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WEALTH ADVISER | MONDAY, DECEMBER 23, 2013

# Ways to Avoid Making Mistakes With Donor-Advised Funds

By VERONICA DAGHER | MORE ARTICLES BY AUTHOR

***Donor-advised funds are becoming a popular way for clients to give to charity. Yet some donors don't fully understand how the funds work--which can lead to some costly mistakes.***

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Donor-advised funds are becoming a popular way for clients to give to charity.

The funds are simple to use. Donors can lock in a full deduction by contributing before year-end. And they can have the fund's managers distribute the money that is growing tax-free to their chosen charity or charities over time.

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But despite the product's relative simplicity and tax advantages, some clients don't fully understand how the funds work--which can lead to some costly mistakes.

Below, financial advisers weigh in on a few of them:

No Second Tax Deduction

Too many clients think they also get a second tax deduction when the charity of their choice receives a distribution, says John Gugle, principal of Alpha Financial Advisors in Charlotte, N.C.: "We have to explain over and over again that their tax deduction stems from their initial donation to the donor-advised fund." Clients also may need reminding that there can be a variance between what they contributed to the fund and what was paid out to their charity due to market fluctuations, he says.

Don't Assume the Charity Is Approved

"To be extra safe, make sure your charities are approved by the donor-advised fund before making the donation to the fund," says Andrew Altfest, executive vice president of Altfest Personal Wealth Management in New York. While larger charities such as universities are likely already approved, smaller charities might not be. If the smaller charities aren't approved, ask the fund's managers to get them on the approved list. "You want to make sure your money will go the charities you want to support," he says.

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The biggest mistake financial planner Rand Spero sees is when clients want something in exchange for their charitable contributions. Donor-advised funds insist that any donation is made with the understanding that no goods or services were received for the gift, says Mr. Spero, president of Street Smart Financial in Lexington, Mass. That's a problem for a client who, say, wants to fulfill his bid on a vacation rental at a charitable auction by using money from his fund.

Don't Forget About It

Financial planner Mark Coffey has seen some clients create donor-advised funds without having any true charitable intent. "In situations where a client funds such an account in order to partially offset a taxable windfall, I've found that their funds will languish each year because they never developed a strategic charitable-gifting approach," says Mr. Coffey, a senior financial adviser at Summit Financial Strategies in Columbus, Ohio. In turn, he works with clients to develop a strategic plan or help them invest the money in their fund to grow the assets over time until they develop a strategy.

Don't Give More Then You Can Afford

Donor-advised funds allow clients to accelerate their charitable contributions to years when they can best take advantage of the tax deduction, says Mr. Altfest. However, clients may mistakenly assume that they will want to donate the same amount to charity every year. However, that is a problem if they need money to pay their bills. All moneys placed in the fund are irrevocable.

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