

Using Private Foundations and Donor-Advised Funds Together

/ CREATE PHILANTHROPIC AND FINANCIAL
SYNERGY BY LEVERAGING BOTH VEHICLES
IN YOUR CHARITABLE PLANS /



When families and their advisors contemplate establishing a charitable vehicle, they often compare and contrast the advantages of private foundations and donor-advised funds (DAFs). **However, for many donors, the best choice isn't either a private foundation or a DAF—it's both.** When used in combination, the advantages of a private foundation and a DAF can be synergistic, providing donors with a full spectrum of options for their philanthropic and wealth-management goals. Here are some of the benefits conferred by using these two popular vehicles in tandem.

Philanthropic Benefits /

Whereas a private foundation offers more control over grants and almost limitless capabilities for out-of-the-box giving, a donor-advised fund enables convenient, anonymous grantmaking. When donors have both vehicles, they have a complete toolkit for achieving their philanthropic goals.

Major Gifts

Making a major gift to a favored charitable project or institution represents a significant commitment. To ensure that funds are used according to their wishes, including naming rights, donors may want to employ a grant agreement, a legally binding document, to reflect the compact's details with their grantees. Because private foundations are independent legal entities, they can enter into such an agreement, setting forth the purpose, terms, and conditions of their grant, with subsequent payments often tied to progress milestones. This option is usually not available with a donor-advised fund because account holders are not agents of the sponsoring organization and cannot enter a legal contract on its behalf.

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Balancing Transparency and Discretion

Private foundations cannot give anonymously because they are legally required to record their grants on their tax returns, which must be available for public inspection. In most instances, this transparency is an advantage. In addition to contributing vital financial resources to an organization or cause, foundations can attract public attention (which, in turn, can attract more resources), building awareness and support.

There are situations, though, when giving publicly does not serve the best interests of the funder. Sometimes, funders prefer not to have their names associated with a grant, such as when the issue in question falls outside of the usual scope of their foundation's mission. (For example, a funder might want to support a local school even though their foundation's mission is global.) To avoid confusing grantees, the philanthropist may elect to contribute from a DAF, which provides flexibility and discretion. And some philanthropists are concerned about having their business or professional reputation linked to a controversial or politically charged issue. Because the sponsoring organization is not required to show which grants are associated with which DAF account, a DAF is ideal for making gifts that require absolute anonymity.

Infinite Giving Options

Gifts from a donor-advised fund are typically restricted to straightforward donations to U.S.-based 501(c)(3) public charities. With the addition of a private foundation, donors have many more giving options, including:

- Making grants directly to individuals and families facing financial hardship, emergencies, or medical distress
- Giving directly to foreign charitable organizations
- Making loans, loan guarantees, and equity investments in support of charitable purposes
- Providing funding to for-profit businesses for programs that support the foundation's charitable mission
- Setting up and running scholarship and award programs
- Running their own charitable programs

Moreover, in addition to providing more giving options, private foundations can reimburse members for reasonable and necessary expenses incurred in pursuit of their charitable purpose. Expenses that the foundation can reimburse include board meetings, administration, site visits, travel expenses, and even costs associated with starting the foundation.

Options for Enabling Discretionary Grantmaking

Many philanthropists establish a charitable vehicle for the express purpose of uniting their family in shared, purpose-driven work. But what happens when members either can't agree on an objective or want to fund their own areas of interest? In addition to granting as a group, some families give their members a portion of funds to donate as individuals. A private foundation can facilitate this practice, formally called discretionary grantmaking, to permit a degree of autonomy and reduce conflict while fostering engagement. Alternatively, the family could set up a donor-advised fund that members could use to fund their side projects. Because neither the discretionary grantmaking funds nor the grants made from the DAF would be subject to an approval process by the full foundation board, they each could serve as "pressure release valves" when individual interests threaten to derail mission and unity.

Financial Benefits /

While private foundations can be funded with and hold a wide array of assets, DAFs provide a higher tax deduction for contributions as well as a higher total limit for combined annual contributions. Combining the two charitable vehicles can return the best possible financial outcome for the donor.

Maximizing Tax Deductibility

The maximum cash that a donor can contribute to a foundation is 30% of AGI. However, donors who have had a significant liquidity event may want to exceed that limit. Because contributions can be made both to a private foundation and to a public charity in a single year, additional cash contributions of up to 20% of AGI can be made directly to one or more public charities, including DAFs. By "stacking" contributions to a DAF and a private foundation, donors can effectively maximize their deduction.

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Funding with Alternative Assets

Private foundations can own nearly any type of asset, including partnerships, real estate, jewelry, closely-held stock, stock options, art, insurance policies, and other valuables. A donor-advised fund may limit investment options to cash equivalents, publicly traded securities, and shares of mutual funds. Donations of real property and nonmarketable securities typically are sold or liquidated by the sponsoring organization. Having both a foundation and a DAF opens a world of possibilities.

For example, a DAF offers fair-market value for a donation of long-term capital assets (e.g., real property, notes, and privately held stock), whereas a private foundation provides cost basis. However, because a private foundation can hold onto these assets and even put them to charitable use, there are other possibilities to consider.



EXAMPLE 1

Realizing the Synergy of Both Vehicles

Following their father's death, Mary and her brother John sold the majority stake in the family's frozen foods business to a multinational competitor. The transaction proceeds totaled \$180 million, with each sibling receiving half, or \$90 million. As part of advanced planning efforts with her attorney, Mary decided to open and fund a foundation with her portion of the proceeds. And because foundations are flexible and designed to work in perpetuity, she was able to involve family members in both the day-to-day operations and the board management to ensure that the foundation was creating a lasting impact in the local area.

Along with the proceeds from the business's sale, Mary's AGI for the year totaled \$91 million. Based on current tax laws, she could fund her foundation with up to 30% of her AGI, or \$27.3 million. Mary also opened a DAF account to take advantage of the higher deductions allowed when making gifts to a public charity, funding it with \$18.2 million, an additional 20% of her AGI, resulting in a total charitable income tax deduction of \$45.5 million, or 50% of her AGI. By putting 50% of her AGI from the sale into charitable giving vehicles, Mary minimized her tax obligations and accelerated her ability to get critical funding to the causes and the people in the community. Working with two vehicles gives her additional flexibility to get her operational infrastructure and programs in place, knowing that the foundation can be passed to her heirs. The DAF account can be spent down and eventually closed.



EXAMPLE 2

From Empty Warehouse to Arts Haven

Alexandra owned a warehouse worth \$7 million. Although she considered selling it outright or donating it to her donor-advised fund, which would have liquidated it immediately, she decided to donate the warehouse to her foundation instead. Because the warehouse could be earmarked as a charitable asset to further her philanthropic goals, Alexandra was able to turn the property into an exhibition space and community meeting place for artists and art lovers like herself. And because the foundation is using the warehouse for a charitable cause, its value will be excluded from the asset base used to calculate the annual 5% payout requirement, and expenses or the cost of capital improvements related to the property may count toward its satisfaction.



Sustainable Benefits /

Because no one can predict their future needs with certainty, establishing both a private foundation and a donor-advised fund provides maximum flexibility. Whereas DAF sponsoring organization policies typically ensure that family control over a DAF eventually sunsets, a private foundation is an independent legal entity built to last. Should philanthropy become a family enterprise, the foundation's assets can be transferred from the control of the founding generation to the next in perpetuity.

Finally, having both a private foundation and a donor-advised fund is ideal for donors to future-proof their philanthropy. Should a private foundation prove too cumbersome over the long haul, the assets can be transferred to a DAF. However, should a DAF prove too limiting, it's all but impossible to do the reverse. Although DAF sponsoring organizations are permitted to make grants to private foundations, most have internal policies prohibiting such distributions. Therefore, should the donor "outgrow" the DAF's philanthropic and investment options, the private foundation provides limitless capabilities. And should the initial forays into philanthropy, typically begun as a DAF, turn into either a "second act" for a retired donor or a family enterprise that includes the next generation, the foundation can serve as an enduring legacy for generations to come.

BY "STACKING" CONTRIBUTIONS
TO A DAF AND A PRIVATE
FOUNDATION, DONORS CAN
EFFECTIVELY MAXIMIZE
THEIR DEDUCTION /



HAVE A QUESTION?

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