Donor-Advised Funds

Maximize the benefits of charitable giving for you and your family.

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Introduction

The opportunity to 'give' or to 'share' financial resources has never been more uniquely connected with 'multiplying' personal prosperity. Financial sharing can come through direct gifting or through trusts established for future distributions. The 'windows' of tax and financial benefits for donors are amplified through wise planning and informed decision-making.

In fact, if you put assets you intend to donate into a donor-advised fund (DAF), you can avoid capital gains taxation on the sale of the asset: You receive an immediate tax reduction on the fair market amount of your contributions. You direct investments that the fund makes and you have the right to direct distributions to the charities of your choice. The amounts given and the charitable recipients can be changed at any time. Family members can become involved in the investment and gift-making decisions and can even continue making DAF decisions after the death of the donor.

1.

What Is a Donor-Advised Fund?

Donor-advised funds are managed by a sponsoring organization. It is an aggregate fund. In other words, the contributions of multiple donors are pooled in order to both democratize and maximize philanthropy. People with high net worth contribute, but some funds will allow you to establish an account with zero initial contribution. You might say it is an all-hands-on-deck approach.

The idea is to facilitate the maximum possible financial benefits for specific causes. Technically speaking, the sponsoring organization has legal control over all assets contributed to a DAF. However, provided the IRS officially recognizes your chosen cause as a U.S. charitable organization, your selection can be the recipient.

DAFs are popular because of the way that they streamline charitable giving while capitalizing on the tax break to grow the amount of money that donors give. Hard times have many Americans eager to help others where they can, so this is much more than a passing trend. The National Philanthropic Trust's 2021 Donor-Advised Fund Report found that the amount of assets in DAFs is on the rise. Total assets were $145.49 billion in 2019, but they rose to $159.83 billion in 2020. That is an increase of 9.9%.

Meanwhile, at the same time, the total number of DAFs grew beyond 1 million for the first time. There are now multiple kinds of donor-advised-fund sponsors. The three most common varieties are community foundations, national donor-advised-fund organizations, and public foundations. Some hospitals, universities, and other public charities establish DAFs under their own respective roofs, as well. The sponsoring organization manages the donor-advised funds, but investment selections and distributions can be determined by the donor. As a result, a donor can manage their contributions to multiple charities through one account. Tax, investment, financial, and lifestyle benefits can be planned and provided for individuals and for families.

Community foundations are often credited as pioneers of donor-advised fund philanthropy, since they were the first to offer the option. Rejecting the headaches of creating a private foundation and the inefficiencies of checkbook donations, they began appealing to donors to support local charities. The result has become a sea change in the way that people give to charity and the size of donations that charitable causes receive.

National donor-advised-fund organizations are the charity-oriented projects of financial services institutions. These include the Vanguard Charitable Endowment Program, the Fidelity Charitable Gift Fund, and the Schwab Charitable Fund, just to name a few. Not all national donor-advised-fund sponsors are tied to the financial industry, though. For example, the National Philanthropic Trust and the American Endowment Foundation are not tied to any investment firm. Most of the time, public foundations sponsor national and international causes centered around a specific region or cultural/social issue.

DAFs are not prohibitively expensive to establish, either. Most providers charge an administrative fee ranging from .5% to 3%. Commercial banks may charge higher investment fees, but many donor-advised accounts have a zero-commission fund into which your money can be deposited. Additionally, some places have accounts for DAF donors below age 40 and offer reduced minimum contribution requirements.

How Is a DAF Different From a Private Foundation?

Where a DAF is an aggregate, everybody-pitches-in endeavor, private foundations are typically funded and controlled by one family or person. The Walton Family Foundation is one of many possible examples. There are two types of private foundations overall; operating and non-operating.

An operating foundation is often closely involved with a project like a library, historical site, research facility, or museum. On the other hand, a non-operating foundation typically serves its cause chiefly by making grants to various selected charities. Non-operating are the most common variety of private foundations found today. So, there are numerous ways in which they can be organized. For instance, a non-operating independent foundation is normally managed independently of the donor, the donor's family, or a company. On the other hand, a non-operating family foundation usually represents the interests of an individual family.

There are multiple differences between a donor-advised fund and a private foundation. However, the most prominent may be how the IRS views them. Taxpayers are allowed deductions on giving to either, but these are not handled in an identical manner. Non-cash donations to a DAF are deductible once they have been held for at least one year. These include (the value of) volunteer services, securities, household items or other property.

Meanwhile, the IRS defines cash gifts as “made by check, credit card or debit card as well as amounts incurred by an individual for unreimbursed out-of-pocket expenses in connection with their volunteer services to a qualifying charitable organization.” Cash tax deductions are limited to 60% of the adjusted gross income (sometimes referred to as “AGI”). For stocks or real estate donations, the deduction limit is 30%.

Tax deductions for a private foundation’s privately-held assets are limited to the fair market value (what some might call the going rate). This includes cash as well as publicly-traded securities held for over a year. The Adjusted gross income deduction limit for cash donations to a private foundation is 30%. Real estate and stock-related deductions are capped at 20%.

The difference does not stop there for private foundations, though. These organizations also pay a 1.39% excise tax on their annual net investment returns. Similarly, all private foundations are legally obligated to file explicit public tax returns. These must detail their trustees’ names, their employees’ salaries, their investment fees, and all grants.

While DAFs and private foundations can both be tremendous avenues for generosity, donor-advised funds tend to have more flexibility as to how benefactors’ giving can be done. For instance, the distribution of grants is not governed by any legal requirements mandating percentages or amounts. DAF donors can also customize charitable grants as they see fit. They can also give anonymously at their own discretion and will the fund to survivors through their estate plan.

Private foundations, meanwhile, must expend 5% of their total assets yearly. How much or how little they have earned up to that point does not matter. Donors are able to fund for-profit businesses, provided that the businesses support the foundation’s mission. Funds from private foundations are allowed to be given to foreign charitable organizations, as well.

As much as 13% of individual American donations to charity involve a donor-advised fund today. The biggest-name investment firms Fidelity, Charles Schwab, and Vanguard have departments solely devoted to DAFs. At the same time, private foundations are involved in a great deal of philanthropy, as well. They hold $1.2 trillion in assets. While giving to charity through a private foundation is better than not donating anything, donor-advised funds can potentially offer superior gift-enlarging capabilities. Some people also find the egalitarian nature of a DAF more appealing.

3. What Is the Process Over Time To Use One & What Are My Options?

There is no shortage of options for giving to a donor-advised fund. For instance, some donors contribute to a DAF annually during their high-income year(s) and then continue their charitable giving through grants from it when their income is lower. High-income earners who are retiring, for example within a decade, may find this strategy useful.

Still other donors use the DAF to ‘maximize’ the tax benefits of the federal standard deduction. Charitable deductions that are planned for future years can be ‘grouped’ into a single year to maximize itemized deductions.

Donors who wish to make charitable contributions utilizing assets in a 401(k) or an IRA even have an option. Taxable liquidations from the 401(k) or IRA account can then be offset with a contribution to a DAF. Distributions from the DAF to qualified charities are made tax-free.

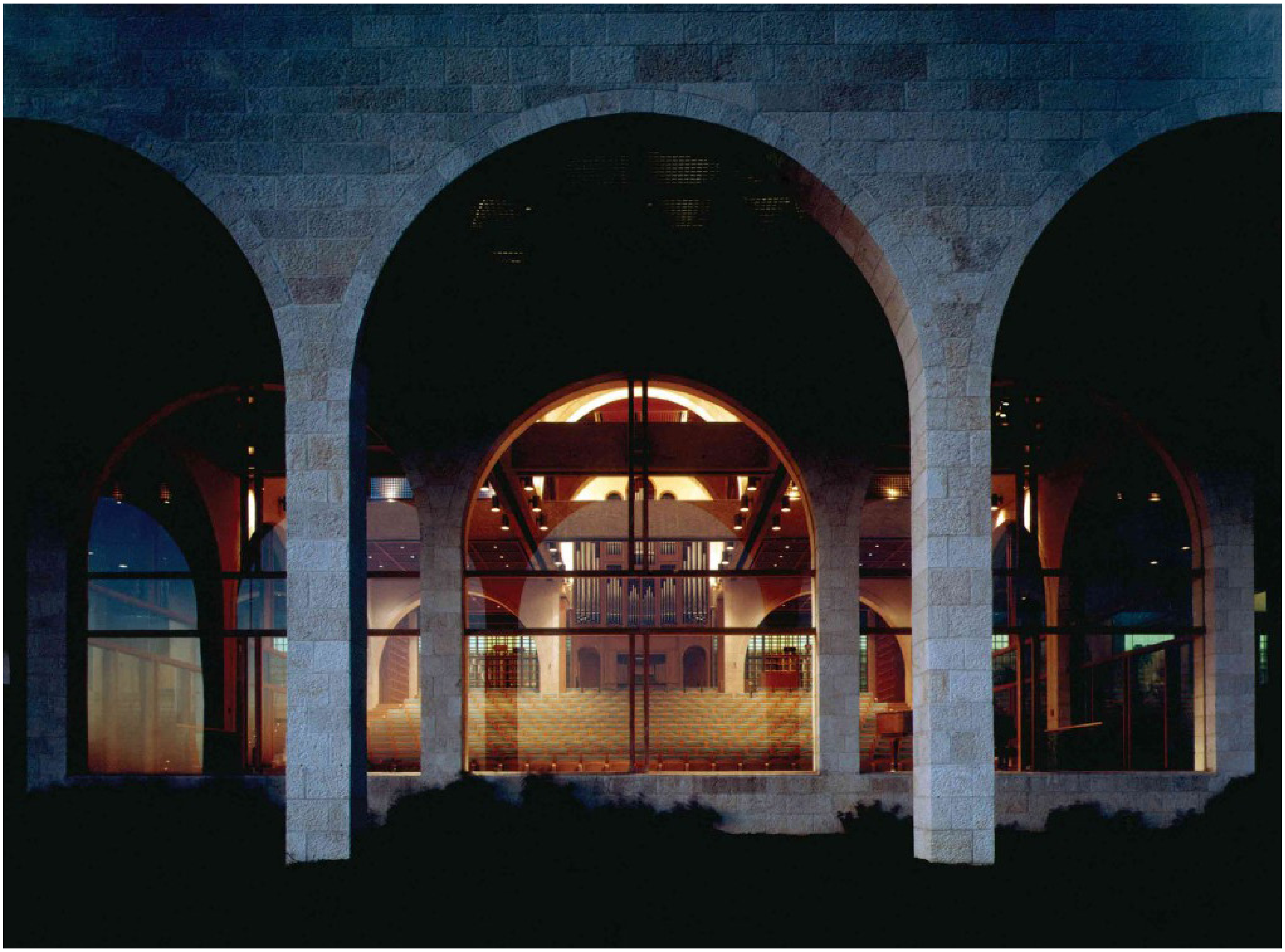
Similarly, it can be advantageous for someone who is selling their business or real estate. Any circumstance in which you find your income level raised, even briefly, affords greater donation capacity. Regardless of your windfall’s source, you can leverage your peak earnings in order to keep giving gifts later. In other words, you can potentially keep giving generously through grants long after your original income has peaked.

If you often rebalance your portfolio, there is also the option of donating a high-performing asset rather than selling it. This can reduce your capital gains tax liability, even if you are not able to itemize your taxes for that year. When you feel particularly passionate about a charity, you may opt to repurchase a high-performing stock, buying it back at its higher price. This scenario could be considered a win-win for both you and the causes your DAF supports.

The IRS has changed some of the specifications about the donation process due to abuses. This is because, unfortunately, some organizations that promoted themselves as donor-advised funds in the past seemed to lack honest intent. Eventually, it was discovered that they were being used for questionable charitable deductions and possibly worse things. As a result, new excise taxes and stricter guidelines have been established.

Thankfully, there are still multiple ways in which genuinely charity-minded people can use the benefits of a DAF to give to their favorite causes. For example, a donor can establish recurring grants to their charities of choice (e.g. $15,000 to a church, $10,000 to a homeless shelter, and $10,000 to a food pantry every year). As long as the fund's accounts do not run dry, your gifts can echo far beyond their initial donation. At your discretion, your grants can remain based on a percentage of the DAF's total assets, recurring annually until the day that the fund empties.

Some investors choose to donate a percentage, such as 10% of their portfolio every year. Building your legacy does not have to revolve exclusively around your personal accounts, either: Some donors use their DAF to create a charitable legacy for their families by encouraging children and grandchildren to participate. Secondary advisors can also be added to accounts. This means they can be trained in regard to making grants with an eye toward assuming control when the donor is no longer able to manage things.



4.

Am I Limited to Making Only Cash Contributions?

The short answer to the question above is “No:” Most DAFs accept wire transfers, cash positions from brokerage accounts, and checks. However, most donor-advised funds also appreciate non-cash assets, like real estate, stock or collectibles. Any capital gain that would be realized from the sale of any of these assets would not be taxed. In addition, the full fair market value of the non-cash asset would be reportable as a deductible charitable contribution, subject to the adjustable gross income (AGI) limitations. For cash donations the taxpayer is generally limited to deductions up to 60% of adjusted gross income and for non-cash donations the limit is 30% of AGI. Any contributions that exceeds these limits can be ‘carried forward’ as an itemized charitable contribution for up to 5 years.

5.

How Would I Benefit From Using One (Now & Over Time)?

In addition to knowing you were providing support to your favorite charities, you could reduce your income tax liability, possibly lower your capital gains, and potentially lessen your estate taxes.

The organization sponsoring a DAF becomes the donor of record, so contributing anonymously is never a problem. Some donor-advised funds also utilize active involvement from an advisor, if you wish.

Imagine that you decide to donate an appreciated stock: You would make the charitable transfer from a brokerage into the DAF account. Next, the sponsor would liquidate the stock and, most likely, provide you with a list of possible charitable resources to recommend from. The whole process is usually much more convenient than trying to send a stock transfer to a single charity (since some may lack the capacity to accept the gift). Just make sure that the stock does not get liquidated before it has been transferred and ensure that the holding; not the cash gets transferred (so you avoid the capital gains tax).

The story does not end here, though. If you are not in a hurry, you can invest the donated money into things like index funds, managed funds, and (in some cases) alternative investments like commodities. In other words, you can leverage the market to potentially enlarge your gift before granting it out.

Donors can give multiple years' worth of gifts to a DAF within a single year. As a result, this could allow you to exceed the standard deduction with your itemized deductions when filing your taxes. This nets a sometimes-impressive tax break for donors. The ability to vary how you give, year-by-year also helps. If you have an unusual windfall or simply a year of higher income, you could set a bigger amount for your preferred cause, offsetting that (larger) tax liability.

Meanwhile, there is something to be said for buying a successful asset and then holding onto it for a bit. Securities that have been in your portfolio for over a year can be donated later at their current fair market value, making them immune to capital gains taxation. This can net the donor a tax deduction of up to 30% of their adjusted gross income (AGI).

The benefits do not stop here, either. Long after you initially donate mutual funds, appreciated securities, real estate, et cetera, you have a five-year deduction that can be carried forward on gifts taking you over your AGI limits.

6.

Could This Also Benefit My Family?

A donor-advised fund creates an outstanding vehicle for planning a future legacy and even perpetual endowment of philanthropy. At Scott Marsh Financial we have researched, taught and written extensively on The Science of Generational Prosperity. One of the well documented opportunities for empowering future generations is to create traditions and opportunities for sharing with others.

You may, for instance, present a DAF to family members as a sort of savings account for charities. Involving them in its use is a ready-made teaching opportunity for upcoming generations to learn the importance of sharing and compassion.

At the death of the original DAF donor, there are multiple options available for leaving the DAF to your heirs. All of the features you have enjoyed with the DAF are then available to your heirs. You can even make additional contributions from your estate to reduce potential estate and income taxes.

Who Is My Best Resource for Setting Up a DAF Account?

At Scott Marsh Financial, we believe our experience and knowledge make us your best choice for setting up a donor-advised fund. If you are familiar with our track record of helping clients grow their wealth, minimize their tax liability, build a solid portfolio, and more, you already know some of the reasons why.

Scott Marsh has been serving and educating the public for the last 30 years. As an independent financial firm, we are not obligated to pursue the interests of any banks or corporations, either. This means that our recommendations are based solely on an action's potential to benefit your portfolio; not the directives of a third party. As fiduciaries, we are legally obligated to put your best financial interests ahead of our own at all times. Where some broker-dealers may suggest a stock partly because of a commission (that puts money in their pocket), we must avoid conflicts of interest.

If this is the first that you have heard of us, thank you for reading this eBook! We are always happy to meet with you and show the difference that our advising can make in your financial life. Helping your charitable donations go farther is only one of many areas in which we can potentially make a profound difference. If you need a portfolio balanced to weather current high interest rates, stress-free legacy planning, or a retirement plan you can look forward to, our solutions are time-tested and current-market-informed.

Call on the Tax and Financial Advisors at Scott Marsh Financial LLC To Learn More!

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