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Estate Planning Update Winter 2018/2019 - Complementary Philanthropy Using Both Donor-advised Funds and Private Foundations

Charitably minded individuals once felt that they had to decide whether to use either a donor-advised fund (DAF) or a private foundation. Savvy philanthropists now strategize ways that the two can be used together to achieve charitable goals. A DAF is a charitable giving vehicle that is established by a public charitable organization (a sponsoring organization). A donor may make a charitable contribution to a DAF and obtain an income tax deduction in the year of the contribution whether or not the funds contributed to the DAF are distributed to the ultimate charitable recipients during that year. While the sponsoring organization has legal control over the DAF, the donor (or another person nominated by the donor) makes recommendations for grants from the DAF to public charities. Many investment firms and community foundations sponsor DAFs. In contrast, a private foundation is a separate charitable organization created by a donor which is organized either as a trust or a charitable corporation. Like a DAF, it allows a donor to obtain a charitable deduction in the year in which property is transferred to the private foundation, whether or not distributions are made from the private foundation to the ultimate charities. However, as a separate charitable organization, the private foundation has to apply for and maintain its charitable status, file tax returns, and comply with other administrative requirements. Private foundations typically are required to distribute at least 5 percent of the value of their assets per year. As mentioned above, strategic philanthropy may involve combining a DAF with a private foundation rather than using one option or the other. A few examples might help illustrate how using both DAFs and private foundations simultaneously may be the most appropriate manner to maximize charitable giving:

- In December, a family is struggling to find suitable grantees to satisfy the family's private foundation's 5 percent annual distribution requirement. The family can easily and inexpensively establish a DAF with a sponsoring organization. Once the DAF is established, the private foundation can make its 5 percent annual distribution to the family's DAF. The family can then take some additional time to find suitable charitable giving opportunities (although when the private foundation files its annual information return, the IRS will want to see how the funds will ultimately be used for charitable purposes).
- A family has a long-standing private foundation that supports religious initiatives but also wants to anonymously support charitable causes that might be at odds with particular religious teachings. Since grants from a private foundation can be easily identified on the private foundation's annual compliance filing, while grants from a DAF can remain anonymous, the family decides to establish a DAF in order to make certain grants while maintaining privacy.
- A family with a private foundation has two children in their 30s who have relatively little experience with charitable giving in general. Charitable giving is very important to the family. While the parents would like their children to continue their charitable legacy after they are gone, they are concerned that the children do not have sufficient experience to run the private foundation. The parents fund a separate DAF for each child in order to allow each child to obtain experience with charitable giving.

- A wealthy donor with a private foundation has significant income as the result of the sale of the family business. She has illiquid, closely held investments that she would like to donate to charity, and she is interested in receiving the greatest tax benefit for her charitable contributions. If she contributes the illiquid investments to a DAF, she can deduct the fair market value of the investments; whereas, if she contributes the illiquid investments to a private foundation, the deduction is limited to the cost basis of the investments. In addition, since contributions to a DAF are treated as contributions to a public charity, such contributions are generally tax-deductible up to 60 percent of adjusted gross income (AGI) for cash gifts and 30 percent for illiquid assets. Contributions to a private foundation are generally deductible up to 30 percent of AGI for cash gifts and 20 percent of AGI for illiquid assets. The donor decides to establish a DAF to maximize her charitable deductions.

As demonstrated above, combining a private foundation with a DAF may be the best solution for maximizing the tax benefit of charitable giving. Please contact your Day Pitney estate planning attorney if you would like to discuss this planning option in further detail.