BRADFORD TAX INSTITUTE

May 2022

Donor-Advised Funds: A Tax Planning Tool for Church and Charity Donations

Do you give money to your church?

Do you get a tax benefit from those donations?

How about your donations to other charities?

Recent changes in the tax code have done much to destroy your benefits from church and other tax-deductible 501(c)(3) donations. But there's a way to donate the way you want, get revenge on the tax code, and realize the tax benefits you deserve.

This get-even tool is the donor-advised fund, an increasingly popular way to donate to your church and other 501(c)(3) organizations. Indeed, donor-advised funds have exploded over the past few years, with over one million donor-advised fund accounts in existence as of 2020.[1]

If you're charitably inclined, there are many benefits to donor-advised funds and few drawbacks, as you will see in this article.

What Is a Donor-Advised Fund?

A donor-advised fund is not a separate charitable entity. It is a charitable giving account you establish with a "sponsoring organization," which must be a Section 501(c)(3) organization.[2] (This differs from a private foundation, which is a separate legal entity established and controlled by its founders—and is much more complex and expensive to establish and administer.)

With a donor-advised fund, you make a charitable gift of cash or property to an account maintained by the fund. The fund—not you—owns and controls the assets in the account. But you control to whom and when the fund disburses the money.

Big picture. You donate $100,000 to the fund today. You get the $100,000 deduction now. From the fund, you donate $10,000 a year to your church (probably more as your money in the fund grows tax-free).

You Don't Need to be Rich to Have a Donor-Advised Fund Account

Anyone can open a donor-advised fund account, and you don't have to be rich to do so. Depending on the sponsor, the required minimum initial contribution to establish a donor-advised fund account typically ranges from $1,000 to $25,000. But some donor-advised funds—including Fidelity Charitable, the nation's largest donor-advised fund—have no minimum initial contribution requirement at all.

In contrast, given the costs involved, experts say you need at least a $10 million to $15 million contribution to make a family charitable foundation worthwhile.

It's Easy

It's easy to establish a donor-advised fund account. You choose a charitable sponsor, complete an application (ordinarily online), and make your initial contribution. You also get to name your donor-advised fund account.

The donor-advised fund sponsor takes care of all the recordkeeping and account administration. Most donor-advised fund sponsors charge nothing to set up your donor-advised fund account, but they do charge administrative and money management fees.

There are hundreds of public charities, including some churches, that sponsor donor-advised funds.

National investment firms such as Fidelity, Schwab, and Vanguard have all created donor-advised funds. These "commercial" donor-advised funds hire an affiliated for-profit investment firm to manage the assets in the accounts for a fee that varies based on the account balance.

You can also establish a donor-advised fund account with a community foundation that has a local orientation; a single-issue non-profit, such as a university or an environmental charity like the Sierra Club; or an independent, non-commercial organization such as the American Endowment Foundation, National Philanthropic Trust, or United Charitable.

Donor-advised fund sponsors have differing policies as to what type of property they accept, how they will invest it, and how they will distribute it. Their fees differ as well. It pays to shop around.

You Can Contribute Money or Property to a Donor-Advised Fund

You can always donate cash, including money in IRAs and 401(k)s, to your donor-advised fund account. But many donor-advised funds also accept non-cash donations, including

- stocks, bonds, and mutual fund shares,

- real estate,
- privately owned company stock,
- LLC and limited partnership interests,
- Bitcoin and other cryptocurrency, and
- life insurance.

Whether you contribute money or property to a donor-advised fund, your contribution is an irrevocable charitable gift. The sponsoring charity now owns the gifted assets, and you can never get them back. The donor-advised fund must give you written acknowledgment of this fact.[3]

If you donate property such as private company stock, real estate, or Bitcoin with a value over $5,000, you need to get an appraisal. This is not required for publicly traded stock or other securities.[4]

Donating stock or mutual fund shares that have appreciated is a great tax strategy. Here's why:

- If you owned the stock for more than one year, you get a deduction equal to its fair market value at the time of the donation.
- And you don't pay any capital gains tax on the appreciated value of the stock.[5]

The donor-advised fund will never owe that capital gains tax either, if it later sells the stock.

Example 1. Darius owns 1,000 shares of Evergreen stock that's publicly traded on NASDAQ. He paid $10,000 for the stock back in 2010, and the shares are worth $100,000 today.

He establishes a donor-advised fund in 2022 and donates the stock.

- He gets a $100,000 charitable deduction for 2022.
- He pays no federal tax on his $90,000 gain.

Contributing stock to donor-advised funds is very popular. Fidelity Charitable reports that 57 percent of all contributions to its donor-advised fund accounts in 2020 were in the form of publicly traded securities.[6]

Donor-Advised Fund Contributions Are Flexible

After making the initial contribution, you have near total flexibility on how much to contribute to your donor-advised fund in future years. There is no legal requirement that you make any additional donations after you establish a donor-advised fund. You can donate as much or as little as you want each year. Most donor-advised funds do not have annual minimum contribution requirements.

Donor-Advised Fund Contributions Are Fully Deductible the Year They Are Made

A contribution to a donor-advised fund account is treated much the same as a donation to your church, a school, or other 501(c)(3) organizations. It is deductible in the year made.[7]

But there is an annual limit on how much you can deduct for all your contributions to charity, whether through a donor-advised fund or otherwise. For 2022, the limits are as follows:[8]

- For **cash contributions**, the limit is 60 percent of your adjusted gross income.
- For **property contributions**, such as corporate stock, it’s 30 percent of your adjusted gross income.

You may carry excess contributions forward until they’re used, but not for longer than five years.

Donor-Advised Funds Can Help You Bunch Your Charitable Contributions

You are able to deduct your charitable contributions only if you itemize your personal deductions on your tax return instead of taking the standard deduction. The Tax Cuts and Jobs Act roughly doubled the standard deduction in 2018.

For 2022, the standard deduction stands at $25,900 for marrieds and $12,950 for singles.[9] As a result, few taxpayers itemize—only about 11 percent. Thus, few taxpayers are able to deduct their charitable deductions.

One way to deduct charitable contributions if you don’t have a lot of other personal deductions is to bunch them into a single year instead of making them over several years. This will give you enough personal deductions to itemize in the bunch year. You don’t need a donor-advised fund account to do this, but the fund certainly makes it easier.

Example 2. Doug and Darla are a married couple who ordinarily take the standard deduction because their total personal deductions (mortgage interest, state taxes, medical expenses) are no more than $20,000 per year.

They plan to donate $5,000 to their church each year over the next five years. If they do so, they won't be able to deduct their contributions because their personal deductions will amount to less than the standard deduction.

Instead, they establish a donor-advised fund account and donate $25,000 in 2022, and then plan to donate nothing to the fund for the next four years.

Their 2022 personal deductions are now $45,000, and they are able to itemize and deduct their charitable contribution. They need not choose in 2022 how to gift the $25,000 they contributed to their donor-advised fund account. They can take their time and decide how to donate the money over the next one, five, or more years.

Donor-Advised Funds Help with Economic Windfalls

A donor-advised fund account can be very helpful if you come into a large sum of taxable money in a single year and enter an especially high tax bracket—for example, when you sell your business or enjoy substantial investment returns. You can establish a donor-advised fund, deduct the full amount of your contribution that year at your high tax rate, and then distribute the money to charity over any number of future years.

Example 3. Andrew and Alicia, a married couple, sell their business for a $1 million profit in 2022.

They establish a donor-advised fund account and contribute $200,000. They deduct the full $200,000 in 2022, saving them about $90,000 in federal and state income tax.

They plan to use the money in their donor-advised fund account to give $20,000 to charity each year over the next 10 years.

You and Your Sponsor Make Investment and Grant Decisions

The assets in a donor-advised fund account are owned and controlled by the charitable sponsor, who makes the final decision on how they are invested and distributed as grants to charity.

But you have advisory privileges over the investment and distribution of the account assets. The charitable sponsor will usually honor your grant recommendations so long as the grants are given to qualified 501(c)(3) charities.

You can use your donor-advised fund account to contribute to any number of charities each year, or to make recurring grants to a single charity over multiple years. Your donor-advised fund sponsor can help advise you about how best to utilize the assets in your account.

As you would expect, you can't use the assets in a donor-advised fund account to benefit you or your relatives personally.

For example, you can't use money in your account to pay for tickets to attend a charity-sponsored event.[10] If you want to receive goods or services (such as tickets) offered by a charity in exchange for a contribution, you should make the contribution from other funds.

Donor-Advised Fund Assets Need Not be Distributed Each Year

There is no legal requirement to distribute to charity any of the money or other property held in a donor-advised fund account. Theoretically, you can donate money to a donor-advised fund account and never distribute it to any charity.

But some charitable sponsors do require a minimum amount to be distributed over a specified number of years. Fidelity Charitable reports that three-quarters of contributions placed in its donor-advised fund accounts are distributed as grants within five years.[11]

Donor-Advised Funds Are Not Subject to Estate Tax

Assets in a donor-advised fund account are not subject to estate tax. This is because your estate doesn't own them —they are owned by the sponsoring charity. Of course, this is important only if your estate is large enough to be subject to estate tax. For 2022, the federal estate tax applies only to estates over $12.06 million.[12] A few states impose taxes on smaller estates.

Donor-advised fund accounts can continue perpetually.

When you establish your donor-advised fund account (or after you have created it), you can name a successor who will take over making grant recommendations after you die.

Takeaways

Here are four takeaways from this article.

1. A donor-advised fund is a charitable giving account established with a tax-defined charitable sponsor. You find such funds at Fidelity, Schwab, and other investment houses, along with some national Section 501(c)(3) organizations such as the Red Cross.

2. The money or property donated to a donor-advised fund account is owned and controlled by the charitable sponsor, not you (the giver). But you generally direct the distribution of the funds from general accounts such as those at Fidelity to your church, a school, or other local or national 501(c)(3) organizations.

3. Donor-advised fund account contributions are deductible in the year they're made, up to annual charitable contribution limits. There is no legal requirement to donate a minimum amount to a donor-advised fund in any year after the account is established.

4. The assets in a donor-advised fund account grow tax-free until they are distributed as grants to charity, but there is no legal requirement that a minimum amount be distributed in any year. This enables you to obtain an immediate tax deduction for your donor-advised fund contributions while spreading your gifts to your church and other 501(c)(3) charities over many years.

1 National Philanthropic Trust, The 2021 Donor Advised Fund Report.
2 IRC Section 4966(d)(1).
3 IRC Section 170(f)(18)(B).
4 IRS Publication 526, Charitable Contributions (2021), dated Feb. 24, 2022, p. 21.
5 Ibid., p. 12.
6 Fidelity Charitable, 2021 Giving Report, p. 5.
7 IRC Section 170(f)(18).
8 IRC Section 170(b); IRS Publication 526, Charitable Contributions (2021), dated Feb. 24, 2022, ps. 15-16.
9 Rev. Proc. 2021-45.
10 IRS Notice 2017-73.
11 Fidelity Charitable, 2021 Giving Report, p. 5.
12 Ibid.