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WEALTH MANAGEMENT

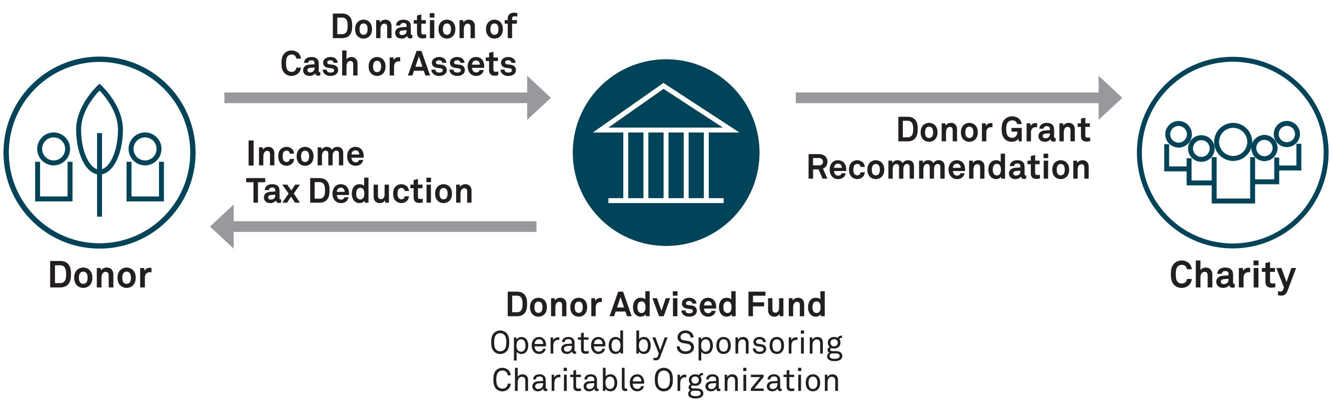
# Best Practices for Leveraging Donor Advised Funds

The key to unlocking DAF dollars is not by relying on potential legislative changes, but by recognizing that DAFs are simply another vehicle for charitable giving.

Donor advised funds (DAFs) have become an increasingly popular option for donors seeking to fulfill their philanthropic goals. In order to understand how charities can tap into DAF assets, it is important to be familiar with the mechanics of DAFs, the features that make them attractive to donors and the creative ways that donors are utilizing them. With that knowledge, fundraisers and charities can more effectively employ strategies to reach donors with DAFs.

## Rules of the Road

According to section §4966(d)(2) of the Internal Revenue Code, a DAF is defined as a separately identified fund or account owned and operated by a sponsoring organization. Each account is composed of contributions made by individual donors. Once the donor makes the contribution, the sponsoring organization has legal control over the funds and the donors have advisory privileges with respect to the distribution of funds and the investment of assets in the account. The following illustration provides an overview of the relationship between the donor and the sponsoring organization:




The process flow for DAFs can be divided into two phases: gifting and granting. This two-part process is one of the reasons that DAFs are distinct from other giving vehicles and appealing to certain donors.

## Gifting

Donors make an irrevocable gift to a DAF and, if they itemize deductions on their income tax returns, may receive an immediate tax deduction in the year the gift is made – up to 60% of adjusted gross income (AGI) for gifts of cash; up to 30% of AGI for gifts of publicly traded securities. Depending on the sponsoring organization's rules, donors can not only make gifts of cash and marketable securities, but of complex, non-cash assets as well. Donors should consult with their personal tax advisor when contemplating gifts to a DAF.

## Granting

The second phase of the DAF process occurs when donors make grant recommendations to benefit a particular charity. The Internal Revenue Service (IRS) has specific guidelines around which kinds of organizations are eligible to receive grants, as well as what purposes those grants may serve. The chart below highlights the granting guidelines outlined in the Internal Revenue Code, section §4966:

| Allowed | Not Allowed |
| --- | --- |
| **Grants can only be made to Qualified Charities, which include:**<br>• Domestic 501(c)(3), 509(a)(1) and 509(a)(2) public charities<br>• Governmental units qualified to receive tax-deductible charitable contributions<br>• Private operating foundations<br>• Some public charities classified under 509(a)(3)<br>**Expenditure Responsibility:**<br>Other domestic charitable organizations and foreign charities (equivalency determination) | **Grants cannot be made to:**<br>• Any natural person<br>• Non-qualifying organizations (unless expenditure responsibility)<br>**Grants cannot be used for:**<br>• A purpose other than charitable purpose within meaning of 501(c)(3)<br>• Grants resulting in donor or related person receiving more than an incidental benefit. Examples of more than an incidental benefit include admission price for an event or gala, charitable auctions, certain memberships, etc. |

Historically, grants could not be used to satisfy legally binding charitable pledges. However, the release of Notice 2017-73 by the Department of the Treasury and the IRS potentially changes that limitation. Section 4 of the notice states that grants that fulfill the personal pledge of a donor, even a legally binding pledge, would not be treated as “more than incidental benefit” under Section 4967 of the Internal Revenue Code, as long as:

- The sponsoring organization makes no reference to the existence of a charitable pledge when making a distribution
- No donor/advisor receives, directly or indirectly, any other benefit that is more than incidental on account of the DAF distribution
- The donor/advisor does not claim a charitable contribution deduction for the DAF distribution (even if the receiving charity mistakenly sends a tax acknowledgement)

While a section of the notice states that it may be relied upon until additional guidance is issued, many sponsoring organizations and grantee charities are waiting for a more definitive ruling.

## Popularity

Ask any salesperson at a car dealership and they will tell you that the features of a vehicle often get the attention of a buyer, but the benefits of those features ultimately influence the decision to purchase. Similarly, the benefits of DAFs have helped to fuel its growing popularity.

| Feature | Benefit |
|---|---|
| **Simple to establish** | Typically, only a short application and/or fund agreement is needed to open a DAF account. Some sponsoring organizations allow the documents to be completed online. |
| **Easy to understand** | The simple structure and process flow of DAFs make them easy for donors to understand and advisors to describe. |
| **Flexible and cost effective** | DAFs are used not only for simple outright granting, but also for complex wealth planning and alongside private foundations. The overall administrative services and investment choices are often competitive from a cost standpoint. |
| **Mostly portable** | Although the rules differ from one sponsoring organization to another, most allow for the "transfer" of th assets in one DAF account to another DAF account at a separate charity. |
| **Accessible** | Many DAF sponsors offer mobile-optimized online portals accessible by smart devices without the need for an app. These portals feature 24/7 access to online granting, statements, tax substantiation letters and transactions. |
| **Tax advantaged** | Contributions are tax deductible in the year gifted and grow tax-free. Many donors find it easier to give a single gift to a DAF and receive one tax substantiation document rather than collecting multiple tax documents for multiple donations. Donors are also able to "bundle" gifts to charities through DAFs. |
| **Typically no required minimum distribution** | Allows donors to plan for an impactful grant or series of grants in the future. |
| **Anonymous granting** | Unlike private foundations, giving through a DAF allows donors to remain anonymous. It is appealing to a certain segment of the population, such as high-profile families and celebrities. |
| **Investment options** | DAF accounts are managed by investment professionals, are cost effective and offer many options for donors to customize their asset allocation, including environmental, social, governance (ESG) and impact investing. Some sponsoring organizations allow donors to use their personal financial advisors to invest their DAF accounts, giving advisors and donors an incentive to use DAFs in lieu of other charitable giving vehicles. |

## Donor's Motivation

Donors use DAFs as charitable giving vehicles in a variety of ways. The following table summarizes some of the primary reasons that donors use a DAF:

| Feature | Educating | Committing |
|---|---|---|
| • As part of tax planning or a liquidity event<br>• Philanthropy as a part of overall financial planning | • To guide, develop and teach family about philanthropy and family values<br>• Training for the next generation and/or successors to the family foundation | • Demonstrating an affinity for one charitable organization<br>• Private-label or single-use donor advised fung |

## Strategies to Leverage DAFs

Stewarding donors with DAFs is important for all charities and can have a meaningful impact. The chart below highlights strategies for fundraisers and charities to consider.

| Fundraisers | Charities |
|---|---|
| **Focus on your donor:**<br>• Recognize a DAF donor's affinity for your organization<br>• Acknowledge donor's relationship with his or her current DAF<br>• Incorporate DAFs into your donor conversations – annual giving, succession plans, etc.<br>**Familiarize yourself with DAF "rules of the road"**<br>• Encourage recurring gifts and legacy gifts (naming your charity as remainder beneficiary)<br>• Help donors comply<br>• Become the DAF expert within your organization<br>**Remember that DAFs are simply another vehicle for giving**<br>• Your donor's charitable intent is what occurs | **Recognize DAF donors' affinity for your organization**<br>*Thank DAF donor, not sponsoring organization*<br>• Do not provide tax substantiations to either<br>*Recognize both the donor and gift officer*<br>• DAF donors in legacy society?<br>• DAF grants in annual giving or campaigns?<br>**Examine internal policies and procedures**<br>• Determine how DAF grants tacked and captured<br>• Designate DAF-only donors in database<br>• Revisit gift forms, agreements, etc. to make DAF-inclusive (i.e., not using the word "pledge")<br>**Incorporate DAF information in marketing efforts**<br>• Educate on how DAF grants benefit organization<br>• List DAFs in "ways to Give" section on website<br>**Make sure DAFs can easily find your organization**<br>• Pub 78 and IRS BMF: GuideStar, IRS Select Check<br>• Reply promptly if contacted by a sponsoring organization, as a grant has already been recommended by a donor |

Charities can go one step further by offering a DAF program, giving them an additional charitable planning tool and stewardship opportunity. This would be accomplished by sponsoring their own DAF program or participating in a private-label DAF offered by a different organization.

## Conclusion

The key to unlocking DAF dollars is not by relying on potential legislative changes, but by recognizing that DAFs are simply another vehicle for charitable giving. To many donors, DAFs are not that far removed from their brokerage accounts or revocable trusts. Charitable organizations and individual fundraisers must take positive steps to engage DAF donors. They must practice, in a word, stewardship.

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