Charitable Giving Using Donor Advised Funds

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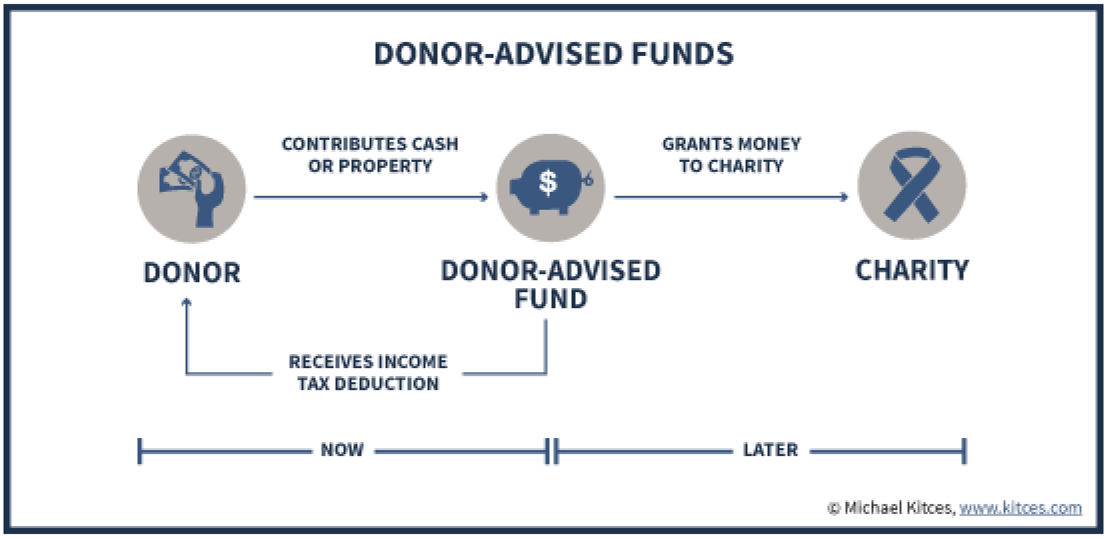
Are you maximizing the benefits of your charitable giving? According to Giving USA, an annual report on American philanthropy, charitable giving in our country reached a record $373.3 billion in 2015. There are a variety of reasons why people are motivated to give to charity. Philanthropy provides psychological and financial rewards to the donor. It can be used as a platform for teaching children the importance of giving back to their community, and serve as a means for leaving a legacy to future generations. Charitable giving is also an important component of income tax planning. Using a donor advised fund (DAF) can facilitate multiple giving strategies and increase the impact of your giving so that your charitable dollars can go further.

What is a Donor Advised Fund?

A donor-advised fund (DAF) is a tax-preferenced investment account created by an individual or family designated specifically for charitable giving. Typically these accounts are sponsored by a charitable organization under the umbrella of a financial institution such as Fidelity, Schwab, or Vanguard. Some community foundations also offer DAFs such as the Boston Foundation here in Massachusetts. An account can normally be opened for as little as $5,000. One of the most attractive features of a DAF is that it allows someone to donate assets for charity today and receive a current income tax deduction, even though the funds might not be directed to the final charity until a later date. In other words, the donor is able to take a tax deduction upfront while deferring their decision on how the charitable dollars are used.



Michael Kitces at Nerd's Eye View
https://www.kitces.com/blog/rules-strategies-and-tactics-when-using-donor-advised-funds-for-charitable-giving/

DAFs can be funded with cash, though funding with appreciated securities such as stocks, mutual funds, and exchange traded funds offer the maximum tax savings. Assuming the securities were held longer than one year, the donor is able to deduct the full fair market value of the securities on the date of the gift rather than their lower cost basis. This effectively avoids having to pay capital gains tax on any unrealized appreciation, a powerful tax planning strategy. Some DAFs can also accept more complex assets including real estate, private equity, hedge funds, and interests in private businesses.

Once assets are contributed to a DAF, they are typically sold immediately (without triggering capital gains tax) and reinvested according to the donor's wishes. DAFs generally offer a menu of mutual funds the donor can select from, giving the fund the ability to continue growing tax-free. When the donor recommends making a grant out of the DAF to a charitable 501(c)(3) organization, the DAF simply sends the charity a check for the specified amount.

Front-Loading

The ability to separate the timing of the contribution into the DAF and its accompanying tax deduction from the eventual donation to the charity itself creates significant income tax planning opportunities. For example, suppose you are in a high income year (and therefore higher than your normal tax bracket) because you received a large bonus, recognized taxable income from exercising stock options, or executed a Roth IRA conversion. You can maximize the value of your charitable deduction by "front-loading" your charitable giving into a DAF. If you normally contribute $10,000 per year to charity, you could make a $50,000 upfront contribution into a DAF to cover your giving over the next five years. You will receive a $50,000 charitable deduction in the current year, but can distribute these funds out to your designated charities in any future year. This can be particularly helpful if you are undecided on the charities you would like to support or want to gift over time.

Alternative to Private Foundations

Many people find DAFs an attractive alternative to setting up a private foundation. DAFs offer many of the benefits private foundations offer at a fraction of the cost, and without the associated legal and tax burdens that can accompany foundations. They also work very well for much lower levels of gifting where grants can be processed for as little as $50 with some DAFs. Investment income earned in a DAF is not subject to an excise tax, which can be up to 2% in a private foundation. Additionally, while private foundations require 5% of its assets to be distributed out to charity annually, DAFs have no such requirement. Another benefit is that charitable grants from DAFs are not public record, unlike grants from foundations whose information is easily accessible online. This anonymity can reduce the number of ongoing solicitations donors receive from charities. Donors of DAFs also enjoy an administrative benefit as they receive a single donation acknowledgement from the DAF for tax purposes rather than multiple acknowledgements from each underlying charitable recipient.

Uses in Conjunction with Private Foundations

Many individuals with large private foundations have difficulty identifying enough charities they would like to support consistently in order to meet the foundation's 5% annual distribution requirement. Because DAFs are 501(c)(3) public charities, individuals can use them in conjunction with their private foundation to "park" some or all of their foundation's 5% required annual distribution. This effectively buys them more time until they ultimately decide their preferred charitable recipients.

Individuals looking to maximize their charitable deductions each year will find that the deduction limits for contributions into DAFs are more generous than they are for contributions into private foundations. Using appreciated securities as an example, a taxpayer can deduct up to 30% of their adjusted gross income (AGI) when giving them to a DAF while the limits for contributions into private foundations top out at 20% of AGI. For those still wanting to add assets to their private foundation while maximizing their charitable deduction, they can incorporate a two-prong giving approach. First, they can contribute 20% of their AGI into their private foundation, and "cap off" their deduction by contributing an additional 10% of their AGI to a DAF. This brings their total contributions up to 30% of their AGI. For cash contributions, the limits are 50% of AGI for DAFs and 30% of AGI for private foundations.

Conclusion

Given their flexibility, low minimums, low cost, and administrative ease, it is no surprise that DAFs are soaring in popularity within the giving community. We continue to educate our clients on the substantial income tax advantages of using appreciated securities for their charitable giving rather than using cash. You can maximize your philanthropy dollars and also do it in the most tax efficient way possible thereby freeing up more assets for future donations or your heirs. It's a win-win for both the charities you choose and easing your own income tax burden.
