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KayneInsights

July 2026

Donor-Advised Fund Tax Benefits: How to Maximize Charitable Giving

A donor-advised fund is designed to provide a structured way to contribute assets, receive a tax deduction in the current year, and recommend grants to charities over time.

Many investors understand that charitable giving can make a meaningful difference while also helping reduce taxable income. What is less widely understood is how a donor-advised fund allows you to separate the timing of the tax benefit from the timing of your charitable decisions.

A donor-advised fund is designed to do exactly that. It can provide a structured way to contribute assets, receive a tax deduction in the current year, and recommend grants to charities over time.

What Is a Donor-Advised Fund (DAF)?

A donor-advised fund (DAF) is an investment account established specifically for charitable giving. You can fund a DAF with multiple years of contributions and may receive a tax deduction in the year the contribution is made. You also retain the ability to recommend how assets are invested and when grants are distributed to charities over time (monthly, annually, etc.).

Benefits of a donor-advised fund may include:

- **The ability to "bunch" contributions.** You can contribute several years' worth of donations in a single year, which may allow itemized deductions to exceed the IRS standard deduction. This can create a larger upfront tax benefit while supporting charities gradually over time.

- **Potential for tax-free growth.** Assets held within the DAF can be invested, allowing for potential growth that increases the amount available for future giving.
- **Flexibility in tax planning.** Contributions can be timed to align with high-income years, such as those involving large bonuses or other one-time events.
- **A range of contribution types.** DAFs can be funded with cash, publicly traded securities, mutual funds, or other appreciated assets, depending on sponsor guidelines.
- **Long-term planning.** A DAF can support a more structured approach to giving and may allow for family involvement over time.

Tax Benefits of Contributing Appreciated Assets

What tax benefits does a donor-advised fund provide to a taxpayer? A donor advised fund can be funded with a range of appreciated assets, and in certain situations, contributing those assets may offer additional tax advantages.

Here are several considerations for making the most of your contributions.

Avoid Capital Gains Tax

When you contribute appreciated investments directly to a DAF, you generally avoid realizing capital gains taxes on embedded appreciation. For example, if you purchased a stock at $10 and the current price is $50, you would not owe taxes on the $40 of unrealized capital gains associated with the shares you donated.

Receive a Deduction for Fair Market Value

When you donate appreciated assets, you may be eligible to deduct their fair market value at the time of the gift rather than what you originally paid for them, subject to IRS limitations.

That means if you purchased stock for $10,000 and it's now worth $25,000, contributing those shares directly to a DAF may allow you to claim a charitable deduction based on the $25,000 value. At the same time, you would avoid paying capital gains tax on the $15,000 of appreciation, which can make donating appreciated investments more tax-efficient than giving cash in certain situations.

Enjoy Tax-Free Growth Inside the DAF

Investments held in a DAF may grow tax-free, provided they are ultimately distributed to a qualified charitable organization. This means you would not pay taxes on dividends, interest, or appreciation generated within the fund.

Contribution Limits and IRS Rules

While there is no limit on how much you can contribute to a DAF, the amount that can be deducted each year is subject to IRS guidelines.

- **Cash contributions** are generally deductible up to 60% of your adjusted gross income (AGI) for the tax year.
- **Non-cash contributions**, such as appreciated stocks and bonds, are typically deductible up to 30% of your AGI.

If your charitable contribution exceeds these limits in a given year, the IRS generally allows you to carry forward unused deductions for up to five years.

Given the complexity of these rules, it is important to work with a wealth advisor and tax professional when determining contribution amounts and timing.

Who Should Consider a Donor-Advised Fund?

There are a several situations where it may make sense to add a donor-advised fund to your charitable giving strategy:

- **You are a high-income earner in a peak tax year.**
  For example, if you are expecting a large bonus or stock-based compensation event, contributing to a DAF may help offset a portion of that income.
- **You are planning a liquidity event.**
  If you expect to sell a business, real estate, or other appreciated assets, contributing those assets before the sale may help manage a potential tax exposure while supporting charitable goals.

- **You want to front-load multiple years of contributions.**
  If you typically donate $25,000 per year, you could contribute or “bunch” $100,000 into a DAF in one year, locking in the tax benefit now while distributing grants over time.

How to Maximize Tax Benefits with a DAF

A more thoughtful approach to charitable giving may improve overall tax efficiency. This often includes identifying which assets to contribute, determining the timing of those contributions, and aligning the investment strategy of the DAF with your broader goals.

Working with a wealth advisor and a tax professional can help ensure that contribution and distribution decisions are coordinated with the context of your overall financial plan.

How KAR Can Help

A KAR wealth advisor, in coordination with your CPA, can provide guidance on integrating charitable giving into your broader financial strategy. This may include evaluating which assets are appropriate to contribute, identifying tax-efficient timing, and aligning your giving approach with your long-term objectives.

To learn more about whether a donor-advised fund fits within your strategy, connect with a KAR wealth advisor.

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