Donor-advised funds: Giving made easy

Americans are generous by nature with the highest percentage of giving done by individuals, followed by foundations, then corporations. To facilitate their charitable gifts, individuals are increasingly using donor-advised funds, which now hold nearly $160 billion in charitable assets.[1]

What is a donor-advised fund (DAF)?

A DAF is a fund dedicated to your charitable giving. DAFs are offered by public charities, generally at community foundations or financial services organizations (the "sponsoring organization"), to make the process of giving easier and to help donors and nonprofits maximize the gift.

The donor makes an irrevocable contribution to the DAF and can generally take a charitable income tax deduction. Cash, stock or other assets may be accepted. As the donor, you or anyone you designate, have the advisory privileges to:

- Direct that contributions to the account will be distributed as a gift or "grant" to a designated public charity, and
- Decide how money in the DAF will be invested.

Any portion of the contribution that isn't distributed from the account to a qualified charity has the potential to grow and all growth is tax free. This is because the assets are the property of the charitable organization offering the DAF, which as a nonprofit, does not pay income tax.

Using DAFs

Many people choose to use DAFs because they offer a number of distinct advantages in planning and making charitable gifts. Some of these include:

Ease of use: You can transfer almost any type of asset to your DAF, such as appreciated securities, complex assets and cash. The professional staff can help you with valuing the amount of your non-cash donation, liquidating the asset and investing the account balance. These are all things your favorite charity may be unable to do or it would come at great expense to the charity.

Later, when you want to support a specific charity or cause, you simply contact the sponsoring organization and recommend the amount of the grant, the charity to which the gift should be made, and when the transfer should occur. Generally, this can be done online, by telephone or through your local advisor, depending on the organization. The sponsoring organization takes care of the rest, including vetting the charity and mailing the check.

Less paperwork: DAFs make giving appreciated securities easy. Instead of completing extensive paperwork, you can simply donate them directly to the fund where they will be liquidated, incurring no capital gains tax and leaving the full fair market value available for charitable purposes. Plus, because your deduction is based upon

[1] National Philanthropic Trust, 2020 Donor-Advised Fund Report

your initial gift, not distributions from the account, you only have to track one gift receipt (to your fund) instead of all the gifts that you may make over the year.

Taxes: The tax deduction for contributions to the DAF is similar to other public charities. Generally, there's a calculation based on your adjusted gross income (AGI) and the type of asset contributed.

Timing: A DAF allows you to make a potentially tax-deductible charitable contribution in a chosen year (perhaps when you have more income to apply the deduction against) and hold the assets in your fund until you want to make a distribution from the account to a specific charity.

> Example: Pat volunteers and also makes annual gifts to her favorite charity in the amount of $5,000. Pat received a $50,000 bonus this year. She wants to reduce her income tax bill which would be higher than normal due to the bonus. Pat decides to make a contribution of $20,000 to her DAF. She applies the $20,000 charitable income tax deduction to the year she got the bonus and made the gift, and makes her regular annual gift of $5,000 to her charity. The rest stays in her account, which she can use to make a gift next year to her favorite charity or to support any other qualified charity she chooses.

In the above example, the benefit is that Pat took the charitable deduction in a year where she would have had a higher income tax, but she retained the ability to give the money over time instead of all at once.

The ability to time the deduction is also useful to individuals who are retiring and will be in a lower tax bracket (and therefore, benefit less from a deduction) or selling a business or have any other type of windfall in a particular year.

In 2022, the standard deduction is $12,950 for single taxpayers and $25,900 for married taxpayers filing jointly. At the same time, under the Tax Cuts and Jobs Act, many other deductions, such as those for mortgage interest and state and local taxes, were reduced or eliminated. These two things taken together likely mean that fewer taxpayers will itemize deductions on their tax returns. While this may simplify the process of tax filing for many people, it may also reduce the incentive to make charitable contributions because, unless the taxpayer's deductions in the aggregate exceed the standard deduction, there would be no added income tax benefit to making a charitable contribution.

The loss of income tax deductibility may not be reason enough for a charitably inclined taxpayer to reduce or eliminate his or her charitable giving for the year. However, a savvy philanthropist may be able to "bunch" deductions into a single year, take full advantage of the charitable income tax deduction and maintain his or her established giving schedule. This bunching strategy entails opening a DAF and making a large contribution in a single year. Because a DAF is a public charity, the contribution is fully deductible in the year of the contribution, provided that it meets the taxpayer's AGI limitations discussed above. The fund could then be used to make grants in the current and future years in line with the taxpayer's customary giving practices. The taxpayer would then itemize deductions in the year in which the large contribution to the DAF was made and use the increased standard deduction in other years.

Who should consider a DAF?

A DAF can make giving both easier and more tax efficient. You may want to consider a DAF if you:

- Have long-term appreciated stock or other assets, like real estate, that you want to use to fund your giving and want the ease of a professional that will liquidate them for you
- Make cash gifts to numerous charities and don't like the necessary recordkeeping
- Make gifts to smaller organizations that don't accept complex assets
- Don't want to deal with tracking multiple gifts and ensuring compliance with IRS rules for each
- Want flexibility to give to various charities or to change charitable recipients over time
- Are in a higher tax year and a charitable income tax deduction would have a larger impact today than in the future, but you'd like to spread out your gifts over future years

Pledges and gifts

Your contribution to DAFs is considered an irrevocable charitable gift and legal control passes to the sponsoring organization, but you or your representative retain advisory privileges that allow you to recommend how gifts or "grants" are distributed.

Because these privileges are advisory, you cannot promise to make a charitable gift on behalf of your fund, nor can your fund satisfy any legally binding pledges that you have personally already made or may make in the future.

As an alternative, if you want to notify a charity of your intent to make a gift or a series of gifts through your DAF, you can sign a "non-binding gift intention" or an "intention to give" statement. These are not legal pledges, but do alert your charity of your intended support.

Comparing DAF options

If you've decided that a DAF is for you, consider these questions when choosing a sponsoring organization:

- What's the minimum initial investment and additional contributions?
- What types of assets are accepted as contributions?
- What investment options are available and can the donor advise on how the monies may be invested?
- Are assets separately managed or pooled with other funds and who is managing them?
- What's the minimum dollar amount allowed for grants and how many are allowed per year?
- Are there restrictions on the type or location of recipient organizations?
- Must a portion of the funds be distributed to certain recipients?
- What are the fees and expenses, to whom are they paid and how are they used?
- What recordkeeping is provided by the charity to the donor?

Establishing a DAF

For more information on DAFs, as well as other strategies for charitable giving, speak with a TIAA advisor.

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