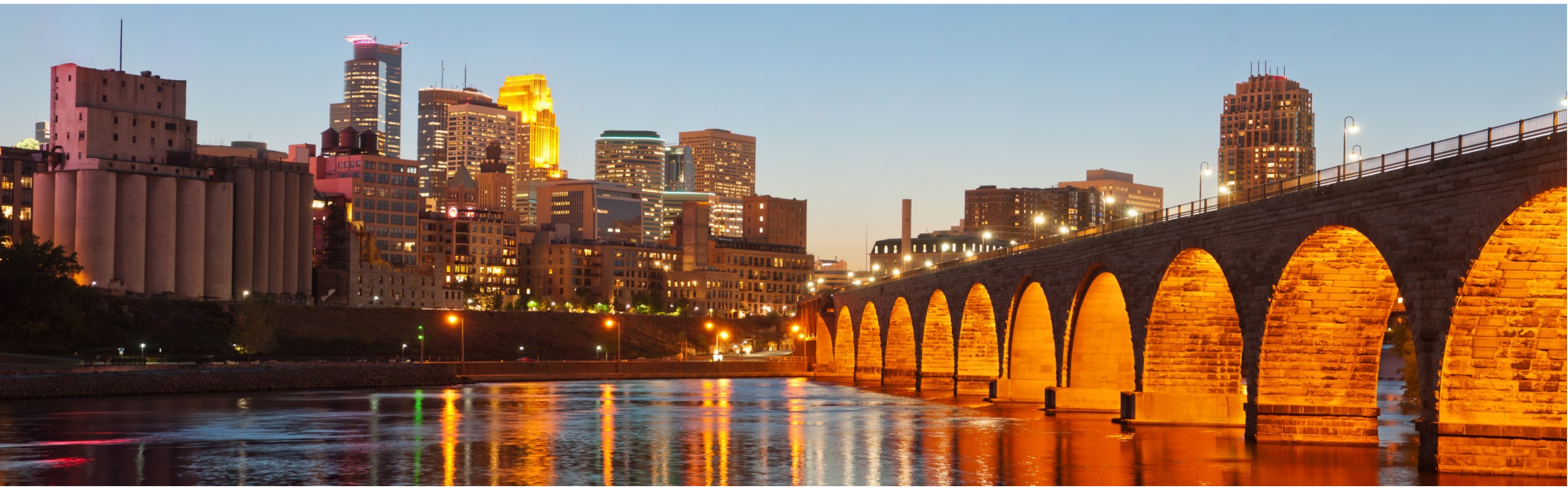
The Bridge Research Article:
A Look Into Donor Advised Funds

August 6, 2019

By: Patrick Kincade, Director of Marketing



Donor advised funds have become one of fastest growing vehicles in charitable giving. In 2018 they accommodated for more than 37% of all donations in the United States. In an article I wrote last fall titled Tax Cuts and Jobs Act-The Impact on Charitable Donations I briefly discussed donor advised funds. For this article I would like to examine what they are and how they may impact the non-profit world.

What Is a Donor Advised Fund and How Do They work?

As described by the IRS, a Donor Advised Fund (DAF) is "a separately identified fund or account that is maintained and operated by a section 501(c)(3) organization, which is called a sponsoring organization." Like an investment fund, you as the donor contribute assets to your account, which have the ability to appreciate. With most donor advised funds these contributions to an account can cover a wide array of assets including cash, stock, bonds, real estate, art and privately held interests.

Since DAFs are operated by a 501(c)(3) as soon as you contribute those assets, they are considered tax deductible (just like contributing directly to a charity, foundation or non-profit). Once an account is established you have the ability to request that the DAF grant (donate) to any charity or non-profit of your choosing.

Direct Contributions vs. Donor Advised Fund's

Growth of Assets

Assets contributed to a DAF have the ability to appreciate through investment vehicles like mutual funds, ETFs and stock/bond purchases, unlike if you make a direct contribution to a charity or non-profit. There are minimums and fees associated with starting an account and growing the assets in an account. While minimums are relatively small, initial fees begin higher and decrease as the size of the account grows. For instance, Schwab Charitable has an account minimum of $5,000 with an annualized administrative fee of 0.60% or $100 whichever is greater and stays this way until your accounts average daily value reaches $500,000 where they drop to 0.30%. There are also investment management fees that can range from 0.15% to 1.11%.

Ease for multiple grants

DAFs make it easy for grantors to select multiple charities at once. Instead of having to write or send individual donations to each charity, the DAF can distribute to multiple charities with less hassle from the grantor. This is especially impactful for a family that all contribute to one DAF, allowing each member of the family to select a charity of their choosing and send a grant from one account.

Payout Requirements

A donor advised fund is legally considered a 501(c)(3), in that when you contribute to the account it is irrevocable. You can then make requests for payouts to charities, request being a key word as DAFs are not required by law to fulfill these requests. While most requests are filled (as that is the purpose of a DAF) it is important to understand the payout rules of a 501(c)(3). According to National Philanthropic Trust, while we have seen a growth in total grants made to charitable organizations (see Figure 1) the payouts on a yearly basis have remained relatively the same, hovering only around 20% (see Figure 5). This is one of the more concerning aspects for charities and non-profits as we continue to see growth in DAF

Figure 1: Total Grants Made by Donor-Advised Funds ($B)

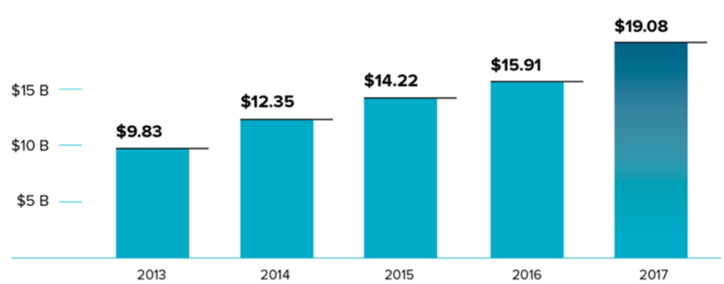
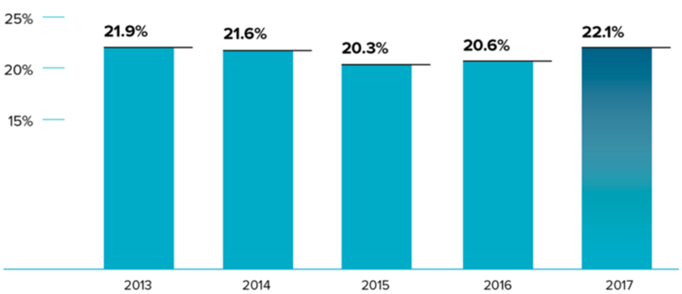


Figure 5: Annual Payout Rate, Total for All Donor-Advised Funds



contributions and very steady payout rates. Much of the accumulated assets in DAFs are sitting with no required payout rules.

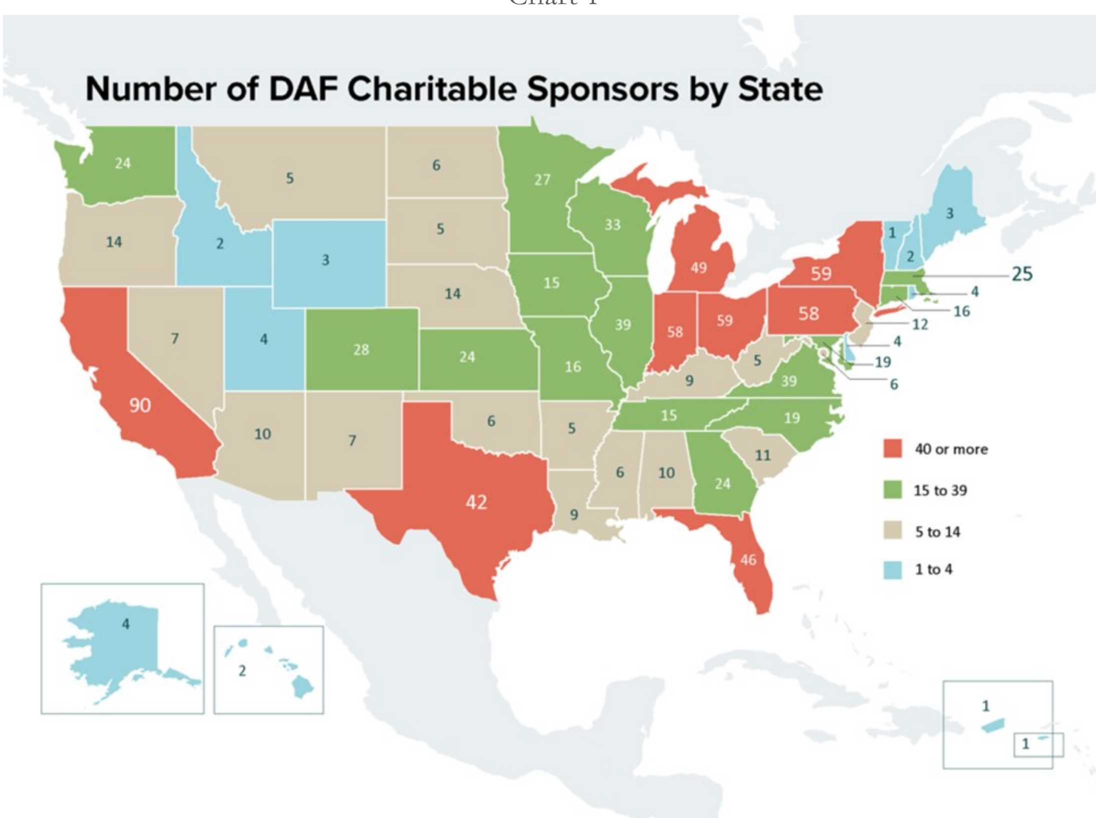
Growth in Donor Advised Funds

According to the National Philanthropic Trust 2018 DAF Report, from 2016 to 2017 contribution increased in donor advised funds by 16.5%. In comparison, Charity Navigator reports that total giving to charities grew at an increase of 5.2% in that same time frame. While total giving directly to organizations is up, the difference in growth between the two is staggering.

In the 2018 DAF Report by the National Philanthropic Trust there was also a large growth in the number of total DAFs, rising 60% in 2017, though largely due to a new national charity that opened a DAF. The span of DAFs across the US has grown as well with DAF sponsors located in "every U.S. state, two territories and the District of Columbia." (chart 1)

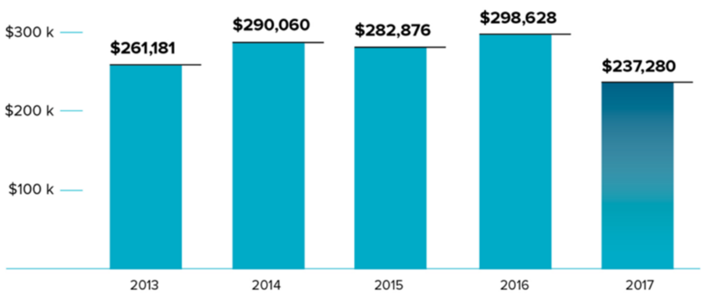
One area of significant interest is the average size of DAFs. While there has been a growth in numbers of advised funds there has actually be a decrease in average size. Many DAFs have minimum account sizes of $5,000, allowing middle income families to seize opportunities in setting up an accounts. Susan J. Link, Attorney and Partner at Maslon LLP, says, "We are seeing more families set up donor advised funds, allowing children and parents alike to get involved and make contributions. And it's not just the ultra-wealthy

Chart 1



utilizing these charitable vehicles anymore." This is reflected in the 2018 DAF Report where average DAF size decreased by 20% (Figure 6). This shift has significantly opened the doors for DAFs to grow amongst different income levels and will likely help expand the overall growth of DAFs.

Figure 6: Average Donor-Advised Fund Size



Tax Benefits of DAFs

James Andreoni, Professor of Economics at the University of California at San Diego, in his analysis "The Benefits and Costs of Donor Advised Funds" states, "The primary financial benefit that DAFs offer to their donors is that of capital gains tax savings." DAFs provide immediate and convenient tax deduction upon contribution. This can be a dual benefit for those looking to avoid capital gain tax on appreciated assets as those contributing receive the charitable donation tax deduction. According to a Warehousing Wealth report, DAFs also provide a different option for tax deductibility wherein donors can deduct anywhere between 30% to 60% versus a private foundation where you can deduct between 20% and 30%. There is also a benefit in regard to estate tax in that contributions are not counted as part of the account holder's taxable estate.

Overall

Growth in donor advised funds has been climbing sharply in the last several years and there does not seem to be any slowdown. The lowering of minimum account size also allows for greater access by middle class families, which will continue to add to the growth and popularity of DAFs.

While they do provide an easy opportunity for people to contribute, donate and reap tax benefits, the major concern for charities is the payout rate. Payouts have remained steady since 2013 only hovering in the 20% area even with growth in contribution. This could cause stree for charities who have relied on annual gifts to execute on their mission.

The non-profit world continues to change and the growth of DAFs has created both opportunity and road blocks. Creativity in fundraising and use of volunteerism will be crucial for this industry as we go forward.

Sources:

Gene Takagi, Nonprofit Radio: Donor-Advised Funds, http://www.nonprofitlawblog.com/nonprofit-radio-donor-advised-funds/

Chuck Collins, Helen Flannery, Josh Hoxie, Warehouse Wealth Donor Advised Charity Funds Sequestering Billions in the Face of Growing Inequality, https://ips-dc.org/wp-content/uploads/2018/07/Warehousing-Wealth-IPS-Report-1.pdf

IRS, https://www.irs.gov/charities-non-profits/charitable-organizations/donor-advised-funds

The 2018 DAF Report, https://www.nptrust.org/reports/daf-report/