

# A Perfect Pair: Private Foundations and Donor-Advised Funds



## Philanthropy Insights

*Private foundations and donor-advised funds (DAFs) are among the most popular ways to give, accounting for nearly 30% of all annual charitable contributions. Conventional wisdom says that based on the advantages of each vehicle, they appeal to different donors. For instance, private foundations, owing to their high degree of control and flexibility, are typically associated with larger-scale gifts, while donor-advised funds are thought to be better suited for smaller donors due to the relatively low costs and simple set up of DAFs.*

In reality, this is not a case of “either/or.” Grant-making private foundation trustees can utilize DAFs in several ways to maximize flexibility and philanthropic bandwidth. That’s why private foundation trustees need to understand how DAFs work—and how they can work for foundations. Here are some of the most common situations where a private foundation may turn to a complementary DAF:



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For more information on Fiduciary Trust Charitable’s services for individuals, advisors and charities, visit:

[www.FTCharitable.org](http://www.FTCharitable.org)

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### **Meeting the “5% payout rule”**

Private foundations are subject to special oversight rules, including a general requirement to pay out at least 5% of assets each year for charitable grants or activities. However, there are times when foundations may find it challenging to identify sufficient, qualified grant opportunities in a timely fashion. Rather than force a premature decision to satisfy the IRS rule, a private foundation might elect to grant part or all of the annual 5% requirement to a DAF, which is not subject to this annual payout rule. By doing so, the foundation would satisfy its statutory distribution requirement in time, while giving the board time to determine thoughtfully when and where to recommend grants through the DAF.

### **Maintaining Anonymity**

There is nothing private about charitable grants made by foundations. By law, that information must be disclosed on IRS Form 990-PF, which can be publicly accessed. A donor to a DAF may remain anonymous to a grant recipient if they choose. A DAF sponsor, such as Fiduciary Trust Charitable, is only required to report in aggregate across all sources the amounts granted to each charity, and is not required to publicly disclose donor names.

### **Enabling a Trustee(s) to Split from the Foundation**

While serving on a family-established private foundation board can be a rewarding and enjoyable experience, it can also become burdensome due to the administrative obligations of serving on a foundation board or even interpersonal reasons. Should a private foundation trustee prefer to end his or her trustee duties but remain involved in the charitable mission, a DAF can provide a solution. If permitted by the foundation's governing documents, the foundation's trustees can distribute a share of the foundation's assets to a DAF that is advised solely by a resigning trustee (or another designated individual).

### **Converting the Foundation to a Donor-Advised Fund**

Given the costs, time, and complexities of operating a private foundation, some foundations that only make grants to public charities have determined that a DAF is a better solution. In these situations, the foundations distribute their funds to a DAF that the foundation's trustees establish. In doing so, they typically eliminate the taxes, legal fees, other operating expenses, and risk associated with the foundation, while also reducing the time required of trustees. When making this transition, it is important to work with a DAF provider and legal counsel who are familiar with this process to help ensure the appropriate steps are taken.

### **Cultivating the Next Generation**

Families often find philanthropy helps to pass values down to the next generation. Enabling members of the younger generation to recommend grants from a DAF is an excellent way to engage them in the charitable giving process, while not immediately requiring them to take on all the responsibilities of a foundation trustee. This can also help prepare the next generation for later assuming the full responsibilities of a private foundation trustee.

### Primary Differences Between Donor-Advised Funds And Private Foundations

Area	Donor-Advised Funds	Private Foundations
Requirements to Set Up and Operate	Simple	Complex
Administrative Responsibilities	None, other than making periodic grant recommendations	Regular board meetings, potentially hiring staff, oversight of foundation's activities, including tax and other filings
Income Tax Deduction	Cash gifts: 60% of Adjusted Gross Income (AGI) Securities or other assets: 30% of AGI Appreciated, non-publicly traded assets held over one year receive a deduction at fair market value	Cash gifts: 30% of AGI Securities and other assets: 20% of AGI Appreciated non-publicly traded assets held over one year may only receive a deduction at their basis
Excise Tax on Investment Income	None	1.39% annually
Other Expenses	Administrative and investment management fees, typically based on assets under management	Legal expenses, any foundation employee compensation, investment management, other operating expenses
Investment Options	Many DAFs have a limited set of proprietary funds as investment options; Fiduciary Trust Charitable uses investment advisors that typically have a variety of investments options from multiple investment managers	High degree of flexibility
Minimum Distributions	Require some distributions every few years with no set minimum amount (FT Charitable requires grants at least every two years)	5% minimum (some expenses count toward distributions)
Allowable Grants	IRS-qualified charities only	IRS-qualified charities as well as direct gifts to individuals, such as scholarships or other charitable purposes
Control	Donors and advisors they designate can recommend grants and investments, but the sponsoring organization has legal authority over decisions	Foundation board has full control over investment and grant decisions

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## Moving Forward

A donor-advised fund can be a valuable complement or alternative to a grant-making private foundation. Depending upon the approaches used, the benefits of DAFs can include reduced administrative costs and taxes, grant anonymity, grant flexibility, reduced time requirements, and lower trustee risk. In determining how best to use DAFs, it is important to obtain the appropriate legal counsel and DAF provider that can provide the necessary guidance and best DAF solution.

Fiduciary Trust Charitable offers a customized donor-advised fund program focused on the needs of individuals, foundations, and family offices. Please contact us if we can be of assistance.

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