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The Better Choice?: A Foundation or a Donor-Advised Fund

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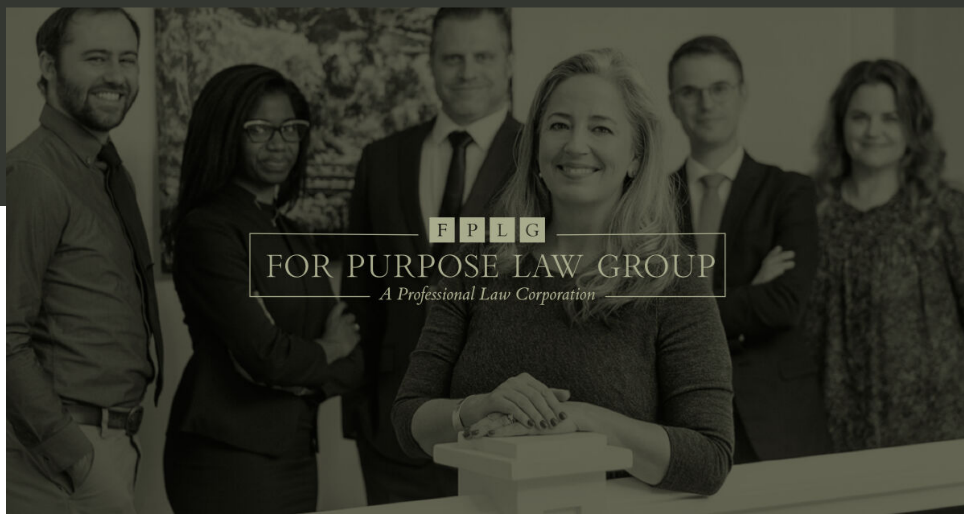

Although the donor-advised fund (DAF) has been around for many decades, this charitable-giving format has surged in popularity in recent years.

Our recent post, "Donor-Advised Funds: An Alternative for High-Net-Worth Philanthropists," provides an introduction to this timely topic.

The DAF is a choice midway between an outright donation to an independent 501(c)(3) organization and establishing a private foundation. "In this model, the philanthropist makes a charitable contribution, relinquishes *legal* control over the contributed money or assets to an independent public charity, the 'supporting organization,' and receives an immediate tax deduction. But the benefactor is permitted from time to time to recommend specific grants from the fund.

> *'An easy way to think about a donor-advised fund is like a charitable savings account: a donor contributes to the fund as frequently as they like and then recommends grants … when they are ready.'*

For some time, observers have noted a shift away from family foundations to donor-advised funds. " Frustrated by the upkeep, philanthropists are increasingly unwinding their private foundations into donor-advised funds,…"

There are pros and cons to each format, but the key distinctions relevant to well-to-do individuals and families making this choice are: time and cost; control and prestige; and financial benefit, including level of deductibility of contributions.

Pros and Cons: DAFs and Foundations

Time and Cost

Perhaps the key reason why well-to-do taxpayers are switching from family foundations to donor-advised funds is that the latter are (1) cheaper and (2) easier.

Creating and maintaining a private foundation involve considerable commitments of time and money. "[T]he factor that drives most people to close a foundation is the heavy time commitment."

The private foundation is a distinct legal entity that must be organized under state law and recognized as tax-exempt by the Internal Revenue Service. Organizational costs and professional fees can cost several thousand dollars; ongoing management expenses and fees for legal and accounting advice and assistance add to the total financial burden. Overseeing the initial phase and well as conducting the day-to-day activities (including grant-making) requires substantial direct participation. There are also tax forms and filings. While some of it can be done by paid staff or consultants, that expenditure will add to the total costs. "Donor-advised funds can cost thousands of dollars less to maintain than foundations — a factor that has taken on increased significance as many foundations' assets have plunged."

There is also a timing factor: while a donor-advised fund can be set up relatively quickly, there will be at least some delay for the foundation vehicle because of the need to create the separate legal entity and get government exemption approvals.

Control and Prestige

Under the private foundation format, the person or family setting up the entity enjoys the benefit of complete and exclusive control and decision-making authority for large and small matters. This element is particularly appealing when the taxpayer(s) have a strong vision for their charitable footprint, or see a philanthropic need that is currently being unmet entirely or adequately. "A foundation can make more sense if the donor prefers paying personal staff to study making grants for a specific goal, like research on a particular disease."

By contrast, when the donor-advised vehicle is used, the donors have advisory authority – but not legally binding control over the charitable contributions. The supporting organization that receives and manages the DAF contributions has the "…final say on where [the] money is donated, and can require minimum contributions to open accounts."

With the foundation choice, the donors are able to make a mark currently as well as into future generations; the family name is, and can continue to be, associated with generosity and worthwhile causes and activities. While there are ways for contributions made via the DAF vehicle to be publicly connected with a particular family, the connection is not as strong or continuously visible to the community.

Financial Benefit

The deductibility of contributions is a big incentive for charitable giving. The donor-advised fund provides larger and more immediate financial benefit.

Under the DAF format, a charitable donation is available immediately – even if some of the distribution of the money to grantees, projects, or activities is delayed until later years. (Under recent rules changes, this delay can't be for more than 5 years.) The deductibility rate is higher, also. "Donors can deduct half their adjusted gross income for an annual cash contribution, and 30% for appreciated securities. Donors to foundations can deduct only of 30% for cash gifts and 20% for appreciated securities."

"Donor-advised funds have another advantage: They don't impose annual distribution requirements. Foundations, by contrast, are required to make annual distributions of at least 5% of their assets, even when markets are plunging."

By choosing the DAF format, donors "can also give many types of assets — including cash, securities and even art — depending on the fund's specific rules."

Conclusion

The final decision is a matter of becoming familiar with the rules and regulations relating to foundations and to donor-advised funds, and then weighing and balancing the many pros and cons.

Choosing a DAF allows the well-to-do "to park … money in a variety of diversified investments, take an immediate tax deduction and recommend where grants should go later." It's especially useful if the desired contribution level is on the (relatively) lower side; a "practical minimum size" for a DAF, depending on the charity's policy, can be in the range of $10,000 to $25,000. The recommended minimum amount of assets required to establish a private foundation is at least $1.0 million and up.

> *Privacy is another potential benefit. Foundation tax forms, which contain details on grants and other revealing information about a donor, are easy to find on the Web. The public forms filed by donor-advised funds don't list individual accounts.*

Then there is the factor of "liability and risk." The foundation rules are complex; an inattentive or incompetent board of directors can make mistakes that will result in hefty hassles and sanctions.