Donor-Advised Funds: Sweeping Changes Proposed

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Highlights

- Proposed federal legislation could have an impact on donor-advised funds (DAFs), donors, and DAF sponsoring organizations, including Bessemer Giving Fund.
- Proponents argue that the new legislation would ensure charities receive funds more quickly and prevent charitable dollars from accumulating in DAFs. Opponents believe the drastic measures could have a chilling effect on charitable giving, if enacted.
- So far, the bill has not gained momentum in the Senate, but we will continue to monitor developments and be prepared to respond quickly if necessary.

Update: On February 3, 2022, shortly after the initial publication of this piece on February 1, U.S. Representatives Pingree (D-Maine) and Reed (R-N.Y.) introduced the ACE Act to the House of Representatives, a bill substantially similar to the Senate's ACE Act, which is discussed below. We are monitoring developments regarding both bills and will provide updates as needed.

On June 9, 2021, U.S. Senators Grassley (R-Iowa) and King (I-Maine) introduced the Accelerating Charitable Efforts (ACE) Act, which includes provisions relating to DAFs as well as private foundations.[1] This somewhat controversial and sweeping legislation aims to ensure that charities receive funds more quickly and that charitable dollars do not simply accumulate in DAFs. Opponents of the legislation believe, however, that the drastic measures set forth in the act are not supported by the data and that the act could have a chilling effect on charitable giving. It is important to note that this act was proposed in June 2021 and there has not been further movement on it since its introduction.

So, what does the act provide with respect to DAFs? For starters, it breaks DAFs into two types — qualified or non-qualified — and donors would have to choose which one they prefer.

A **qualified DAF** would be required to distribute all funds to qualified charities within 15 years of contribution. A donor to a qualified DAF would receive an upfront charitable income tax deduction in the year of the contribution.

A **non-qualified DAF** would be obligated to distribute funds within 50 years. As a consequence, a donor to a non-qualified DAF would only receive an income tax charitable deduction in the year that the DAF actually makes a distribution to a qualified charity — and the deduction would be limited to the actual amount distributed. In addition, if the non-qualified DAF failed to distribute the assets within 50 years, the DAF's sponsoring organization would incur an excise tax of 50% of the contribution plus any earnings attributable to that contribution.

These concepts of qualified and non-qualified DAFs and the 15- and 50-year limitations on duration contrast sharply with the current legal requirements

[1] ACE Act, S. 1981, 117th Cong. (2021).

of DAFs, which do not have any term limits or minimum distributions, and donors receive a full charitable income tax deduction in the year of contribution to the DAF.

The act also creates another new category of DAF — the **qualified community DAF** — which gets preferential treatment under certain circumstances. This would be a DAF controlled by a qualified community foundation (under the act, defined as a community foundation that holds at least 25% of its assets outside of DAFs and serves a geographic area of no more than four states). The qualified community DAF would not be subject to the restrictions for qualified and non-qualified DAFs set out above if it met certain requirements.[2]

Another notable feature of the act is how it treats illiquid assets contributed to any of the new categories of DAFs. Under the act, if a donor donates non-publicly traded assets (e.g., real estate, collectibles, privately held business interests) to a DAF, the donor cannot receive the charitable deduction until the assets are sold. Further, the deduction would be limited to the value of the sale proceeds. Under current rules, a donor receives a full fair market value deduction in the year he or she contributes illiquid assets to a DAF. Opponents of the act have questioned whether this rule will stifle charitable giving or, at a minimum, cause donors to contribute these assets only to sophisticated or heavily endowed charities since they could most readily handle such a sale.

The act also proposes a few significant changes for private foundations. A private foundation is currently required to pay out 5% of its assets annually; under the act, a distribution to a DAF would not count toward its annual 5% payout unless the DAF made a qualifying distribution of the contribution in the same year. In addition, a private foundation could not count administrative expenses paid to disqualified persons as part of its 5% annual payout. The act also creates exemptions to the tax on investment income for private foundations; a private foundation that distributes more than 7% in a particular year (in qualifying distributions) would be exempt from the tax on investment income for that year. There is also an exemption from the tax on investment income for certain limited-duration private foundations (those with a duration of not more than 25 years).

Proponents of the act contend that, if passed, the act would help charities receive the funds now that they need to carry out their charitable work, instead of simply aggregating those funds in DAFs for the indefinite future.

But opponents speculate that such legislative changes would put the administrative onus of enforcement of these new rules squarely on the sponsoring organizations. Smaller sponsoring organizations may not be well-positioned to take on these additional recordkeeping burdens. Others are concerned that if the act were to become law, charitable giving would be reduced. For example, donors might be less inclined to donate illiquid assets given their less favorable treatment under the act. Multigenerational charitable giving — an important tool for many wealthy families attempting to pass down philanthropic values to their future generations — could be severely curtailed with the duration limits on DAFs under the act.

Although, as we noted above, the ACE Act has not gained momentum in the Senate, it has garnered significant attention and debate on both sides of the philanthropic aisle. While the bill itself may not become law, perhaps it (and the debate surrounding it) may generate changes nonetheless.

For example, some sponsoring organizations impose "dormant fund" policies for their DAFs, requiring that distributions be made from the DAFs at regular intervals. In addition, data suggest that, on average, DAFs annually pay out much more than the 5% required of private foundations. According to the 2020 Donor Advised Fund Report published by National Philanthropic Trust (NPT) for fiscal year 2019, the average annual DAF payout rate was 22.4% (and this rate has consistently remained over 20% for all years since 2015, when the data were first collected by NPT).[3]

At this point, it's impossible to know for certain whether the act will be enacted as proposed, enacted with changes to the original proposal, or not enacted at all but perhaps inspire organizations to change anyway. We will continue to monitor developments closely and be prepared to respond quickly if and when any changes are made.

If you would like more information or have any questions about this proposed legislation or DAFs in general, please reach out to your client advisor.

[2] These requirements include the following: (i) No individual has advisory privileges with respect to one or more DAFs sponsored by the qualified community foundation with an aggregate value of over $1 million, and (ii) the donor, by written agreement, requires that the DAF pay at least 5% of the value of the DAF's assets each calendar year.

[3] https://www.nptrust.org/reports/daf-report/.

Donor-Advised Funds and Private Foundations Under Current Law

	Donor-Advised Fund (DAF)	Private Foundation Annually
Start-Up Costs	None; services provided by the DAF administrator	Yes; legal and tax costs vary depending on structure
Income Tax Deduction Limited to % of Donor's Adjusted Gross Income	Cash gifts: up to 60% Appreciated securities: up to 30%	Cash gifts: up to 30% Appreciated securities: up to 20%
Annual Distribution Requirement	No required payout under existing law; some sponsoring institutions require annual distributions	5% annually of net assets
Annual Administrative Expenses	Varies widely depending upon the DAF sponsoring institution. For Bessemer Giving Fund, annual administrative expenses are 0.15% of assets	0.15% to 2% of assets; typically dependent on foundation size
Public Exposure	Account name may be listed in public documents, or donor can request anonymity	Foundation managers and annual contribution information available to public
Taxes on Investment Income	None	1.39% annually of net investment income
Donor's Ongoing Responsibilities	Donor advisor recommends charitable grantees; all other services provided by the DAF sponsoring institution, including due diligence and tax documentation	Responsible for overseeing investment managers, IRS reporting and compliance, due diligence on grantees, and distributing annual grants
Control of Donated Assets and Grants	The DAF sponsoring institution controls assets; donor advisor may recommend grants	Board has control over grant and investment decisions; subject to best interest of foundation and self-dealing rules
Donor's and Family's Continuing Participation	Donor advisor may designate family members or others to serve as donor advisors and successors to continue charitable legacy	Allows donors to continue charitable legacy over many generations
Updating Documents	Simple forms	Cumbersome legal forms

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