With a Donor-Advised Fund, You Give One Sum, Share the Wealth Over Years

Supercharge Your Charitable Deduction

by Alexandra Armstrong, CFP, and Christopher Rivers, CFP

In our last article, we discussed the effect the new tax bill will have on charitable giving as well as the increasing popularity of the recommendation to "lump" several years' worth of charitable contributions into the current year. From a tax standpoint, the primary goal of lumping is to increase your itemized deductions above the new standard deduction: $12,000 for single filers, $24,000 for married couples who are filing jointly.

In its simplest form, lumping simply means accelerating your annual or planned donations for the next several years into 2018. For example, if you typically give $5,000 annually to charities in cash or stock, this year you might consider donating $15,000 to get more bang for your buck. But you may not want to give this money all at once or you may donate to a number of different charities. In recent years, donating to a donor-advised fund has gained popularity, since it provides you with a tax deduction now but you can decide which charities will benefit later.

What Is a Donor-Advised Fund?

A DAF is a philanthropic vehicle established as a public charity. Often these are charitable organizations under the umbrella of a financial services firm or a nonprofit entity such as a community foundation. It allows individuals or families to make charitable contributions and receive an immediate tax benefit.

Once the contribution is made to the DAF, you've made an irrevocable charitable gift, just as you would have if you'd given directly to your favorite charity. With the DAF, however, you have the flexibility of spreading out the giving to your specific charities over many years.

Funding a Donor-Advised Fund

A donor-advised fund can be set up in similar fashion to a traditional investment account and typically can be established with most of the major financial services firms. You might title it something like the "John and Jane Smith Charitable Fund." You then simply transfer cash or appreciated securities from your account to this account.

If you own a stock where you have a big gain, this obviously would be an ideal candidate to transfer to the DAF, since when investments are sold within the DAF there are no taxes due on these sales. At transfer, you receive a letter acknowledging the gift and the value for charitable deduction purposes. (You should give stock you have owned for at least a year to get the full tax deduction.)

Donor-advised funds are classified as 501(c)(3) charities, which means that your charitable deduction is limited to 30 percent of your adjusted gross income if you're donating appreciated securities.

If you're simply donating cash, the deduction is limited to 60 percent of your adjusted gross income under the current tax bill.

Typically the company offering the DAFs will have an online donor portal that allows you to log in, identify your preferred charities and manage your donations. Your donations must be made to a public charity recognized by the IRS as a 501(c)(3) organization. Gifts cannot be made to private foundations or individuals.

To establish a DAF you have to donate a minimum amount, typically starting as low as $5,000. You will be charged an annual fee that covers the cost of administering the gifts and of tracking and reporting on the account. Once you have established a DAF, you can add to it periodically.

Investing Within a DAF

Investments within a donor-advised fund grow tax-free. The investments in a DAF may be restricted to a limited menu of choices offered by the sponsoring entity, similar to the menu of options available in a 401(k) plan. But many of the largest funds offer a brokerage account option, giving you access to a wide universe of investments.

Why Start a DAF Now?

There are many reasons you might want to give to a DAF instead of giving directly to the charities of your choice.

- **You expect taxes in general** to be lower in the future than they are this year.
- **You expect your personal tax rate** to be lower in the future than in the current year.
- **Your personal tax situation** would be improved by making a larger donation in a given year than spreading it out evenly over multiple years.
- **You want to involve family** in giving; the endowment is a means for you and your children or grandchildren to have an annual giving celebration to teach them the value of charity.
- **You think market values** might be lower next year than they are currently.

Example of How This Might Work

Let's say you're getting ready to retire. In the past you have given regularly a total of $10,000 annually to various charities. You'd like to continue to support these charities.

But you don't know whether you can afford to keep giving when you're no longer working. At the same time, because of stocks you've bought over the years with information you've gained at your investment club meetings, you own several stocks with large gains.

Thus, you might consider giving $50,000 worth of stock this year to the DAF, taking advantage of current market values. This would give you a good deduction this year. If you can't use it all this year, you can carry forward the deduction you didn't use into future years (a five-year limitation).

You invest the money in your DAF and then for the next five years continue to give $10,000 from this DAF. Or you might decide to narrow your list and give $5,000, or whatever amount you choose, per year from the DAF. If the stock market cooperates, the money that remains in the DAF may continue to grow in the fund without being currently taxed so that the corpus grows. With a little bit of luck, you may end up being able to give more than the original $50,000 to charities, although you won't be able to take any additional tax deduction.

Conclusion

With many stock market prices hitting all-time highs and the current tax law, we think donor-advised funds offer a good tax-planning tool for those who are charitably inclined. Donor-advised funds can be a powerful vehicle for doing well by doing good, generating tax savings, facilitating tax-free growth and unlocking the potential of investments with significant gains. As they say, a win-win for all concerned!

Alexandra Armstrong is a CERTIFIED FINANCIAL PLANNER and chairman and founder of Armstrong, Fleming & Moore, Inc., a registered investment advisory firm located at 1800 M St. NW, Suite 1010-S, Washington, D.C. 20036-5813, 202/887-8135.

Christopher Rivers, a CERTIFIED FINANCIAL PLANNER and co-author of this article is a principal of Armstrong, Fleming & Moore, Inc. Securities are offered through Commonwealth Financial Network, member FINRA/SIPC.

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