Wealth Notes

By Rob Wrubel

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Wealth Notes offers an insightful look at financial planning topics. This quarterly column reviews current financial planning trends and seeks to educate you about planning and investment opportunities. This column covers a wide-range of topics to help you make informed financial planning

Charitable Gift Flexibility with Donor-Advised Funds

Community service organizations, educational institutions and religious affiliations depend on donations to achieve their missions. Many of us give to these groups because we believe in the work they do, the transformative experiences they deliver and their ability to alleviate problems not easily addressed, underfunded by or handled well by government.

There are many different ways people give.

It seems like so much giving is done in small amounts. Some people give to school bake sales, PTA popcorn drives or just make small contributions to the schools attended by their children. Others drop a check or cash in a donation basket during religious services. Others give when asked by a friend who volunteers for a local service organization.

Charitable giving can take other, more complex forms. Some donate interests in businesses, appreciated stock or make multi-year gifts to fulfill a pledge to a capital campaign. Others use charitable trusts, where some of the income or the value of the trust in the future will go towards charitable goals.

And then others make estate gifts – their wills or trusts specify a certain dollar amount or percentage of their final estates to go to educational institutions, foundations or nonprofit organizations in their communities and around the world.

Donor-advised funds are another technique and they are an increasingly popular way for donors to handle their charitable giving. In 2016, contributions to donor-advised funds totaled more than $23 billion, an all-time high (according to the National Philanthropic Trust).

So what are donor-advised funds (DAFs) and how can they be a part of your giving?

A DAF is a way to make your charitable donation into an investment vehicle without having to give the money to a specific charity at the time you make the donation. You make the donation into an account (a fund) and then have the choice on timing when the donations are made to the nonprofits of choice. Why does this matter? Some donors need the tax benefit in a given year but do not have a charity in mind to give to or that the amount needed to gain tax benefits is more than they want to give out in one year. Others might be looking to create a legacy pool of funds where only some portion is given out each year and the money can make an impact over decades.

Simple, right? It's easier to use an example to understand how they work. You can use a DAF to hold that gift until such time as you feel the need to give it out. For instance, you might have $10,000 of appreciated stock in a company – maybe you've owned Microsoft for 30 years. If you sell the stock, you will owe capital gains taxes – maybe 15% or more. If you give the stock to a nonprofit, like your college alma mater, you get the tax deduction and the college can sell the stock without owing tax. The DAF allows you, as the donor, to give all the stock away in one year without giving the college all the money at once. Why would this make sense? Maybe you're used to giving an annual gift of $2,500 and want to reserve

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your rights to choose each year whether to make a gift or not. Or it feels like too much to give $10,000 at once. With a DAF, you maintain control of the gift.

In this case, you set up a DAF and donate the $10,000 of Microsoft stock. You get the deduction and you get full control of when the money will be gifted out. The transfer to a DAF of stock (or funding one with cash or other investments) sets the timing of the charitable gift for tax purposes. The money sits in the DAF and stays invested until you give instructions to have some of it sent to the college (or other nonprofit organization) of your choice. You could give $1,000 per year for a decade or in any other way you choose. You could decide to give to many organizations or just one with the money available in the DAF.

DAFs have become popular, in part, because of the flexibility they provide to fund an account that can be used at any time. They can be simple in structure, like the example, or they can be more complex in the timing of giving, the people involved in decision making and the ability to engage family in the charitable conversation over time.

DAFs do come with some restrictions (you know they have to) that can impact your choice on whether to use them, gift outright, or set up a family foundation.

For one, deferring payments to charities might not help them. All the organizations you give to need money coming in every year. If you use a DAF for tax planning but wait on using it for charitable giving, some smaller organizations might feel the loss. Of course, you can keep giving normally through a DAF or outside the DAF to sidestep this issue.

You have to find a resource to sponsor a DAF. There are many options here but the decision making can be complex if you are not working with an advisor familiar with the choices to help you. You can choose from a company that specializes in DAFs, a mutual fund company that also sponsors DAFs, a community foundation or even some other nonprofits with DAF services. Each has unique features to consider.

Lack of investment control. Many DAF sponsors do not let you have a say in how funds are invested. Part of this is in response to government rules. The donor cannot gain benefit from the DAF – it is a charitable gift from day one. Part of this comes from the need to streamline investment management to provide reasonable risk-based returns to hundreds or thousands of fund holders. Some people like to have a say in their investment choices – maybe for social purposes or because they like the process of investing. Some DAF sponsors allow people to keep their investment adviser as long as they have funds over a certain dollar amount with the sponsor but not all do.

Part of our work is helping clients with their charitable gifting strategies as we talk through long-term goals. The donor-advised fund is one way to give but there are others. So often, our clients do not see themselves as philanthropists even though they give to schools, advocacy groups, religious organizations and service nonprofits throughout the year. We look forward to hearing what groups are important to you and consulting with you to incorporate charitable techniques into your overall plan.

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