

Abstract: A DAF is a tax-advantaged investment account administered by a not-for-profit “sponsoring organization.” Anyone planning to make significant charitable donations in the coming year should consider one. This article explains the attributes of these accounts and discusses their valuable tax benefits.

DAFs bring an investment angle to charitable giving

If you’re planning to make significant charitable donations in the coming year, consider a donor-advised fund (DAF). These accounts allow you to take a charitable income tax deduction immediately, while deferring decisions about how much to give — and to whom — until the time is right.

Account attributes

A DAF is a tax-advantaged investment account administered by a not-for-profit “sponsoring organization,” such as a community foundation or the charitable arm of a financial services firm. Contributions are treated as gifts to a Section 501(c)(3) public charity, which are deductible up to 50% of adjusted gross income (AGI) for cash contributions and up to 30% of AGI for contributions of appreciated property (such as stock). Unused deductions may be carried forward for up to five years, and funds grow tax-free until distributed.

Although contributions are irrevocable, you’re allowed to give the account a name and recommend how the funds will be invested (among the options offered by the DAF) and distributed to charities over time. You can even name a successor advisor, or prepare written instructions, to recommend investments and charitable gifts after your death.

Technically, a DAF isn’t bound to follow your recommendations. But in practice, DAFs almost always respect donors’ wishes. Generally, the only time a fund will refuse a donor’s request is if the intended recipient isn’t a qualified charity.

Key benefits

As mentioned, DAF owners can immediately deduct contributions but make gifts to charities later. Consider this scenario: Rhonda typically earns around \$150,000 in AGI each year. In 2017, however, she sells her business, lifting her income to \$5 million for the year.

Rhonda decides to donate \$500,000 to charity, but she wants to take some time to investigate charities and spend her charitable dollars wisely. By placing \$500,000 in a DAF this year, she can deduct the full amount immediately and decide how to distribute the funds in the coming years. If she waits until next year to make charitable donations, her deduction will be limited to \$75,000 per year (50% of her AGI).

Even if you have a particular charity in mind, spreading your donations over several years can be a good strategy. It gives you time to evaluate whether the charity is using the funds responsibly before you make additional gifts. A DAF allows you to adopt this strategy without losing the ability to deduct the full amount in the year when it will do you the most good.

Another key advantage is capital gains avoidance. An effective charitable-giving strategy is to donate appreciated assets — such as securities or real estate. You're entitled to deduct the property's fair market value, and you can avoid the capital gains taxes you would have owed had you sold the property.

But not all charities are equipped to accept and manage this type of donation. Many DAFs, however, have the resources to accept contributions of appreciated assets, liquidate them and then reinvest the proceeds.

Requirements and fees

A DAF can also help you streamline your estate plan and donate to a charity anonymously. Requirements and fees vary from fund to fund, however. Please contact our firm for help finding one that meets your needs.

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