DONOR-ADVISOR FUNDS ARE RISING: WHY THIS MATTERS TO NONPROFITS

By: Richard English, J.D., Managing Director, Commerce Family Office

In spite of the massive uncertainty the health care crisis and economic disruptions brought to our lives this past year, one constant emerged like a ray of sunshine through even the darkest of days: Most Americans are generous people who want to help others in times of need. Donor-advised funds (also known as DAFs) have become an important, popular way for charitable individuals to respond to and assist people and communities who can benefit from their gifts.

Regardless of the type or level of experience with donor-advised funds — as a donor, nonprofit organization, or sponsoring organization (i.e., institutional investor) — it is essential to understand how a DAF works as a charitable giving vehicle. A knowledge of how donors, nonprofits, and DAF sponsoring organizations interface and work together has never been more vital, and their impact never more impressive.

This growth trend continued into 2020 and was captured in the NPT special Donor-Advised Fund COVID Grantmaking Survey conducted among 13 DAF sponsors providing data for the first six months of last year.

As the pandemic spread across the country, so did the number of grants made from DAFs — they increased by more than one-third over the same period in 2019 to nearly 1.3 million. Grant dollars also increased, from $6.41 billion in the first half of 2019 to $8.32 billion during the first six months of 2020. Andrew Hastings, NPT's Chief Development Officer, reported the number of grants rose for every charitable subsector, with human services charities representing the most significant increase at 78.1 percent.[1]

DAFS GROW FOR TENTH CONSECUTIVE YEAR[1]

In February, the National Philanthropic Trust (NPT) released its 2020 Donor-Advised Fund Report highlighting DAF trends from 993 charities through the 2019 fiscal year. According to Andrew Hastings, NPT's Chief Development Officer, grants from DAFs to charitable organizations reached a new high of $27.37 billion, up 15% from nearly $24 billion in 2018. The aggregate grant payout rate for 2019 was 22.4%. Payouts from DAFs have exceeded 20% for every year on record.

In 2019, the number of donor-advisor fund accounts rose by 19.4%, with the average account estimated at $162,556. Donor contributions for DAFs totaled almost $39 billion.

At this point, there is no indication that growth trends for donor contributions to DAFs are going to slow down anytime soon. For the most part, DAFs are growing in popularity with older individuals, but they are also gaining favor with younger members of wealthy families. The DAF is an easy, convenient tool for parents to use in getting children, grandchildren, and other family members involved in philanthropy, and DAFs do not require as much funding and oversight as Private Foundations.

Private Foundations are often the best giving tool for many wealthy families to implement customized philanthropic strategies. Some families choose to use a DAF in conjunction with a Private Foundation for flexibility. However, DAFs can sometimes offer the best option for donors who want to create a giving pool, as they can be practical when funded at a much lower dollar value. Also, DAFs have no mandatory distribution requirements and do not require donors to bear the same level of administrative responsibility as a Private Foundation.

WHY DONOR-ADVISED FUNDS ARE A POPULAR CHARITABLE GIFTING OPTION

Donor-advised funds have gained popularity with donors over the past decade for a variety of reasons, due in large part to evolving legislation, platforms, and tools donors can use to fund their philanthropic strategies. According to the National Philanthropic Trust's "2019 DAF Report," the number of individual DAF accounts has grown over 50% for the second year in a row. Here are a few reasons this trend is gaining traction.

- Tax benefits. With DAFs, donors can support their favorite charities now and in the future by depositing funds into specially designated accounts set aside for charitable purposes.
  - Funds are earmarked as donor gifts and cannot be retracted for personal use or diverted to family members — control of the money transfers to the sponsoring organization.
  - Donors take their tax deductions when they place assets in the DAFs.
  - Donations grow tax-free in DAF accounts.
  - Donors have the option to make decisions regarding the amounts of money to give to specific charities at a future date.
- Gifts of appreciated assets. Donors may also consider gifts of appreciated property with DAFs.
  - Donors can contribute publicly traded securities and real estate.
  - They can take a tax deduction for the fair market value of the stock if they have held the stock for more than one year.
- Charitable "bunching". The Tax Reform Act of 2017 gave individuals the incentive to donate a large amount of money in one year then skip donations for a year or two to save on their tax bills. This is a popular trend for people who previously itemized deductions and now, because of the significant changes in the tax laws, use the increased standard deduction.
  - For example, a donor might take advantage of "bunching" three years' worth of donations into a DAF in 2021, and take the itemized deduction for that year.
  - Over the next two years, the donor reverts to the standard tax deduction.
  - The funds can still be disbursed to the donor's designated charities from the DAF over a span of several years.
- The privacy factor. Donor-advised funds offer one advantage many wealthy philanthropists crave: anonymity. For many, their privacy is paramount — charitable giving through DAFs is a means of protecting their identity and shielding them from unwanted publicity. As mentioned in the previous section, this is a big advantage for families who don't like dealing with their private foundations' tax filings where they must disclose the recipients of donations and information about directors and investments.

- Customized investment options. Many DAF sponsoring organizations now allow donors to use their own investment advisor so they can receive the same type of customized advice and communication they experience with their own portfolio. This trend also allows donors to implement customized criteria around Environmental, Social & Governance (ESG) investing preferences, as well as consider making "impact" investments to drive benefits for society in particular areas of interest.

DAF BENEFITS AND TRENDS FOR NONPROFITS

In addition to providing a variety of benefits to donors, donor-advised funds also have advantages for nonprofit organizations. A new report released last October by the Indiana University Lilly Family School of Philanthropy, "Nonprofits and Donor-Advised Funds: Perceptions and Potential Impacts,"[2] examines nonprofits' perceptions of, and experiences with, DAFs during the past three years. Highlights of the report's findings[3] include the following:

- Many nonprofit organizations believed that larger gift sizes and the ability to reach wealthier donors were positive aspects of DAF grants.
- Receiving unsolicited grants was another positive experience with DAFs.
- Nonprofits that received a donor-advised fund grant in the past three years were less concerned and more encouraged about DAFs in general, suggesting that their experience with DAFs generated more positive perceptions of their organizations.

However, the highlights also reported several recommendations for nonprofits benefiting from donor-advised funds. Suggestions for nonprofits included:

- Expanding their efforts to solicit grants from DAFs by educating donors about the funding vehicle, communicating with DAF sponsoring organizations, or including information about giving through DAFs in fundraising efforts. (Nonprofits already implementing these recommendations received DAF grants at an 87% higher rate than those who had not solicited for them.)[3]
- Understanding the DAF distribution process and being prepared to accept and process grants made via DAFs, whether or not they actively solicit these types of donations.
- Having a formal process in place for tracking DAF grants. Grants from DAFs are typically received in the form of a check, which is similar to traditional donations. However, nonprofits should credit both the donor and the sponsoring organization for DAF gifts to ensure proper tracking, reporting, appreciation acknowledgment, and potential recognition.

THE IMPORTANT CONNECTION WITH SPONSORING ORGANIZATIONS

Another significant factor contributing to the growth of DAFs can be attributable to sponsoring organizations and the institutional advisors who have built strong relationships with major donor funds. Their relationships with — and subsequent referrals to — educational institutions, community foundations, health care facilities, and faith-based organizations have helped expand and personalize the DAF experience for all involved.

In recent years, institutional investors have been providing a broader menu of charitable giving opportunities for all types of clients, from the mass affluent to the ultra-high net worth. Not only are they adding philanthropic specialists to their staffs, they are also educating bankers and institutional advisors on techniques, implementing gifting tools such as DAFs, and offering social impact investments that can maximize the clients' philanthropic giving options.[4]

The overall benefits are measured in recent years by larger charitable giving amounts, thanks to a combination of good stock market performance, increased investment advisor referrals, and a growing number of sponsoring organizations. If you fold in the connections to wealthier donors and increased amounts of unsolicited gifts (especially during the pandemic), these benefits add up to an improved perception of the donor-advised fund experience on many fronts.

Contact your Commerce Trust Company Institutional Advisor — or complete the form to find an experienced advisor — for more information regarding donor-advised strategies and to discuss your specific needs.

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[1] Source: Andrew Hastings, "Highlights from the 2020 DAF Report and COVID Grantmaking Survey," Community Foundations Nationwide Launch Coronavirus Relief Efforts," ©National Philanthropic Trust, blog published February 2021.

[2] Source: "Nonprofits and Donor-Advised Funds: Perceptions and Potential Impacts," Indiana University Lilly Family School of Philanthropy," published October 7, 2020.

[3] Source: Andy Ware and Kristi Howard-Shultz, "Four key takeaways from the 2020 donor-advised fund report," blog.philanthropy.iupui.edu/2020/10/21/four-key-takeaways-from-the-2020-donor-advised-fund-report/, October 21, 2020.

4 Source: Eileen Heisman, CEO, National Philanthropic Trust, Worth Newsletter, "Donor Advised Funds Were Up Almost 300 Percent This Decade. Why?" https://www.worth.com/donor-advised-funds-were-up-almost-300-percent-this-decade-why/, December 31, 2019.

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Richard is a managing director of Commerce Family Office in Kansas City. He collaborates closely with clients on strategies for addressing the complex personal, family, and financial challenges that can accompany significant wealth and often impact current and future generations. Richard works to help clients integrate core values into wealth planning and decision making, translate vision and mission statements into actionable solutions, implement successful family communication strategies, and establish effective family governance structures and processes. He has more than 30 years of experience providing comprehensive and sophisticated services to multiple high net worth families. Prior to joining the Commerce Family Office team, Richard was a partner at Stinson Leonard Street serving as co-chair of the firm's Tax, Trusts, and Estates practice division. In this role, he represented individuals and families in the areas of estate planning, estate administration, and related litigation. He also represented corporate fiduciaries in connection with trust and estate administration and related litigation. Richard holds a law degree from the University of Kansas and an undergraduate degree from Washington University in St. Louis. During his practice, he was listed in The Best Lawyers in America and included in Missouri & Kansas Super Lawyers for estate planning and probate. Additionally, he is a member of the Kansas City Metropolitan Bar Association and Estate Planning Society of Kansas City as well as a fellow in the American College of Trust and Estate Counsel. Richard has served as a trustee of The Barstow School; he has also served the Blue Valley Educational Foundation, Colonial Presbyterian Church Foundation, Greater Kansas City Community Foundation, and the National Christian Foundation-Heartland in various capacities.

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