

## DONOR ADVISED FUND STRATEGY

*Get your deduction now, and pick your charity later.*

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*“No one has ever become poor by giving” - Anne Frank*

When I think of Donor-Advised Funds (DAF), the above quote by Anne Frank keeps coming back to me. As an advisor to my clients, two common goals are frequently brought to my attention: their desire to make a difference in others' lives and their need to find tax-efficient strategies. A Donor-Advised Fund is a strategy that meets both those goals and creates an infrastructure for long-term charitable giving in a tax-efficient way.

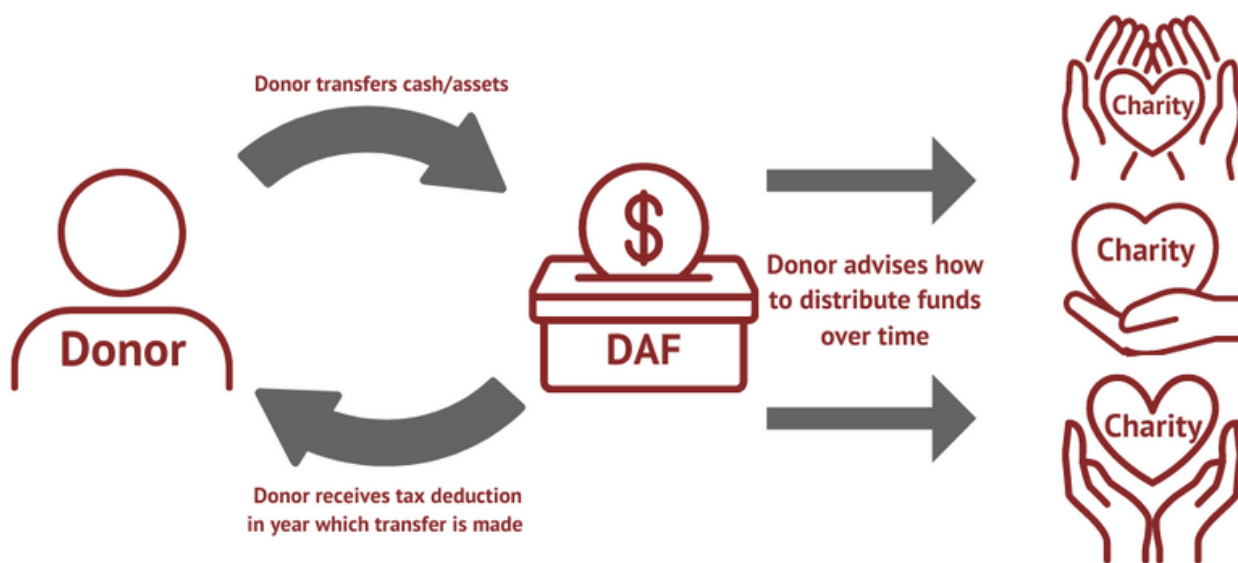
### **WHAT IS A DONOR-ADVISED FUND?**

A Donor-Advised Fund is a charitable giving vehicle that allows individuals, families, or organizations to make a charitable contribution, receive an immediate tax deduction, and recommend grants from the fund over time. Essentially, it acts as a charitable savings account. Think of a DAF as a charitable account that enables you to initiate, invest, and distribute charitable gifts at your convenience.

### **HOW DO DONOR-ADVISED FUNDS WORK?**

1. **Contribution:** A donor contributes assets (cash, securities, or other assets) to a Donor-Advised Fund, which a sponsoring organization like Schwab Charitable typically manages. Contributions go into a charitable account on behalf of the donor. That donor can make future contributions to the same DAF for years to come.
2. **Tax Deduction:** Donors receive an immediate tax deduction for their contribution to the fund. This is because the donation is irrevocable, meaning the assets now belong to the fund and are earmarked for charitable purposes. This can be advantageous in years of high income or other circumstances where you would need a significant tax deduction.

3. **Grant Recommendations:** Donors can then recommend grants from the fund to qualified charitable organizations. The sponsoring organization typically has guidelines to ensure that the recommended grants comply with IRS regulations for charitable giving. Which means you can only make grants or donations to 501(C)(3) charities. There is no limit on how much or how often you may make donations from your DAF account.
4. **Investment Growth:** The assets within the Donor-Advised Fund account can be invested for potential tax-free growth, and donors can continue to contribute additional funds to the account over time. This can allow your charitable dollars to grow while you are deciding the right time and charity to donate to.
5. **Anonymity:** In many cases, donors can choose to remain anonymous when making grant recommendations, as the grants are made in the name of the fund rather than the individual donor.



### **WHEN IS A DONOR-ADVISED FUND STRATEGY MOST BENEFICIAL TO INVESTORS?**

#### **Need for immediate tax deduction for future charitable grants.**

If you have a year of higher-than-normal income due to realized capital gains in your portfolio, have exercised employment-related options (ISO or NQSO), or any other unique event where your income will push you into a higher tax bracket, setting up a Donor-Advised Fund account could be highly beneficial from a tax efficiency point of view.

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### **Investors would like to create a legacy of giving.**

A Donor-Advised Fund account can be a great way to create a charitable legacy for you and your family. You can contribute to your account over your lifetime, and upon your passing, your heirs can continue to use the funds in your DAF to make grants to charities over time. This way, you can maintain a tradition of giving in your family for generations.

### **Pairing a Donor-Advised Fund strategy with a Roth Conversion Strategy**

For those looking to implement a Roth Conversion Strategy, the hurdle to successful implementation is often the high tax burden that comes with converting assets from Traditional IRA to Roth IRA. Pairing a Roth Conversion with a contribution to a Donor-Advised Fund in the same year allows individuals to balance their taxable income, thus reducing the effective cost of the conversion.

### **Need for diversification of low-cost basis stock.**

Often, long-term investors find themselves holding a high concentration of low-cost basis stock in their portfolio. Over time, this stock can start to reduce the optimum level of diversification in the portfolio, which can lead to high volatility of returns or, worse, poor long-term returns.

In such cases, investors are often discouraged from selling these positions due to the exposure to realizing long-term capital gain tax. By using the Donor-Advised Fund, investors can use these low-cost basis stocks to transfer assets into their DAF account without any long-term gain. Once the securities are transferred, they can be sold tax-free, and funds can be used to achieve proper diversification.

### **Reducing the tax effects of Required Minimum Distributions (RMDs)**

Contributing your RMD amounts to your Donor-Advised Fund account provides you with the tax deduction to offset the income from your RMD. (Please note that for this to be beneficial, investors must be able to itemize their deductions, and there may be limitations to the deduction you can take). Your RMD funds will also continue to grow tax-free over time till you make the grant to qualified charities.

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It is essential to highlight that for those investors who do not itemize or want to donate less than \$100,000 to a charity directly in the same year, there is another charitable strategy called Qualified Charitable Distribution (QCD) that might be helpful to reduce the tax burden of RMDs.

### **THINGS TO BE MINDFUL OF REGARDING DONOR-ADVISED FUND STRATEGIES**

**Any transfer to a DAF is irrevocable** – Once you transfer assets or cash to a Donor Advised Fund account, the gift to charity is made. You cannot reverse this transfer, and the funds are only available for the use of charitable grants to 501(c)(3) charities.

**Minimum grant requirements** - Most Donor-Advised Fund sponsors, including Schwab Charitable, have requirements relating to minimum grants to be made in a certain number of years. For example, in the case of Schwab Charitable, you must make at least a \$50 grant to a charity in a three-year period from your DAF account.\*

**You must be able to Itemize your deductions** – To achieve this strategy's tax benefit, you must be able to use itemized deductions on your income tax return. In 2023, a single filer can itemize if their total deductions exceed \$13,850, and for married filing jointly, that number is \$27,700 in 2023.\*\* You should consult with your financial and tax advisors to ensure you can benefit from this strategy.

**Administration Cost** – Most Donor-Advised Fund sponsors charge an administrative fee on these accounts. Over time, these fees can potentially reduce the charitable impact of these donations. In most cases, all fees are charged from the account. In the case of Schwab Charitable, the administrative fee structure starts at 60 basis points (0.60%) annually and is reduced for balances over \$500,000 or more.\* Other sponsors might have different fee schedules. Investors should carefully review fees and expenses related to these accounts. Professionally managed accounts might incur additional fees and expenses by your investment professional.

\* These costs and minimum requirements are specific to Schwab Charitable. Read more at <https://www.schwabcharitable.org/>

\*\* These standard deduction amounts are specific to 2023. Read more at <https://www.irs.gov/>

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In summary, a Donor Advised Fund is a wonderful strategy for someone who enjoys giving to great causes and does so regularly. The added benefit of tax deduction and tax-free growth of your charitable dollars can provide you with the satisfaction that some say money cannot buy...

If you have additional questions regarding this strategy, please do not hesitate to contact me or your financial advisor or tax professional. The mention of Schwab Charitable in this article is not to be considered our recommendation for a Donor-Advised Fund sponsor. Please consider the fees and expenses of all sponsoring financial institutions to select the best selection for your needs.

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