Understanding Donor-Advised Funds and Family Foundations

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These two common vehicles for charitable giving each offer their own advantages.

Whether you're helping to fund religious causes, education, the arts or medical research, donating to charitable causes feels good. And for affluent individuals and families, contributing to important philanthropic causes can ensure your wealth makes a lasting difference — today and for generations to come.

While you may be tempted to simply write a check to support your favorite cause, consider a more strategic approach: Funneling your charitable efforts through a donor-advised fund or family foundation can make the gifting process more efficient and sustainable.

Both of these strategies offer powerful benefits such as favorable tax advantages and flexibility over the gifting process. But donor-advised funds and family foundations each have unique characteristics that may make one more appealing to you and your family. Here are the basics of each of these powerful charitable vehicles.

Donor-advised funds

Donor-advised funds (DAFs) are a simple, flexible tool for donors who want to give, but don’t want to be heavily involved in the direct management of funds — or who don’t have the resources to run a family foundation, which has its own board of directors and staff. While DAFs typically require maintenance fees and minimum contributions, they’re less expensive than a family foundation to administer. Minimum contributions to DAFs generally run between $5,000 and $25,000, and most charge administrative fees of less than 1%.

DAFs are managed by a sponsoring organization — typically a financial institution — that handles all of the investment and administrative work. You make tax-deductible contributions, select your investments and your donations grow tax-free. Then, you get to choose when to distribute grants and recommend where they go. It’s important to note that sponsors have the final word on grants, but as long as you’re recommending grants to qualified charities, your wishes are usually carried out.

One of the biggest perks to using a DAF is its tax advantages — especially these days. The Tax Cuts and Jobs Act of 2017 doubled taxpayers’ standard deduction, leaving more taxpayers to simply take the standard deduction rather than itemizing their taxes and deducting charitable gifts. DAFs, however, offer a way to take advantage of that tax break: contributions can be bundled together in a single year, but can be given to charities over time.

For example, if you typically donate a total of $10,000 each year, you may not receive any tax breaks for those deductions under the new tax rules. However, making a one-time contribution of $50,000 — or five years’ worth of gifting — to a donor-advised fund means you’d be eligible to deduct those contributions. In effect, you get a big tax break the year you contribute assets to the fund, but the unique structure of DAFs means that you don’t have to distribute the funds all at once. Instead, you can continue to dole out your typical $10,000 per year, if you prefer.

The size of your tax break, however, also depends on your income: The amount of property you give to a DAF that qualifies for an immediate income tax deduction can be as high as 60% of your adjusted gross income for cash or 30% of appreciated property. If your income fluctuates from year to year, consider making DAF contributions in higher earning years, which may allow you to maximize your tax deductions.

Family foundations

If you have a larger sum to direct toward charitable giving, a family foundation might be the right vehicle. There’s no monetary threshold for starting your own foundation, but family foundations must give at least 5% of their total assets to charities each year. For many people, it takes assets of at least $500,000 to make a family foundation a worthwhile gifting vehicle.

Funding the majority of the family foundation upon your death will remove assets from your estate, effectively reducing any potential estate tax bill. However, the tax breaks may not be as generous if you create a family foundation during your lifetime: The amount of the donation that qualifies for an immediate income tax deduction is limited to 30% of your adjusted gross income for cash or 20% of appreciated property.

That said, creating a family foundation during your lifetime offers certain benefits, including more control over how the foundation is structured and its overall philanthropic mission. If those benefits are appealing, there are strategies that can help maximize your deductions. For instance, you may consider funding part of the family foundation in December and the remaining amount in January in order to take advantage of the immediate income tax deductions over two tax years.

Establishing a foundation also requires creating a board of directors to manage administrative tasks, investing and grant-making. While family foundations are more expensive to administer, they offer greater control and allow you to be much more hands-on in managing charitable gifts.

Creating your own foundation might be ideal if you have very specific ideas for how you want to use your money. With a family foundation, you can go beyond merely directing funds toward a particular cause or a benefactor, and create your own charitable programs. You also can set up scholarships or prizes that can be awarded to individuals.

A family foundation can also be a great way to get younger generations involved in philanthropy and to pass on the values and ideals that define you. By inviting your children and grandchildren to share their ideas and play a direct role in foundation projects, you can give your family legacy the strong footing it needs to carry on for generations. Compensation for board members and expenses related to attending family foundation meetings are allowed. This is a great way to have your family get together once a year to reunite and carry forward your charitable purpose.

Charitable giving is rewarding. And when you find the vehicle for gifting that best fits your family's goals, you can establish an even more meaningful habit that benefits the people, places and issues that matter most to you.

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