Ren

How DAFs complement other charitable giving vehicles

Written by Jordan Richardson

Table of Contents

Introduction

When it comes to serving clients with a wide range of philanthropic goals, offering a variety of charitable giving options is important. Donor-advised funds (DAFs) have become the most popular for their flexibility and tax advantages, but to truly optimize a client's philanthropic impact, it's important to strategize the potential of combining different giving vehicles.

> This guide is intended to share the intricacies of DAFs and other philanthropic mechanisms, along with their benefits and practical applications.

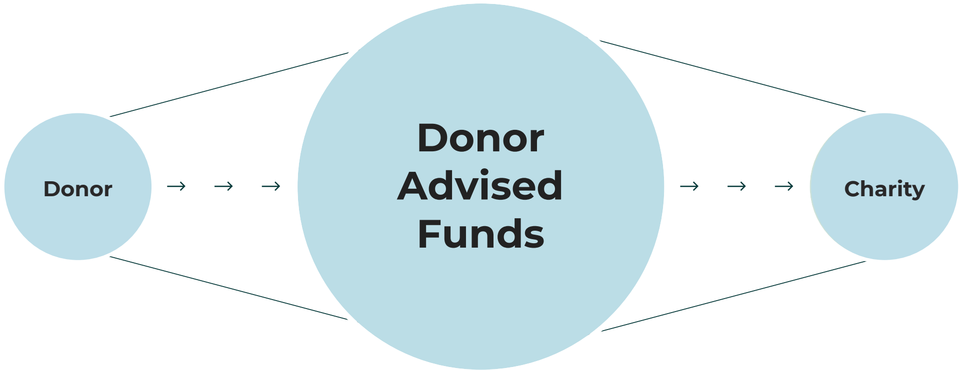
Whether you're advising seasoned donors or guiding newcomers to the world of giving, this eBook will equip you with the knowledge to enhance your clients' goals.

SECTION ONE

What is a donor-advised fund?

A donor-advised fund, or DAF, is a philanthropic giving vehicle maintained by a qualified public charity, and is created when a donor makes a gift of cash or assets.

It allows donors to make charitable contributions, receive an immediate tax deduction for their donation, and then recommend grants from the fund over time.



Donors contribute assets — such as cash, stocks, or real estate — to the DAF, and those assets are invested for potential growth. Donors can then advise the DAF sponsor on how they want the funds to be distributed to qualified charities, either immediately or over time. DAFs allow the donor to receive an immediate income tax deduction, avoid capital gains tax on appreciated assets, and make grant recommendations to charities at any time over their lifetime. Future generations can also be appointed to make the recommendations for the rest of their lives.

Take a look at some of these insights from The 2023 DAF Report:

> While overall charitable giving in the U.S. saw a decline in 2022 and eventually rebounded to pre-pandemic levels, donors contributing to DAFs notably increased their giving during this period.

> In 2022, grants from DAFs and contributions to DAFs reached an all-time high.

> Despite the slower rate of growth from 2021 to 2022, grants have more than doubled — increasing 118.5% — over the past five years.

SECTION TWO

Popular charitable giving vehicles

In addition to DAFs, there are popular charitable giving vehicles that offer diverse and flexible ways to contribute to meaningful causes:

Private foundations

Private foundations distribute charitable funds throughout a tax year and rely entirely on contributions from individuals, families, or corporate donors for funding. Private foundations are mandated to have a board of directors, just as public charities are. The difference is that the private foundation's board can be entirely composed of donors. Those who create private foundations often enjoy more control over the foundation's operations and grant-making activities compared to other charitable endeavors.

Charitable trusts and annuities

Charitable trusts and annuities are separate tools with similar objectives. The latter is a contract between a charity and a donor in which there is an irrevocable transfer of assets. In exchange, the donor receives an immediate income tax deduction for a portion of the gifted assets; a fixed stream of income for the lifetime of up to two annuitants (the donor and/or beneficiaries designated by the donor); and a legacy gift donated to the charity upon the passing of the annuitants.

Charitable remainder trusts are tax-exempt with an income interest paid to private beneficiaries throughout the trust term and a remainder interest to charity at the end of the trust term

Pooled income funds

Pooled income funds involve irrevocable gifts provided by multiple donors, resulting in income streams to designated beneficiaries. The donors all benefit from current income tax deductions for direct contributions to the pooled income fund, as well as transfer tax deductions.

Like DAFs, these popular charitable giving vehicles offer flexible ways for individuals to contribute to meaningful causes, providing various benefits and opportunities for philanthropic impact. While all of these vehicles have unique benefits, when combined with a DAF they can provide even greater advantages to donors.

SECTION THREE

DAFs and private foundations

Pairing a DAF with a private foundation allows for the best of both worlds: Leveraging the strategic, long-term vision of a private foundation with the administrative simplicity of a DAF.

While both giving vehicles are extremely similar in structure, a private foundation may allow for more creativity in distributions while a DAF, in many cases, provides more favorable tax deductibility.

Cash contributions are deductible up to 60% of adjusted gross income for contributions to DAFs and 30% of AGI for PFs. For appreciated securities, deductibility is up to 30% of AGI for DAFs and 20% for PFs.

If the administrative burden of a PF becomes too large, a best practice is to consider rolling it into a DAF for simplicity for the next generation.


SECTION FOUR

DAFs and charitable trusts

There are two main types of charitable trusts to consider, each with its own payment structure and benefits when combined with a DAF.

DAFs and charitable remainder trusts (CRTs)

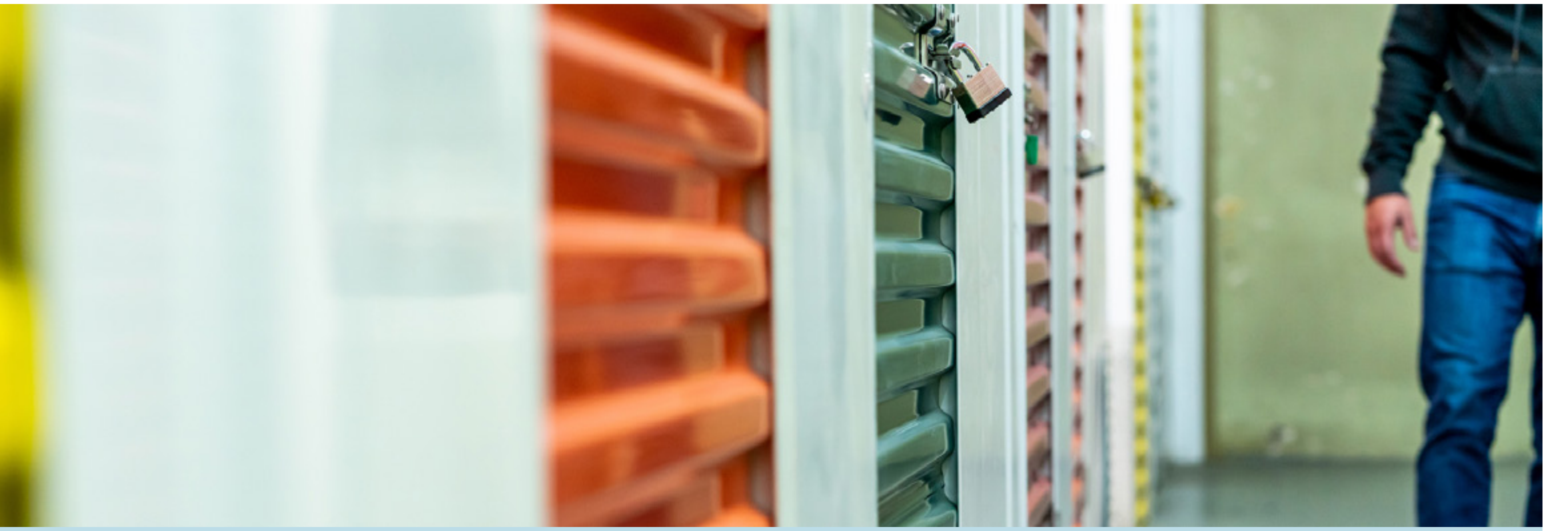
- The ability to be nimble with the selection of charitable beneficiaries through a DAF, while maintaining access to some of the assets via the income stream from the trust, is one of the top benefits.

- The deductibility of CRT contributions vary based on factors such as donor age, duration of the trust, and rate of distributions. They're limited compared to an outright gift to a charity or to a DAF.

- Best practice is to name the DAF as the remainder beneficiary of the CRT. This allows more flexibility for heirs to make decisions on charitable giving after the life of the trust.

DAFs and charitable lead trusts (CLTs)

- A donor can maximize charitable giving capacity during their lifetime while ensuring assets remain available for heirs.
- Income tax deductibility is limited, if available at all, depending on the structure of the CLT. In many cases, the tax benefit of a CLT is more relevant to estate tax savings, rather than income tax. A CLT is not tax-exempt, so be aware of phantom income on earnings within the trust that are taxable to the grantor.
- Consider making contributions to both a DAF and a CLT to provide both income and estate tax relief. Also, consider naming a DAF as the income beneficiary of a CLT to build up a charitable resource for the future.



SECTION FIVE

Creating a lasting philanthropic legacy

Case Study

One of our advisors recently consulted with a long-term high-net-worth (HNW) client who was in the process of selling his storage business, organized as a C-corporation, for $400 million.

The sale would generate more wealth than the client and his family would ever need. The client had already been actively engaged in charitable activities within his hometown and surrounding community for years. But now, with careful planning, we could help him and his wife establish a philanthropic footprint that will endure well beyond their lifetimes.

Together, the client and advisor identified the following objectives:

- Reduce the tax burden on the sale of the business
- Provide a predictable income source
- Create charitable deductions
- Ensure current and future funding for their favored charities

Collaborating with our complex asset group, they structured a DAF through Renaissance Charitable Foundation (RCF) to receive approximately 15% of the company's C-corp stock, valued at $60 million. This strategy resulted in capital gains tax savings of $16.8 million, based on a combined federal and state tax rate of 28%. Additionally, the $60 million income tax deduction from the stock contribution would yield another $16.8 million in tax savings on the stock sold personally.

To satisfy the client's request for a predictable income source, two charitable remainder trusts (CRTs) were created:

1. A 10-year term 5% standard unitrust funded with $20 million of stock
2. A 5% joint life income interest net income with makeup charitable remainder unitrust (NIMCRUT), set to flip in 10 years, funded with another $20 million of stock

The 10-year term unitrust would generate $1 million in annual distributions and provide a $12.2 million income tax charitable deduction. The joint life flip unitrust would produce a $5.2 million income tax deduction, deferring distributions for 10 years, at which point the trust would switch from a net income format to a standard unitrust, replacing the income from the matured 10-year term CRT.

The combined contributions would shelter another $40 million from capital gains tax, saving $11.2 million, and the income tax deductions from the two CRTs, totaling $17.4 million, would create an additional $4.87 million in tax savings from the sale.

This approach effectively met each objective through strategic planning and thoughtful structuring. The client and his wife were able to not only ensure personal wealth, but also create a lasting philanthropic legacy.

SECTION SIX

Maximizing philanthropic impact

Advising clients on achieving their philanthropic goals takes strategic planning and consideration of various charitable giving vehicles. DAFs offer flexibility and tax advantages, making them powerful tools, but here are some actionable tips for leveraging DAFs alongside other means of giving.

Understanding the goal

Understanding the goal is crucial from the get-go. Whether it's supporting a particular cause, making a long-term impact, or maximizing tax benefits, gaining clarity about your clients' goals will guide the giving strategy you present.

Knowing and conveying the options

Knowing and conveying the options is your main objective as an advisor. A client relies on professional insight to evaluate charitable giving options based on fees, investment options, flexibility, and more.

Leveraging tax benefits

Leveraging tax benefits is a priority for many donors. It allows them not only to maximize their financial resources but to make a bigger charitable impact. Combining the tax benefits of DAFs — avoiding capital gains tax and receiving an immediate tax deduction — with other giving mechanisms is a great way to do this.

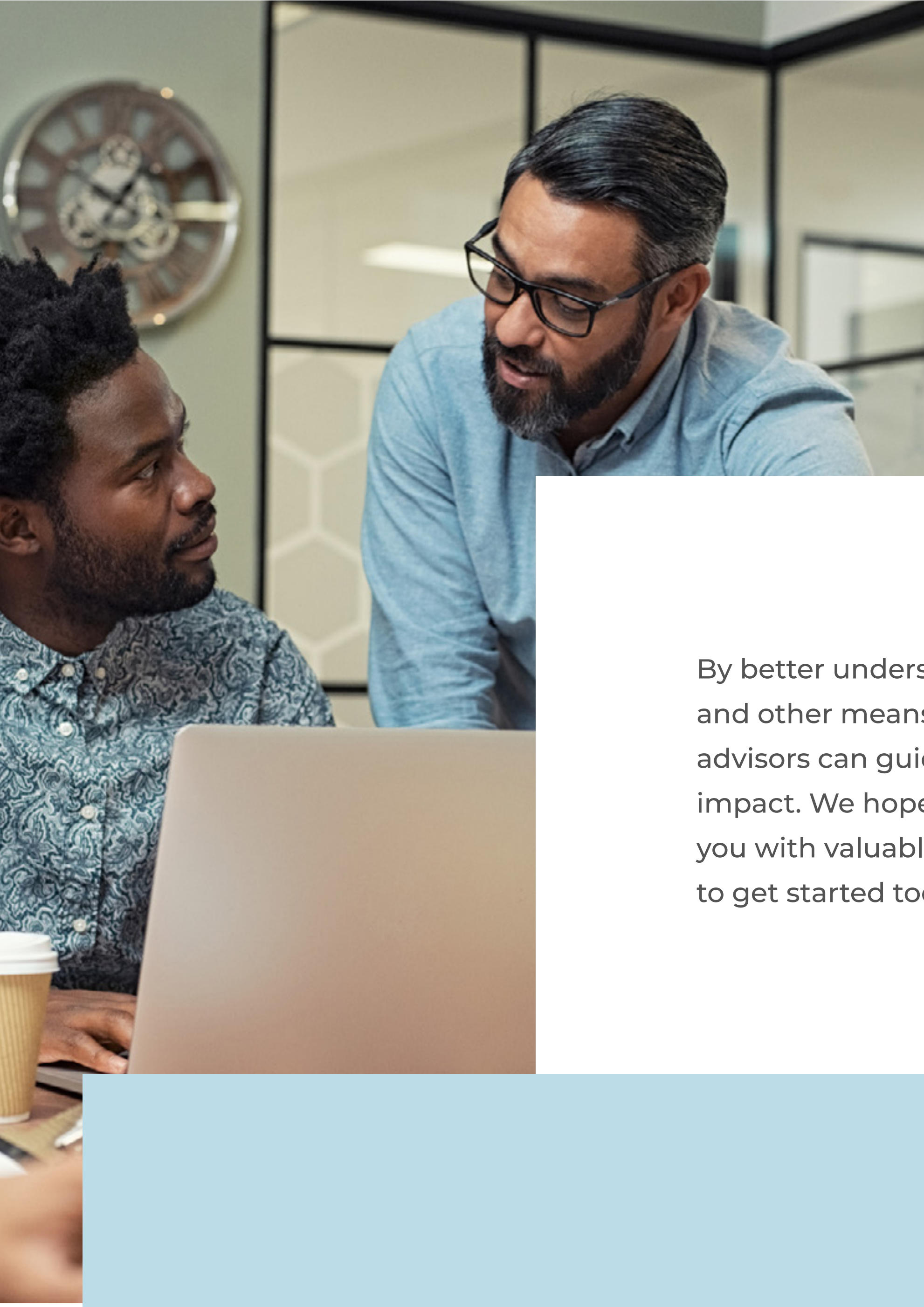
Establishing a legacy of giving

Establishing a legacy of giving allows donors to perpetuate their charitable impact for generations to come. The creation of DAFs, endowments, and charitable trusts are just a few sustainable ways to leave a meaningful legacy.

Staying educated

Staying educated about regulations and best practices allows for informed decision-making and the greatest philanthropic impact. Take advantage of professional development opportunities, stay informed on and attend relevant conferences, and subscribe to leading industry publications.

Following these tips is a sure way to guide clients toward their philanthropic goals and make a meaningful impact.



By better understanding the use of DAFs and other means of philanthropy, financial advisors can guide clients to maximize their impact. We hope this eBook has provided you with valuable insights and practical tips to get started today.

You may have one last question –

Where can I find an expert to help me get started?

Contact Us →