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# Tax Advantaged Giving: The Donor Advised Fund

Maximize your impact while optimizing tax advantages through contributions to a donor advised fund.

A **Donor Advised Fund (DAF)** is an investment account earmarked specifically for charitable giving. You can fund a DAF with multiple years of charitable contributions and receive a large, upfront tax deduction. Additionally, you have discretion over how your contributions are invested in the DAF and when to distribute assets from the DAF to your favorite charities (monthly, annually, etc.). This article breaks down the unique tax benefits of a DAF and explains who may benefit most from frontloading charitable contributions into a DAF.

## What are the tax-benefits of contributing appreciated investments to a Donor Advised Fund?

A DAF may be funded with a wide range of appreciated assets. These include exchange traded funds (ETFs), mutual funds, stocks, bonds, real estate, LLCs or limited partnership interests, and in some cases even life insurance. Funding a DAF with appreciated investments can provide multiple tax benefits that you can't take advantage of when giving cash.

First, you receive a tax-deduction equal to the appreciated investment's value on the day is it contributed to the DAF. For example, say you bought a stock several years ago for $10 per share. Today, that stock is worth $50 per share, and you decide to transfer it to a DAF. Your tax deduction will equal the stock's current value of $50, not the $10 price you paid for it.

Second, no capital gains taxes are created when contributing appreciated investments directly to a DAF. This means you won't owe taxes on the $40 of unrealized capital gains embedded in the stock you donated [$50 current price - $10 purchase price].

Third, if you'd like to repurchase the stock, you can buy it back at its current value of $50. Now you own the same stock but have reset your cost basis. If you decide to later sell the stock for $70 per share, you will only owe capital gains tax on $20 of appreciation [$70 current price - $50 recent purchase price], instead of $60 of appreciation [$70 current price - $10 original purchase price].

Fourth, investments in a DAF grow tax-free so long as they're given to charity. This means you won't pay taxes on any dividends, interest or appreciation generated from the investments in the DAF.

## How much can I contribute to a Donor Advised Fund?

While a DAF has no contribution limits, we suggest working together with your KAR wealth advisor and tax professional to create a thoughtful funding strategy that maximizes your overall tax benefits while being mindful of certain IRS charitable tax-deduction limits. Based on current tax laws, you may only receive an itemized tax deduction for cash contributions up to 60% of your Adjusted Gross Income (AGI)[1], and non-cash contributions (i.e., appreciated stocks, bonds, etc.) up to 30% of your AGI. If your charitable contribution exceeds your AGI limit in any given year, the IRS allows you to carry forward your unused charitable tax deduction for up to five years.

## Who should consider contributing to a Donor Advised Fund?

With the standard deduction for married couples filing jointly increasing from $27,700 in 2023 to $29,200 in 2024 ($14,600 for single filers and married couples filing separately) it's important for charitable taxpayers to reevaluate their giving strategy to make sure they're still receiving tax benefits for their charitable donations. As explained in our article on Stacking Charitable Contributions, each year the IRS allows your taxable income to be reduced by the greater of the flat standard deduction, or the sum of your itemized deductions. These include charitable donations, state and local taxes paid up to $10k ($5k if married filing separately), mortgage interest on a home loan of $750k ($375k if married filing separately), and unreimbursed medical expenses that exceed 7.5% of your AGI.

If you expect that the sum of your itemized deductions will fall short of the new standard deduction, you may want to consider frontloading multiple years of charitable contributions into a DAF to bump your itemized tax deductions over the standard deduction threshold. This strategy may be especially helpful if you're anticipating an unusually high-income tax year from the sale of a business, real estate property, or other appreciated investment. The following example illustrates the increased tax benefit of frontloading multiple years of charitable contributions into a DAF during a high-income tax year.

## Contributing to a DAF Example:

Imagine the Scott Family gives $50,000 annually to charity and both spouses plan on retiring at the end of the year. While they're projecting AGI of $800,000 this year, they think it will drop to only $300,000 per year in retirement.

To receive a large upfront tax deduction in their last year as high-income earners, they decided to frontload four years of charitable contributions into a DAF by transferring appreciated stocks from their trust account. With an AGI of $800,000, the Scotts were eligible to receive the full $200,000 itemized tax deduction [$50,000 charitable contribution x four years] because their $200,000 contribution was under the 30% AGI limit of $240,000 [$800,000 AGI x 30%] for non-cash charitable contributions.

*1 https://www.irs.gov/e-file-providers/definition-of-adjusted-gross-income*

Had the Scotts decided to wait until their first year of retirement to fund their DAF, the tax deductibility of their $200,000 contribution would have been capped at $90,000 [$300,000 AGI x 30%]. This means they would have been left with $110,000 of unused tax deductions [$200,000 charitable contribution - $90,000 tax deduction limit] to carry forward to lower income tax years when tax deductions are less valuable.

For example, suppose the Scotts paid taxes at an average rate of 35% while working full time. A $90,000 itemized tax deduction would produce tax savings of $31,500 [$90,000 x 35% tax rate]. If their average tax rate dropped to 22% in retirement, the same $90,000 itemized tax deduction would only produce tax savings of $19,800 [$90,000 x 22% tax rate].

Because tax laws for charitable giving often change, KAR wealth advisors recommend contacting your tax professional before frontloading contributions into a DAF. We also suggest reaching out to the financial institution where your DAF is held to confirm the assets you'd like to contribute can be held inside your DAF.

## How can Kayne Anderson Rudnick help?

A more thoughtful approach for your charitable giving may increase your overall tax savings by generating larger upfront tax deductions in high income tax years and reducing large unrealized capital gains in your appreciated investments.

As part of KAR's service to clients, we'll work with your tax professional to determine how much you can afford to budget for charitable giving, identify which assets to give, and evaluate in what years your contributions will give you the greatest tax benefit. We can also advise on the appropriate asset allocation for the investments in your DAF based on your risk tolerance and timeline for distributing funds to charity.

If you're interested in evaluating more tax-reduction strategies like frontloading charitable contributions, please reach out to your KAR wealth advisor.

Kayne Anderson Rudnick is an investment firm specializing in high-quality investment and wealth management strategies. The firm has an over 30-year history serving a diverse client base that includes high-net-worth individuals, corporations, endowments, foundations, public entities, taft-hartley clients, and mutual funds. Kayne Anderson Rudnick is known for its commitment to high-quality investment strategies and business practices. For more information, please visit www.kayne.com.