BALENTINE

Philanthropic Giving

One of the many discussions we have with business owners and entrepreneurs going through liquidity events is determining effective ways to channel their financial resources towards creating a positive impact on society. The choice between establishing a donor-advised fund (DAF) or a private foundation is a crucial decision that requires careful consideration. Both options offer unique advantages and disadvantages, catering to different philanthropic goals, financial circumstances, and desired levels of involvement. We look to provide a comprehensive analysis of DAFs and private foundations, allowing clients to make well-informed decisions aligned with their values and objectives as well as highlighting typical points of discussion that families work through while making their decisions.

Donor-Advised Funds

A donor-advised fund (DAF) is a philanthropic vehicle that allows individuals, families, or corporations to make contributions to a charitable account held by a sponsoring organization, typically a public charity or financial institution. Donors retain advisory privileges over the distribution of funds, recommending grants to qualified nonprofit organizations. The sponsoring organization manages administrative tasks, investment of assets, and compliance with legal requirements.

Advantages:

1. **Simplicity and Low Administrative Burden:** DAFs offer a streamlined process for philanthropy. Donors are relieved of the complex administrative tasks associated with managing a private foundation, allowing them to focus on strategic giving and impact.

2. **Immediate Tax Benefits:** Contributions to DAFs are eligible for an immediate tax deduction in the year they are made. This feature is particularly advantageous for families of significant means seeking to optimize their tax liabilities while supporting charitable causes.

3. **Flexibility in Grant-Making:** Donors enjoy flexibility in recommending grants to a wide range of charitable organizations, including educational institutions, arts organizations, and religious entities, provided they are recognized as eligible by the IRS.

4. **Anonymity:** DAFs provide the option for donors to remain anonymous when making grants. This appeals to individuals who wish to support causes discreetly without drawing public attention.

5. **No Mandatory Payout Requirements:** Unlike private foundations, DAFs do not have an annual payout requirement, potentially allowing assets to accumulate within the fund without an immediate impact on charitable giving.

Disadvantages:

1. **Limited Legal Control:** Although donors retain advisory privileges, they relinquish legal control over the funds once contributed to the DAF. The sponsoring organization makes final decisions regarding grant distributions.
2. **Lack of Direct Oversight:** DAFs may not have the same level of accountability and transparency as private foundations. This can lead to concerns about how efficiently and effectively funds are being used for charitable purposes.

Case Study*: Creating a Charitable Legacy

In this example, the DAF enables the Smith family to formalize their charitable giving, involve their children in philanthropy, benefit from tax deductions, and create a legacy of giving that spans generations.

The Smith family, comprised of John, his wife Sarah, and their two children, Emily and Michael, had always been passionate about giving back to their community. Over the years, they made regular donations to various charities, attended fundraising events, and volunteered their time. However, as their financial situation improved, they wanted to create a more structured approach to their philanthropy and involve their children in the process.

Here's how their story unfolds:

Getting Started:

- **Setting Up the DAF:** John and Sarah worked with their financial advisor to set up a DAF under their chosen provider. They contributed a significant lump sum to the fund, which was invested, and allowed it to grow over time. This initial contribution qualified as a tax-deductible charitable donation.
- **Involving the Next Generation:** As part of their desire to pass on philanthropic values to their children, John and Sarah decided to involve Emily and Michael in the decision-making process. They held family meetings to discuss causes that were important to each family member and allowed the children to research and propose charitable organizations they believed in.
- **Choosing Meaningful Causes:** Using the DAF, the Smith family made regular grants to the charitable organizations they had chosen. Emily selected a local animal shelter, as she had a deep love for animals, while Michael chose an organization focused on providing educational resources to underprivileged children.

Long-Term Impact:

- **Creating a Giving Tradition:** Over the years, the Smith family continued to contribute to their DAF. They also involved their extended family during holiday gatherings, encouraging others to join in the giving process.
- **Passing on Values:** As Emily and Michael grew older, they developed a deep sense of responsibility for their family's charitable legacy. They actively participated in selecting new organizations to support and even started their own charitable initiatives within the scope of the DAF.
- **Creating a Lasting Legacy:** Over many years, the Smith family's DAF grew substantially. John and Sarah had instilled a strong tradition of giving back in their children, and Emily and Michael continued to manage and grow the fund, passing on the values of philanthropy to their own families.

* Case Studies are representations of common client experiences and do not directly reflect any one family's experience.

Private Foundations

A private foundation is a legal entity established by an individual, family, or corporation with the primary purpose of philanthropy. Private foundations operate as independent organizations and have distinct legal obligations, including annual distribution requirements, investment policies, and reporting obligations to the IRS.

Advantages of Private Foundations:

1. **Complete Control and Flexibility:** Private foundations offer a high degree of control over grant-making strategies, enabling donors to define the foundation's mission and focus areas. This control allows for personalized, targeted philanthropy aligned with the donor's values.

2. **Long-Term Vision:** Foundations can engage in strategic, long-term philanthropy, addressing complex social issues that require sustained commitment and investment. This ability to take a comprehensive approach to solving problems is a unique advantage.

3. **Family Involvement and Legacy:** Private foundations can involve multiple generations of a family, fostering a legacy of giving. This family engagement not only strengthens philanthropic values but also nurtures a culture of community impact.

4. **Public Visibility and Credibility:** Private foundations are recognized as independent entities, which can enhance credibility and attract additional support from other donors, partners, and stakeholders.

Disadvantages of Private Foundations:

1. **Higher Administrative Burden:** Private foundations require extensive administrative efforts, including legal compliance, financial reporting, and governance. Establishing and maintaining a foundation demands time, expertise, and financial resources.

2. **Upfront Costs:** Setting up a private foundation involves initial costs for legal fees, administrative expenses, and potentially higher operational costs compared to establishing a DAF.

3. **Reduced Anonymity:** Private foundation grants are typically public information, potentially compromising donor anonymity. This may not suit those who prefer a more discreet approach to philanthropy.

4. **Distribution Requirements:** Private foundations are legally required to distribute a minimum of 5% of their assets annually, ensuring a steady flow of funds to charitable causes. This requirement may impact the foundation's ability to accumulate assets for larger impact projects.

Case Study: Amplifying Charitable Impact*

The Johnson family, consisting of Mark, his wife Lisa, and their three adult children, Amanda, David, and Sarah, had always been deeply committed to making a positive impact on society. Over the years, they had actively volunteered, donated to various causes, and participated in community projects. As their financial situation improved, they decided to establish a private foundation to take their philanthropic efforts to the next level.

Getting Started:

- **Establishing the Private Foundation:** Mark and Lisa consulted with legal and financial advisors to set up the Johnson Family Foundation. This involved creating a legal entity with its own board of directors (which included family members) and adhering to legal and regulatory requirements for private foundations.
- **Control and Customization:** One of the main reasons the Johnson family chose a private foundation was to maintain direct control over their charitable giving. They wanted to have a say in every aspect of their philanthropic efforts, from selecting beneficiaries to designing programs and initiatives. This level of control allowed them to align their giving with their values and address specific issues they felt passionate about.
- **Tailored Giving Strategies:** With their private foundation, the Johnson family had the flexibility to design their own giving strategies. For instance, they decided to focus on education, healthcare, and environmental conservation. They established scholarship programs for underprivileged students, partnered with local healthcare clinics to improve access to medical services, and supported conservation projects in their region.
- **Involving the Next Generation:** Mark and Lisa saw the private foundation as an opportunity to involve their adult children in the family's philanthropic efforts. They encouraged Amanda, David, and Sarah to participate in foundation meetings, share their perspectives, and even propose their own initiatives. This allowed the younger generation to learn about philanthropy and carry forward the family's values.

Long-Term Impact:

- **Building a Lasting Legacy:** The Johnson family envisioned their private foundation as a vehicle for creating a lasting legacy of positive change. They carefully managed the foundation's investments, ensuring that the endowment would continue to grow and support charitable initiatives for generations to come. This long-term perspective reflected their commitment to making an enduring impact on the community.
- **Collaborating with Other Organizations:** Through their private foundation, the Johnson family had the opportunity to collaborate with other nonprofits, community groups, and government agencies. By pooling resources and expertise, they were able to amplify the impact of their giving and tackle complex social issues more effectively.
- **Adaptation and Evolution:** Over time, the Johnson family's private foundation evolved to reflect changing societal needs and the interests of the younger generation. New family members who joined the foundation's board brought fresh perspectives and ideas, ensuring that the foundation remained relevant and responsive to emerging challenges.

A Different Angle: Private Stock Donations

While clients should always look to gift appreciated securities as a way to fund their charitable intent, business owners and entrepreneurs may also want to look at opting to donate private stock to a DAF or private foundation prior to a transaction, as opposed to contributing cash after the sale, due to the distinct advantages.

By donating the stock directly, individuals can potentially avoid capital gains taxes they would have incurred upon selling the stock themselves. This allows them to magnify the impact of their contribution. This strategy not only aligns philanthropic intentions with potential financial benefits but also presents an opportunity to optimize the overall value of the gift. However, it's important to engage with financial and legal experts to ensure compliance with tax regulations and to determine the best approach for maximizing the advantages of such a donation.

The chart below shows an example of the benefits of utilizing private stock to fund your donor advised fund or private foundation.

	Post-Tax Cash Gift	Pre-Tax Shares (Donor Advised Fund)	Pre-Tax Shares (Private Foundation)
(A) Gross Proceeds	$38M	$38M	$38M
(B) Pre-Transaction Charitable Gift	-	$10M	$10M
(C) Tax Reduction (due to gift)	$0	$2.3M	$2.3M
(D) Taxes Due on Sale[1]	$9M	$6.7M	$6.7M
(E) After-Tax Proceeds	**$29M**	**$21.3M**	**$21.3M**
(F) Post-Transaction Charitable Gift	$10M	-	-
(G) Tax Savings on Charitable Deduction	$3.7M	$3.7M[2]	$1,850[3]
Total Tax Savings (C+G)	**$3.7M**	**$6.1M**	**$2.4M**
Total Net Proceeds (E-F+G)	**$22.7M**	**$25.0M**	**$21.3M**

1 All estimated taxes due are at a rate of Federal 23.8% rate (20% long term capital gains + 3.8% Medicare surtax)
2 Based on appraised value of gift and 37% Federal tax bracket.
3 Charitable deduction limited to basis for Private Foundation contribution of complex assets. Assumes $5,000 * 37%
Source: Balentine

The choice between a donor-advised fund and a private foundation represents a pivotal decision for families seeking to maximize their philanthropic impact.

Donor-advised funds offer simplicity, immediate tax benefits, and anonymity, albeit with limitations on control and transparency. Private foundations grant complete control, flexibility, and the potential for long-term impact, but come with higher administrative burdens and costs. Families must carefully evaluate these advantages and disadvantages considering their philanthropic vision, financial goals, and desire for influence over their giving strategy. Ultimately, the decision rests at the intersection of financial strategy and the deep-seated desire to create positive change in the world and a lasting legacy.

If you have questions about how to get started with your own philanthropic giving strategy, we encourage you to reach out to your relationship manager and consult the attached checklists:

What issues should I consider when establishing my charitable gifting strategy?

Should I use a DAF when giving to public charities?