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Donor-Advised Fund

A **donor-advised fund (DAF)** is a charitable giving vehicle administered by a public charity created to manage charitable donations on behalf of organizations, families, or individuals. A DAF enables a taxpayer to contribute personal assets, including cash, securities, and real estate, to an investment account, in which the assets grow tax-free. The taxpayer receives an immediate tax deduction in the amount of the fair market value of the assets contributed to the DAF. However, the taxpayer does not need to immediately decide which charities to support when he/she contributes the assets. Rather, the assets can potentially grow in the DAF based on the taxpayer's investment preferences, creating even more money to give to charities in the future. Although the taxpayer surrenders ownership of the assets contributed to the DAF, he/she retains advisory privileges over how the assets are invested and the eventual distributions to charities.

DAFs vs. Direct Giving and Private Foundations
A DAF is an alternative to direct giving or establishing a private foundation. Since a DAF's sponsoring organization handles the paperwork after the initial contribution, donors to DAFs have less of an administrative burden than donors to private foundations. The cost of administering a DAF is generally less than the cost of administering a private foundation. Also, a DAF offers certain tax advantages that a taxpayer cannot achieve through direct giving or by establishing a private foundation.

Although both DAFs and private foundations can accept donations of unusual or illiquid assets (e.g., a partnership or LLC interest, stock in a private corporation, art, real estate, etc.), a donation to a DAF can result in a higher tax deduction in the current year than a donation to a private foundation, depending on the gift.

The founders or board members of a private foundation have complete control over where its giving goes within broad legal bounds. In a DAF, the donor may only advise the sponsoring organization where the money should go. While rare, a sponsoring organization could conceivably ignore the donor's intent. In addition, most DAFs can only give to IRS certified 501(c)(3) organizations or their foreign equivalents. This rules out most types of donations to individuals and scholarships, which private foundations can do more easily.

DAFs have a significant cost advantage over private foundations. While DAFs generally charge only a 1% administrative fee, private foundations generally carry a 2.5–4% of assets overhead/maintenance fee, a 1–2% excise tax on net investment earnings, and a required 5% spending of assets each year. Because a sponsoring organization houses the DAF, donors to DAFs receive the maximum tax deduction available, while avoiding excise taxes and other restrictions imposed on private foundations. Further, donors avoid the cost of establishing and administering a private foundation, including staffing and legal fees.

Unlike a private foundation, a DAF may have a limited lifetime, although this varies depending on the sponsoring organization. While a private foundation can persist for generations or in perpetuity, some sponsoring organizations impose a "sunset" on DAFs, after which they collapse individual funds into their general charity pool.

DAFs also provide certain advantages over direct giving. While DAFs allows donors to contribute securities and other illiquid assets, many individual charities are not set up to receive donations of such assets and only take cash. Some DAFs allow gifts to foreign charities, while direct gifts to foreign charities by individuals are generally not tax deductible. In addition, a DAF gives the donor an immediate tax deduction but provides the donor with the option of deciding later which charities will be the beneficiaries. Lastly, a DAF eliminates the administrative burden of a donor who wishes to make small donations to numerous charities. For example, donating 100 shares to a DAF with 20 separate grant recommendations is a much more convenient than donating 5 shares each to 20 separate charities.

Tax Advantages of DAFs

The Tax Cuts & Jobs Act of 2017 eliminated or reduced the allowable amount of certain itemized deductions but increased the standard deduction to $12,000 for single taxpayers and $24,000 for married taxpayers filing jointly. These changes will increase the importance of the tax deduction for charitable contributions beginning in 2018. With more limited itemized deductions but a higher standard deduction, certain taxpayers will choose to make relatively significant donations in order to utilize the tax deduction for charitable contributions. For example, a single taxpayer who is going earn more income than usual in a given year but does not have existing itemized deductions more than $12,000 may wish to contribute to a DAF and get an immediate tax deduction that is sufficient to put his total allowable itemized deductions over $12,000.

When a taxpayer donates appreciated securities or other assets to a DAF, he/she not only gets an immediate tax deduction in the amount of the fair market value of the contributed assets, but he/she also avoids capital gains tax on the disposition of those assets, which could be as high as 23.8% on the Federal tax return alone.

For example, a taxpayer in the highest income tax bracket decides to sell securities held for longer than a year for $10,000 and then donate the cash proceeds directly to a charity. Although the taxpayer can deduct the donation of $10,000, he must recognize a long-term capital gain on the sale of the securities. The cost basis of the securities is $4,000, so there is a long-term capital gain of $6,000, which results in Federal income tax of $1,428 ($6,000 x 23.8%). To avoid the capital gains tax, the taxpayer should have donated the appreciated securities to a DAF rather than selling the securities and donating the cash proceeds directly to a charity. The donation of the securities to a DAF would have still resulted in a tax deduction of $10,000.

This double tax advantage can make donating appreciated assets to a DAF more attractive than selling the assets and donating cash. By donating appreciated assets to a DAF and then advising the fund to make donations to several charities, one can reap these tax advantages without the hassle and paperwork of transferring non-cash assets to several organizations. This combination of convenience and full tax advantage is just another reason why DAFs are an excellent option for charitable-minded taxpayers.

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