SPECTRUM

A newsletter for the friends and clients of First Republic Private Wealth Management

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Donor-Advised Funds vs. Private Foundations

A Guide to Choosing Your Philanthropic Giving Strategy

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An effective giving strategy aligns charitable spending with personal priorities, but it also hinges upon a philanthropist's ability to select the most appropriate tool—whether that's a donor-advised fund, a private foundation or a combination of the two.

A **donor-advised fund** allows the donor to contribute assets and enjoy immediate tax advantages, make grants on a flexible timetable, build a charitable legacy, and increase philanthropic funds for future grantmaking. It's a good fit for those who seek a consolidated giving strategy with a lower donation threshold and who want a sponsoring organization to accept some control over assets and administration.

A **private foundation** is an independent charitable organization created and controlled by an individual, family or business. Like a donor-advised fund, a private foundation also provides an immediate tax advantage. Grants can be distributed on a flexible schedule meaning future philanthropic funds can

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increase (or decrease). Private foundations can foster family involvement and allow a charitable legacy to extend beyond the donor's lifetime that can last generations. The major difference is that a private foundation has more administrative responsibilities than a donor-advised fund of which can be handled by third-party organizations. A private foundation maintains its own set of bylaws and is managed by its own trustees and directors. This powerful giving vehicle is best suited for those who want more control and want to involve family in the management of philanthropic endeavors. However, there are more administrative responsibilities than a donor-advised fund.

Both vehicles support strategic giving, but each offers unique opportunities and benefits that can aid a philanthropist in different ways. Before establishing a strategy, ask yourself:

	Donor-Advised Fund	Private Foundation
Which causes would you like to support?	• Allows for donations to any 501(c)(3) qualified charity • May not make grants to individuals or families	• Grantmaking decisions fully controlled by the foundation • Can include international organizations, direct scholarships and fellowships, and for-profit endeavors
Who will be involved in the charitable gifting decisions?	• Administered by a sponsoring organization and does not have ultimate control over the account • Account privileges—which include grantmaking recommendations—available to multiple family members. • Can be useful when a main donor's philanthropic pursuits may not be shared by future generations	• A collaborative enterprise with paid employees and an independent board of directors (employed or volunteering) • May include family, professional contacts, or anyone the founder chooses to appoint • Can last for successive generations and can help establish an intra-generational family legacy or can also be set up for a particular period of time (ex: 30 years).
How would you like your charitable donations to be acknowledged?	• Anonymous grantmaking permissible	• IRS form 990-PF required • All grants and contributions become public record
What types of assets will be part of your charitable contribution?	• Typical investments include cash equivalents, publicly traded securities and mutual funds. Additional potential investments include unique assets such as art, antiques, real property and S-Corp stock. • Above a certain dollar threshold in the account, some sponsoring organizations may permit outside investment advisor to manage underlying investments.	• A wide universe of investment options available which may include hard-to-value assets like art, antiques or real property as well • Can self-direct or appoint investment advisor

	Donor-Advised Fund	Private Foundation
How important is the tax treatment of underlying assets to your overall charitable goals?	• 60% AGI deductibility for cash contributions • 30% AGI deductibility for publicly traded securities, real property and privately held assets • Income tax deduction generally equals fair market value of gift for cash or publicly traded securities	• 30% AGI deductibility for cash contributions • 20% AGI deductibility for publicly traded securities, real property and privately held assets • Up to 2% excise tax on annual net investment income • Must file IRS Form 990-PF annually (state filing requirements may also apply)
What level of control and flexibility is important to you?	• Simple to establish • Account administration is offloaded onto the sponsoring organization • Sponsoring organization takes responsibility for all due diligence related to grantmaking	• Must file with the state, establish as a corporation and apply to the IRS for private foundation status • Foundation must appoint a board of directors and hire staff to run administration of organization • Foundation is responsible for all legal, compliance and due diligence associated with grantmaking
How much capital can you commit to the charitable vehicle?	• Minimum contribution is typically around $5,000 (no start-up costs)	• Initial contribution typically starts between $1 and $2 million • Costs associated with legal filing and accounting will be incurred
Have you established a timeline for charitable giving goals?	• There is no established timeline or annual minimum for the distribution of funds. • Easy to accelerate giving during high-income years or via a “bunching” strategy (taxpayer groups deductions into a single year to surpass the itemization threshold) • In off-years (or “skip-years”), donors take standard deduction • Can hold the cache of charitable dollars, which can then be distributed to charities for years to come	• The IRS requires private foundations to distribute 5% of the fair market value of their assets each year. If a private foundation fails to distribute the required 5% by the end of the subsequent fiscal year, it is subject to a 30% excise tax on the undistributed amount. If the required amount remains undistributed, the foundation may be subject to an additional excise tax of 100% of the undistributed amount.
What is your vision for the succession plan?	• Can name individuals and charities as successors for the account	• Successors and officers confirmed only by vote of the organization’s board of directors or trustees. For family foundations, the board is typically made up of family and friends who support the mission.

A DONOR-ADVISED FUND AND PRIVATE FOUNDATION CAN BE USED AS COMPLEMENTARY VEHICLES

There's no such thing as a one-size-fits-all charitable strategy, which is why it is often beneficial to apply the advantages of more than one vehicle. Using the vehicles in concert with each other may be valuable:

When making an anonymous donation

While donations made through a private foundation are a matter of public record, those made through a donor-advised fund are not. A donor-advised fund can be used as a complementary vehicle through which to make anonymous donations when looking to minimize solicitation from similar organizations, to avoid scrutiny or to donate to a cause that may not align with the foundation's overall mission.

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When seeking advantageous tax treatment

The charitable income tax deduction is generally preferential for a donor-advised fund over a private foundation. For cash donations, an individual can receive a deduction of up to 60% of adjusted gross income (AGI) when donating to a donor-advised fund while a private foundation donor can receive a deduction of up to 30%. For appreciated securities the deduction for a donation to a donor-advised fund is 30% of AGI, 20% for private foundations.

For non-publicly traded stock donations held for more than one year, the deduction for a donor-advised fund is generally the fair market value on the date of contribution. Inversely, if the assets are held for a year or less, the deduction will be limited to the lesser of current fair market value or the asset's cost basis. For a private foundation, the deduction is the cost basis. Unused deductions can be carried forward for five years.

As a learning opportunity for the next generation

The management of a smaller donor-advised fund can act as a succession planning tool that gives offspring the opportunity to gain philanthropic experience before taking on a leadership position within a family foundation.

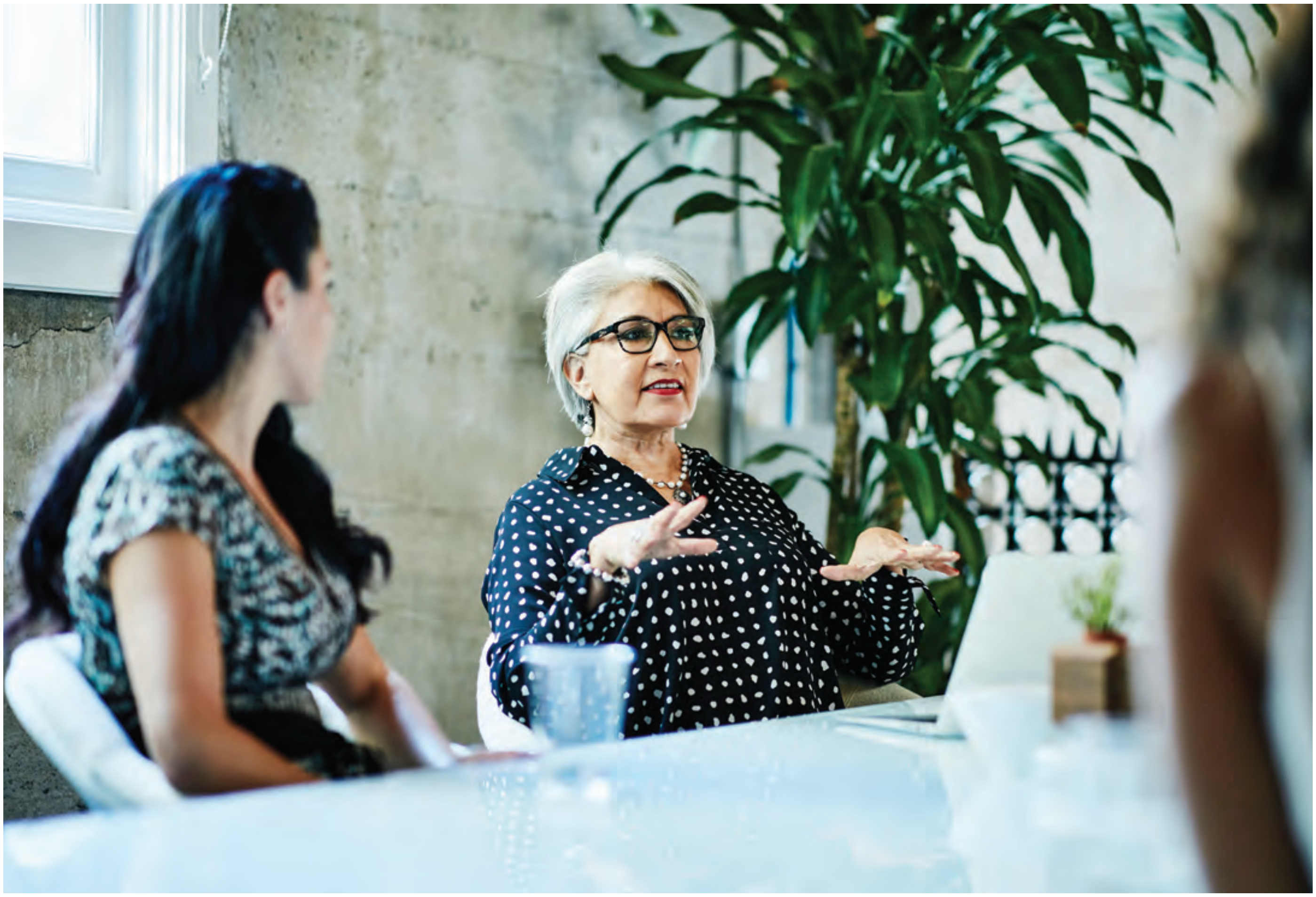
To fulfill the mandatory annual distribution requirement

A donor-advised fund can act as a vehicle to receive the 5% annual distribution required for foundations. This can come in handy at the end of year if a donor has yet to make a final funding decision.

THE TAKEAWAY

When determining the best vehicle to solve for your philanthropic goals, it is important to consider the pros and cons of each charitable vehicle and how they apply to your overall giving goals. It's also key to understand that donor-advised funds and private foundations can be used complementarily. Contact your wealth advisor to discuss which option can best meet your long-term charitable goals.

The strategies mentioned in this article may have tax and legal consequences; therefore, you should consult your own attorneys and/or tax advisors to understand the consequences of any strategies mentioned in this document. The information has been verified by the author, but it does not constitute legal or tax advice and First Republic is not acting as your attorney or tax advisor. We make no claims, promises or guarantees about the accuracy, completeness or adequacy of the information contained here. This information is governed by our Terms and Conditions of Use.



Preparing to Sell Your Business

How to Get Started With a Successful Exit Strategy

Jay Halverson, Estate & Business Planning Specialist,
First Republic Securities Company

If you are a business owner, one thing is certain: At some point, you will exit your company. In order to leave—on your terms and when the time is right—you should begin to design your plan now in order to achieve a successful outcome.

According to the U.S. Census Bureau's most recent Survey of Business Owners, in 2012, 75% of U.S. businesses with paid employees were owned by individuals ages 45 and older; many of these business owners are Baby Boomers set to transition over the next 10 to 15 years. A study by the Exit Planning Institute shows that only 20% to 30% of businesses that go to market actually sell, leaving up to 80% without solid options to harvest their wealth and ensure economic continuity into the next generation. An owner who is "ready" with an attractive business greatly increases the odds that the business will survive a transition. The question is, how ready are business owners?

Many owners often believe that their exit plan begins when they receive an offer for their business. That should not be the case. The key to a successful transition is to start as early as possible and to seek help as you navigate the process. There are endless details to keep track of during exit, succession and transition planning, and it can become a second job. The No. 1 trap to avoid is losing focus on running your company. Finding the right advisor to guide you through the pre-event planning experience is a critical first step in maximizing the opportunity to achieve your goals.

In addition to seeking outside guidance, there are additional steps that any business owner contemplating a change should consider:

> The key to a successful transition is to start as early as possible and to seek help as you navigate the process.

Begin to prepare yourself emotionally

Business owners are often told to set their emotions aside when thinking through an exit.

While this may be true when it's time to get into the weeds of closing a transaction, it's critical to think through the emotional and personal aspects of a sale early in the process. For most business owners, selling a company isn't just about getting the best financial terms; it's also about separating themselves from what has, in many cases, been the focus of their lives for years.

With that in mind, we encourage business owners to think about an exit initially in terms of how it will change their daily personal life and routines. Some of the key questions we ask our clients include: What are your biggest strengths, talents and passions? What keeps you up at night? What's left on your personal and professional bucket list? What is the single biggest opportunity in your life right now—and how does selling your company strengthen or detract from that?

For some owners, a sale doesn't just offer a financial return; it can also open doors for them to pursue other passions. For others, running their company is their passion. Wherever you fit, considering how your business impacts your personal life is the cornerstone of the entire planning experience.

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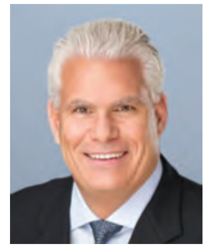
Know your “go home” number

Odds are that your business is your most valuable asset and makes up a significant part of your wealth. While it’s paramount to be realistic about what your company is worth, it is equally important to identify your “go home” number—what it would take to walk away from your business (after taxes and other costs) and never have to work again.

Prior to an exit, business owners should go through an interactive cash flow modeling experience that not only provides analysis around a potential transaction but incorporates it in the context of their broader goals around spending, saving and investing. Cash flow modeling provides a visual representation of a financial plan—from current income needs to estate planning and legacy goals. Most owners we have worked with comment that this is the most eye-opening step in the exit process.



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> Being able to articulate the value drivers in your business is a key step in the exit planning process.

The earlier you are able to pinpoint your “go home” number, the more options and control you will have as you explore if an exit is right for you. There are instances where a company’s current valuation far exceeds what an owner needs to achieve his or her objectives, but it’s often the case that it does not. Fortunately, business owners who take time to understand the distinction between what they need and what they would get if they sold their company today are afforded time to reconcile the two.

As you begin to think through the financial implications of a sale, don’t underestimate the value of your “cookie jar”—the benefits that come with owning a business, which include everything from company credit cards and medical coverage to cell phone plans or vehicle perks for you and your family. Putting a value on these perks as if the company was not around to provide them is sometimes the difference between selling or not.

The second most overlooked aspect is taxes. Tax implications of a sale may be one of the single biggest drivers around the structure and timing of a deal; you’ll want to make sure your team of advisers includes professionals who can identify creative solutions to minimize the tax burden and to identify possible tax traps.

When all is said and done, your “go home” number may not match your company’s current valuation, as is often the case in the early stages of a sale. The good news is that by going through this process early you will have options, both in terms of what you can do to make your business more valuable and how to make your personal financial needs line up.

Understand what makes your business valuable—and know how to articulate it

The No. 1 rule in determining whether or not you're ready to sell is whether that business can operate without you for an extended period of time, because if it can't, it's not going to have much value if you aren't around. Some of the most valuable companies that buyers are looking for are the ones that don't need an owner to stick around to run it every day.

One of the biggest challenges owners face is balancing the strategic planning needed to work toward a successful exit while still running their businesses day to day at what is often a critical time.

Being able to articulate the value drivers in your business is a key step in the exit planning process. Value drivers are a company's secret sauce and can have a real impact on driving up valuation multiples. Value drivers can vary greatly by industry and company—from intellectual property to customer concentration to brand recognition to a motivated management team—and owners need to identify these early on and understand what makes them important to a potential buyer.

Think about how to articulate what those value drivers are and why they distinguish you from your competitor down the street. Practice telling your story and get comfortable with it; if you choose to head down the exit path, you will be telling it a lot.

Make exit planning a priority—but not a distraction

There is a big difference between creating a plan and executing a plan. Countless owners have plans just sitting in their filing cabinet collecting dust. One of the biggest challenges owners face is balancing the strategic planning needed to work toward a successful exit while still running their businesses day to day at what is often a critical time. Many owners fall into the "working in your business" trap—they get so tangled in the day-to-day issues of running their business they never have time to come up for air and address the big-picture priorities. Often this can lead to both the business and the exit planning not receiving adequate attention.

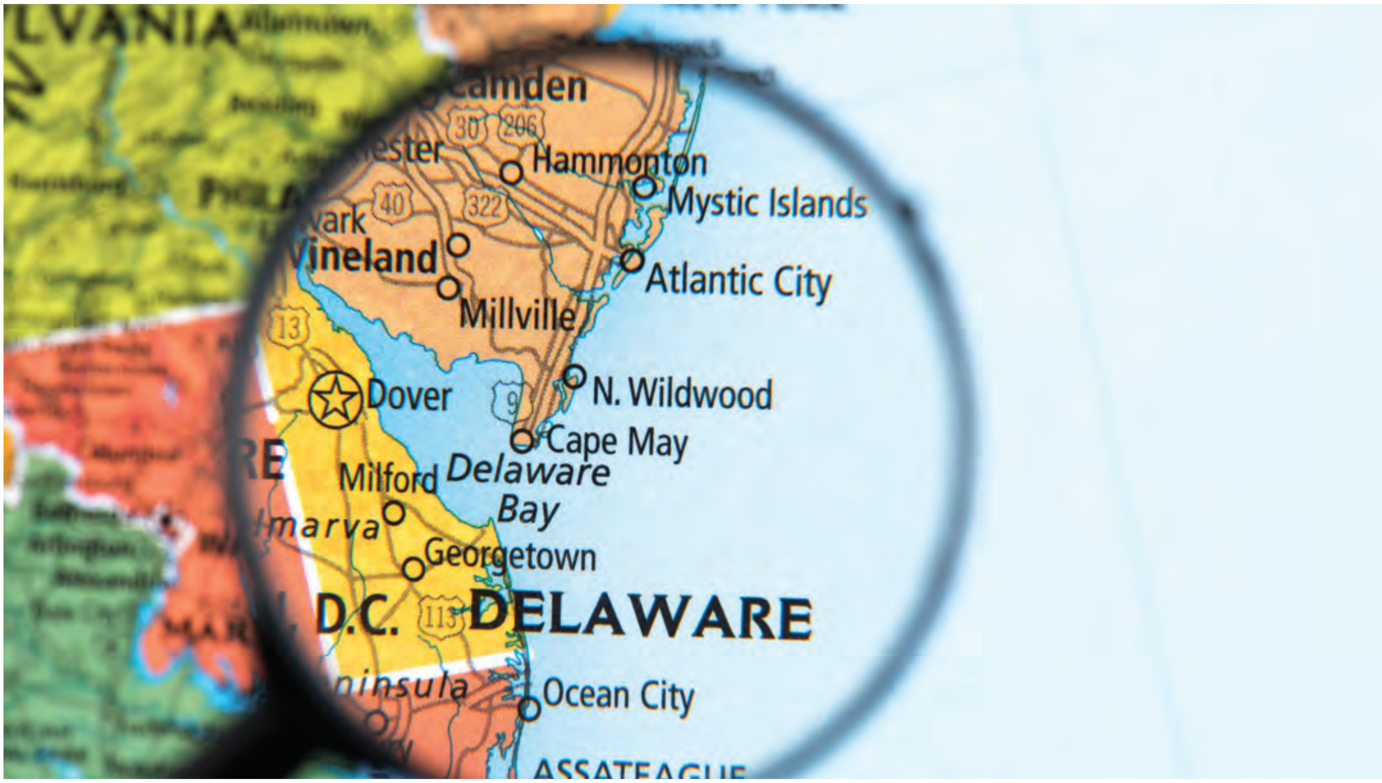
To balance the demands of running a business and potentially transitioning out of it, consider adopting some of these best practices.

- ☐ Carve out strategic time for exit planning—just as you would for any other big project—while staying focused on running and growing the business.

- ☐ Enlist an "exit-planning architect" who can help you map out a timeline, work through key steps and stay on task. Let them help you initially identify your desired exit options, create a written plan and manage the task list that the attorneys, CPAs, investment bankers and wealth managers will need to complete.
- ☐ Get your corporate documents in order. Would-be buyers will want to see clean and up-to-date corporate documentation; be proactive about this to avoid the risk of delaying or derailing a deal.
- ☐ When it's time, bring key employees into the conversation. They will need to stay beyond the close. Work with your advisors to craft the right communication strategy and incentivize your employees to stay well beyond the finish line, not just to it.

Exit planning is a journey. If done correctly, it will ensure you have the following: an exploration of all the options, a written plan identifying your wishes, a contingency plan for the "what if's" and a task list for your advisory team. Finding the right exit-planning advisor will increase the chances of your vision coming true.

If you have any questions, comments or suggestions for Spectrum, please contact us at **privatewealthmanagement@firstrepublic.com**



Trust Situs Matters

A Small State Offering a Wealth of Trust Planning Advantages

Alison G. Westbrook, Regional Team Lead,
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Delaware's rich history in trust and business matters, which dates back to colonial times, serves as the foundation for the First State's forward-thinking approach to trust planning. Delaware has a well-thought-out body of trust laws, which it updates on an ongoing basis, and a supportive legislature, executive branch and legal community. The following are some of the unique aspects of Delaware trust law:

> Delaware has a well-thought-out body of trust laws, which it updates on an ongoing basis, and a supportive legislature, executive branch and legal community.

Directed trusts

A directed trust is a trust in which the responsibility for investment, distribution or other administrative decisions is vested in one or more advisors, as appointed in the trust agreement. Delaware law allows for this division of trustee duties, as opposed to having one trustee retain full authority over distribution, investment and administration. For example, a trust could name the grantor's sibling as the investment advisor, who could direct the trustee to hold shares in the grantor's closely-held business. In a traditional trust, this type of investment would not be acceptable to a corporate trustee. Other types of advisors can be appointed in situations where the terms of the trust stipulate that a beneficiary comply with certain requirements (e.g., remaining free of drugs or alcohol) in order to receive trust distributions. These distribution advisors may be in a better position to monitor or track these types of requirements if they are familiar with the beneficiary and their circumstances, while corporate discretionary trustees usually are not.

Dynasty trusts

A dynasty trust is a trust that has the ability to last for multiple generations, often in perpetuity. Delaware abolished its rule against perpetuities in 1995, paving the way for the creation of dynasty trusts (the only exception is for real estate held directly by the trust, which has a limitation of 110 years). Dynasty trusts have made it possible for wealthy families to pass their assets down to succeeding generations free of transfer tax. A dynasty trust may also be a directed trust.

Possible state income tax advantage

Delaware law allows resident trusts to not only take a deduction on income that is actually distributed to beneficiaries, but also to take a deduction on income that is accumulated, provided that the beneficiary is not a resident of Delaware. This means that for a large majority of Delaware trusts, there is no state fiduciary income tax on income or capital gains at the trust level.

Although an analysis of how the client's state of residence will treat the income and capital gains of a Delaware trust is essential, this unique advantage can serve as a powerful tax planning tool. For example, if a client funds a Delaware trust with shares of low basis stock or an interest in a closely-held company prior to a liquidity event, the savings in state capital gains tax could be sizable when the shares are sold.

Creditor protection

Spendthrift provisions in Delaware trusts are strictly enforced and can provide trust beneficiaries substantial protection from creditor claims.

Silent trusts

A "silent trust" is essentially a trust that includes language dictating that statements are not to be sent to some or all beneficiaries for a period of time. Most states require trustees to send periodic statements to beneficiaries regardless of the trust language. In Delaware, a trust grantor can restrict beneficiary access to information as to the existence of the trust or the assets and administration thereof, for a period of time. For example, a trust's grantor may want to wait until his beneficiary child attains a certain age—perhaps 35 or 40, when he or she may be more financially mature—to learn about their wealth.

Flexibility

In order to benefit from some of the advantages of Delaware trust law, many trusts may move situs to Delaware simply by naming a Delaware trustee. Existing Delaware trusts may be modified or decanted into new trusts to make changes to trust provisions for administrative or estate planning reasons.

So don't be fooled by Delaware's size. This small state offers a host of trust planning alternatives, making it a national leader in modern day wealth management.

Alison G. Westbrook, Regional Team Lead, First Republic Trust Company of Delaware

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spec´trum, n.

A broad range of related ideas or objects, the individual features of which tend to overlap so as to form a continuous series or sequence.

—Random House Unabridged Dictionary