Complete Guide to DAFs

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Ren

Donor-advised funds continue to be the fastest growing choice of charitable giving vehicles. According to National Philanthropic Trust's **2022 Donor-Advised Fund Report**, the number of **donor-advised fund (DAF)** accounts in the United States rose to almost 1.3 million in 2021 with an annual compound growth rate of 28% between 2017 and 2021. In contrast, there were 471,036 accounts in 2017. Here's what you need to know about DAFs.

What is a DAF?

A **donor-advised fund** is a charitable investment account that lets donors make charitable gifts as frequently as they would like.

DAFs have been around for nearly a hundred years, but it wasn't until 2006 that Congress gave them a formal definition. The key elements of that definition are that a DAF is:

A properly created DAF is a completed gift to the sponsor for tax purposes.

A DAF is **not** a fund created to support only one charity and is not a scholarship fund.

How do DAFs work?

With a donor-advised fund, money is deposited into an account that can grow in value, and funds that are deposited into a DAF are granted out to charities.

Donors are able to make gifts directly to a sponsoring charity that maintains their DAF account and receive an immediate tax deduction for their donation. In exchange for their gift to the sponsoring charity, the donors receive advisory privileges to recommend grants to qualified charities and advise on how the gift is invested.

These funds are "donor-advised" because, although the donor does not have direct control over the fund, they can recommend how their funds are invested and which charities will receive payments.

What are the benefits of a DAF?

Donors use DAFs because they are simple to create, highly flexible, and provide superior income tax charitable deductions when compared to private foundations.

The benefits of a DAF:

- Easy to create (most DAFs are created by completing a brief application).
- Provide tax-free growth and a flexible array of investment strategies.
- Accept a variety of gifts. Most organizations that sponsor DAF programs accept contributions of not only cash, but also illiquid assets such as marketable. securities, real estate property, and closely-held business interests
- Many DAF programs support a variety of grantmaking approaches and allow donors to support multiple charities over time.
- Unlike grants from private foundations, grants from a DAF can be truly anonymous.
- Donors frequently contribute appreciated assets because they are allowed a deduction for the full value of the gift while avoiding any capital gain when the sponsor sells the contributed assets.
- A gift to a DAF is a gift to a public charity, which qualifies for maximum deductibility.
- The opportunity for donors to create a **legacy of giving** by leaving a bequest in their will to the DAF sponsor or naming heirs as successor grant advisors.

If you're interested in seeing the tax savings of a securities donation to a donor-advised fund, use our **Securities Donation Calculator**.

How does a DAF compare to a private foundation?

DAFs are frequently compared to **private foundations**. Here are the key differences to these two "endowment giving" vehicles:

- DAFs do not require the creation of a separate legal entity with associated costs; private foundations do.
- DAFs do not require the donor to create a board of directors with fiduciary responsibility that must adhere to governance best practices and procedures; private foundations do.
- DAFs do not require the maintenance by the donor of separate financial statements and the preparation of a separate Form 990-PF; private foundations do.
- DAFs are not subject to a 2% excise tax on their investment income; private foundations are.
- DAFs are not required to make annual grants; private foundations are.
- DAFs can make grants that are completely anonymous to the grant recipient; private foundations can't.
- Contributions to a DAF qualify for maximum deductibility; contributions to a private foundation don't.

Read our **companion blog post** for a more in-depth look at how donor-advised funds compare to private foundations.

How does a DAF compare to a charitable trust?

Charitable trusts are also considered alternative options to DAFs, as they provide similar benefits while allowing donors full control over which individuals or organizations receive grants.
Here are key differences between these giving vehicles:

- Information on gifts given to charitable trusts is publicly available and so, unlike gifts to DAFs, they can't be given anonymously.

- While the donor can change which charities receive grants from a DAF, the recipient of charitable trust disbursements can't be changed.

- DAFs can be set up as the charitable beneficiary of a trust to streamline the giving process and provide flexibility in which beneficiaries can receive grants.

- The start-up time for charitable trusts can be weeks or months, while DAFs can be set up immediately.

- There are no set-up fees for DAFs, while charitable trusts will incur legal and accounting fees to establish.

- You can donate either liquid or illiquid assets to both DAFs and charitable trust, but donors may need to sell or couple non-liquid assets with a cash donation to ensure a charitable trust can make its required payments.

Read our companion blog post for a more in-depth look at how donor-advised funds compare to charitable trusts.

Types of DAF sponsors and providers

There are three main types of DAF sponsors and providers:

- **Community foundations** are defined as tax-exempt public charities dedicated to a specific geographic area, and reports estimate there are anywhere from 700–900 community foundations across the United States. A community foundation is supported financially by the public to support local community initiatives, programs, and needs. Examples include the Philadelphia Foundation, the Community Foundation for Greater Buffalo, and the Community Foundation of Western Massachusetts.

- **National donor-advised-fund organizations** are either independent or affiliated with an investment firm and typically don't have a specific focus. Examples include Vanguard, Schwab, Fidelity, National Philanthropic Trust, and Ren.

- **Public foundations or charities** are defined as organizations that have active fundraising programs and receive financial support from a variety of sources, including the government, public donations, corporations, private foundations, and other charities. Examples include universities, nonprofits, hospitals, churches, and some medical research institutions.

How to get started

If a client is interested in establishing a DAF account, the first step is to consider their tax situation, charitable goals, and how they want to support their family. From there, determine the type of DAF sponsor or provider that can best support their financial and personal goals.

Once a donor selects a sponsor, they may make an irrevocable, tax-deductible contribution into the fund, name the account, as well as any successors and beneficiaries. To simplify the process, advisors, charitable organizations, and financial firms should consider partnering with a one-stop-shop DAF leader such as Ren that combines philanthropic expertise with the latest in fintech innovation and technology.
With modern approaches and tailored solutions, we serve a variety of clients including financial institutions, religious organizations, higher education institutions, nonprofit organizations, and individuals. We also offer private-labeling so nonprofits can provide their own branded DAF program.

DAFs are suitable for almost any donor. They are simple, flexible, and cost-effective. They permit donors to recommend to the charitable sponsor both grant recipients and investment options. Moreover, they permit donors the opportunity to contribute appreciated property and avoid recognizing the capital gain on sale. Finally, they provide superior anonymity and deductibility compared to private foundations.

Contact us to find answers to any of your other charitable planning questions.

FAQs

What happens to a DAF at the end of your life?
Donor-advised funds can exist in perpetuity if you have named an individual, a charity, or combination of either as a successor. Successor advisors are granted advisory privileges on accounts created out of your account assets. If no successors are named, then upon your death the remaining balance of the donor-advised fund will be granted out.

What rights do donors have?
In general, donors can retain the right to recommend that the sponsor make charitable grants from their DAF to qualifying charitable organizations and they can retain the right to advise the sponsor regarding the investment of their DAF assets. However, it is important to note that in either case the donor's right is advisory in nature. Ultimately the sponsor must approve, deny, or modify the payment of a charitable grant or the implementation of an investment recommendation.

What types of organizations can receive a grant?
In general, a sponsor may only make grants to publicly-supported section 501(c)(3) organizations. However, a sponsor may make grants to foreign charities or for charitable events organized and sponsored by groups such as Kiwanis, Rotary, or chambers of commerce, but only if the sponsor exercises appropriate due diligence over the use of the funds by the recipient. A sponsor must not make distributions (including payments for charitable purposes or expense reimbursement) to an individual or certain types of charities called "Type III non-functionally integrated supporting organizations."

What IRS rules apply to the operation of a DAF?
Because DAFs are regulated by the IRS, they are subject to several important rules. First, for a donor to claim a deduction for a contribution to a DAF, the sponsor must provide a timely written acknowledgment to the donor stating that the sponsor has "exclusive legal control" over the contribution. Second, a punitive excise tax is imposed on any grant that results in a more than incidental benefit to the donor or a donor advisor. Third, a sponsor that receives contributions of a closely-held business into one or more DAFs is generally required to sell those contributions within a five-year period if the sponsor's holdings, combined with those of the donor and the donor's family, exceed a 20% threshold. Failure to comply with this divestment requirement will result in the imposition of an excise tax on the DAF.

For more details, see our most recent update on **DAF Rules and Contribution Limits**.