

PRIVATE FOUNDATIONS AND DONOR-ADVISED FUNDS

A Side-by-Side Comparison

In looking to create a charitable vehicle, you may be considering whether to establish a private foundation or a donor-advised fund (DAF). At the most basic level, the difference between a DAF and a private foundation is the construct, or form, in which each entity is created and operated.



PRIVATE FOUNDATION

A private foundation is a wholly distinct, tax-exempt legal entity governed by its own set of bylaws, articles of incorporation, etc.



DONOR-ADVISED FUND

A donor-advised fund is a giving account that is offered by and housed in a public charity, which may be connected to a community foundation, a financial institution, or a university.

A difference in structure may sound like a trivial distinction, but when comparing private foundations and donor-advised funds, it turns out that form really does dictate function. Because a private foundation is a freestanding legal entity, and a donor-advised fund is an account, the two charitable vehicles offer very different levels of control, authority,

and philanthropic versatility. The differences between private foundations and DAFs are highlighted on the following chart. As DAF policies and procedures vary by the sponsoring organization, the information on this chart is based on standard common practice.

ORGANIZATIONAL DIFFERENCES: CONTROL VS. PERPETUITY

| | PRIVATE FOUNDATION | DONOR-ADVISED FUND | GOOD TO KNOW |
|---|---|--|---|
| Remain under the legal and financial control of the family in perpetuity | YES. If the board chooses, legal and financial control of the foundation and its assets can remain within the family for unlimited generations. | NO. The family never has legal control of the DAF or its assets. Control resides with the fund's sponsors. Most DAFs allow the donors to appoint successors for one—possibly two—generations, after which the family's philanthropic legacy ends. | If no successor is appointed for the DAF, or if it remains dormant for a specified number of years, the account may revert to the control of the sponsoring agency. |
| Appoint its own board of directors or trustees | YES. Once the foundation is established as a legal entity, the founder(s) may appoint a board of directors or trustees to help set foundation strategy, establish operating rules and procedures, and provide oversight. | NO. A DAF is not an independent legal entity, but rather an account maintained by the sponsoring organization. It therefore cannot have its own board of directors or trustees. | Foundation Source establishes private foundations in the state of Delaware where, if desired, the founder may act as the president and sole director of the foundation. |
| Hire and compensate staff, including family members | YES. A private foundation may hire and compensate staff, including family members, to provide professional services to the foundation provided that they are qualified for their positions and their compensation is reasonable and necessary. | NO. Hiring staff is not an option with a DAF. | Foundation Source provides a compensation benchmarking service that includes third-party salary review and recommendations, and completion of IRS-required documentation. |
| Convert from private foundation to DAF and vice-versa | YES. A foundation may grant out all of its assets to a DAF. | NO. DAF fund sponsors typically have rules against gifting assets to a private foundation. | A private foundation may convert to a DAF, but it is all but impossible for a DAF to convert to a private foundation. |
| Required to file state and federal filings | YES. A foundation is required to file an annual IRS Form 990-PF and comply with other state and federal filing requirements. | NO. State or federal filings are not required for DAF accounts. | Foundation Source prepares and files all federal returns and filings for the state in which the foundation is formed or incorporated. |

GRANTMAKING DIFFERENCES

| | PRIVATE FOUNDATION | DONOR-ADVISED FUND | GOOD TO KNOW |
|--|---|--|---|
| Control grantmaking decisions and allocations | YES. Grantmaking decisions are fully controlled by the foundation. | NO. When someone makes a grant from a DAF, they are technically making a recommendation to its sponsoring organization, which has the authority to either accept or reject that recommendation. | With a private foundation, authority over grantmaking decisions rests solely with the foundation's members. |
| Engage the family in collaborative giving | YES. The board structure of a foundation makes it an inherently collaborative endeavor. The founder may appoint his or her family—spouse, children, or others—to the foundation's board. | MAYBE. In a DAF, any family member with account privileges is permitted to make grant recommendations independent of the others. | Foundation Source's online platform enables geographically dispersed families to communicate and collaborate on their philanthropy. |
| Provide scholarships and fellowships, and choose the recipients | YES. With IRS advance approval, a foundation may provide scholarships and fellowships directly to individuals. Foundation members may also choose the recipients. | NO. DAFs are prohibited from making grants to individuals. Grants may be made to an organization that administers a scholarship program, and that entity chooses the scholarship recipients. | Foundation Source provides program design assistance for scholarships and fellowships, including submission of proper forms for IRS advance approval. |
| Grant directly to individuals and families facing hardships, emergencies, or medical distress | YES. A foundation may make grants directly to individuals and families for hardships and emergencies as long as these grants meet IRS criteria. | NO. A DAF is prohibited from making grants to individuals and families. | Foundation Source has created a streamlined process that makes it easy to grant to individuals and families in compliance with IRS regulations. |
| Grant to international organizations | YES. A foundation may make grants directly to overseas charities and non-governmental organizations by undertaking expenditure responsibility or by making an equivalency determination. | NOT DIRECTLY. Donors usually recommend grants to intermediary organizations that accept responsibility for following regulations regarding oversight and reporting for international grants. | Foundation Source facilitates international grants to help ensure that they are compliant with IRS regulations. |
| Engage in Program-Related Investments (PRIs) | YES. A foundation may provide PRI loans, loan guarantees, and equity investments. PRIs may earn returns for the foundation, and funds are recycled back to the foundation through repayment or return on equity. | NO. A DAF typically only issues grants to 501(c)(3) charitable organizations. | Foundation Source provides guidance to foundations that wish to extend their impact through PRIs. |

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| <p>Make grants to for-profit businesses and tax-exempt organizations that are not 501(c)(3) entities</p> | <p>YES. A foundation may make grants to such entities provided they are for a charitable purpose, and the foundation follows proper procedures for these types of grants.</p> | <p>NO. A DAF typically only issues grants to 501(c)(3) charitable organizations.</p> | <p>Foundation Source enables foundations to compliantly grant to entities such as for-profit companies, civic organizations, other private foundations, and foreign organizations.</p> |
| <p>Run programs (Direct Charitable Activities)</p> | <p>YES. A foundation may run its own programs and pay for related expenses (supplies, salary, rent, etc.), provided these activities fall within the IRS guidelines.</p> | <p>NO. A DAF typically only issues grants to 501(c)(3) charitable organizations.</p> | <p>Foundation Source assists foundations that want to conduct their own charitable programs by providing due diligence and documentation that conform with IRS guidelines.</p> |
| <p>Create grant agreements</p> | <p>YES. A private foundation may enter into an agreement with its grantee, setting forth the purpose, terms, and conditions of its grant, with subsequent grant payments often tied to benchmarks of progress.</p> | <p>MAYBE. DAFs typically don't offer the ability to create customized grant agreements.</p> | <p>Foundations often enter into grant agreements when making major gifts, conditional grants, and grants that involve multi-year commitments.</p> |
| <p>Required to meet federal minimum distribution requirement (MDR)</p> | <p>YES. The IRS requires private foundations to meet an annual 5% minimum distribution requirement based on the previous year's net average assets.</p> | <p>NO. There is typically no minimum distribution requirement for a DAF, but the idea of imposing one has been proposed for consideration by the U.S. legislature.</p> | <p>Expenditures that count toward a private foundation's MDR include grants and qualified expenses, including Foundation Source's administrative fee.</p> |
| <p>Pay expenses</p> | <p>YES. A foundation may pay all reasonable and necessary expenses associated with its charitable purpose, including start-up costs, board meetings, administration, site visits, legal counsel, etc.</p> | <p>NO. Expenses may not be reimbursed through a DAF.</p> | <p>The ability to pay expenses for everything from consultants to site visits can help donors achieve more impact with their philanthropy.</p> |
| <p>Control delivery of grant checks</p> | <p>YES. With a foundation, donors can deliver grant checks and transmittal letters in person (at a fundraising event, for example), or by mail.</p> | <p>NO. Delivering a grant check in person is not an option because the donor is not a legal agent of the sponsoring organization and therefore cannot have control over the execution of grants.</p> | <p>Foundation Source prepares grant checks and transmittal letters that can either be delivered to the recipient or to a foundation member for personal delivery.</p> |
| <p>Give anonymously</p> | <p>NO. A foundation must file an IRS Form 990-PF annually, listing assets, contributors, and grantees.</p> | <p>YES. In making a grant, the donor may remain anonymous.</p> | <p>Foundation Source can provide limited anonymity by issuing both grant checks and transmittal letters that do not bear the foundation's name.</p> |

INVESTMENT/ASSET MANAGEMENT DIFFERENCES

| | PRIVATE FOUNDATION | DONOR-ADVISED FUND | GOOD TO KNOW |
|---|--|---|--|
| Total control over investments | YES. A foundation exercises total control over investment strategies, vehicles, policies, and managers. Financial control rests entirely with the foundation’s governing body in conjunction with its wealth advisor and preferred financial institution. | NO. The donor recommends to the sponsoring organization how assets will be invested and typically must choose from a standardized selection of mutual funds or limited menu of proprietary, pooled investment options. Over a certain size, some DAFs offer the flexibility of separately managed investment accounts. | Although Foundation Source does not manage or custody assets, we coordinate closely with our clients’ designated advisors. |
| Contribute diverse types of assets | YES. Foundations may own and hold cash, publicly traded securities, mutual fund shares, publicly traded bonds, art, antiques, real property, and more. | MAYBE. Contributions typically are limited to cash equivalents, publicly traded securities, and mutual funds. In some cases, high-value, non-cash assets may be accepted by the sponsoring organization to be liquidated prior to deposit, which may result in additional fees. | A foundation may hold a wider array of assets than a DAF. Once an asset is contributed, the foundation may hold it indefinitely until the board chooses to liquidate or sell it. |
| Excise Tax | YES. Foundations are required to pay a 1.39% excise tax on net investment income and realized capital gains. | NO. DAFs do not pay an excise tax. | The excise tax paid by private foundations is typically a negligible sum. For example, a foundation with \$10,000 of tax liability would pay \$139 in excise tax. |

CONTRIBUTION DIFFERENCES

| | PRIVATE FOUNDATION | DONOR-ADVISED FUND |
|--|---------------------------------|---------------------------------|
| Tax deduction for cash contributions | Up to 30% AGI | Up to 60% AGI* |
| Tax deduction for contributions of long-term, publicly traded appreciated securities | Fair market value up to 20% AGI | Fair market value up to 30% AGI |
| Tax deduction for other long-term capital assets, e.g., real property, notes, bonds, privately held stocks | Cost basis up to 20% AGI | Fair market value up to 30% AGI |

Note: Contributions to private foundations and donor-advised funds that exceed their respective annual limits can be carried over in each of the next five years until used up.

*Up to 50% AGI if a combination of cash and non-cash assets.

WHAT IS THE BOTTOM LINE?

Ultimately, your choice of a philanthropic vehicle must be consistent with your financial goals. The tax deductions associated with private foundations and DAFs are important to understand. DAFs are frequently promoted as the better wealth management solution because they offer higher tax deduction limitations. In practice, tax deduction limitations do not typically represent a barrier to private foundation donors.

First, many individuals do not reach the Adjusted Gross Income (AGI) limits on tax deductions. When they do, contributions that exceed the respective annual limits can be carried over to subsequent years. Second, contributions can be made both

30/30

If the maximum 30% AGI limit of cash contributions to the foundation is reached, use the 30/30 rule: Additional cash contributions of up to 30% AGI can be made directly to one or more public charities, including DAFs.

to a private foundation and to a public charity in a single year, so if the maximum 30% AGI limit of cash contributions to the foundation is reached, additional cash contributions of up to 30% AGI can be made directly to one or more public charities, including DAFs.

Finally, private foundations and DAFs do not present an either/or proposition. In many cases, using a private foundation and DAF together can be the optimum solution for managing wealth and achieving philanthropic impact.

ABOUT FOUNDATION SOURCE
www.foundationsource.com

Foundation Source is the nation's largest provider of comprehensive support services for private foundations. Our complete outsourced solution includes foundation creation (as needed), administrative support, active compliance monitoring, philanthropic advisory, tax and legal expertise, and online foundation management tools.

Now in our second decade, Foundation Source provides its services to more than 1,600 family, corporate, and professionally staffed foundations, of all sizes, nationwide. We work in partnership with wealth management firms, law firms, accounting firms, and family offices as well as directly with individuals and families. Foundation Source is headquartered in Fairfield, Connecticut.

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