PUGH CPAs

Donor-Advised Funds: Giving with a Tax Advantage

If you donate to charitable organizations, you might want to consider establishing a donor-advised fund. A donor-advised fund is a charitable tax-saving tool that enables you to maintain a certain level of control over how funds are distributed while receiving immediate tax benefits.

Opening a donor-advised fund is like starting a charitable investment account, where your money can grow tax-free and be used to support non-profit organizations of your choosing. Even better, you can claim an immediate tax deduction for funds placed in the account enabling you to reduce your adjusted gross income, while still contributing to the greater good.

How Donor-Advised Funds Work

A donor-advised fund is established by making an irrevocable contribution to a fund that is controlled and managed by a third-party called a sponsoring organization.

The sponsoring organization is typically a bank, financial institution, community foundation, or individual charity that will invest the money where it grows tax-free.

You will receive an immediate tax deduction for the amount contributed up to a certain limit; beyond that, the deduction can be carried forward for up to five years.

As the donor, you can recommend how the funds should be donated. As long as the funds are donated to registered 501(c)(3) organizations and don't provide personal benefit to the donor, the sponsor will typically carry out the donor's recommendations.

There is no timeframe on when funds must be disbursed, but the funds must eventually be donated to a registered 501(c)(3) organization.

Benefits of a Donor-Advised Fund

Donor-advised funds are a great way to save on taxes and support charities that are near and dear to your heart. Here are a few advantages of DAFs:

You can maximize tax deductions now while being able to contribute to charities over an extended period of time. If you donate year after year to charity, you only receive a tax benefit in any given year if you itemize and exceed the standard deduction. By aggregating your charitable contributions into a single year, you're better able to exceed the standard deduction and maximize your itemized deductions. Plus, with this strategy, you're able to take deductions now instead of waiting until the donation is made.

Many charities are not set up to accept non-cash donations such as public securities, restricted stock, cryptocurrencies, private equity positions, or shares in privately held companies. Many sponsoring organizations make it very simple to contribute these types of assets to your fund.

With a donor-advised fund, you can reduce or avoid capital gains tax on appreciated assets. If you contribute appreciated assets to the fund, you can avoid being taxed on the capital gain so long as the asset has been held for at least a year. For appreciated assets, you can claim an immediate tax deduction of up to 30% of your adjusted gross income.

Your charitable contribution can grow tax-free. While your donor-advised fund grows, it is not taxed. So, an initial donation of $20,000 could eventually grow and provide, say, $30,000 in charitable funds to nonprofits of your choice over time.

Your donor-advised fund can last in perpetuity. You can appoint co-advisors and/or successors to ensure your heirs and loved ones will always have input over how the DAF funds are disbursed.

You can reduce paperwork. With a donor-advised fund, you can give to various charities over the year and receive a single document outlining all of your charitable deductions. This is a bit simpler than tracking donations to 20 different non-profits.

Drawback of Donor-Advised Funds

While there are many benefits of DAF, there are also a few drawbacks:

Donor-advised funds are irrevocable, so you are not able to get your money back for any reason.

Donor-advised funds are managed by the third-party sponsor. Even though you can make recommendations on how the funds are donated, you don't technically have the final say. But with that said, most sponsors will act in accordance with your recommendations so long as the recipient is an eligible charity.

Many donor-advised funds require a minimum investment and do have fees for maintaining the account. While you can make a $500 donation to a local charity, it is unlikely you will be able to set up a donor-advised fund with any less than $5,000. As for the fees, most sponsors charge an annual fee based on the amount held in the fund. Typical fees are not onerous but do reduce the amount eventually donated to charities.

Finally, you may not like the investment options provided by the sponsoring organization. For this reason, you'd want to research investment options provided by any sponsoring organizations under consideration.

Final Thoughts

Our firm supports charitable giving, and we really like helping people minimize their taxes, so we're ready to provide practical advice regarding Donor-Advised Funds. If you are interested in learning more about how Donor-Advised Funds can help you achieve your charitable and tax goals, please contact our office for a consultation.

About Pugh CPAs

We got our start in Knoxville, Tennessee in 1969 and have grown into a regional firm with global connections. We've been in business a LONG time and that means we've worked with a diverse group of industries and clients. Of course, we do tax planning, compliance, auditing, and accounting but our passion is collaborating with our clients to ensure that your business and financial goals are met. It's critical for your business advisors to understand how your business operates within your industry—we get that! Our longevity is connected to the relationships we build with our clients and that's how we build trust. You can be confident that Pugh CPAs has the knowledge, skills and abilities to help you achieve your goals. Brilliant people with servant hearts work here.

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