



## Donor Advised Funds: The Do's and Dont's

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Imagine yourself in this situation. You're in the donor relations office at the premier arts institution in town. You receive a call from Elizabeth, a major donor wanting to confirm that a recent generous donation from her donor-advised fund has been received. You confirm that is the case and thank her. Elizabeth then inquires when she can expect her four tickets to the gala fundraiser next month. You explain that the organization is not permitted to provide gala tickets in exchange for the gift from her donor-advised fund. Elizabeth, now in a huff, asks your name and says this has never been a problem before and her next call will be to the CEO, whom she knows personally. Her final words: "Such incompetence!"

The extraordinary popularity of donor-advised funds (DAFs) in philanthropy has resulted in non-profits receiving increasingly generous grants from these funds, now estimated to be in the billions of dollars annually. The expanding role of DAFs has not gone unnoticed by the IRS, however, whose watchful eye has turned to these funds and the charities receiving grants.

Charity staff are well advised to become educated around the IRS regulations regarding grants received from DAFs. The Pension Protection Act of 2006 imposes stiff penalties in the form of excise taxes for DAF sponsors as well as DAF donors for violation of the rules governing permissible distributions from DAFs. A DAF sponsor is subject to a 20% excise tax if the DAF makes taxable distributions to non-charitable beneficiaries plus a 5% excise tax if such distributions were made knowingly. Donors who recommend grants and receive, directly or indirectly, more than an incidental benefit are subject to an excise tax equal to 125% of the grant. A review of IRS "do's and dont's" will assist with compliance and may save your organization from an expensive and embarrassing violation. See [IRS Donor-Advised Funds Guide Sheet Explanation](#).

**The donor does not receive an income tax charitable deduction when a grant is made from her donor-advised fund.** The donor received a charitable deduction when the gift was made to her DAF. This is important for the charity receiving a grant from a DAF when issuing an acknowledgment for the gift. The acknowledgment should be different than the gift receipt customarily issued for outright gifts, and should clearly state that the gift was a grant from a donor-advised fund. Some charities go so far as not to include the amount of the gift.

**A grant from a DAF cannot be used to fulfill a legally enforceable pledge of the donor.** However, if the donor has entered into an agreement stating her intention to make a gift and the intention is not legally binding, the intention can be satisfied by a grant from the DAF. Organizations should check with donors to ascertain if they plan to pay a commitment from a DAF, in which case the charity may wish not to make the commitment legally binding.

A grant from a DAF cannot result in the donor, advisor, or any related party receiving more than an

incidental benefit. Goods or services such as a cap, key chain, mug, etc. are permissible. If the goods or services are more than of de minimis value, it violates IRS regulations and subjects the donor to the 125% excise tax. Meals, discounted merchandise, free event admission, and material quid pro quo benefits are prohibited.

**Raffle tickets, tickets to galas and other special events, auction items, and benefits conferred in connection with the DAF grant are not permitted.** Preferential seating or parking at athletic events generally cannot be given. IRS has specifically ruled that costs associated with fundraising events cannot be separated, a practice known as “bifurcation.” For example, if the ticket breaks out the cost for the dinner and the gift to the charity, the donor must pay from sources other than her DAF for the full value of the ticket and not just for the non-charitable amount.

**A grant from a DAF cannot be used to pay for membership benefits if any portion of the membership fee is not tax deductible.** If more than incidental benefits are provided along with the membership, a grant cannot be made from the DAF to pay for the cost of the membership.

**A grant from a DAF cannot be made to or for the benefit of a certain individual, such as for tuition, a scholarship, or other required fees.** For example, a grant cannot be made where the donor has discretion as to which student is to receive a scholarship. Also, grants cannot be made directly to individuals.

Donor-advised funds hold billions of dollars waiting to be granted to 501(c) (3) charities. The IRS regulations were not written with donor relations in mind. Hopefully, if donors understand that the charity did not make the rules but must follow them, donors will continue to suggest grants from their DAFs without any expectation of receiving benefits in return.