charity as the beneficiary of your Individual Retirement Account (IRA) or 401(k)

Charities do not pay income tax on donations they receive from these accounts. However, you may need spousal consent in the case of a 401(k); check your state's laws.

Business owner strategies

Charitable Remainder Trust (CRT). As an alternative to a taxable business sale, the owner could contribute all or a portion of their interests to a CRT and receive a charitable deduction. The Trust would sell the company's interests or liquidate (gains would be tax exempt) and use the proceeds to provide the owner with income for their lifetime, after which, the Trust would terminate and transfer its remaining assets to the charitable organization(s) they had chosen. Income payments would be based on a percentage of the Trust's annual value.

Charitable Lead Trust (CLT). Many business owners use gifts to charitable Trusts to leverage the income tax impacts when selling an appreciated business and the sale of a business could be a windfall where use of a CRT is not permitted from a timing standpoint. A CLT is beneficial if the business owner or his or her family members do not need an income stream at the time the Trust is created. Upon creation, the charity would receive the income stream and, at the end of the term, the remaining assets would pass to noncharitable beneficiaries. The value of the income stream going to charity for a term of years may create a charitable deduction at the time the Trust is created or each year during the term, depending on the structure of the Lead Trust.

With numerous avenues for charitable giving, choosing the right option for you may be challenging. Let your BMO financial professional help you with your giving options to ensure a rewarding giving experience.

How do you operate a DAF or Private Foundation?

The operations of the DAF are dictated by the sponsoring charity. Timing and minimums may apply to grants. Typically, simple forms are used for the donors to advise on the ongoing investments and grants. There are typical ongoing administration and management fees ranging between 60–100 basis points for accounts under $500,000 and 30–75 basis points for the next $500,000. This also varies by the sponsor and level of services.

The operations of a private foundation are generally managed by directors or trustees. While the investment of the assets of the foundation can be managed by the trustees and directors, in many cases these powers are delegated to an investment management firm. Federal law requires that 5% of the net assets valued annually are disbursed each year to qualified charities or a penalty is imposed. A professional investment manager can be retained to ensure that capital growth is maintained, and the 5% disbursement quota is met from the annual investment revenue. Private foundations must also file detailed and public annual tax returns (there is an excise tax on investment income of 1%–2%) and may need independent audits. If you outsource ongoing administration and management, the costs can add up to 1% of assets.

What is the tax treatment of gifts made to a DAF or Private Foundation?

Gifts to a DAF are valued at fair market value for cash, stock, and real property held over one year. You can deduct up to 60% of your adjusted gross income (AGI) on cash contributions and 50% of AGI on mixed cash/noncash donations (gifts of stock or real property held greater than a year can be deducted up to 30% 0f AGI). Unused deductions can be carried over for up to five additional years.

Gifts to a private foundation are valued at fair market value for cash, and certain publicly traded stock held over one year (gifts of closely held stock or real property are valued at cost basis). You can deduct up to 30% of your AGI for contributions to a private foundation (gifts of stock or real property held greater than a year can be deducted up to 20% 0f AGI). Unused deductions can be carried over for up to five additional years.

Many DAFs and private foundations are created to coincide with a significant event in the founder's life, such as the sale of a business. The sale of a business can result in a tax liability as well as significant cash proceeds so the establishment of a DAF or private foundation at this time can provide some personal tax relief for the business owner. For more information on the tax treatment of gifts made to a DAF or private foundation, you should seek advice from a professional tax advisor.

Transitioning away from your business is not easy; pursuing philanthropic interests can be rewarding for you as a business owner who is proud of the legacy you have created. Giving shape to your charitable giving through a DAF or private foundation can be gratifying, and a learning experience that complements the satisfaction you have achieved from your business endeavors.

Planning in advance can make this philanthropic journey easier, so we suggest that you speak with one of our philanthropic advisors at BMO Wealth Management about whether a DAF or private foundation is the right choice for you.

BMO Wealth Management