Donor-Advised Funds

What is a donor-advised fund (DAF)?

A donor-advised fund (DAF) offers an easy way for a donor to make significant charitable gifts over a long period of time. A DAF is similar to a private foundation but requires less money, time, legal assistance, and administration to establish and maintain. A DAF also enjoys greater tax advantages than a private foundation.

Technically, a DAF is an agreement between a donor and a charity that gives the donor the right to advise the charity on how a portion of the donor's contributions to the charity will be distributed to other charities. Contributions may be tax deductible in the year they are paid to the DAF if they are structured so that they aren't considered earmarked for a particular distributee. Though they may bear the donor's name, these funds are not operated as separate entities, but are mere bookkeeping entries. They are components of the DAF. The DAF must own the funds and have ultimate control over distributions.

During life, a donor (or a donor's designee) can make ongoing, nonbinding recommendations to the DAF as to how, when, and where grants from the fund should be made. Additionally, the donor can offer advice to the DAF regarding how contributions should be invested. The donor may suggest that, upon death, grants be made to charities named in his or her will or other legal instrument such as a revocable living trust. Or, the donor may designate a surviving family member(s) to recommend fund distributions. However, the fund is not obligated to follow any of the donor's suggestions — hence the name "donor-advised fund." As a practical matter, though, the DAF will generally follow a donor's wishes. Grants to recipients are typically identified as being made from a specific donor's account, but they can be made anonymously at the donor's request.

Technical Note: *The community foundation was the first type of organization to offer a DAF but, today, many funds are offered by financial institutions and many public charities have DAFs or will create a DAF upon request.*

DAFs vs. private foundations

Both private foundations and DAFs allow a person to take tax deductions now and decide later to whom to give. Both DAFs and private foundations can be named to honor the donor.

A DAF usually receives contributions from many unrelated donors, while a private foundation is typically funded by one source (an individual, family, or corporation). While donors to a DAF may only offer advice regarding distributions, private foundations offer the donor exclusive control and direction over distributions and investments, an attractive feature to some philanthropists.

However, various legal restrictions imposed on private foundations are not imposed on DAFs, and the federal income tax treatment of a donation to a private foundation is less favorable than that afforded to a DAF. Because gifts to a DAF are considered gifts to a "public charity," they may allow a greater income tax deduction than gifts to a private foundation. Furthermore, private foundations are required to distribute a minimum of 5 percent of their assets each year. DAFs have no such minimum distribution requirement (though some DAFs follow the 5 percent rule voluntarily), and DAF donors may be allowed to let their accounts build up tax free for many years and be distributed only upon a specified date or upon the occurrence of a specified event.

Also, DAFs do not need to fulfill many of the reporting and filing requirements that are imposed on private foundations. And because the organization that offers the DAF handles any legal, administrative, and filing requirements (including tax returns), the donor is completely freed from these responsibilities. In addition, since separate accounts within a DAF are administered as part of the larger organization, the administrative costs borne by the donor are generally lower than those incurred by a private foundation.

Endowed DAFs vs. non-endowed DAFs

Endowed funds only distribute income, not principal. These funds invest a donor's assets in perpetuity for potential growth over time. Because they are permanent, endowed funds provide a lasting memory of the donor's philanthropic nature.

Non-endowed funds permit a donor to make ongoing recommendations for distributions up to the entire fund balance (principal and income). Such funds remain non-endowed, unless the donor specifies otherwise, until such time as the donor or the donor's designees are no longer providing advice to the fund.

What are the tax advantages of a DAF?

A donor can generally take an immediate income tax deduction for charitable contributions of money or property to — or for the use of — a DAF if the donor itemizes deductions on his or her federal income tax return. The amount of the deduction depends on several factors, including the amount of the contribution, the type of property donated, and the donor's adjusted gross income (AGI). Generally, deductions are limited to 50 percent of the donor's AGI. For 2018 to 2025, the limit is increased to 60% for charitable contributions of cash to public charities. If the donor makes a gift of long-term capital gain property (such as appreciated stock that has been held for longer than one year), the deduction is limited to 30 percent of the donor's AGI. The fair market value of the property on the date of the donation is used to determine the amount of the charitable deduction. Any amount that cannot be deducted in the current year can be carried over and deducted for up to five succeeding years.

Moreover, there are no federal gift tax consequences because of the charitable gift tax deduction, and federal estate tax liability is minimized with every contribution since donated funds are removed from the donor's taxable estate. Additionally, DAFs are not subject to the excise taxes levied against private foundations.

How to establish a DAF

It's easy to set up a DAF account. The donor first signs a letter of understanding with the administering organization, establishes an account, names the account, and recommends an investment strategy. Then, the donor makes required minimum gifts of assets, which may include cash, real estate, stocks, mutual funds, closely held securities, and, in some instances, private and restricted securities, depending on the DAF. The required minimum donations vary from organization to organization, but are usually less than those required by private foundations.

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