
OPENING THE FLOODGATES: PROVIDING LIQUIDITY TO THE
CHARITABLE MARKETPLACE THROUGH CHANGES TO DONOR-
ADVISED FUNDS

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Charitable giving in the United States is growing; one of the fastest growing vehicles in the space, however, is largely unknown to the public. The Internal Revenue Code (“the Code”) has provided an avenue for charitable giving known as the donor-advised fund. A donor-advised fund allows a donor to allocate assets to an investment intermediary—which is itself a charitable entity under the Code—as a charitable donation and immediately observe the tax benefit. These assets are not required to be donated to a traditional charity but rather are held by a fund managed by some of the largest financial institutions in the country. The fund (which now holds the donated asset) is actively managed and is held by, and pays fees to, the sponsoring organization. Upon donating the asset to the donor-advised fund, the donor loses all legal rights to the assets and can only make recommendations that the assets be liquidated and donated.

This Note recognizes the role donor-advised funds have had on charitable giving in the United States, and advocates for its protection as a charitable investment vehicle. However, while donor-advised funds are a very useful charitable investment vehicle, this Note argues that, in its current form, the vehicle incentivizes a clog of funds and harmful asymmetric information. Accordingly, this Note provides a path to a middle ground that protects benefits of the vehicle while also providing liquidity to the charitable marketplace. This Note recommends a method to eliminate certain aspects of donor-advised funds that cause asset build-up and simultaneously provide charities with an adequate tool for soliciting from established donor-advised funds by creating a charitable information marketplace. The recommended plan will not detract from the tax incentives of this charitable investment vehicle (i.e., immediate tax deduction and allowing tax-free growth) and will protect other donor interests such as acceptability of complex assets, legacy giving, and anonymity. As a result, the integrity of the Code and usefulness of the vehicle will be protected, further enhancing and solidifying the charitable marketplace by providing added liquidity.

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I. INTRODUCTION

Charitable giving in the United States is growing;¹ one of the fastest-growing vehicles in the space, however, is largely unknown to the public.² The Internal Revenue Code (“the Code”) has provided an avenue for charitable giving known as the donor-advised fund.³ The success of this vehicle is undeniable. The top charity in the United States is now Fidelity Charitable (a sponsoring organization that runs donor-advised funds), which beat out the United Way

1. See Giving Statistics, CHARITY NAVIGATOR, <http://www.charitynavigator.org/index.cfm/bay/content.view/cpid/42> (last visited May 20, 2018) (“Charitable giving continued its upward trend in 2016. . . . For the third year in a row, total giving reached record levels.”).

2. Peter J. Reilly, *Donor-Advised Funds: The Good, the Bad and the Ugly*, FORBES (June 24, 2016, 11:33 AM), <http://www.forbes.com/sites/peterjreilly/2016/06/24/donor-advised-funds-the-good-the-bad-and-the-ugly/#22fa70160294> (“DAFs have been in my bag of tricks for a while, but public awareness remains light.”).

3. 26 U.S.C. § 170(f)(18) (2012).

Worldwide in terms of donations from private sources.⁴ Furthermore, three other donor-advised fund sponsoring organizations were among the top twenty charities in the country for 2015.⁵

A donor-advised fund allows a donor to allocate assets to an investment intermediary—which is itself a charitable entity under the Code—as a charitable donation and immediately observe the tax benefit.⁶ These assets are not required to be donated to a traditional charity but rather are held by a fund managed by some of the largest financial institutions in the country.⁷ The fund (which now holds the donated asset) is actively managed and held by, and pays fees to, the sponsoring organization.⁸ Upon donating the asset to the donor-advised fund, the donor loses all legal rights to the assets and can only make recommendations that the assets be liquidated and donated.⁹

This framework has provided a steady growth in donor-advised funds over the past seven years, both in total assets and number of funds.¹⁰ The most recent data shows that donor-advised fund assets are over \$85 billion in the United States.¹¹ Critics assert that the vehicle is ripe for tax-abuse¹² and, in turn, provides either no benefit, or a delayed benefit, to traditional charities.¹³ Many argue that this vehicle must be altered to simultaneously protect the charitable intent donations, ensure the vehicle is not abused for tax benefits, and protect charities.¹⁴ Others maintain that the vehicle's current form is a positive

4. Drew Lindsay, Peter Olsen-Phillips & Eden Stiffman, *Fidelity Charitable Pushes United Way Out of Top Place in Ranking of the 400 U.S. Charities That Raise the Most*, CHRON. PHILANTHROPY (Oct. 27, 2016), <https://www.philanthropy.com/article/Fidelity-Charitable-Knocks/238167>; Vauhini Vara, *Donor Advised Funds Create Striking Changes to Charity Landscape*, NEW YORKER (Oct. 27, 2016), <https://rpmnewsdigest.wordpress.com/2016/10/31/donor-advised-funds-create-striking-changes-to-charity-landscape/>; see also *Fidelity Charitable Ranks No. 1 on 2016 Philanthropy 400 List*, GRANTWELL (Oct. 27, 2016), <http://www.thegrantwell.com/news/2016/10/27/fidelity-charitable-ranks-no-1-on-2016-philanthropy-400-list> [hereinafter *Fidelity Charitable Ranks No. 1*].

5. Fidelity Charitable ranks first, Schwab Charitable ranks fourth and Vanguard Charitable ranked eleventh on this year's Philanthropy 400. Vara, *supra* note 4. Further, National Philanthropic Trust ranked seventeenth on the 2015 Philanthropy 400. Lindsay, Olsen-Phillips & Stiffman, *supra* note 4.

6. See *5 Primary Tax Benefits to Donors*, AM. ENDOWMENT FOUND., <https://www.aefonline.org/tax-benefits> (last visited May 20, 2018); *The Tax Advantages of Donor-Advised Funds*, NAT'L PHILANTHROPIC TR., <https://www.nptrust.org/what-is-a-donor-advised-fund/daf-tax-consideration> (last visited May 20, 2018).

7. Veronica Dagher, *How Donor-Advised Funds Work—and Don't Work*, WALL ST. J. (Feb. 9, 2014, 4:57 PM), <http://www.wsj.com/articles/SB10001424052702304325004579296302683506122> [hereinafter Dagher, *How Donor-Advised Funds Work*].

8. *Id.*

9. Lewis B. Cullman & Ray Madoff, *The Undermining of American Charity*, N.Y. REV. BOOKS (July 14, 2016), <http://www.nybooks.com/articles/2016/07/14/the-undermining-of-american-charity/>.

10. *2017 Donor-Advised Fund Report: Introduction*, NAT'L PHILANTHROPIC TR., <https://www.nptrust.org/daf-report/introduction.html> (last visited May 20, 2018) [hereinafter *2017 Donor-Advised Fund Introduction*].

11. *Id.*

12. See *Donor-Advised Funds*, IRS, <https://www.irs.gov/charities-non-profits/charitable-organizations/donor-advised-funds> (last updated Aug. 3, 2017) [hereinafter *IRS Donor-Advised Funds*].

13. See, e.g., Cullman & Madoff, *supra* note 9.

14. *Id.*; Veronica Dagher, *Risks to Consider with Donor-Advised Funds*, WALL ST. J. (Apr. 13, 2014, 4:50 PM), <http://www.wsj.com/articles/SB10001424052702303725404579459240785431588> [hereinafter Dagher, *Risks with Donor-Advised Funds*].

force on charitable giving and that proposed changes to the vehicle could discourage charitable giving.¹⁵

This Note recognizes the role donor-advised funds have had on charitable giving in the United States,¹⁶ and advocates for its protection as a charitable investment vehicle.¹⁷ While donor-advised funds are a very useful charitable investment vehicle,¹⁸ this Note argues that, in its current form, the vehicle incentivizes a clog of funds and harmful asymmetric information. Accordingly, this Note provides a path to a middle ground that protects benefits of the vehicle while also providing liquidity to the charitable marketplace. This Note recommends a method to eliminate certain aspects of donor-advised funds that cause asset build-up and simultaneously provide charities with an adequate tool for soliciting from established donor-advised funds by creating a charitable information marketplace. The recommended plan will not detract from the tax incentives of this charitable investment vehicle (*i.e.*, immediate tax deduction and allowing tax-free growth) and will protect other donor interests such as acceptability of complex assets, legacy giving, and anonymity.¹⁹ As a result, the integrity of the Code and usefulness of the vehicle will be protected, further enhancing and solidifying the charitable marketplace by providing added liquidity.

Part II of this Note reviews the tax basics of charitable donations under the Code and examines how the Code treats donor-advised funds. It further describes the role the Pension Protection Act of 2006 plays in regulating donor-advised fund abuse. Finally, Part II also looks at the functional aspects and characteristics of donor-advised funds in practice, and the impact that donor-

15. See Howard Husock, *Why Donor-Advised Funds Can Increase Charitable Giving*, INSIDE PHILANTHROPY (Apr. 23, 2015), <http://www.insidephilanthropy.com/home/2015/4/23/why-donor-advised-funds-can-increase-charitable-giving.html>.

16. From 2009 through 2014, charitable giving by individuals increased in inflation-adjusted dollars. *Charitable Giving in America: Some Facts and Figures*, NAT'L CTR. FOR CHARITABLE STAT., <http://nccs.urban.org/nccs/statistics/charitable-giving-in-america-some-facts-and-figures.cfm> (last visited May 20, 2018). Further, in 2016 Americans gave over \$390 billion, an increase of 4.2% from 2015. *Charitable Giving Statistics*, NAT'L PHILANTHROPIC TR., <https://www.nptrust.org/philanthropic-resources/charitable-giving-statistics/> (last visited May 20, 2018); see also *Giving USA: 2015 Was America's Most-Generous Year Ever*, GIVING USA (June 13, 2016, 4:58 PM), <https://givingusa.org/giving-usa-2016/> [hereinafter *2015 Was America's Most-Generous Year*].

17. Cullman & Madoff, *supra* note 9 (“We now write because we are alarmed about a major new force that has entered the field of charitable giving. . . . But now it is threatening to undermine the American system for funding charity. This force is the commercial ‘donor-advised fund,’ the fastest-growing, but still largely unknown, charitable vehicle.”).

18. Donor-Advised funds are often referred to as a charitable savings account. See *What Is a Donor-Advised Fund (DAF)?*, NAT'L PHILANTHROPIC TR., <https://www.nptrust.org/what-is-a-donor-advised-fund> (last visited May 20, 2018) [hereinafter *What is a DAF?*].

19. See *Donor-Advised Fund Program Guide*, NAT'L PHILANTHROPIC TR. 8, <https://www.nptrust.org/daf-forms/Donor-Advised-Fund-Program-Guide.pdf> (last visited May 20, 2018) [hereinafter *Program Guide*]; *NPT Donor-Advised Funds: FAQ*, NAT'L PHILANTHROPIC TR., <https://www.nptrust.org/donor-advised-funds/faq> (last visited May 20, 2018) [hereinafter *Donor-Advised Funds FAQ*]; *What Is a Donor-Advised Fund?*, FIDELITY CHARITABLE, <https://www.fidelitycharitable.org/giving-strategies/give/donor-advised.shtml> (last visited May 20, 2018) [hereinafter *What is a Donor-Advised Fund?*, FIDELITY CHARITABLE].

advised fund growth has had on charitable giving. Part III analyzes the tax incentives and benefits of donating through a donor-advised fund, the common critiques of donor-advised funds, how charities have responded to the new charitable landscape created by donor-advised funds, and an examination of pre-existing proposals to alter donor-advised funds. Part IV recommends a two-prong approach that would facilitate a higher rate of distribution from donor-advised funds to traditional charities. First, this plan will enact a coordinated scheme of removing the perpetuity aspect allowed in practice while simultaneously amending § 4966(c)(2) of the Code to change tax-exempt distributions from donor-advised funds. Second, the plan will then establish an information marketplace for donor-advised funds to be used by charities for a more open communication of information. Part V concludes.

II. BACKGROUND

This Part will outline the basics of charitable giving under the Code as well as the associated requirements imposed on donations made via donor-advised funds under the Code. This Part will then provide a brief overview of the Pension Protection Act of 2006 (“the PPA”) and its impact on donor-advised funds. Next, this Part will examine some characteristics and realities of the vehicle in practice and finally will close with an examination of the impact that the growth of donor-advised funds has had on charitable giving.

A. *The Mechanics of Charitable Donations and Donor-Advised Funds Under the Code*

The Code provides incentives in the form of an income tax deduction and governs the rules around charitable giving.²⁰ Specifically, § 170(a)(1) of the Code provides that “[t]here shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year.”²¹ “Charitable contribution” is then defined under § 170(c) as: “a contribution or gift to or for the use of . . . (2) A corporation, trust, or community chest, fund, or foundation . . .”²² Simply put, the taxpayer gets to deduct from gross income the amount of a qualifying charitable donation as defined under the Code, subject to limitations.²³

Before donor-advised funds were codified, the United States Claims Court analyzed an analogous case. In *National Foundation, Inc. v. United States*,²⁴ the National Foundation, Inc. (“NFI”) sought a judgment that it was a tax-exempt organization under § 501(c)(3) of the code.²⁵ NFI had stated two

20. See 26 U.S.C. § 170 (2012).

21. *Id.* § 170(a)(1).

22. *Id.* § 170(c).

23. 5 *Primary Tax Benefits to Donors*, *supra* note 6. Limitations include 60% of adjusted gross income if cash is donated and 30% of adjusted gross income for the deduction of securities. *Id.*

24. 13 Cl. Ct. 486, 488 (1987).

25. *Id.*

purposes: “(1) to raise and distribute funds to other nonprofit organizations; and (2) to initiate, fund, and administer a wide variety of charitable, educational, religious, scientific, and literary projects, most of which are recommended by donors.”²⁶ The court found that NFI refused to administer a project if it did not meet its five standards and that donors relinquished ownership and control and had donated the funds to NFI, which had full autonomy to reject any suggestion or request made by the donor.²⁷ This case laid the foundation for what is currently found in the Code. Sponsoring organizations are themselves § 501(c)(3) entities²⁸ and eligible to receive charitable deductions under § 170, allowing the Code’s current mechanics.

After the PPA,²⁹ donor-advised funds were incorporated under the Code, specifically under §§ 170 and 4966.³⁰ § 170(f)(18) provides:

- (18) CONTRIBUTIONS TO DONOR ADVISED FUNDS.—A deduction otherwise allowed under subsection (a) for any contribution to a donor advised fund (as defined in § 4966(d)(2)) shall only be allowed if—
- (A) the sponsoring organization (as defined in § 4966(d)(1)) with respect to such donor advised fund is not—
- [subsections (i) and (ii) are omitted; each provides requirements on the sponsoring organization]
- (B) the taxpayer obtains a contemporaneous written acknowledgement (determined under rules similar to rules of paragraph (8)(C)) from the sponsoring organization (as so defined) of *such donor advised fund that such organization has exclusive legal control over the assets contributed*.³¹

Therefore, under § 170(f)(18), a donation to a donor-advised fund is recognized as a charitable contribution if the taxpayer chooses the appropriate sponsoring organization, relinquishes legal control of the assets, and receives a contemporaneous written acknowledgement detailing such relinquishment of control.³² Only then will the taxpayer get the income tax deduction benefit.³³ Of note, a contemporaneous written acknowledgement under this section “is obtained on or before the earlier of (1) the date the taxpayer files a return for the tax year in which the contribution was made, or (2) the due date (including extensions) for filing the return.”³⁴ Further, this written acknowledgment explicitly details that the donor acknowledges that he or she no longer maintains legal control over

26. *Id.*

27. *Donor-Advised Funds Guide Sheet Explanation*, IRS 1–2 (July 31, 2008), https://www.irs.gov/pub/irs-tege/donor_advised_explanation_073108.pdf.

28. See 26 U.S.C. §§ 170, 4966(d) (2012); see also *IRS Donor-Advised Funds*, *supra* note 12.

29. An overview of the PPA is provided *infra* Section II.B.

30. See 26 U.S.C. §§ 170(f)(18), 4966 (2012).

31. *Id.* § 170(f)(18) (emphasis added).

32. See *id.*

33. See *id.*

34. *Id.*

the assets.³⁵ The relinquishment of control a common criticism regarding donor-advised funds.³⁶

Donor-advised funds and sponsoring organizations are defined elsewhere in the Code.³⁷ Specifically, § 4966(d) provides:

- (d) DEFINITIONS.—For purposes of this subchapter—
 - (1) SPONSORING ORGANIZATION.—the term “sponsoring organization” means any organization which—
 - (A) is described in section 170(c) (other than in paragraph (1) thereof, and without regard to paragraph (2)(A) thereof),
 - (B) is not a private foundation (as defined in section 509(a)), and
 - (C) maintains 1 or more donor advised funds.
 - (2) DONOR ADVISED FUND.—
 - (A) IN GENERAL.—Except as provided in subparagraph (B) or (C), the term “donor advised fund” means a fund or account—
 - (i) which is separately identified by reference to contributions of a donor or donors,
 - (ii) which 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.³⁸

The Code goes on to establish that exceptions do not include, for example, an account that makes distributions to a single organization or governmental entity.³⁹

At this point, it is imperative to summarize the organizational structure of this vehicle: the sponsoring organization (a charitable entity itself) establishes, maintains, and runs donor-advised funds.⁴⁰ The sponsoring organization is the owner of the asset,⁴¹ and the donor retains advisory privileges only.⁴² This

35. *Id.*

36. See discussion *infra* Section III.B. for a full analysis; see also Alan Cantor, *Strings on Donor-Advised Funds Are Making Charity Supporters Angry*, CHRON. PHILANTHROPY (Aug. 12, 2015), <https://www.philanthropy.com/article/Opinion-Strings-on/232197> [hereinafter Cantor, *Strings on Donor-Advised Funds*]; Cullman & Madoff, *supra* note 9; Dagher, *Risks with Donor-Advised Funds*, *supra* note 14; Mark Noll, *Donor Advised Funds: The Good, the Bad and the Ugly*, RES. PROJECT INST. (Jan. 19, 2015), <http://www.prospectresearchinstitute.org/dafs-goodbadugly/>.

37. 26 U.S.C. § 4966(d)(1)–(2) (2012).

38. *Id.* § 4966(d).

39. See *id.* § 4966(d)(2)(A)–(B).

40. Terry W. Knoepfle, *The Pension Protection Act of 2006: A Misguided Attack on Donor-Advised Funds and Supporting Organizations*, 9 FLA. TAX REV. 221, 224 (2009); see also *Frequently Asked Questions*, FIDELITY CHARITABLE, <https://www.fidelitycharitable.org/faqs.shtml#start> (last visited May 20, 2018) [hereinafter *Frequently Asked Questions*, FIDELITY CHARITABLE].

41. Knoepfle, *supra* note 40, at 227.

42. 26 U.S.C. § 170(f)(18)(B) (2012).

structure provides consistency between sections of the Code. § 170(f)(18) requires that the donor relinquish legal control over the asset.⁴³ Similarly, § 4966(d) requires that the donor merely has a reasonable expectation for advisory privileges after the donation is made.⁴⁴

There are limitations on what institutions can actually qualify as a sponsoring organization and create donor-advised funds.⁴⁵ The most popular sponsoring organizations have become financial institutions such as Fidelity, Vanguard, and Schwab.⁴⁶ The growth of these institutions is discussed later in this section.⁴⁷

Finally, the Code limits the amount of donation that will be allowed as a deduction by the donor.⁴⁸ Generally, cash donations are subject to a 60% limitation of the taxpayer's gross income, so long as that donation is made to a qualifying charity.⁴⁹ That requirement is true for cash donations to donor-advised funds as well.⁵⁰ For donations of appreciated assets to donor-advised funds, the limitation is lowered to 30% of the taxpayer's adjusted gross income.⁵¹ There are also a number of other requirements for charitable giving, such as obtaining a receipt for certain deductions⁵² and maintaining records of the donation,⁵³ which are outside the scope of this Note.

B. The Pension Protection Act of 2006: Protecting Against Donor-Advised Fund Abuse

The PPA defined for the first time a donor-advised fund under the Code, specifically in § 4966.⁵⁴ The PPA enacted many provisions aimed at curtailing abuse of this vehicle and improving the accountability of donor-advised funds.⁵⁵ By defining terms donor-advised fund and sponsoring organization and enacting a scheme of excise taxes of donors, sponsoring organizations and advisors are penalized for any improper usage of donor-advised funds.⁵⁶ The Internal Revenue Service ("IRS" or "Service") is "aware of a number of organizations that appeared to have abused the basic concepts underlying donor-advised funds. . . . established for the purpose of generating questionable chari-

43. *Id.*

44. 26 U.S.C. § 4966(d)(2)(A)(iii).

45. *See id.* § 4966.

46. Cullman & Madoff, *supra* note 9; *see also* Lindsay, Olsen-Phillips & Stiffman, *supra* note 4; Vara, *supra* note 4.

47. *See infra* Section II.D.

48. *See* 26 U.S.C. § 170(b)(1) (2012).

49. *Id.*; *see also* *What Is a Donor-Advised Fund?*, FIDELITY CHARITABLE, *supra* note 19.

50. *What Is a Donor-Advised Fund?*, FIDELITY CHARITABLE, *supra* note 19.

51. 26 U.S.C. § 170(b)(1)(C)(i); *see also* *What Is a Donor-Advised Fund?*, FIDELITY CHARITABLE, *supra* note 19.

52. *See* 26 U.S.C. § 170(f)(8) (listing substantiation requirements for donations of over \$250).

53. *Id.* § 170(f)(17).

54. *Donor-Advised Funds Guide Sheet Explanation*, *supra* note 27, at 2–3.

55. *Id.* at 2.

56. *Id.*

table deductions, and impermissible economic benefits to donors and their families . . . and management fees for promoters.”⁵⁷

The IRS may take a series of actions in relation to impropriety and donor-advised fund abuse.⁵⁸ Such actions include the disallowance of deductions for a charitable contribution on payment to the fund, excise taxes on sponsoring organizations and managers of donor-advised funds, excise taxes on donors or managers of donor-advised funds, and denial or revocation of a charity’s § 501(c)(3) exemption.⁵⁹ Under § 4966 of the Code, the structure of the excise tax regime starts with the definition of taxable distributions.⁶⁰ Specifically, § 4966 provides:

- (c) TAXABLE DISTRIBUTION.— For purposes of this section—
- (1) IN GENERAL.— the term “taxable distribution” means any distribution from a donor advised fund—(A) to any natural person, or(B) to any other person if—
- (i) such distribution is for any purpose other than the one specified in section 170(c)(2)(B), or
- (ii) the sponsoring organization does not exercise expenditure responsibility with respect to such distribution in accordance with section 4995(h).⁶¹

This definition sets up the entire framework and allows the excise tax regime examined below to operate.⁶²

Professor Knoepfle walked through the PPA’s impact on donor-advised funds in a 2009 article.⁶³ In § 4966 of the Code, a 20% tax on sponsoring organizations is imposed for taxable distributions, as well as a 5% tax on “any fund manager who knowingly makes such a distribution. . . .”⁶⁴ The 5% tax for this violation is limited to \$10,000.⁶⁵ In addition, the Service states that “transactions between sponsoring organizations and fund managers may be subject to intermediate sanctions excise taxes and donor-advised funds may be subject to taxes on excess business holdings.”⁶⁶ Specifically, § 4943(e) applies a 10% ex-

57. *IRS Donor-Advised Funds*, *supra* note 12.

58. *Id.*

59. *Id.*

60. 26 U.S.C. § 4966(c) (2012).

61. *Id.*

62. See 26 U.S.C. §§ 4966, 4967, 4958 (2012) (enacting excise taxation based on improper distributions as defined therein).

63. Knoepfle, *supra* note 40, at 244–45.

64. 26 U.S.C. § 4966(a); Knoepfle, *supra* note 40, at 243. Of note, a fund manager is defined as “an officer, director, or trustee of [a] sponsoring organization (or an individual having powers or responsibilities similar to those officers, directors, or trustees of the sponsoring organization) . . .” 26 U.S.C. § 4966(d)(3).

65. Knoepfle, *supra* note 40, at 246–47.

66. *New Requirements for Donor-Advised Funds*, IRS, <https://www.irs.gov/charities-non-profits/charitable-organizations/new-requirements-for-donor-advised-funds> (last updated Apr. 26, 2018).

cise tax on the value of excess business holding, and, if not disposed of quickly enough, an additional tax of 200% of excess holdings is imposed.⁶⁷

The PPA also added § 4967 to the Code.⁶⁸ § 4967 imposes excise taxes on more than incidental benefits received and taxes the fund manager who knowingly makes an improper distribution.⁶⁹ § 4967 provides that the donor is subject to an excise tax for 125% of the value of the benefit received that results in an incidental benefit to the donor, donor advisor, or related person who advises the sponsoring organization to make such distribution from a donor-advised fund.⁷⁰ Specifically, if “disqualified persons provide advice to a donor-advised fund that results in any disqualified person receiving more than an incidental benefit, an excise tax of 125% is imposed on that person.”⁷¹ Further, “[t]he disqualified person who benefits from an excess benefit transaction is liable for the excise tax.”⁷² Fund management also receives a 10% excise tax of the incidental benefit received.⁷³

Finally, § 4958 of the Code “imposes an excise tax on excess benefit transactions between a disqualified person and an applicable tax-exempt organization.”⁷⁴ Specifically, any “grant, loan, compensation, or other similar payment from a donor-advised fund to a person that with respect to such fund is a donor, donor advisor, or a person related to . . . automatically is treated as an excess benefit transaction under section 4958.”⁷⁵ The entire amount paid to such person is then treated as an excess benefit subject to taxation.⁷⁶ In all, donor-advised funds and sponsoring organizations are subject to the requirements of the PPA,⁷⁷ which enables the IRS to use appropriate action to combat the improper usage of donor-advised funds.⁷⁸

C. *Characteristics and Functionality of Donor-Advised Funds in Practice*

In practice, donor-advised funds come with a variety of characteristics that are examined in this Section. These include: assets the vehicle can accept, fees (which individuals primarily use this vehicle), the use of the vehicle as a legacy-planning device, and unexpected limitations of donating possibilities. Each is examined below.

67. *Donor-Advised Funds Guide Sheet Explanation*, *supra* note 27, at 5.

68. Knoepfle, *supra* note 40, at 246.

69. 26 U.S.C. § 4967 (2012).

70. *Id.*

71. Knoepfle, *supra* note 40, at 251.

72. *Intermediate Sanctions*, IRS, <https://www.irs.gov/charities-non-profits/charitable-organizations/intermediate-sanctions> (last updated Mar. 12, 2016).

73. 26 U.S.C. § 4967.

74. *Intermediate Sanctions*, *supra* note 72.

75. *Donor-Advised Funds Guide Sheet Explanation*, *supra* note 27, at 5.

76. *Id.*

77. *New Requirements for Donor-Advised Funds*, *supra* note 66.

78. *IRS Donor-Advised Funds*, *supra* note 12.

One characteristic of charitable giving that is somewhat unique to donor-advised funds is the ability to take in complex assets.⁷⁹ Donor-advised funds easily accept a variety of property, including common types such as cash equivalents, publicly traded securities, and mutual fund shares.⁸⁰ Complex assets such as illiquid privately held C corporation shares, restricted stock, personal property (such as artwork and collectibles), and real estate (among other assets) are eligible to be donated to a donor-advised fund.⁸¹ Through this wide array of assets, donor-advised funds provide flexibility, further control to the donor, and makes giving more accessible.⁸²

These three benefits are easily demonstrated when considering donating appreciated securities or complex assets. The benefit often can be found in the low cost basis that provides a maximum tax benefit to the donor.⁸³ While donating assets such as these to traditional charities would provide the same benefit, contributing complex assets to charity “can be complicated and is fraught with technical requirements and potential pitfalls.”⁸⁴ Donating to a donor-advised fund makes the process easier and can be financially advantageous for the traditional charity.⁸⁵ Often times, the traditional charity is not equipped to handle contributions of these types, and even if able to handle these securities, the cost imposed on the charity can be great.⁸⁶ Accordingly, they may ask the donor to liquidate the asset and donate the proceeds—which of course takes away from the tax advantages of the donation in the first place.⁸⁷ Because of the cost of these items and tax benefits to the donor, donor-advised funds maximize net proceeds available to charitable organizations, making them the optimal vehicle for complex assets.⁸⁸ The sponsoring organization as the legal owner of the assets (as discussed above) has the responsibility for liquidating complex assets, relieving the burden on traditional charities.⁸⁹ Since they are tax-exempt entities themselves (specifically, § 501(c)(3) entities), when the sponsoring organization liquidates the asset there are no taxes paid on the liquidation.⁹⁰

79. Karla D’Alleva Valas, *Donating Complex Assets to Charity: An Effective and Tax-Efficient Way to Make More of a Difference*, FIDELITY CHARITABLE 1, <https://www.fidelitycharitable.org/docs/Donating-Non-Publicly-Traded-Assets.pdf> (last visited May 20, 2018); see also *What Is a Donor-Advised Fund?*, FIDELITY CHARITABLE, *supra* note 19.

80. *What Is a Donor-Advised Fund?*, FIDELITY CHARITABLE, *supra* note 19.

81. Valas, *supra* note 79, at 2.

82. *Fidelity Charitable Ranks No. 1*, *supra* note 4.

83. Valas, *supra* note 79, at 1. The cost basis of an asset is a tax concept and is an incredibly important portion of this calculation. Cost basis is how gains on property are calculated (MV of the asset minus the adjusted-cost basis). See 26 U.S.C. §§ 1001, 1011, 1012 (2012).

84. Valas, *supra* note 79, at 1.

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.* at 2.

89. *Id.* at 3.

90. See 26 U.S.C. § 501(a) (2012).

After taking legal control of the asset,⁹¹ the sponsoring organization assumes a variety of responsibilities.⁹² These responsibilities include “donor services, phone support, mailed notices, statements and communications, tax reporting, compliance, grants administration, and online services.”⁹³ For these services, the sponsoring organization unsurprisingly charges an administrative fee, which is charged directly to the fund, not the donor.⁹⁴ While processes may vary, institutions such as the American Endowment Foundation (“AEF”) force an additional 1% distribution from the investment account to AEF’s liquidity fund, from which the administration fee is taken.⁹⁵ Once a year, a further distribution is taken to return this liquidity account to 1%.⁹⁶ The effect of this process is the amount removed from the account exceeds that of the administrative fees on an annual basis to keep the donor-advised fund’s liquidity account at 1%.⁹⁷ Another common criticism of donor-advised funds is that these fees—while aimed at operating the vehicle and providing the service—take away from money that would have been donated to charity.⁹⁸ The dichotomy between allowing assets to grow and fees being taken away from the charitable donation will be discussed further in the analysis.⁹⁹

Another unique aspect of donating assets through a donor-advised fund is the ability of donors to use the vehicle to support their legacy plans.¹⁰⁰ There are a variety of succession options available to donors that use donor-advised funds.¹⁰¹ This flexibility allows the donor to establish a legacy into perpetuity as they would like.¹⁰² The donor can retain assets in the account and appoint successors as advisors, establish a new donor-advised fund account for each individual named as a successor (funded from the balance of the original donor-advised fund upon death), and name charitable beneficiaries.¹⁰³ By appointing successors, a donor may also appoint secondary advisors who can recommend from the account, though such advisor will not automatically become a successor.¹⁰⁴ Finally, the donor may also name a financial advisor to the fund who will also receive the authority to recommend investment allocations and grants

91. *Getting Started*, AM. ENDOWMENT FOUND., <https://www.aefonline.org/getting-started-donor-advised-fund> (last visited May 20, 2018).

92. *Id.*

93. *Id.*

94. *Id.*

95. *New DAF Procedure*, AM. ENDOWMENT FOUND., <https://marketing.aefonline.org/acton/attachment/9733/f-0056/1/-/-/-/New%20DAF%20Procedure%20Sheet.pdf> (last visited May 20, 2018).

96. *Id.*

97. *Id.*

98. Cullman & Madoff, *supra* note 9.

99. *See infra* Section III.B.

100. *Planning for the Future*, FIDELITY CHARITABLE, <https://www.fidelitycharitable.org/giving-account/giving-account-details/planning-for-the-future.shtml> (last visited May 20, 2018); *Program Guide*, *supra* note 19, at 8; *What Is a Donor-Advised Fund?*, FIDELITY CHARITABLE, *supra* note 19.

101. *Program Guide*, *supra* note 19, at 8.

102. *See id.*

103. *Id.*

104. *Id.*

on the primary advisor's behalf.¹⁰⁵ If the donor has no recommended grants or successors upon his or her death, the entire balance is generally given to the sponsoring organization's giving fund.¹⁰⁶

Donor-advised funds are used primarily by wealthy donors.¹⁰⁷ One reason for this phenomenon is the minimum requirement to start a donor-advised fund that are imposed by sponsoring organizations.¹⁰⁸ For example, "Fidelity and Schwab both require a minimum of \$5,000 to start an account, and Vanguard and National Philanthropic Trust set the bar much higher, at \$25,000."¹⁰⁹ Vanguard also requires that subsequent donations to the fund exceed \$5,000, and that distributions from the fund to the subsequent charity be at least \$500.¹¹⁰ Another reason why this vehicle is used primarily by the very wealthy are the administrative fees charged by the sponsoring organization.¹¹¹ Additionally, the control and flexibility provided led one commentator to observe "[t]he greatest beneficiaries are wealthy donors. Affluent people love [donor-advised funds] because they make it easy to time their contributions to get the maximum tax benefit—without giving up any say over where the funds will go, and in many cases, how their assets are managed."¹¹² Simply put, starting a donor-advised fund with small donations is either prohibited by initial donations, or its effectiveness is severely curtailed or minimized by the impact of minimums or fees.¹¹³ The average individual donor-advised fund in 2016 had approximately \$269,550, according to National Philanthropic Trust.¹¹⁴ This number is up from the 2015 average, which was \$259,726.¹¹⁵

There are misunderstandings of the general rules or operations of donations through donor-advised funds on behalf of the donors.¹¹⁶ For example,

105. *Id.*

106. See *Donor-Advised Funds FAQ*, *supra* note 19. The AFA Foundation, which also is a sponsoring organization, process for this situation is

[t]he income and the principle of the DAF shall not be subject to any restrictions of the Agreement, shall be co-mingled with other funds or property of AFA Foundation, and shall be held, administered and distributed for such charitable, educational, and religious purposes as AFA Foundation, in its sole discretion, deems advisable.

Id.; *Frequently Asked Questions About Donor Advised Fund*, AFA FOUND., <http://afafoundation.net/?pageID=1007> (last visited May 20, 2018) [hereinafter *AFA FAQ*].

107. Kerri Anne Renzulli, *Everything You Need to Know About Giving to Charity Through a Donor-Advised Fund*, TIME MONEY (Dec. 22, 2015), <http://time.com/money/4142706/charity-donor-advised-fund/>; see also Vara, *supra* note 4.

108. Renzulli, *supra* note 107.

109. *Id.*

110. *Id.*

111. *Id.*

112. Ray D. Madoff, *Charities and Taxpayers Deserve More from Donor-Advised Funds*, CHRON. PHILANTHROPY (Oct. 27, 2016), <https://www.philanthropy.com/article/Opinion-Charities-and/238202> [hereinafter Madoff, *Charities and Taxpayers Deserve More*].

113. See Renzulli, *supra* note 107.

114. *2017 Donor-Advised Fund Report: Comparison by Sponsor Types*, NAT'L PHILANTHROPIC TR., <https://www.nptrust.org/daf-report/sponsor-type-comparison.html> (last visited May 20, 2018) [hereinafter *2017 Donor-Advised Fund Comparison*].

115. *Id.*

116. Cantor, *Strings on Donor-Advised Funds*, *supra* note 36.

rules of donor-advised funds prevent providing personal benefits for a donor-advised fund.¹¹⁷ This problem was highlighted by a national conservation group, which quoted an employee as stating that “[d]ealing with angry donors is pretty much my full-time job. And nearly all the anger revolves around misunderstanding about giving through their donor-advised funds.”¹¹⁸ Misunderstandings often extend to what charities or entities can actually be donated to from the donor-advised fund, or else be subjected to an excise tax.¹¹⁹ Further discussion of the issues with donor-advised funds, as well as discussion of the benefits received by the taxpayer and positives of the vehicle, is taken up in Part III.¹²⁰

D. *Impact of Donor-Advised Funds on Charitable Giving*

Despite the fact that donor-advised funds have been around since the 1930s,¹²¹ the vehicle’s popularity is undeniably growing¹²² and is changing how people give to charity.¹²³ For the seventh consecutive year the number of individual donor-advised funds, total contributions to donor-advised funds, and total assets held by donor-advised funds grew.¹²⁴ In 2016, contributions to donor-advised funds hit an all-time high of \$23 billion.¹²⁵ Contributions to donor-advised funds increased 9.7% in 2016.¹²⁶ Donor-advised fund assets are now over \$85 billion.¹²⁷

Donor-advised funds are also becoming some of the most popular charities in the United States, as two donor-advised funds are in the top five of the “Philanthropy 400.”¹²⁸ The Philanthropy 400 is an “annual ranking of charities that raise the most from private sources.”¹²⁹ Fidelity Charitable is now the most popular charity in the United States according to this list, recently dethroning the United Way Worldwide.¹³⁰ Fidelity received \$4.6 billion in money raised from private sources, wherein the United Way received \$3.7 billion.¹³¹ Fidelity Charitable’s donations grew by 20% from the previous year, while the United

117. *Id.*

118. *Id.*

119. *Id.*; Gene Takagi, *Donor-Advised Funds: What You Should Know*, NONPROFIT LAW BLOG (Aug. 18, 2016), <http://www.nonprofitlawblog.com/donor-advised-funds/>.

120. *Infra* Section III.A.

121. *Donor-Advised Funds Guide Sheet Explanation*, *supra* note 27, at 1.

122. See *Fidelity Charitable Ranks No. 1*, *supra* note 4; *Giving Statistics*, CHARITY NAVIGATOR, <http://www.charitynavigator.org/index.cfm/bay/content.view/cpid/42> (last visited May 20, 2018); Vara, *supra* note 4.

123. Stacy Palmer (an editor at the Chronicle of Philanthropy) in reference to donor-advised funds stated, “There is a transformation going on in how donors give.” *Fidelity Charitable Ranks No. 1*, *supra* note 4.

124. *2017 Donor-Advised Fund Introduction*, *supra* note 10.

125. *Id.*

126. *Id.*

127. *Id.*

128. *Fidelity Charitable Ranks No. 1*, *supra* note 4; Vara, *supra* note 4.

129. Lindsay, Olsen-Phillips & Stiffman, *supra* note 4.

130. *Fidelity Charitable Ranks No. 1*, *supra* note 4; Vara, *supra* note 4.

131. Lindsay, Olsen-Phillips & Stiffman, *supra* note 4.

Way saw a 4% drop.¹³² Schwab Charitable is also ranked fourth on this list,¹³³ Vanguard Charitable is eleventh,¹³⁴ and National Philanthropic Trust ranks seventeenth.¹³⁵ There are nearly triple the number of donor-advised funds than private foundations.¹³⁶ Between 2014 and 2015 donor-advised fund growth (in terms of billions of dollars) grew 11%, whereas private foundations grew around 2% over the same time period.¹³⁷ In spite of these trends, charities such as the United Way Worldwide do not view donor-advised funds as competition. President of the United Way, Brian Gallagher said, “If it’s a convenient vehicle for individuals to give to charitable causes, and we’re a recipient of that, we’re good with that. . . . We don’t see ourselves as competitive with Fidelity.”¹³⁸

The issue becomes whether donor-advised funds are reallocating funds that otherwise would have been donated or are actually spurring more donations than otherwise would have happened. Both Fidelity Charitable and Schwab Charitable have conducted surveys concluding that approximately two-thirds of donors donate more than they otherwise would because of donor-advised funds.¹³⁹ Critics of donor-advised funds point to the fact that over the past forty years charitable giving has remained relatively constant at 2% of disposable net income.¹⁴⁰ That estimate notwithstanding, after adjusting for inflation, 2014 marked the fifth year in a row where giving went up.¹⁴¹ In 2015 donations reached an estimated \$373.25 billion, which set a record for the second year in a row.¹⁴² After adjusting for inflation, total giving went up 4% from 2014.¹⁴³ Further, taking 2014 and 2015 together, “the combined growth for 2014 and 2015 hit double digits, reaching 10.1% when calculated using inflation-adjusted dollars.”¹⁴⁴ Finally, according to Amir Pasic,¹⁴⁵ “[t]he last two years represent the highest and second-highest totals for giving—and the third and fourth largest percentage increases in giving—in the last 10 years, adjusted for inflation.”¹⁴⁶

132. *Id.*; see also *Fidelity Charitable Ranks No. 1*, *supra* note 4.

133. *Vara*, *supra* note 4.

134. *Id.*

135. *Lindsay, Olsen-Phillips & Stiffman*, *supra* note 4.

136. *2017 Donor-Advised Fund Comparison*, *supra* note 114.

137. *Id.*

138. *Fidelity Charitable Ranks No. 1*, *supra* note 4.

139. Holly Hall, *Donor-Advised Funds Show Strong Growth and Giving*, *Fidelity Report Says*, CHRON. PHILANTHROPY (June 10, 2015), <https://www.philanthropy.com/article/Donor-Advised-Funds-Show/230815>; Kim Laughton, *Beyond 2%: How Donor-Advised Funds Help Increase Giving*, SCHWAB CHARITABLE 2, <https://www.schwabcharitable.org/public/file/P-8398992/> (last visited May 20, 2018).

140. *Cullman & Madoff*, *supra* note 9.

141. *Giving USA 2015 Press Release*, GIVING INST. (June 16, 2015), <http://www.givinginstitute.org/?page=GUSA2015Release>.

142. *2015 Was America’s Most-Generous Year*, *supra* note 16.

143. *Id.*

144. *Id.*

145. Amir Pasic has a Ph.D. and is the Eugene R. Tepel Dean of the Indiana University Lilly Family School of Philanthropy. *Id.*

146. *Id.*

Donor-advised funds are taking in more than they are distributing.¹⁴⁷ In 2016, \$23 billion was contributed to donor-advised funds, setting a record high.¹⁴⁸ Daniel Borochoff, President of CharityWatch, estimates that over \$15 billion are currently delayed from being given to American charities.¹⁴⁹ Simply put, the argument of critics asserts that Americans are donating assets to donor-advised funds that otherwise would have been given directly to charities, which at best creates a time lag.¹⁵⁰ At worst, the problem is much more pervasive, and donations to donor-advised funds displace funds that will never actually be put towards a productive use.¹⁵¹ Statistics vary as to what percentage of funds are being distributed. Aggregate numbers sit at approximately 16%,¹⁵² whereas only 8% of funds make any distribution annually.¹⁵³ This potential problem is precipitated because of a particular donor-advised fund characteristic: the donated assets are assignable to heirs.¹⁵⁴ If the donor fails to distribute funds during their lifetime, the right to advise can be passed on to any assigned beneficiary or heir.¹⁵⁵ This gives rise to the concept of legacy giving,¹⁵⁶ which will be discussed further in Part III.¹⁵⁷ If an heir or beneficiary is not designated the assets in the donor-advised fund can in turn be given to the sponsoring organization.¹⁵⁸

III. ANALYSIS

While the popularity of donor-advised funds has grown considerably,¹⁵⁹ the vehicle is neither without controversy nor suggestions for reform. This Part will begin with a comprehensive analysis of why the donor-advised fund is ad-

147. 2017 *Donor-Advised Fund Introduction*, *supra* note 10.

148. *Id.*

149. Ana Swanson, *Wall Street Is Sitting on Billions Meant for American Charities*, WASH. POST (June 21, 2016), <https://www.washingtonpost.com/news/wonk/wp/2016/06/21/the-questionable-new-way-wealthy-people-are-giving-to-charity/> (“Our charitable resources are getting locked away . . . it’s problematic for us to be taking \$15 billion off the table for later.”).

150. Leon Neyfakh, *Donor-Advised Funds: Where Charity Goes to Wait*, BOS. GLOBE (Dec. 1, 2013), <https://www.bostonglobe.com/ideas/2013/12/01/donor-advised-funds-where-charity-goes-wait/tYa8P5trm6av9BnXPhyQTM/story.html>.

151. The idea here is that funds that are invested in a donor-advised fund are likely to stay invested. Rationales used by these authors include, *inter alia*: removing urgency to decide which charity to donate to makes donors less motivated to donate, and donor-advised funds makes the donor think he has a continuing interest in the asset making them less likely to donate (called the “endowment effect”). Cullman & Madoff, *supra* note 9. These rationales and purported impacts are discussed *infra* Section III.B.

152. Ray Madoff, *5 Myths About Payout Rules for Donor-Advised Funds*, CHRON. PHILANTHROPY (Jan. 13, 2014), <https://www.philanthropy.com/article/5-Myths-About-Payout-Rules-for/153809> [hereinafter Madoff, *5 Myths*].

153. Paul Arnsberger, *Nonprofit Charitable Organizations and Donor-Advised Funds, 2012*, STAT. INCOME BULL., Winter 2016, at 1, <https://www.irs.gov/pub/irs-soi/soi-a-npco-id1603.pdf>.

154. *Program Guide*, *supra* note 19, at 8; *see also* Cullman & Madoff, *supra* note 9.

155. *See Program Guide*, *supra* note 19, at 8.

156. *See Planning for the Future*, FIDELITY CHARITABLE, <https://www.fidelitycharitable.org/giving-account/giving-account-details/planning-for-the-future.shtml> (last visited May 20, 2018).

157. *See infra* Section III.B.

158. *See, e.g., Donor-Advised Funds FAQ*, *supra* note 19.

159. *See Fidelity Charitable Ranks No. 1*, *supra* note 4.

vantageous to the taxpayer. It will then examine in greater detail the issues, risks, and criticisms of donor-advised funds. Next, this Part will examine the responses charities have enacted (or lack thereof) to combat and utilize the growth of donor-advised funds. Finally, this Part will conclude by providing an analysis of some commonly suggested reforms to donor-advised funds, before moving into the recommendation in Part IV.

A. Donor-Advised Funds: A Taxpayer's Benefit

Throughout the following illustration, keep in mind the overarching end-goal of using this vehicle for tax purposes: the deduction from gross income in the current taxable year of the full market-value of the asset while retaining advisory privileges over its end destination.¹⁶⁰ Section 170(a) of the Code allows deductions from gross income on any charitable contribution.¹⁶¹ Further, § 170(f)(18) specifically authorizes contributions to donor-advised funds to qualify as a deduction.¹⁶² What may not be abundantly clear is why someone would choose this vehicle to facilitate their donative intent and what advantages the vehicle provides. After all, the donation to the sponsoring organization does not immediately benefit a traditional charity. The following example and analysis will show the benefits of this vehicle and provide insight as to why the vehicle has seen such rapid growth.¹⁶³

1. Demonstrating the Benefit: An Illustration

An individual, (the “Taxpayer” for purposes of this example) has the following assets in his portfolio: \$500,000 worth of stock in publicly traded corporation XYZ, \$50,000 in cash, and an annual salary of \$425,000.¹⁶⁴ Additionally, when he bought the stock in XYZ he only paid \$100,000 approximately ten years ago. Taxpayer wants to make a charitable donation and also wants to make sure he gets the tax benefit this year. He has a few options in mind, but is still deciding which charity to donate to. His options include: (1) donate a percentage of his on-hand cash today, and deduct that amount from his annual sal-

160. See 26 U.S.C. § 170(a)(1) (2012); *What Is a DAF?*, *supra* note 18.

161. 26 U.S.C. § 170(a).

162. *Id.* § 170(f)(18). § 170 limits the amount of this deduction to 30% of the taxpayer's adjusted gross income, but there are carryover provisions to the taxpayer if need be under the code. *Id.* §§ 170(b), (d).

163. *2017 Donor-Advised Fund Introduction*, *supra* note 10 (\$22.26 billion donated using donor-advised funds in 2015); *2016 Donor-Advised Fund Report: Market Overview*, NAT'L PHILANTHROPIC TR., <https://www.nptrust.org/daf-report/market-overview.html> (last visited May 20, 2018) [hereinafter *Donor-Advised Fund Market Overview*] (providing a growth of 11.9% in 2015 and now over \$78 billion in assets are in donor-advised funds).

164. This example is in part built off a common example. See, e.g., FIDELITY CHARITABLE, A GIVING ACCOUNT AT FIDELITY CHARITABLE 5 (n.d.), <https://www.noyescapital.com/documents/FidelityCharitableDonorBrochure.pdf> (last visited May 20, 2018); *Donate Long-Term Appreciated Securities*, FIDELITY CHARITABLE, <https://www.fidelitycharitable.org/giving-strategies/tax-estate-planning/appreciated-securities.shtml> (last visited May 20, 2018) [hereinafter *Long-Term Appreciated Securities*]; *The Tax Advantages of Donor-Advised Funds*, *supra* note 6.

ary of \$425,000 under § 170(a); (2) he could liquidate some of his current holdings of XYZ and donate the net proceeds; or (3) he could make a donation through a donor-advised fund.¹⁶⁵ Option one is straightforward: whatever his risk tolerance is, Taxpayer would make a cash donation to a charity of his choice and receive the deduction under § 170(a), limited to 50% of his adjusted gross income by § 170(b).¹⁶⁶ The limitations are obvious: liquidity concerns, risk tolerances, and limited means in comparison to the rest of his portfolio. This option is straightforward and immediately impactful, but not his best option.

Taxpayer has disposable assets and associated optionality that highlights the true benefit of a donor-advised fund. Taxpayer knows that he has a large investment in XYZ Corporation and, for purposes of this example, that this investment is sitting on a considerable gain. Taxpayer purchased it ten years ago, and it currently has a cost-basis of \$100,000. Given his risk tolerance, without the donor-advised fund, Taxpayer could liquidate a portion of his position and pay capital gains taxes.¹⁶⁷ Given his income level, Taxpayer will almost certainly pay 20% on the gain from disposition of this stock.¹⁶⁸ If Taxpayer does this, his post-tax position after liquidation is lower than the amount he liquidated, and the charity will receive less than the gross liquidation of corporation XYZ, assuming Taxpayer does not make the liquidation whole out of his disposable income which would simply increase the cost of the donation. If Taxpayer liquidated 20% of his shares (fair market value of \$100,000, basis of \$20,000 will yield \$80,000 gain taxed at 20%) he has \$84,000 leftover.¹⁶⁹ There is \$16,000 that is paid in taxes and no longer can be donated to charity. Taxes are the cost of this method as well as any transaction costs (*i.e.*, brokers fees), which provide no benefit to the end-game charity.

Taxpayer has an alternative option under § 170(f)(18) of the Code, namely donating shares of XYZ to a donor-advised fund.¹⁷⁰ In doing so, Taxpayer does not need to liquidate his shares of XYZ corporation, avoids realizing any gain on his shares, and does not have to pay the capital gains tax on the appreciation of stock he has accumulated.¹⁷¹ Using the same reduction in position as above, by assigning \$100,000 worth of shares to the donor-advised fund, Taxpayer's deduction from gross income is the full value of the \$100,000.¹⁷² Further, no taxes have been taken away from the donation.

165. All of these options are available under § 170 of the Code. *See* 26 U.S.C. § 170.

166. *See id.* §§ 170(a), (b).

167. Stock is a capital asset, held longer than a year, therefore qualifies for capital gains treatment. *See* 26 U.S.C. §§ 1221(a)(1), 1222(3), 1231 (2012). Further, not all charities are equipped to handle donations that are not cash. *See* Valas, *supra* note 79.

168. 26 U.S.C. § 1(h) (2012). Assume for purposes of this example taxpayer has no carry-over capital losses. *See* 26 U.S.C. § 1212 (2012).

169. *See* 26 U.S.C. §§ 1(h), 1001, 1011, 1012.

170. *See* 26 U.S.C. § 170(f)(18).

171. *Long-Term Appreciated Securities*, *supra* note 164.

172. *See* 26 U.S.C. § 170(b)(1)(C)(i); *see also* 5 *Primary Tax Benefits to Donors*, *supra* note 6. Limitation of 30% of adjusted gross income for the deduction of securities. Since Taxpayer's adjusted gross income is

It is important to not overlook what happens after the donation is made and the taxable year closes. National Philanthropic Trust tells people to think of donor-advised funds “like a charitable savings account: a donor contributes to the fund as frequently as they like and then recommends grants to their favorite charity when they are ready.”¹⁷³ In some ways, however, it is better than a savings account as the investment can grow, which (assuming funds are eventually donated to charity) benefits charities. While the investment is in a donor-advised fund, it will move with the market and can experience gains tax-free.¹⁷⁴

Functionally, the shares of XYZ Corporation (or any other non-cash donation) that Taxpayer donates will not be held as that investment.¹⁷⁵ Rather, the proceeds of the donated asset will be allocated to Taxpayer’s donor-advised fund, which will then purchase shares or units of a given investment strategy chosen by Taxpayer.¹⁷⁶ These assets experience gains tax-free.¹⁷⁷ Given the right market conditions and investing, it is possible that Taxpayer’s \$100,000 donation could grow, and the end-charity will receive more money than his original donation. The Taxpayer’s tax benefit is the market value of the donated securities at the time of the donation, but the benefit to a charity could exceed that.¹⁷⁸ Of course, it is also possible that the investment will depreciate, and the end charity will not receive Taxpayer’s entire initial donation. Also, Taxpayer’s donation is not without cost: the sponsoring organization collects fees on the investment and administration fees.¹⁷⁹ When the Taxpayer is ready to make a donation, he can instruct the sponsoring organization to distribute the funds.¹⁸⁰ These costs and risks notwithstanding, the tax-advantageous benefits, upside, and ease of this vehicle demonstrate why it is becoming so popular.¹⁸¹

\$425,000, his donation is 23.5% of his adjusted gross income, and assuming no other donations or deductions that affect said adjusted gross income, this deduction is fully recognized as it is under the limit.

173. *What Is a DAF?*, *supra* note 18.

174. See Michael Kitces, *Strategies and Tactics When Using Donor-Advised Funds for Charitable Giving*, KITCES (June 17, 2015, 7:01 AM), <https://www.kitces.com/blog/rules-strategies-and-tactics-when-using-donor-advised-funds-for-charitable-giving/>; *What Is a Donor-Advised Fund?*, FIDELITY CHARITABLE, *supra* note 19.

175. See, e.g., *Frequently Asked Questions*, FIDELITY CHARITABLE, *supra* note 40; *Donor-Advised Funds FAQ*, *supra* note 19.

176. See, e.g., *Frequently Asked Questions*, FIDELITY CHARITABLE, *supra* note 40; *Donor-Advised Funds FAQ*, *supra* note 19.

177. *What Is a Donor-Advised Fund?*, FIDELITY CHARITABLE, *supra* note 19 (“Your donation is also invested based on your preferences, so it has the potential to grow, tax-free, while you’re deciding which charities to support.”).

178. *Id.* (“[Y]ou can take an income tax deduction in the amount of the full fair-market value, up to 30% of your adjusted gross income (AGI).”).

179. *Donor-Advised Funds FAQ*, *supra* note 19 (“Charitable administration fees are charged. These fees cover grant making, recordkeeping, annual audits, tax filing, quarterly statements, insurance and various other operating expenses. . . . Other fees include the asset management and, for some donor-advised fund accounts, a fee to financial advisors.”).

180. This is a function of the advisory right under 26 U.S.C. § 170(f)(18) (2012).

181. For a discussion on growth of the vehicle, see *supra* Section II.D.

2. *Important Implications*

The sponsoring organization is itself a 501(c)(3) entity.¹⁸² Sponsoring organizations are not doing anything that traditional charities cannot do; rather donor-advised funds provide a solution to a market inefficiency. Individuals can donate property to traditional charities.¹⁸³ Some charities, however, may not be equipped to accept certain assets, or it may be costly for them to do so, taking away from the effectiveness of the donation.¹⁸⁴ Therefore, in this regard, donor-advised funds create a low-friction avenue to provide optionality in a market while removing time pressure on donors. This is the true appeal of the donor-advised fund. Fidelity Charitable and Schwab Charitable have found that people donate more because of donor-advised funds,¹⁸⁵ and the appeals of a vehicle spurring this type of growth must be maintained.

The illustration discussed above is not the only type of asset that an individual can donate to a donor-advised fund, and one of the biggest benefits is the versatility of donor-advised funds being able to absorb complex-assets.¹⁸⁶ Fidelity Charitable asserts that “[i]n many cases, an optimal method for donating complex assets to charity—measured by cost, flexibility, simplicity, and tax benefits to the donor, as well as by maximizing the net proceeds ultimately made available to charitable organizations—is to make a contribution to . . . donor-advised funds.”¹⁸⁷ Because of the ability for donor-advised funds to absorb these assets, donors can experience the significant tax benefits detailed in the above example where they otherwise would not be able.¹⁸⁸

B. *Commonly Asserted Issues with Donor-Advised Funds*

There are a variety of concerns regarding donor-advised funds, but they can be grouped into two categories: (1) the vehicle’s negative tax implications that are ripe for abuse; and (2) the negative impact the vehicle has on charities and donors.¹⁸⁹ The following discussion examines each in turn.

1. *Tax Impacts*

The IRS is seemingly most concerned with taxpayers attempting to use the benefit of a donor-advised fund to obtain a tax benefit and return the funds to themselves or their families.¹⁹⁰

182. *IRS Donor-Advised Funds*, *supra* note 12.

183. *Tax Information on Donated Property*, IRS, <https://www.irs.gov/charities-non-profits/contributors/tax-information-on-donated-property> (last updated Apr. 2, 2018).

184. *See* Valas, *supra* note 79.

185. Hall, *supra* note 139; Laughton, *supra* note 139, at 2.

186. Valas, *supra* note 79.

187. *Id.*

188. *Id.*

189. Knoepfle, *supra* note 40, at 239–47 (regarding changes in the statute that prevented tax abuse); *see, e.g.,* Cullman & Madoff, *supra* note 9.

190. *IRS Donor-Advised Funds*, *supra* note 12.

The IRS is aware of a number of organizations appeared to have abused the basic concepts underlying donor-advised funds. These organizations promoted as donor-advised funds appear to be established for the purpose of generating questionable charitable deductions, and providing impermissible economic benefits to donors and their families (including tax-sheltered investment income for the donors) and management fees for the promoters.¹⁹¹

There are two techniques implemented to combat this issue under the Code: limiting eligible distributions directly¹⁹² and the excise tax regime of the PPA.¹⁹³

Taxable distributions are governed under § 4966.¹⁹⁴ Generally, taxable distributions are to any natural person or any other person if it is not for a reason specified in § 170(c)(2)(B).¹⁹⁵ Functionally, this means that any distribution not to a qualified charity under § 170(c)(2)(B) is taxable. Qualified charities under § 170(c)(2)(B) are:

(2)A Corporation, trust, or community chest, fund, or foundation—

[subsection A omitted]

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;¹⁹⁶

Next, the exception to taxable distributions steps in under § 4966(c)(2) and provides that taxable distributions do not apply to any distribution made to organizations described in § 170(b)(1)(A),¹⁹⁷ the sponsoring organization of the donor-advised fund,¹⁹⁸ and other donor advised funds.¹⁹⁹ § 170(b)(1)(A) details nine types of charitable contributions that are eligible for deductions, examples being: churches, educational organizations, foundations, or § 170(c)(2) institutions which receive a substantial part of its support from a government entity, or direct or indirect contributions from the public. Taken together, the combination of § 4966(c) and § 170 limit the eligible charities that are eligible for tax-free distributions.²⁰⁰ The effect of these sections causes considerable complica-

191. *Id.*

192. 26 U.S.C. § 4966(c) (2012).

193. *See Donor-Advised Funds Guide Sheet Explanation*, IRS, *supra* note 27, at 2.

194. Specifically, under 26 U.S.C. § 4966(c).

195. *Id.*

196. 26 U.S.C. § 170(c)(2) (2012).

197. 26 U.S.C. § 4966(c)(2)(A).

198. *Id.* § 4966(c)(2)(B). Note that this subsection and exception is vitally important to what happens to assets after the donor passes away. This subsection will be discussed further in the analysis and recommendation. *See infra* Subsection III.B.2., Part IV.

199. 26 U.S.C. § 4966(c)(2)(C).

200. *See id.* §§ 170, 4966(c).

tions and confusion to donors, such as limiting the distributions that can be made tax-free from a donor-advised fund.²⁰¹

The PPA then steps in and implements a series of excise taxes to prevent abuse and improper benefits via usage of the vehicle.²⁰² These are aimed at related persons,²⁰³ excess benefits,²⁰⁴ excess business holdings,²⁰⁵ and incidental benefits received.²⁰⁶ Consequently, the more incidental benefit received plays a significant role with misunderstandings and limitations placed on donors, as discussed below.²⁰⁷ This two-pronged approach allows the IRS to prevent impermissible distributions and ensures donative intent is preserved in the vehicle.²⁰⁸

While the IRS is outwardly concerned with taxpayer behavior, others have raised concerns as to the impact on the tax base.²⁰⁹ The argument asserts that by allowing this preferential deduction, income generated by an individual taxpayer escapes taxation, the tax base artificially shrinks, and the cost of donor-advised funds is placed on the tax-paying public.²¹⁰ According to the Tax Policy Center, in 2018, deductions for charitable contributions were the twelfth largest “tax expenditure.”²¹¹ This expenditure accounted for approximately \$51.2 billion in 2018.²¹² While captured under this category, the real impact of donations to donor-advised funds on the tax base does not stop here. Because of the nature of property that can be donated to donor-advised funds, appreciation of assets completely escapes capital gains taxation.²¹³ Capital gains was the fourth largest tax expenditure for the fiscal year 2018, at \$108.6 billion.²¹⁴ This number represents the preferential rate treatment that capital assets receive, ranging from taxation at 0% to 20% as opposed to 10% to 39.6% for ordinary income.²¹⁵ Therefore, the leak from the tax base is actually a complete escape of taxation from capital gains as well as the deduction allowed for a charitable donation. On its face, these facts give credence to the argument that

201. See *id.* §§ 170(c)(2), 4966(c). A further discussion is provided *infra* Subsection III.B.2.

202. *Donor-Advised Funds Guide Sheet Explanation*, *supra* note 27, at 2.

203. See 26 U.S.C. § 4958 (2012).

204. See *id.*

205. See 26 U.S.C. § 4947(e) (2012).

206. See *id.* § 4967.

207. *Infra* Subsection III.B.2.

208. *IRS Donor-Advised Funds*, *supra* note 12.

209. Cullman & Madoff, *supra* note 9.

210. *Id.* (“The donor is happy; the DAF sponsor is neutral; the party that has been harmed is the taxpaying public. . . . the rise of [donor-advised funds] has imposed costs on American taxpayers as well as operating charities and beneficiaries they serve.”).

211. *Briefing Book: What are the Largest Tax Expenditures?*, TAX POL’Y CTR., <http://www.taxpolicycenter.org/briefing-book/what-are-largest-tax-expenditures> (last visited May 20, 2018) [hereinafter *Briefing Book*]. Note that this expenditure is classified as “[d]eductibility of charitable contributions, other than education and health.” *Id.*

212. *Id.*

213. Julie Cooling, *Benefits of Donor-Advised Funds and Why Now Is a Good Time for Charitable Giving*, FORBES (Nov. 21, 2016, 11:08 AM), <http://www.forbes.com/sites/juliecooling/2016/11/21/benefits-of-donor-advised-funds-and-why-now-is-a-good-time-for-charitable-giving/#2419c1d3552d>.

214. *Briefing Book*, *supra* note 211.

215. *Id.*

donor-advised funds have facilitated an exploitation in the Code and cost the tax-paying public.²¹⁶ Is this phenomenon truly a donor-advised fund issue? Rather, donations of this nature are explicitly allowed by Congress²¹⁷ and contemplated as part of the overall taxation scheme. Donor-advised funds are not the cause but rather a tool to use contemplated by Congress that provides benefits²¹⁸ that increases charitable giving.²¹⁹

The impact of donor-advised funds on the tax base may be exacerbated in the future. Under President Donald Trump's taxation scheme that was promised during the election cycle, changes to the Code were predicted to result in donor-advised funds donations increasing dramatically during 2017, before the proposed rules come into effect.²²⁰ These predictions proved true. In fact, in anticipation of these changes (and the subsequent change with the Tax Cuts and Jobs Act), Fidelity Charitable and Schwab Charitable both saw extreme growth in donor-advised funds in 2017.²²¹ Fidelity Charitable doubled its goal (adding 22,000 accounts) and Schwab Charitable had more than 20% of its 45,000 accounts added in the last six months of 2017.²²² This flooding to the vehicle resulted because of changes to the Code from the Tax Cuts and Jobs Act. The new law nearly doubled the standard deduction to \$12,000 for individuals and \$24,000 for couples.²²³ The 2017 standard deduction was \$6,350 for a single individual.²²⁴ The standard deduction is codified at § 63 and allows all taxpayers to receive its benefit.²²⁵ Functionally, a taxpayer is taxed on his gross income for the year, less the standard deduction (as well as other deductions such as the personal exemption).²²⁶ Since you cannot claim both, the true value of a taxpayer's itemized deduction (of which charitable deductions are a part²²⁷) is the extent itemized amounts exceed the standard deduction.²²⁸ As a result, it

216. Cullman & Madoff, *supra* note 9.

217. 26 U.S.C. § 170(f)(18) (2012).

218. *The Tax Advantages of Donor-Advised Funds*, *supra* note 6.

219. Hall, *supra* note 139; Laughton, *supra* note 139, at 2.

220. Veronica Dagher, *Donor-Advised Funds See Surge in Contributions, Value, Grants*, WALL ST. J. (Nov. 16, 2016, 1:06 PM), <https://www.wsj.com/articles/donor-advised-funds-see-surge-in-contributions-value-grants-1479186062> [hereinafter Dagher, *Surge in Contributions*]; Ashlea Ebeling, *The \$80 Billion Charity Stash: Donor-Advised Funds Reach Record Highs*, FORBES (Nov. 15, 2016, 10:59 AM), <http://www.forbes.com/sites/ashleaebeling/2016/11/15/the-80-billion-charity-stash-donor-advised-funds-reach-record-highs/#2b0d4dbc7246> [hereinafter Ebeling, *Charity Stash*].

221. Richard Rubin, *Charity Funds Take Off as Tax Law Reshapes Giving*, WALL ST. J. (Feb. 1, 2018, 7:35 PM), <https://www.wsj.com/articles/charity-funds-take-off-as-tax-law-reshapes-giving-1517502089>.

222. *Id.*

223. *Charitable Giving to Take a Hit from the Tax Law*, CBS: MONEYWATCH (Dec. 28, 2017, 8:34 PM), <https://www.cbsnews.com/news/charitable-giving-to-take-a-hit-from-the-tax-law/>.

224. Kelly Phillips Erb, *IRS Announces 2017 Tax Rates, Standard Deductions, Exemption Amounts and More*, FORBES (Oct. 25, 2016, 4:39 PM), <http://www.forbes.com/sites/kellyphillipserb/2016/10/25/irs-announces-2017-tax-rates-standard-deductions-exemption-amounts-and-more/#5e231457387a>.

225. See 26 U.S.C. § 63 (2012).

226. See 26 U.S.C. § 67(b) (2012).

227. See *id.*

228. See *What are Standard Tax Deductions*, INTUIT TURBOTAX, <https://turbotax.intuit.com/tax-tools/tax-tips/Tax-Deductions-and-Credits/What-Are-Standard-Tax-Deductions-/INF14448.html> (last visited May 20,

seems that donors used the advantages of donor-advised funds to capture the deduction in 2017 (with the lower standard deduction) while simultaneously preserving the ability to donate to the end-charity at a later date in reaction to the tax law changes.²²⁹ Moving forward, some expect donors to bunch multiple years worth of giving into a single year—the idea being to concentrate donations so they exceed the standard deduction only in some years.²³⁰ Professor Madoff of Boston College commented “[y]ou could not have designed a tax bill that would have driven more money into donor-advised funds.”²³¹

2. *Impact on Charities and Donors*

While the IRS concerns itself with tax-abuse associated with donor-advised funds, there are a different subset of complaints against the vehicle. The overarching thesis of these complaints may best be described as undermining charities and negatively disrupting the status quo.²³² The common assertions in support of this thesis by some commentators is examined below.

The first set of criticisms is best characterized as presenting risks to the donor. The first subset of this criticism: unknown limitations on the charities that can be donated to from a donor-advised fund.²³³ The limitations of eligible charities arises from significant legal restrictions on how grants from donor-advised funds can be distributed.²³⁴ The first limitation is that donor-advised funds cannot be used to distribute to a charity if the donor gets any sort of personal benefit.²³⁵ Next, donor’s cannot use a donor-advised fund to redeem a personal pledge.²³⁶ For example, donors to a capital campaign used to sign pledges to give money over a span of the next few years.²³⁷ This strategy cannot be accomplished through a donor-advised fund.²³⁸ Some charities have tried to get around this by encouraging donors to sign “intent-to-donate” forms creating moral obligations but not legal ones.²³⁹

Incidental benefits in the form of free meals from charity events or being unable to receive traditionally offered premiums for large donations are just a few more examples of how distributions from donor-advised funds are lim-

2018) (“You have the option of claiming the standard deduction or itemizing your deductions. However, you can never claim both in the same year.”).

229. See Rubin, *supra* note 221.

230. *Id.*

231. *Id.*

232. See, e.g., Cullman & Madoff, *supra* note 9.

233. Cantor, *Strings on Donor-Advised Funds*, *supra* note 36.

234. *Id.*

235. 26 U.S.C. § 4967(a)(1) (2012) (“[P]erson described in subsection (d) to have a sponsoring organization make a distribution from a donor advised fund which results in such person . . . receiving, directly or indirectly, a more than incidental benefit as a result of such distribution, a tax equal to 125 percent of such benefit.”); Cantor, *Strings on Donor-Advised Funds*, *supra* note 36.

236. Cantor, *Strings on Donor-Advised Funds*, *supra* note 36.

237. *Id.*

238. *Id.*

239. *Id.*

ited.²⁴⁰ For example, a donor who donated to his alma mater using a donor-advised fund became livid when he learned he could not receive homecoming tickets as he normally did as a thank you for donating.²⁴¹ This is just one example of many wherein donations from a donor-advised fund to a charity that typically allows for gifts in return becomes ineligible to receive such benefits.²⁴² “Many of these donors grew livid with the organization when staff members explained . . . they were ineligible to receive the gift.”²⁴³ The ban on receiving donor perks and fringe benefits such as these is why *Time Money* recommends not using funds as a charitable vehicle if such perks are important to you as an aspect of giving.²⁴⁴ This assertion may ignore an important element of charitable giving: donative intent. Surely these perks incentivize giving, but disallowing them for donor-advised funds ensures that donors who give to charities truly support the missions of those charities. Further, those donors may become more consistent supporters in years to come.

Another common assertion that is portrayed as a risk to donors is the fact that donors lose legal control of the assets and assume merely an advisory role.²⁴⁵ Industry investment advisors warn, “many [sponsoring organizations] have provided donors with the look and feel of control—a feature that has helped them attract new donors . . . sponsors/administrators have the right to introduce restrictions on investments or grantees at any time. When you donate assets to a donor-advised fund, you relinquish legal control.”²⁴⁶ Commentators assert that even though donors retain a right to advise, it is not much of a right as “sponsors are legally allowed to ignore donors’ advice about the disposition of their [donor-advised] funds.”²⁴⁷ Commentators have even admitted this has little practical effect as most sponsors are going to follow the donor’s advice because of the business model.²⁴⁸ A few instances were highlighted where donors either lost their funds when a sponsor went bankrupt or when the sponsor used funds to pay employees.²⁴⁹ This critique loses sight of, and discounts, the importance of the Code. Simply put, you must give up legal control of the asset to receive a tax benefit, which is true for charitable donations and for trusts as well.²⁵⁰ Without giving up control, the entire tax incentive would be taken

240. *Id.*

241. Renzulli, *supra* note 107.

242. Cantor, *Strings on Donor-Advised Funds*, *supra* note 36.

243. *Id.*

244. Renzulli, *supra* note 107.

245. Cullman & Madoff, *supra* note 9.

246. *Private Foundations and Donor-Advised Funds: Making the Best Use of Your Philanthropic Vehicle(s)*, BERNSTEIN PHILANTHROPY, https://www.bernstein.com/Bernstein/EN_US/Research/Publications/Instrumentation/PrivateFoundationsandDonor-AdvisedFunds.pdf (last visited May 20, 2018).

247. Cullman & Madoff, *supra* note 9.

248. *Id.*

249. *Id.*

250. See 26 U.S.C. §§ 170, 671, 673, 676 (2012). Regarding relinquishing control, see *Corliss v. Bowers*, 281 U.S. 376, 378 (1930).

away, and donor-advised funds that have over \$78 billion in assets²⁵¹ would cease to exist.

The next subset of criticisms represents the strongest critique against donor-advised funds, namely that assets take too long to get to a traditional charity and the effectiveness of the vehicle is cut into in the form of fees.²⁵² Before diving into the distributions percentages, recall that the sponsoring organization takes a fee from the donor-advised fund.²⁵³ The fees charged on the donor-advised funds go to the following: “grant making, recordkeeping, annual audits, tax filing, quarterly statements, insurance and various other operating expenses. . . . Other fees include the asset management and, for some donor-advised fund accounts, a fee to financial advisors.”²⁵⁴ Fees may vary. For example, National Philanthropic Trust “determines the amount of these fees by applying a blended schedule against the average daily balance of your account at the end of each month.”²⁵⁵ Alternatively, AEF takes a 1% distribution from the fund each year,²⁵⁶ and Fidelity Charitable takes 0.6% or \$100, whichever is greater.²⁵⁷ Fidelity also provides a tiered schedule based on fund size.²⁵⁸ On top of fees the sponsoring organization charges, if the donated assets were originally being managed by a financial advisor, that financial advisor still collects management fees on assets sitting in a donor-advised fund.²⁵⁹ So, while the assets are in the donor-advised funds, multiple fees take funds away from the end-game charities and market growth, another common critique.²⁶⁰ These fees and the sponsors are governed by a strict set of fiduciary duties and excise taxes, which are outside the scope of this Note.²⁶¹ Since fees are, and assets do not need to be, distributed from the donor-advised fund, the funds can sit in an account into perpetuity, accruing fees and helping no traditional charity.²⁶²

251. 2017 *Donor-Advised Fund Introduction*, *supra* note 10.

252. See, e.g., Cullman & Madoff, *supra* note 9; Madoff, *Charities and Taxpayers Deserve More*, *supra* note 112; Swanson, *supra* note 149.

253. *Donor-Advised Funds FAQ*, *supra* note 19; *New DAF Procedure*, *supra* note 95.

254. *Donor-Advised Funds FAQ*, *supra* note 19.

255. *Id.*

256. *New DAF Procedure*, *supra* note 95.

257. Fidelity Charitable uses a graduated schedule for its fees. As the size of the fund increases, the amount of fees charged decreases as a percentage of the fund. See *The Giving Account: What It Costs*, FIDELITY CHARITABLE, <https://www.fidelitycharitable.org/giving-account/what-it-costs.shtml> (last visited May 20, 2018).

258. *Id.*

259. Alan M. Cantor, *Donor-Advised Funds and the Shifting Charitable Landscape: Why Congress Must Respond*, B.C. L. F. ON PHILANTHROPY & PUB. GOOD 131, 135 (2017), https://www.bc.edu/content/dam/files/schools/law/pdf/academics/forum_philanthropy/08_Cantor.pdf [hereinafter Cantor, *Shifting Charitable Landscape*]. Cantor provides a straightforward analysis as to why financial advisors prefer donor-advised funds for their client’s charitable donations. *Id.* at 134–35. Further, Cantor details how sponsoring organizations target marketing at financial advisors. *Id.* at 135–36.

260. Cullman & Madoff, *supra* note 9.

261. See generally Johnny Rex Buckles, *Fiduciary Assumptions Underlying the Federal Excise Taxation of Compensation Paid by Charities*, 45 REAL PROP. TR. & EST. L. J. 53 (2010).

262. See, e.g., Cullman & Madoff, *supra* note 9; Dagher, *How Donor-Advised Funds Work*, *supra* note 7; Madoff, *Charities and Taxpayers Deserve More*, *supra* note 112.

Outside of fees taking away from donations, the very benefit that draws investors to the donor-advised fund vehicle (the immediate tax-benefit) has become a significant problem amounting to delayed distribution to eligible charities.²⁶³ What percentage of these funds is actually distributed from donor-advised funds to charities? Statistics vary, mainly due to what each statistic is measuring. National Philanthropic's most recent data from 2016 suggests states that aggregate payout rates from donor-advised funds have remained consistent around 20% annually.²⁶⁴ National Philanthropic Trust characterizes this as a good thing, stating "donors who use this type of charitable giving vehicle are supporting philanthropic organizations and the public good with a consistent level of grantmaking, regardless of economic conditions."²⁶⁵ Fidelity Charitable boasts a payout rate of 26%.²⁶⁶ On average, organizations appear to distribute about 16% a year from donor-advised funds.²⁶⁷ These statistics look at distributions not from individual funds but rather aggregate the data. Even considering aggregate amounts, the amount of funds flowing into donor-advised funds exceeds the amounts that are being distributed.²⁶⁸

When you consider the data on a fund-by-fund basis, the statistics become even more bleak. The most recent IRS data suggests that approximately 8% of donor-advised funds make distributions (a 2012 report).²⁶⁹ Critics of the vehicle note that the methodology used by sponsoring organizations skews numbers higher than the fund-by-fund distribution rate.²⁷⁰ Large distributions from a small number of funds artificially inflate these numbers, and the actual number of funds making distributions to charitable institutions is much smaller.²⁷¹ Already enacted solutions to the delayed distribution issue will be discussed in Section III.C, already proposed solutions will be discussed in Section III.D, and this Note's recommendation addresses the issue in Part IV. Proponents of donor-advised funds point to the idea that whatever the actual distribution rate, it is greater than the donation rate from foundations, which hovers around 6%.²⁷² At least one commentator says this argument is misguided, and comparing donor-advised funds distribution to the annual distribution rates of foundations solidify donor-advised funds as a perpetual tool, exacerbating the problem.²⁷³

263. See, e.g., Kelley Holland, *The Pros and Cons of Donor-Advised Funds*, CNBC (Dec. 15, 2014, 11:30 AM), <http://www.cnbc.com/2014/12/15/the-pros-and-cons-of-donor-advised-funds.html>.

264. *2017 Donor-Advised Fund Report: Projections and Observations*, NAT'L PHILANTHROPIC TRUST 1, 46, <https://www.nptrust.org/daf-report/projections-and-observations.html> (last visited May 20, 2018).

265. *Id.*

266. Bion Piepmeier & Jennifer M. Pagnillo, *Donor-Advised Funds: Is Additional Regulation Required?*, WEALTH MGMT. (Sept. 21, 2016), <http://www.wealthmanagement.com/charitable-giving/donor-advised-funds-additional-regulation-required>.

267. Madoff, 5 *Myths*, *supra* note 152.

268. Contributions to donor-advised funds were \$23 billion in 2016, whereas distributions from donor-advised funds were a record \$16 billion. See *2017 Donor-Advised Fund Introduction*, *supra* note 10.

269. Arnsberger, *supra* note 153, at 5.

270. Piepmeier & Pagnillo, *supra* note 266.

271. *Id.*

272. Cantor, *Shifting Charitable Landscape*, *supra* note 259, at 140.

273. *Id.* at 146.

Foundations present a complicating feature. Foundations have a required 5% annual distribution, which can be met by distributing funds to donor-advised funds.²⁷⁴ By providing private foundations the ability to meet the 5% requirement by donating to donor-advised funds, the flow of money to charities is disrupted with no requirement that it ever be paid out to another charity.²⁷⁵

Another separate characteristic that causes the distribution lag is that the right to advise on donor-advised funds can be granted to successors as part of estate planning.²⁷⁶ If assets sit in a donor-advised fund and can be passed along to a family member (to advise where to go), it takes longer for charities to actually get funds and the donation to charity is at risk of being cut away by the administrative fees.²⁷⁷ The effect can be that “assets . . . can be held in a [donor-advised fund] for decades or even centuries, all the while earning management fees for the financial institutions managing the funds, and producing no social value.”²⁷⁸ Kelley Holland of CNBC reported that some expect this phenomenon to get worse with baby boomers retiring, “setting in motion an enormous transfer of wealth to the next generation . . . donor-advised funds to reap the benefits as recipients of the money.”²⁷⁹ Proponents, however, point to the fact that many families use donor-advised funds as a vehicle for family charitable giving (also called “legacy giving”).²⁸⁰ A middle ground between these two points is examined further in Part IV, which aims to provide liquidity to the distribution lag while protecting legacy giving.

C. *Market Forces: Charities Respond to the Impact of Donor-Advised Funds*

With the growth of donor-advised funds as a charitable vehicle, charities have been put in a position where they need to change strategies to solicit donations.²⁸¹ The only tangible change in strategy has been that nonprofits have launched their own donor-advised funds.²⁸² Sponsors of donor-advised funds now include United Way affiliates, universities and colleges, and various religious groups.²⁸³ Further, some charities open donor-advised funds “with an ex-

274. Madoff, *5 Myths*, *supra* note 152.

275. Cullman & Madoff, *supra* note 9.

276. See, e.g., *A Giving Strategy That Passes to the Next Generation*, THE NONPROFIT TIMES (Mar. 21, 2016), <http://www.thenonprofitimes.com/management-tips/giving-strategy-passes-next-generation/>; Cullman & Madoff, *supra* note 9; Philip T. Tobin, *Donor Advised Funds: A Value-Added Tool for Financial Advisors*, PLANNED GIVING DESIGN CTR., <http://www.pgdc.com/pgdc/donor-advised-funds-value-added-tool-financial-advisors> (last updated May 18, 2011).

277. Cullman & Madoff, *supra* note 9.

278. *Id.*

279. Holland, *supra* note 263.

280. Ashlea Ebeling, *5 Donor Advised Fund Giving Tactics*, FORBES (Aug. 22, 2014, 9:04 AM), <http://www.forbes.com/sites/ashleaebeling/2014/08/22/5-donor-advised-fund-giving-tactics/#257fca964b30>.

281. See Alex Daniels & Drew Lindsay, *Donor-Advised Funds Reshape the Philanthropy Landscape*, CHRON. PHILANTHROPY 26, 27 (Nov. 2016), http://www.cce-rochester.org/Philanthropys_New_Landscape_-_How_Donor-Advised_Funds_Are_Changing_Giving.pdf.

282. *Id.*

283. *Id.*

pllicit goal to raise money for themselves.”²⁸⁴ Now donors can donate to the charity’s donor-advised fund and receive the tax benefit as examined in Section III.A.²⁸⁵ Further, because donor-advised funds can donate to other donor-advised funds,²⁸⁶ currently existing donor-advised funds can donate directly to a charity’s donor-advised fund.

Innovation in the marketplace has allowed donor-advised funds sponsors to be creative. Some sponsors of donor-advised funds no longer seek assets of individual donors but rather manage “funds of financial companies, wealth-management firms, and nonprofits that, in effect, would rather outsource a donor-advised fund than set up their own.”²⁸⁷ One firm in particular, Renaissance Charitable Foundation, raised \$350 million with this strategy and with just three employees in 2015.²⁸⁸ Such creative innovation has not taken place on behalf of charities.

Is the growth of donor-advised funds really a problem, or should charities be required to change to respond to market forces? While employing their own donor-advised funds gets charities participating,²⁸⁹ further changes should be aimed at providing charities access to the market. Currently, Fidelity Charitable provides two options for how a charitable organization can present to donors: keep an updated website with your mission, or make sure your information is current with nonprofit research sites.²⁹⁰ This presentation is at best imperfect but simply reflects the incentives of Fidelity Charitable. Since sponsoring organizations collect fees from assets under management,²⁹¹ it is easy to understand why they don’t want funds to leave and likely are not looking to facilitate that process seamlessly. Surely this is an opportunity for growth.

The real issue is that charities have no meaningful way to be anything but passive recipients of donor-advised funds. Sponsoring organizations pool contributions and aggregate all donations made into a single report.²⁹² Therefore, donations appear to come from the sponsoring organization, and it is impossible to see activities of individual donor-advised accounts.²⁹³ This is the inefficiency in need of fixing; innovation cannot occur if information remains in an unknown abyss. Professor Madoff advocates for more transparency in the donor-advised fund marketplace.²⁹⁴ Of note, foundations communicate ultimate

284. *Id.*

285. *See supra* Subsection III.A.1.

286. 26 U.S.C. § 4966(c)(2) (2012).

287. Daniels & Lindsay, *supra* note 281, at 27.

288. *Id.*

289. *Id.*

290. *For Charities*, FIDELITY CHARITABLE, <https://www.fidelitycharitable.org/about-us/nonprofits/work-with-donors.shtml> (last visited May 20, 2018).

291. *Getting Started*, AM. ENDOWMENT FOUND., <https://www.aefonline.org/getting-started-donor-advised-fund> (last visited May 20, 2018).

292. Madoff, *Charities and Taxpayers Deserve More*, *supra* note 112.

293. *Id.*

294. *Id.*

destinations of contributions,²⁹⁵ and charities can obtain a list of grant-making foundations in their area.²⁹⁶

Donor-advised funds have accumulated a mass of funds that has been earmarked for charity already;²⁹⁷ all charities have to do is get their hands on it. Simply put, donor-advised funds are an opportunity for traditional charities. Donor-advised funds can provide flexibility outside of tax implications²⁹⁸ in ways that traditional donations often cannot: both because income has already been set aside (so wage fluctuations of the donor need not matter), and entities have the ability to make anonymous donations.²⁹⁹ Ken Nopar, an advisor to nonprofits, weighed in on the potential positive impact of donor-advised funds specifically stating, “Everybody in the nonprofit world should support any technique that creates more opportunity for charitable giving.”³⁰⁰ Incorporating a method where information is more readily available to allow charities to be active participants in this market will be examined further in Part IV.

D. Suggested Reforms to Donor-Advised Funds

Donor-advised funds have already been reformed once: when they were written into the Code and finally defined as part of PPA.³⁰¹ These reforms were guided at preventing the tax abuse of donors and sponsoring organizations in using the vehicle for non-charitable purposes.³⁰² Professor Knoepfle asserts that the attacking donor-advised funds and supporting organizations was misguided.³⁰³ Supporting this assertion, Professor Knoepfle argued it was a bad tax policy, inconsistent with treatment of other tax-exempt organizations under the Code, and dissuaded donors from being actively involved in charitable issues (among other assertions).³⁰⁴ In a slightly more recent article, Professor Johnny Rex Buckles examined federal excise taxation that governs charities across a variety of types of tax-exempt organizations, including donor-advised funds.³⁰⁵ With respect to donor-advised funds, Professor Buckles concluded “the current taxation of compensation paid to DAF insiders from a DAF is sufficiently rational to remain unchanged.”³⁰⁶

295. Vara, *supra* note 4.

296. Joe Garecht, *Guide to Raising Money from Foundations (Part II)*, FUNDRAISING AUTH., <http://www.thefundraisingauthority.com/grants/guide-to-raising-money-from-foundations-part-ii/> (last visited May 20, 2018).

297. *Donor-Advised Fund Market Overview*, *supra* note 163 (“Charitable assets in donor-advised funds grew by \$7.52 billion in 2016 to \$85.15. This represents an 9.7 percent growth from a revised total of \$77.63 billion last year.”).

298. See *supra* Subsection III.A.1.

299. Ken Nopar, *Donor-Advised Funds Are a Boon to Savvy Charities*, CHRON. PHILANTHROPY (Oct. 28, 2014), <https://www.philanthropy.com/article/Donor-Advised-Funds-Are-a-Boon/152339>.

300. *Id.*

301. Knoepfle, *supra* note 40, at 223.

302. See *supra* notes 54–58 and accompanying text.

303. Knoepfle, *supra* note 40, at 256.

304. See *id.* at 256–63.

305. Buckles, *supra* note 261, at 57–58.

306. *Id.* at 111.

Current reform suggestions look at a different issue—specifically, delayed benefits to traditional charitable entities. There are two suggested solutions directly aimed at solving this problem: instituting an annual minimum distribution requirement,³⁰⁷ or requiring the fund be liquidated within a certain number of years.³⁰⁸ Each solution will be examined below.

Professor Hussey succinctly described the problem as “insufficient funds are being used for active charitable purposes because no minimum payouts are required.”³⁰⁹ To solve this problem, he suggested the individual retirement account (“IRA”) should be used as a model, rather than comparing donor-advised funds to private foundations.³¹⁰ This model would be used to compel the sponsoring organization to make annual distributions.³¹¹ Professor Hussey chose this model, in part, because it builds upon existing legal structures easing administration and usage amongst taxpayers.³¹² The IRA-based model also encompasses minimum distributions which varies based on age.³¹³ Further, Professor Hussey’s recommendation would not allow fees charged to the donor-advised fund to count towards the minimum payout requirement.³¹⁴ Finally, in the event that the donor fails to make a recommendation in the required time period, he or she would forfeit the privilege to make such recommendation.³¹⁵ The sponsoring organization would be able to make charitable grants without the recommendation from the grantor, and if a distribution is not made for the year, an excise tax would be imposed on the sponsoring organization.³¹⁶ Of note, the Congressional Research Service suggests that if minimum required distributions are applied to donor-advised funds, they need to do so on an individual basis, not in the aggregate, so that the inflation of statistics (discussed in Subsection III.B.2.) is not used to get around the regulation.³¹⁷

Other advocates propose that a set number of years be imposed that requires distribution of donated funds.³¹⁸ Professor Madoff suggests to “[r]equire donors setting up advised funds to name a charity that would receive any unspent funds at the end of the seven years.”³¹⁹ Madoff acknowledges that “[t]he sponsoring organization would simply need to track account spending, and at

307. See Michael J. Hussey, *Avoiding Misuse of Donor Advised Funds*, 58 CLEV. ST. L. REV. 59, 89 (2010).

308. See, e.g., Cantor, *Shifting Charitable Landscape*, *supra* note 259, at 144–46; Howard Gleckman, *Should Congress Curb Donor Advised Funds?*, TAX POLICY CTR. (Apr. 22, 2014), <http://www.taxpolicycenter.org/taxvox/should-congress-curb-donor-advised-funds>; Madoff, *5 Myths*, *supra* note 152.

309. Hussey, *supra* note 307, at 87.

310. *Id.* at 88.

311. *Id.* at 89.

312. *Id.* at 88.

313. *Id.* at 89.

314. *Id.* at 91.

315. *Id.*

316. *Id.*

317. MOLLY F. SHERLOCK & JANE G. GRAVELLE, CONG. RESEARCH SERV., R43595, AN ANALYSIS OF CHARITABLE GIVING AND DONOR ADVISED FUNDS 28 (July 11, 2012).

318. Gleckman, *supra* note 308; Madoff, *5 Myths*, *supra* note 152.

319. Madoff, *5 Myths*, *supra* note 152.

the end of seven years, it would automatically send unspent money to the donor's chosen charity.³²⁰ Further, each donation would be tracked separately to follow the seven-year rule.³²¹ Madoff is not the only advocate of this proposal; in fact, it has received attention from Congress.³²² In 2014, Michigan Congressman Dave Camp "proposed legislation that would mandate a 5-year spend down for [donor-advised funds], with funds that failed to meet this deadline being subject to a 20 percent tax on any unspent amounts."³²³

These proposed solutions have two common flaws: the added administrative requirements to impose such regulation, and losing sight of the attractive characteristics of donor-advised funds. As discussed earlier, administrative fees are charged for grant making, audits, tax filings, record keeping, reporting statements, and operating expenses.³²⁴ Further, other fees, including asset management fees and financial services fees, are applicable for certain donor-advised funds.³²⁵ Proponents argue that imposing solutions such as these make donor-advised funds administratively burdensome.³²⁶ One result could realistically be an increase in fees. This would further take away from end-game charities.³²⁷ Further, the increased burden would not be placed on just the sponsoring organization, but on the IRS as well, increasing the amount they would need to regulate.

Professor Hussey's proposal overlooked the costs associated with IRAs. Without diving too deeply into retirement accounts, use of a federal life-expectancy table to calculate the required minimum distribution.³²⁸ This adds another level of complexity and administrative burden on both the IRS and the sponsoring organization. Not only would each have to track distributions made, but the amount that needs to be distributed would be calculated annually based on tenure in the donor-advised fund. The proposal is made more difficult considering the pooling of funds,³²⁹ but it does seem possible, albeit costlier.

These suggestions also seem to lose track of important characteristics of donor-advised funds. Recall that one of the benefits of a donor-advised fund is flexible giving since the tax benefit has already been received and there is no

320. *Id.*

321. *Id.*

322. Gleckman, *supra* note 308.

323. Piepermeier & Pagnillo, *supra* note 266.

324. *Donor-Advised Funds FAQ*, *supra* note 19.

325. *Id.*

326. Piepermeier & Pagnillo, *supra* note 266; Ellen Steele & C. Eugene Steuerle, *Discerning the True Policy Debate over Donor-Advised Funds*, URB. INST. (Oct. 2015), <http://www.urban.org/sites/default/files/publication/72241/2000481-Discerning-the-True-Policy-Debate-over-Donor-Advised-Funds.pdf>.

327. See Cullman & Madoff, *supra* note 9 (demonstrating that fees go to a variety of purposes and are not taken away from distributions to charities.).

328. *Retirement Topics—Required Minimum Distributions (RMDs)*, IRS, <http://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-required-minimum-distributions-rmds> (last updated Mar. 26, 2018).

329. *Frequently Asked Questions: Contributions*, FIDELITY CHARITABLE, <http://www.fidelitycharitable.org/faqs.shtml#contributions> (last visited May 20, 2018).

time limit on when the distribution needs to be made.³³⁰ Specifically, the taxpayer gets to absorb the tax benefit while getting time to grant funds to charities and decide which charity to give to.³³¹ By imposing a required time-limit as Professor Madoff and Congressman Camp suggest,³³² this benefit is curtailed by adding complexity and sacrificing freedom. It also loses sight (and same is true of the minimum distribution requirement approach) of family giving and leaving legacies through donations by being able to assign your interests to heirs.³³³ This may be a particularly attractive characteristic to donors, and the impact could be a decline in amounts donated. Each suggestion causes a greater burden, creates a need for further oversight on all parties involved, and detracts from the flexibility of the vehicle, making them imperfect solutions to the illiquidity problem in the charitable marketplace. To help direct some of the \$15 billion currently delayed,³³⁴ other reform is examined in Part IV.

IV. RECOMMENDATION

Donor-advised funds are an undeniably useful tool³³⁵ for charitable giving that are becoming more and more popular.³³⁶ Their growth has been spurred by the following characteristics: (1) full tax benefit of the donation received upfront;³³⁷ (2) assets donated receive tax-free growth;³³⁸ (3) complex-assets are more easily taken by donor-advised funds than other charities;³³⁹ (4) legacy-based giving;³⁴⁰ and (5) potential anonymity.³⁴¹ In return for these benefits, all the Code requires is a loss of legal control of the asset³⁴² and a limitation on the amount the donor can claim as a deduction in a given year.³⁴³ The problem with this vehicle is that its growth has resulted in an estimated \$15 billion being delayed from distribution to charities,³⁴⁴ and charities have no meaningful participation in the market because of a lack of information.³⁴⁵

330. See, e.g., Holland, *supra* note 263.

331. See Cullman & Madoff, *supra* note 9.

332. See Gleckman, *supra* note 308; Madoff, *5 Myths*, *supra* note 152.

333. See Ebeling, *supra* note 280.

334. Swanson, *supra* note 149.

335. *The Tax Advantages of Donor-Advised Funds*, *supra* note 6; Valas, *supra* note 79 (regarding flexibility of assets allowed to be donated); Vara, *supra* note 4 (regarding technology benefits and changing how donors give because of practical flexibility and convenience).

336. See *supra* notes 122–27 and accompanying text.

337. See 26 U.S.C. § 170(f)(18) (2012).

338. *What Is a Donor-Advised Fund?*, FIDELITY CHARITABLE, *supra* note 19 (“Your donation is also invested based on your preferences, so it has the potential to grow, tax-free, while you’re deciding which charities to support.”).

339. Valas, *supra* note 79.

340. Ebeling, *supra* note 280; *Donor-Advised Funds FAQ*, *supra* note 19.

341. *Donor-Advised Funds FAQ*, *supra* note 19.

342. 26 U.S.C. § 170(f)(18).

343. See *id.* § 170(b)(1).

344. Swanson, *supra* note 149.

345. Madoff, *Charities and Taxpayers Deserve More*, *supra* note 112.

Due to these problems, certain aspects of the vehicle need to be changed to correct the market inefficiencies. This Note suggests two reforms to donor-advised funds. First, the vehicle should be changed to donate assets upon the death of the donor—with a grace period—while maintaining some flexibility with legacy planning. As part of this reform, § 4966(c)(2) needs to be altered to prevent sponsoring organizations from receiving grants from donor-advised funds and put restrictions on donor-advised fund transfers to other donor-advised funds. Second, a charitable information marketplace needs to be created by making an anonymous opt-in and by establishing a third-party recorder office. The recommendation this Note puts forth will not violate simple tax principles and will aim to keep donor-advised funds simple and keep administrative costs (and subsequent fees charged to the vehicle) controlled.

A. *Limiting the Perpetuity Option of Donor-Advised Funds and Altering Exceptions of Taxable Distributions*

The concept of legacy-based giving presents one of the advantages of a donor-advised fund.³⁴⁶ Legacy-based giving is accomplished by the ability to name successors to your own interest,³⁴⁷ allowing advisory rights for donor-advised funds to be passed from generation to generation at the donor's request and assets to never actually be distributed to charities.³⁴⁸ Funds, in turn, sit and earn administrative fees.³⁴⁹ To combat this issue, three coordinated changes should be made: (1) eliminate the option to pass on advisory privileges to successors after the original donor's death; (2) repeal § 4966(c)(2)(B) from the Code, and (3) amend § 4966(c)(2)(C).

The overall operating policy would be that, upon the advisor's death, the funds remaining in the donor-advised fund have six months to be distributed to qualified charities.³⁵⁰ Section 4966(c)(2)(B) would be repealed to prevent the sponsoring organization from ever receiving this distribution, ensuring that funds end up at qualified charities. Further, § 4966(c)(2)(C) would need to be altered to prevent donor-advised funds from donating to other donor-advised funds during the succession process.

Functionally, this process would look as follows. First, upon setting up the donor-advised fund, the donor could name certain beneficiaries to advise where the funds should be donated upon the donor's death. One caveat is key: Impose a time limit. Grant the beneficiaries a six-month period to distribute the entirety of the donor-advised fund's undistributed assets to a charity. Explicitly require that those funds be distributed to qualified charities as described under § 170 of the Code.³⁵¹ A similar excise tax regime could be imposed on undistributed funds or funds distributed to other donor-advised funds that mirror the current PPA regime.³⁵² Furthermore, by removing § 4966(c)(2)(B), distributions to sponsoring organizations that run the donor-advised fund would become taxable distributions. Note that the process of picking eligible charities for donor-advised funds is already employed. Not all charities are able to be donated through donor-advised funds, as §§ 170 and 4966 specifically outline taxable distributions and eligible organizations.³⁵³ The only reason this is currently allowed is because Congress wrote in an exception, which was an error in need of correction. This aspect ensures that sponsoring organizations are simply providers of a vehicle that lowers friction in the charitable marketplace.

346. See *What Is a Donor-Advised Fund?*, FIDELITY CHARITABLE, *supra* note 19.

347. *Program Guide*, *supra* note 19, at 8.

348. See, e.g., Cullman & Madoff, *supra* note 9; Dagher, *How Donor-Advised Funds Work*, *supra* note 7.

349. See, e.g., Cullman & Madoff, *supra* note 9; Dagher, *How Donor-Advised Funds Work*, *supra* note 7.

350. One way to administer this change would be by adding in qualifying language to 26 U.S.C. § 170(f)(18) or § 4966(c). It would require that the donation was no longer tax-exempt or charitable if funds sit longer than six months after death, and the estate would be taxed accordingly.

351. 26 U.S.C. §§ 170(b)(1)(A), (C).

352. See the discussion of the PPA excise tax regime, *supra* Section II.B.

353. 26 U.S.C. §§ 170(c), 4966(c); see also *supra* Subsection III.B.1.

A few key objectives are met by requiring the funds to be distributed from the donor-advised fund to a separate charity within a given timeline upon death of the donor. First, the distribution percentage from funds (approximated at 8% of funds making distributions)³⁵⁴ is likely to rise. Second, legacy planning can still be achieved by naming beneficiaries. The six-month deadline speeds up the process, but beneficiaries during this process get a sixth-month grace period to determine how to best honor the deceased donor and distribute the assets. The downside of clogged-up funds is an inadequate reason to leave perpetuity in place when a simple alternative exists. Further, donors who care deeply about legacy planning could be allowed to set up donor-advised funds in the name of the intended recipient and allow advisory privileges for that person only. To not let this defeat the purpose of the proposed change, this process should only be administered once. If a donor-advised fund is set up with advisory privileges for someone who is not the donor, those funds should be prevented from being passed on.

Currently, under the Code, donor-advised funds can make tax-free distributions to other donor-advised funds.³⁵⁵ To prevent this new provision from being circumvented, beneficiaries, after the death of the donor, should not be allowed to grant undistributed funds to currently existing or new donor-advised funds. Donor's with advisory privileges could set up new donor-advised funds in the name of another person while alive, allowing legacy-planning to persist. But donor-advised funds should not be allowed to be passed on through successors. Code § 4966(c)(2)(C) would need to be prevented from being amended to match these requirements and limit the distributions that can be made from donor-advised funds to other donor-advised funds.³⁵⁶

Two further contingencies can happen under this plan and need to be answered. First, what happens to funds upon death if no beneficiary is named? Second, what happens under this plan if the named beneficiaries do not distribute the funds within six months? The answer to each is the same: place the burden to distribute on the sponsoring organization. Currently, using National Philanthropic Trust as an example, sponsoring organizations provide a variety of options for what can happen upon death of the donor.³⁵⁷ If the donor selects no option, the funds will be transferred to National Philanthropic's Giving Fund.³⁵⁸ Instead of this process, if no beneficiary is named, the sponsoring organization should be required to distribute within the same six-month time frame. If this process is invoked because of inactivity of the named beneficiaries, however, the sponsoring organization should be allowed only one additional month after the period expires to determine how to distribute the assets of the donor-advised fund. If the donor-advised fund has a history of distributions, require that the sponsoring organization mirror that pattern at this end-of-life dis-

354. See Arnsberger, *supra* note 153, at 5.

355. 26 U.S.C. § 4966(c)(2).

356. *Id.*

357. *Donor-Advised Funds FAQ*, *supra* note 19.

358. *Id.*

tribution. Therefore, if the donor had a history of recommendations to particular charities, the sponsoring organization would liquidate the fund by donating to such charities in proportion to past grants.³⁵⁹

If a fund has made no distributions in the past, the sponsoring organization has the discretion to make a distribution. Since § 4966(c)(2)(B) has been altered, the liquidating distribution could not go to the sponsoring organization or another donor-advised fund. Therefore, no self-dealing issues can exist. Further, this proposal comes with the added benefit of allowing charities to solicit funds from sponsoring organizations directly, actively getting them into the marketplace. While this concept is analyzed further below,³⁶⁰ providing charities another tool has significant benefits. The downside of this proposal is that sponsoring organizations now have to choose which charities to donate to, which likely comes at the detriment of polarizing charities. Rather than regulating this issue, by allowing charities to solicit funds from a sponsoring organization (that now has to distribute funds), this solution allows the charitable marketplace to come to a natural solution.

By removing the perpetuity aspect of donor-advised funds, this proposal maintains the possibility of legacy-based giving but ensures assets do not remain delayed by ending up under the indefinite control of sponsoring organization or passed on to later generations indefinitely. Further, imposing the six-month distribution requirement on the beneficiaries ensures more distributions made and decreases the impact of administrative fees. Finally, donative intent is preserved and traditional charities can get involved in the marketplace by being able to directly solicit sponsoring organizations who are required to donate funds. Accordingly, the perpetuity aspect needs to be removed from donor-advised funds and § 4966 needs to be altered to establish donor-advised funds as a vehicle to reduce friction in the charitable marketplace.

B. *Creating a Charitable Information Marketplace*

Solutions put forth by charities to the delayed funds problem presented by donor-advised funds have been inadequate, resulting in an estimated \$15 billion being delayed from being granted to charities.³⁶¹ Charities have further been stripped of some strategies they were formerly allowed to use to incentivize donations, such as gifts to donors.³⁶² But, primarily it is the lack of transparency³⁶³ that prevents real innovation from happening in this market.

By creating an information marketplace for donor-advised funds that is accessible by charities only, traditional charities will be given meaningful access to this market rather than being passive beneficiaries. There are two chief

359. This is currently a choice for a donor at the onset of setting up the fund under National Philanthropic's system. *See id.* The fact that this is an option suggests that this is not administratively too costly and is possible.

360. *See infra* Section IV.B.

361. Swanson, *supra* note 149.

362. *See Cantor, Strings on Donor-Advised Funds, supra* note 36.

363. Madoff, *Charities and Taxpayers Deserve More, supra* note 112.

incentives that stand in the way of pure information sharing in this context: anonymity³⁶⁴ and the interests of the sponsoring organization.³⁶⁵

There is a practical solution that solves both the anonymity issue and the potentially divergent interests of the donor and sponsoring organization: upon the donation to the donor-advised fund, make the donor opt in to remain anonymous. Any donor that does so will in turn make distributions from the fund on an anonymous basis. Allowing optional opt-in will help to communicate as much information as possible. For donors who use the default, their information will be “published” to a third party that facilitates information to the charitable marketplace.³⁶⁶

Functionally, the sponsoring organization, as part of setting up the fund, would record the fund and the name of the advisor of the fund with a third party. Furnishing this information would likely need to be codified under the Code and should likely be included under the definition of sponsoring organization in § 4966(d).³⁶⁷ This third party would simply be a centralized record keeper of all the donor-advised funds and the grants they make. The third party would keep information such as the name of the fund and the name of the advisor.³⁶⁸ As part of the distributions down the road, the sponsoring organization would furnish information to the third party detailing distributions made from the donor-advised fund to which charities (not amounts) and when they were made. Registered charities that are eligible for distributions from donor-advised funds³⁶⁹ would then subscribe to memberships from the third party for a fee and, in turn, could view the information. Charities would then be able to target their marketing to particular donors, primarily those who have already communicated to the marketplace they are willing to donate. The strategies that charities could implement with this information could cause an explosion in the efficiency and effectiveness of their efforts. The purpose of tracking whom donations are made to is a business decision, one that allows charities to more effectively identify potential donors. Simply put, by placing more information at the charity’s disposal, unnecessary friction is removed from the market. The charities themselves can be the stimulus for more seamlessly getting charitable dollars to the organizations the vehicle is supposed to benefit.

364. Donations and distributions can be anonymous. *Donor-Advised Funds FAQ*, *supra* note 19.

365. The longer assets stay under the control of the sponsoring organization, the more fees they accrue, cutting away from the end-game charities. *See* Cullman & Madoff, *supra* note 9; Dagher, *How Donor-Advised Funds Work*, *supra* note 7.

366. A good comparison for this system is simply a county recorder’s office, where land records are kept. Instead of being publicly accessible, however, charities (and only charities) would pay membership fees to access the information, as examined *infra*.

367. The addition to the Code could stipulate: “(D) and complies with the information furnishing requirements (as promulgated by the Secretary) to an approved intermediary.” Of course, approved intermediary would then need to be defined as well (potentially regulated).

368. This Recommendation does not advocate for including the size of the donor-advised fund which should be omitted for privacy purposes (and to encourage participation of donors in the system).

369. *See* 26 U.S.C. §§ 4966(c), 170(c)(2) (2012).

A similar process to this proposal is available for foundations.³⁷⁰ Tracking individual grants from donor-advised funds, however, is much more important in the donor-advised fund context. Foundations have specific funding priorities and missions which are transparently communicated,³⁷¹ whereas donor-advised funds are an information black-hole. By using a familiar process, charities are likely to more easily solicit the enormity of assets, currently over \$85 billion.³⁷² Providing this information about donor-advised funds can give charities a powerful tool as well as ease the burden on donors to select charities. By creating this charitable information marketplace, charities will be provided the solution to the illiquidity problem of donor-advised funds that has to-date remained elusive; they will be no longer be kept on the sidelines.

V. CONCLUSION

Donor-advised funds are a fundamentally positive force on charitable giving in America³⁷³ but need revisions to correct the current incentive structure which has led to far-too-low distribution rates.³⁷⁴ Rather than a clogging device (an estimated \$15 billion delayed from being donated to charity),³⁷⁵ the vehicle should provide liquidity and growth to the marketplace and incentivize a higher rate of charitable giving than exists today.³⁷⁶ Donor-advised funds must provide a facilitation role in the marketplace, providing liquidity and enhancing charitable giving overall. Total assets donated to traditional charities should increase as a result of this vehicle, not be delayed.

This Note recommends a way to achieve having donor-advised funds play his role, protecting both the donor and charity alike without compromising the integrity of the Code. First, the indefinite characteristic of donor-advised funds should be curtailed by preventing the transfer of advisory rights to donor-advised fund assets after death, while amending § 4966(c) to prevent distributions to sponsoring organizations and other donor-advised funds (in the event of the death of the advisor). Second, charities must be given meaningful access to the market through the creation of an information marketplace that adequately communicates information from sponsoring organizations to a third-party intermediary that is accessible by charities. Donor-advised funds have spurred

370. *Supra* notes 4, 295–96 and accompanying text.

371. Garecht, *supra* note 296.

372. *2017 Donor-Advised Fund Introduction*, *supra* note 10.

373. For the growth of charitable giving over the past two years generally, see *2015 Was America's Most-Generous Year*, *supra* note 16. For growth of donor-advised funds recently, see *2017 Donor-Advised Fund Introduction*, *supra* note 10; *Growth in Recent Years*, NAT'L PHILANTHROPIC TR., <https://www.nptrust.org/daf-report/recent-growth.html> (last visited May 20, 2018).

374. Arnsberger, *supra* note 153, at 5; Piepmeier & Pagnillo, *supra* note 266.

375. Swanson, *supra* note 149.

376. Again, what this number actually is and the proper calculation method is disputed. Fidelity reports an aggregate distribution rate of 26%. Piepmeier & Pagnillo, *supra* note 266. The most recent IRS report grants from donor-advised funds was approximately 8% in 2012 using a different calculation. Arnsberger, *supra* note 153, at 5.

growth in the charitable marketplace,³⁷⁷ but such growth has come at the cost of its role in charitable giving: being a low-friction facilitator and a solution to a market inefficiency. Under this recommendation, donor-advised funds will return to this purpose while becoming even more efficient at distributing funds, maximizing the benefit to donor and charity alike.

In providing these small revisions, the benefits of the vehicle and the integrity of the Code will be retained without adding so much complexity to the system that the solution becomes unfeasible. Ultimately, this approach will provide greater liquidity to the charitable marketplace that donor-advised funds have fundamentally altered. It will not hinder the benefits or growth that the vehicle has experienced over the past few years and will allow the usefulness of the donor-advised fund in the charitable market to reach its maximum potential.

377. Hall, *supra* note 139; Laughton, *supra* note 139.