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Donor-Advised Funds (DAFs): Proposed Legislation

Donor-advised funds (DAFs) are funds or accounts established within a sponsoring organization. Taxpayers are allowed to make deductible charitable contributions to DAFs. Sponsoring organizations are organized as charities that can receive tax-deductible donations and they in turn make distributions (grants) to active charities. The gift to the sponsor is irrevocable, as in the case of a gift to a foundation or any other charity. The donor does not legally oversee the payment of grants to charities from the fund, which the sponsoring organization determines. Donors make recommendations for grants (hence donor-advised), and there is general agreement that these recommendations determine, with few exceptions, the distributions. DAFs, like private foundations, can accumulate assets and earn a return tax free, but they are not subject to many of the restrictions on foundations, including the minimum payout rate.

Magnitude and Growth of DAFs

DAFs have been growing rapidly, in part through funds set up by major financial institutions. Since 2016, contributions have increased by 90%, and in FY2020, accounted for 10.1% of total charitable giving. According to the National Philanthropic Trust 2021 report, in FY2020, there were more than 1.005 million individual DAFs, with contributions of $47.85 billion, assets of $159.83 billion, and distributions of $34.67 billion. The DAFs were managed by 55 national charities, 603 community foundations, and 318 single-issue charities.

Whereas DAFs were originally largely found among community foundations, grants, assets, and contributions are now concentrated in national charities. In FY2020, 61% of grants, 70% of contributions, 63% of assets, and 86% of accounts were in national charities. In FY2020, Fidelity Charity donors made 26% of grants; in FY2021, more than 286,000 donors had accounts at Fidelity Charity, with grants of over $10.3 billion. The five largest national charities—Fidelity Charitable, National Philanthropic Trust, Schwab Charitable Fund, Vanguard Charitable Endowment, and the Silicon Valley Community Foundation—were responsible for half the FY2020 contributions.

Average account sizes are smaller among national charities, $115,901, compared to $543,553 in community foundations and $244,238 in single-issue charities. The overall average account size is $159,019, an amount that has been falling as the relative size of assets in national charities has been growing.

Benefits and Concerns About DAFs

DAFs are a simpler way to provide sustained giving than through a private foundation, and they are practical for those with smaller amounts of charitable giving. Private foundations are complicated and costly to set up and run. DAFs can also facilitate year-end tax planning, by allowing a large contribution in a year when tax rates are higher, which can be distributed in the following years without determining the charities to receive deductions. Individuals may also choose to make large contributions in a single year when deductions can be itemized, rather than making smaller, potentially nondeductible charitable contributions annually.

Evidence suggests DAFs are replacing, rather than increasing, charitable giving. A 2021 report by Boston College Law School Forum on Philanthropy and the Public Good found that contributions to DAFs rose from 4% of total contributions in 2007 to 13% in 2019, whereas total charitable contributions remained unchanged as a share of income. The data also suggest that DAF contributions did not substitute for contributions to private foundations but rather displaced contributions to active charities. The share of giving to DAFs and private foundations combined grew from 18% in 2007 to 28% in 2019. It is possible that DAF giving is offsetting a general decline in giving, such as giving to religious organizations, although most of that decline preceded DAFs' growth.

A common concern about DAFs and their growth is that charitable contributions do not fully flow to active charities but may remain in DAF accounts. Assets can also remain in private foundations, although there is a 5% minimum distribution requirement. Contributions as a share of income are more restrictive for gifts to private foundations: 30% for private foundations compared to 50% for other charitable contributions. (The 50% limit is temporarily increased to 60% through 2025.) Gifts of appreciated property are limited to 20% for gifts to private foundations, but are 30% for charities. DAFs are also not subject to the private foundation excise tax of 1.39% of investment income or the private foundation rules on self-dealing. Thus, DAFs allow the accumulation of assets without some of the restrictions imposed on private foundations.

DAF payout rates (as a percentage of end of previous year assets) averaged 23.8%. Payouts were 23.9% from national charities, 19.8% from community foundations, and 35% from single-issue charities. Proponents of DAFs point to these measures as indications that DAFs are distributing more than private foundations, who, according to FoundationMark, typically distribute in the aggregate about 8% of assets.

A 2020 National Bureau of Economic Research study by James Andreoni and Ray Madoff (Working Paper 27888) contended that the payout rate is overstated for determining how much money is going to charities. The payout rate,

while comparable to that used by foundations, is measured as grants divided by beginning of year assets. They indicate that a proper measure is grants divided by the sum of *end of year* assets plus grants. (The denominator is also equal to beginning of year assets plus contributions plus earnings.) This method has significant effects when assets are growing rapidly, and the revised measure changed the payout rate from 22.4% to 14.7% in 2017. This measure was used in the past by the National Philanthropic trust and using this method for FY2020 resulted in a payout rate of 17.8%.

Although payout rates from assets are higher than the required minimum rate for private foundations, they reflect a mix of DAF objectives. Some accounts pay out most of their contributions as they are used for simplifying tax planning, whereas others maintain funds in accounts. The Andreoni and Madoff study found that even among DAF sponsors, 24% had payout rates of less than 5%. Some sponsors also provide for endowment DAFs that pay grants out of earnings.

No aggregate data exist on the payout rates for individual accounts in sponsoring organizations, but within sponsoring organizations, high payout rates for some accounts could conceal low or no payout rates for accounts. A Williams and Kienker study of 2,600 DAF accounts in Michigan community foundations found that, for 2020, 57% had distribution rates of less than 5%, including 35% of accounts that had no distributions. A Vance-McMullen and Heist study of 13,000 accounts in community foundations and religious-affiliated sponsors found 35% of accounts made distributions of less than 5% over the four years of the study, including 14% that made no distributions. Neither of these studies, however, included accounts with national sponsors that hold the most assets.

Some are concerned that DAF contributions to other DAFs are reported as charitable distributions and that private foundations' contributions to DAFs are counted as part of their minimum distributions.

Legislative Proposals

The Administration's FY2023 budget proposal contains a narrow provision that would affect DAFs, and more extensive legislation, the Accelerating Charitable Efforts (ACE) Act, has been introduced in Congress.

Administration Proposal

The FY2023 budget proposal would clarify that a distribution by a private foundation to a DAF does not count in satisfying the 5% minimum distribution requirement unless the DAF funds are distributed as grants by the end of the next year.

ACE Act

The ACE Act, S. 1981 (King and Grassley) and H.R. 6595 (Pingree, Reed, Khana, and Porter), includes the budget proposal regarding donations by private foundations but would make a broader set of changes to DAFs.

For existing DAFs, contributions of property (noncash contributions) would not be deductible unless the sponsoring organization sells the property for cash and deductions would not be allowed until the cash is distributed. Distributions would be on a first-in, first-out basis so that distributions would first come from preexisting amounts in the fund. The distribution would not be able to be made to another DAF to permit deductibility. Distributions would have to be made within 50 years or a 50% excise tax would apply.

The bill would create two categories of qualified DAFs not subject to these restrictions. A qualified DAF in general would terminate advisory privileges on a contribution and its earnings after the last day of the 14th taxable year beginning after the contribution year. The donor would have to specify a preferred organization to receive the distribution after 14 years. A 50% excise tax would be imposed on the sponsoring organization for amounts not distributed after 14 years. A qualified community foundation DAF is not subject to these restrictions but the bill would limit advisory privileges to $1 million and require a 5% payout from each account. No deduction for a nontradeable asset would be allowed to either type of qualified DAF until the asset is sold.

The public support test requires that a third of contributions for charities come from the public; otherwise, the charity may be classified as a private foundations. The bill provides that contributions from DAFs would not be counted unless the donor is identified.

The proposal also includes some provisions for private foundations unrelated to DAFs. One provision would disallow administrative expenses from qualifying for the 5% minimum distribution if made to disqualifying persons (such as substantial contributors). The bill also includes two provisions favorable to private foundations by eliminating the excise tax on investment income for foundations that distribute at least 7% of assets or foundations limited to 25 years.

Prior Proposed IRS Regulations

The public support test in the ACE Act was also included in a notice to consider regulations (IRS Notice 2017-73). The proposed regulations would also have asked for public comment on the inclusion of contributions to DAFs by private foundations in satisfying the 5% minimum payout rule. These proposed regulations have not been developed further.

Issues

As discussed earlier, one of the concerns addressed by the ACE Act is to speed the distribution of funds to active charities. Opponents argue that these rules would reduce charitable giving, although, as noted above, data on giving trends suggest that contributions to DAFs have displaced other giving rather than increasing overall giving.

One particular concern is the requirement that DAFs identify donors for purposes of the public charities support test. It is argued that this provision may make it more difficult for charities with sensitive or controversial issues to raise funds.

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