

PRIVATE FOUNDATIONS AND DONOR-ADVISED FUNDS

Critical Differences That May Matter to Your Clients

Many advisors recommend a charitable vehicle for their philanthropic clients as part of their overall wealth management strategy. And for many advisors, the default recommendation for high-net-worth individuals and families is often a donor-advised fund (DAF). After all, they're quick to set up, simple for the client to use, and require minimal ongoing effort to manage.

Although DAFs are a great option for many, in certain circumstances, a private foundation could be a better choice. Neglecting to consider this option could be a potential disservice for your philanthropic clients. Unfortunately, a private foundation is often dismissed out of hand because advisors may believe that they are inherently expensive, complicated, and time-consuming, both to set up and to manage. And unless the client is going to fund it with at least \$5 million, many contend it just doesn't make sense. That was true 20 years ago, but not today. Times and private foundations have changed. Private foundations can be established quickly, with as little as \$250,000, and, thanks to the advent of outsourced management firms, are as easy to administer as a DAF but with some potentially important advantages.

Here are 10:

1. A private foundation is a legal entity controlled by the founder, whereas a DAF is controlled by the board of its public charity sponsor.

Maintaining control of their hard-earned assets is a common priority for high-net-worth individuals. Happily, because private foundations are freestanding legal entities, they provide complete control for your client. Every grant decision and investment choice is 100% within your client's



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grasp. For grant and investment choices, a DAF offers less control because technically, the donor's wishes are "recommendations." Although these recommendations are almost always honored, final decision-making authority rests with the sponsor. For clients for whom "almost always" is an insufficient degree of certainty, a private foundation's autonomy is a significant differentiator.

2. Your client can fund the private foundation with a wide array of 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 other nonmarketable securities typically are sold or liquidated by the sponsoring organization.

For certain clients, these differences may be extremely important. Let's say that your client owns a warehouse worth several million dollars. She could establish a private foundation and donate the warehouse, which could then be earmarked as a charitable asset, to further her philanthropic goals. If she loves art, she could turn the warehouse into a community meeting place for artists and art lovers with revolving art installations on display. 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. That's meaningful considering the property's value.

3. Setting up a private foundation is now as fast and easy as a donor-advised fund.

For a very affordable fee, Foundation Source can set up your client's foundation in as little as three business days. And once the foundation has been established, we handle everything needed to run the foundation efficiently: grants processing, monitoring activities for compliance, tax preparation and filing, etc.

4. The entry point is much lower than it used to be.

Until fairly recently, the operating costs of a private foundation made them impractical for any client with less than \$5 million in funding. However, the economies of scale afforded by technology and outsourcing have dramatically lowered the costs of running a private foundation. It now makes sense to start a foundation with as little as \$250,000 in initial funding. In fact, 67% of all private foundations have less than \$1 million in assets.

There are many reasons why your clients might choose to "start small" with a private foundation. Increasingly, we've seen foundations being set up by high-net-worth individuals who want to take an active role in their philanthropy throughout their lifetime rather than leaving a large bequest. These individuals often add to their foundations over time as they develop their philanthropic interests. Others may decide to start small to test out their family's interest before funding the foundation in full.

5. Your client can be reimbursed for expenses incurred while carrying out foundation activities.

Foundation members may pay for reasonable and necessary expenses associated with running the foundation. Expenses that can be reimbursed by the foundation include board meetings, administration, site visits, travel expenses, and even costs associated with starting the foundation. As long as expenses help achieve the foundation's charitable purpose, they count toward the foundation's 5% minimum distribution requirement.

6. Foundations enjoy a world of giving options.

Gifts from a donor-advised fund are typically restricted to straightforward donations to U.S.-based 501(c)(3) public charities. Private foundations provide many more avenues to achieve the donor's philanthropic goals, including:

- Making grants directly to individuals and families facing hardship, emergencies, or medical distress

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- Supporting organizations based outside the U.S.
- Making loans, loan guarantees, and equity investments
- Providing funding to for-profit businesses that support the foundation's charitable mission
- Setting up and running scholarship and award programs
- Running their own charitable programs

7. Foundations are entitled to hire staff, including family members.

State and federal regulations allow foundations to pay a salary to those who provide services to the foundation—even family members—as long as these individuals are qualified for the position, the compensation is reasonable and necessary, and the foundation follows the rules governing compensation to insiders. (Foundation Source provides an optional compensation benchmarking service for its client foundations.) Hiring and compensating staff is not an option with a donor-advised fund.

8. Your client can negotiate and enforce grant agreements.

If your clients want to make a large grant (for example, to build a wing of a local hospital), they may want a legally binding agreement that ensures the funds will be used according to their wishes. It's commonplace for private foundations to enter into such an agreement with their grantees setting forth the purpose, terms, and conditions of their grant, with subsequent grant payments often tied to benchmarks of progress. As this option is not available with a donor-advised fund, this differentiating factor could be critically important if your client intends to make major gifts.

9. Your client can hand-deliver his or her donation.

With a private foundation, your client may hand-deliver a grant check to their favorite nonprofit organization or present it at a fund-raising event or recognition dinner. This is not an option when giving through a donor-advised fund because the donor is not an agent of the sponsoring organization and therefore cannot be given control over the execution of grants.

10. A private foundation is not a binding choice.

Imagine that you've recommended a DAF to your client. A few years later, they come back to you and say that their needs have changed. They want more control than the DAF permits, and their philanthropic options are too limited. Can they grant all of their assets from a DAF to a private foundation? Unfortunately, no. The IRS does not disallow it, but DAF sponsors almost always have rules against gifting assets to a private foundation. However, your client could easily convert their private foundation to a DAF if they decide to do so in the future. Therefore, when advising clients whose needs may change or who may be undecided about their choice of charitable vehicle, many advisors recommend starting with a private foundation.

Good to know:

A private foundation may be converted into a donor-advised fund, but it is all but impossible for a donor-advised fund to convert to a private foundation.

ABOUT FOUNDATION SOURCE

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Foundation Source is the nation's largest provider of comprehensive support services for private foundations. Our complete outsourced solution includes foundation creation (as needed), administrative support, active compliance monitoring, philanthropic advisory, tax and legal expertise, and online foundation management tools.

Now in our third decade, Foundation Source provides its services to more than 1,700 family, corporate, and professionally staffed foundations, of all sizes, nationwide. We work in partnership with wealth management firms, law firms, accounting firms, and family offices as well as directly with individuals and families. Foundation Source is headquartered in Fairfield, Connecticut.

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