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Donor-Advised Funds Are Booming, but Nonprofits See Little Benefit

By Alan M. Cantor

Something troubling is happening to charitable giving in the United States.

On the surface, this is a strange assertion, as overall contribution levels are remarkably consistent from year to year. Giving rates don't fluctuate much. The rise in overall charitable giving, adjusted for inflation, was less than 1 percent in 2011, "Giving USA" said in its most recent report. That kind of stability is typical.

But one part of the charitable world is booming: donor-advised funds. And that has significant implications for the rest of the system.

Donor-advised funds are a very convenient way to give. They allow people to put their money into a giving account, get a tax deduction immediately, and then parcel out the money whenever they want to whatever cause they want to support.

The funds are particularly helpful for someone who all of a sudden gets a big influx of cash, such as from the sale of a business. The donor gets a tax deduction now to offset capital gains and then can give the money to charity any time. It's very much like creating one's own private foundation but without the hassle and expense.

Donor-advised funds were historically the province of community foundations and national religious federations.

But virtually all of the growth is now coming from a relatively new kind of entity: company-sponsored gift funds like Fidelity Charitable Gift Fund, Schwab Charitable Fund, and Vanguard Charitable Endowment Program. These three funds attracted 56 percent more in gifts in 2012 than 2011

Fidelity's growth comes after an 89-percent increase from 2011 to 2012.

The big three of Fidelity, Schwab, and Vanguard Charitable landed at Numbers 2, 12, and 22 respectively in *The Chronicle's* most recent "Philanthropy 400," the annual listing of charities that raise the most money. To put that in perspective, Numbers 20 and 21 on that list were Harvard and Yale.

So why do I consider this a problem?

- These funds are essentially warehouses of charitable dollars. They don't feed or clothe a single person. They don't educate a single student or cure a single patient. I call them NINOs—nonprofits in name only. Until the funds go out, they do nothing for society.
- The amounts going into these funds are enormous. In 2011, $9.6-billion went into donor-advised funds, according to the National Philanthropic Trust. That's 4.4 percent of all the charitable giving from individuals. In fact, contributions to donor-advised funds in 2011 were $2-billion more than all the money donated to environmental and animal-rights groups combined. It stands to reason that if charitable giving is flat overall and donor-advised funds are gaining so quickly, then nonprofits that actually provide services are losing contributions.
- Donor-advised funds are not required by federal law to distribute grants. Unlike private foundations, there is no federally required minimum annual payout. Funds can sit in a donor-advised fund account indefinitely.
- With the meteoric rise of the company-sponsored donor-advised funds, many firms and financial advisers are making money all along the line—while charity is losing out.

Let me give an example to show how people take advantage of a flawed system.

I ran into a friend who's a financial adviser at a respected brokerage house. He somewhat sheepishly told me of a client who five years ago dropped $100,000 into the firm's donor-advised fund. Since that time, the client had recommended only a single grant of $1,000 to charity.

So in 2008, this individual had received a $100,000 charitable deduction, which, if he was in the 28 percent tax bracket, saved him (and cost the rest of us) $28,000.

My friend, the broker, has been receiving a commission on his client's donor-advised fund assets ever since, even though that money technically belongs to charity rather than the client himself. Let's guess that my friend has been receiving 50 basis points a year, or $2,500 over five years, as his management fee.

And, of course, all along the funds have been invested in mutual funds managed by my friend's company. Let's figure another 1 percent per year for investment fees—that's $5,000 over that time for my friend's firm. Plus more for the NINO's operating fees, perhaps 50 basis points a year—another $2,500.

Add it all up: The donor saved $28,000 on his taxes. My friend and his firm and the donor-advised fund they run have made about $10,000. And charity has received $1,000.

This is, frankly, a mockery of the charitable deduction.

It is also a significant threat to the nonprofit world. Donor-advised funds, because of their flexibility, are inherently attractive to donors. Add to that the gravitational pull of the financial-services industry encouraging clients to put their money into donor-advised funds rather than making outright gifts to charities. Finally, the financial advisers' incentives further encourage donors to keep money in donor-advised funds rather than distribute it.

We can cure most of the ills of the donor-advised fund, while keeping it as a viable option. But that will require the federal government to impose a healthy minimum annual charitable-distribution requirement for each donor-advised fund, something on the order of 20 percent of its year-end market value. This will flush out the funds so they can do actual good rather than pad the profit margins of their Wall Street sponsors.

Alternatively, the government could rule that donor-advised funds (and their cousins, private foundations) would be eligible for a tax deduction of only 50 percent of what an outright gift to an operating charity will bring. (Give $10,000 to a soup kitchen, and you can deduct $10,000 from your taxable income. Give $10,000 to a donor-advised fund, and you can deduct $5,000.)

It would be terrible public policy to allow donor-advised funds to continue to grow and metastasize and cut off the flow of funds to real nonprofits.

Defenders of donor-advised funds will protest that money going into the funds does, after all, go back out to charity. But in the most recent report from the National Philanthropic Trust, nearly $2-billion more a year was going into donor-advised funds than was coming out in grants to serve charitable causes.

If these funds are giving donors the benefits associated with charitable giving, then the money can and should be invested in people and causes, not the markets.

After all, is it too much to expect that charitable giving involve at least a little bit of actual charitable good?

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