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CHARITABLE GIVING OPTIONS: DONOR-ADVISED FUNDS VS. PRIVATE FOUNDATIONS

Wealthy individuals and families are increasingly incorporating charitable goals into their estate plan. For donors who want to manage their philanthropic activities through longer-term vehicles, two of the most common options are donor-advised funds and private foundations.

DONOR-ADVISED FUNDS

A donor-advised fund (DAF) is like a charitable savings account. A donor opens and funds an account with a national sponsor organization or community foundation, which maintains and manages the account or "fund." The donor receives an immediate charitable deduction for the fund contribution, and the DAF uses the contribution (either in the same tax year or in the future) to make grants to public charities. Contributions not given to charities will stay in the account and invested for future grants.

With a DAF, the donor does not control the fund, meaning they cannot unilaterally decide how to invest the assets therein or to which charitable organizations grants should be made. However, the sponsoring organization will solicit the donor's recommendations on both topics and will generally follow donors' recommendations if their goals and purposes are aligned.

PRIVATE FOUNDATIONS

A private foundation is an independent charitable trust or corporation established as its own tax-exempt entity under Section 501(c)(3) of the Internal Revenue Code. Like a DAF, a private foundation is used to make grants to support charitable causes. Private foundations are funded entirely through contributions from an individual or family and can be set up to operate in perpetuity.

Unlike a DAF, a private foundation gives its donors complete control on all areas of operation, including how assets are invested and distributed, which charities are supported, and who is involved in the foundation's governance. The private foundation has its own governing legal documents and a governing body (a board of directors or trustees) who has the final say on investment and grantmaking decisions.

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WHICH IS RIGHT FOR ME?

Set Up Costs and Ongoing Management. The main benefits of a DAF are that there are no initial set-up costs and DAFs can be funded with smaller amounts than a private foundation. A private foundation will have legal and accounting fees to create the governing documents and to file the application for tax-exempt status. Furthermore, DAFs do not require ongoing management by the donor. The sponsoring organization handles all the administrative duties, including managing investments, recordkeeping, tax receipting and grant administration, thereby reducing the responsibilities of the donor. Private foundations, on the other hand, manage and invest their own assets (often with the help of a hired investment manager), keep records, select charities and administer grants, file federal and state tax returns, and maintain board minutes.

Control and Flexibility. If, on the other hand, a donor has larger sums to invest and wants complete influence in how funds are to be used, then a private foundation may be a better choice. Private foundations are also excellent charitable tools for those donors who want to establish a legacy of intergenerational giving. The donor's family members can help run the foundation and get involved in the grantmaking process. The foundation can also establish its own grantmaking policy to provide a set of rules or guidelines on the family's philanthropic values and the types of organizations to support.

Some other considerations when comparing the two options are as follows:

- **Family Legacy.** Both private foundations and DAFs are named by its donor(s). Many individuals choose to name their private foundation or DAF after their individual or family name. For example, either structure can be named the "[Last Name] Family Foundation," and grants received by the charities, in each case, would come from the [Last Name] Family Foundation.
- **Privacy.** Private foundations must disclose detailed information about its grantees, its board members, its staff salaries, etc. on publicly available tax documents filed with the IRS. No such disclosure requirements or filings apply to DAFs.
- **Broader Class of Grantees.** DAFs are restricted to making grants only to 501(c)(3) organizations and may not donate to individuals or international organizations. Private foundations, on the other hand, can establish scholarships as long as it complies with the applicable regulations, or, subject to some restrictions, make grants to individuals or international organizations.

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This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.

- **Unique Assets.** DAFs are usually funded with cash or highly appreciated stock. If you have other types of assets (i.e., an art collection) that you would like to use as part of your charitable giving, then a private foundation would be better suited to handle those assets. For example, the foundation might loan or rent those assets for income.
- **Tax Benefits.** Both options offer tax advantages, including tax-deductible contributions. DAFs, however, have higher limits for charitable deductions than private foundations. DAFs allow for a tax deduction at a higher percentage of adjusted gross income (60% of cash contributions and 30% for other contributed assets), compared to 30% of cash and 20% of assets for private foundations. Also, while private foundations are exempt from federal income tax, they must pay a 1.39% excise tax on net investment income and realized capital gains.
- **Required Minimum Distributions.** The IRS requires that private foundations must distribute 5% of their net investment assets through grants or administrative expenses each year in order to pay taxes. DAFs do not have such required minimum distributions.

The right charitable vehicle is one that best fits your circumstance and values. Many individuals use both a DAF and a private foundation to accomplish their specific charitable goals. Keep in mind that a private foundation can be converted to a DAF in the future, but a DAF cannot be converted to a private foundation. Contact your Wiggin and Dana attorney to discuss these and other philanthropic vehicles for donating.