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NONPROFITS: DONOR ADVISED FUNDS

Donor-Advised Funds: IRS Asks for Public Comment

12.13.17 | Linda J. Rosenthal, JD

Donor-advised funds (DAFs) have been available for decades, but it's only in recent years that DAFs have surged in popularity in the United States to become the "fastest-growing charitable giving vehicle."

With that growth has come scrutiny. For wealthy people, a donor-advised fund is certainly an attractive alternative to creating a private family foundation. DAFs involve less time and money; they offer more control and privacy as well. Critics worry, though, that there may not be enough benefit to society as a whole to warrant the generous tax advantages.

The discussion in 2017 has moved from the policy-wonk world of academics and philanthropy experts to federal officials and legislators. The current tax-legislation reconciliation talks involve consideration of DAF-related provisions along with a huge number of other issues with significant public impact. Most of the action is happening behind tightly closed doors beyond public reach; it will be dealt with in up-or-down votes on the entire package.

But the Internal Revenue Service has entered the DAF debate fray, too, with a notice of proposed rule-making and request for public comments issued just recently on December 4, 2017.

The Donor-Advised Funds Debate

Before we get to the specifics of IRS Notice 2017-73, a brief review of earlier developments should be helpful.

In the summer of 2016, what had been relatively quiet rumblings in certain quarters about the runaway growth of donor-advised funds – particularly the large, commercial ones including Fidelity Charitable – burst out into the open. In the *New York Review of Books*, law professor Ray Madoff and philanthropist Lewis B. Cullman published a provocative article titled *The Undermining of American Charity*.

Following up a year later, Professor Madoff, now joined by fellow law professor Roger Colinvaux, took these biting criticisms to the next level. They penned a letter dated July 17, 2017, to Senate Finance Committee Chairman Orrin Hatch (R-UT), "deftly making use of the opportunity to respond to his 'request to stakeholders for input on tax reform, specifically with respect to the tax treatment of 501(c)(3) charitable organizations.'"

The 4-page letter from Madoff and Colinvaux was comprehensive and detailed, requesting Congressional action to impose significant new requirements and restrictions on donor-advised funds. There were two key recommendations: first, mandating payout periods for all funds sitting in DAF accounts; and second, prohibiting private foundations from satisfying their own payout requirements by distributing funds to DAFs.

These two proposals were based on research they cited suggesting that DAF donors stockpile too much money in the DAF accounts for too long, instead of releasing them to good use in the charitable community.

Since the donors receive an immediate, highly valuable, charitable deduction, it's only fair, they argue, to require charitable use of the money within a reasonable period of time.
Donor-advised funds and other "stakeholders" were invited by Chairman Hatch to respond. Some 100 community foundations, along with the Council on Foundations, Independent Sector, and the Alliance for

Charitable Reform created a 12-page rebuttal dated September 6, 2017. In this response addressed to Senator Hatch and Ranking Member Ron Wyden (D-OR), these proponents did not hold back; they characterized the law professors' July letter as "misguided and misleading." In particular, they argued that the mandatory payout proposal along with the suggestion to block private foundation payouts to DAFs are based on "erroneous statistics and claims."

Their purpose was to (1) dispel these unfounded assertions, and (2) explain how the law professors' proposals "would actually be harmful to philanthropy, rather than increase charitable giving or curb abusive practices."

These community foundations and their allies took particular aim at the claim that donor-advised funds "stockpile" money at all or in excessive amounts. They argue that there is "no evidence" at all of stockpiling; moreover, there is "little incentive to donors" to stockpile, because they are given a tax benefit upfront. They explain as well that there is an accreditation procedure under the National Standards for U.S. Community Foundations. Many community foundations seek this certification which requires them to have a policy that addresses "inactive funds."

Proponents explain also about the process of making DAF distributions; in some cases, there are legitimate reasons that some payouts don't get started right away, or why they may be halted for a while.

Federal Action on Donor-Advised Funds

While the ink was hardly dry on these provocative, pro and con, letters, Congressional attention turned to the matter of drafting comprehensive tax legislation. Because we are still in the behind-closed-doors, sausage-making phase of the conference's deliberations, it's anyone's guess if donor-advised funds will be affected directly or indirectly.

In the meantime, the Internal Revenue Service has chosen this moment to dip its administrative toes into the waters. In Notice 2017-73, issued on December 4, 2017, the federal tax agency "describes approaches" that Treasury and the IRS "are considering to address certain issues regarding donor-advised funds (DAFs) of sponsoring organizations." If adopted, they propose administrative action including future new regulations under Internal Revenue Code section 4967.

This would be a limited intervention only – way short of the more comprehensive changes proposed last July by Professors Madoff and Colinvaux.

There are two proposals discussed:

- ***Purchase of Tickets by DAF for Charity Event Attendance***. The Treasury wants to add a regulation that, if a donor-advised fund pays for tickets for its donor or certain (related) others to attend a charity event, that payment would be considered more than an "incident benefit" to that person within the meaning of IRC section 4967.
- ***Fulfillment of Pledges by Donor***. The Treasury wants to make clear that if a donor-advised fund makes payments to fulfill a pledge made by a donor or certain (related) others, that payment would *not* be considered more than an "incidental benefit" to that person within the meaning of IRC section 4947 – if certain conditions are met.

A third possible proposal is listed, too:

- ***Change to Public Support Computation. "The Treasury Department and the IRS are considering developing proposed regulations" about the effect of donor-advised funds' grants to certain public charities in connection with their public support calculations and in a way that will stop DAFs from avoiding excise tax rules that apply to private foundations.***

Conclusion

As required by law, Notice 2017-73 includes a request for public comments for a period of 90 days that ends on March 5, 2018. Even though this Notice involves only preliminary ideas under consideration by the Treasury Department and the IRS, those directly affected or otherwise interested should take this opportunity to submit information and reaction to these tentative proposals.