Donor-Advised Funds: A Great Way to Donate to Your Favorite Charity

by

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Due to recent changes in the tax law, taxpayers are asking financial advisers the best way to donate to IRS-qualified nonprofit organizations. Knowledgeable financial advisers explain how taxpayers (TPs) can either write a check directly to the charity or open a donor-advised fund (DAF) and disburse from it. A DAF is not only tax-efficient, but it is administratively efficient. The DAF provider manages all requisite paperwork by keeping track of tax forms and accounting statements, which is important when donating to more than one IRS-qualified entity. With one click of a button, a TP can see the account balance and full accounting of all donations made throughout the year.

What is a donor advised fund (DAF)?

A DAF allows a TP to receive an immediate tax deduction for the full amount contributed to the account. Discount brokerages including Fidelity, Vanguard and Schwab provide DAF accounts. TPs can establish either a permanent endowment or a non-endowment pass-through gifting account. A permanent endowment limits the donation in any one year to 5 percent of the value of the account. A non-endowment account allows the TP to donate the entire value of the account less fees at any time without restriction. The North Carolina Community Foundation provides the same services and has a local affiliate here in NHC. I serve on the NCCF NHC affiliate board.

How did the Tax Cut and Jobs Act of 2017 affect charitable gifting?

The new law is probably having a negative impact on charitable giving to qualified nonprofit organizations. First off, it raises the limit a taxpayer can contribute to 60 percent of adjusted gross income, up from 50 percent under old law. Although it does not remove the ability to deduct charitable contributions, it doubles the standard deduction to $24,000 for married couples ($12,000 for single filers and $18,000 for heads of households) and reduces many itemized deductions previously allowed. The combination of a higher standard deduction and fewer itemizations likely will prompt taxpayers who historically have itemized to take the increased standard deduction. Some estimates are 90 percent of taxpayers will take the standard deduction as opposed to itemizing. If a taxpayer takes the standard deduction (does not itemize), he/she cannot deduct the gift.

How does a DAF work?

DAFs are easy to set up and manage. Once funded and the TP is ready to donate, he/she can do so quickly because funds have already been set aside. With the click of a few buttons, a TP can send a donation to the qualified nonprofit. Online access is available at the discount brokerages and will be soon at the North Carolina Community Foundation. TPs also can keep their financial adviser involved by sharing online access to see appropriate investment selections from a menu of mutual funds.
DAFs are ideal because they allow a tax deduction at the time of the contribution, but granting the money can be made at the discretion of the donor—which could be years later
Without a DAF (writing a check), TPs would have to do some forecasting for bunching contributions into a single year to meet the higher-deduction threshold. DAFs make bunching unnecessary.

As an investment vehicle, endowment DAFs grow once the money is donated while waiting to be granted. Regardless of how the assets perform inside the endowment, the tax deduction is set by the original donation.

Besides cash, TPs can contribute appreciated, noncash assets, which tend to be the most tax-efficient because the donor would not have to pay a capital-gains tax.
Many noncash contributions are facilitated by financial advisers, especially for donors who hold assets that have appreciated over the last five years during the recent bull market. Donating appreciated assets increases the amount available to the charity by as much as 20 percent.

Schwab and Fidelity require a minimum $5,000 to open a donor-advised fund. Vanguard's minimum is $25,000. All three providers charge a 0.6 percent annual administrative fee, plus underlying investment fees incurred by the mutual fund within the endowment.

Setting up a DAF and funding it with cash or journaling assets from another account can occur quickly. Funding a DAF with appreciated assets, like real-estate or stock certificates, takes longer to process.

Contributions to an endowment account must be invested in one of many available mutual funds. An endowment allows the account to grow over the years so the TP can make sizable gifts to the charity later. Besides funding an endowment DAF, TPs have the option of establishing a gifting non-endowment account that acts as a conduit for passing to the charity up to the full value of the account less any fees. An endowment account is limited to passing on no more than 5 percent of the account value in any a year. A non-endowment gifting account has no such limitation.

For people who will no longer itemize deductions under the new law, opening a DAF account and prefunding it for making gifts, whether via an endowment account or a non-endowment gifting account, makes perfect sense. LOL

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