The Nuts and Bolts of Donor-Advised Funds

Paying It Forward: Philanthropy Matters

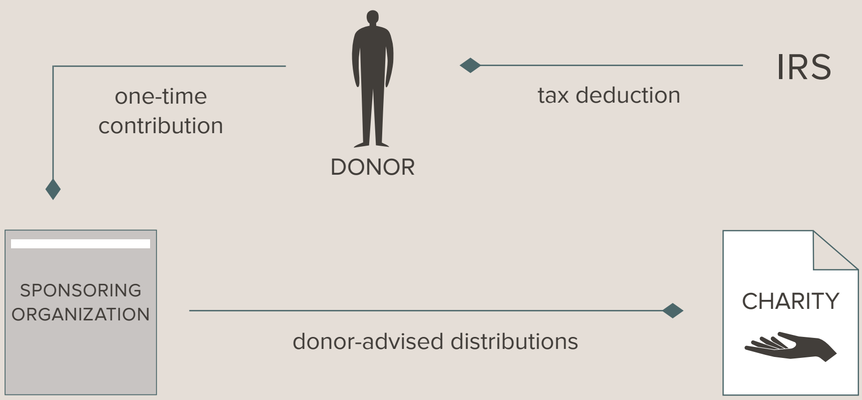
Catholic Foundation of Southwest Iowa

A donor-advised fund (DAF) is a contractual relationship between a donor and a sponsoring organization that features the value of the donor's advice. The donor makes a charitable contribution to the sponsoring organization, which then owns the assets and administers the fund. The donor retains advisory privileges over the charitable donations that are distributed from the account. This arrangement qualifies the donor for an immediate income tax deduction for the amount of the contribution, even though funds won't be distributed until later, when the donor suggests supporting a specific charity.

A donor-advised fund offers remarkable versatility in letting donors choose how they give at a time that works best for them. This unique "hands on" philanthropy is a personally satisfying giving option that also provides freedom from the administrative responsibilities of managing the account, including investment decisions.

At a glance
As the following diagram shows, the initial contribution to a DAF is tax deductible. Later, distributions can be recommended from the account (which are *not* tax deductible) under the terms of the DAF.

HOW DONOR-ADVISED FUNDS WORK



1. The donor makes a one-time contribution to the sponsoring organization.
2. The donor qualifies for an immediate federal income tax charitable deduction, subject to limitations. A donor must itemize to receive a deduction for a charitable contribution.
3. The donor makes recommendations for distributions to charity.

Donor-advised funds offer increased appeal

Because the standard deduction increased significantly under the 2017 tax law, fewer people are itemizing on federal returns. Those who want to make the most of their charitable deductions in a single year may find it makes sense to “bunch” donations so they reach the threshold amount that is required to take a deduction that exceeds the standard deduction. An effective way to accomplish this goal is with a donor-advised fund.

When you contribute to a donor-advised fund, your gift qualifies for a charitable deduction in the year of the gift. This means you can make a large, tax-deductible contribution to the DAF in one tax year and delay recommending distributions—or grants—from the account until later years.

Advantages for Donors

There are many ways to make meaningful, personally satisfying gifts, so why would a donor-advised fund rise to the top of a donor’s list of ways to reach philanthropic goals? Here are some key DAF benefits to keep in mind.

Advisory privileges
Although the sponsoring organization owns and manages the DAF and is legally required to retain ultimate authority over distributions, advisory privileges are the key reason why donors select this gift option. Donor-advised funds can meet charitable planning goals in sensible and pragmatic ways.

- Anna is a highly paid consultant who just signed a long-term creative services contract that included a substantial up-front bonus. She will be able to benefit from an itemized charitable tax deduction this year, so she makes a major contribution to a donor-advised fund. Her goal: To support her favorite charity on a long-term basis, specifically directing distributions to the work that, in her opinion, represents the greatest opportunity to make a meaningful impact. She is particularly pleased that she can use this charitable strategy that meets immediate needs while providing the flexibility to meet future charitable goals that are not yet specifically identified.
- Andrew is about to receive a substantial inheritance from his father—part of it made up of retirement assets that will be taxable to him. Although he could opt to receive the retirement assets over time, he elects to receive them in full now. To offset the tax that will be due, he makes a tax-deductible contribution to a donor-advised fund. One of

the motivating factors for Andrew's approach is the desire to honor his father's memory by making an immediate grant from the DAF. He also appreciates the luxury of taking his time to consider how and when to make future grants. Andrew benefits from a tax deduction now and looks forward to participating in meaningful personal philanthropy for years to come.

Timing and tax deductions matter

As the examples illustrate, eligibility for a charitable tax deduction can be an important part of planning. Although the primary motivation behind giving is the desire to make a philanthropic impact, it is wise to consider timing realities and how a gift can benefit the giver as well as the charitable organization. For instance, a particular year with a large or unexpected bump in taxable income can be an ideal time to consider a donor-advised fund, because of the welcome tax deduction.

Timing can also be important for other reasons. For example, George and Sydney are nearing retirement and want to enjoy the benefits of a tax deduction while they are still working. They also want to segment their charitable funds from other funds for future planning purposes. With a DAF, they can make a substantial contribution during their working years, then make their grants to charity in the future—when the time is right for them.

An alternative to a private foundation

For many donors, a DAF provides a rewarding alternative to a private foundation. Like a private foundation, a DAF can offer satisfying, "hands-on" participation in deeply meaningful long-term philanthropic endeavors. Family members can work together to meet charitable goals and shape a family legacy. However, when compared to a private foundation, donors may find a DAF more appealing because it:

- is easier and substantially quicker to establish
- has no start-up costs
- enjoys substantially lower administrative fees each year
- can offer a greater tax deduction as a percentage of adjusted gross income (currently 60% of AGI vs. 30% for a private foundation)
- is not subject to potential excise taxes
- is not subject to annual grant distribution requirements
- offers greater protection for donors who wish to make anonymous gifts

Even though the sponsoring organization has ultimate legal authority over grant distributions, many donors are more than content with the role of "advisor" in exchange for these benefits.

A Word from the IRS

When considering personal philanthropy, it is necessary to keep in mind the tax laws that apply to planned gifts. IRC §4966 describes three important requirements of a DAF:

1. **Separate identification.** The first requirement, that the fund be "separately identified by reference to contributions of a donor or donors," means the fund must be sequestered from the sponsor's general fund and specifically identified by reference to a particular donor (or group of donors) in that all contributions must be attributable to the named donor (or group).
2. **Ownership and control.** The second requirement states that the fund or account must be "owned and controlled by a sponsoring organization." Under this section of the Code, "sponsoring organization" is defined as a public charity (not a private foundation) that has one or more donor-advised funds.
3. **Advisory privileges.** The third requirement states that the "donor (or any person appointed or designated by such donor) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor's status as a donor."

Planning Considerations

The following questions and answers may help you determine how a donor-advised fund might fit into your personal planning.

Are all sponsoring organizations the same?
No, they are not. Community foundations have been associated with donor-advised funds for several decades. More recently, many different types of charitable organizations have established sponsoring organizations to administer donor-advised funds. In addition, some financial companies have created sponsoring organizations. Each sponsoring organization can have unique rules regarding the donation required to begin the fund, how grants are made from the fund, and fees associated with the fund.

Are additional contributions allowed?
Generally, yes—however, as noted above, each sponsoring organization has its own rules.

Who can receive grants from a donor-advised fund?
Grants or distributions from a DAF must be made to IRS-qualified charitable organizations. The sponsoring organization may have requirements for grant amounts and frequency—remember that the sponsoring organization has ultimate legal authority over distributions from the DAF.

Can a donor pass a DAF on to others?
Again, it depends on the specific rules of the sponsoring organization. Some sponsoring organizations allow for the transfer of advisory privileges to another individual. Others allow you to designate a specific charitable organization to receive the funds in the account when you die.

A Simple, Rewarding Philanthropic Option

At their core, donor-advised funds are remarkably simple. They allow you to make a single donation that can benefit one or more charities through multiple grants from the DAF at different future dates, with minimal constraints on the timing of those grants. DAFs can be highly rewarding and useful for donors who want to make a charitable commitment now, benefit from a current tax deduction, and retain the right to “fine-tune” grant distributions or make multiple grants in the future.

Please contact us for more information about donor-advised funds and grants to our organization. It would be our pleasure to help you explore the possibilities associated with this flexible giving strategy.

Notes:

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