

# Donor Advised Funds -- A Comprehensive Exploration

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# Fundamentals of Donor Advised Funds (DAFs)

- Donor makes irrevocable contribution to an exempt organization (“charity”) that administers the fund
- Receive immediate income tax deduction
  - Qualify for public charity deductions



# Fundamentals of DAFs

- Donor recommends how assets will be invested
- Donor recommends charitable grants based on his/her timetable
  - Named beneficiaries assume advisory role after death



# Fundamentals of DAFs

- DAFs may be named as beneficiary in new or existing (if trust agreement allows) charitable remainder and/or charitable lead trusts
- DAFs have traditionally been used to receive grants from private foundations (PFs) or supporting organizations (SOs)
  - **Significant** changes due to Pension Protection Act of 2006
  - Still opportunities to train succeeding generations, etc.



# Fundamentals of DAFs

- Often discussed in comparison of PFs, SOs, and DAFs
- DAFs offer simplicity v. PFs and SOs (see chart courtesy of National Christian Foundation (NCF))
  - Excellent discussion of these choices by Victoria Bjourkland, Esq., Michael Bourland, Esq., and others (much of which is freely available online)





## Comparison among Donor Advised Funds, Supporting Organizations and Private Foundations

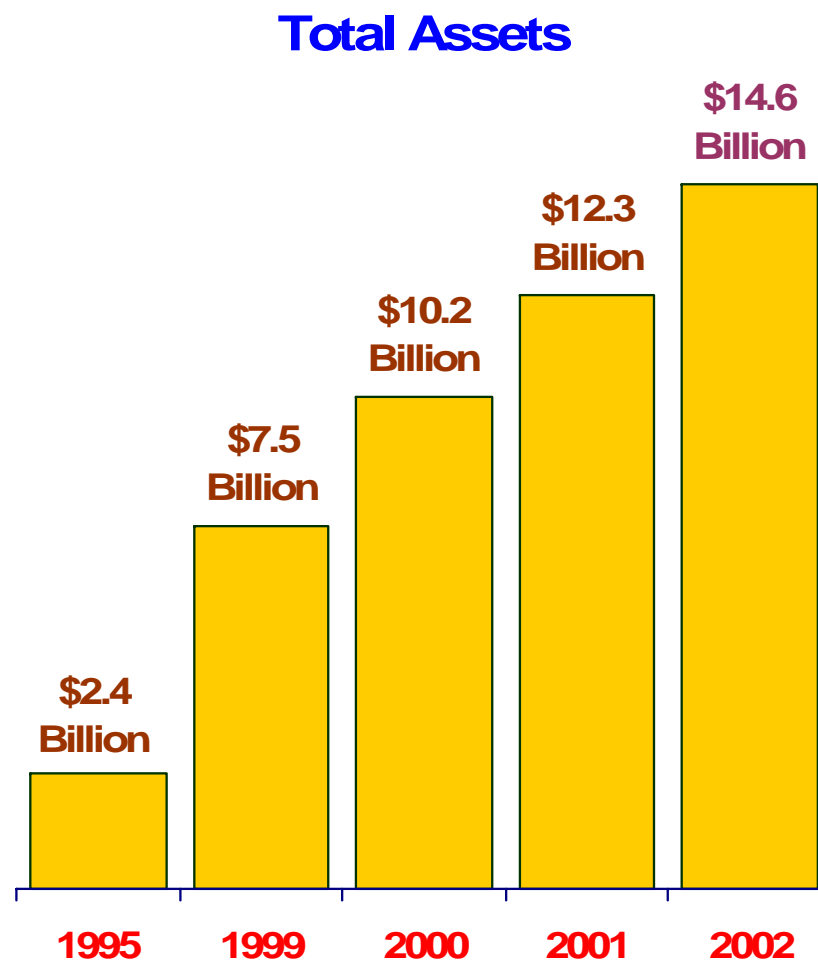
ISSUE / FEATURE	DONOR ADVISED FUNDS	SUPPORTING ORGANIZATIONS	PRIVATE FOUNDATIONS
<b>Description of Donor's role and Governance</b>	Donors are advisors. Ultimate control rests with the public charity.	Donor cannot control more than 49% of the board but can control who the supported organization(s) is and then may participate in the selection of board members	Donor family can control 100% of board; however, after donor's death, the board has control.
<b>Control over grants and assets</b>	Donor may recommend grants and investment options, but the public charity has ultimate control over decisions.	Donor may recommend grants and investments, but the board of the SO has ultimate control over decisions.	Board has complete control of all grants and investment decisions, subject to self-dealing rules.
<b>Tax deduction limits for gifts of cash and publicly traded securities</b>	Cash: 50% of adjusted gross income Publicly traded securities: 30% of adjusted gross income.	Cash: 50% of adjusted gross income. Publicly traded securities: 30% of adjusted gross income.	Cash: 30% of adjusted gross income. Publicly traded securities: 20% of adjusted gross income.
<b>Tax deduction limits for gifts of other non-liquid appreciated assets held long-term</b>	Fair market value	Fair market value	Restricted to donor's basis in asset
<b>Excise taxes</b>	None	None	Up to 2% of net investment income
<b>Distribution requirements</b>	None	None	5% of foundation assets must be distributed annually.
<b>Start up costs</b>	None	Legal and accounting fees for incorporation, IRS filing, and other documents (+/- \$4,000).	Legal and accounting fees for incorporation, IRS filing and other documents (\$5,000 – \$20,000 <sup>1</sup> ).
<b>On-going administrative and management costs</b>	Varies depending on the public charity providing the service. Generally 1% per year or less.	On-going fees for accounting, legal and administrative advisors (\$5,000 – \$20,000 <sup>1</sup> ) to oversee the assets, balance the books, pay the bills, keep the records and file the tax returns.	On-going fees for accounting, legal and administrative advisors (\$5,000 – \$20,000 <sup>1</sup> ) to oversee the assets, balance the books, pay the bills, keep the records and file the tax returns.
<b>Ability to employ people/ pay salaries and benefits</b>	No	Yes, subject to excess compensation limits. No to disqualified persons	Yes, subject to excess compensation limits.
<b>Ability to pay expenses for travel/other reimbursements</b>	No	Yes, able to pay expenses but not able to reimburse expenses to disqualified persons.	Yes
<b>Ability to make grants to non-exempt individuals or foreign charitable organizations</b>	No to individuals. Yes to foreign charities, however it is often the policy of the DAF's to limit grants to foreign charities.	Yes, however, thorough and documented due diligence (satisfactory to the IRS) must be acquired prior to issuance of grant and after funds are expended. This is true of a donor advised fund (to foreign charities), as well.	Yes, however, thorough and documented due diligence (satisfactory to the IRS) must be acquired prior to issuance of grant and after funds are expended.
<b>Anonymity of donor</b>	Yes	No <sup>2</sup>	No <sup>2</sup>
<b>Privacy</b>	Complete privacy is available. DAF information is aggregated with other DAF information to maintain privacy, and an individual tax return is not required for each DAF.	Must file Form 990 which becomes a matter of public record and contains detailed information on grants, investment fees, salaries, etc. <sup>2</sup>	Must file Form 990 which becomes a matter of public record and contains detailed information on grants, investment fees, salaries, etc. <sup>2</sup>
<b>Succession and Perpetuity</b>	Can exist in perpetuity	Can exist in perpetuity	Can exist in perpetuity

<sup>1</sup> The creation of any legal entity, especially one that could last in perpetuity and/or involves irrevocable actions, requires the careful input and oversight of a competent attorney that has a thorough understanding of the donor's family and their giving goals and objectives.

<sup>2</sup> Combining this tool with a donor advised fund (NCF Giving Fund) can achieve partial privacy and anonymity.

# Exponential Growth of DAFs

- Size of DAF market grew more than 500% from 1995 to 2001
- Proliferation of "commercially sponsored" DAF programs



Source: *The Chronicle of Philanthropy*



# Pension Protection Act of 2006 (PPA)

- PPA defined DAFs for first time
  - Formerly created via Private Letter Rulings in general
- Several PF restrictions placed on DAFs under the PPA
- Potentially more legislation in the future (Treasury study, etc.)



# PPA: Definition of DAF

- Any fund or account
  - Which is separately identified by reference to contributions of the donor(s);
  - Which is owned or controlled by the sponsoring organization; and
  - With respect to which a donor or person appointed by the donor has or reasonably expects to have advisory rights with respect to investments or distributions.



# PPA: Exceptions to DAF Definition

- Funds that make distributions to *single* organization
- Funds for travel, study, or similar purposes
  - Recipients selected by a committee
  - Donor's advice is limited to participation on the committee
  - Donor does not appoint a majority of the committee or otherwise control the committee directly or indirectly
  - Charity board appoints all members of the committee
  - Charity board approves procedure for selecting recipients on objective, non-discriminatory basis
- Treasury may exempt certain funds (to be determined)



# PPA: Compliance Issues to Prepare

- IRS Form 990 reporting for DAFs
  - Tax years ending after August 17,2006
  - Total number of funds
  - Aggregate assets held
  - Aggregate contributions to and distributions from DAF
- Precisely track those funds that satisfy the legal definition of a DAF under the PPA



# PPA: Compliance Issues to Prepare

- Rename funds that meet the DAF definition
- Stop referring to anything else as “donor advised”
- Change fund agreements, annual reports, marketing materials, and related materials to eliminate confusion



# PPA: Intermediate Sanctions

- General rule: No unfair benefit to a disqualified person
  - “Disqualified person” = person in a position to exercise substantial influence
  - Only prohibits “excess” benefits -- permitted if fair to the charity
  - Penalties apply to excess amount (not entire transaction)
- Expanded “disqualified person” definition for DAF transactions
  - Donor and donor advisors (appointed or designated by donor)
  - Family members of donors and donor advisors
  - Thirty-five percent (35%) controlled entities (by any of the above)
  - Investment advisors to assets of donor advised funds



# PPA: Intermediate Sanctions

- Should immediately stop excess benefit payments
- Criticized by PPA comments (below) -- double standard (PF rules v. DAF rules)
  - However, must comply with all new PPA rules
  - Hopefully Treasury and/or Congress will clarify and even improve the PPA provisions, including these



# PPA: Excess Benefit Transactions

- Automatic excess benefit transactions from DAFs
  - Grant, loan, compensation, or similar (expense reimbursement)
  - Donor, donor advisor, family, or controlled entities
  - Entire amount is prohibited
- Penalties
  - Donor, donor advisor, or related person must repay entire amount (100%)
  - Twenty-five percent (25%) for donor, advisor, related persons
  - Ten percent (10%) on fund managers



# PPA: Excess Benefit Transactions

- Should immediately stop paying/reimbursing donors and others
- Also criticized by PPA comments (below) – another double standard (PF rules v. DAF rules)
  - Same compliance requirement and hopes as intermediate sanctions above



# PPA: Update DAF Procedures

- Gift receipt must say that funds are under the exclusive legal control of the charity
  - Applies to all gifts after February 13, 2007
- No benefits for donors, advisors, etc.
  - “Incidental” benefits are permissible
  - Pledges?
  - Penalties for beneficiary and person who recommended grant



# PPA: Update DAF Procedures

- No grants to individuals
  - However, more on scholarships below
- Expenditure responsibility (generally similar to PF rules) for:
  - International grants
  - Grants to non-charities (IRC s. 501(c)(4) *et seq.*)
  - Grants to some supporting organizations



# PPA: Scholarships

- Ensure not classified as DAF
- Donor may participate but cannot control selection of recipient(s)
- Charity's board must appoint all scholarship committee members
  - Reconstitute scholarship committee if necessary
- Charity's board must approve procedure for selecting recipients on objective, non-discriminatory basis
  - Issues regarding disbursements to recipients already selected under pre-existing PPA rules/procedures



# PPA: Excess Business Holdings

- Aggregate DAF interest and interest held by donor, donor advisors, and related parties
- DAF cannot hold more than twenty percent (20%) of voting or profit interest
  - Thirty-five percent (35%) exception if effective control elsewhere
  - Two percent (2%) de minimis exception



# PPA: Excess Business Holdings

- Generally have five (5) years to divest excess holdings under PPA
- Adopt policies covering gifts moving forward
- Transition rules for assets held before August 17, 2006



# PPA: Required DAF Treasury Study

- Are charitable deductions “appropriate” for gifts to DAFs?
  - Is the retention of advisory rights consistent with treatment of the transfers as completed gifts?
  - Do these issues arise with respect to other gifts?
- Payout requirement for DAFs?
  - If so, calculated aggregate or fund-by-fund basis?
  - Same percentage and rules as PFs?



# PPA: Comments on DAFs Submitted by Professional Organizations

- ABA Section of Taxation (see [link](#) -- under “Government Submissions”)
  - Clarifications of definition and exceptions
  - No distribution requirement, either on aggregate or fund-by-fund basis
  - If required, then only applied on aggregate DAF and rules should be same for DAFs and PFs (i.e., all under IRC s. 4942)
  - Eliminate third excise tax (automatic excess benefit transactions) on DAFs again to apply same rules as PFs (i.e., no self-dealing and intermediate sanctions under IRC s. 4958)



# PPA: Comments on DAFs Submitted by Professional Organizations

- ABA Section of Real Property, Trust & Estate Law (see [link](#) -- under “Other Links of Interest ”)
  - Exceptions to automatic excess benefit transactions for satisfaction of donor pledges and bifurcated grant (e.g., fundraising table sponsor)
  - Clarification regarding certain “DAF” funds and scholarship funds



# PPA: Comments on DAFs Submitted by Professional Organizations

- Council on Foundations (COF) (see [link](#))
  - Use existing tax law (e.g., material restriction rules (Treas. Reg. s. 1.507-2(a)(8)) to determine propriety and deductible amount of charitable gifts to DAFs
  - Allow payments for and reimbursement of reasonable expenses
  - Clarify treatment of scholarship and award funds
  - Allow expanded hardship and disaster relief grants to needy individuals
  - More on COF website (see link above)



# Case Study of NCF's DAF

(See attached materials)



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# Conclusion

- DAFs are still excellent charitable vehicles and one of the most flexible for donors
- Additional considerations due to the PPA
- Must evaluate specific situation of donor
- Charities must implement changes required by the PPA and consider other changes to make DAFs a strong choice for future donors



**Thank you for your time and attention, as well as the invitation to come and discuss these issues and perspectives with you. We hope that our presentation helps you to serve your clients well. Please contact either/both of us if you have questions or a situation that you would like to discuss.**



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