How to donate with intention: Donor-advised funds versus private foundations

When planning how to donate to charitable causes, it is important to be aware of all of the tax implications. Two strategies often used by individuals and families are donor-advised funds (DAFs) and private foundations; each has unique costs and tax advantages.

Donor-advised funds ("DAF"s)

DAFs allow you to gift cash, appreciated securities, or other assets directly into a fund, then help choose which charitable organizations the fund makes grants to. DAFs are relatively easy to set up and inexpensive to maintain. You have the ability to make donations from the fund and are not subject to minimum annual donations. DAFs are also characterized with low startup costs, tax deductions and minimal time commitments.

DAFs have notable tax advantages where an individual's adjusted gross income (AGI) can be reduced by as much as 60% for cash donations or 30% for appreciated assets, compared to just 30% and 20%, respectively, for foundations.[3] This can be incredibly useful in years with a large tax bill, as you can donate a large sum to a DAF, which can spread the actual donations to charities over several years.

One key limitation of DAFs is that the donation must be made to a 501(c)(3) public charity such as Make-Wish America, religious organizations, or educational institutions. DAFs cannot donate to individual causes or charities that are not characterized as a 501(c)(3)[6]. More about DAFs.

Private foundations

As seen by the chart below provided by the Giving USA 2021 Annual Report[5], foundations made up 19% of charitable giving in 2020. They are also the fastest growing source of giving for the year, growing 17% year-over-year. Private foundations can be a tax advantageous vehicle for you to donate to the causes that mean the most to you and your family.

Source: Giving USA 2021 Annual Report | * All figures on this infographics are reported in current dollars unless otherwise noted.

Private foundations have several pros and cons compared to a DAF. Foundations are often associated with a 'prestige' element where wealthy individuals create a fund with a specific goal of donating to charitable causes that mean the most to them. Foundations can make grants with fewer restrictions compared to a DAF to help ensure that donations are aligned with the donor. A private foundation is designed to last in perpetuity with a requirement to donate 5% of net assets annually3.

However, foundations can be incredibly expensive to organize and operate. You should consider hiring legal and accounting professionals to handle startup and ongoing regulatory and compliance matters like bookkeeping, tax preparation and corporate filings. If the net assets of the foundation are not high enough, these expenses can quickly deteriorate the corpus of the fund and make the foundation unfeasible.

Which is right for you?

While both strategies allow up to grow your donations with minimal taxes, there are several differences to consider. In order to determine which strategy is best for you, it is important to be aware of the key differences between DAFs and private foundations:

Key differences

	Donor Advised Fund (DAF)	Private foundation
Setup Costs	Minimal	Complex, requires Legal and Accounting
Management Fees	Typically less than 1%	Typically less than 1%
Administrative Responsibilities	None other than making periodic grants	Depending on size, regular board meetings, accounting, potentially hiring staff to maintain books
Typical Minimum Amount Recommended to Open	Typically \$5,000	Typically \$250,000
Value Used to Calculate Deduction for Noncash Donation	FMV for assets held for over one year	FMV for publicly traded securities; Cost basis for other appreciated assets
Tax Deduction for Cash as a Percent of Adjusted Gross Income	60%	30%
Tax Deduction for Securities as a Percent of Adjusted Gross Income	30%	20%
Annual Minimum Distributions	None	5% of assets
Excise Tax	None	Typically 1.39% on Investment Income
Privacy	Donors and grantees can be kept confidential	Requires detailed tax returns which are public records
Fund Lifespan	Varies, many revert to the sponsor organization after the original donors or succeeding generations die	Can live in perpetuity with the board named successors
Grant Recipients	501(c)(3) organizations only	501(c)(3) organizations, individuals (in need or for scholarships, for example), other charitable intentions
Investment Options	Limited depending on sponsor organization	High degree of flexibility
Tax Filing	No annual tax filings	Form 990-PF filed annually

Sources: Mesirow, IRS, NCFP, Moss Adams, Giving USA

When considering if setting up a private foundation or a donor-advised fund is consistent with your charitable goals, it is important to consider the pros and cons to both strategies and alternative options, such as giving directly to a charity that is aligned with your values. Please discuss each of these charitable strategies with your wealth advisor and other professional resources before making any material donations.

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Sources:

1. https://www.irs.gov/charities-non-profits/private-foundations/tax-on-net-investment-income

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3. https://www.ncfp.org/knowledge/how-do-donor-advised-funds-compare-with-private-foundations-and-other-vehicles/#:~:text=A%20private%20foundation%20is%20a,the%20sponsor%20organization%20must%20approve.

4. https://www.mossadams.com/articles/2021/10/donor-advised-funds-versus-private-foundations

5. https://store.givingusa.org/products/2021-annual-report?variant=39329211613263

6. https://www.irs.gov/charities-non-profits/charitable-organizations/the-restriction-of-political-campaign-intervention-by-section-501c3-tax-exempt-organizations

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