

COMPARING PHILANTHROPIC GIVING STRUCTURES: PRIVATE FOUNDATION OR COMMUNITY FOUNDATION-BASED FUND

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Community foundations, philanthropic families and private foundation board members regularly reach out to CMF to learn about the benefits of private foundations and community foundations-based funds, particularly donor advised funds (DAFs). In many cases, these individuals are considering whether to maintain a private foundation or transition their philanthropy to a fund held by a local community foundation. This document is a reference tool for considering which philanthropic giving structure is most appropriate to the unique situation and priorities of these individuals and families.

This resource is intended to provide an overview of important distinctions between two primary institutions that may house a family or institution's philanthropic funds:

- **Community Foundations and Other Public Charitable Entities:** This category includes community foundations, religious and other charitable organizations that serve as sponsoring organizations holding DAFs and other funds.
- **Private Foundations:** This category includes family foundations, corporate foundations and other grantmaking entities that are required to follow private foundation requirements set by the IRS.

The transition of a private foundation into a community foundation fund (DAF or otherwise) is not reversible, so it is particularly important for the family or private foundation board to consider the costs and benefits of these philanthropic giving structures. Specifically, a family cannot take back the funds and create/re-create their family foundation in any form. Any new foundation would need to be created from an entirely different set of assets to establish such a private foundation. The family or private foundation should engage qualified professional advisors and legal counsel to assist in any transition activities.

BENEFITS OF COMMUNITY FOUNDATION FUNDS

A private foundation may choose to transition its assets into a community foundation, oftentimes to ease the burden of administering a stand-alone organization and to engage the support of community foundation staff, who also have local expertise on needs in the area and relationships with organizations working on the ground in the community. In making this transition, the foundation's board no longer needs to do annual filings or cover insurance and related costs, and its directors have no more fiduciary duties and potential legal exposure.

- **Back Office Functions:** A community foundation (or other sponsoring organization) provides back-office functions for the funds held within the organization, including accounting, grant application management, grantmaking, reporting and investing of the assets. The community foundation also ensures that the fund follows state and federal regulation. The costs of these activities are covered by a fee structure established when the fund is established per a written fund agreement document, although this fee may change over time. Please note that some community foundations may allow for limited input on the investment strategy of a DAF if it meets a specified minimum size.
- **Legal Oversight:** The community foundation board has discretion and control over the fund. While a family or committee of individuals may recommend grants or advise a fund, the community foundation has final determination over the activities of the fund (including fundraising and gift acceptance, as well as grantmaking). Once the community foundation accepts transfer of the assets and creates a fund, the assets are then legally owned and held by the community foundation and cannot be returned.
- **Policies and Procedures:** The community foundation sets the policies and procedures for all funds held within the institution, including grantmaking cycles, lifespan of the funds, payout rates, fees, fundraising/gift acceptance policies, data protection and others. While many community foundations within the state of Michigan are affiliated with the National Standards for U.S. Community Foundations program, which requires certain policies and procedures be put into effect, the exact language used within policies and other procedural documents may vary from one organization to another. Individuals are advised to discuss the relevant policies and procedures that may impact their potential fund with the sponsoring organization under consideration.
- **Transitioning or Terminating Operations:** In the case that a private foundation decides to terminate its operations, it may transfer funds to a community foundation or other public charity. Specifically, a private foundation terminating operations by transferring all of its assets to a public charity (i.e., community foundation, including a DAF) would be one of a limited number of ways that it could avoid termination taxes that apply to private foundations. Questions about the current rules and regulations for transitioning or terminating a foundation should be directed to qualified legal counsel.
- **Multiple Fund Types Available:** While board members asking about transitioning a private foundation into a community foundation may inquire specifically about DAFs, there are a number of fund types available at community foundations. Depending on the specific strategy

and needs of the family or private foundation, several options may be available at the community foundation of their choice. Please note that minimum fund balances, fund types and other restrictions on the use of funds may vary by institution.

- **Donor Advised Funds (DAFs):** DAFs are a special category of fund held by community foundations and other sponsoring organizations that allow for the donor to contribute assets into the fund and then regularly recommend grants out of the fund over time. The donor or a small committee (family or previous board members, in the case of a dissolving foundation) may continue to have input on the grantmaking of this fund for a length of time, typically a maximum of one to two generations. After that period, most community foundations will require the funds to be absorbed into a general field of interest fund (topic-oriented) held by the community foundation, or the funds may become undesignated funds of the community foundation. All grants made by the DAF are recommended by the donor/committee, but the community foundation board can decline the recommendation and has final approval over all grants. Individuals should contact the community foundation or other sponsoring organization under consideration, as specific policies and procedures may vary by institution. Please note that DAFs are a continued topic of discussion for a number of regulatory bodies, and as such, federal and/or state rules that affect the operation of DAFs are subject to change.
- **Other Fund Types:** Community foundations house a number of other fund types, including field of interest (topic-specific), designated (organization specific), discretionary (community foundation operations/unrestricted), scholarship or special project funds. These funds may serve as a means for the private foundation's original grantmaking priorities to continue within the operations of the community foundation, especially if they focus around a theme (i.e., arts or social services), geographic region or specific charitable organizations. These fund categories require that more than half of the advisory committee for a fund include individuals *not* recommended by the original donor, thereby adding new perspectives to continue the work beyond the private foundation's own board members. Individuals should contact the community foundation under consideration to explore available fund types.

BENEFITS OF PRIVATE FOUNDATIONS

A private foundation may choose to continue as a stand-alone organization for a number of reasons, including remaining in control of its assets, strategy and grantmaking. A private foundation structure also allows the institution, its assets and board to remain active and independent beyond a limited lifespan or similar policy limitations implemented by a community foundation.

- **Independent Mission and Leadership:** The private foundation has the latitude to function as an independent organization with its own designated mission, purpose and board of directors.
- **Independent Finances and Operations:** The foundation can manage its own finances, operations and reporting to the IRS and other regulatory institutions. It also has direct control of

the process to determine external counsel in these areas, including contracting with legal counsel, auditors and consultants to assist with these activities.

- **Control over Foundation Investments:** The foundation board can determine the institution’s investment strategy, consider spending at a payout rate beyond the federal minimum and hire external investment firms to manage day-to-day investment activity. The board can also choose to involve the foundation in alternative forms of impact investing, including program- or mission-related investments.
- **Organizational Lifespan:** The foundation board has final determination of the lifespan of the foundation. The organization can be designed to last in perpetuity (indefinitely) or decide to have a limited lifetime, with a timeframe of the board’s choice.
- **Grantmaking Activities:** The foundation board (with assistance from staff or consultants) can determine the organization’s own grant priorities, grant cycles (frequency of grantmaking), and structures, without requirements set by external boards or institutional policies.

RECOMMENDED RESOURCES

Council of Michigan Foundations. “Options for Your Financial Giving: A Comparison of Philanthropic Giving Structures for Individuals and Families.” 2021.

<https://www.michiganfoundations.org/resources/options-your-financial-giving>.

National Center for Family Philanthropy. “How Do Donor-Advised Funds Compare with Private Foundations and Other Family Giving Vehicles?” <https://www.ncfp.org/knowledge/how-do-donor-advised-funds-compare-with-private-foundations-and-other-vehicles/>.

National Center for Family Philanthropy. “Options for Family Philanthropy: Comparing Donor-Advised Funds and Private Foundations.” <https://www.ncfp.org/wp-content/uploads/2019/03/Getting-Started-Comparing-DAFs-and-PFs-NCFP-2019.pdf>.

ABOUT ASK CMF

This document was authored by Brittany Kienker, Ph.D., Knowledge Insights Expert in Residence for the Council of Michigan Foundations (CMF). Legal aspects of this document were reviewed by Jennifer Oertel, outside legal counsel to CMF. CMF members can find answers to their most pressing questions through CMF’s Knowledge Insights division, including Ask CMF, the Knowledge Center and the Sample Documents Hub. Ask CMF is a free service to CMF members, available through the “Ask CMF” link on the CMF homepage or by visiting <https://www.michiganfoundations.org/practice/ask-cmf>.

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