

Abstract: Donating funds to a community, alma mater or charitable organization benefits others and offers tax advantages to the donor. But becoming a philanthropist is not as easy as it sounds. One way to do so is to open a donor-advised fund (DAF). This article defines a DAF and identifies its tax advantages.

The ABCs Of Donor-Advised Funds

Donating wealth to your community, alma mater and charitable organizations benefits others as well as offers you tax advantages. But becoming a philanthropist is not as easy as it sounds. Deciding which charities to donate to often requires research to discover which ones are honorable, effectively support the causes you favor, assiduously maintain their 501(c)(3) tax-exempt status and are capable of accepting appreciated assets. And setting up a private foundation -- the hallmark of a cultivated philanthropist -- can be time consuming and may require several million dollars to make it worthwhile.

A simpler way to become a philanthropist is to open a donor-advised fund (DAF). DAFs have existed for nearly 30 years, but they've surged in popularity recently because of the booming economy and increased charitable giving. Community foundations and religious federations first set up DAFs. Major colleges, public charities, hospitals and, more recently, investment firms and trust companies have joined the founding organizations in offering DAFs to private donors. The Chronicle of Philanthropy estimates that the total assets of DAFs have roughly tripled from 1995 to 1999.

What Is a DAF?

A DAF is a charitable account you set up in your name, for example the John Doe Charitable Gift Fund. The account is physically held by an organization -- such as a community foundation, university or brokerage firm -- that administers the funds and makes the grants. Your DAF is a component of that organization. Although the account is in your name, the funds belong to the organization.

A DAF allows you to contribute assets and claim a charitable deduction in the same tax year. In addition, you can make recommendations to the organization that holds the DAF as to which charities it should distribute the funds. If the organization is a public charity, it will offer comprehensive research on which charities meet your personal criteria to help you make your recommendations.

All DAFs have a minimum initial donation, typically between \$10,000 and \$25,000. But some DAFs allow you in for as little as \$1,000 while others require at least \$250,000. You can make subsequent contributions at any time, usually in increments of \$1,000.

Tax Advantages of DAFs

Although you may take immediate tax deductions for your donations (which are irrevocable), a DAF needn't distribute your donation in the same year. For example, let's say your alma mater is planning a 100th anniversary event in 2003. You would like to make a donation in 2003 to the college's scholarship fund, but you need the tax deduction this year. You can contribute the money to the DAF now and advise the fund that you would like the money donated to the college in 2003, but still take an immediate deduction. The organization that holds the fund invests the money in financial markets, and in some cases, will allow you to recommend investments.

In addition to the immediate tax deduction and reduction in your taxable estate, a DAF has another advantage. You can deduct contributions of appreciated assets at fair market value, which lets you avoid paying capital gains tax. (See “Erase Capital Gains by Contributing to a DAF” on page 2.) By contrast, you can deduct some contributions of appreciated assets to a private foundation are deductible at your cost basis.

Make Your Charity Recommendations

When you make your charity recommendations, you can name a particular charity or several. You can specify a broad category of nonprofit organizations -- such as those that support the arts, promote literacy or alleviate homelessness. Public charities will help you select appropriate charities in the category that you designate.

A DAF can make grants in your name or anonymously. Most funds charge an administrative fee ranging from around 0.5% to 2% of the account balance. Some require you to maintain a minimum balance, but many do not.

Keep the Fund In Your Family

You can name a successor advisor for each DAF, usually someone in your family. This advisor will continue making grant recommendations -- and hopefully donations -- when you die or if you become incapacitated. This provision lets you keep your philanthropic activities alive and in your family for future generations.

A DAF is a hassle-free and effective way to enter the field of philanthropy and enjoy big tax advantages. If you would like help finding an appropriate DAF and plan contributions that meet your philanthropic goals, please give us a call.

Erase Capital Gains by Contributing to a DAF

You can gain many tax benefits when donating an appreciated asset to a donor-advised fund (DAF). For example, Melissa, who pays tax in the highest tax bracket (39.6%), contributes \$20,000 in stock to her DAF. She paid \$14,000 for the stock two years ago, a gain of \$6,000.

By deducting the \$20,000 from her taxable income, Melissa saves \$7,920 in income tax. She also saves \$1,200 that she would have paid in capital gains tax if she had sold the stock. Thus, she was able to make a gift of \$20,000 to a worthy cause at a cost of only \$10,880. In addition, she reduces the value of her taxable estate by \$20,000, potentially saving several thousand dollars more.