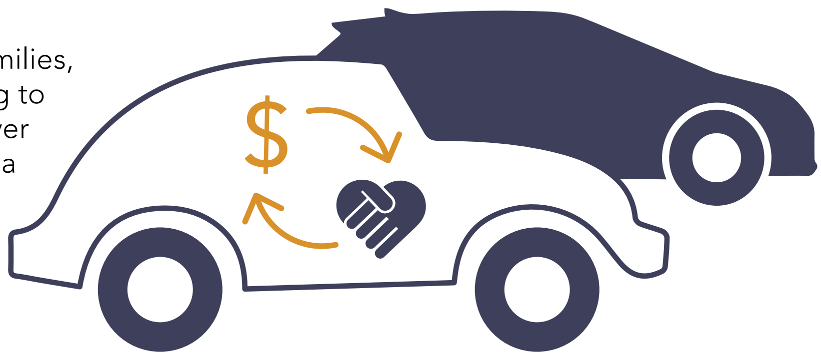
Vertical Community Foundation
INSIGHT HUB

Actionable Insight To Inform Your Giving

Giving Made Easy

Driving Your Giving: Donor advised fund, family foundation, or both?



Private foundations were once the primary giving vehicle for many families, businesses, and individuals wishing to make significant charitable gifts over time. But these days that model is a bit like a classic car that still works but is not as nimble or efficient as another mode of giving, the donor advised fund.

Donor advised funds (DAFs) can be a better approach to giving for ease of administration, privacy, flexibility, and tax reasons. Consequently, some charitable individuals and families choose to convert foundations to donor advised funds or put assets in a DAF to begin with. Other people choose to give from a combination of both—essentially parking more than one vehicle in the garage. That scenario can work, too. But the important thing is for donors to fully consider the options and **choose the approach that best works for their goals and situation in today's world.**

> Donor advised funds work well for clients with a variety of means.

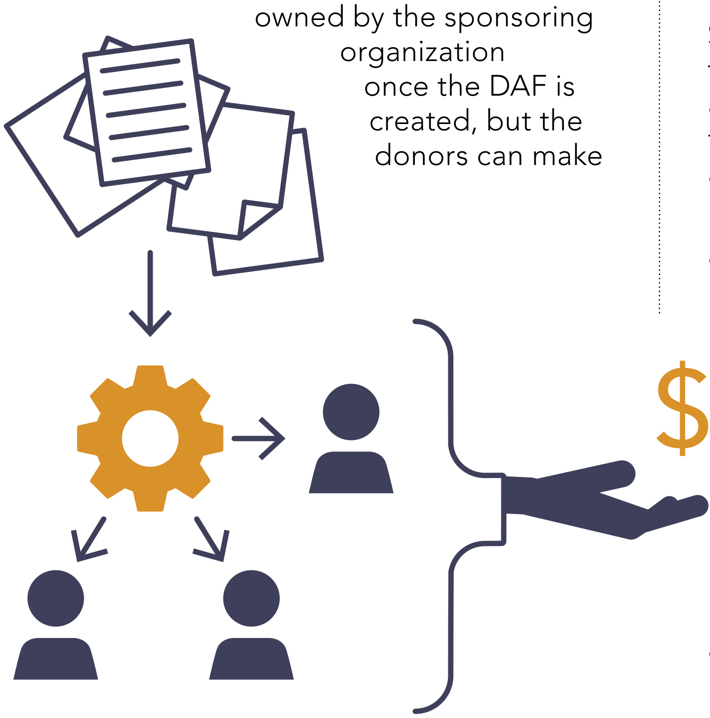
Here are three distinctions:

1. A DAF operates with simplicity in mind, much like a charitable checking account. A sponsoring charitable organization handles the administration of a DAF, whereas the person opening a foundation has to manage it or hire people to do so.
2. A DAF is more advantageous for tax purposes. For a cash gift to a DAF, the allowable tax deduction is up to 60 percent of adjusted gross income, compared to 30 percent for a private foundation.
3. Donors can make anonymous gifts from DAFs, whereas foundation tax reporting is more public.

Reducing the workload

Donor advised funds are about simplicity. They reduce costs and administration so donors can focus on grant making. They are administered by a sponsoring 501(c)(3) charitable organization such as the Vermont Community Foundation that handles required tax filings, writes the checks to recipients, and oversees investing the fund balance in accordance with the charitable individual's recommendations. These services minimize paperwork hassles and allow donors to focus on how and where they want to give.

Charitable individuals can set up a DAF with assets including cash, stock, real estate, or other privately held assets and get an immediate tax break for the full value deposited even if it is disbursed over many years. The assets are owned by the sponsoring organization once the DAF is created, but the donors can make recommendations on where and how the money is distributed. The funds can be given away entirely under a relatively short timeline, or the donor can choose an approach that will support gifts well into the future such as legacy giving. For example, a parent who creates a DAF can appoint a child as the successor advisor to take over after the parent has died.



Sponsoring organizations charge fees to manage DAFs but these can be more affordable than the costs of running a foundation in many cases, even when the assets are in the tens of millions of dollars.

People who create foundations to accomplish charitable goals typically need to hire lawyers to draft the start-up documents, accountants to help with annual tax filings, and financial professionals to invest the principal. Then, vetting grant recipients and writing checks is yet another aspect of running a foundation.

Managing a family foundation can be a significant undertaking, says Andrew Kestner, a Burlington estate planning attorney at Langrock Sperry and Wool.

"Family foundations are a wonderful planning tool and a great fit for the right client. However, once we have walked through the steps required to maintain a foundation, many clients find a donor advised fund a more appealing option."

He frequently advises clients that they would be well served to consider a donor advised fund, depending upon their individual needs and objectives.

"Donor advised funds work well for charitably inclined clients with a variety of means, and particularly so for those clients who do not have heirs willing and available to carry on the management of a foundation in the future," Kestner says.

The bottom line: "Donor advised funds provide many of the benefits of a family foundation while shifting the administrative obligations to a professional custodian like the Vermont Community Foundation."

Flexibility, expertise

Another key difference between donor advised funds and family foundations is around the required rate of giving. Private foundations must adhere to a five percent annual pay-out under IRS rules. There is **no required payout for donor advised funds,** although many give substantially. The payout rate averaged 23 percent in a 2021 National Philanthropic Trust Study of 976 charitable organizations that sponsor donor advised funds.

Still, the absence of a mandate gives DAFs flexibility. If donors want to make a major, transformational gift, they can recommend no giving for a certain period to save up for the big gift. If the DAF's investment performance is sluggish one year due to stock market woes, the donor can hit a temporary pause on giving. Family foundations don't have that option.

> It doesn't have to be **either or.**

Another benefit of donor advised funds is that sponsoring organizations such as the Vermont Community Foundation offer expertise on giving through philanthropic advisors who are well-versed in Vermont's strengths and challenges. They also know Vermont's landscape of need—and the nonprofit organizations that respond to those needs. "Our philanthropic advisors live in the communities that you live in and have a finger on the pulse of the needs in communities," says Ruth Henry, a senior philanthropic advisor at the Vermont Community Foundation.

> **Advance planning** is key.

Whether donors are passionate about giving to improve the environment, food security, education, land conservation, or racial justice, philanthropic advisors can help them find deserving projects and give to nonprofits doing effective, innovative work.

This navigational help, and the desire to reduce administrative burdens, spur some families to convert family foundations to donor advised funds, especially when the family foundation has been spent down significantly and the cost of running it no longer makes sense.

Sometimes the younger generation prefers to be less hands-on than the older generation was when the family foundation was created. Some families and individuals also may want to keep an established foundation but supplement giving with a donor advised fund. A DAF can work well alongside a private foundation when individual family members have interests that are outside the purpose or focus of a private foundation. Family foundations can make gifts to donor advised funds, which helps put this dual approach to philanthropy in place.

"A donor advised fund can be supplemental to a foundation. It doesn't have to be either/or," Henry says.

Consulting with a philanthropic advisor can help people choose the right charitable vehicle. It's especially important to do the research when a major event is anticipated, whether that's the sale of a business, a large real estate or securities transaction, a pending inheritance, or all the above. "Advance planning is key," Henry says.

Wonder how to convert from a foundation to a donor advised fund?

Here's a case study scenario to fill in the picture.

Robert, age 46, is helping his widowed mother Pat, age 83, run a family foundation that was created in the late 1970s after the success of a family-owned appliance manufacturing business. Pat and her late husband Don were passionate about giving to local community needs and often attended ribbon cuttings, fundraisers, and served on nonprofit boards. As a couple, they were extroverts who enjoyed being in the spotlight and felt that it inspired others to give.

They contracted with lawyers, accountants, and a financial advisor to help with the foundation and did most of the research on giving themselves. The foundation at one time had a balance of $20 million and has been spent down to $5 million. Pat would like the foundation to continue but has substantial health problems and has asked Robert to take charge. He has a busy dental practice and three teen-age children. He volunteers at a dental clinic and gives

Tax advantages and privacy

Donor advised funds offer significant tax deductions and are especially useful in years when a donor experiences major financial events that boost income and generate capital gains tax liability. Donors get the tax break for contributions in the year they are made, regardless of when the money is disbursed. The deduction for cash contributions to DAFs is up to 60 percent of adjusted gross income, compared to 30 percent for foundations. Once the funds are deposited, they can be invested and accumulate in value, tax-free. This sheltering allows DAFs to compound and grow even as they increase giving in some cases.

Family foundations also offer tax breaks to the people who contribute to them but are less attractive for major financial events. And unlike DAFs, they pay a federal excise tax on investment gains.

One other key difference between DAFs and foundations is privacy. Charitable individuals who prefer to keep a low-profile can do so with a donor advised fund. They can make gifts anonymously through their DAF and the sponsoring charitable organization is not required to publicly disclose the identity of the donor who makes them or created the DAF.

Foundation giving is more public. IRS rules require foundations to disclose recipients of grants, amounts of gifts, and the names of the directors of the foundation in annual tax filings.

In the end, both family foundations and donor advised funds are vehicles that work to drive giving. But before going behind the wheel, be sure and kick the tires and decide what works best for you or your family's needs.

For additional recommendations about giving in Vermont, please reach out to our Philanthropy Team at philanthropy@vermontcf.org or 802-388-3355 opt. 5.

If you found this information useful, find similar content at vermontcf.org/insighthub.

The heart of the Community Foundation's work is closing the opportunity gap—the divide that leaves too many Vermonters struggling to get ahead, no matter how hard they work. Learn more about the Community Foundation's philanthropic advising services or opening a donor advised fund at vermontcf.org.

philanthropically on his own but rarely attends fundraisers and sees himself as a lower-profile person than his parents. Still, Robert wants to honor the legacy they created with the family foundation. He feels crunched for time and approaches a philanthropic advisor for ideas. Together he and his mother decide to convert the foundation to a donor advised fund with a sponsoring charitable organization that is a qualifying 501(c)(3) and will handle the legal and tax aspects of the account, as well as investing the funds and carrying out the recommended gifts. They open the account with Pat as the advisor and list Robert as the successor advisor, so he can guide giving when his mother is gone. They work with their trust attorney to transfer a first batch of funds to the DAF at the sponsoring charitable organization, and then to go through the legal steps to dissolve the foundation, which takes a few months. Both Robert and Pat feel good about the new approach and breathe a sigh of relief knowing they can continue giving without so much paperwork and stress.