Donor-advised funds: US regulators scrambling to catch up with boom in charitable giving accounts

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A revolution in charitable giving is underway due to the growth of donor-advised funds in the United States.

Known widely as DAFs, these financial accounts are designated for charitable giving. Donors can get an immediate tax deduction by putting money or other assets into the accounts, and advise the accounts' managers to give away the money at a later date.

After years of concerns about how quickly the money reserved for charity gets distributed and whether donor-advised funds need to operate more transparently, proposed new federal regulations are now pending. Though the regulations would not create new requirements for how rapidly these funds distribute money, they do provide some new guidelines for what uses for DAFs are allowed by law.

As an accounting researcher who studies DAFs, I believe these new changes may mark the start of what could become a series of reforms.

Nearly $230 billion

DAFs have been around since the 1930s but got off to a slow start. After decades of being concentrated in community foundations, DAFs became more widely accessible with the introduction of Fidelity Charitable—a DAF-sponsoring organization tied to Fidelity Investments—in 1991.

Many more DAF sponsors connected to investment companies have since emerged.

Because donors get tax breaks when they put money in them and can then wait a long time before distributing it to nonprofits, DAFs essentially operate as streamlined foundations.

DAFs are not, however, subject to the same restrictions.

Foundations have to disclose their donors to the public and also have to distribute minimum amounts for charitable use each year. DAFs face neither requirement.

DAFs held nearly US$230 billion in assets by the end of 2022 and distributed some $52 billion to charities that year. Those are significant sums as giving of all kinds totaled about $500 billion that year.

As of 2023 there were about 2 million donor-advised funds, according to the National Philanthropic Trust.

40% don't distribute a dime

Critics of DAFs say that the government should require them to regularly disburse at least some of their charitable funds.

Foundations have faced that kind of obligation for more than five decades. They must pay out at least 5% of their assets each year—although some of that money can be used to pay for their operations or even be set aside in a donor-advised fund.

Supporters of DAFs counter that the payout rate for those accounts is already much higher than the foundation floor of 5%. It hovers around 20%.

However, that statistic applies to all the money held in DAFs, not what happens with each one of them. And almost 40% of them don't distribute any money at all in a given year.

Calling for change

Other changes have been proposed over the years, including:

- Not letting foundations count money they put in a DAF toward their annual 5% payout requirement.
- Introducing new disclosure requirements because currently the public, the charity that gets money from a DAF and even the IRS have no way of knowing for sure who originally provided those funds.
- Reining in the commercial investment companies that have been at the center of much of the growth in DAFs, by limiting the fees they can earn or restricting the ties between them and their affiliated charities.

IRS regulations

The IRS released proposed new DAF regulations at the end of 2023, and gave the public an opportunity comment on them.

The proposed regulations would clarify what constitutes a DAF, who is considered a fund's adviser, and restrictions on DAF disbursements.

Though largely focused on definitions, these proposed regulations are not without teeth. Nor have they been immune to controversy.

The proposed regulations would identify certain distributions as taxable and declare that donors are not the only parties considered DAF advisers—the donors' personal financial advisers are, too. This means the financial advisers, like donors, cannot receive any benefits from a DAF.

In identifying taxable distributions, the regulations include the possibility that funds used to support lobbying or activities tied to political campaigns could lead to penalties for both the donor and the fund's manager. And evidence suggests DAFs are commonly used to support lobbying.

A tax would be levied on the DAF totaling 20% of the distribution and another 5% charged to a participating fund manager.

By including a donor's personal financial adviser in the group considered advisers to the DAF, investment fees paid to such financial advisers for their services would become impermissible "excess benefit" transactions. As such, the proposed new rules would require the repayment of their compensation plus a 25% penalty.

Some DAF proponents have objected to the proposed regulations. A key concern they've expressed has to do with what the regulations could mean for financial advisers.

Since financial advisers often oversee investments of both the donor and the donor's charitable funds, such dual advisory roles may be eliminated by the threat of penalties.

Changes possible in Congress

Additional, bigger, changes could occur in the near future through legislation.

Possibilities include requiring DAFs to disclose donors and connect them with distributions so the public can follow the money or delaying tax benefits when donations to DAFs are not immediately distributed to charities to encourage donors with DAFs to dispatch their gifts quickly.

Although legislation aimed at requiring faster payouts was first proposed in 2014, few lawmakers have made it a priority.

The most recent bill, the Accelerating Charitable Efforts Act, was first proposed by Sens. Angus King and Chuck Grassley in 2021. It did not amass enough support to garner a vote. At this point, it is unclear whether the lawmakers will reintroduce that measure.

But as DAFs play an ever larger role in charitable giving, I believe that Congress will eventually have to take action if it wants to meaningfully regulate this new charitable environment.

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