



American Endowment Foundation

# Why Private Foundations Establish Complementary Donor Advised Fund Accounts

In recent years, many donors who have private foundations have considered whether to replace their private foundation with a donor advised fund (DAF) or open one to complement their foundation if they have not yet already done so. The awareness and number of donor advised funds has increased dramatically over the past decade to the point where there are now three times more donor advised funds than foundations. Much has been written about reasons why donors should create a DAF instead of a foundation, but this piece elaborates on why donors who already have a foundation would want to open up a DAF while continuing to operate their foundation.

## **Some of these reasons include:**

### **Anonymity**

Donors have a choice whether to make grants anonymously or publicly from their donor advised fund accounts, while anyone can view all of the grants made by private foundations. Though most donors who make grants from their DAF accounts tell their grantees that they are the ones making the grants, some prefer to give anonymously to organizations that are outside the stated mission of their foundation, as they don't want to be solicited for grants from similar grantees. Additionally, other donors do not want other donors, fellow volunteers or board members, or friends or colleagues to know of the amounts or recipients of some or all of their grants.

### **Tax advantages**

Donors often can have more of an impact by donating certain assets to a donor-advised fund instead of to their private foundation. If the donor contributes appreciated illiquid assets such as closely held C or S corporation stock, real estate, LLC, or LP interests to a DAF, the tax deduction is valued at the fair market value instead of only the cost basis if donated to a foundation. Furthermore, the donor can receive a deduction up to 50% of Adjusted Gross Income to a DAF vs. only 30% to a foundation for donations of cash, and 30% to a DAF vs. 20% to a foundation for donations of appreciated assets.

### **Succession Planning**

Before appointing children to the foundation board, or paying them to manage the foundation, many parents create smaller donor-advised fund accounts and let their children gain experience with the DAFs to first prove that they are capable of running the foundation or of becoming excellent foundation board members.

### **Geographic or Issue Differences**

While family members can decide together to make grants from a foundation or donor advised fund, some families choose to make grants together from a foundation, but also establish separate donor advised funds for the children when they want to support different charities, often in different geographic areas from where they were raised or where the parents live. After the death of the parents, this strategy helps families honor their parents' legacy by giving together from the foundation while respecting the next generation's different giving interests and allowing them to make grants from their separate donor advised fund accounts.



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### **DAF Tryout and Ease of Use**

Some families who are considering closing their foundation and using a DAF instead, first make a grant from the former to create the latter. Many donors with foundations have heard of some of the advantages of donor advised funds including online grantmaking and ability to view past grants, no tax filing requirements, no taxes paid on investment income, and how the DAF sponsor is responsible for vetting grantees, etc. Setting up a donor advised fund enables the donors to first make sure they are comfortable using it before closing their foundation.

### **No mandatory distribution**

Many donors with foundations open donor advised funds with a grant from their foundation so they can fulfill the 5% mandatory annual foundation distribution requirement. This often occurs at the end of the year when donors are not ready to make a final decision about where to make their grants, and DAF accounts can typically be opened very quickly and without cost. There is not a mandatory annual distribution requirement from DAFs.