



# Donor Advised Funds vs Donor Pledges

Have you received checks from Charles Schwab, Fidelity or Vanguard Charitable Funds or from Benevity or the Seattle Foundation? If your nonprofit organization has received checks from these and other similar entities, you've likely received a contribution from a donor advised fund. Donor advised funds have increased in popularity as a means of donation to a favorite charity. It is important for recipient nonprofit organizations to understand how donor advised funds work, so that the contributions are properly recorded and reported in both the financial statements and the Form 990. In particular, contributions from donor advised funds cannot be used to fulfill a pre-existing individual donor pledge.



## What is a donor advised fund?

A donor advised fund (DAF) is a charitable giving vehicle administered by a public charity (sponsoring organization) which manages charitable donations on behalf of individuals, families or organizations. It allows donors to make a charitable contribution to a DAF, receive an immediate tax benefit, and then recommend grants to be distributed from the DAF to other public charities over time. Although the donor can advise the DAF on what distributions to make, the ultimate decision is made by the sponsoring organization; that is, the sponsoring organization controls the distribution, also known as having variance power.

There are certain requirements to maintain a DAF, which, if not followed, can result in significant penalties to the donor (125% of the amount involved) as well as excise taxes imposed on the sponsoring organization or fund

**Jones**  
& Associates LLC  
Certified Public Accountants  
TEL 206.525.5170  
1701 NE 104th Street  
Seattle, WA 98125-7646  
www.judyjonescpa.com

manager. For example, the donor may not receive more than an "incidental benefit" from a recommended distribution from a DAF. A benefit is considered more than incidental if the donor receives a benefit that would have reduced or eliminated a charitable contribution if the benefit was received as part of the transaction. For example:

- The donor makes a legally enforceable pledge to the nonprofit and advises the DAF to make a distribution to the nonprofit to fulfill the pledge. Although what is legally enforceable depends on individual state law, the theory behind this is: a) the donor received a charitable deduction for the pledge and b) payment from the DAF constitutes a satisfaction of a legal obligation, either/or of which represent a more than incidental benefit to the donor.
- The donor receives benefits as a result of this pledge, such as free tickets to a special event or free membership. Amounts over the de-minimus allowed by the IRS for charitable contributions are considered a more than incidental benefit.

To avoid the potential for creating a more than incidental benefit to the donor, when making a distribution to a nonprofit, the sponsoring organization of the DAF is generally careful to include language in the award letter that this contribution is not being made to fulfill a pledge. That is, the distribution received from the DAF should be recognized by the nonprofit organization as a donation from the DAF, not the original donor.

## Nonprofit recipient organization

Under nonprofit accounting rules, pledges are recorded in full at the time they are made and when they are considered a firm commitment (i.e., there is a written pledge form signed by the donor). This may result from a fundraising appeal asking for multi-year pledges or at a special event when an attendee pledges to make a contribution within the next year. What steps can the nonprofit take to ensure that a subsequent payment received from a DAF is not used to reduce the pledge? Here are some ideas:

1. Be sure the development department understands the rules and risks with donor advised funds. Although the donor relationship is likely with the individual donor, when grants are received from a DAF, the actual donor to the nonprofit is the sponsoring organization of the DAF.
2. Communicate with the donor upfront to clarify their intention. If they plan to fulfill an annual pledge by advising their DAF to make a grant to the nonprofit, then consider their commitment an intent to give rather than a pledge. An intent to give would not be recorded as a pledge in the accounting records; however, it is a way for the individual donor to demonstrate commitment to the organization.
3. Add language to pledge forms to indicate how the individual plans to fulfill the pledge, such as personal check or recommendation to a DAF.

4. When payment is received, carefully review the source of the funds to ensure proper recording. If it is discovered that a distribution from a DAF was used to fulfill an individual pledge, the pledge from the individual donor should be written off, and a new contribution recorded from the DAF. The nonprofit should consider notifying the individual donor to clarify the treatment.

Here is a link to more information: <https://www.irs.gov/charities-non-profits/charitable-organizations/donor-advised-funds>.

