The Tax Advantages of DAFs

 By John Nersesian
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A donor advised fund (DAF) is a philanthropic vehicle that is maintained and operated by a public charity. One of the greatest features of DAFs for your clients is the ability to efficiently transfer securities, both public and private, at their fair market value. This means neutralizing the tax concerns of holding certain assets while freeing up mindshare to concentrate on maximizing risk-adjusted returns.

DAFs are widely available, relatively uncomplicated and a cost-effective way to realize charitable aims. They are simpler to set up and less capital-intensive than a private foundation. They also allow for greater control and personal input than direct donations.

Here are a few ways DAFs can benefit a tax plan, and why that's so important now.

Tax benefits of transferring portfolio assets to a donor advised fund:

- **Avoid capital gains taxes on highly appreciated securities.** Making donations using appreciated stock or mutual fund shares is one of the most tax-efficient ways of giving. Donors not only get a tax deduction, they also eliminate paying any capital gains tax.
- **Reduce future tax burden on heirs**. If a client has an IRA or a 401(K) plan with assets greater than heirs will need, making a DAF an IRA beneficiary can offer tremendous tax advantages. Assets are removed from estate and gift tax consideration.
- **Mitigate large expected tax bills.** A deduction for a donation to a DAF is taken in that same year as contribution to the fund, rather than the year of the distribution from the fund to a charitable organization. This allows for the flexibility to minimize taxes in years when your client expects a large tax bill - perhaps from the sale of a business or an inheritance -- while still preserving the ability to make a gift at the right time, emotionally. Additionally, any gifts that exceed AGI limits (50% for cash, 30% for property) can carry forward for up to five years.

Why DAFs are important now:

- **Deductions and capital gains mitigation are more valuable.** Because of the increase in marginal income and capital gains taxes, limiting their effect is now of greater benefit. Charitable donations are more valuable if the investor is impacted by the 39.6% tax rate, rather than the previous top rate of 36%. The same can be said for those paying a capital gains tax of 20% rather than 15%**.**
- **Donation timing is more important.** The reinstituted Pease limitation on itemized deductions can reduce the value of charitable contributions. DAFs allow clients to donate big in a year when the Pease limitation may not apply to them due to lower than normal AGI, allowing them to control the timing of any distributions without forgoing deductions.

- **People are richer.** The recent equity bull market likely means folks are sitting on large liquid gains and highly appreciated securities just waiting to be resourcefully allocated. A DAF may allow an investor to donate highly appreciated securities without realizing capital gains.
- **People are feeling more charitable.** Charitable giving increased by $23 billion, from $335 billion to $358 billion, between 2013 and 2014. We expect that trend to continue, based on research in Giving USA's most recent annual report on philanthropy.
- As charitable giving becomes more important, especially among young and middle class investors, DAFs will become more prevalent.

John Nersesian currently chairs the board of directors