DONOR-ADVISED FUNDS OFFER TAX SAVINGS AND A PATH TO BOOST CHARITABLE GIVING

by: Tim Sullivan, CFP®, EA

Despite the rollercoaster ride the stock market has taken in 2020, many investors have profited handsomely on investment portfolios over the last 10 years. For individuals with appreciated assets in taxable accounts, a Donor Advised Fund (DAF) may present an ideal vehicle to boost philanthropic giving with the bonus of saving tax dollars along the way.

When stocks or bonds are held by an investor for longer than one year, any sale triggers a long-term capital gain on assets that have increased in value. Long-term capital gains are taxed at the preferential long-term capital gain rate of 0, 15, or 20% depending on the owner's income bracket. Prior to the sale, any gain or loss is considered "unrealized."

The owner may have gained or lost money on paper, but without selling the asset, there is the opportunity for the value to continue to fluctuate up or down.

For charitably inclined investors facing capital gain taxes on these sales, this situation may present an advantageous financial planning opportunity. Consider a married couple back in 2017 with an AGI of $150,000 and $24,000 in itemized deductions including a $10,000 donation to charity. Instead of donating the money in cash, they donated $10,000 in stock from their taxable portfolio with a basis (what they paid originally) of $4,000.

The sale of such stock would have triggered a capital gain tax of 15% on the now-realized gain of $6,000. But by donating the stock to charity, they were able to take a charitable deduction of $10,000, saving $2,800 in income taxes while also permanently avoiding $900 in capital gain taxes - a rare double tax benefit.

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The previous scenario is correct, but only if a taxpayer can itemize deductions. However, the Tax Cuts & Jobs Act that went into effect in 2018 reduced the number of taxpayers itemizing charitable contributions by more than half as households like the one above no longer had itemized deductions exceeding the increased standard deduction.

Because of these tax law changes, a donor advised fund may be a useful option to consider. A DAF is a philanthropic vehicle that allows for the irrevocable gift of appreciated assets to a charity qualified as a 501(c)(3) organization. This organization essentially acts as a conduit to hold the donated funds - typically in conservative investments - before distributing the assets to the other qualified non-profits over time as directed by the original donor. The investor receives an immediate IRS - allowable tax deduction upon completion of the transfer with the ability to spread out their charitable giving beyond the current year.

Using the example couple, assume for the 2020 tax year they decide to bundle their charitable giving for three years into one larger donation of $30,000 in appreciated assets which they direct to a DAF. When combined with their other itemized deductions, they would exceed the standard deduction and receive a charitable deduction of $30,000 in 2020 while permanently avoiding the capital gains tax on the sale. They could then use those assets to support their intended charities over the next several years by directing distributions from the DAF as they choose.

Most large financial custodians such as Vanguard, Schwab, or Fidelity operate DAFs. Closer to home, the Community Foundation of Mid-Missouri works with individuals to establish donor advised funds and can offer greater flexibility than some of the large custodians. Consider using a DAF in 2020 and by the end of the year, you may be able to put a little more in the coffers of your favorite charity - an a little less in those of Uncle Sam!

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