Donor-Advised Funds (DAFs): Proposed Legislation

Donor-advised funds (DAFs) are funds or accounts established within a sponsoring organization. Taxpayers are allowed to make deductible charitable contributions to DAFs. Sponsoring organizations are organized as charities that can receive tax-deductible donations and they in turn make distributions (grants) to active charities. The gift to the sponsor is irrevocable, as in the case of a gift to a foundation or any other charity. The donor does not legally oversee the payment of grants to charities from the fund, which the sponsoring organization determines. Donors make recommendations for grants (hence donor-advised), and there is general agreement that these recommendations determine, with few exceptions, the distributions. DAFs, like private foundations, can accumulate assets and earn a return tax free, but they are not subject to many of the restrictions on foundations, including the minimum payout rate.

Magnitude and Growth of DAFs
DAFs have been growing rapidly, in part through funds set up by major financial institutions. Since 2016, contributions have increased by 90%, and in FY2020, accounted for 10.1% of total charitable giving. According to the National Philanthropic Trust 2021 report, in FY2020, there were more than 1.005 million individual DAFs, with contributions of $47.85 billion, assets of $159.83 billion, and distributions of $34.67 billion. The DAFs were managed by 55 national charities, 603 community foundations, and 318 single-issue charities.

DAFs were originally largely found among community foundations, grants, assets, and contributions are now concentrated in national charities. In FY2020, 61% of grants, 70% of contributions, 63% of assets, and 86% of accounts were in national charities. In FY2020, Fidelity Charity donors made 26% of grants; in FY2021, more than 286,000 donors had accounts at Fidelity Charity, with grants of over $10.3 billion. The five largest national charities—Fidelity Charitable, National Philanthropic Trust, Schwab Charitable Fund, Vanguard Charitable Endowment, and the Silicon Valley Community Foundation—were responsible for half the FY2020 contributions.

Average account sizes are smaller among national charities, $115,901, compared to $543,553 in community foundations and $244,238 in single-issue charities. The overall average account size is $159,019, an amount that has been falling as the relative size of assets in national charities has been growing.

Benefits and Concerns About DAFs
DAFs are a simpler way to provide sustained giving than through a private foundation, and they are practical for those with smaller amounts of charitable giving. Private foundations are complicated and costly to set up and run. DAFs can also facilitate year-end tax planning, by allowing a large contribution in a year when tax rates are higher, which can be distributed in the following years without determining the charities to receive deductions. Individuals may also choose to make large contributions in a single year when deductions can be itemized, rather than making smaller, potentially nondeductible charitable contributions annually.

Evidence suggests DAFs are replacing, rather than increasing, charitable giving. A 2021 report by Boston College Law School Forum on Philanthropy and the Public Good found that contributions to DAFs rose from 4% of total contributions in 2007 to 13% in 2019, whereas total charitable contributions remained unchanged as a share of income. The data also suggest that DAF contributions did not substitute for contributions to private foundations but rather displaced contributions to active charities. The share of giving to DAFs and private foundations combined grew from 18% in 2007 to 28% in 2019. It is possible that DAF giving is offsetting a general decline in giving, such as giving to religious organizations, although most of that decline preceded DAFs’ growth.

A common concern about DAFs and their growth is that charitable contributions do not fully flow to active charities but may remain in DAF accounts. Assets can also remain in private foundations, although there is a 5% minimum distribution requirement. Contributions as a share of income are more restrictive for gifts to private foundations: 30% for private foundations compared to 50% for other charitable contributions. (The 50% limit is temporarily increased to 60% through 2025.) Gifts of appreciated property are limited to 20% for gifts to private foundations, but are 30% for charities. DAFs are also not subject to the private foundation excise tax of 1.39% of investment income or the private foundation rules on self-dealing. Thus, DAFs allow the accumulation of assets without some of the restrictions imposed on private foundations.

DAF payout rates (as a percentage of end of previous year assets) averaged 23.8%. Payouts were 23.9% from national charities, 19.8% from community foundations, and 35% from single-issue charities. Proponents of DAFs point to these measures as indications that DAFs are distributing more than private foundations, who, according to FoundationMark, typically distribute in the aggregate about 8% of assets.

A 2020 National Bureau of Economic Research study by James Andreoni and Ray Madoff (Working Paper 27888) contended that the payout rate is overstated for determining how much money is going to charities. The payout rate,
Contributions to donor-advised funds (DAFs) are counted as part of a private foundation’s contributions to DAFs. They are reported as charitable distributions and that private foundations unrelated to DAFs. A qualified community foundation DAF is not subject to these restrictions but the bill would limit advisory privileges to $1 million and require a 5% payout from each account. No deduction for a non-tradeable asset would be allowed to either type of qualified DAF until the asset is sold.

The public support test requires that a third of contributions for charities come from the public; otherwise, the charity may be classified as a private foundations. The bill provides that contributions from DAFs would not be counted unless the donor is identified.

The proposal also includes some provisions for private foundations unrelated to DAFs. One provision would disallow administrative expenses from qualifying for the 5% minimum distribution if made to disqualified persons (such as substantial contributors). The bill also includes two provisions favorable to private foundations by eliminating the excise tax on investment income for foundations that distribute at least 7% of assets or foundations limited to 25 years.

Prior Proposed IRS Regulations

The public support test in the ACE Act was also included in a notice to consider regulations (IRS Notice 2017-73). The proposed regulations would also have asked for public comment on the inclusion of contributions to DAFs by private foundations in satisfying the 5% minimum payout rule. These proposed regulations have not been developed further.

Issues

As discussed earlier, one of the concerns addressed by the ACE Act is to speed the distribution of funds to active charities. Opponents argue that these rules would reduce charitable giving, although, as noted above, data on giving trends suggest that contributions to DAFs have displaced other giving rather than increasing overall giving.

One particular concern is the requirement that DAFs identify donors for purposes of the public charities support test. It is argued that this provision may make it more difficult for charities with sensitive or controversial issues to raise funds.

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