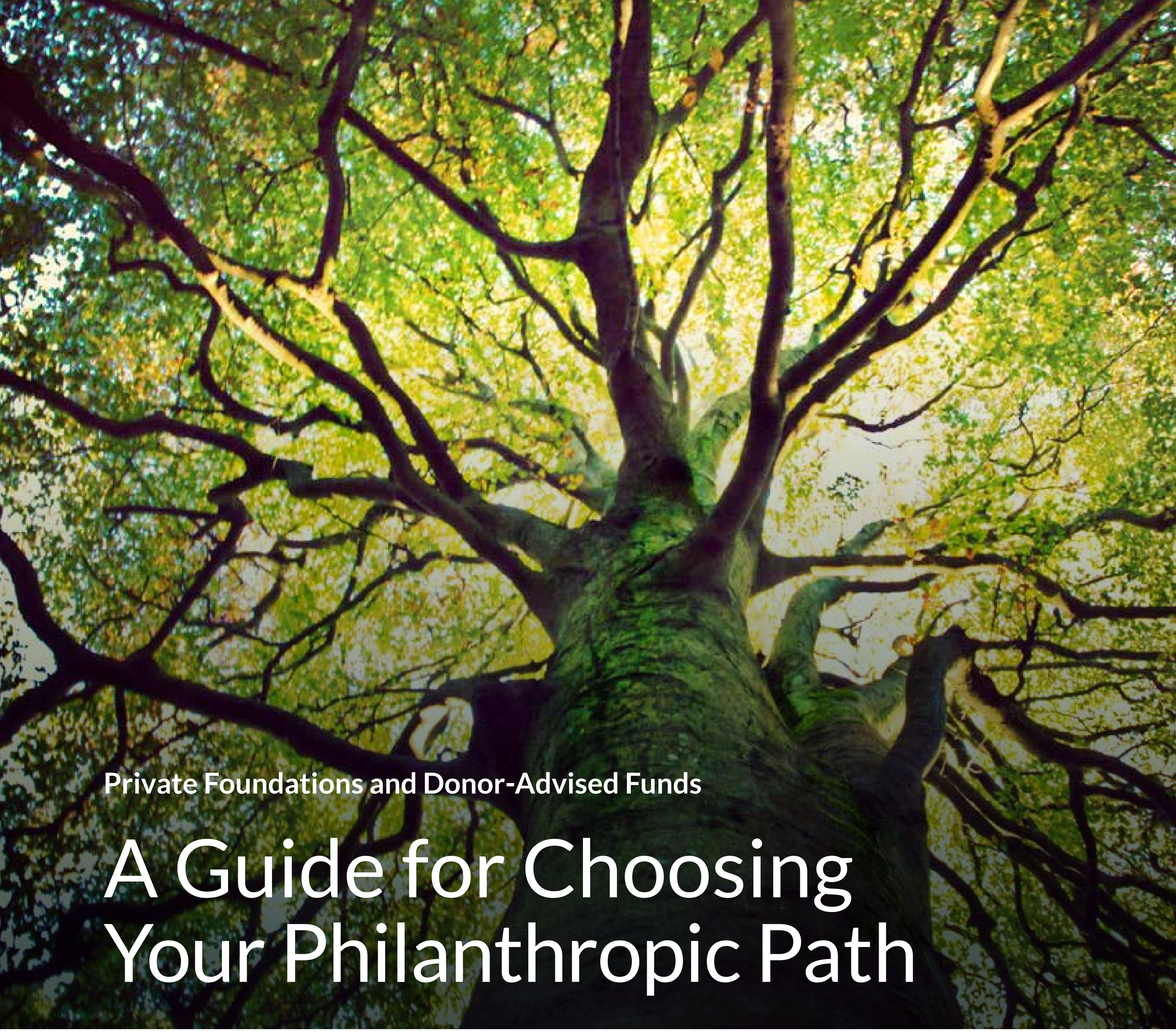

Private Foundations and Donor-Advised Funds

A Guide for Choosing Your Philanthropic Path

The following guide was created to help you understand the benefits donor-advised funds (DAFs) and private foundations provide—separately or as a complement to each other. As a donor, your charitable needs can be wide-ranging; what is crucially important to one donor may not even make your list of priorities. That's why it's important to consider all of the factors before starting down your philanthropic path.

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The charitable giving landscape has broadened, with more options than ever to help you carry out your philanthropic goals. Two of the most popular vehicles—private foundations and donor-advised funds (DAFs)—present different approaches for accomplishing the same goal of getting funds to charitable causes you care about. But with differing structures, rules, privacy, and flexibility, the two vehicles each come with a unique set of advantages and limitations.

What is a donor-advised fund?

A donor-advised fund (DAF) is like a charitable investment account, for the sole purpose of supporting charitable organizations you care about. You can contribute a variety of assets to a public charity that sponsors a DAF, and you are generally eligible to take an immediate tax deduction. The funds can be invested for tax-free growth, and are available for you to recommend grants to any IRS-qualified public charity in a time frame that works best for you.

DAFs can be a great choice for donors who want a simple, efficient solution that helps maximize their philanthropic efforts. While they do not offer the same grant-making flexibility as private foundations, DAFs are an effective solution that will meet the needs of many donors who do not wish to take on the extensive administration or grant-making due diligence involved in running a private foundation.

What is a private foundation?

A private foundation is a type of charitable organization that typically is established by an individual, family, or corporation to support charitable activities. A board of directors or trustees oversees the foundation and is responsible for managing and investing assets and making grants to other charitable organizations in support of the foundation's public mission.

As its own legal entity, a private foundation offers broader license for grant-making activity and control over investments and management. With this flexibility, donors must also take on additional recordkeeping responsibilities and comply with more stringent tax rules. A private foundation is a very powerful charitable tool, but you should weigh all of the factors before jumping into this level of commitment.

Donor-advised funds compared to private foundations

	Donor-advised funds	Private non-operating foundations
Establishment	The donor fills out a simple application for the sponsoring organization. There are no costs associated with establishing a DAF, and most accounts can be established and ready for use in just a few days.	The donor must file with the state to establish a trust or corporation and apply to the IRS for private foundation status. This process can take a significant amount of time and incurs costs associated with legal filing and accounting.
Administration	A DAF is an account administered by the sponsoring organization; therefore, the donor does not have ultimate control over the account.	As a freestanding legal entity, a private foundation can appoint a board of directors and hire employees (including family members) to run the foundation.
Tax treatment and deductions* **Percentage of adjusted gross income (AGI)*	• 60% deduction for cash • 30% deduction for appreciated assets[1] • No excise tax	• 30% deduction for cash • 20% deduction for appreciated assets[2] • 1–2% federal excise tax on the foundation's annual investment income
Investment management control	Donor can recommend investments based on options available. Many sponsoring organizations also allow donors with higher account balances to recommend an outside advisor who can control the investments.	Donor can appoint an investment advisor or can self-direct the investments.
Grant-making control	The donor can recommend grants to eligible 501(c)(3) public charities. Donors may not direct grants to individuals, provide scholarships directly to individuals, or grant directly to international organizations. The DAF-sponsoring organization takes on all due diligence related to grant making.	The donor has full control over grants to eligible 501(c)(3) public or private charities and individuals but is also responsible for all due diligence and legal compliance related to grant-making activity.
Privacy	Donors can grant anonymously from their DAFs. The sponsoring organization of the DAF must submit IRS Form 990 but can keep individual donor records private.	The private foundation must submit IRS Form 990-PF so that all contributions and grants are public record.
Recordkeeping and expenses	Donor-advised funds offer consolidated recordkeeping and tax reporting. To maintain the DAF, the sponsoring organization charges administrative fees and management fees on investment pools.	The donor is responsible for all IRS filing and compliance. The private foundation assumes ongoing legal, accounting, investment management, and payroll expenses.
Successor election	The donor can name other individuals or charities as successors on the account.	The board of directors or trustees must vote for successor directors or officers.

1 Appreciated assets held for over a year are generally deductible at fair market value. (This applies to both publicly and non-publicly traded assets.)

2 Appreciated, publicly traded assets held for over a year are generally deductible at fair market value, while non-publicly traded assets are generally deductible only at basis.

Complementing a private foundation with a DAF

You don't necessarily have to pick between a DAF and a private foundation; choosing only one isn't always the best option. Sometimes you may be best served with a strategy including both.

Establishing a DAF to complement a private foundation can be an incredibly effective way to fulfill all of your philanthropic goals. Think of the two vehicles as two different tools in a set—each with its own particular uses. The following are a few of the scenarios when a DAF could provide additional utility to support a foundation.

Grant with flexibility and privacy. DAFs offer the ability to make grants anonymously, while the grant-making activity of private foundations is public record. There are a variety of reasons you may wish to make anonymous grants. You may want to prevent additional solicitations or avoid disclosing your involvement in a sensitive cause.

Similarly, a private foundation's grant-making often aligns with a specific public mission statement. This consistency helps to establish a philanthropic legacy related to that mission. However, there may be times when you wish to make a grant outside of your mission statement. A DAF can be a great tool in these situations.

Take advantage of in-house expertise. DAF-sponsoring organizations often have extensive experience that you can use to become a more strategic and effective philanthropist. A DAF can give access to experts in processing non-cash assets, such as private equity, restricted stock, real estate, or cryptocurrency. This proficiency can greatly simplify the process of donating complex assets.

When granting funds to charity, DAFs can provide guidance on making effective gifts and the rules and restrictions related to giving. Some DAF-sponsoring organizations may have expert staff members who can help with your overall philanthropic strategy and research. The sponsoring organization also takes on the legal responsibility involved with granting, putting its considerable resources to work performing due diligence and ensuring the eligibility of the receiving charitable organization.

Take advantage of more favorable tax treatment. DAFs and private foundations are subject to different tax treatment, with donations to DAFs generally receiving a more generous deduction. When you contribute to a public charity that sponsors a DAF, you are eligible to deduct up to 60% of your AGI for cash contributions and 30% for appreciated securities. In contrast, when contributing to a private foundation, you are eligible to deduct up to 30% of AGI for cash and 20% for appreciated securities. In years when you donate a really significant portion of your income to charity, it may be tax-savvy to contribute to a DAF.

Contributions of non-cash assets to DAFs have an additional advantage. You can generally deduct the fair market value (FMV) of your long-term appreciated assets, including real estate, securities, and privately held stock. Conversely, when contributing these assets to a private foundation, you can generally only deduct the cost basis of the property. If you have a highly appreciated asset to contribute, donating it to a DAF may provide a greater tax benefit.

Note: It is important to remember that funds can be transferred from a private foundation to a DAF, but DAFs generally cannot grant funds to private foundations. Donors should take this limitation into account when developing their preferred contribution plan.

Collapsing a private foundation into a DAF

There are a variety of reasons you may decide that it's time to close a private foundation. Maybe you wish to simplify your administrative responsibilities or move to a more anonymous grant-making strategy. Maybe you would benefit from the more favorable tax treatment DAFs receive. Whatever the reason, collapsing a private foundation into a donor-advised fund is an excellent way to carry out your philanthropic mission in a simpler way.

Considerations when collapsing a private foundation

In general, a foundation can liquidate into a public charity as long as the public charity has been exempt and in existence for more than five years. Collapsing the foundation requires an affirmative vote of dissolution by the foundation's board of directors or trustees.

To contend with final administrative responsibilities, the foundation should retain assets to cover the cost of winding down its affairs.

How to collapse a private foundation

- ***Distribute assets.*** To fully terminate its existence, a private foundation must distribute all its net assets to a public charity. All estimated foundation expenses—such as invoices, accounting fees, and other administrative costs—should be fully paid before distributing the assets to a DAF.

- ***File final tax returns.*** Although a foundation is operationally terminated upon final distribution of all its net assets, your client is still required to file a final IRS Form 990-PF (and related state filings) for the taxable year in which the distribution was made. You should also send a notification letter to the IRS that the foundation's final Form 990 has been filed. The letter must include the name of the charity to which the foundation's assets have been donated and should specify that the charity has been in existence for at least five years.

- ***Fulfill additional state requirements.*** The state in which the foundation was established may require additional steps to start and complete the termination process, generally with regard to the dissolution of the underlying foundation entity, trust, or corporation. Requirements for liquidation vary from state to state, but typically include filing with the state's division of public charities. Dissolution may also involve a review process by a state court to ensure that the assets are donated to a public charity.

Asking the right questions to determine the best strategy

You must consider many factors when choosing how to carry out your philanthropic mission. There simply isn't a one-size-fits-all solution. To help you along your philanthropic journey, it's important to start by asking the right questions. To figure out which strategy might be best, consider questions like the following:

- ***Do you know which causes and charities you'd like to support?***
- ***Who is or will be involved in the charitable giving decisions?***
- ***Is anonymous grant making important to you?***
- ***Will the different tax treatments for donor-advised funds and private foundations make a difference in your specific situation?***
- ***Would you benefit from in-house expertise on donating non-cash assets?***
- ***Do you have highly appreciated assets that you would like to contribute?***
- ***Do you require more flexibility or desire more control over investments or grant making?***
- ***Do you have a broad range of causes you would like to support?***

As you can see, there are many factors to take into account when creating an effective plan. The answers to these questions will help you narrow your focus and begin to prioritize your needs.

Conclusion

As you continue your philanthropic journey, you should seek out the most efficient and effective strategies to achieve your charitable goals. But when there is no "right" answer to the question of how to give, it is easy to get lost in the options. But by asking the right questions and understanding your priorities, you can chart your path to becoming a more successful philanthropist.

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