CONGRESS SHOULD RESPOND: A PAYOUT FOR SOME DAFS AND NEW RULES FOR NONCASH CONTRIBUTIONS

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Abstract: Donor advised funds attract a significant share of charitable giving and warrant Congress's attention. The national sponsoring organization is distinct from other DAF sponsors. The national sponsoring organization's exempt purpose is to spend money for the benefit of other 501(c)(3) organizations, and is best characterized as a fundraising organization. Given the national sponsoring organization's exempt purpose, it is already subject to a facts and circumstances based payout. Because national sponsoring organizations fundamentally are vehicles for spending not saving, Congress should apply legislatively the commensurate in scope test and require that national sponsoring organizations spend contributed funds over a specified time period. The goal is to provide a spending period long enough so as not to alienate new donors, but short enough so as not to extend unduly the delay to charity that results when DAFs are used as public charity substitutes. Congress also should note that DAFs increasingly are used for noncash charitable contributions. The positive effect will be to make property conversions more efficient. The negative effect will be to accentuate the broken system for property contributions at great expense. DAFs present an opportunity for Congress to reduce the cost of the subsidy for property contributions and move to a net benefit to charity approach to the deduction.

INTRODUCTION

The donor advised fund (or DAF) is the worst development in the history of philanthropy. The donor advised fund is the best development in the history of philanthropy. Which is it? The answer of course is neither – both statements exaggerate. But the sentiment that the donor advised fund is a disrupting presence with unknown ramifications to the 501(c)(3) sector is accurate.

Without a doubt, the donor advised fund (DAF) is a burgeoning force in philanthropy in the 21st century. Two of the five top recipients for charitable gifts in the United States are sponsoring organizations of donor ad-

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vised funds – the Fidelity Charitable Gift Fund and the Schwab Charitable Fund.[1] There are over 1,000 charities that sponsor more than 217,000 DAF accounts, holding almost $54 billion.[2] DAFs spent about $9.66 billion in 2013 on 501(c)(3) purposes,[3] a significant share of spending in the nonprofit sector. The money is pouring in, and will likely continue. In 2013, $17.28 billion was contributed to DAFs, as compared to $13.99 billion the year before and about $10 billion five years before that (2007).[4] DAFs are popular with donors because they are efficient, convenient, and rewarding.

Yet with success comes scrutiny. The concern most often voiced is straightforward: donors are allowed a charitable deduction for federal income tax purposes upon contribution to a DAF sponsoring organization but there is no requirement that the DAF (or the sponsoring organization) ever spend the money. This is unusual if DAFs are compared to private foundations, which like DAFs make grants of contributed funds over time. Private foundations though are subject to a precise pay out rule; DAFs and sponsoring organizations are not. One of the plainest policy questions then is whether DAFs should be subject to a payout requirement either at the DAF or sponsoring organization level.

DAFs also are emerging as a leading source of charitable contributions of property. DAF sponsoring organizations are actively soliciting contributions of illiquid assets like privately traded stock, real estate, fine art, and collectibles, as well as publicly traded securities. The use of DAFs to convert property to cash for the benefit of charities has appeal but also raises questions about whether DAFs will improve or worsen the already broken system of property contributions.

More broadly, the success of the donor advised fund is disturbing longstanding norms for charitable giving and spending in the United States. In 2013, roughly 7.2 percent of all charitable giving by individuals was to

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[1] The Fidelity Charitable Gift Fund ranks second; the Schwab Charitable Fund ranks fourth. Another, the Vanguard Charitable Endowment Program, is tenth. "The 2014 Philanthropy 400," *The Chronicle of Philanthropy*, Oct. 14, 2014 (measuring the top 400 charities, measured by amount of contributions received).

[2] NATIONAL PHILANTHROPIC TRUST, 2014 DONOR-ADVISED FUND REPORT (2014) (hereinafter "NPT 2014 Report").

[3] *Id*. at 1.

[4] *Id*. at 5. Giving USA noted (regarding 2013 data) that "Giving through donor-advised and donor-directed funds, as well as commercial gift funds, continues to grow at staggering rates. GIVING USA, THE ANNUAL REPORT ON PHILANTHROPY FOR THE YEAR 2013, 161 (hereinafter "Giving USA Report for 2013"). With respect to 2014 data, Giving USA found that "Contributions to national donor advised funds slowed substantially between 2013 and 2014." GIVING USA, THE ANNUAL REPORT ON PHILANTHROPY FOR THE YEAR 2014, 56 (hereinafter "Giving USA Report for 2014").

donor advised funds.[5] As DAFs share of the charitable giving pie grows, questions arise. Are DAF contributions substitutes for gifts to other public charities, depriving active causes of much needed funds? Are DAFs instead substitutes for private foundations? Or are DAFs attracting funds that otherwise would have been privately consumed?

The DAF debate is in a confused state, in part because there is no common understanding of what DAFs represent. DAF sponsoring organizations are called public charities, but as grant-making entities, seem more like private foundations. One difficulty is that not all DAF sponsoring organizations are the same making it hard to generalize. The biggest and perhaps best-known of DAF sponsors are national in scope and often affiliated with large investment firms (like Fidelity, Schwab, and Vanguard). The main activity of national sponsoring organizations is to sponsor DAFs. National sponsoring organizations "largely focus on receiving contributions, converting non-cash donations into a more liquid form, facilitating grant-making, and managing the investment of DAF assets, rather than the direct provision of charitable services."[6] National sponsoring organizations sponsor roughly 52 percent of all DAFs, make 43 percent of all grants, collect 53 percent of all contributions, and hold 47 percent of DAF account asset value.[7] Thus, national sponsoring organizations amount to about one-half of the DAF industry even though they are the fewest in number (about four percent).

Other sponsors are community foundations, which have a more local focus. "Community foundations commonly raise funds and make grants to support numerous charitable initiatives in their communities, and they hold endowments for local charitable projects in a number of funds, often including DAFs."[8] Still other sponsoring organizations are organized around a

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[5] The National Philanthropic Trust describes DAF contributions as 5.2 percent of all gifts to charity. Though accurate, the 5.2 percent number is somewhat misleading. The calculation divides total contributions ($17.28 billion) by "total charitable giving" ($335.17 billion) as reported by Giving USA. "Total charitable giving," however, does not represent new gifts to the charitable sector. Rather, "total charitable giving" measures all giving, including not only giving by individuals, but also by foundations, corporations, and by bequest. To get a better sense of DAF contributions as a share of charitable gifts, what matters is not DAF contributions as a percentage of "total charitable giving," as that number is typically used, but DAF contributions as a percentage of *new* giving, i.e., the percentage of all money flowing into the charitable sector for the first time that goes to a donor advised fund. Only this percentage will convey the significant of DAFs as a giving vehicle as compared to other choices donors have. A better formula is to divide total contributions ($17.28 billion) by total individual giving ($240.60 billion), or 7.2 percent. This assumes that total contributions are by individuals. *See generally* NPT 2014 Report at 1; Giving USA Report for 2013 at 8.

[6] DEPARTMENT OF THE TREASURY, REPORT TO CONGRESS ON SUPPORTING ORGANIZATIONS AND DONOR ADVISED FUNDS 49 (Dec. 2011) (hereinafter "Treasury Report").

[7] Percentages compiled from information in NPT 2014 Report at 7-9 for the year 2013.

[8] TREASURY REPORT at 51.

single issue. "Some common Single-Issue Charities include universities, Jewish federations, other faith-based charities, and issue-specific charities, such as those in the environmental, social justice or international relief arenas."[9] A distinguishing feature of single-issue sponsoring organizations is that some are "primarily involved in the direct provision of charitable services."[10] This means that in contrast to national sponsoring organizations, which mainly provide DAFs, and community foundation sponsors, which are primarily grant-making organizations, many single issue sponsors are active charities that use DAFs as a fundraising tool.

This Article seeks to advance the understanding of the donor advised fund and to provide answers to two of the main policy questions: whether to impose a payout on DAFs and their sponsoring organizations and how to respond to the increased use of DAFs for noncash charitable contributions. In general, it is beyond the scope of this article to fine-tune the discussion of DAFs to account fully for each type of sponsoring organization. Often, the generic term "DAF" or "DAF sponsoring organization" is used. That said, Part I of the Article refers in the main to national sponsoring organizations, though some of the general discussion in Part I also pertains to DAFs sponsored by community foundations and single-issue sponsors.[11] Part II of the Article is concerned with national sponsoring organizations exclusively and whether national sponsoring organizations should be subject to a payout. Part III of the Article (regarding noncash contributions) applies more broadly to all sponsoring organizations eligible to receive charitable contributions.

Part I of the Article sets the stage by discussing the different, sometimes overlapping ways DAFs are viewed – as quasi private foundations, public charity substitutes, or as catalysts for new charitable giving. Viewed as quasi-private foundations, the issue is whether DAFs should be subject to more aspects of the private foundation regime. Viewed as public charity substitutes, the concern is that DAFs are intermediaries and delay charity and should be subject to a payout rule. Viewed as the reason for new gifts, DAFs have promise but also require shaping to work best for the charitable sector.

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[9] NPT 2014 Report at 2.

[10] TREASURY REPORT at 49.

[11] Although Parts I and II of the Article are focused on national sponsoring organizations, donor advised funds at community foundations and single-issue sponsors merit separate consideration. One of the anomalies of current law is that donor advised funds are defined and regulated without regard to sponsor. DAFs, however, need not be uniform. Characteristics of sponsoring organizations may be such that different rules should apply. Notably, important definitional questions will need to be addressed when sponsoring organizations are distinguished.

Part II then considers the basis of the 501(c)(3) status for national sponsoring organizations. The exempt purpose of an NSO is to make grants to other 501(c)(3) organizations. This is a sufficient predicate for exempt status, but as a fundraising organization, the national sponsoring organization also is required to pay out commensurate with its resources. National sponsoring organizations, like other fundraising organizations, also raise private benefit concerns that cast a shadow on national sponsoring organization operations. Part II concludes that because national sponsoring organizations fulfill their mission by spending, it is appropriate for Congress to apply the commensurate in scope test with a bright line and impose a payout at the fund level.

Part III of the Article then examines the use of sponsoring organizations (not just national sponsoring organizations) to process noncash assets. Property contributions have long been a source of concern, quite apart from donor advised funds. The issues vary but include a deduction for unrealized appreciation, overvaluation of contributed property, uncertain benefits to charity, equity concerns, and enforcement. The widespread use of DAFs for noncash contributions will accentuate the problems of current law. Part III concludes that if Congress intends to retain the subsidy for property contributions, DAFs present an opportunity to improve and lower the cost of the subsidy both by reducing the amount of unrealized appreciation that may be deducted and by basing the amount of the deduction on the net benefit to charity. Part III generally applies to any charitable contribution of property, not just contributions to sponsoring organizations.

It is important at the outset to identify the federal interest in regulating DAFs. As an initial matter, there is a clear federal interest to protect against abuse of the charitable deduction. Because donors receive a charitable deduction for DAF contributions, the federal government has an interest in ensuring that the funds are not directed to private use. It should go without saying that charitable giving that mainly benefits the donor is charitable in name only and should not be allowed, whatever the giving vehicle.[12]

Apart from anti-abuse measures, which potentially could be extensive,[13] the federal interest in DAFs is esoteric, but important. As measured by the huge sums pouring into donor advised funds, DAFs clearly matter to the 501(c)(3) sector as a whole and to how charitable services are delivered in the United States. The government has a stake, not simply as a matter of taxation, but as a matter of the public interest, to help ensure a reasonably efficient and equitable system of private charity. In other words, setting

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[12] As discussed in Part I, Congress has already adopted a number of anti-abuse rules in the DAF context.

[13] For example, a payout rule not consistent with perpetuity could fit under an anti-abuse heading, where the abuse is defined as not spending fast enough.

aside abuse, the challenge is to adopt an affirmative public policy toward donor advised funds, taking into account the unique characteristics of DAFs and a sense of how DAFs should operate within the philanthropic system.

PART I. UNTANGLING THE OVERLAPPING VIEWS OF DAFS

A main question about donor advised funds is what DAF contributions, and DAFs, represent. Are DAFs taking from private foundations, other public charities, or attracting funds that otherwise would have been privately consumed? Each alternative destination for DAF contributions suggests a different regulatory approach. Relatedly, DAFs represent different things to different observers – some view DAFs as private foundation equivalents, others as something else. This part of the article outlines three different, though not mutually exclusive, views of DAFs – as quasi-private foundations, public charity substitutes, and as catalysts for new charitable giving. Each view provides insights about the role of DAFs in the philanthropic system, and suggests ways in which DAFs should be regulated.

A. DAFs as Quasi Private Foundations

Perhaps the most common way to conceptualize donor advised funds is by analogy to the private foundation.[14] The comparison is made because the DAF and the private foundation have a similar core function. Both are grant-making vehicles, subject to the direction or advice of the donor. In the case of a private foundation, donors establish and control a separate entity, contribute funds, and then over time distribute the funds for the exempt purposes of the foundation. In the case of a DAF, donors make arrangements with a (typically pre-existing) private charity, the sponsoring organization, to open and administer a separate and distinct account often in the donor's name. The donor funds the account, and then gives advice over time about account distributions, consistent with the donor's charitable preferences.

A key difference between the private foundation and the DAF is the legal control over funds exercised by donors. With the private foundation, donors and related parties may and do exercise control of donated funds through control of the foundation. With DAFs, donors typically do not con-

[14] *See e.g.*, TREASURY REPORT at 29 (stating that "[t]he closest analogue among private foundations . . . to DAFs are grant-making non-operating foundations"). The DAF is often coined as the "poor man's private foundation." Private foundations can be "non-operating" or "operating." The private foundation referred to in this Article generally is non-operating, meaning a grant-making organization.

trol the sponsoring organization, and therefore may at best only provide advice to the sponsoring organization about the distribution of fund assets.[15]

Nevertheless, although legal control over funds is vested with the sponsoring organization, for the DAF to be attractive to donors there is a strong expectation that sponsoring organizations will follow donor advice.[16] If donor advice were not followed regularly and as a matter of course, donors would quickly grow frustrated and end the relationship. Accordingly, the advice rendered by donors with respect to funds contributed by the donor is often thought of as a legal fiction, masquerading as control.[17] Donors remain in effective control of the assets and can make grants in a similar manner as with a private foundation.

But as compared to a private foundation, the DAF is a less costly, attractive alternative. The amount allowed as a deduction is larger for many types of noncash contributions to a DAF sponsoring organization than for contributions to private foundations.[18] Charitable contributions to DAF sponsoring organizations are subject to a higher cap (based on the donor's adjusted gross income).[19] Further, a private foundation is subject to a tax on investment income, a payout requirement, a comprehensive self-dealing regime, and limitations on spending[20] – none of which apply to sponsoring

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[15] When national sponsoring organizations first emerged, an early question was whether donors provided "advice" (no legal control) or gave "direction" (legal control). *See e.g.,* INTERNAL REVENUE SERVICE, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION (CPE) TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 1996, M. DONOR DIRECTED FUNDS. If a donor retains control, then the contribution is not viewed as a completed gift, and no charitable deduction is allowed.

[16] TREASURY REPORT at 69 (noting that "[n]o respondent reported ongoing disagreements with donors over the appropriateness of potential grants, and all respondents said that, in general, donor advice was followed").

[17] *See* Molly F. Sherlock & Jane G. Gravelle, CONGRESSIONAL RESEARCH SERVICE, AN ANALYSIS OF CHARITABLE GIVING AND DONOR ADVISED FUNDS 3 (July 11, 2012) (hereinafter "CRS Report") (noting that "[e]vidence suggests . . . that donors to DAFs have effective control over grants, and to some extent investments, because sponsoring organizations typically follow the donor's advice."); TREASURY REPORT, at 69 (noting that one respondent thought that DAFs "appear to give DAF donors de facto control over investment and distribution decisions"). As an illustration of how donor-advised funds are viewed in the field, Giving USA defines a donor-advised fund as: "An account by which donors may provide charitable gifts. This type of account is facilitated by community foundations or financial services companies. Donors typically contribute large amounts in the form of tax-deductible assets to these accounts in order to grow the assets, and donors usually *choose* to have significant *control* over the funds and *direct* which nonprofits will be recipients of the gifts." Giving USA Report for 2014 at 263 (emphasis added). The definition is a good example of the fact that legal formalities aside, in practice donors expect to control fund distributions.

[18] In general, for contributions of appreciated property, the donor may deduct the fair market value of the property if to a public charity, but may only deduct the cost basis if to a private foundation. I.R.C. § 170(a), (e). Exceptions apply. See *infra* Part III for additional discussion.

[19] I.R.C. § 170(b).

[20] I.R.C. §§ 4940-4945.

organizations (or DAFs). In addition, donors do not have to administer DAFs and so are free of compliance burdens.[21]

When donors choose a DAF over a private foundation, one regulatory model thus emerges. Viewed as a quasi-private foundation, the question is simply whether the DAF is essentially a loophole, i.e., a vehicle donors can use to avoid the private foundation regime. If so, then the issue is whether any or all of the private foundation rules, including the less favorable deduction rules and a payout, should apply to DAFs.

To date, the view of DAFs as quasi-private foundations has guided the legislative process. In 2006, Congress determined that the public charity nature of DAF sponsoring organizations provided insufficient protection against abuse[22] and applied some of the private foundation rules (or close analogues) to donor advised funds.[23] Thus, Congress penalized certain transactions even if at arm's length,[24] restricted the types of permissible distributions from DAFs,[25] and directly applied the private foundation limits on the permissible holdings in any one business.[26] Congress did not, however, require a payout,[27] impose the harsher charitable deduction rules, or subject DAFs to a tax on investment income.[28]

The more DAFs are understood as private foundations, the more DAFs resemble a loophole, and the stronger the logic for applying additional parts of the private foundation regime to DAFs.[29] Thus, one continuing thread of the policy debate is whether Congress should continue on the current path

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[21] Private foundations also file a different information return, the Form 990-PF than public charities.

[22] The path for abuse is straightforward. A donor takes a deduction for a DAF contribution, and then advises out a grant that directly or indirectly benefits the donor. Unless a sponsoring organization is very active in supervising grants, this type of abuse would be fairly easy. This is the reason DAFs generally may not make grants to individuals, but are limited to public charities.

[23] Congress implicitly copied the private foundation approach. For additional discussion, see Roger Colinvaux, *Charity in the 21st Century: Trending Toward Decay*, 11 FL. TAX REV. 1, 60-63 (2011). Congress did not distinguish among sponsoring organizations but focused on the DAF qua DAF.

[24] I.R.C. § 4958(c)(2).

[25] I.R.C. §§ 4966, 4967.

[26] I.R.C. § 4943(e).

[27] A payout was enacted in the Senate but did not survive final passage. The Tax Relief Act of 2005, S. 2020, 109th Cong. § 331 (as passed by the Senate, Nov. 18, 2005).

[28] For a description of all the rules imposed on DAFs, see STAFF OF JOINT COMM. ON TAXATION, GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 109TH CONGRESS 624-44 (Comm. Print 2007).

[29] This was the initial approach of the Treasury Department, which in 2000 proposed regulating sponsoring organizations and DAFs (at the account level) as private foundations. DEPARTMENT OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2001 REVENUE PROPOSALS, Clarify Public Charity Status of Donor Advised Funds 105 (Feb. 2000).

and apply more of the private foundation rules to DAFs and DAF sponsoring organizations.

B. DAFs as Public Charity Substitutes

Donor advised funds are also viewed as substitutes for other public charities. Under this view, DAFs offer the functionality of a private foundation but are funded with money that otherwise would have gone to another public charity.[30] For example, but for the existence of DAFs, a donor would have given to a human services organization, the donor's alma mater, an art museum, or some other operating charity. When the donor instead contributes to a DAF, the DAF has altered the distribution of charitable funds. In a zero sum game,[31] the success of DAFs comes at the expense of other public charities.32

This then invites closer consideration of the true nature of the DAF and the national sponsoring organization. If DAFs perform just like other public charities, then the federal tax issues are nothing new. The shift in charitable giving would simply reflect a (healthy) competition. For example, if a new art museum is so successful that it attracts charitable gifts away from other art museums, the public writ large still gets art (supported by the same donors), albeit in a different location and form. A slightly different case arises if the new art museum attracts contributions that normally would have gone to the soup kitchen. Now, the success of art comes at the cost of serving the needy. This may be of concern (the competition now is perhaps less healthy), but non-interference with the substantive preferences of donors is an endemic policy of the charitable deduction, which largely avoids making value judgments about exempt purposes.[33]

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[30] In general, the tax law divides section 501(c)(3) organizations into two broad categories: private foundation and public charity. The default characterization is a private foundation. Organizations avoid foundation status either based on their principle function (e.g., as a church, school, or hospital) or by reason of their public support. I.R.C. § 509.

[31] For illustrative purposes here, a zero sum game is assumed. The assumption of a non zero sum game is discussed next.

[32] The substitution effect is plainest with respect to contributions to NSOs, and so is the focus of the discussion here. Substitution may occur at DAFs sponsored by single issue charities or community foundations, but to a lesser extent. For example, if a donor created a DAF at his alma mater, but for DAFs, this same gift might well have gone to the alma mater, so there is no substitution. The DAF in this context is merely an additional fundraising tool for the university. Contributions to DAFs at community foundations present other considerations. Community foundation DAFs may be substitutes for private foundations, other public charities, or, because community foundations offer a unique form of community support, the community foundation DAFs might be more like the university, with no substitution.

[33] The charitable deduction is generally value-neutral, based on the purposes of the organization. Value judgments are reflected in the purposes chosen – charitable, educational, scientific, religious, literary – but apart from that, the IRS mostly assesses means not ends. Whether the

DAFs at national sponsoring organizations though are not like other public charities. National sponsoring organizations do not have an independent substantive charitable purpose or goal. National sponsoring organizations are not formed to relieve poverty, eliminate malaria, improve education, foster community development, etc.[34] Rather, national sponsoring organizations are essentially fundraising machines. The national sponsoring organization principally collects funds, retains financial advice, and performs the administrative function of ensuring that the recipient suggested by the donor-advisor is on the IRS's list of eligible public charities.[35] Given the nature of the national sponsoring organization, the delay in distributions caused by DAFs is problematic.[36]

Further, donors to national sponsoring organizations are encouraged, implicitly or not, to become savers rather than spenders. To see why, consider a hypothetical (but likely typical) contribution by a donor to Fidelity Charitable.37 The donor already has funds invested with Fidelity on a private, commercial basis. As the end of the year approaches, the donor receives charitable solicitations from a number of local charities but, as in prior years, has trouble deciding which ones to support and in what amount. Coincidentally, the donor then also receives a solicitation from Fidelity Charitable. The solicitation promises an immediate charitable deduction, and tells the donor that he or she can advise at any time in the future about the eventual 501(c)(3) recipient.

Given the donor's indecision about which charities to support, the offer is perfect, and the donor establishes a DAF with Fidelity. The donor is

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charitable deduction should remain value neutral is a different debate outside the scope of this Article.

[34] As Fidelity puts it: "The mission of the organization is to further the American tradition of philanthropy by providing programs that make charitable giving simple and effective." FIDELITY CHARITABLE, *2015 Giving Report: A Deeper Look at Fidelity Charitable Donors and the Many Ways They Give* 26 (2015) (hereinafter "Fidelity 2015 Report").

[35] Noncharitable status would be the main basis for a sponsoring organization to reject a donor's advice. If a donor advises a grant to a bona fide public charity, and the sponsoring organization is unaware of any benefits flowing to the donor because of the contribution, then sponsoring organizations would be hard pressed (even though legally entitled) to reject donor advice.

[36] There is a technical argument that DAF contributions do not result in a delay to a charity in receiving benefits. The argument would be that because a sponsoring organization is a bona-fide public charity, there is no "delay" because the funds have been contributed to charity. An analogy also could be to funds contributed to any charity where the funds are not spent immediately, but accumulated by the charity for future use. In such (common) cases, there clearly is a delay or gap between the time of the deduction and the ultimate use of the funds for charitable beneficiaries, yet this delay does not seem to cause similar agitation as occurs with DAFs. As discussed in Part II, NSOs, though public charities, are distinct from other organizations in that spending funds is their main activity.

[37] The Fidelity Charitable Gift Fund is chosen by reference here because it is the largest sponsoring organization of DAFs, organization in the United States.

very pleased. The donor has made a deductible charitable contribution, and because the donor has legally parted with the funds, feels the "warm glow" often associated with charitable giving. The arrangement also suits Fidelity because the funds remain under management by the for-profit side of Fidelity, thus continuing to earn management fees.38

In addition, the donor may even reconsider how to give in the future. Before establishing the donor advised fund, the donor typically made contributions to a variety of public charities in small amounts each year. But now that the donor's annual giving may accumulate in a DAF, the donor starts to think about giving differently – less as spending and more as saving. The donor considers: should I accumulate assets to make a really big gift later? Should I build up a sufficient sum so that I can advise distributions of just the income each year? Should I involve my children in grant-making? This attitude likely is reinforced by the fact that many sponsoring organizations have relatively high contribution thresholds for initial gifts of several thousand dollars. This reinforces for the donor the idea that money set aside in a DAF is more of an investment for the future than a spending transaction.

Relatedly, the donor may become possessive of the DAF. The donor knows that the money formally is out of her legal control, but this is not transparent. The funds, prior to contribution, were held and managed by Fidelity in a mutual fund in her name. After the contribution, the funds are held and managed by Fidelity in a mutual fund in her name. The funds may even be in a similar mutual fund as before the contribution.39 She knows Fidelity is unlikely to distribute money from her DAF without her advice. She receives quarterly statements showing investment gains in her account.

Taken altogether, from the donor's perspective, the money in the DAF still feels like it is "hers," subject to her will. As additional reinforcement, sponsoring organizations honor advisory privileges across generations,40 meaning that the ability to advise becomes a kind of asset that the

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[38] The loser from this transaction (at least in the short-term), however, is the public charity that would have received the money but for the DAF. The charity must wait to receive funds at a later date, if at all. The DAF here is little more than an intermediary, delaying the time at which the ultimate beneficiary will receive control of the funds. Arguably, another loser from the transaction is the federal government. If the donation is $10,000 and the donor is in the 35 percent tax bracket, then the government supports the transaction by foregoing $3,500 in revenue. But the payoff to the government does not occur until the donor advises that the money be distributed from the DAF.

[39] "At Fidelity Charitable, donors can recommend an investment strategy that aligns with their goals and giving time horizons through Fidelity Charitable's investment pools or investment advisor-managed accounts." Fidelity 2015 Report at 3.

[40] As reported by the Treasury Department: "A sponsoring organization . . . may allow a donor to appoint a successor advisor for the DAF, e.g., a spouse, child, or other descendant, who would

donor can pass on to her heirs outside the property system, but only if the donor does not spend the money. In short, the DAF has converted a donor from a charitable spender to a charitable saver.

In sum, viewed as public charity substitutes, contributions to national sponsoring organizations represent a delay to charity, pure and simple. Instead of receiving a contribution in year one, the art museum receives a contribution in year two, or year three, four, five, or never. True, a contribution received later might be larger due to investment gains,[41] but if the contribution was made in year one, the donee then could also have reaped those gains, and more importantly, would have had discretion about how best to use the funds, discretion that is deferred by the DAF intermediary.[42]

The delay in charitable spending caused by DAFs at national sponsoring organizations could be addressed broadly in one of two ways. One is to mandate an aggressive payout, far in excess of the private foundation payout, to minimize the extent of the delay. Another would be to delay the charitable deduction for contributions to sponsoring organizations to match the distribution from the donor advised fund. Both approaches are discussed in more detail in Part II.

C. DAFs as Vehicles for New Giving

Another way to view DAFs are as vehicles that spur new charitable giving, i.e., money that but for the existence of DAFs would be privately consumed. Here, DAFs are not diverting contributions from one part of the charitable sector to another. Rather, DAFs are *the* reason donors give. For example, an investor with Schwab may have never made charitable contributions before. But after hearing his friends and colleagues talk about their DAFs decides to open an account – either from peer pressure or just because the DAF appeals to his giving matrix in a way that other charities never did.

DAFs also can be a source of supplemental giving. For instance, a donor who regularly gives two percent of her income each year to active pub-

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continue to make recommendations regarding distributions from the account." TREASURY REPORT, at 22.

[41] The contribution also could be smaller due to investment losses.

[42] It is often noted that DAFs increase charitable giving through investment growth. Fidelity incorporates asset growth as part of its giving philosophy "Give, Grow, Grant," and says that "[i]nvestment growth has generated $3.6 billion in additional charitable dollars." Fidelity 2015 Report at 12. Asset growth also is viewed not "as capital denied to charity [but] instead can be understood as a major philanthropic capital reserve fund." Howard Husock, GROWING GIVING: AMERICAN PHILANTHROPY AND THE POTENTIAL OF DONOR-ADVISED FUNDS, 7 (Manhattan Institute, Apr. 2015).

lic charities decides upon creating a DAF to add DAF contributions to her giving profile, increasing overall giving to 2.5 percent of income each year.

In addition, donor advised funds likely attract new charitable gifts when donors have a financial windfall, e.g., through inheritance or a bonus.[43] Here, the DAF offers a convenient way to make a large charitable gift both before the donor digests the windfall into her personal portfolio (becoming possessive of it) and without having immediately to select beneficiaries, a burden that might otherwise have thwarted the gift.

Also, as discussed in Part III, DAFs increasingly are used for contributions of complex assets, which other public charities might not accept and which are not tax preferred if given to a private foundation. This could represent new giving, at least to the extent that donors do not reduce other giving to compensate.

As a source of new contributions, one course is to adopt a celebratory tone, and advocate a hands-off regulatory approach. After all, if regulation undermines the fundamental appeal of DAFs for donors, the risk is that DAFs as a catalyst for charitable giving would be eliminated, which would be woefully counterproductive. Further, why regulate at all? Just because the DAF is a bountiful vehicle should not mean that regulation must follow – like a moth to a flame.

As a practical matter, it seems unlikely that most DAF contributions to national sponsoring organizations ($8.72 billion in 2013)[44] are new giving. People give what they can afford, which is why it is telling that individual giving as a percentage of disposable personal income has been largely fixed at two percent over a forty-year period.[45] Regardless, even if all DAF contributions to national sponsoring organizations were gifts that would not otherwise have been made, the federal government still has an interest in ensuring that the DAF works for the charitable sector as a whole, and not

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[43] Fidelity reports that 27 percent and more than one-third of high net worth donors use donor-advised funds to absorb financial windfalls. Fidelity 2015 Report at 22.

[44] NPT 2014 Report at 9.

[45] According to Giving USA, in both 1974 and 2014, individual giving as a percentage of disposable personal income (DPI) was two percent. In the intervening years, the percentage fluctuated slightly above and below two percent, going as low as 1.7 percent (1995) and as high as 2.4 percent (2000). This suggests that individuals in the aggregate give about two percent of DPI to charity, regardless of the giving vehicle. This is one indicator that DAFs primarily are substitutes and without them about the same amount of giving would occur. Giving USA Report for 2014 at 244-45. A different "two percent" number – giving as a percentage of gross domestic product – is sometimes also used to assess whether giving levels change or remain constant over time. Giving USA also calculates this percentage (1.7 percent in 1974 and 2.1 percent in 2014). But this percentage is less useful than individual giving as a percentage of DPI because it uses "total giving" in the numerator. Total giving is not the same as new giving by individuals, but includes giving already counted as well as corporate giving.

just in preventing abuse. The question then becomes whether the accepted federal interest should be articulated through a mandated payout rule.

PART II. A PAYOUT FOR DAFS AT NSOS AS FUNDRAISING ORGANIZATIONS

The legal and policy challenge is to start from first principles. How *should* national sponsoring organizations be regulated? What is the appropriate role of the national sponsoring organization in the philanthropic system? What are national sponsoring organizations good at? What are national sponsoring organizations good for? This Part of the Article characterizes the national sponsoring organization as a fundraising organization that meets its charitable objective through spending, and argues that a payout for national sponsoring organizations, mandated by Congress, is appropriate.

A. Grounds for NSO Exempt Purpose

A national sponsoring organization primarily collects, invests, and distributes charitable contributions; it does not perform a meaningful advisory role. Why is the NSO exempt as a 501(c)(3) organization at all? What is the exempt purpose?

The exempt purpose of national sponsoring organizations is derived from a 1967 IRS Revenue Ruling.[46] In the Ruling, the IRS held that an organization "formed for the purpose of providing financial assistance to several different types of [501(c)(3)] organizations" was itself a 501(c)(3) organization.[47] The organization carried "on no operations other than to receive contributions and incidental investment income and to make distributions of income to such exempt organizations at periodic intervals."[48] Under this line of legal authority, the plain basis for 501(c)(3) status of the national sponsoring organization is that it makes grants to other organizations for charitable purposes.[49] In other words, the purpose of fundraising is an exempt purpose.

What if the organization described in the Ruling received $1 million dollars a year, but only paid out $100 each year to charity? Should the organization nonetheless be recognized as a 501(c)(3)? What should it depend on? The organization is still "organized" for an exempt purpose – to pay out to charity. But is it "operated" primarily for an exempt purpose – i.e., does the failure to pay out money mean that the organization has failed the pri-

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[46] The ruling in turn is derived from a 1924 Supreme Court decision, Trinidad v. Sagrada Orden de Predicadores, 263 U.S. 578 (1924).

[47] Rev. Rul. 67-149, 1967-1 C.B. 133.

[48] *Id*.

[49] There are peripheral grounds for exemption – such as education of donors about philanthropy, but national sponsoring organizations are not educational organizations.

mary purpose test? The IRS would answer that whether the organization qualifies for 501(c)(3) status depends on whether the organization pays out commensurate with its financial resources, also known as the "commensurate in scope" test.

The IRS first articulated the commensurate in scope test in a 1964 Revenue Ruling. The Ruling concerned an organization that owned and operated a commercial office building. The principal source of income for the organization was rent from the building.[50] The organization paid the rent it collected from commercial tenants to section 501(c)(3) organizations. As described by the IRS, "[t]he charitable purposes of the corporation are carried out by aiding other charitable organizations, selected in the discretion of its governing body, through contributions and grants to such organizations for charitable purposes."[51] The organization would be entitled to exemption "where it is shown to be carrying on through such contributions and grants a charitable program commensurate in scope with its financial resources."[52] Translation – the fundraising purpose of the organization is sufficient, but exemption is contingent on whether the organization spends enough.

The commensurate in scope test began as a tool to determine an organization's primary purpose in cases where the activity of the organization is commercial in nature and not inherently charitable.[53] The idea of commensurate in scope is a variation on the destination of income doctrine articulated by the Supreme Court in 1924 in Trinidad v. Sagrada Orden de Predicadores.[54] As articulated in the Revenue Ruling, it is not enough for an organization to say it will pay money to charity (when that is the organization's only purpose); it must also do it.

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[50] Rent is passive income exempt from the unrelated business income tax.

[51] Rev. Rul. 64-182, 1964-1 C.B. 186.

[52] *Id*.

[53] For discussion of the commensurate in scope test, see Jack Siegel, *Commensurate in Scope: Myth, Mystery, or Ghost?—Part One*, TAXATION OF EXEMPTS (2008). *See also* Thomas Kelley, *Rediscovering Vulgar Charity: A Historical Analysis of America's Tangled Nonprofit Law*, 73 FORD. L. REV. 2437 (2005) (noting that the role of the commensurate in scope doctrine "appears to be to permit decision makers to approve of charitable status for commercial charities that have appealing missions and that spend most of their commercially raised funds on their charitable purposes"); John D. Colombo, *Commercial Activity and Charitable Tax Exemption*, 44 WILL. & MARY L. REV. 487, 514 (2002) (discussing the commerciality doctrine and the commensurate in scope test).

[54] 263 U.S. 578 (1924). Under the destination of income test for exemption, what matters is not whether an organization's activities are charitable, but the destination of the income from the activities. Congress responded to the destination of income test in 1950 by enacting a rule barring exempt status for feeder corporations, and with the unrelated business income tax. Destination of income as a basis for exempt status mostly remained intact, except in cases where the primary purpose of the organization is for profit trade or business activity.

The commensurate in scope test has led to considerable confusion because it is not clear when it applies,[55] nor is it clear what the test requires when it does apply. As the IRS has said on numerous occasions: "[t]he 'commensurate test' does not lend itself to rigid numerical distribution formulas – there is no fixed percentage of income that an organization must pay out for charitable purposes."[56] Rather, "the particular facts and circumstances of the fund-raising organization must be considered."[57]

Regardless, in the context of national sponsoring organizations, the important point is that the commensurate in scope test consistently has been applied to assess the exempt status of fundraising organizations.[58] In other words, as fundraising organizations, national sponsoring organizations *already* are subject to a payout requirement, albeit an uncertain one. For example, if an national sponsoring organization paid out no money to 501(c)(3) organizations (and had no plan to do so), the sponsoring organization should lose exempt status by failing the commensurate in scope test. As the IRS has said: "an organization that raises funds for charitable purposes but consistently uses virtually all its income for administrative and promotional expenses with little or no distribution to charity cannot reasonably argue that its distributions are commensurate with its financial resources and capabilities."[59]

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[55] In 2007 and 2008, the specter of the commensurate in scope test was raised in connection with university endowments. *See* Jack Siegel, *Commensurate in Scope: Myth, Mystery, or Ghost?—Part Two*, TAXATION OF EXEMPTS (2009) (citing letter dated 5/29/07 from Sens. Max Baucus and Charles Grassley to Secretary of the Treasury Henry Paulson suggesting the Treasury and IRS should "put teeth" into the commensurate in scope test).

[56] INTERNAL REVENUE SERVICE, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION (CPE) TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 1989, M. SPECIAL EMPHASIS PROGRAM – CHARITABLE FUND-RAISING 13.

[57] *Id*. at 14.

[58] *Id*. at 13 ("Whether a fund-raising organization's activity may be said to accomplish exempt purposes often centers on the issue of whether there has been a sufficient turnover of funds to charity. This issue is resolved through use of the 'commensurate test' . . . ."); INTERNAL REVENUE SERVICE, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION (CPE) TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 1986, G. UPDATE ON FUNDRAISING 3 (noting that the commensurate in scope test "remains the basis by which such fundraisers are tested. If this test is met, exemption will not be foreclosed to an organization notwithstanding that its primary fundraising activity in carrying out its purposes is not inherently charitable or is an unrelated trade or business."); INTERNAL REVENUE SERVICE, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION (CPE) TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 1982, L. FUNDRAISING 48 ("The commensurate test has been used as the dominant rationale for fund raising event exemption cases in recent years" but has been applied "with confusion and inconsistency.").

[59] INTERNAL REVENUE SERVICE, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION (CPE) TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 1989, M. SPECIAL EMPHASIS PROGRAM – CHARITABLE FUND-RAISING 14.

In addition, notwithstanding that the fundraising rationale for exempt status is longstanding, the 501(c)(3) fundraising organization stands at the edge of legitimacy. Charity is accomplished in the doing. To grant "charitable" status[60] to a shell seems awkward and counterintuitive. Thus, in order to achieve 501(c)(3) status as a fundraiser, the formalities are important. For example, if a fundraising organization contracts with 501(c)(3) organizations to solicit, collect, and distribute the collected contributions for a fee, the fundraising organization does not qualify as a 501(c)(3). Even though the organization's "activities consist entirely of providing fundraising services to organizations," exempt status fails because the services here are a commercial fee-for-service activity and the organization did not retain control of the funds.[61] Although the distinction with a national sponsoring organization is clear, both organizations perform essentially the same function – fundraising for charity.[62] Section 501(c)(3) status turns on formalism.

Fundraising organizations face an additional hurdle, namely acute concerns about private inurement and private benefit. For an organization to qualify as a 501(c)(3), the organization must not inure to the benefit of organization insiders,[63] and must serve "a public rather than a private interest."[64] In the fundraising context, it is not uncommon for the putative 501(c)(3) organization to have pre-existing relationships with for-profit companies that benefit from the fundraising activity.[65] Thus, the IRS will conclude that even if a charity benefits from the fundraising, the fundraising

[60] Contributions to any 501(c)(3) organization technically are "charitable" contributions. I.R.C. § 170(c).

[61] *See* Priv. Ltr. Rul. 201438029 (concluding that "[y]our fundraising services do not constitute the provision of grants to charities, rather they are services that are bought by the charities").

[62] At bottom, the fees collected by the sponsoring organization come from the same source as the organization in the ruling – out of donor contributions.

[63] The Code requires that for an organization to qualify as a 501(c)(3) "no part of the net earnings [may inure] to the benefit of any private shareholder or individual."

[64] Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). The regulation further provides: "it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests."

[65] In a pithy summary of the legal hurdles facing fundraising organizations: "If the 'commensurate test is met, an organization may qualify for exempt status under IRC 501(c)(3) notwithstanding the fact that the fund-raising activity itself is not inherently charitable or is an unrelated trade or business. However, even if an organization makes a real and substantial contribution to charity commensurate with its financial resources, a substantial private purpose may still be found that will disqualify it from IRC 501(c)(3) exemption." INTERNAL REVENUE SERVICE, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION (CPE) TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 1989, M. SPECIAL EMPHASIS PROGRAM – CHARITABLE FUND-RAISING 14-15.

organization is not exempt because of the private benefit that flows to a related entity.[66]

Again, the comparison to national sponsoring organizations is relevant.[67] Private benefit concerns have long dogged national sponsoring organizations. The for-profit arms of Fidelity, Vanguard, Schwab, and other commercial investment firms that sponsor DAFs all benefit from the fees earned by DAF accounts.

All that said, national sponsoring organizations indubitably are recognized as 501(c)(3) public charities. Whatever private benefit exists in current arrangements would appear unlikely at this stage to jeopardize exempt status. It also is unlikely that the IRS would challenge exempt status based on the commensurate in scope test given reported aggregate payout levels by many sponsoring organizations.[68] Nevertheless, even though the public charity status of national sponsoring organizations has been established, the case for exempt status is qualitatively weak. As a fundraising organization, the national sponsoring organization qualifies on the basest of grounds – paying out to others – and amidst concerns about private benefit.

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[66] *See e.g.,* Priv. Ltr. Rul. 201438029 (concluding that in addition to not having an exempt purpose, the organization provided a substantial private benefit because the organization was founded by a for-profit company, four of its six directors are related through their work with the company, the organization licensed a product owned by the company, and had a management agreement with the company whereby the organization paid the company $25,000 a month plus 2 percent of all of the donations).

[67] Private benefit concerns were rife at the time sponsoring organizations were seeking exemption, though eventually turned out not to be a bar. *See* INTERNAL REVENUE SERVICE, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION (CPE) TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 1999, O. DONOR CONTROL; INTERNAL REVENUE SERVICE, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION (CPE) TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 1996 M. DONOR DIRECTED FUNDS. Albert R. Rodriguez, *The Tax-Exempt Status of Commercially Sponsored Donor-Advised Funds*, 17 EXEMPT. ORG. TAX REV. 95 (1997). The issue though continues to simmer. Relatedly, the Treasury released private benefit regulations, which could affect the calculation going forward. Treas. Reg. §1.501(c)(3)-1(d)(1). The IRS has applied the regulations to disqualify organizations "where a charity was essentially required to use the services of a particular commercial entity, even where the fees charged represented fair market value." *See* PAUL STRECKFUS, EO TAX JOURNAL 2015-164, Commercial DAFs and Private Benefit (comments of Marcus Owens). Owens notes that one possible issue is "whether 'commercial DAFs,' e.g., DAFs formed and managed by commercial investment businesses, are incompatible with notions of private benefit as set forth in the 2008 private benefit regulations (and the private benefit court decisions). Will we ever see, for example, Fidelity Charitable Gift Fund turning to Vanguard or Schwab for investment and sales management? Will Schwab or Vanguard sales representatives ever recommend Fidelity Charitable Gift funds to clients?"). *But see* Husock, *supra* note 42, at 6 ("Ultimately, the debate over DAFs is one not about fees that may flow to private financial firms but about whether the U.S. wants to encourage growth in charitable giving as a portion of the economy.").

[68] The IRS could argue that the commensurate test requires a sponsoring organization to have in place a policy that each DAF account spend commensurate with its resources.

B. A Fund-Based Payout in Fulfillment of Exempt Purpose

The legal background regarding the 501(c)(3) status of national sponsoring organizations is relevant, less for what the IRS should or may do based on existing law, but whether Congress should establish a policy and write special rules for national sponsoring organizations. The short answer is yes, Congress should. DAFs at national sponsoring organizations should be welcomed as a tool further to promote a culture of giving. But the welcome should be at arm's length.

Congress should channel the national sponsoring organization to do the most for charity. Congress should recognize that not all DAF contributions represent new giving, but come at a cost to active public charities. Further, DAF accounts are not the same as private foundations – where perpetual life is useful to foster institutional permanence and innovation. Rather, as a fundraising organization, the 501(c)(3) mission of the national sponsoring organization, the basis for its exempt status, is to spend money. The principal issue is quite simply the appropriate rate of spending. Congress, not national sponsoring organizations, not donors, and not the IRS, should set this rate.

In the DAF context, Congress should apply the commensurate in scope test with a bright line. Congress should require that each DAF of a national sponsoring organization pay out each contribution within a range of five to fifteen years.[69] Whatever number Congress settles on (be it a five year payout or fifteen), what matters is that the payout be set so that it is long enough so that the appeal of DAFs for donors that would not otherwise give is not undermined, but not be so long that the delay to charity that results due to donors who use DAFs as public charity substitutes is not excessive. In other words, the ideal spending period would be one that does not deter too many new donors while limiting the net detriment to charity that occurs when DAFs are used as public charity substitutes. To the extent that DAF contributions are in lieu of private foundation contributions, there is no issue except that these donors may opt for a private foundation instead of a DAF in search of a lower payout (but more control).

National sponsoring organizations generally object to a payout. One objection is that a payout is unnecessary. Many national sponsoring organizations claim already to pay out at high levels and so argue that a payout is

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[69] In theory, the payout rate could be as high as 100 percent, on the view that, notwithstanding that formal legal control is vested in the sponsoring organization, national sponsoring organizations are essentially conduits, and as substitutes for gifts to other public charities, the distribution should be delayed no longer than necessary. Although a 100 percent payout may sound extreme, a similar payout is used to permit conduit foundations to be eligible for the 50 percent limitation. I.R.C. § 170(b)(1)(A)(vii), 170(b)(1)(F)(ii); Treas. Reg. § 1.170A-9(g) ("p]rivate nonoperating foundation distributing amount equal to all contributions received").

redundant. This objection though is beside the point. Regardless of current payout levels, a mandated payout would standardize expectations for national sponsoring organizations and donors and end disputes about how payouts are calculated70 and whether payouts are high enough. Further, for national sponsoring organizations that already pay out at a high level, a mandate would not change behavior. For national sponsoring organizations that do not make substantial payouts, a mandate would accelerate spending, which would be the point.

Further, the payout levels reported by sponsoring organizations are at the aggregate level, not the fund level. Payout should be at the fund level. The reasoning is straightforward. Donors that create DAFs and do not advise a pay out, or pay out very slowly, are a main reason for a payout. These are the donors that most need a push to spend and who, for whatever reason, are indecisive. The ability to use a DAF is a benefit to the indecisive donor, but the law should not tolerate limitless indecision. The point is to spend the money not to save it.

Moreover, if the payout is objectionable to these donors, then what are the consequences? One is that the donor instead funds a private foundation – but this is not necessarily a bad outcome. If the donor's motives are to establish a perpetual institution, then the foundation is the appropriate form.[71] Some might argue that donors should not be encouraged to incur the expense of a private foundation, especially if the whole point of DAFs is as a convenient alternative to the private foundation.[72] But as discussed earlier, to the extent DAFs are used as private foundation substitutes, the DAF represents a loophole, which a high payout would close. In addition, some donors that now object to a payout might, once a payout is the law, accept it as reasonable, along with the preferred tax status of the sponsoring organization over a private foundation.

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[70] It is beyond the scope of this Article to address payout calculations in detail. One approach might be for national sponsoring organizations to maintain annual subaccounts for each donor. Contributions made during the year to the account would be added together and the account would be closed to additional contributions at the end of the year. The account (including any gains) then would be spent down within the spend-down period. A definition of a qualifying distribution also would be required, for example, to prevent distributions from one DAF to another DAF.

[71] Another possible alternative is that the donor instead contributes to a DAF at a community foundation. In depth discussion of how community foundations may be distinguished from national sponsoring organizations is outside the scope of this Article but is an important issue.

[72] The Treasury Department noted that: "[a]necdotal reports suggest that some smaller private foundations are being advised to consider choosing to 'reorganize' as DAFs by transferring all assets to a DAF and terminating the private foundation." TREASURY REPORT, at 29. A spend down of assets need not mean an end to foundation conversions, but would change the calculation for small foundations, perhaps in a positive way. Foundations could trade for a less expensive and restrictive regulatory environment but give up perpetual life.

Another possible consequence of a fund-based payout is that some donors might not give to charity at all. In other words, the payout could have the effect policymakers should seek to avoid – driving away new charitable donors and thus encouraging private consumption. But a donor's decision not to give because of a high fund-based payout also is not a bad outcome in this context. Under present law, the donor has taken a charitable deduction, but is not spending the money. The point of the DAF at a national sponsoring organization should be to attract new charitable money, and also to encourage donors to spend it. The DAF at a national sponsoring organization is a charitable spending vehicle – that is the basis for the sponsor's exemption. Donors should know when giving that perpetuity is not an option.

A final objection to a fund-based payout is that it would be an administrative burden on the sponsoring organization. Sponsoring organizations would have to calculate distribution requirements for each fund, inform donors of their obligations, and make distributions when donors fail to provide advice. This would be a burden, and the costs would undoubtedly be passed on to donor accounts through higher administrative fees for account maintenance. Nevertheless, sponsoring organizations already have access to account balance information and the timing of contributions and distributions. Fidelity for example reports that "[m]ost contributions to Fidelity Charitable are granted out to charities within 10 years, based on a first-in, first-out analysis of contributions and grants."[73]

An alternative to a payout would be to delay the charitable deduction until the DAF makes a distribution. A delayed deduction approach would be to opt for substance over form and in effect treat the sponsoring organization as a conduit or agent. A similar approach has been used in other circumstances. For example, in Revenue Ruling 85-184,[74] a charity designated a public utility its authorized agent to collect voluntary contributions on the charity's behalf from the utility's customers. The utility exercised no dominion or control over the funds. The IRS held that the customers were allowed a charitable deduction in the year the utility paid the funds to the charity, not when the customer paid the funds to the utility. Although national sponsoring organizations are distinguishable from the utility in the Revenue Ruling, national sponsoring organizations again are on the edge – relying in large part on legal formalities for beneficial treatment.

Delaying the charitable deduction until the DAF distribution would likely be as effective as a payout, if not more so, at speeding up distributions. Indecisive donors generally would seek to accelerate deductions and

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[73] Fidelity 2015 Giving Report at 4.
[74] 1985-2 C.B. 84.

reach a decision far more quickly than the payout period. This approach, however, likely would have the effect of ending the DAF at national sponsoring organizations, the main appeal of which is a current deduction but delayed decision.[75] Again, this is not necessarily a bad result, except to the extent that DAF contributions represent new giving.

Donor advised funds at national sponsoring organizations are now a proven fundraising vehicle. Congress should take steps to ensure that donor advised funds also become institutionalized as a spending vehicle. Donors who are attracted by the convenience and efficiency of national sponsoring organizations will not be deterred by a reasonable mandate to distribute deducted contributions over an appropriate period. Donors who are deterred have other giving choices. Donors who choose not to give are the donors who probably should not be receiving federal income tax deductions for DAF contributions in any event.

PART III. A NET BENEFIT APPROACH FOR NONCASH ASSET CONTRIBUTIONS

A. The Broken System of Non-Cash Asset Donations and the Growing Role of DAFs

The donor-advised fund is emerging as a key source of non-cash charitable contributions. The Fidelity Charitable Gift fund reports that in 2014, "more than half of Fidelity Charitable donor contributions were made with non-cash assets,"[76] that "[n]early two-thirds of donors set up or use their DAFs to donate appreciated assets,"[77] and "[s]ince inception, Fidelity Charitable has assisted in converting $2.4 billion of illiquid assets into charitable dollars available for grants."[78] The National Philanthropic Trust concurs, noting that: "contributing illiquid assets to DAFs continues to be an increasingly popular trend."[79] Policymakers should take note. Donor-advised funds present an opportunity to improve the current broken system of noncash contributions.

Charitable contributions of noncash assets (property) are a long-standing source of concern, for reasons that have nothing to do with donor advised funds. What began as a simple notion – a charitable deduction for donated assets – has become an immensely complicated cacophony of woefully nontransparent rules that are inefficient, inequitable, promote abusive transactions, harm the reputation of the nonprofit sector, and in many cases

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[75] Substantiation issues also would arise.
[76] Fidelity 2015 Giving Report at 4.
[77] Fidelity 2015 Giving Report at 22.
[78] Fidelity 2015 Giving Report at 11.
[79] NPT 2014 Report at 11.

yield an uncertain benefit to charity. The issues range from pure matters of policy to administration and include: allowing a deduction for unrealized appreciation, uncertain valuation of donated assets, the net benefit that inures to charity (the donee), tax incentives that encourage property over cash contributions, and complexity.

Although it is beyond the scope of this article to present each issue in detail[80] a brief summary of the rules and issues raised may be helpful and is necessary to provide context. A simple example serves as a useful starting point. Assume that a donor owns 100 shares of publicly traded stock and donates the stock to a 501(c)(3) organization. At the time of the donation, the stock is trading at $10 a share. What is the donor's deduction? The general rule is that a charitable deduction is allowed for property contributions equal to the fair market value of the property at the time of the contribution.[81] Thus, the deduction would be $1,000.[82] This seems a reasonable result, since the donor has parted with property worth $1,000. But what if the donor paid only $1 for each share of stock, or $100 total? If so, the donor is allowed a $1,000 deduction (to shelter wage income) even though the tax cost of the property was just $100. This ability to deduct unrealized (i.e., untaxed) appreciation has been widely condemned.[83]

In addition, what if within days of the donation, the stock value plunges 65 percent. Worried about further devaluation of the stock, the donee charity sells the stock for $350. Does the amount of the deduction change? No, the deduction is based on date-of-contribution value of $1,000, not date of sale value. This too may seem reasonable. Someone has to bear the risk of loss. Since the donor has parted with legal control of the asset, the risk of loss should pass to the donee as an incident of ownership. On the other hand, it is not just the charity that bears the risk of loss, but taxpayers generally. The taxpayers, through the charitable deduction, have subsidized a

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[80] For extensive discussion, *see* Roger Colinvaux, *Charitable Contributions of Property: A Broken System Reimagined*, 50 HARV. J. ON LEGIS. 263 (2013).

[81] I.R.C. § 170(a); Treas. Reg. § 1.170A-1(c)(1)(2012).

[82] If the donor held the property for one year or less, then the deduction is equal to the donor's cost basis in the stock. I.R.C. § 170(e)(1)(A).

[83] Evelyn Brody, *Charities in Tax Reform: Threats to Subsidies Overt and Covert*, 66 TENN. L. REV. 687, 720 (1999) ("inefficient and unfair"); Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-in Gains*, 56 TAX L. REV. 1, 4 (2002) ("inequitable"); Wendy C. Gerzog, *From the Greedy to the Needy*, 87 OR. L. REV. 1133, 1158 ("inequitable"); Calvin H. Johnson, *Ain't Charity: Disallowing Deduction for Kept Resources*, 128 TAX NOTES 545, 549 (2010) (a "mistake"); Richard Schmalbeck, *Gifts and the Income Tax – An Enduring Puzzle*, 73 LAW & CONTEMP. PROBS. 63, 89 (2010) ("a clear error"). *See also* Harvey P. Dale & Roger Colinvaux, *The Charitable Contributions Deduction: Federal Tax Rules*, 68 TAX LAW. 331, 359 (2015) (noting that in 2011, 41 percent of noncash contributions were claimed by individuals earning $1 million or more of adjusted gross income, or .747 percent of total returns).

gift of $1,000. If the actual benefit to charity is less than $1,000, taxpayers bear some of the burden by in effect overpaying for the donation.[84]

What if instead of publicly traded stock, the donor contributes illiquid property, like privately traded securities or real estate? Now, the rules diverge based on the type of donee organization. If the illiquid property is donated to a (nonoperating) private foundation, then the deduction is limited to the donor's cost basis, i.e., the donor is not allowed to deduct unrealized appreciation, and thus neither of the two issues above matter.[85]

If the illiquid property is donated to a public charity, then as before, the donor is allowed to deduct unrealized appreciation based on the date of contribution value.[86] In addition, unlike with publicly traded stock, illiquid assets raise the stakes of relying on date of contribution value to determine the amount of the deduction. The value of publicly traded stock, though variable from day to day, at least is based on exchange value – a verifiable amount equal to what buyers and sellers pay in market-based arm's length transactions.

By contrast, illiquid assets do not have a similarly objective measure for value. Unlike in a market transaction, where buyers and sellers negotiate a value and a price, in a donative transaction, market pressure is absent. Instead, the value of illiquid assets must be determined by third-party appraisers, hired by the donor. The donor has an incentive to inflate the value (because it leads to a higher deduction). The donee is not responsible for valuing the asset, and generally has an institutional interest in not challenging donor valuations (so as not to alienate donors). Further, the donee also generally benefits from a higher valuation, which increases on paper the amount of public support received by the donee.

In short, in a donative transaction of illiquid assets to a public charity, the principal check on valuation abuse is the Internal Revenue Service.[87] For the IRS effectively to police property contributions is a daunting task. Many overvaluations will go unchallenged. And challenges when mounted are time consuming and expensive.[88] In short, the inherent uncertainty in

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[84] In this (admittedly dramatic) example, if the donor is in the 39.6 percent tax bracket, the donor takes a $1,000 deduction, which is worth $396 to the donor. The charity gets $350, meaning that it cost the federal government $396 to deliver $350 to charity.

[85] I.R.C. § 170(e)(1)(B)(ii). If the illiquid property is depreciated (i.e., has a value less than the donor's basis), then the deduction is fair market value, and valuation still is a concern.

[86] An appraisal is required. The appraisal must be dated no earlier than 60 days before the contribution and no later than the due date for filing the return. Treas. Reg. 1.170A-13(c)(3).

[87] The secondary check on valuation is the integrity of the appraisal process. The regulations define appraisal standards. In addition, there are penalties on donors (and appraisers) for overvaluation all in an effort to get to an accurate value of contributed property. I.R.C. §§ 6662, 6695A.

[88] For extensive discussion, *see* Colinvaux *supra* note 80, at 282-89.

valuation adds to the cost of the donation – in administrative time and expense, and by overpaying for the subsidy.

Further, the cost of the donation should be viewed not just from the perspective of the tax system and the public fisc, but also from the donee's perspective. Accepting property donations is not costless. Donees incur carrying costs (maintenance, insurance, etc.) and expenses related to sale. This again raises an incongruity between the net benefit to charity from a donation, and the amount allowed as a deduction, which, again, is based on an uncertain date of contribution value.[89]

If the property is tangible personal property, like clothing, household items, collectibles, or artwork, another set of rules applies. If made to a private foundation, the donor is limited to a deduction of basis (unless the property is worth less than the donor's basis, in which case the deduction is the fair market value of the property).[90] If made to a public charity, a fair market value deduction is allowed if the property is for the donee's use in exempt programs (known as a "related use").[91] Otherwise, the deduction is limited to the donor's basis. (As with private foundations, if the property is worth less than the donor's basis, the deduction is fair market value.) In addition, special rules exist for certain types of tangible personal property (vehicles, fractional interests of artwork, taxidermy) adding to the overall complexity.[92] There are also distinct rules for contributions of inventory and intangible property.[93]

The donor advised fund enters this array of rules as a magnet for noncash contributions of all kinds, but especially of illiquid assets.[94] As a public charity, contributions to DAF sponsoring organizations receive the more favorable treatment – the ability to deduct unrealized appreciation[95] – than the same contribution to a private foundation.[96] This is one reason to believe

[89] The industry relating to processing noncash contributions is substantial. Consider the website for Charitable Solutions, LLC, a "planned giving risk management consulting firm" that focuses on non-cash asset receipt and disposition, among other services. The firm notes on its home page that non-cash donations are one of only "two types of gifts in which a charity can actually lose more money than the original gift." The firm has a relationship with the Dechomai Foundation, which helps charities "eliminate their non-cash risks." *See* www.charitablesolutionsllc.com.

[90] I.R.C. § 170(e)(1)(B)(i).

[91] I.R.C. § 170(e)(1)(B)(i)(I).

[92] I.R.C. § 170(e)(1)(B)(iv), (f)(12), (o).

[93] I.R.C. § 170(e)(3), (m).

[94] Fidelity reports that "[t]hree-quarters of donors say the ability to donate [noncash] assets is a reason they set up or use a donor-advised fund" Fidelity 2015 Report at 4.

[95] Fidelity reports that 78 percent of donors use or set up a DAF "[t]o potentially minimize capital gains taxes." Fidelity 2015 Report at 22.

[96] Property contributions to public charities also are subject to a more generous cap (30 percent of adjusted gross income) than property contributions to private foundations (20 percent of adjusted gross income). I.R.C. § 170(b).

that for some contributions, donors may use a donor-advised fund instead of a private foundation.[97]

As one example, in marketing materials Fidelity relays the experience of a donor who was preparing to sell his interest in a privately held company:

> 'I wanted to create an ongoing charitable concern, something to serve as a legacy for me and my whole family. I thought first of establishing a private foundation, but found there were two problems: one, that donating privately held stock to a private foundation is not a tax-efficient option, and two, that the administrative challenges were considerable and expensive. Establishing a DAF at the Fidelity Charitable Gift Fund was absolutely the best option.'[98]

Apart from tax advantages, which sponsoring organizations share with any other public charity, sponsoring organizations market themselves as the more efficient vehicle for converting complex assets into cash, and increasing the net benefit to charity. Again, according to Fidelity:

> Many non-profit organizations, being primarily mission- and program-focused, are not well-equipped to handle this type of contribution [(non publicly traded assets)] . . . . Further, while some charitable organizations might have some limited experience in handling contributions of non-publicly traded assets, *the cost to the charity to outsource the compliance and liquidation work can be considerable*. Although the donor would still be eligible to claim a fair market value deduction, *the net result to the charity would once again be significantly reduced* . . . .
>
> In many cases, an optimal method for donating non-publicly traded assets to charity – measured by cost, flexibility, simplicity, and tax benefits to the donor, as well as by maximizing the net proceeds ultimately made available to charitable organizations –

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[97] Giving USA reported on a multi-million dollar donation split between the donor's private foundation and a donor advised fund. In general, for tax planning purposes, it would make sense to give cash and public securities to the private foundation and illiquid assets to the DAF. The DAF then could fund the same causes as the private foundation (under the donor's name), and the private foundation could make distributions to the DAF in satisfaction of the foundation's payout requirement. (DAFs are subject to the excess business holdings rules, meaning that they cannot be used to avoid this aspect of the private foundation regime.)

[98] Fidelity Charitable Gift Fund, "Donating Complex Assets to Charity" available at: http://www.fidelitycharitable.org/giving-strategies/tax-estate-planning/donate-non-publicly-traded-assets.shtml.

> is to make the contribution to a charity that offers donor-advised funds.[99]

In other words, Fidelity argues that donors with complex assets *should*, as a matter of public interest, give to a DAF instead of another public charity. Other public charities are not in the business of buying and selling assets, and so will drive up the costs of the transaction, resulting in less benefit to charity. It is much better Fidelity says to give the asset to a DAF sponsoring organization, have the sponsoring organization sell the asset, and then distribute the proceeds to charity from the donor's DAF account – less "any applicable unrelated business income tax, . . . actual carrying and maintenance costs, and certain tax preparation consultancy costs,"[100] which are taken from the proceeds of the sale. In either case, the donor's deduction will be the same – and based on the date of contribution value. But if a DAF is used, the amount actually distributed to a "mission" or "program" focused charity will be greater.

The marketing materials are suggestive. Clearly, sponsoring organizations are competing for the noncash contribution business,[101] indicating that some DAF contributions are substitutes (both for other public charity gifts, and private foundation giving), not new giving. More important though is the likely trend:

> Until recently, non-publicly traded assets *were a largely untapped source of philanthropic funding*, in part because these assets can

[99] *Id* (emphasis added). The other major national gift funds have similar materials. Vanguard Charitable, "Donating illiquid assets: Non-publicly traded stock," May 20, 2015, available at: https://www.vanguardcharitable.org/blog/blog_donating_illiquid_assets_non_publicly_traded_stock/ ("Many charities – especially small to mid-sized ones – do not have the resources to accept this type of asset.); Schwab Charitable, "Why it Might Make Sense to Donate Your Best Investments Instead of Cash: Appreciated Assets Can Be Among the Most Tax-Advantaged Items to Contribute to Charity," May 2013, available at: http://www.schwabcharitable.org/public/file/P-7256879/Complex_Assets_Donating_Appreciated_Assets.pdf ("Unfortunately, not all charities have the resources or capabilities to accept gifts of appreciated investments directly. That's where donor advised fund accounts can come in handy. These charitable accounts. . . allow you to more easily convert appreciated investments into tax-effective charitable contributions. This is because the sponsoring charity may have more experience with these types of gifts and can be in a better position to evaluate prospective contributions of appreciated property and liquidate the property once it is donated."); National Philanthropic Trust, "Illiquid Asset Contribution Guidelines," available at: http://www.nptrust.org/daf-forms/Illiquid-Asset-Contribution-Guidelines.pdf.

[100] Fidelity Charitable Gift Fund, "Donating Complex Assets to Charity." Other gift funds have similar models.

[101] The Fidelity materials say that the mission-driven public charity "might require that a donor first sell the assets and contribute the proceeds. A donor in this situation would have taxable income and thus would not, in most cases, choose to donate the entire amount of the proceeds." *Id*.

be complicated for individuals to give and for some nonprofits to accept.[102]

As a hint of untapped sources of funding to come, Fidelity cites to a report by Deloitte Consulting, which states that: "the top one percent of all U.S. households hold 36 percent of their wealth in privately held businesses."[103] In short, Fidelity believes that the donor advised fund is the uniquely appropriate vehicle for attracting new charitable contributions of complex assets, and that the potential market is significant.[104]

Further, the target property is varied. In "The art of donating property," Vanguard Charitable promotes the contributions of "fine art, real estate, vehicles, and other illiquid assets."[105] In "Minimize capital gains by donating complex assets" Vanguard Charitable lists a number of primary asset types, including: non-publicly traded stock, an LLC or LLP interest, private equity, hedge fund interest, restricted stock, insurance policy, and "other."[106] Schwab Charitable has a similar list, with the addition of "collectibles and artwork."[107] The Boston Foundation noted the gift of a share in a cruise ship.[108]

The push by sponsoring organizations, especially national sponsoring organizations, for noncash contributions raises another legal question regarding their 501(c)(3) status. As already discussed, national sponsoring organizations as primarily fundraising organizations are at the edge of

[102] Fidelity 2015 Report at 11 (emphasis added).

[103] Fidelity 2015 Report at 11 (citing Deloitte Consulting, LLP, "The Next Decade in Global Giving Among Millionaire Households," 2011).

[104] Of total contributions to Fidelity in 2014, nine percent were of non-publicly traded assets, 46 percent were publicly traded securities, and 45 percent cash. Fidelity 2015 Report at 11. Fidelity is not alone in this belief, as the marketing materials of other sponsoring organizations suggest.

[105] Vanguard Charitable, available at: https://www.vanguardcharitable.org/blog/blog_the_art_of_donating_property/.

[106] Vanguard Charitable, available at: https://cdn.unite529.com/f/248/21630/7d/im.uprinv.com/rc/sr2/vcep/VSAS_062015.pdf.

[107] *See supra* note 99. The donation of art and collectibles that are worth less than the donor's basis are deductible at fair market value. Although valuation is a concern, donors are not able to deduct unrealized appreciation. If the property is appreciated property, however, then a fair market value deduction is allowed (i.e., donors may deduct unrealized appreciation) only if the property is for the related use of the donee. Some sponsoring organizations may be using other intermediaries to satisfy the related use test. In "The art of donating property," Vanguard Charitable describes one donation of fine art, where Vanguard partnered with a for-profit company and a related foundation to process the art donation and transfer the proceeds to the donor's DAF at Vanguard. The details are not clear – but illustrate the fact that multiple entities can be involved – perhaps for tax planning purposes.

[108] The Boston Foundation, Valuing Non-Cash Assets for Charity: What Donors Need to Know, available at available at: http://www.tbf.org/tbf/65/complex-assets (noting that "[t]he Internal Revenue Service requires that [non-cash] assets be valued, a sometimes difficult task for things like illiquid company stock, land, privately held corporations or anything else not price by a public market").

501(c)(3) exempt status. As a shell, national sponsoring organizations must avoid characterization as a feeder organization, spend in accordance with their resources, and must remain vigilant against private benefit and inurement from relationships with affiliated for-profit investment firms. Now, a deepening involvement in managing complex asset donations further muddies the waters.

For example, in two private letter rulings, the IRS considered and rejected the 501(c)(3) status of organizations that were formed to facilitate donations of noncash property. In a 2005 ruling, an organization sought exemption as "a facilitator to contributors who want to donate tangible personal property, such as boats, to a charity that the donors designate."[109] The IRS said that:

> Arranging for donors for the charitable contribution of their boats, by taking possession and title to the boats; by arranging with third parties for their moorage, for necessary repairs and upgrades, and for sales by brokers; and by paying the net sales proceeds to the charity designated by the donor, all constitute common commercial activities, rather than activities that further a charitable purpose.[110]

The IRS concluded that the organization was "organized and operated for the primary purpose of carrying on an unrelated trade or business," i.e., a feeder organization. Similarly, in a 2008 ruling the question raised was: "Does an organization formed to facilitate donations of real estate qualify for exemption"[111] under section 501(c)(3)? The IRS said that: "The facilitation of real estate transactions through for-profit third party entities for a fee constitutes a trade or business ordinarily carried on for profit."[112]

On the surface, the comparison to sponsoring organizations is obvious. Sponsoring organizations are engaged in the same basic activities as the organizations in the rulings. But there are important possible distinctions. A key conclusion for the IRS in both rulings was that the organizations were deemed to be the agents of the donor, which imbued the sales activity with more of a commercial hue. Thus, the organization was judged to be providing commercial services for the donor (and also, incidentally, would have sheltered the donor from capital gains taxes). Whether sponsoring organizations can be characterized as agents for their donors returns to the essential nature of "donor advice" in the donor-advised fund context.

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[109] Priv. Ltr. Rul. 200512027 (Mar. 25, 2005).
[110] *Id*.
[111] Priv. Ltr. Rul. 200825051 (June 20, 2008).
[112] *Id*.

Another distinction is that the organizations in the rulings did not engage in other activities.[113] Sponsoring organizations are not exclusively in the noncash asset business. But as this business increasingly becomes a primary activity, if it is not already,[114] the overall purposes of sponsoring organizations as charitable or not will again be called into question.

All of this leads to questions about how, as a matter of public policy, Congress should respond to the increasing use of sponsoring organizations to process noncash charitable contributions. As the sponsoring organizations state, there are reasons to think that sponsoring organizations are a more efficient vehicle than other public charities for accepting many kinds of noncash contributions, especially illiquid assets. Because sponsoring organizations specialize in the liquidation of complex assets, they are better positioned to reduce transaction costs, potentially making more cash available to mission driven charities.

In addition, the ability to liquidate a complex asset for the benefit of multiple charities is also an attractive feature of using a donor-advised fund in this context. Without a DAF, the contribution of indivisible property must go to a single charity (if tax benefits are to be preserved).[115] Further, the intricacies of complex asset donation likely have depressed the market. The sophistication offered by many sponsoring organizations likely does represent an opportunity to release an "untapped" source of charitable contributions.[116]

On the other hand, as yet more complex, and inherently difficult-to-value assets are contributed, the opportunities for abuse will multiply, as will administrative costs, overpayments of the subsidy by the federal government, and equitable concerns that the deduction favors the wealthiest. The charitable deduction already is claimed disproportionately by those at the very top of the income distribution.[117] DAFs, by providing a lucrative deduction for the top "one percent,"[118] will put further pressure on the charitable deduction generally.

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[113] The extent to which sponsoring organizations rely on for-profit firms to process transactions may also be a distinction. Schwab says that it accepts non-cash assets "via a charitable intermediary, with proceeds of your donation transferred to your donor-advised account upon liquidation." Schwab, *supra* note 99, at 4 (fine print).

[114] Fidelity in 2014 received more contributions in noncash assets than cash. Fidelity 2015 Report at 11.

[115] CRS REPORT at 3 (noting that a "DAF can permit the contribution of a large indivisible appreciated property such as real estate. When the property is not divisible, the contribution cannot be spread across many charitable donors or donated over time).

[116] This strengthens the case that here, donor advised funds may be vehicles for giving that would otherwise not occur, but only to the extent that donors of complex assets do not reduce other contributions.

[117] *See supra* note 83.

[118] *See supra* note 103.

B. A Net-Benefit to Charity Approach to Noncash Assets

Congress could respond in any number of ways. Least attractive is to do nothing. As outlined above, the system for property contributions is broken, notwithstanding some positive features of using DAFs in this context.[119] So, some response is warranted.

To fashion a response, Congress should begin by taking note of first principles. In theory, as a matter of income measurement, no charitable deduction should be allowed for unrealized appreciation.[120] The ability to deduct unrealized appreciation is no more and no less than a subsidy, the presumed intent of which is to encourage asset owners to transfer wealth to charity. To be sure, it is a longstanding and popular subsidy, but also one that is about to get more expensive with the rise of DAFs. DAFs thus provide an opening to question whether to keep the subsidy at all.[121]

For purposes of this Article, it is assumed that policymakers want to continue to subsidize noncash charitable contributions.[122] Nonetheless, with DAFs, tolerance for a deduction determined by an appraised value may finally be untenable. Sponsoring organizations operate complex donation programs primarily to liquidate donated property to cash. With a system emerging in the marketplace for intermediaries to accept and liquidate noncash property, there is a strong case that a deduction, if allowed, should be based on the net benefit to charity (i.e., the amount made available for distribution from the donor advised fund), not the appraised amount. Thus, again assuming Congress intends to keep the subsidy, Congress should take the rise of the DAF giving vehicle as an opportunity to improve the system for noncash contributions (i.e., not just contributions to DAFs but to any charity) by reducing the costs of the subsidy and moving to a "net benefit to charity" approach to the deduction.

A net benefit to charity approach for the deduction makes a lot of sense. It aligns the deduction with the amount that goes to the (active) chari-

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[119] As noted above, however, as sponsoring organizations become more deeply engaged in the business of selling assets, the more doubt is cast on exempt status. Unrelated business income tax issues are could arise.

[120] William Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 372. *See also supra* note 83.

[121] STAFF OF J. COMM. ON TAXATION, 109TH CONG., OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES 293-307 (Comm. Print 2005) (recommending elimination of the subsidy); Halperin, *supra* note 83 (arguing for a constructive realization of gain upon contribution). The author has argued elsewhere that the charitable deduction for property contributions should be viewed as a distinct tax expenditure with high tangible and intangible costs. Colinvaux, *supra* note 80. The article argues that if a charitable contribution for property is allowed, it should be only in cases where there is a measurable benefit to charity.

[122] *But see* Tax Reform Act of 2014, H.R. 1 (introduced by Dave Camp) (ending the ability to deduct unrealized appreciation for real estate and privately held securities).

ty. As a result, donee organizations would have incentives to reduce transaction costs in order to maximize donor deductions. Donors would be more likely to give noncash assets to donee organizations that have the most efficient liquidation programs (meaning, in many cases, sponsoring organizations). If property does not sell for as much as donors hope or anticipate, the government (and so other taxpayers) will not be shortchanged by overpaying for the contribution.[123] Further, the net benefit to charity approach is not new, but is used in the context of vehicles[124] and intellectual property.[125]

A net benefit to charity approach would raise a number of issues. What is the deduction if the donee does not sell the property? Should there be a forced sale rule? Should the net benefit approach apply to all noncash assets, or only those where valuation is a problem, or assets above a minimum value? Should there continue to be special rules for related use property? These are all important questions that, once there is agreement to move to a net benefit approach, would require answers.

To see how a net benefit approach might work, one general rule (the "rule") could be that the deduction for contributions of noncash assets to a public charity is equal to the lesser of: (1) the donor's basis in the property plus one half of the appreciation (the "initial amount"); or (2) the net benefit to charity. The net benefit to charity would be determined based on: (1) in the case of a contribution to a sponsoring organization, the amount made available for distribution from the donor advised fund by donor advice; or (2) in the case of another public charity, the net sales proceeds. In the case of depreciated property, the initial amount would be the fair market value. The deduction could be allowed in the year of contribution, subject to recapture in the year the net benefit to charity can be determined, with a limit on recapture of a specified period from the contribution date. Although the initial amount of the subsidy (basis plus one-half the appreciation) may seem arbitrary, it is no less arbitrary in this context than fair market value, just not as generous. Further, the initial amount already is used as the allowable amount for certain contributions of inventory, and so has some precedent.[126]

The rule could be applied to any type of noncash asset, with appropriate adjustments. Applying the rule to publicly traded securities, the amount of the deduction would be reduced from the exchange value (present law) to

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[123] *See e.g.,* National Philanthropic Trust, "Illiquid Asset Contribution Guidelines," *supra* note 99 (cautioning donors that "[d]ue to the amount of time required to liquidate the asset, sales proceeds may differ from the appraised or fair market value at the time of the contribution").

[124] I.R.C. § 170(f)(12) (basing amount of deduction for vehicles on sales price).

[125] I.R.C. § 170(e)(1)(B)(iii), (m) (allowing an initial deduction of basis, to increase in later years based on income from the contribution to the donee).

[126] I.R.C. § 170(e)(3).

the exchange value less one-half of the appreciation.[127] Donors would still be able to deduct some of the appreciation in the property (i.e., the subsidy would not be eliminated), but not all. If the donee sold the securities for less than the initial amount, then the amount of the deduction would be reduced accordingly. If the contribution and sale occur in the same tax year of the donor, then no recapture would be required.[128] For publicly traded securities, the limit on recapture could be one year after the contribution date, meaning that if the donee sold the securities more than one year later, there would be no recapture and the donor's deduction would be the initial amount (basis plus one-half of the appreciation).

Applying the rule to illiquid noncash assets like real estate and privately held securities,[129] the initial amount would be the donor's basis plus one-half of the appreciation based on the appraised value. In general, the recapture period for illiquid assets should be longer than one year to account for the additional time it may take to dispose of the property. The net benefit to charity would be determined by reducing the sales proceeds by the costs associated with carrying and selling the property. Sponsoring organizations already make similar calculations in determining how much to charge each donor advised fund for the contribution.[130] The principal difference then is a reduction in the amount of the deduction from full appraised value to the initial amount, not to exceed the net benefit to charity.

Applying the rule to tangible personal property requires some additional consideration. As noted, the general rule is that, for appreciated property, the deduction is the donor's basis unless the property is for the related use of the donee. In general, contributions to a sponsoring organization will not be for a related use, so already the allowable amount is just the donor's basis. The rule should not be applied to increase the deduction.

Otherwise, the question is whether the subsidy should be reduced from appraised value to the initial amount for related use property. A full discussion is outside the scope of this Article,[131] but as an initial matter, related use property should not be treated differently from other property. For tan-

[127] Some might argue that there is no reason to apply the rule to publicly traded assets, because valuation is not a problem. The reason to reduce the subsidy for the contribution of publicly traded assets is not to curtail abuse, but simply to reduce the cost of a generous subsidy.

[128] As a practical matter, to avoid recapture and close the transaction, many donees would sell the property in the year of contribution. Nonsponsoring organization donees that prefer to retain the securities could do so, and the donor's deduction would be fixed at the initial amount.

[129] Some publicly traded securities could fall into this category if the securities were subject to substantial restrictions.

[130] Non sponsoring organization public charities would have to track these amounts.

[131] Related use property presents a slightly different challenge from other property. The main issue is that the subsidy here is, or should be, intended to deliver a specific type of property to charity (e.g., art to an art museum). The question then is the efficient level of the subsidy for the particular market.

gible personal property that is depreciated, the rule might apply only to items of property with a minimum value;[132] otherwise a net benefit to charity calculation might not be feasible.[133]

Over decades, Congress has wrestled with the correct deduction amount for charitable contributions of noncash assets, resulting in a multitude of scenarios. Donor advised funds present Congress with an opportunity both to embrace the vehicle as an efficient mechanism for converting complex assets to cash for the benefit of charity, and also to improve the system of noncash contributions and reduce its many costs.

CONCLUSION

Donor advised funds attract a significant share of charitable giving and warrant Congress's attention. The DAF is hard to conceptualize. The different types of DAF sponsors and the different reasons donors give make it difficult to design a regulatory approach for all donor advised funds. Important considerations are that contributions to donor advised funds are substitutes for giving to other public charities and private foundations, but also represent new gifts.

The national sponsoring organization emerges as distinct from other sponsors. The exempt purpose of the national sponsoring organization is to spend money for the benefit of other 501(c)(3) organizations, and is best characterized as a fundraising organization. Given the national sponsoring organization's exempt purpose, the national sponsoring organization already is subject to a facts and circumstances based payout – the commensurate in scope test. Because national sponsoring organizations fundamentally are vehicles for spending not saving, Congress should apply legislatively the commensurate in scope test and require that national sponsoring organizations spend contributed funds over a specified time period. The goal of the payout is to provide a spending period long enough so as not to alienate new donors, but short enough so as not to extend unduly the delay to charity that results when DAFs are used as public charity substitutes.

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[132] As noted *supra*, sponsoring organizations actively solicit tangible personal property like collectibles and artwork. *See also* NPT 2014 Report at 11 (noting that many sponsoring organizations "are willing to accept . . . real estate and tangible personal property. Typically, [they] liquidate them relatively quickly . . . ."). Sponsoring organizations also generally require a minimum value for complex assets. Thus, applying a net benefit to charity approach should not impose a significant new burden on sponsoring organizations, which already screen for appropriate contributions and track costs.

[133] Low value clothing and household items are an example. Donor advised funds appear to be used rarely for this type of property, however, leaving a more fulsome discussion for other occasions. TREASURY REPORT, at 61 (reporting a total of 142 donations in 2005 of clothing and household items, with a total value of $129,000, all at community foundations).

Congress also should recognize that DAFs increasingly are used for noncash charitable contributions. The positive effect will be to make property conversions more efficient. The negative effect will be to accentuate an already broken system of property contributions at great expense: increasing the cost of the subsidy, straining administration of the charitable deduction, and exacerbating equity concerns. Assuming that Congress intends to retain the subsidy for noncash contributions, Congress should use DAFs as an opportunity to reduce the cost of the subsidy of the entire system (not just DAF contributions) and move to a net benefit to charity approach to the deduction.