Donor advised funds: the Swiss Army knife of charitable planning.

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Donor advised funds (DAFs) are a longstanding and versatile tool for charitable giving. However, many charitably inclined people (and even some financial and tax professionals) do not know they exist or why they are so popular. The flexibility of DAFs means that they can achieve many different goals and have significant benefits for charities and donors alike. This article gives an overview of DAFs, including the history, status, planning options, and applications of the vehicle.

To begin with – what is a DAF? The IRS states in a straightforward manner that it "is a separately identified fund or account that is maintained and operated by a section 501(c)(3) organization."[1] Simply put, it is an individual fund owned and maintained by a public charity, which is funded by an individual donor (or sometimes multiple donors).

Since the contributions to the DAF are charitable, the donor no longer has legal ownership or control, although he or she "retains advisory privileges with respect to the distribution of funds and the investment of assets in the account."[2] The investment of DAF assets means that they can grow over time before eventually being granted out with the advice of the donor. Of course, that same contribution is generally tax deductible, since the asset is being given irrevocably to a charity.

A Brief History and Current Status of DAFs

The first donor advised fund is usually credited to the New York Community Trust in 1931.[3] Compared to modern DAFs, the fund was unregulated and administered similarly to other charitable funds at then-contemporary community foundations.[4] The category of DAFs was further distinguished from other charitable funds (particularly private foundations) in the Tax Reform Act of 1969. That reform added strict regulations for private foundations, which were often created by individuals or families. Public charities, meanwhile, maintained a certain degree of latitude in their operations.[5] Since DAFs are always administered and maintained by public charities, this opened the door for the use of DAFs rather than private foundations.

However, in the early 1990s, large brokerage houses began establishing standalone DAFs as independent charities.[6] In the decades since that time, DAFs have grown in popularity to the point where they are among the largest charities in the United States.[7] Nearly every large bank, brokerage house, community

1 Internal Revenue Service, "Donor-Advised Funds," https://www.irs.gov/charities-non-profits/charitable-organizations/donor-advised-funds (last accessed July 13, 2020).

2 Id.

3 The New York Community Trust, "Our History: Nine Decades of Making New York Better," https://www.nycommunitytrust.org/about/history/ (last accessed July 13, 2020).

4 Berman, L.C. (October 2015), "Donor Advised Funds in Historical Perspective," Boston College Law Forum on Philanthropy and the Public Good, 13.

5 Id.

6 Olen, H. (December 13, 2017), "Is the New Way to Give a Better Way to Give?," The Atlantic, available at https://www.theatlantic.com/business/archive/2017/12/donor-advised-funds-deduction-charity/548324/.

7 Id.

foundation, and Jewish federation offers a DAF option. By 2018, over $120 billion in assets were held in DAFs.[8]

The incredible growth of DAFs applies across seemingly every metric. This includes the number of individual funds, the total dollars granted out from DAFs to other charities, the total contributions to DAFs, and the total assets held in DAFs.[9] This growth has drawn scrutiny and criticism from inside and outside of the charitable world, usually driven by a perception that the charitable dollars are sitting within the DAF structure and not being deployed for charitable purposes.[10] DAF supporters respond that annual grants from the funds are typically about 20% of total assets.[11] Further, they argue that DAFs allow for more participatory, democratized charitable giving – making long-term charitable planning and growth available to donors of all backgrounds. Regardless, DAFs appear to be here to stay, considering they are the "fastest growing form of charitable spending" in the country.[12]

DAF Planning

When can a DAF be a useful option for someone who is charitably inclined? How can a budding philanthropist deploy a DAF? There are a number of situations where a DAF may be a wonderful solution.

Any time a person has a large spike in income is usually a good time to consider charitable giving. The reasoning is twofold. First, a spike in income means that the donor in question has more income than usual and may be more able to make charitable donations. Secondly, higher income usually means higher taxes, so a donation makes more sense from an accounting perspective – the deduction is often more valuable in high income years.

Funding a DAF during such a time can allow for many years of charitable giving following the higher-income year.

Similarly, a person with highly appreciated noncash assets can utilize that illiquid portion of their balance sheet for tax efficient charitable giving. Donating cash is simple, but appreciated assets given to charity means that the donor is not paying capital gains on the appreciation – simply because they contributed the asset to a tax-exempt organization. If the DAF is able to accept the noncash asset (not all can or will), it will usually sell the asset, which can then be reinvested or granted out just like a normal DAF funded with cash or public stock.

The DAF can be a wonderful solution for donors considering a very long term, multigenerational charitable plan. DAFs can and do change advisors over time within families. As discussed above, the DAF has advantages over a private foundation, but it can also provide the collaborative, long-term charitable experience that some families look for. Nearly every DAF has simple mechanisms to designate successor advisors for individual funds. To a similar end, a DAF can easily be funded through testamentary language in a will. That can be either initial funding or additional contributions (including noncash

contributions from the estate, where allowable).

Key Attributes of DAFs

If a donor does create and fund a DAF, what advantages does it offer after the money is in the DAF? How can a donor fulfill their charitable goals? This is where DAFs shine – they are remarkably flexible when it comes to charitable grantmaking.

As discussed above, DAFs can be a long-term charitable fund. This is a

8 National Philanthropic Trust, "The 2019 DAF Report," https://www.nptrust.org/reports/daf-report/ (last accessed July 13, 2020).

9 Id.

10 Hobson, W. (June 24, 2020), "Zombie Philanthropy: The Rich Have Stashed Billions in Donor-Advised Charities — but It's not Reaching Those in Need," The Washington Post, https://www.washingtonpost.com/lifestyle/style/zombie-philanthropy-the-rich-have-stashed-billions-in-donor-advised-charities--but-its-not-reaching-those-in-need/2020/06/23/6a1b397a-af3a-11ea-856d-5054296735e5_story.html.

11 National Philanthropic Trust's "2019 DAF Report" cites that grant payout in 2017 was 22.8% and in 2018 was 20.9%.

12 Hobson, W.

major part of their appeal for many donors. Unlike private foundations, DAFs are not required to grant out a set percentage of their assets every year. That means grants can be very small relative to the size of the fund. This may work well for donors hoping to provide small amounts of support for a period of years before making larger grants in the future.

Similarly, DAFs are not endowed funds. Endowed funds are permanent charitable funds that make grants solely based on income and appreciation only – no grants may be made from principal. DAFs are generally not intended to be permanent and are able to make grants from principal (as well as from income and appreciation).

The latitude with grantmaking from DAFs extends to the recipient charities as well – any U.S. public charity in good standing with the IRS is generally eligible to receive a grant from a DAF. In practice this means donors can support the same charities from their DAF that they could support by writing a check. Some DAF sponsors also allow international grants as long as they are to IRS equivalent charitable programs.

Which charities cannot receive grants from DAFs? Most private foundations, foreign charities (except where noted above), or charities that have lost their tax-exempt status. DAFs also will not generally make grants to fulfill the legally binding pledge of a donor, or where the donor would receive some tangible benefit in exchange.

Another advantage is that grants can be made anonymously. Some donors have a strong preference to maintain privacy in their giving. DAFs are typically able to accommodate these concerns by making anonymous grants. Further, a donor can have a DAF without any identifying features or traits.

Conclusion

Donor advised funds are an extremely versatile tool for the charitably inclined. Although DAFs have been around for many decades, they have grown exponentially in number, value, contributions and general popularity over the last twenty years. The funds may be appealing for donors with some combination of appreciated assets, unusually high income, or with long-term charitable goals. This is particularly true given the significant latitude that DAFs allow when it comes to grantmaking.

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