Q: Joe is in the 24% marginal tax bracket and lives in Colorado. He has unrealized gain in an appreciated stock with a cost basis of $6,000 and a current value of $10,000. Please explain how a Donor Advised Fund works, including a local one like Longmont Community Foundation, along with a tax analysis and example of the pros and cons of using a DAF vs. just gifting cash to a charity

Donor-Advised Fund (DAF) Explanation and Tax Analysis for Joe

How a Donor-Advised Fund Works

1. **Contribution**: A donor contributes assets (cash, appreciated securities, real estate, etc.) to a DAF, managed by a 501(c)(3) public charity, such as the Longmont Community Foundation (LCF). Contributions are irrevocable, meaning the donor relinquishes legal control of the assets to the sponsoring organization.
2. **Tax Deduction**: The donor receives an immediate federal income tax deduction in the year of the contribution, subject to IRS limits:
    - Cash contributions: Deductible up to 60% of adjusted gross income (AGI).
    - Appreciated securities (held for more than one year): Deductible up to 30% of AGI, based on the fair market value (FMV) of the asset. Excess deductions can be carried forward for up to five years.
    - No capital gains tax is incurred on appreciated assets donated to a DAF.
3. **Investment Growth**: Assets in the DAF can be invested and grow tax-free, potentially increasing the amount available for charitable grants. Sponsors offer investment options like mutual funds or professionally managed portfolios.
4. **Grant Recommendations**: The donor advises the sponsoring organization on which IRS-qualified 501(c)(3) charities should receive grants. The sponsor has final approval to ensure compliance with IRS regulations, but recommendations are typically followed if

aligned with guidelines. Grants can be distributed immediately or over time, anonymously or with recognition.

5. **Administration**: The sponsoring organization handles recordkeeping, tax reporting, and due diligence on grant recipients. Donors may incur fees (typically ~1% of the account balance annually) for management and investment services.

Longmont Community Foundation as a DAF Sponsor

The **Longmont Community Foundation (LCF)**, a 501(c)(3) organization in Longmont, Colorado, offers DAFs tailored to community-focused giving. Key features include:

- **Minimum Contribution**: LCF typically requires a minimum contribution to open a DAF, often $5,000–$25,000 (confirm with LCF).
- **Local Impact**: LCF supports Longmont-specific initiatives (e.g., education, arts, social services) but allows grants to any IRS-qualified 501(c)(3) nationwide.
- **Administrative Support**: LCF manages paperwork, tax receipts, and grant vetting. They charge administrative fees (e.g., ~1% annually) and offer investment options.
- **Community Connection**: LCF's expertise helps donors align giving with local priorities, such as scholarships or community development in Longmont.

Tax Analysis for Joe's Situation

Joe is in the **24% federal marginal tax bracket** and lives in **Colorado**, with a flat **4.25% state income tax rate** in 2025. He holds appreciated stock with a **cost basis of $6,000** and a **current FMV of $10,000**, resulting in a **$4,000 unrealized long-term capital gain** (assuming held for more than one year). Below is a tax analysis comparing donating the stock to a DAF versus selling the stock and donating the after-tax cash.

Scenario 1: Donating Appreciated Stock to a DAF

- **Contribution**: Joe donates the $10,000 stock to a DAF (e.g., at LCF).
- **Federal Tax Deduction**: Joe deducts the FMV ($10,000), within the 30% AGI limit (assuming AGI of $100,000, limit is $30,000). At 24%, this saves **$10,000 × 24% = $2,400** in federal income taxes.
- **Colorado State Tax Deduction**: Colorado allows charitable deductions. The $10,000 donation saves **$10,000 × 4.25% = $425** in state taxes.
- **Capital Gains Tax**: Donating the stock avoids capital gains tax on the $4,000 gain. The federal long-term capital gains tax rate for the 24% bracket is **15%**, plus the **3.8% Net**

Investment Income Tax (NIIT) if Joe's modified AGI exceeds $200,000 (single filer; confirm status). Assuming only 15% applies, Joe avoids **$4,000 × 15% = $600** in federal capital gains tax. Colorado has no separate capital gains tax.

- **Total Tax Savings**: $2,400 (federal income tax) + $425 (state income tax) + $600 (federal capital gains tax) = **$3,425**.
- **Charitable Impact**: The DAF receives the full $10,000 FMV, which LCF can sell tax-free for grants.

Scenario 2: Selling Stock and Donating Cash

- **Sale of Stock**: Joe sells the $10,000 stock, paying $600 in federal capital gains tax (**$4,000 × 15%**). After tax, Joe has **$10,000 - $600 = $9,400** to donate.
- **Federal Tax Deduction**: Joe donates $9,400 in cash, within the 60% AGI limit (for cash). This saves **$9,400 × 24% = $2,256** in federal income taxes.
- **Colorado State Tax Deduction**: The $9,400 donation saves **$9,400 × 4.25% = $399.50** in state taxes.
- **Total Tax Savings**: $2,256 (federal income tax) + $399.50 (state income tax) = **$2,655.50**.
- **Charitable Impact**: The charity receives **$9,400**, $600 less than the DAF scenario.

###EAD

Tax Comparison

- **DAF Donation**: Total tax savings = **$3,425**, charity receives **$10,000**.
- **Cash Donation**: Total tax savings = **$2,655.50**, charity receives **$9,400**.
- **Net Benefit of DAF**: Joe saves an additional **$3,425 - $2,655.50 = $769.50** in taxes, and the charity receives an additional **$600** (6% more).

Additional Considerations

- **Itemizing Requirement**: Joe must itemize to benefit from deductions. The 2025 federal standard deduction is ~$14,600 (single) or $29,200 (married filing jointly). If itemized deductions are below these, Joe may not benefit unless he "bunches" contributions.
- **Carryforward**: Excess deductions above 30% AGI can be carried forward for five years.
- **DAF Fees**: LCF may charge ~1% annual fees ($100/year for $10,000), reducing funds available for grants.

- **Alternative Minimum Tax (AMT)**: Charitable deductions may reduce AMT liability. Consult a tax advisor.

Pros and Cons of DAF vs. Cash Gift to Charity

Donor-Advised Fund

Pros:

- **Tax Efficiency**: Avoids $600 capital gains tax, deducts $10,000 FMV, saving $3,425 vs. $2,655.50.
- **Flexibility**: Recommend grants over time, ideal if Joe is undecided on charities.
- **Tax-Free Growth**: DAF assets grow tax-free, increasing grant potential.
- **Simplified Giving**: LCF handles paperwork, tax receipts, and vetting.
- **Local Impact with LCF**: Supports Longmont causes with LCF's expertise, with national giving options.
- **Anonymity**: Grants can be anonymous.
- **Bunching**: Large DAF contribution in a high-income year maximizes deductions, allowing standard deductions later.

Cons:

- **Irrevocability**: Donated assets cannot be retrieved.
- **Limited Control**: LCF has final grant approval.
- **Fees**: ~1% annual fees reduce funds over time.
- **No Personal Benefits**: Grants cannot benefit Joe or family.
- **Complexity**: Donating stock requires IRS Form 8283 for deductions over $500.
- **No Distribution Requirement**: Funds could sit unused, though LCF may encourage granting.

Cash Gift to Charity

Pros:

- **Simplicity**: Direct donation, no intermediary.
- **Immediate Impact**: Charity receives funds immediately.
- **No Fees**: 100% of after-tax amount goes to charity.
- **Control**: Joe chooses charity directly.

Cons:

- **Lower Tax Efficiency**: Capital gains tax reduces donation ($9,400 vs. $10,000) and savings ($2,655.50 vs. $3,425).
- **No Flexibility**: Must choose charity at donation.
- **Multiple Receipts**: Tracking receipts for multiple charities is cumbersome.
- **No Growth**: No tax-free investment growth.
- **Less Strategic**: No bunching or timing for tax optimization.

Example Using Joe's Situation

DAF with LCF:

- Joe donates $10,000 stock to an LCF DAF.
- Avoids $600 capital gains tax, deducts $10,000, saving $2,400 (federal) + $425 (state) = $2,825 in income taxes.
- Total tax savings: $3,425.
- DAF receives $10,000, invested at 5% annual growth (~$10,500 after one year, minus ~$100 fees).
- Joe recommends $5,000 grant to a Longmont nonprofit in 2025, $5,000 in 2026.

Cash Donation:

- Joe sells $10,000 stock, pays $600 capital gains tax, donates $9,400.
- Deducts $9,400, saving $2,256 (federal) + $399.50 (state) = $2,655.50.
- Charity receives $9,400 immediately.

Recommendation for Joe

A **DAF with LCF** is preferable if Joe wants to:

- **Maximize tax savings** ($3,425 vs. $2,655.50).
- **Gain flexibility** in grant timing.
- **Support Longmont** with LCF's guidance.
- **Accept irrevocable contributions** and fees.

A **cash donation** is better for simplicity, immediate impact, and no fees, but offers less tax savings and flexibility. Joe should consult a tax advisor to confirm AGI, itemization, and AMT

implications. Contact LCF at **info@longmontfoundation.org** or (303) 678-6555 for DAF details.

Disclaimer: This is for educational purposes, not tax or legal advice. Consult a tax professional.