



The *ART* of Charitable Giving

*— A comparison of Private Foundations and
Donor Advised Funds.*

Philanthropist

A person who seeks to promote the welfare of others, especially by the generous donation of money to good causes.

This means that a philanthropist is anyone that donates their money, experience, time, talent, or skills to help others and create a better world. Though we often think of a philanthropist as someone who has millions of dollars to donate, you don't have to be famous or wealthy to qualify, philanthropists come in a variety of shapes, sizes, and relative net worth. There is no "typical" philanthropist.

There are many giving options, but this outline compares private foundations and donor advised funds.

Private Foundations

Private Foundations trace their roots to feudal England and perhaps even earlier. Over the years they have grown to be a major force in private philanthropy because they give the donor maximum control of the philanthropy while fostering values-based planning and intergenerational involvement.

Families, individuals, and corporations can create a private foundation to meet their charitable goals in an organized manner.

A private foundation allows unique flexibility for framing an organization in accordance with special preferences, purposes, and predilections. It also allows the founders to specify directors or trustees, including the founder and family members, who can engage in charitable activities without the approval of an independent institution (other than the IRS). There are primarily three types of private foundations:

A pass-through foundation distributes an amount equal in value to 100 percent of all contributions received in the tax year by the 15th day of the 3rd month after the close of its tax year, has no remaining undistributed income for the year, and distributes only qualifying distributions that are treated as distributions out of corpus.

An operating foundation is one that carries on its own specified purposes, invests in projects as opposed to stocks and bonds and has a staff.

A non-operating foundation acts as a conduit to fund other charitable endeavors. Such foundations are required to distribute not less than five percent of their investment holdings to public charities each year.

Non-operating foundations are the most common for personal philanthropy.

Income Tax Deduction

The tax code authorizes a charitable income tax deduction for gifts to a private foundation, the amount of which is dependent upon the type of foundation.

Pass through Foundation: A charitable deduction is allowed for the full market value of a contributed asset and may be deducted up to 50% of the donor's adjusted gross income.

Operating Foundation: A charitable deduction is allowed for the full market value of contributed assets and may be deducted up to 50% of the donor's adjusted gross income.

Non-Operating Foundation: A charitable deduction for gifts, other than appreciated property, is allowed up to an amount equal to 30% of the donor's adjusted gross income. If the gift is appreciated property, the allowable deduction is limited to 20% percent.¹

Note: If appreciated securities are not "qualified" (i.e., readily marketable on an exchange) the income tax deduction is limited to the donor's cost basis.

Characteristics of a Private Foundation

The operation of a private foundation can be likened to establishing and running a business. Below are a few of the characteristics of a foundation:

- The donor determines the type of organization and the entity.
- The organization drafts its governing documents and applies for charitable status with the IRS, these include the founding trust or corporate document, IRS Form 1023, specifying what the foundation will do, its budget and other governance items and the form to obtain the Employer Identification Number.
- Distributions can be made to individuals and other entities in furtherance of the charitable purpose.
- IRS Form 990PF (the tax return) must be filed annually.
- Record keeping is critical as an accurate summary of capital gains and losses, dividends and interest is required as well as proof of adherence with the tax code.
- There are restrictions on "self-dealing" between the foundation and "disqualified persons" (officers of the foundation, donors, etc.).

¹ Limits on contribution deductions for gifts to private foundations do not apply to estate or gift tax charitable contributions. Hence, a testamentary gift to a private foundation works extremely well.

Resource: During its existence, a private foundation has numerous interactions with the IRS - from filing an application for recognition of tax-exempt status, to filing required annual information returns, to making changes in its mission and purpose. The IRS provides information, explanations, guides, forms, and publications on these subjects - they are available through this [IRS website](#).²

Donor Advised Funds (DAF)

A donor advised fund is a fund managed by a third party that has qualified as a public charity. Through a written agreement with the charity, a donor creates a specially named fund to which contributions are made. The fund can be a permanent endowment or a provisional fund. The terms of the agreement provide the donor, or others specified by the donor, with the privilege of making nonbinding recommendations regarding charitable distributions and investment decisions. The charity typically allows the donor to name the account as desired. Thus, a donor may establish the “Smith Family Fund” and recipients acknowledge the gift accordingly.

Donor’s Income Tax Deduction

Gifts to a donor-advised fund are deductible up to 50% of the donor's adjusted gross income and as with gifts to a public charity, contributions of appreciated securities that are not publicly traded can be deducted at their full fair market value.

Characteristics of a Donor Advised Fund

DAFs allow a donor to remain involved without the annual tax on investment income, minimum annual payout requirements and other restrictions that apply to private foundations. Additionally, the charity that holds the fund takes responsibility for all administration including filing annual returns and preparation of financial statements.

A donor advised fund is different from a foundation or other option in several ways.

- Little or no start-up costs and no papers to file with IRS.
- DAF may carry the donor's name or be anonymous.
- DAFs do not have the annual tax on investment income, minimum annual payout requirements, limits on business holdings and other restrictions that apply to a private foundation.
- DAFs can make distributions only to public 501(c)3 organizations.
- Deductibility limits are generally higher than gifts to Private Foundations.
- Because DAFs are administered and invested by the “host” public charity, they require less administration and cost.

² <https://www.irs.gov/charities-non-profits/private-foundations/life-cycle-of-a-private-foundation>

Comparing Donor Advised Funds

There are a variety of organizations that offer donor advised funds, including Community Foundations, Universities, and financial services firms. Each fund varies and the donor should find a fund that suits his or her giving style and goals.

Key comparison points include:

- Minimum initial investment
- Minimum subsequent contributions
- Investment options
- Asset manager
- Minimum grant size
- Maximum grants per year
- Fees and expenses
- Recordkeeping
- Are distributions restricted to type, location, or organization?

Conclusion

Due to the higher deductibility limits and fewer administrative responsibilities some clients prefer a donor advised fund over a private foundation. The donor and family member may be involved in the grantmaking process, but have few, if any, administrative responsibilities.

Others prefer the formal process to engage family members and retain distribution flexibility.

Whether a foundation or donor advised fund fits your giving depends upon your goals, the type and amount of assets you want to contribute and whether foundation administration is more burdensome than desired. The Bandera Law Firm can help you choose and organize.

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