View metadata, citation and similar papers at core.ac.uk

brought to you by CORE

provided by Digital Commons @ Boston College Law School

Boston College Law School
Digital Commons @ Boston College Law School

Law School Publications | Law School Archive

10-24-2017

Letter to Orrin G. Hatch and Ron Wyden on Donor-Advised Funds

Ray D. Madoff
Boston College Law School, madoffer@bc.edu

Roger Colinvaux
The Catholic University of America Columbus School of Law, colinvaux@law.edu

Follow this and additional works at: http://lawdigitalcommons.bc.edu/law_school_publications

Part of the Estates and Trusts Commons, Taxation-Federal Commons, and the Tax Law Commons

Digital Commons Citation

Madoff, Ray D. and Colinvaux, Roger, "Letter to Orrin G. Hatch and Ron Wyden on Donor-Advised Funds" (2017). *Law School Publications*. 944.
http://lawdigitalcommons.bc.edu/law_school_publications/944

This Response or Comment is brought to you for free and open access by the Law School Archive at Digital Commons @ Boston College Law School. It has been accepted for inclusion in Law School Publications by an authorized administrator of Digital Commons @ Boston College Law School. For more information, please contact nick.szydlowski@bc.edu.

Ray Madoff
Professor of Law
Director, Forum on Philanthropy & the Public Good
Boston College Law School
885 Centre Street
Newton, MA 02459

Roger Colinvaux
Professor of Law
Columbus School of Law
The Catholic University of America
3600 John McCormack Rd., NE
Washington, DC 20064

October 24, 2017

The Honorable Orrin G. Hatch, Chairman
The Honorable Ron Wyden, Ranking Member
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Hatch and Ranking Member Wyden:

We write in response to the letter of September 6, 2017, from charitable industry representatives about our letter to you of July 17, 2017, regarding the proper taxation of donor advised funds ("DAF"s).

We write for two reasons. The first is to correct some astonishing misrepresentations made in the industry letter, and second, to return the focus to our main goal: encouraging the adoption of tax rules that support charities in getting the funds they need to do their important work.

In laying out our case in favor of requiring a payout from DAFs, we made four basic points regarding DAFs and cited relevant authoritative data. These points are as follows:

1. While DAFs have grown astronomically, there is no evidence to suggest that the growth of DAFs have produced an overall increase in charitable giving.

2. DAF payout rates vary tremendously and in a given year many DAF sponsors distribute little or nothing.

3. A payout rule is necessary because the public value of DAFs does not occur until such time as funds come out of the DAF and become fully available for use by a charitable organization.

4. It would not be difficult to implement a per account payout requirement.

Rather than honestly respond to these points, the industry letter instead misrepresented both our views and the existing data on DAFs. To take the most glaring example, the industry letter at the outset and **in bold** says that our letter uses "erroneous statistics and claims," and then devotes several paragraphs as their lead argument to criticize what they say is our "misleading use of GDP to characterize charitable giving." Yet our letter does not use, mention, or rely on GDP in

any way. The letter authors therefore attributed to us a statistic we did not use, and then critiqued us for misusing it.[1] We do not know whether this inaccuracy was deliberate or the result of sloppiness, but whatever the reason, it casts doubt on the credibility of their entire testimony.

The industry letter also misrepresents the data on payout. In support of our point that many DAF sponsors distribute little or nothing in a given year, we cited an article by a senior IRS statistician that analyzed the 2012 tax returns of DAF sponsors. This study found that 466 DAF sponsors (or 21% of all DAF sponsors) reported no grants at all.[2] In an attempt to counter these troubling figures, the industry letter claims that these low-paying sponsors were not "community foundations or even commercial sponsors." However, there is nothing in the article to support their claim. The study is based on all 2,121 DAF sponsors that filed Form 990's for tax year 2012 and says nothing about the identity of these low-distribution sponsors.[3]

The writers of the industry letter then try to bolster their argument by making reference to a different report (this one done by the Congressional Research Service), and misrepresent the findings of that report as well. Citing the CRS report, the industry letter suggests that any problems with low payout are limited to DAF sponsors holding a single DAF account (and suggests therefore that Congress should focus any regulatory restrictions only on single-account DAF sponsors). However, this misconstrues the CRS report. According to the CRS study of 2008 tax returns, 26% of the sponsoring organizations had no payout at all. While the CRS study also looked at DAF sponsors with a single DAF account, they did so as a way of gathering insight into the behavior of individual DAF account holders (since this per-account information is not otherwise available), and not because they thought that single-account DAF sponsors were the source of the problem. In fact, the CRS study made a similar recommendation as ours, namely that all DAF accounts should be subject to a per account payout requirement.[4]

---

[1] When analyzing the effect of DAFs on charitable giving, it is most appropriate to look at charitable giving—as we do in our letter—with reference to disposable personal income (household income after taxes), because disposable personal income has been described as "a key determinant in how much a household gives." GDP by contrast is the market value of all goods and services performed within the country's borders, which has only, at best, a tangential effect on how much a household can give. *Giving USA 2017: The Annual Report on Philanthropy for the Year 2016*, a publication of Giving USA Foundation, 2017, researched and written by the Indiana University Lilly Family School of Philanthropy. Available online at www.givingusa.org.

[2] Paul Arnsberger, Donor-Advised Funs: An Overview Using IRS Data (2015). http://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?article=1017&context=philanthropy-forum. We also cited a statistic from the same report that over 25% of DAF sponsors made total distributions of less than 1% of their assets in 2012. After we wrote our letter, we learned that the author subsequently revised and republished this article using a new payout rate formula. Applying the same data to this alternative method, the 25% statistic was changed to 4.1%. Paul Arnsberger, Donor-Advised Funds: An Overview Using IRS Data (2016). https://www.irs.gov/pub/irs-soi/15rpdonorfunds.pdf

[3] Moreover, since the letter writers are specifically not seeking special treatment for community foundations, their point also seems irrelevant to the central question of whether all DAF accounts should be subject to a payout requirement.

[4] Molly F. Sherlock and Jane G. Gravelle, An Analysis of Charitable Giving and Donor Advised Funds, Congressional Research Service, July 11, 2012. https://fas.org/sgp/crs/misc/R42595.pdf

While the industry letter contains several other misstatements and mischaracterizations, we want to return to the reason we wrote our letter: to encourage Congress to adopt rules that will ensure that donations that receive the tax benefits of charitable giving, become fully available for use by charitable organizations within a reasonable period of time. We urge you to act promptly because donor-advised funds are undergoing extraordinary growth and DAF sponsors are receiving an ever-greater portion of charitable contributions. In 2007 contributions to DAFs were 5% of all charitable contributions and by 2014 this percentage had grown to 10%.[5] Moreover, there is every reason to think that this exponential growth will continue. Just this month Fidelity Charitable announced that contributions to donor-advised funds held by Fidelity Charitable skyrocketed to $6.85 billion in the fiscal year that ended June 30, 2016, a 68 percent increase over the previous year.[6]

The reason DAFs are experiencing such extraordinary growth is because of the tremendous tax benefits that they offer donors while allowing donors the ability to effectively control their donations. In considering the proper regulation of DAFs, it is important to remember that these tax benefits to donors are not free of cost but are borne by the larger taxpaying public, and that Congress has often legislated when donor control issues are present.

First, DAFs enable donors to claim a charitable deduction in years when the donor is in the highest income tax brackets, while still allowing the donor to defer full release of the donated funds until a later year (when the donor may be in a lower income tax bracket). While donors may be able to achieve similar front-loading of charitable benefits and maintain control by creating a private foundation, donations to private foundations receive fewer tax benefits than donations to DAFs and private foundations are subject to greater oversight than DAF funds.

In addition, DAFs enable donors to secure maximum tax benefits for contributions of appreciated property, particularly private business interests, real estate, tangible personal property and other complex assets. While donors can achieve these benefits by making outright contributions to public charities, without a DAF the donor would have to cede all on-going control to the charity. If these donations were made to a private foundation controlled by the donor, the donors' deduction would be limited to basis. It is only by giving to a DAF, that the donor can get a deduction for the full fair market value of the property and still maintain on-going effective control over the donated assets. Allowing a full fair market value deduction for contributions of complex assets are particularly concerning because of the difficulty of ensuring accurate valuation of these donations.[7] In addition, if the assets are difficult to sell, the donor will have gotten a charitable deduction for the value of the property measured as of the date of the contribution, even if a significant portion of the contribution will go to carrying costs and administrative expenses of converting the asset to cash.

---

[5] James Andreoni, The Benefits and Costs of Donor Advised Funds, forthcoming, *Tax Policy and the Economy,* Volume 32, Number 1, 2018.

[6] https://www.philanthropy.com/article/Donor-Advised-Funds-Soar-Amid/241413

[7] Roger Colinvaux, *Donor Advised Funds: Charitable Spending Vehicles for 21st Century Philanthropy,* 92 WASH. L. REV. 39 (2017); Roger Colinvaux, *Charitable Contributions of Property: A Broken System Reimagined*, 50 HARV. J. ON LEGIS. 263 (2013).

DAFs are neither inherently good nor bad – but at bottom, they function as middlemen, plain and simple. DAF accounts may be under the legal control of the DAF sponsor, but the whole point of the DAF is to cede effective control over the timing and substance of distributions to the donor or the donor's designee.[8] Legal niceties aside, when donated funds are in a DAF, they are not fully available to a charity to be used in pursuit of its charitable mission, even though the donor has received maximum tax benefit for their contribution. We need a DAF payout rule because charities can only put funds to work if they can exercise full control over the funds.

Given that this is the nature of DAFs – a vehicle for granting maximum tax benefits and processing donor advice – we take a very common sense approach. We believe that there should be *some* time period after which society can be certain that DAF funds (including their growth) will be made available to charities. We suggested 10 years, Congressman Camp proposed 5 years and others might suggest a different time period. However, the status quo—in which DAF accounts are subject to no payout rules at all—do a disservice to charitable organizations that depend on donations and to American society as a whole, which benefits when our charities are well-funded.

The letter writers take a "sky is falling" approach to a payout rule: as if with a payout rule, donors would stop giving to DAFs. But the industry's objections to a payout are similar to the concerns private foundations made before the landmark Tax Reform Act of 1969; yet foundations have thrived (and benefited) from the rules then put in place. And although we understand the industry's support for using DAFs to absorb income windfalls, give donors more time to develop a plan, and involve family members in philanthropy, we believe that these goals can be fulfilled with a reasonable payout period. Most importantly, these goals must be balanced with society's interest in ensuring that dollars that have received charitable tax benefits be made available for use by charities within a reasonable period of time.

The industry letter says that a payout would be a "nightmare" and introduce "unprecedented complexity." We urge you not to be swayed by their use of adjectives. DAF sponsors are already managing and reporting on each of these accounts separately in terms of both investment returns and distributions. It would not be complicated to add the name of the charity that would receive any remaining funds at the end of the 10-year period. All contributions made within a single year could be grouped together and payout requirements would be imposed on the appreciation and earnings from the funds as well. This is not complex.

Apart from payout, our letter raised another issue, which is whether private foundations should be allowed to count grants to DAFs as qualifying for their own private foundation payout. The industry letter provides a number of testimonials about examples where the use of DAFs by

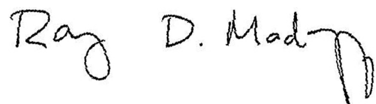
---

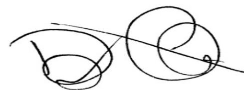
[8] We recognize that some DAF sponsoring organizations partner with donors and guide donors toward making better philanthropic decisions. We believe that a DAF payout rule would be helpful for those organizations seeking to help direct DAF funds to their communities.

private foundations advanced a "genuine charitable objective."[9] However, these testimonials fail to address the larger point. That is, whether private foundations should be allowed to skirt payout requirements by making contributions to DAFs. The industry letter acknowledges that this use is inappropriate (in the words of their letter, "clearly we would frown on such an activity"), but they make no suggestions to close this loophole.

The Economist magazine recently reported that some private foundations distribute 90% of their qualifying distributions to DAFs.[10] We are concerned that these transfers are not necessary to secure charitable ends, but serve other goals, either to avoid the payout requirement or private foundation disclosure rules. In our view, neither of these reasons is consistent with the spirit of the rules that have governed private foundation conduct since 1969. The payout is intended to measure distributions to active charities, not to other investment funds.

To conclude, we have in good faith presented a case for a payout rule from donor advised funds. A payout rule would harness the fundraising benefits of DAFs to provide a steady stream of funds to active charities, for the benefit of the charitable sector as a whole. Thank you for considering our views.





Ray Madoff
Professor of Law
Director, Forum on Philanthropy & the Public Good
Boston College Law School

Roger Colinvaux
Professor of Law
Columbus School of Law
The Catholic University of America

[9] We are not persuaded by these testimonials. In fact, we think the testimonials show that the presence of DAFs leads to seemingly strange decisions.

As described in the industry letter, in the first testimonial, the Woodruff Foundation nobly wanted to provide assistance to a hospital in financial straights. Instead of granting $200 million at once, the foundation wanted to space out the financial assistance over time. So the foundation used a DAF, making a $200 million contribution that was distributed over eight years. But why use a DAF? Presumably the foundation could utilize the set-aside rules designed for situations like these. I.R.C. §4942(g)(2).

The two other testimonials also raise more questions than they answer. The second concerns a foundation that used its DAF to transfer funds back to itself in order to bolster its asset base so as to reduce its payout obligation during an economic downturn. Apart from the circularity of this arrangement (and the overall reduction in net payout entailed), if the foundation had kept the money in the first place and not given it to a DAF, it would not have had to re-grant it to itself to reduce its payout obligation.

The third testimonial describes a contractual arrangement between a community foundation and a private foundation whereby the community foundation provides guidance to the private foundation about local needs. The industry letter acknowledges that "it would be possible for the donor to make grants directly from the private foundation to the local organizations" but that using a DAF allows the donor to work with the professional staff of the community foundation. As a contractual arrangement, however, there is no reason to use a DAF. The foundation could just pay for the community foundation's expertise.

[10] https://www.economist.com/news/finance-and-economics/21719494-rise-dafs-may-be-much-about-tax-charity-philanthropic-boom