Charitable Giving: *Donor Advised Funds and Private Foundations*

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In a recent piece we covered the "easier" ways individuals can accomplish their charitable goals. Now we will continue the discussion on charitable and philanthropic planning by covering more complex structures for high-net-worth families. As I developed this, it became clear to me that the information that remains is too great for two parts, so to make things easier (and avoid any eyes glazing over) this will be a three-part series.

In Part One, I mentioned that some people may itemize in certain years, and they may take the standard deduction in other years. This may be by design, through "bunching". Bunching means consolidating deductions normally taken across several years into a single year to optimize tax efficiency and income tax strategies.

A business owner that sells their company, or any client that has a significant liquidity event or other unusual windfall, would generally be more inclined to accumulate more deductions in the years that their income is higher. This might look like completing a larger number of charitable gifts in one year instead of smaller amounts across multiple years, just for one example. The result is a higher charitable deduction in the year of the gifts, in this case.

Donor Advised Funds (DAFs)

Using our example of the business owner who sells and has a large income year and decides to strategically gift more to charity in that year for a larger deduction, there are two options. One is to make individual charitable donations to their nonprofits of choice. Those would need to be fully completed by the end of the year.

However, the second option is to utilize a Donor Advised Fund, which is a charitable vehicle by which a donor can irrevocably contribute assets to a separate account for the purpose of donating to nonprofit organizations. This can be done in a large-scale manner with cash or other investments, and the contributed assets can typically be invested for additional growth and giving potential, if desired.

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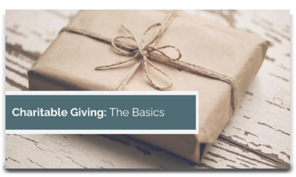

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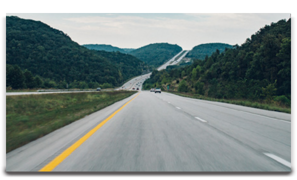

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The donor can then make grant recommendations to the sponsor, who can approve the grants and issue checks to the nonprofits receiving the grants, either anonymously or with recognition to the donor. DAFs allow an immediate tax deduction in the year of the contribution, and there is no minimum amount of funds required to be distributed out to the eventual charities in that same year. Any deduction in excess of the AGI limits carries forward for five years.

The donor's administrative duties are limited to recommending grants to their favorite or preferred charities or nonprofit organizations, while the sponsor organization handles managing the assets, recordkeeping, and all other operational duties. This set up makes DAFs increasingly more common vehicles for clients to accomplish their philanthropic goals while keeping administrative duties limited and costs to establish low.

Advantages of DAFs	Disadvantages of DAFs
Simple, immediate, and low (or zero) cost to set up	Contributions are irrevocable by the donor
Tax deduction for assets contributed (60% of AGI limit for cash and 30% of AGI limit for appreciated assets)	Limited control over the administration of the fund
Lower ongoing fees and administrative burden falls on the sponsor organization, not the donor	DAFs may only give to qualified charities and nonprofit organizations, not private charities or individuals
No minimum requirement for distributions/ grants for a given year	In some cases, investment management is relinquished to the sponsor organization
Grants can be given anonymously, and/or in honor or memory of others	DAFs cannot be converted to another type of charitable vehicle

Private Foundations

You may have noticed in the DAF section that I specifically reference "public charities". Why does that matter?

There is a difference between a public charity and a private charity or foundation. Public charities are broadly supported by the general population and carry fewer restrictions and more favorable tax-deduction limits. Think most nonprofits and 501c3 organizations.

A private foundation is an independent tax-exempt organization set up by an individual, family, or corporation for the purpose of making charitable distributions. Most private foundations are non-operating corporations meaning they are not directly operating their own charitable programs or facilities, but instead award grants to other nonprofits, or in some cases, individuals.

A board of directors or trustee(s) usually oversees the operations of a private foundation, including all administrative matters, investment management, tax filings, recordkeeping, and grant making.

Private foundations are classified as private charities, and as such are subject to more limitations on tax deductions and more requirements than a public charity, including a minimum distribution of 5% of assets each year and more consistency in types of organizations and projects to which they can make distributions. For example, there are significantly strict guidelines in place for making foundation grants to individuals as opposed to other public charity organizations.

Advantages of a Private Foundation	Disadvantages of a Private Foundation
Tax deduction for assets contributed to the foundation (30% of AGI limit for cash and 20% of AGI limit for appreciated assets)	Startup costs and ongoing expenses are higher than with a DAF
Complete control over foundation's operations rests with the family and/or board of directors/trustees	Amount of time needed to set up a private foundation can be weeks or months
Grants can be given to public or private charities or individuals (with restrictions)	Administrative duties including filing tax returns, recordkeeping, and legal filings fall on the directors/trustees, or foundation employees
Allows the donor and their family to establish a long-term legacy of giving	Must distribute 5% of net investment assets per year
Can be converted to a Donor Advised Fund if desired and it makes sense	Annual tax filings are public information, and anonymous gifting is not possible
	Can be subject to an excise tax on net investment income

At Truxton, we not only help clients with their investments. We have a dedicated team of experts across tax, legal, investment, and advisory services, and when clients want to be charitable, we can help them assess the best way forward and implement a charitable plan that works best for them in their unique circumstances. If you are wondering whether you might need some help in this area, or have questions about how to proceed, please give us a call. We are happy to help!