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Amplifying the Rewards of Charitable Giving with Donor-Advised Funds

Versatile. Powerful. Enduring. Words to describe a perfectly tailored suit, a timeless Shakespearean sonnet, and, in the world of wealth management, a donor-advised fund. A donor-advised fund (DAF) is a charitable giving vehicle that allows donors to accomplish their personal philanthropic goals in a targeted, tax-advantaged manner. While DAFs have been available as a charitable giving mechanism since the 1930s, their popularity has increased significantly over the past decade. At the end of 2014, over $70 billion resided within DAFs, a 24% increase from the prior year, making it the fastest-growing charitable giving tool available to Americans.[1]

What is a DAF?

A DAF is a charitable gifting vehicle established by an individual, family, or consortium of individuals and held under the umbrella of a larger organization such as a community foundation (e.g., the Chicago Community Foundation or Berrien Community Foundation) or a financial institution (e.g., Fidelity or Schwab). Donors make irrevocable gifts of cash, stock, and even illiquid assets such as private equity interests or artwork to their DAF in a lump sum or over multiple years. Upon funding a DAF, the donor receives a charitable tax deduction and provides the operating organization with recommendations of charities to receive grants. (While "recommendation" seems prohibitive, practically speaking, a donor's request is rarely denied.)

Distributions to charities need not be made immediately, so these funds can continue to grow over time and be distributed at the donor's discretion. Additionally, DAFs allow for donors to name successor advisors, thus preserving a charitable legacy for multiple generations.

How are DAFs different from alternative methods of charitable giving?

When making a donation to a charitable organization, sponsoring a friend's participation in a marathon, or supporting a place of worship, many people's default solution is to write a check directly to the recipient. There is nothing wrong with outright gifts of cash, but there are other ways for donors to support worthy causes while also reaping benefits of their own. A DAF can be used to accomplish any of the aforementioned giving goals and, since tax deductions are given at the time of DAF contributions – not donations – donors can control the timing of their tax deductions. Some operating organizations accept initial contributions as low as $5,000 (most have a $25,000 minimum), which makes this tool accessible to almost anyone with long-term philanthropic goals.

Foundations are another charitable giving vehicle that families have used for more than a century. While establishing a foundation may be the appropriate solution in certain circumstances, DAFs tend to be more advantageous for the donor. IRS guidelines require foundations to distribute a minimum of 5% of assets annually, which typically necessitates at least one annual meeting of the board of directors to determine which organizations to support. Contrarily, since DAFs are not mandated to distribute a minimum amount in any given year, gifts to the DAF grow until grants are made. »

As it relates to donor tax deductions, gifts to DAFs are deductible up to 50% of the donor's adjusted gross income (AGI), while foundations only allow deductions of up to 30% of AGI. Furthermore, while considered tax-exempt organizations, foundations are required to report annually to the IRS and keep detailed records of their contributions, beneficiary organizations, and general operations, which can make the administrative responsibilities (including the need to appoint a board of directors) rather burdensome in terms of both time and cost. Since DAFs are under the umbrella of a larger operating organization, the IRS does not require detailed reports, leaving funds available for their intended purpose of supporting charitable causes.

Is a DAF right for you?

While not unequivocally true, funding a DAF is typically most powerful in years of high tax liability, whether that results from receiving a large bonus, exercising stock options, or executing a Roth conversion, to name a few possible scenarios. A couple approaching retirement may want to prefund their future charitable gifts by contributing cash or highly appreciated stock to a DAF and taking the tax deduction prior to retirement, when they are in a higher tax bracket.

For families looking to start a dialogue with the next generation about managing wealth, DAFs can help parents and grandparents begin this conversation. They create an opportunity to instill the importance of charitable giving and to encourage children and grandchildren to consider the causes they would most like to support. They also open the door to discussions on investing and estate planning, topics that can be challenging to broach but are integral to educating younger generations on wealth stewardship.

While most people associate the end of the calendar year with charitable giving, it is always a good time to consider how it fits into your personal financial plan. Your RMB advisor is well versed in the many different DAF options as well as other wealth planning tools to help you achieve your charitable goals. ■

1 *"2015 Donor-Advised Fund Report," National Philanthropic Trust,accessed May 13, 2016, http://www.nptrust.org/daf-report/introduction.html.*