ISSUE GUIDE

What's the Issue?

FEDERAL

Regulating Donor Advised Funds

Background:

A donor-advised fund is a giving vehicle designed to manage donations on behalf of individuals, families or organizations. DAFs provide a flexible way for donors to give to charities—an alternative to direct giving or creating a private foundation. Donors to DAFs enjoy administrative convenience, tax advantages and cost savings compared to operating a private foundation..

DAFs are the fastest growing charitable giving vehicle in the United States, with more than 200,000 accounts open, holding over $53 billion in assets as of 2013. Contributions to DAFs now represent 7 percent of all individual donations to charity.

The first DAFs were developed by the New York Community Trust in 1931 and grew in popularity among community foundations across the United States. It was one of several types of funds community foundations offered. Although this form of giving has existed for over 70 years, the IRS only formally defined DAFs in 2006. Fidelity Investments accelerated the popularity of DAFs in 1991 with the creation of the Fidelity Charitable Gift Fund, a separate 501(c)(3) nonprofit organization. Soon after, Vanguard and Charles Schwab launched similar services, creating much greater public awareness and motivating more national sponsors, educational institutions and independent charities to offer DAFs.

As defined by the IRS, DAFs are separately identified funds or accounts established and maintained at a public charity. They allow donors to make a charitable donation and receive an immediate tax-benefit; in exchange, the donor transfers legal control over the funds to the charity. However, donors or their representatives retain non-binding advisory privileges with respect to the distribution of funds and investment of assets.

The Pros & Cons:

Over the last several years, critics of DAFs have sought greater regulation that would require more disclosure and establish minimum giving requirements. This section presents many of the statements that have been made in favor of those additional regulations and against additional regulations. These arguments come from media coverage, position papers, and online commentary. The statements here, pro or con, are not necessarily true, and do not represent the opinion of Philanthropy New York. This section is intended to summarize the arguments made by their proponents. We encourage the reader to check out the additional resources listed at the end of this piece.

Individual DAF accounts are not required to spend any particular percent of their assets per year on grants and administration. Critics of DAFs have characterized them as "warehousing" charitable dollars, with some donors taking a charitable deduction and then not distributing the DAF's assets promptly. Some critics are working to advance federal tax legislation that would set a payout rate for the funds. Others are advocating regulations that would force DAFs to disperse all funds within seven years. Recently proposed federal legislation would require (DAFs or charities) to pay out contributions within five years of receipt, and subject any remaining undistributed assets to a 20 percent excise tax.

The accusation that DAFs are holding onto charitable dollars that could be going to charities is probably the most common and fundamental critique. Those critics say that the best way to donate money is to pick a charity and give directly to it, and DAFs are an unnecessary mechanism.

By contrast, supporters of institutional philanthropy say there is considerable merit in dedicating resources to charitable purposes now, building those resources over time and continuing to direct funds strategically to nonprofits to address social challenges as they evolve. A much greater threat to most nonprofits' operating budgets is the decrease in federal, state and local government funding for social services. In contrast to government dollars, the rate of charitable giving has remained constant at about 2 percent of GDP. Of that 2 percent, 5 percent is currently going to DAFs.

In addition, supporters maintain that a DAF can streamline and support donors giving to multiple charities by making the process more regular and systematic. At the same time, the funds the donor intends to give to charity are invested for growth. DAFs are very helpful for donors making gifts of appreciated securities – it's far simpler to make a single transfer of stock into a DAF than to parcel out the stock shares to various charities. DAFs are particularly useful for gifts of closely-held stock.

Advocates for a stronger regulatory structure for DAFs have proposed that DAFs should have a mandated annual payout rate, suggesting the same, or larger, payout rate as the 5 percent applicable to private foundations.

Those concerned about this proposal note that while it may seem on its face to be straightforward, the result will be an increase in administrative costs for the institutions holding DAFs, including community foundations, and would thus ultimately reduce the dollars available for charities. In addition, the best data available demonstrates that the overall percentage of giving from DAFs averages 20 percent, a percentage far higher than any likely mandated payout rate.

Critics contend that DAFs are too opaque and that donor information should be made available to the nonprofit community. There may be value in donor transparency, yet charities regularly receive contributions where the institutional or individual donors ask to remain anonymous. Additionally, the vast bulk of donors are already known to the nonprofit community through their prior history of giving.

Supporters say DAFs make it much easier to make contributions to nonprofits once you've set aside money in a giving account. It is money dedicated to charity that a donor might have decided to spend on other less charitable pursuits. The act of establishing a DAF and having access to the tools for examining one's history of charitable giving can lead to more strategic giving than just writing occasional random checks to charities. Any mechanism that makes planned giving easier and more regular for donors is, supporters argue, ultimately a good thing for the nonprofit sector. With administrative costs lowered by economy of scale (as opposed to many small, independently run private foundations), more money goes to charitable giving instead of foundation operating costs. DAFs' ease of donating non-cash assets such as appreciated stock encourages people to give more generously. DAF managers have become very good at helping donors turn non-cash assets, such as shares of stocks that have appreciated, into cash for donations. That's something a typical small charity lacks the resources to do.

Supporters of DAFs also note that many of the organizations that manage them often support collective impact organizing and the development of learning among donor communities. Community foundations and other charitable sponsors can also leverage the many funds of donors who share a common interest in a specific issue, like child health or adult learning. This allows one individual to "combine forces" with others and have a greater impact on a shared cause. Many DAF managing organizations also provide materials and access to learning opportunities to grow a sense of community for the philanthropically-inclined. One of the common critiques of the national DAF managers in particular is that they do not do enough to support either collective giving or provide general information about worthy nonprofits to account holders.

At core, the arguments for and against regulating DAFs largely align with larger philosophical concerns about the best ways to encourage charitable giving and the value of dedicating resources to charitable endeavors over time versus distributing maximum resources immediately to current needs.

Philanthropy New York's Position:

Philanthropy New York has no official position on increased regulations for donor-advised funds.

PNY pays close attention to any new rules and regulations affecting the philanthropic sector and is generally concerned about any changes that might reduce charitable giving.

Many foundation and nonprofit leaders disagree with the proposed new rules on DAFs. Regulations on DAFs are a concern not only to the community foundations, charitable funds established by money management firms, and other public charities running them, but also to the entire philanthropic sector, which includes private foundations, corporate giving programs and family foundations. Holding funds in income-producing vehicles over long periods of time to support charitable purposes as they evolve over decades is crucial to nearly all "institutional" philanthropy, as practically all money for philanthropy is held in financial institutions that sustain themselves by holding and managing assets.

One of PNY's core values is transparency in philanthropy. As such, we encourage the organizations that manage donor-advised funds – and the entire philanthropic field – to provide appropriate data to the public annually that would help fully answer questions about payout rates.

Check out these additional information sources:

"Role of Donor-Advised Funds Prompts Heated Debate" – The Chronicle of Philanthropy

"The Rise of Donor-Advised Funds: Should Congress Respond? Conference Papers" – Boston College Forum on Philanthropy and the Common Good

"Backers and Critics of Donor-Advised Funds Debate Their Merits" – The Chronicle of Philanthropy

"Who's Afraid of DAFs?" –Stanford Social Innovation Review @ Philanthropy News Digest

"Should Congress Curb Donor Advised Funds?" – Forbes

"Growing Giving: American Philanthropy and the Potential of Donor-Advised Funds" –Manhattan Institute for Policy Research

"The New Reality in Donor-Advised Funds" – WealthManagement

"Sen. Grassley Worries Payout Rule for Donor-Advised Funds Would Backfire" – The Chronicle of Philanthropy

"5 Myths About Payout Rules for Donor-Advised Funds" –The Chronicle of Philanthropy

"Donors Use Charity to Push Free Market Policy in States" – The Center for Public Integrity

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