

WHEN PRIVATE FOUNDATIONS GIVE THROUGH DAFS:

Exploring the How and Why of this Practice

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Executive Summary

- ◆ **Private Foundations strategically use DAFs for various purposes, including pooling resources, streamlining administration, supporting geographically diverse causes, and responding quickly to crises.**
- ◆ **DAFs offer significant benefits to private foundations through increased grantmaking capacity, access to expertise and research, and flexibility for diverse philanthropic interests.**
- ◆ **Criticisms of private foundation use of DAFs are unfounded and proposed restrictions could negatively impact overall charitable giving, stifle innovation, and limit access to valuable expertise.**
- ◆ **Data and practice demonstrate that DAFs actively support philanthropy. High payout rates and evolving upward trends in grantmaking highlights this positive impact.**
- ◆ **DAFs have and continue to serve as a valuable tool for private foundations offering strategic advantages, collaboration opportunities, expertise access, privacy protection, and flexibility for impactful grantmaking.**

Donor-advised funds (DAFs) are charitable giving accounts used by many Americans as a flexible, accessible way to give to charities. Popular with individual donors, DAFs are also sometimes used by private foundations to facilitate their donations. With unique features that encourage giving, DAFs have been used by some foundations to pool resources, streamline administrative tasks, and set aside seed capital for a group that is pursuing IRS determination as a charity.

This primer will explore the valuable ways private foundation use DAFs, consider criticisms of this practice, and examine the potential consequences that could arise from imposing new restrictive regulations on private foundation use of DAFs.

DAFS SERVE PRACTICAL REALITIES

When looking at the broad impact of DAFs and private foundations on charitable giving, it is clear they facilitate robust giving that supports causes and communities Americans care about. These two types of vehicles operate differently, and other Roundtable publications address each one individually in detail.¹

The purpose of this brief is to address the issues that arise when a private foundation gives through a DAF. There are a wide range of legitimate reasons why a foundation may do so according to its charitable goals.

Private foundations give through DAFs for many reasons including:

- ◆ **To streamline giving by pooling resources with other donors, ensuring charities receive maximum impact without excessive administrative burdens.**
- ◆ **To allow small private foundations to leverage the economies of scale and investment expertise inherent in DAF structures.**
- ◆ **To streamline administrative and legal processes for scholarship funds.**
- ◆ **To mitigate bookkeeping difficulties for challenge and multi-year capital grants.**
- ◆ **To foster harmony when family foundations have varied philanthropic interests.**
- ◆ **To provide a strategic avenue for having a dispersed geographical impact.**
- ◆ **To donate internationally. Smaller foundations may not have the resources to comply with paperwork and due diligence requirements. Giving through a DAF allows them to outsource these functions.**
- ◆ **To buy time for giving decisions when a founder passes or when there is an administrative change in a foundation.**
- ◆ **To issue a one-time, off-mission grant, such as COVID relief or wildfire disaster recovery, without opening the door for further solicitations.**
- ◆ **To train future generations in grantmaking.**
- ◆ **To protect donor information when granting to a controversial cause.**

¹ See: McGuigan, Elizabeth. "Donor-Advised Funds: A Powerful, Popular Charitable Giving Tool." Philanthropy Roundtable, August 2021. <https://www.philanthropyroundtable.org/resource/donor-advised-funds-a-powerful-popular-charitable-giving-tool/>; Salmon, Jack. "Private Foundations and the 5 Percent Payout Rule." Philanthropy Roundtable, November 2023. <https://www.philanthropyroundtable.org/the-truth-about-private-foundations-and-the-5-percent-payout-rule/>

Below we explore eight valuable and innovative ways private foundations use DAFs in their grantmaking operations.

1. *Pooling Resources*

One of the significant strategic advantages of DAFs for private foundations is the ability to pool resources from multiple donors. DAFs can act as a conduit for aggregating charitable contributions from various individuals, families or foundations into a single fund. By combining resources, private foundations can deploy larger grants than they could individually, with less overhead burden for the receiving charity, significantly increasing their impact on the causes they support.

This consolidation of resources enables foundations to address critical issues on a broader scale and support a greater number of projects and organizations, ultimately driving more significant positive change within communities.

In 2020, for example, when the COVID-19 pandemic began, foundations increased their grantmaking by a staggering 24 percent, while grants from DAFs increased by nearly 30 percent in the first six months of 2020 compared to the same period in 2019.

2. *DAF Sponsor Knowledge*

In some cases, the DAF sponsor is a community foundation or mission-based organization that offers valuable resources on effective ways to direct charitable funds. They may offer due diligence and on-the-ground research and relationships with grantees.

DAF sponsors in general bring valuable expertise to the grantmaking process. They may have in-depth knowledge of the charitable sector and trends, plus

effective strategies for creating positive social impact. Private foundations can collaborate with DAF sponsors to gain valuable insights and leverage their expertise in due diligence processes and impact evaluation. This collaboration ensures the foundation's grants are well-informed and directed toward organizations and projects that align with its mission and have the potential for meaningful change.

One way private foundations can benefit from this collaboration is through working with community foundations to create DAFs focused on supporting local community initiatives that align with the foundations' mission. For example, a community foundation in the Southeast that offers donor-advised funds helped a foundation start a DAF to create an endowment for an impact investment fund at a state university's business school.² This fund allows students to invest and learn from the experience. This is just one example of how private foundations, through grantmaking to DAFs, can work collaboratively with community foundations to make a difference in their communities.

3. *Streamlining Administrative and Legal Processes for Scholarship Funds*

Private foundations often seek efficient and effective ways to establish scholarship funds while minimizing administrative burdens and navigating complex legal requirements. Utilizing DAFs emerges as a valuable strategy for achieving these goals.

² Philanthropy Roundtable conversation with anonymous private foundation.



Private foundations can recommend grants directly from their DAF to educational institutions or scholarship recipients, reducing the administrative overhead associated with traditional grantmaking procedures.

The regulatory landscape governing scholarship funds can be complex to navigate. DAF providers often have dedicated teams with expertise in compliance matters, ensuring the scholarship fund adheres to all relevant legal requirements. This can be particularly advantageous for private foundations seeking to establish scholarship programs without delving into the complexities of tax laws and regulatory frameworks.

Another advantage of using DAFs to administer scholarship funds is consolidated record keeping. Managing scholarship fund records, including grants, donations, and relevant documents, is essential for auditing and compliance purposes. DAFs offer centralized record-keeping systems, facilitating the easy retrieval of information and ensuring private

foundations can maintain organized and accurate records of their scholarship activities.

DAFs also handle tax reporting requirements, alleviating the private foundation's responsibility to track and report individual scholarship transactions. This can save time and resources, allowing foundations to focus on their core mission of supporting education.

4. *Mitigating Bookkeeping Challenges for Challenge and Multi-Year Capital Grants*

Private foundations often encounter intricate bookkeeping challenges when making challenge grants, “up to” grants, and multi-year capital grants. Challenge grants typically involve the foundation committing to match funds raised by a grantee within a specified time frame. DAFs excel in this context by allowing the private foundation to set aside the maximum amount while disbursing the funds according to the specified time frame. This avoids the complexities of



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managing multiple transactions and potential fund returns if the challenge is not fully met.

“Up to” grants, where the foundation commits to providing funds up to a certain limit, often pose bookkeeping challenges as the actual disbursement may be less than the initially allocated amount. DAFs offer a streamlined solution by holding the full “up to” amount, releasing only the warranted funds, and maintaining the remaining balance within the DAF for future grantmaking. This simplifies the tracking of funds and reduces the need for complex bookkeeping adjustments.

Multi-year capital grants involve the commitment of funds over an extended period, introducing complexities in tracking disbursements and ensuring compliance with the agreed-upon schedule. DAFs provide a structured approach by holding the entire committed amount and disbursing funds according to the predetermined schedule. This eliminates the need for private foundations to manage intricate

bookkeeping associated with multi-year commitments and ensures a seamless flow of funds to the recipient.

A key advantage of utilizing DAFs for challenge and multi-year grants is the ability to avoid funds being returned to the foundation. If the challenge is not fully met or the grant schedule is altered, the remaining funds must be retained within the DAF and cannot be returned to the foundation. This allows private foundations the flexibility to redirect those funds for other grantmaking purposes without the need for extensive bookkeeping adjustments.

5. *Fostering Harmony for Family Foundations*

Family foundations, by their nature, can sometimes face challenges related to diverse philanthropic interests within the family. However, DAFs have emerged as a valuable tool for family foundations seeking to not only make occasional off-mission grants but also reduce family tension by providing an inclusive platform for all family members

to engage in philanthropy, regardless of alignment with the foundation's primary mission.

Family foundations often have a defined mission that guides their grantmaking. However, family members may have varied philanthropic interests that do not align perfectly with the foundation's mission. DAFs provide a flexible solution by allowing family members to establish individual DAF accounts within the foundation. This enables them to pursue their philanthropic passions without compromising the foundation's core mission.

By incorporating DAFs, family foundations create a space for non-aligned family members to actively participate in philanthropy on their terms. This inclusivity fosters a sense of empowerment and reduces potential friction, as each family member can contribute to the causes they are passionate about without conflicting with the foundation's primary mission.

6. A Strategic Approach for Having a Geographically Dispersed Impact

Private family foundations sometimes face the challenge of having board members spread across different geographic regions. This dispersion can be an opportunity to broaden the foundation's impact beyond its primary geographical interest area. Geographically dispersed board members bring diverse perspectives and connections to a family foundation.

DAFs provide these members with a personalized mechanism to recommend gifts in their respective local communities. This empowerment not only taps into their local expertise but also strengthens the foundation's overall reach and impact.

Family foundations can establish guidelines for board members to recommend a limited number of gifts each year through their DAFs in communities outside the primary interest area. This ensures a strategic and measured approach, preventing dispersion of resources that might dilute the foundation's impact while still allowing for meaningful contributions to diverse geographic regions.

Utilizing DAFs also allows family foundations to stay nimble in responding to evolving community needs. Geographically dispersed board members can use their DAFs to address emerging challenges or seize opportunities that may not have been anticipated during the foundation's initial planning, ensuring a dynamic and responsive philanthropic strategy.

7. Tools for Innovation

DAFs offer private foundations a flexible space for experimentation and innovation in grantmaking. Traditional philanthropic strategies may not always address complex and evolving societal issues adequately. DAFs allow foundations to explore novel and unconventional approaches to tackling challenges and achieving their mission.

Through DAFs, private foundations can pilot new ideas, such as social impact investing, venture philanthropy, or collaborative funding models. These innovative approaches can test the feasibility and effectiveness of new strategies before scaling them up. By embracing innovation, private foundations can stay ahead of the curve, adapt to changing circumstances, and maximize the long-term impact of their philanthropic efforts.

Traditional grantmaking processes in private foundations often involve careful risk assessments and a conservative approach to funding projects. However, relying solely on traditional grantmaking practices can limit the potential for transformative change. DAFs provide a platform for private foundations to be more risk-tolerant and explore projects with higher uncertainty but the potential for significant positive outcomes.

By using DAFs, private foundations can support early-stage initiatives, cutting-edge research, or projects that challenge the status quo.

Embracing a more risk-tolerant mindset fosters a culture of innovation and experimentation, encouraging grant recipients to think creatively and pursue ambitious solutions to pressing social issues.

Private foundations, such as the Knight Foundation, have increasingly leveraged DAFs in innovative ways to support various causes. The Knight Foundation is an example of how DAFs can be employed effectively to foster change in journalism, communities, and the arts. One of the distinctive features of the Knight Foundation is its strategic use of DAFs to channel resources into initiatives that promote informed and engaged communities.

Through its DAF, the foundation collaborates with community foundation leaders and local advisory committees. This collaborative approach enables the Knight Foundation to identify investment opportunities that align with its mission and have a meaningful impact on the communities it serves.

A key aspect of the Knight Foundation's DAF strategy is its commitment to

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community foundation endowments. With a substantial commitment of \$140 million, the foundation aims to strengthen the financial sustainability of local organizations dedicated to community development. This financial support provides community foundations with the means to address pressing issues and contribute to the well-being of the regions they serve.

The Knight Foundation exemplifies how private foundations can harness the potential of DAFs to drive change. Through strategic collaboration, financial commitments, and a focus on civic innovation, the foundation demonstrates a commitment to addressing the diverse needs of communities.³

3 "Community Foundations Program." Knight Foundation. <https://knightfoundation.org/community-foundations/>.

8. *Protecting Personal Safety*

Private foundations often find themselves at a crossroads between their desire to make a positive impact and the need to protect the safety of their staff and families. In recent years, many charitable causes have become divisive in our society. When foundations seek to grant to a charity, but fear threats or harassment, DAFs have emerged as a strategic tool for private foundations to balance their philanthropic objectives with the ability to maintain donor privacy.

One public charity that focuses on public interest litigation has experienced a growing influx of funds from donors using DAFs. This shift in funding is motivated by donors' apprehension that revealing their names might expose them to threats, harassment, or retaliation from those opposing their endorsement of the charity.

Despite enjoying widespread public support, the charity would encounter unwarranted compliance challenges if obligated to track individual DAF gifts. Eliminating the option of private giving, including giving by private foundations through DAFs, could potentially result in a reduction of overall donations to the charity.

Preserving privacy through DAFs empowers private foundations to engage in strategic giving without external influence or pressure. Anonymity allows them to support causes that may be sensitive or controversial, such as advocacy for underrepresented communities, social change, or research on contentious topics. By keeping their involvement private, foundations can remain focused on their mission and objectives without fear of harm to their staff.

THE POTENTIAL HARM OF IMPOSING NEW REGULATIONS

Despite the reasons outlined above, critics call for new restrictions on private foundation use of DAFs. This is primarily because foundations are required to pay out 5 percent of their assets to charities each year, and payments to DAFs count as qualified distributions because DAFs are public charities. Critics, therefore, say a foundation could fulfill its payout requirement each year by contributing to a DAF account and never grant it to a charity.

However, there is little evidence foundation donors are using DAFs in this way. Critics often exaggerate the proportion of private foundation grants allocated to DAFs, as data reveal such contributions represent a minor fraction of total giving, amounting to less than 3 percent of all private foundation grants in 2021.⁴ In that year, private foundations granted \$2.6 billion to national DAFs. This figure stands in the shadow of the staggering \$91 billion foundations distributed to public charities in 2021.

This has led some critics to call for excluding grants to DAFs from being counted as qualifying distributions toward the minimum 5 percent payout requirement for private foundations or setting arbitrary time limits for payout requirements.⁵ These proposals are misguided and could have unintended consequences. DAFs are a useful tool for some private foundations as they help to pool resources, offer insight into communities, and protect the safety of givers. However, in recent years, DAFs have

faced scrutiny, with some proposing new regulations that could potentially harm the philanthropic sector.

Excluding contributions into DAFs from being counted as qualifying distributions could lead to a reduction in the flow of funds to public charities. The vast majority of private foundations are small, with few if any staff. Where DAFs are being used to increase efficient giving, removing this tool handcuffs foundations working to meet their giving goals.

By excluding grants to DAFs from qualifying distributions, private foundations may lean away from innovative grantmaking and prioritize more traditional and conservative projects. This shift toward risk aversion could stifle innovation within the philanthropic sector. DAFs provide a flexible platform for testing new ideas and unconventional solutions, allowing private foundations to address complex challenges in novel ways.

Whether we consider proposals to exclude grants to DAFs as counting toward qualified distributions or placing arbitrary timing restrictions, imposing new regulations may disincentivize private foundations from exploring uncharted territories and limit the potential for transformative change.

4 Salmon, Jack. "Much Ado About Private Foundations Using DAFs". Philanthropy Roundtable (Blog). June 22, 2023. <https://www.philanthropyroundtable.org/much-ado-about-private-foundations-using-dafs/#:~:text=Foundations%20Use%20of%20DAFs%3A%20Amplifying,irrevocably%20dedicated%20to%20charitable%20giving.>

5 Collins, Chuck, and Helen Flannery. Gilded Giving 2020: How Wealth Inequality Distorts Philanthropy and Imperils Democracy. Inequality.org, February 4, 2020. [https://inequality.org/great-divide/gilded-giving-2020/.](https://inequality.org/great-divide/gilded-giving-2020/)

DAFS DISCOURAGE WAREHOUSING DONATIONS

Furthermore, extensive research and data demonstrate DAFs actively support philanthropic endeavors and donors use them to contribute to charitable organizations at robust rates.

DAF sponsors impose strict regulations to ensure the timely allocation of funds to charitable causes. A report published in 2023 analyzed the internal policies from the twenty-two largest DAF sponsoring organizations and found the vast majority of sponsors, up to 91 percent, have written policies about regulating inactive accounts.⁶ The voluntary policies and remedies of sponsors indicate DAF sponsoring organizations hold themselves accountable to ensure money designated for charity does not sit indefinitely but is being actively used.

As for concerns surrounding payout trends, median payout rates typically lie between 11 and 13 percent and average rates range from 15 to 30 percent, underscoring the substantial role DAFs play in supporting philanthropy.⁷ These figures increase when excluding endowed and newly established DAFs, further emphasizing their positive impact.

Grants from DAFs to qualified charities surged by an impressive 9 percent in 2022 to an estimated \$52 billion, with charitable grants from DAFs growing at a compound annual rate of 21.6 percent between 2018 and 2022.⁸

6 Heist, Dan, and Kendra Stone. "Self-Regulating Donor Advised Funds An Analysis of Inactive Account Policies and Endowed DAFs." DAF Research Collaborative, January 2023.

7 For median payout rates, see: Heist, Daniel, and Danielle Vance-McMullen. "Donor-Advised Fund Account Patterns and Trends (2017-2020)." Donor Advised Fund Research Collaborative, 2022; Heist, H. D., and Danielle Vance-McMullen. "Understanding Donor-Advised Funds: How Grants Flow During Recessions." Nonprofit and Voluntary Sector Quarterly 48, no. 5 (2019), 1066-1093. For average payout rates, see: "16th annual Donor-Advised Fund Report." National Philanthropic Trust, 2022. <https://www.nptrust.org/reports/daf-report/>.

8 "17th annual Donor-Advised Fund Report." National Philanthropic Trust, 2023. <https://www.nptrust.org/reports/daf-report/>

CONCLUSION

Donor-advised funds have proven a rarely used but valuable tool for private foundations in enhancing their philanthropic impact. Despite facing criticism, DAF donors have demonstrated the vehicles' positive influence on charitable giving by supporting philanthropic endeavors and contributing to charitable organizations at substantial rates. By pooling resources, offering research and insight into communities, and protecting the safety of foundation staff, DAFs empower private foundations to be more effective and strategic in their grantmaking.

The strategic advantages of DAFs include the ability to experiment with innovative grantmaking approaches,

embrace risk-tolerant mindsets, and collaborate with experts to address complex societal issues. DAFs offer a flexible space for private foundations to explore novel strategies and scale them up for greater impact.

Moreover, the collaboration with DAF sponsors enables private foundations to access specialized expertise, conduct thorough due diligence, and evaluate the social impact of their grants more effectively. In addition to their positive impact on philanthropy, DAFs play a vital role in preserving privacy for private foundations, empowering them to support sensitive causes while protecting their staff.

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ABOUT PHILANTHROPY ROUNDTABLE

Philanthropy Roundtable is a nonprofit organization dedicated to building and sustaining a vibrant American philanthropic movement that strengthens our free society. To achieve this vision, the Roundtable pursues a mission to foster excellence in philanthropy, protect philanthropic freedom and help donors to advance liberty, opportunity and personal responsibility.



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