fall 2016

Nonprofit Newsletter Fall 2016 - Donor Advised Funds Spark Ongoing Debate

Over the past few decades, donor advised funds have become a significant avenue for charitable giving and are increasingly marketed as an attractive alternative to establishing private foundations. Notwithstanding this popularity, as donor advised funds continue to grow in size and scope, their use for estate planning and charitable giving purposes is the subject of debate.

Donor Advised Funds Generally

A donor advised fund is a fund or account (i) that is separately identified by reference to the contributions of a donor or donors, (ii) that is owned and controlled by a sponsoring organization and (iii) with respect to which a donor (or any person appointed or designated by such donor) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor's status as a donor. Once assets are contributed to a donor advised fund, the sponsoring organization makes the ultimate decision on when and how to deploy them for charitable purposes. Nonetheless, the donor has the ability to recommend beneficiaries to the sponsoring organization.

A donor who gives appreciated long-term capital assets (those held for more than one year) to a donor advised fund is entitled to an income tax deduction for the full fair market value of the gift, limited to 30 percent of the donor's contribution base (typically the donor's adjusted gross income). Gifts of cash have a deduction limit equal to 50 percent of a donor's contribution base. Amounts that the contribution limits prevent a donor from deducting in the year of the contribution may be carried forward for deduction in the five following tax years.

Donor advised funds can be subject to various taxes and penalties on certain transactions. Generally, a donor advised fund cannot make any distribution to an individual, for any non-charitable purpose or to tax-exempt organizations that are not public charities, and cannot provide any benefit to any "disqualified person" (a donor, a donor-advisor, a family member, or a 35 percent-controlled entity of a donor or donor-advisor) that is more than incidental.

Donor Advised Funds vs. Private Foundations

Higher deductibility limits is one feature that makes donor advised funds more attractive than private foundations. A donor who gives cash to a private non-operating foundation is entitled to an income tax deduction limited to 30 percent of the donor's contribution base, and a contribution of appreciated long-term capital assets is limited to 20 percent of the donor's contribution base.

Donor advised funds also lack the administrative and maintenance requirements that are incumbent upon private foundations. In addition, donor advised funds provide privacy for donors, who can recommend distributions from the donor advised fund to a charity without disclosing the donor's name. In contrast, private foundations are required to make their annual information returns available to the public.

Despite their popularity, donor advised funds have generated controversy in the estate planning and philanthropic communities. Some argue that a donor feels less urgency to actually make distributions to charity from a donor advised fund once the tax benefits of charitable giving have been claimed. Critics also contend that sponsoring organizations associated with financial institutions are disincentivized to encourage donors to make distributions, as fees are earned from managing the funds rather than from making distributions to charities. To ameliorate these issues, critics have suggested that donor advised funds should be required to fully pay out assets over periods ranging from five to 20 years or upon the occurrence of certain trigger events.

Supporters of the existing donor advised funds regime argue that donor advised funds often have payout rates above the 5 percent minimum distribution required of private foundations. They also claim that mandating minimum spending amounts on donor advised funds would increase administrative burdens on charities and potentially deprive them of resources that can be used for charitable purposes. They question why donor advised funds should be treated differently from endowment assets at universities, which may sit in perpetuity.

Donor advised funds will likely remain an important and growing part of the American charitable giving landscape for some time. So long as they present a simple means to facilitate charitable giving while allowing for generous tax deductions, donors will continue to use them. That said, the debate around the use of donor advised funds will likely remain unabated.