

Weighing the Options: Private Foundation or Donor-Advised Fund?



When you're working on the charitable components of a client's estate or financial plan, one of the first areas you'll likely explore is the structure. Certainly you are familiar with both private foundations and donor-advised funds as useful charitable giving tools. Before you jump into [one or the other](#) for a particular client, though, it's important to review the similarities and differences between the two so that you can best achieve your client's goals.

To help you evaluate a client's options, here are three common myths about the differences between private foundations and donor-advised funds.

Myth #1: Donor-advised funds are all the same and only private foundations can be customized

Private foundations will always differ from donor-advised funds in [important ways](#), not only because of their status as separate legal entities and the deductibility rules for gifts to these entities, but also because of the opportunities to customize governance. But it is a mistake to assume that a donor-advised fund is a cookie-cutter vehicle. Indeed, "donor-advised fund" is simply a [term](#) used to describe the structure of a fund and its relationship with a sponsoring organization such as a community foundation. The donor-advised fund vehicle itself is extremely flexible. Here's why:

- Donor-advised funds are popular because they allow your client to make a tax-deductible transfer of cash or marketable securities that is immediately eligible for a charitable deduction. Then, your client can recommend gifts to favorite charities from the fund when the time is right.
- A donor-advised fund at the Chester County Community Foundation is frequently a more effective choice than a donor-advised fund offered through a financial institution. That's because at a community foundation, your client is part of a community of giving and has opportunities to collaborate with other donors who share similar interests. Plus, the Community Foundation is itself local and is deeply knowledgeable about the needs of our region and the nonprofits meeting those needs.
- The Community Foundation can work with you and your client to build a charitable giving plan that extends for multiple future generations. That is because the team at the community foundation supports your clients in strategic grant making, family philanthropy, and opportunities to learn about local issues and nonprofits making a difference.

Myth #2: Deciding whether to establish a donor-advised fund or a private foundation mostly depends on size

The size of a donor-advised fund, like the size of a private foundation, is unlimited. The United States' [largest private foundations](#) are valued well into the billions of dollars. Information about private foundations, ironically, is not so private. The Internal Revenue Service provides [public access](#) to private foundations' Form 990 tax returns. That is not the case for individual donor-advised funds.

Similarly, [donor-advised funds](#) are not subject to an upper limit. Although information on the asset size of individual donor-advised funds is not publicly available, anecdotal information indicates that some donor-advised funds' assets may total in the billions of dollars.

Indeed, a donor-advised fund of any size can be an effective alternative to a private foundation, thanks to fewer expenses to establish and maintain, maximum tax benefits (higher deductibility limitations and fair market valuation for contributing hard-to-value assets), no excise taxes, and confidentiality (including the ability to grant anonymously to charities).

The net-net here is that the decision of whether to establish a donor-advised fund or a private foundation—or both—is much less a function of size than it is other factors that are tied more closely to the objectives a client is trying to achieve.

Myth #3: Donor-advised funds and private foundations are mutually exclusive

Make sure you're aware of the [benefits](#) of using [both](#) a donor-advised fund and a private foundation to accomplish clients' charitable goals. For example:

- Donor-advised funds can help meet the need for anonymity in certain grants, which is typically difficult using a private foundation on its own.
- A donor-advised fund can receive a client's gifts of highly-appreciated, nonmarketable assets such as closely-held stock and real estate, and benefit from favorable tax deduction rules not available for gifts to a private foundation.
- An integrated donor-advised fund and private foundation approach can help a client balance and diversify investment and distribution strategies to ensure that giving to important causes remains steady even in market downturns.

Transferring a private foundation to a donor-advised fund

Some private foundations are even considering transferring their assets to a donor-advised fund at the Chester County Community Foundation to carry on the foundation's mission. Terminating a private foundation and consolidating giving through a donor-advised fund is sometimes the best alternative for a client when the day-to-day management and administration of the private foundation has become more time-consuming than expected and is taking time and focus away from nonprofits, the community, and making grants.

Along these lines, some families find that the tax rules related to investments, distributions, and "[self-dealing](#)" have become harder to navigate and are perhaps even preventing the family from maximizing tax benefits of charitable giving. Finally, the administrative load of managing a private foundation sometimes becomes overwhelming, especially if the family members who handled these functions initially have retired, passed away, or simply become busy with other projects.

The bottom line here is that we encourage you to reach out to our team at the Chester County Community Foundation anytime you are evaluating how to structure a charitable giving plan to achieve both your client's charitable goals and financial goals. Our team is here to help. In many cases, the Community Foundation's tools and services are a great fit for your client's needs. If not, we will point you in the right direction.

For more information, contact the Chester County Community Foundation:

Jason Arbacheski, CAP – Gift Planning & Stewardship Director – jason@chescofcf.org

Karen Simmons – President/CEO – karen@chescofcf.org

The team at the Chester County Community Foundation is a resource and sounding board as you serve your philanthropic clients. We understand the charitable side of the equation and are happy to serve as a secondary source as you manage the primary relationship with your clients. This newsletter is provided for informational purposes only. It is not intended as legal, accounting, or financial planning advice.