

# Do Donor-Advised Funds Require Regulatory Attention?

by Ruth McCambridge

**T**HE *NONPROFIT QUARTERLY* IS BY NO MEANS convinced that there is widespread abuse in donor-advised funds—but do we believe that the *conditions* exist for widespread abuse? That is a different proposition. There are two categories of concern that some advocates would like to see answered with regulation: the first has to do with the establishment of systems of accountability that look into the transactions of individual funds, and the second is what such a sight line might reveal—for example, overvaluation of noncash contributions, inactivity in disbursement of funds, and transfers of funds from private foundations in an attempt to bypass their payout rates. Thus, the first concern about opacity can lead to the polarization we now see about whether or not the field is in need of regulation, because the concerns of DAF skeptics are not disprovable while DAF sponsors see the veil as being of value to the donors they serve. Is there a way forward other than waiting for the almost inevitable scandal to catch the attention of Congress? We think so.

## Background

A donor-advised fund (DAF) is defined as “(1) a fund or account owned and controlled by a sponsoring organization, (2) which is separately identified by reference to contributions of the donor or donors, and (3) where the donor (or a person

appointed or designated by the donor) has or reasonably expects to have advisory privileges over the distribution or investments of the assets.”<sup>1</sup> Donor-advised funds tend to be held at three different types of institutions: community foundations, commercial funds established by investment firms, and charities serving a particular field or need.

To establish a little background, while donor-advised funds have by some accounts been around since 1931 (when the first such fund was started by the New York Community Trust, by its own claim), DAFs only started to spread significantly since the Tax Reform Act of 1969, when Congress enacted regulatory reform (including reduced tax benefits and payout requirements) on private foundations.<sup>2</sup> Given the new constraints, community foundations (which were designated public charities rather than private foundations) realized that they could provide donors with a beneficial alternative (to foundations) by offering a relatively individualized giving vehicle for donors through the donor-advised fund model. Donors would get all the tax benefits of a transfer to a public charity, but there would be an understanding that the funds would be segregated and the donor would retain functional control over

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the distribution (and sometimes investment) of the donated funds.

In 1981, the category of donor-advised funds was written into law.<sup>3</sup> At that point, DAFs began to proliferate largely in community foundations, but they have only become controversial since commercial financial firms entered the field as sponsors in the early 1990s, establishing their own public charities to receive, hold, and dispense the funds.<sup>4</sup> This placed them in direct competition with community foundations, and there was a good deal of hostility that built up. That hostility has since dissipated to some extent as community foundations realized that the marketing of DAFs done by the financial services industry assisted the growth of DAFs in community foundations as well. But the discomfort that others feel with the vehicle in general has grown, along with the very rapid expansion of the field, which is maintained below the sight line of the public. Tracking the extent of any problem (or whether a problem even exists) is made difficult by the veil provided by sponsors—which allows DAFs to be almost entirely opaque. This raises questions about accountability and access, and it should come as no surprise that these questions are emerging even as these funds grow relatively astronomically in numbers and dollar value.

DAF asset values more than doubled between 2010 (\$33.6 billion) and 2015 (\$78.6 billion).<sup>5</sup> Year over year, as you can see below, the growth has been nothing short of phenomenal while all of giving as a proportion of disposable income has stayed relatively stable.<sup>6</sup>

Changes in the Number of Funds and the Asset Value of DAFs and Private Foundations from 2014 to 2015						
Type of Giving Vehicle	Total Number of Funds (thousands)			Dollar Value of Assets (billions)		
	2014	2015	Percent Change	2014	2015	Percent Change
DAFs	242.4	269.2	11.1%	\$70.3	\$78.6	11.9%
Private Foundations	79.7	81.8	2.6%	\$712.45	\$781.6	9.7%

Source: National Philanthropic Trust (2016)

Another grounding issue for those trying to make sense of policy needs for this vehicle is that DAFs have a dual character that leaves them sitting oddly between foundation and individual

giving. You must approach the individual (or vice-versa), but the grant is finally made by the DAF sponsor, which retains real ownership/stewardship over funds that have been transferred to the DAF. Lila Corwin Berman calls this an “intersection of these two modes—charitable endowments and individual donor control over public charitable dollars.”<sup>7</sup>

This plays out to hold the sponsor responsible for its own transparency as a whole entity while obscuring the activities of the individual funds. Tax guidelines promulgated in [the Pension Protection Act of] 2006 require each donor-advised fund sponsor to report the total number of funds, total assets in the funds, and total contributions to and from the funds on their Forms 990, but any information on the individual funds themselves, regardless of size, is obscured.<sup>8</sup>

To explain what the issues are, we invited two advocates, Ray Madoff and Dean Zerbe, well known for their criticisms of the DAFs field, to provide their takes on what needs regulatory attention. We also invited others to write about

For the most part, charities with DAFs face laws and rules simpler than those applying to private foundations, but they must still deal with some provisions not applying to other public charities. For example, donors can donate assets (and sometimes capital gains taxes) on the unrealized appreciation, but the deduction limits as a share of adjusted gross income for the deduction are lower for donations to private foundations than for those to DAFs, which are treated like most other charities. Private foundations must pay a 1 or 2 percent excise tax on net investment income each year, but DAFs are not subject to the excise tax. Private foundations are mandated to make minimum distributions each year, but DAFs do not have a distribution requirement, although some sponsoring organizations have their own policies regarding minimum or occasional distributions. Private foundations must disclose donor information on tax form 990-PF, but sponsoring organizations (e.g., a community foundation or Fidelity Charitable) are not required to publicly disclose donor information. Thus, DAFs can grant more anonymity to donors than can private foundations, but not necessarily any more anonymity than donors to other public charities.<sup>9</sup>

Proposals from Madoff and Zerbe		
Proposal	Problem it addresses	Objections
<p>Impose some requirement that encourages or ensures that DAF assets make their way to nonprofits. Three proposals are:</p> <p>(1) Create a legal annual percentage requirement for payouts from donor-advised funds.</p> <p>(2) Require that all funds in donor-advised funds be spent out within a set period of time.</p> <p>(3) Adopt rules that incentivize distributions from each fund such that donors are encouraged to move more quickly in making final distributions.</p> <p><b>(Madoff and Zerbe)</b></p>	<p>The problem being addressed here is the concern that donors are being given maximum tax benefits for contributions to DAFs (because they are public charities), but there is no requirement for the funds to ever be distributed out of the DAF. Currently, it is impossible to determine how many of the individual donor-advised funds may simply be in holding patterns and for what periods of time.</p>	<p>Those in the field object to payout requirements, because overall payout percentages on the pools of funds are in many cases higher than at most private foundations, which have tended to view the minimum floor payout of 5% as a ceiling requirement. In contrast, some donor-advised fund sponsors report payout rates of 10% to 20%; this, of course, is an average, and may include some funds that act as pass-throughs (receiving and dispensing funds in close chronological proximity) and some that are relatively inactive. Furthermore, the donor-advised funds are as much like individual donors as they are like foundations; in other words, the individual funds are not regarded as endowments.</p>
<p>DAF sponsors should have boards that are credibly independent from their related for-profit financial institutions.</p> <p><b>(Zerbe)</b></p>	<p>The boards of any public charity should be free from the temptation to serve the interest of a private institution over the interests of the public.</p>	
<p>Tie the tax benefits of complex asset contributions to the actual amount that becomes available for distribution for charity rather than an appraised value.</p> <p><b>(Madoff and Zerbe)</b></p>		
<p>End the practice of transfers from foundations and/or make them transparent.</p> <p><b>(Madoff and Zerbe)</b></p>	<p>Some foundations use giving to donor-advised funds to meet the 5% payout requirement. This constitutes a violation of public trust and exacerbates the sense that the funds are being used as a workaround to the legal requirements of private foundations.</p>	<p>There are pages of examples of why this practice of transferring between private foundations, public foundations, and other DAFs should be allowed. Objectors to curtailment of such activity include the Philanthropy Roundtable, the Council on Foundations, Independent Sector, and others.</p>
<p>To provide protection against abuse of charitable laws, improve reporting requirements and transparency so that reasonable monitoring is possible on payout, dormant/inactive funds, acceptance of non-publicly-traded property, and other issues.</p> <p><b>(Madoff and Zerbe)</b></p>		

why such broad-based congressional attention was not now needed and to speak up about what additional, but more limited, regulations were needed, but we mostly got demurrals. So, we were stuck trying to make some sense of what may be priority issues for regulation, which we have done below with the benefit of prior analyses from the Urban Institute and others. The issues we have identified as deserving of attention are not the issues you may most commonly hear from nonprofits, by the way, which have to do with the ability to identify donors with DAFs; but they are the issues where we have determined the most abuse might be occurring.

None of the proposals advanced below have

to do with affording more access for nonprofits, which is what bugs many organizations. When complaining about donor-advised funds, nonprofits generally talk about the inability to access the names and contact information of fund advisors and related information about grant types, amounts, and so forth. That particular issue flows from the individual giver aspect of the DAF identity. Despite the fact that the money is being held as charitable funds and a deduction has been taken, there is no requirement for the publishing of material that identifies the giver, and the funds see that prospect as being a potential wet blanket on the proposition they are offering donors—that of nailing



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the donor down to a dollar-giving intention but not revealing that publicly nor requiring any pre-commitment to any particular nonprofit.

While the funds are championed as democratizing giving, there are some indications that the donors continue to act more like high- than low-end givers; as the Lilly Family School of Philanthropy at IUPUI reports, “there are some similarities between donor-advised fund granting patterns and the national distribution patterns . . . there are even more similarities when donor-advised fund granting patterns are compared to data on individual donors only.”<sup>10</sup> Some may feel that providing a veil for high-end givers primarily is unfair treatment; that veil, in fact, stands directly in the way of our understanding the extent of some of the problems identified by Madoff and Zerbe. Thus, no one really knows the extent of the problem of private foundations avoiding the 5 percent payout rate through the use of donor-advised funds, but they have been left trying to surmise it through the use of other information, as is described here by IUPUI:

. . . researchers endeavored to understand why giving to public-society benefit (PSB) from donor-advised funds was higher than the national trendline. In 2015, giving to PSB accounted for 16 percent of donor-advised fund grant dollars, while PSB garnered 8 percent of total giving in the same year according to *Giving USA 2017*.

The public-society benefit subsector, as defined by *Giving USA*, is a collection of many distinct charities including national donor-advised funds, United Way chapters, Jewish appeal funds and federations, veteran’s affairs organizations, civil rights nonprofits, and others.

Upon closer inspection of the public-society benefit subsector data, we found that a certain proportion of granting from donor-advised funds was going to other organizations classified as donor-advised fund sponsors (DAF-to-DAF granting).<sup>11</sup>

This particular problem of private foundations using contributions to DAFs to bypass

payout rules should be seen as especially egregious, since it may not be illegal but certainly flouts the intent of the payout requirement. But there is no way to determine the extent of the problem without extraordinary efforts. Of course, there *is* a way for donor-advised fund sponsors to help make the field more transparent by funding more independent research themselves, based on increased access to the data. See more on this idea below.

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It is unclear what the congressional appetite is for the regulation of DAFs. Former Michigan Congressman David Camp’s proposal in 2014 to levy an excise tax on DAF funds not distributed within five years of contribution has been largely left for dead.<sup>12</sup> However, as evidenced by the recent rules regarding university endowments and sports seating, Congress does appear largely mindful of concerns over the relationship between charitable tax benefits and the public good.<sup>13</sup> While Congress appears largely uninterested in donor-advised funds, it is demonstrably increasingly and critically interested in endowments that do not accrue properly to the benefit of the public. Donor-advised funds that aren’t fluid are alike enough to endowments to pose a threat to the entire field by providing rich soil and a veil for misbehavior in that sweet spot of congressional attention. Additionally, it is in the best interests of the whole sector to understand how these bodies work to ease or dam the flow of charitable giving into nonprofits that provide benefit to our communities and society.

The one issue that is most talked about as in need of policy change is the issue of payout rates, which has compared very favorably to foundation payouts—but not so favorably, of course, to direct giving, if you assume that the same amount would have been given elsewhere.

In any case, in the absence of transparency, one could assume that none of the proposals have merit or almost all of the proposals have merit—and therein lies a big problem. It should be said that many DAF sponsors have already begun implementing internal rules that answer

some of the concerns—for instance, some have rules in place to prevent funds from remaining dormant for too long. Fidelity Charitable, for example, sweeps funds that have been dormant for three years or more, and grants the money itself in individual funds. But codifying such practices and fine-tuning them to close any loopholes that have opened up during this period of explosive growth will either be done by the field in a way that lends itself to strict fieldwide standards or may eventually end up in the hands of Congress when we least expect it (and possibly following a scandal or two).

Finally, the whole field would benefit from independent research that examines a number of key questions, identifying patterns that violate standards already in law or regulation. This proposal was advanced in 2015 by the Urban Institute, in their paper “Discerning the True Policy Debate over Donor Advised Funds,” in which a call was issued to national DAF sponsors “to share data with independent third-party researchers in ways that could accommodate privacy concerns.”<sup>14</sup> In fact, such access could provide the robust research and data that would allay regulators’ concerns—if no cause for concern exists.

In the end, as former Massachusetts Attorney General Scott Harshbarger asserts in the introduction to this section, the field itself has an opportunity to achieve the best balance of imposed and voluntary accountability measures if it moves toward accrediting DAF sponsors, but it cannot expect the public to continue to take it on faith that these bodies are managed to the highest ethical standards without more assurances than exist now.

## NOTES

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