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NONPROFITS: CALIFORNIA LEGISLATION

Big Week of DAF-Reform Buzz

02.10.22 | Linda J. Rosenthal, JD

"The question now – at the beginning of 2022 – is whether the nonprofit community is any closer to a consensus … or to any action at all." That was our pithy observation on January 10, 2022, in The Latest on DAF and Foundation Reform Proposals .

But just a few short weeks later, the Chronicle of Philanthropy's Stacy Palmer began her February 5th newsletter with quite a different message. "Good morning," she greeted her readers. "This was a big week for news and contentious debate about donor-advised funds, which have been growing especially fast in recent years and are now worth more than $159 billion."

So … what happened last week?

- House companion bill introduced: On February 3, 2022, Representatives Chellie Pingree (D-ME) and Tom Reed (R-NY) introduced H.R.6595, the Accelerating Charitable Efforts Act (ACE). It's the long-anticipated companion bill to last summer's SB 1981, sponsored by Senators Angus King (I-ME, caucuses with Democrats) and Chuck Grassley (R-IA).
- New DAF recommendations from opponents: On February 1, 2022, the Strengthening Community Philanthropy Ad Hoc Working Group, convened by the Council on Foundations, released four "final" recommendations on DAFs, "outlining steps to improve their effective and transparent use."
- New working draft of ten guidelines from proponents: On February 4, 2022, the California Association of Nonprofits published a "working draft" document called Principles for the Reform of Policies Governing Philanthropy. CalNonprofits describes it as a call to the nonprofit sector to participate with them in shaping a final version of these Principles to guide the upcoming debate on DAF reform.

CalNonprofits sums up the new situation fairly: "With the introduction of HR 6595, we appear to be in a moment when new regulations for private foundations and for donor-advised funds are gaining momentum."

It remains to be seen whether the changes – if any – follow the contours of pending SB 1981 and HR 6595, are modified along the lines now suggested by opponents, or are watered down to meaningless drivel. Anything and everything is possible including the once long-shot notion of Congress acting at all. With bicameral and bipartisan support, the pending legislation could (possibly) pass in one form or another.

Why is this all so important right now? We're talking about an enormous (and growing each year, apparently) treasure trove of donated funds that could be redirected much more quickly to the nation's and the world's "working charities."

A *Nutshell Summary*

According to advocates for legislative change, this moment has been a long time coming.

The impetus behind the current legislative push to push more money out the door of DAFs and private foundations in a timely manner has been picking up steam for several years. But the roots of the problem go back much further.

"The first DAF may date back to 1931," explains CalNonprofits CEO Jan Masaoka in Will Congress Act to Reform Philanthropy? (November 30, 2021) The Nonprofit Quarterly. But "the significance of DAFs has increased markedly in the past half-century, with the number of assets held in DAF accounts nearly quadrupling in value (even after adjusting for inflation) since 2007." See also Donor-Advised Funds Saw Rapid Growth in 2020 (November 9, 2021) Michael Theis, The Chronicle of Philanthropy.

"To date, congressional action has been conspicuous in its absence," according to Ms. Masaoka. She adds: "… Congress only rarely passes laws that directly regulate philanthropy. The last truly foundational law regarding philanthropy was passed in 1969…." It was in the Tax Reform Act of 1969 that the special rules for private foundations were first enacted, including the mandatory five-percent minimum payout rule…."

"Of course, a lot has changed in philanthropy since 1969!" including the explosive growth and popularity of donor-advised funds, particularly beginning in the early 1990s with the introduction of commercial DAF firms.

"Proponents of the federal reform estimate some $160 billion is set aside for future charitable gifts," according to Mark Hrywna in Changes To DAF Rules Drafted, Again, On Capitol Hill (February 3, 2022) The Nonprofit Times. "While the funds are dedicated to charities once the contributions are made, there is no requirement to ever distribute them. Commercial DAFs, such as Fidelity Charitable and Schwab Charitable, have ballooned over the past decade, in part due to increasing contributions as well as appreciated assets to become some of the largest charities in the nation with tens of billions of dollars in assets."

Opponents of legislative changes, as proposed in the new legislation or otherwise, describe the situation as a solution in search of a problem. They dispute certain of the foundational assertions made by proponents, including the scope and extent of funds being tied up, and dismiss any talk of a need for Congressional action.They also characterize the proposed solutions as harmful overall. See House Legislation From Reps. Pingree and Reed Will Crush Charitable Giving (February 3, 2020) Philanthropy Roundtable.

See our January 10th post for a summary of how and why this issue of DAF reform has moved front and center, particularly in the past two years or so, and for the positions and arguments of the proponents and opponents before the most current developments of last week.

The New House Bill

A "bipartisan set of tax proposals intended to speed up distributions from foundations and donor-advised funds has been introduced in the House of Representatives, raising the hopes of its backers that the legislation has momentum."See Legislation Intended to Speed Up Giving Gets a Boost in Congress (February 3, 2022) Dan Parks, The Chronicle of Philanthropy.

"The new payout bill backed by Pingree and Reed," explains Mr. Parks, is based on a proposal developed by the billionaire philanthropist John Arnold and Boston College law professor Ray Madoff. It is a companion to a bill introduced in the Senate last year."

More particularly, it "would allow donors to get an upfront tax deduction for donor-advised-fund deposits only if they distribute the money within 15 years. For community foundations and certain other organizations like Jewish federations, the bill would exempt donor-advised fund accounts of $1 million or less from any payout requirements; larger accounts would have to distribute at least 5 percent annually."

The legislation "also includes an incentive, but not a requirement, for foundations to boost their annual payout from the 5 percent minimum required by federal law to 7 percent."

House Bill 6595 – full text here – is spearheaded by Democrat Pingree and Republican Reed. There are at least two additional co-sponsors so far including Representatives Ro Khanna (D-CA, including Silicon Valley) and Katie Porter (D-CA).

In a press release, Rep. Pingree explained the urgency of Congressional action: "The coronavirus pandemic highlighted just how important working charities are to our communities ….Yet, $1 out of every $8 donated to U.S. charities goes to donor-advised funds, giving the wealthy generous tax breaks for their charitable contributions but not ensuring those funds help anyone in need. Our half-century old philanthropy laws must be reformed to correct this fundamental flaw in our current system…."

Congressman Reed added: "We were glad to join in this bipartisan effort to help charities receive the funds that they so rightfully deserve. The reforms from this bill will make sure that charities will quickly receive contributions that will go to better the organization and those in the community they are dedicated to serving."

In a statement, Rep. Khanna noted that "loopholes in our current laws allow the ultrawealthy to make contributions and receive immediate tax benefits without any distribution requirements" with the result "that money promised to charity can sit unused for years."

Jan Masaoka has noted that her organization, CalNonprofits, while representing a broad array of groups, has chosen to support this bicameral legislation: "While the pressures for philanthropic reform in society have been growing for some time now, the legislation reform effort is modest in scope. Nonetheless, if it became law, ACE would be the most significant philanthropic legislation to pass Congress in a half century. If passed, ACE would establish limits on how long funds can stay in DAFs, provide some transparency on foundation-to-DAF transfers, and encourage higher levels of giving by private foundations."

CoF Recommendations

Just a day or so before H.R. 6595 was introduced, the Strengthening Community Philanthropy Ad Hoc Working Group convened by the Council on Foundations (a leading opponent of the proposed legislation), offered its latest recommendations titled titled Strengthening Community Philanthropy Ad Hoc Working Group Final Recommendations. The download link is here for this 9-page PDF document.

See *Community Funds Urged to Set Annual Distribution Rate* (February 2, 2022) Dan Parks, *The Chronicle of Philanthropy*.
[Update 2/11/22]*: The middle of this section has been modified this morning in order to delete the discussion based on Mr. Parks's 2/2/22 article, and instead to include reference to a new Letter to the Editor of The Chronicle of Philanthropy on behalf of the Ad Hoc Working Group, taking issue with the 2/2/22 article.*
But see and compare: *Council on Foundation DAF Recommendations Deserve a Closer Look* (February 11, 2022) ["…the Chronicle of Philanthropy's reporting — "Community Funds Urged to Set Annual Distribution Rate" — gives the recommendations less than a fair shake, quoting only critics and none of the many supporters…."]

Their recommendations, they write, "are informed by the available data and the real-world experience of community foundation leaders like us. We and dozens of others who have engaged with us in our deliberate, six-month process believe that these strategies taken together would improve philanthropy without undermining or slowing down charitable giving."

They conclude: "To those who say our recommendations aren't strong enough, we say this: Please, join our conversation about ways to improve them. This is just a first step,…" *[End of 2/11/22 modification]*

The nine-page download begins: "Strengthening Community Philanthropy Ad Hoc Working Group Final Recommendations for community foundations" [are] "to provide additional narrative about any inactive funds, so community foundations can provide additional context if they choose."

There are five sections, each with a header, a description of the "issue," and one or more "recommendations."

- Standardizing Community Foundation Inactive Funds Policy
- Aggregate DAF Annual Distribution Requirement
- Private Foundation Distributions to Donor-Advised Fund

- Donation of Complex Gifts
- Expanding Charitable Giving

The recommendations document concludes with a section titled "Principles": "The Strengthening Community Philanthropy Ad Hoc Working Group agreed to the following set of shared beliefs about donor-advised funds as a starting point to guide the development of the above recommendations."

There are nine listed items: the first two, for example, are: "DAFs incentivize charitable giving and build a culture of philanthropy in communities large and small, rural and urban, across the country" and "DAFs enable people and businesses from a wide range of income levels to invest in their communities as they determine best."

CalNonprofits' Ten Guidelines

The day after the introduction of HR. 6595, CalNonprofits published a "working draft" document called Principles for the Reform of Policies Governing Philanthropy.

The accompanying article on its website explains: " Just yesterday a major bill in the U.S. Senate was bolstered by the introduction of a counterpart in the House: the Accelerating Charitable Efforts (ACE) Act. We appear to be in a moment when new regulations for private foundations and for donor-advised funds are gaining momentum…."

CalNonprofits had endorsed the Senate companion bill last year. This document provides continuing support for SB 1981 as well as the new House companion bill – possibly influenced at least in part by the opponents' new recommendations for how the DAF reform debate should proceed). The 10 Guidelines (1) confirm that Congressional action is, indeed, needed; and (2) suggest how the debate should proceed.

"…[L]aws must be updated to reflect current philanthropic realities. We must strike a better balance between donors' interests in determining when and where donations are made, intermediaries' interests in benefiting from holding funds, and the public's interest in prompt and fair distribution of donated funds held in public trust….At a minimum, greater transparency is needed so the public has ways to track how, when, and where tax-deductible donations are used."

To get a flavor of these ten points (which are decidedly different than the latest recommendations by the working group formed by the Council on Foundations), here are (portions of) the first two:

- "Because individuals and companies receive federal and state tax benefits for charitable contributions, the public has a direct financial and legal stake in ensuring that such contributions are used for public benefit…."
- "Societal losses due to tax deductions for charitable donations should be matched with corresponding societal gains through prompt distribution of donations to charities to serve their communities…."

The California Association of Nonprofits seeks the help of the philanthropy community to shape these "draft" points into final ones. "These draft principles are meant to act as a guide for emerging legislation and other policy reforms, as a request for strong oversight of the sector, and as a call to philanthropy to act in ways that put the public's interest first."

A few months ago, Jan Masaoka describes the challenge ahead in moving forward on meaningful DAF reform: "ACE isn't perfect, but, at Cal Nonprofits, we believe it is necessary. It is embarrassing, frankly, that a 1969 law is still the main framework of a philanthropic field that has evolved considerably in the half century since that legislation passed. We believe ACE will free up resources currently being held in philanthropic institutions and will help bring much-needed additional resources to nonprofits and the communities we serve."

She continues: The ACE bill is meant to set guardrails and 'rules for the road' for philanthropy…. It has been crafted thoughtfully and helps to bring the public cost and the public benefits of foundations and DAFs into better alignment. And it can also help accelerate the movement of already-donated funds towards active, operating nonprofits."

Conclusion

Both the 2020 Initiative to Accelerate Charitable Giving as well as the June 2021 introduction of Senate Bill 1981 touched off a firestorm of internecine squabbling not ordinarily seen within the nonprofit sector.

It's likely there will be lots more to come in the days and weeks ahead.

— Linda J. Rosenthal, J.D. FPLG Information & Research Director