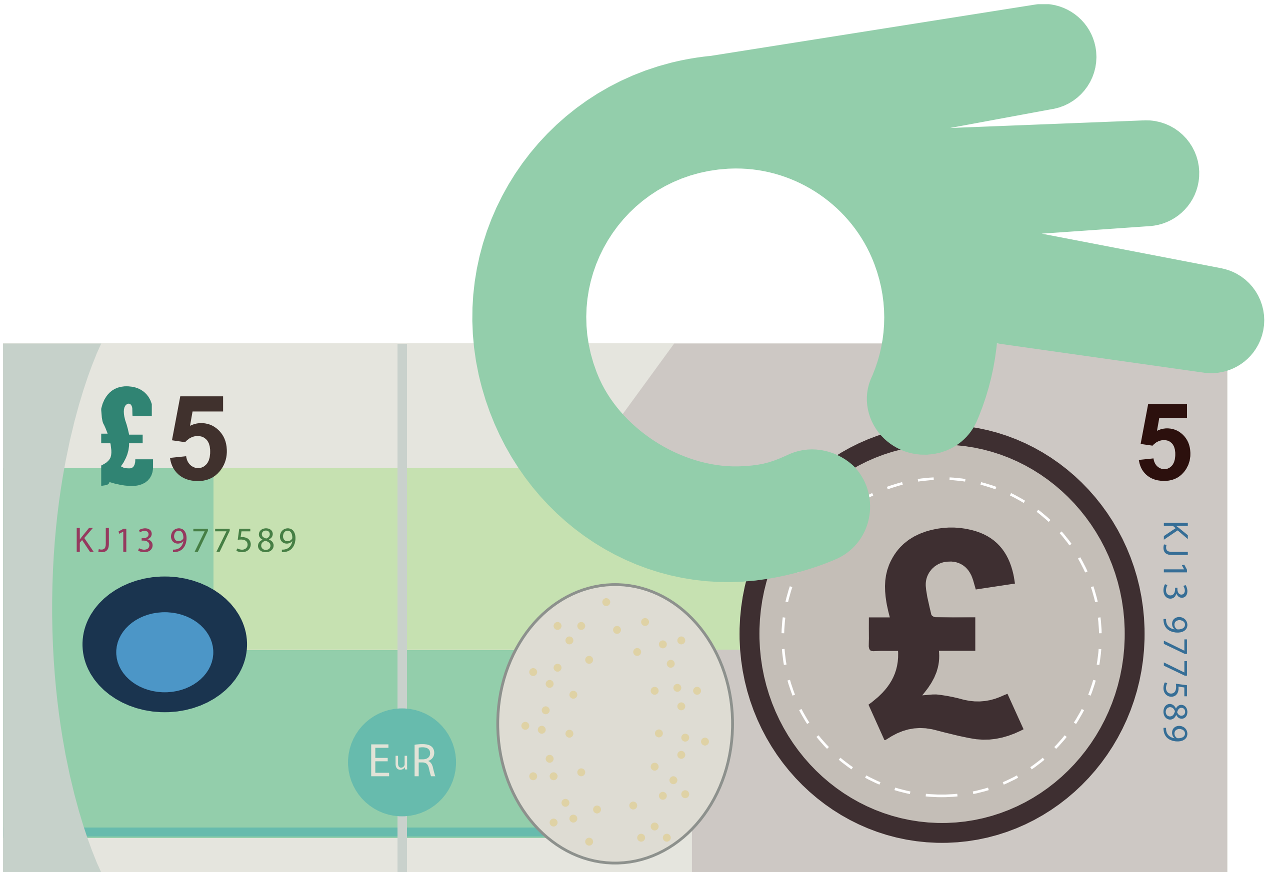

THE DOs AND DON'Ts OF DAFs

Donor-advised funds are a cost-effective, convenient and flexible estate planning tool, explains **John Canady**

KEY POINTS

WHAT IS THE ISSUE?
In the US, donor-advised funds (DAFs) are the fastest growing giving vehicle and a popular way of minimising the administrative burden of charitable giving. In Europe, they are relatively unknown, so philanthropists and their advisors may be missing out.

WHAT DOES IT MEAN FOR ME?
DAFs are flexible, tax-efficient charitable giving vehicles that are easy to set up; advisors can add real value to discussions with clients by offering a DAF as an alternative option to simply setting up a foundation.

WHAT CAN I TAKE AWAY?
DAFs are an ideal tool in estate planning, and their popularity in the UK is growing.

Donor-advised funds (DAFs) are the US' fastest growing charitable giving vehicle, now outnumbering private foundations almost three times over.[1] UK-based advisors increasingly see DAFs as essential in estate planning, and they are an ideal choice for individuals and families seeking a convenient and cost-effective way to manage their philanthropy. So, when are DAFs the right choice for your client?

HOW DAFs WORK

Defined as a philanthropic giving vehicle or a fund administered by a charitable sponsor, a DAF is basically a charitable savings account. DAFs are a less administration-heavy alternative to setting up a charitable trust or grant-making foundation. They are easy to create (they can be established in a day) and require very little oversight from the donor, providing a simple way to streamline the process of giving.

A family or individual will establish a DAF and contribute personal assets (cash, shares, property, etc), for which they receive tax relief. These assets are converted to capital that can be used to make grants immediately or invested to increase the amount available for future giving. The creator of the DAF recommends grants to whichever (and however many) charitable organisations they wish to support, and the charity that sponsors the DAF handles Gift Aid receipts, due diligence on the recipient, etc. In terms of estate planning, a DAF can be set up with comparatively little initial outlay in anticipation of a later bequest.

This simplicity of use is one of the reasons that DAFs are so popular in the US. According to the 2016 edition of National Philanthropic Trust's (NPT's) *Donor-Advised Fund Report*[2] on the US market, 2015 saw total grants from DAFs reach a record USD14.52 billion, and DAF assets available for grant making grew to

USD78.64 billion. Donors' contributions to DAFs also hit an all-time high of USD22.26 billion, representing 8.4 per cent of total giving by Americans. This growth is an ongoing trend, one that is reflected in an increased appetite for DAFs in the UK.

DAFs – THE ADVANTAGES

CONVENIENCE

A DAF allows your client to maximise their charitable giving while minimising the administration and related costs: there's no juggling of multiple Gift Aid forms or charitable receipts. A DAF is established by a sponsoring charity that administers the account; this includes processing contributions, Gift Aid and grant recommendations, and providing receipts for tax purposes. Donors can pay in now (and get the relevant tax relief) but decide where the money goes later, so they can contribute when it makes most sense to them financially. This makes DAFs an attractive option for estate planning: assets can be left to a DAF as a legacy or bequeathed in a will (and are treated as a charitable donation for inheritance tax (IHT) purposes), but with no pressure to choose recipients at a time when the family may be grieving.

TAX EFFICIENCY

DAFs are managed by registered charities, so gifts to DAFs are tax relieved. Many donors make gifts when a significant liquidity event occurs (an initial public offering, bonus or inheritance), thereby receiving immediate tax relief, but giving themselves breathing space to consider how best to distribute their giving.

For individuals who pay tax in both the UK and US, for example, dual-qualified DAFs are particularly useful, as donations to them are recognised as charitable for tax purposes in both jurisdictions. DAFs are also suitable for those with non-domiciled tax status who want to support charities with offshore assets without creating any remittance income issues, as the DAF can accept offshore assets.

PRIVACY

Charities are under more pressure than ever to 'hard sell' for contributions, with previous supporters often heavily targeted. A DAF allows anonymity (the charity that sponsors the fund acts as the grantor), thereby avoiding unwelcome publicity or solicitations. DAFs are also ideal for those who, for personal or religious reasons, prefer anonymous giving.

ESTABLISHED TRACK RECORD

With crackdowns in many jurisdictions on anything seen as tax avoidance, clients are understandably wary of untested vehicles. DAFs rose to prominence in the 1990s, but they have been around since the 1930s. They are now recognised by tax authorities on both sides of the Atlantic as tax-effective giving vehicles that make it convenient and easy to give to charities and support the third sector.

DAFs allow confidence as to both grants and investments. The DAF sponsor conducts due diligence on the grant recipient and any necessary follow-up to comply with tax and charity laws. In addition, since the sponsor will only make investments to grow the fund on the recommendation of the donor, clients can be sure that their money will not be invested in areas they may object to, such as alcohol or tobacco.

FLEXIBILITY IN CONTRIBUTIONS

DAFs make it easy to convert a wide variety of assets into philanthropic capital, including shares, property, and other, more illiquid assets, such as art. Clients are taking increasingly sophisticated views on charitable giving and looking beyond cash across their entire investment portfolio to decide which assets are the most tax efficient to give away. Say, for example, a client has appreciated shares in their portfolio. Donating to a DAF allows the client to receive tax credit and avoid paying capital gains tax on those shares, while taking their time to choose the best recipient. Clients may also convert more illiquid or complex assets, such as private equity or hedge fund alternative investments, into philanthropic capital by donating an interest to a DAF.

> 'DAFs make it easy to convert assets into philanthropic capital, including shares, property and illiquid assets'

Donors can make a single contribution to their DAF (for example, after an inheritance) or 'top up' with regular payments as and when makes most sense to them financially. They can also recommend as many grants to as many approved charities over as long a period as they like.

FAMILY INVOLVEMENT

DAFs are a useful way to involve future generations in the family's charitable legacy. For example, a client can establish a DAF and name it as a charitable beneficiary of a bequest/legacy in their will; this would qualify as a charitable gift for IHT purposes. The client could then name their children as successor advisors so the latter can carry on that charitable giving after the client's death.

These advantages aside, there will be instances when DAFs are not an appropriate choice.

THE DOWNSIDES OF DAFs

LACK OF COMPLETE CONTROL

Donor control is one of the key differentiators between DAFs and other giving vehicles. When donors make contributions to their DAFs, they are gifting those assets irrevocably to the charity that administers the DAF. With a DAF, the client recommends investments and grants, but the sponsoring charity has the ultimate decision.

ONLY FOR GRANT-MAKING

A DAF is a useful alternative to a grant-making trust or foundation that is set up primarily to simply make charitable grants, but it is not a viable replacement for an operational foundation. You cannot, for example, hire employees or run a programme (for instance, running a school). For those wanting 'hands on' management of an operational programme, a DAF is probably not the right choice.

GIFTS ARE IRREVOCABLE

A DAF is a useful way of ring-fencing capital for future giving. However, the donor cannot remove any of the capital from the fund except by way of recommending grants to recognised charitable organisations.

CONCLUSION

While DAFs are not suitable for every client, they are an increasingly popular solution. They are cost effective, convenient and flexible, allowing donors to maximise their giving and minimise the effort involved. This makes DAFs an invaluable option in estate planning.

1 *2015 Donor-Advised Fund Report*, National Philanthropic Trust (2015), bit.ly/2ilskb4
2 bit.ly/2gEVLpO

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