Charitable Giving and Donor-Advised Funds

By H. G. Mumford, Jr.

What is a Donor-Advised Fund (DAF)?

Community foundations began offering donor-advised funds to their donors in the 1930s, and today DAFs represent one of the fastest-growing vehicles for charitable giving.

In simple terms, a DAF is a separate account over which the donor and his designees have the power to recommend grants and investments. The account is owned and held by a sponsoring charity, which may or may not receive a percentage of the grants made. The sponsoring charity may be a community foundation, a large public charity such as a hospital or educational institution, or a newly created nonoperating foundation. A DAF does not generate any income for the donor because all income and asset appreciation are retained by the DAF.

Today, more than 80,000 individuals, families, trusts, investment clubs, private foundations, and corporations have established a variety of giving structures, including donor-advised funds, with new accounts opening at rates exceeding 16 percent a year. According to a study by the National Philanthropic Trust, DAF assets totaled $27.7 billion in 2007, with distributions that same year of $12.1 billion.

The use of donor-advised funds now has spread beyond community foundations to other charitable institutions and financial services firms. Colleges and universities such as Harvard and Cornell began to offer DAF options as a gifting vehicle for their alumni and friends because DAFs often were less expensive to establish and maintain than private and family foundations. Additionally, several financial services organizations began to provide DAF products to their charitably inclined clients.

How Do DAFs Work?

A charitable donation occurs when the donor transfers assets to the DAF account at the sponsoring charity, whether during life or upon death. Grant-making recommendations can be made over the succeeding months or years. DAF assets have the potential to grow, thus providing increased assets for future gifting. Another key feature is the ability of the donor and designees to name family members and friends as “account advisors,” thus enabling a DAF account to be used as a multi-generational vehicle to promote family philanthropy (see figure 1).

Any unused tax deduction from the year the contribution is made can be carried forward for up to five years subject to the later year’s ceiling. Unlike a donor who establishes a private or

Tax Consequences

A contribution to a DAF is treated for tax purposes as a direct irrevocable transfer to the sponsoring charity. As a result, applicable income tax limitations are the same as for transfers to public charities: a 50-percent limitation for gifts of cash and a 30-percent limitation for gifts of noncash items based on the contributor’s adjusted gross income. Any unused tax deduction from the year the contribution is made can be carried forward for up to five years subject to the later year’s ceiling. Unlike a donor who establishes a private or
family foundation or supporting organization, a contributor to a DAF does not need to establish a board of directors or file tax returns for the DAF.

**DAF Services Provided by Financial Service Firms**

In recent years, the financial services industry has begun assessing its various lines of business with a view toward increasing and enhancing client relationships. Beyond the fundamental recognition that assets under management (AUM) are a key focus for advisors, the industry also has focused on offering a broader range of products and services to clients to significantly enhance the stability and permanence of client relationships. Large national financial institutions are seeing significant business opportunities in supporting the charitable giving desires of affluent, high-net-worth, and private banking clients. They have recognized that offering various giving vehicles, including DAFs, is a way to assist clients in giving, planning for current and future gifting desires, and preparing for estate and family legacy planning.

The entry of mutual fund companies (Franklin Templeton, Fidelity, and Vanguard, to name a few) into the charitable giving arena has placed the concepts of structured giving and philanthropic planning within the reach of people of average means. Private or family foundations have been perceived as—and in fact are—utilized almost exclusively as tools of the wealthy, while many donor-advised funds accept minimum contributions of as little as $5,000. This allows many donor clients to establish gifting programs regardless of how small the donation.

Certain advisors’ clients are realizing that they have more than enough money to leave to their children, and they wish to find ways to turn their success into something that is significant by giving a portion of their assets to charity. At the same time, those clients are seeking an easy and simple way to donate assets and make grants, and they want to be able to transact their charitable giving online in the same manner they pay their bills online.

Bill Bradley, Paul Jansen, and Les Silverman made several observations in an article in the *Harvard Business Review* in 2003, when they pointed out the need for increased efficiency on the part of charities in fundraising efforts and specifically highlighted the opportunities available through online fundraising and the use of DAFs to gain this efficiency. This increased attention to DAFs as a solution for simplifying the donation process has caught the attention of many clients, and as a result they are turning to their financial advisors, attorneys, and accountants for guidance when considering simple and easy-to-implement options for charitable giving. It benefits these professionals to become knowledgeable about DAFs because clients are likely to ask about their use.

**Advisors’ Role**

Regardless of how well-designed a DAF is and how well its features fit with the public need and interest, advisors won’t recommend a DAF unless they can find a smooth and easy way to discuss the product. Broker and advisor education, sales training, and ongoing exposure are critical to their comfort with the product and to successful implementation. The advisor also must be willing to learn more about the personal and family aspects of each client. By understanding a client’s feelings about “giving back,” or a client’s personal interests in specific causes or issues and how that client wishes to accomplish giving, the advisor is better prepared to make recommendations about using various giving vehicles including a DAF.

**Seven steps to enhance your ability to create charitable giving solutions for clients:**

1. Work with other tax, estate, accounting, investment, and legal professionals for referrals to clients with charitable intentions.
2. Identify clients and prospects with small private foundations (less than $500,000) who may benefit from moving to a DAF and significantly reduce costs while continuing their charitable mission.
3. Explain how clients unhappy with current DAFs have the ability to move to a new DAF program.
4. Talk to your current clients about how much they are giving annually to charity, what kinds of organizations they are interested in supporting, and if they are interested in developing a long-term charitable-giving strategy.
5. Explain to corporate executive clients with large lump-sum payments or bonuses who would like to reduce their current-year income tax liability and donate to charity that they can enjoy an immediate income-tax charitable deduction and will have the flexibility to select charities in the future using a DAF account.
6. Help individuals with appreciated securities contribute them to DAF accounts and deduct their fair market value without incurring any capital gains liability—so they can give more, at less cost.
7. Show business owners who recently have sold companies how they can make donations to DAFs to help reduce current tax liability as well as meet charitable intentions for years to come.
With some DAF programs failing to offer the advisor any competitive compensation, many advisors undoubtedly consider the charitable giving arena a zero-sum game, with every dollar given to charity representing a dollar out of the personal AUM tally. Many of the new programs provide for either a front-end or trail-based compensation for the advisor, which eliminates much of this distraction. Moreover, have added a fact-finding stage as a preliminary step in the sales process. This is not only critical to understanding a client’s needs and interests but serves as a foundation for the delivery of solutions and implementation. That step, coupled with the integration of new products and solutions into existing sales model and presentations, can improve dramatically the opportunity to aid and retain clients.

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since most of those who are charitably inclined have assets earmarked for donation in some manner, these assets actually may represent money going into or remaining in the AUM tally while they reside in the DAF.

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Implementing a charitable giving strategy for a client, regardless of the product solution involved, is both a matter of charitable intent and financial strategy. Discovering intent or developing a strategy for a client requires more time and discussion than some brokers may be willing to spend in fostering traditional transactional business.

Fortunately today, more and more firms are encouraging their advisors to adopt a consultative or planner-oriented approach to developing client relationships. Following a model used by the insurance industry for generations, investment advisors and planners at Franklin Templeton Distributors, Inc. Contact Dan Reinhold at dreinhold@frk.com with any questions about this article.

Endnotes


Conclusion

Despite the fact that early efforts to offer DAF solutions through a financial services distribution model have met with selective success, we believe that for the first time there now exists a significant opportunity to successfully offer DAF platforms within the investment community and for financial services firms to more fully explore the expanding audience for these offerings among their clients, prospects, and community.

By recognizing the importance of DAFs as a way for donors to gain control and flexibility over gifting, advisors can expand client relationships. Within these stronger relationships, client/donors then are likely to look to advisors for guidance and help in all aspects of their financial investment activities, estate planning, and charitable giving. DAFs are certainly a giving vehicle and an opportunity to be considered.

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