

**CHARITABLE GIVING TO A PRIVATE FOUNDATION AND THE
ALTERNATIVES, THE SUPPORTING ORGANIZATION AND THE DONOR-
ADVISED FUND¹**

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The purpose of this paper is to discuss charitable giving to a private foundation as compared with giving to its two primary alternatives: a supporting organization or a donor-advised fund at a community foundation or other public charity. The paper also examines the donor-advised fund in detail. It concludes with a proposal for legislative reform regarding classification of donor-advised funds as public charities rather than private foundations so long as each fund complies with a prescribed structure and operating policies.

When I began practicing in the area of charitable-giving and exempt-organization operations 17 years ago, donor-advised funds were hardly well known. Charitably-minded individuals and corporations in cities with well-developed community foundations (such as New York, Boston, Cleveland, and San Francisco) may have heard of a donor-advised fund and some small subset of that

1. Copyright © 1999 Victoria B. Bjorklund. All rights reserved. I thank Simpson Thacher & Bartlett summer associates Joanna Pressman and Natalie Margulies for their assistance in preparing this paper. This paper expands upon "The Emergence of the Donor-Advised Fund," presented at Georgetown University's 15th Annual Conference on Representing and Managing Tax-Exempt Organizations and reprinted at 3 *Paul Streckfus' EO Tax Journal* 15

group might actually have given to one. But in 1999, donor-advised funds are widely covered in the popular press and potential donors either open one without any advice of counsel or confer with counsel about multiple alternatives, including donor-advised funds.

The success of the Fidelity Charitable Gift Fund may be the biggest charitable-giving story of the 1990s. In 1999 one measure of the emergence of the donor-advised fund is to be found in the placement of the Fidelity Charitable Gift Fund at number 3 of The Philanthropy 400. The Gift Fund, which began operations only in 1991, had received contributions totaling more than \$1.5 billion by 1998.² In 1998 alone, the Gift Fund had total income of \$695 million. The Gift Fund's annual receipts in 1998 placed it behind only the Salvation Army and the YMCA of the USA. It moved in front of the American Cancer Society, the American Red Cross, Harvard University, and Catholic Charities.³ For such a new charity to move so quickly into the ranks of these charitable icons is evidence of the appeal to donors of the advised-fund model.

The emergence of the donor-advised fund in the 1990s marks a dramatic change in the American charitable-giving paradigm. Now virtually every explora

(May 1998).

2. Monica Langley, "You Don't Have to Be A Rockefeller to Set Up Your Own Foundation-- Investors Pour \$1.5 Billion Into Fidelity's Gift Fund; What Will the IRS Do?," *The Wall Street J.*, Feb. 12, 1998 at A1.
3. "Raising the Roof, Private Donations to Top Charities Rose 16 percent in '98, Survey Finds: The Philanthropy 400," *Chronicle of Philanthropy*, Nov. 4, 1999, p.1, col. 1.

tory conversation between an advisor and a prospective donor includes discussion of the donor-advised fund option. The donor-advised fund focuses on values important to donors in the 1990s: involvement and efficiency⁴ but with lower operating costs than would apply to a private foundation or supporting organization. And not just the Gift Fund is growing: community foundation and public charity donor-advised funds are also seeing record growth. While their growth percentages may be staggering their absolute number is not: There are probably fewer than 600 donor-advised funds in the United States today, with the vast majority being operated by community foundations. Of course, each donor-advised fund may administer dozens or hundreds of funds.

By way of comparison, there were 46,000 private foundations in existence in 1999 (up from 2,000 in 1950). Of those 46,000 foundations 29.5% or 12,259 held assets of \$1 million or more or made grants of \$100,000 or more per year. Thanks to America's longest period of private wealth accumulation, Americans are experiencing the largest intergenerational transfer of wealth in history, with an estimated \$225 billion changing hands each year until 2040. It is predicted that this period will see the formation of more family foundations than at any time before in history. Nonetheless, the percentage of private foundations to all charities (4%)

4. See, e.g., "Wired': Giving With a Bottom Line," *Chronicle of Philanthropy*, p. 37 (Sept. 9, 1999) ("A new breed of donors is trying to reinvent the art of philanthropy, matching generosity with the no-nonsense rules of business, *Wired Magazine* writes....").

has remained unchanged since 1950. As of June 30, 1999 there were 25,962 organizations qualified as supporting organizations under section 509(a)(3).⁵

I. CHOOSING AMONG A PRIVATE FOUNDATION, A DONOR-ADVISED FUND, A SUPPORTING ORGANIZATION, AND A PUBLIC CHARITY

The main advantage of a private foundation over the alternatives can be summarized in one word: *Control*. Generally, determining the degree of control that the donor requires will determine whether the donor must have a private foundation. If the donor is willing to give up some or all control over her gift, she can gain other advantages, including greatly reduced administrative responsibilities and costs. For a donor who is committed to becoming a philanthropist, no alternative other than the private foundation may provide a degree of control sufficient to allow the donor to achieve her goals. See Appendix A for a comparison of control by type of entity. This broadest latitude is the reason that private foundations are recognized as the free agents of the charitable world: They are not answerable to large public memberships or required continuously to raise funds, as are most public charities, including community foundations. They enable the donor to refer grant seekers to her foundation, where their proposals can be evaluated against the

5. Telephone conversation with Ron Williams, IRS Employee Plans and Exempt Organizations Division, July 7, 1999.

donor's charitable goals. They can provide anonymity in giving and a shield from nonprofit bulk mail.⁶

But the features that make a private foundation so attractive are also present in a donor-advised fund in somewhat diluted form. Specifically, the donor may make non-binding grant recommendations for charitable grant making but is (or should be) relieved of administrative and investment authority (and burdens). Thus, for many donors, the donor-advised fund represents the best of both worlds.

The first major advantage of a gift to a donor-advised fund over a gift to a private foundation is that federal tax law does not subject donor-advised funds to the private-foundation excise-tax system discussed below.

The second major advantage is that a gift to a donor-advised fund is a gift to a public charity. Therefore, it is subject to the more favorable public charity percentage and other limitations, which do not apply to gifts to most private foundations.⁷

In summary, the donor-advised fund has been called “the poor man’s private foundation.”⁸ This phrase is correct to the extent that a donor-advised fund can be

6. Legal aspects of private foundations are discussed in greater detail in Sections III and IV below.

7. Section 170. All section citations unless otherwise noted, are to the Internal Revenue Code of 1986, as amended (the “Code”).

8. Andrew Tobias, “Sort-Of Rich Guy Admits to Serial Philanthropy,” *N.Y. Times* Dec. 9, 1997 at 9, col. 1.

operated with much smaller donations than would be recommended for a private foundation (or a supporting organization). Despite that smaller donation, the donor acquires some (but not all) of the control associated with private foundation grant making for much less administrative cost and hassle.

II. COMPARISON OF CONTRIBUTIONS

There are three income-tax differences for the living donor who gives to an organization classified as a private foundation rather than as a public charity: treatment of gifts of cash, treatment of gifts of appreciated property, and valuation of gifts of appreciated property.⁹

First, an individual who donates cash generally is limited to deducting as a charitable contribution in any year an amount equal to no more than 50% of the donor's adjusted gross income. This 50% limitation applies to cash gifts to public charities (including the supporting organization and typical donor-advised fund) and to three types of special private foundations.¹⁰ Cash gifts to the main types of private foundations (namely, the usual endowed or family foundation) can be deducted up to 30%.

9. The estate tax rules do not contain the same limitations.

10. They are the private operating foundation, the flow-through foundation, and the pooled common fund. Section 170(b)(1)(E)(i), (ii), and (iii).

Second, the deduction limitations on gifts of appreciated property are 30% of adjusted gross income for gifts to public charities and to the three types of private foundations identified above, but 20% for gifts to main types of private foundations. If in any year the donor exceeds either of these limitations, the excess can be carried forward for the next five years.

Third, in addition to the percentage limitations for gifts of appreciated property, gifts of appreciated property to a private foundation are generally deductible only at basis, not at fair market value.¹¹

It is important to note that Congress has finally made permanent Code section 170(e)(5), which was first enacted in 1984. In general, this provision permits donors to deduct the full fair market value (up to their maximum percentage limitations) of gifts to a private foundation of qualified appreciated stock, which is stock

- for which market quotations are available on an established securities market,
- which is capital gain property in the donor's hands, and
- in a company of which the donor and her family will have contributed less than 10% in value, counting prior contributions.

11. Section 170(e)(1)(B)(i), although three types of foundations listed in the previous footnote qualify for the more favorable limits applicable to public charities. *Id.*

This rule which has repeatedly expired and been reinstated,¹² now finally permits the donor to a private foundation to claim a deduction in an amount equal to the fair market value of qualified appreciated stock. But this limitation does not apply to gifts of appreciated property other than qualified appreciated stock to public charities, a category which includes the donor-advised fund and the supporting organization. Therefore, in weighing the alternatives to the private foundation, the donor-advised fund—with its relative administrative ease, lower costs, and equal-or-higher deductibility limitations—and the supporting organization are attractive alternatives to a private foundation, especially if the donor has appreciated property other than publicly-traded stock to contribute.

III. WHAT IS A PRIVATE FOUNDATION?

By tax-law definition, a private foundation is a religious, charitable, etc. domestic or foreign organization that is *NOT* a public charity.¹³ Having been created as a legal negative construction contributes to a private foundation's cachet: The organizations carved out as public charities all have higher responsibilities to persons other than a single donor, whether those persons are the constituents who pay for the organization's services or who contribute to the organization in great

12. Monica Langley, "All in the Family: A Tax Break Prompts Millionaires' Mad Dash to Create Foundations – Private Charities Let Them Keep Control of Money and Get Full Deductions – A Wrinkle: It's Over in May," *The Wall St. J.*, Monday, Jan. 27, 1997, at A1. The extension was made permanent on October 22, 1998 by enactment of the Omnibus Consolidated and Emergency Supplemental Appropriations Act.

13. Section 509(a).

enough numbers and even enough amounts to be able to satisfy mechanical or facts and circumstances public support tests¹⁴ or whether those persons are representatives of such publicly supported organizations.¹⁵ Those organizations that are left are the private foundations.

Confusion exists about what it means for an organization to be a foundation. As a practical matter, any not-for-profit organization, even a public charity, may use the word “foundation” in its name. Federal tax law, however, classifies as “private foundations” only those organizations that typically have three features:

- a single major source of funding—usually gifts from one family or corporation, rather than funding from the general public,
- a grant-making program instead of direct operation of charitable programs, and
- payment of grants and administrative expenses from the organization’s endowment income rather than from the proceeds of a fund-raising program.

If an organization intends to have many sources of funding and an on-going fund-raising program, it should consider seeking classification as a public charity rather than a private foundation. If an organization intends to support one or

14. Section 501(a)(1) and (2).

15. Section 509(a)(3).

more identified public charities, it should consider seeking classification as a supporting organization.¹⁶ If a donor wants to conduct grant making from an endowment but does not want to run her own organization, she should consider a donor-advised fund. If a donor wants to control grant making and investments, and plans to contribute assets in an amount sufficient to justify the operating costs of a stand-alone organization, the donor should form a private foundation.

In practice, private foundations generally fall into five categories:

1. *Endowed private foundations.* This is the most familiar type of private foundation and is usually funded by an individual or a family. Examples include the Charles Stewart Mott Foundation and the William Randolph Hearst Foundation. Endowed foundations may build up their endowments through quality investments and annually expend only the minimum distributable amount in a variety of grant programs. Some endowed foundations are dedicated to particular areas of interest that may change from time to time, such as homelessness or pre-school education. Family members or business colleagues may serve as directors and officers and participation may be intergenerational.

16. Details of the rules governing operations of public charities, community foundations and supporting organizations are beyond the scope of this paper. For further information about these options, *see* publications, especially *First Steps in Starting a Foundation*, by John Edie, produced by the Council on Foundations, 1828 L Street NW, Washington, DC 20036, or call (202) 466-6512 for a list of publications. The list below of categories of foundations was adapted from Edie's *First Steps*.

2. *Unendowed private foundations.* This type of foundation has little or no endowment and usually receives its funding annually from its founder. It is sometimes used as a vehicle for extending the donor's giving season over a period of a few months or for other timing reasons. Many corporate foundations are unendowed private foundations.

3. *Pass-through or "conduit" foundations.* This type of foundation is a short-term holding tank for certain charitable contributions. The donor's contribution must be passed-through within two and one-half months after the close of the year in which the contribution was made. A donor to a pass-through foundation is entitled to the more advantageous deduction limitations. A pass-through foundation is sometimes used by executives who wish to contribute low-basis assets likely to realize rapid appreciation, such as closely held stock in a company that may go public.¹⁷

17. For a fuller discussion of pass-through foundations, see V. Bjorklund, "Current Developments Affecting Private Foundations," Proceedings of NYU's *Twenty-Third Conference on Tax Planning for 501(c)(3) Organizations* (Matthew Bender, 1995); Paul Feinberg, "Creative Uses of Flow-Through Foundations," 12 *E.O.T.R.* 972 and 984 (November 1995); and Martin E. Grief, "Charitable Contributions of Stock to Private Foundations – Window of Opportunity Exists," 12 *E.O.T.R.* 1215 (Dec. 1995).

Donors of rapidly-appreciating assets should use caution in the timing of their contributions, however: Under the "anticipatory assignment of income" doctrine, they may recognize gain on the assets if their right to receive income ripens before their gift is completed. The Ninth Circuit recently affirmed a Tax Court decision that donors could be taxed on the gain in appreciated stock that was transferred to various charities because the donors' right to receive cash via an ongoing tender offer or pending merger agreement had ripened before the date of the transfer. *Ferguson v. Commissioner*, 174 F.3d 997 (9th Cir. 1999), *aff'g* 108 T.C. 244 (1997).

4. *Pooled common funds.* The donor and the donor's spouse may retain the right annually to designate the recipients of income earned from the donor's prior contributions. The recipients must be public charities. At the end of the donor's or surviving spouse's life the corpus goes to a charity that they have designated. An example is The Boston Community Fund. A donor to a pooled common fund is entitled to the more advantageous deduction limitations.

5. *Operating foundations.* A private operating foundation is a private foundation that behaves like a public charity in that it runs its own charitable activities (*e.g.*, a museum, library, or historic building) instead of making grants for charitable activities conducted by other organizations. Examples are the Isabella Stewart Gardner Museum in Boston and the de Menil collection in Houston. George Soros's Open Society Institute is a private operating foundation with a multiplicity of charitable and educational programs. A private operating foundation's donors are entitled to the more advantageous deduction limitations.

IV. THE PRIVATE FOUNDATION EXCISE TAXES

Except for the 2% tax on net investment income, the private foundation excise taxes discussed below are avoidable. Nevertheless, they cannot be ignored because they set the boundaries for all foundation operations. And, if incurred, these

penalty taxes can be substantial and can be imposed on both the foundation and its managers.

The donor generally will be deemed to be a substantial contributor to the foundation. Therefore, the donor's dealings with the foundation will come under special scrutiny, as will those of other "disqualified persons." In the case of a donor who is an individual, disqualified persons include the donor's relatives (except siblings) and any corporation, trust, or partnership in which the donor directly or indirectly owns more than a 35% interest.

Benefits to the donor or to any other disqualified person that are more than incidental and tenuous can trigger excise taxes. A benefit that the Internal Revenue Service ("IRS") has held to be more than incidental and tenuous is displaying a foundation's art collection in the donor's home. Similarly, a foundation cannot buy, sell, or lease anything from a disqualified person without penalty. If a disqualified person directly or indirectly leases office space to the foundation, the space must be leased rent-free, or else both the disqualified person and the foundation can be subject to excise taxes. Naming the foundation after the donor is permissible, however, and does not trigger excise taxes.

The specific excise taxes are:

1. *Excise tax on investment income.*¹⁸ A private foundation is subject to a 2% tax on its net investment income. This is the only excise tax that is not avoidable. If the foundation donates a sufficient amount to qualified charities in a given year, it may be entitled to a rate reduction to 1% for that year.

2. *Excise tax on self-dealing.*¹⁹ Subject to certain exceptions, a private foundation cannot engage in any prohibited transactions with disqualified persons. Prohibited transactions include, but are not limited to, selling or leasing the foundation's property, loaning assets, and furnishing goods, services, or use of the foundation's facilities. For recent roadmaps on some of the unexpected aspects of direct and indirect self dealing, see PLR 9312022 (December 28, 1992) and PLR 9325061 (April 1, 1993). This is probably the most important Chapter 42 excise tax. It is the provision that prevents the influential persons in control of a private foundation from taking unfair advantage of the organization or its assets. It is the provision upon which new Code Section 4858, intermediate sanctions on public charities, is modelled.

18. Section 4940.

19. Section 4941.

3. *Excise tax on failure to distribute income.*²⁰ Within 12 months after the end of each fiscal year, a private foundation must make qualifying distributions in an amount equal to or greater than 5% of the aggregate fair market value of the foundation's assets that are not used directly to carry out the foundation's exempt purposes.
4. *Excise tax on excess business holdings.*²¹ A private foundation may own the stock and securities of a corporation only up to a permitted level, which is generally 20% of the corporation's voting stock less the amount of voting stock owned by the foundation's officers, directors, trustees, or substantial contributors. Similar rules apply to ownership of other business interests.
5. *Excise tax on jeopardy investments.*²² A private foundation cannot invest its funds in ways that could jeopardize the foundation's ability to carry out its charitable purposes.
6. *Excise tax on taxable expenditures.*²³ A private foundation cannot make taxable expenditures, which include payments for political campaigns

20. Section 4942.

21. Section 4943.

22. Section 4944.

23. Section 4945. It specifies a "generic affidavit" procedure intended to encourage grant making to non-United States organizations that could otherwise qualify for exemption as public charities within the meaning of section 509(a).

and lobbying, and certain grants to individuals. In addition, while a private foundation may make qualifying distributions to another private foundation or even to a for-profit entity, the distributing foundation will have to monitor the grant to avoid a penalty. If the private foundation intends to make certain grants to individuals (*e.g.*, scholarships, travel stipends, writing allowances), advance written approval of the selection procedures must be obtained from the IRS or the grants will be subject to tax. Grants to foreign charities are also governed by this section. On April 27, 1999, The Council on Foundations issued through its counsel, Caplin & Drysdale, a discussion draft proposal to simplify grant making abroad. These changes are warranted and should be supported both by foundations and by the public charities they support.

Foundation managers would be well advised to obtain and review the most recent version of IRS Publication 578, *Tax Information for Private Foundations and Foundation Managers*, for a discussion of the excise taxes as well as to consult their own tax advisors and the Code, regulations, and applicable rulings as to particular matters.²⁴

24. For practical and easy-to-understand explanations of the private foundation rules in operation, see John A. Edie, *Family Foundations and the Law: What You Need to Know* (Washington, D.C.: The Council on Foundations, 1995). For information on compensation, see *1997 Grantmakers Salary Survey and 1997 Management Report* (Washington, D.C.: Council on Foundations, 1998).

Private foundations will be subject to new public inspection requirements that have been enacted, but which are not yet effective, for public charities and all other tax-exempt organizations that file annual information returns. In summary, a private foundation will be required to make available for inspection its annual information return (IRS Form 990-PF) for any of the three most recent taxable years and its application for recognition of exemption (IRS Form 1023) and related correspondence (if it had its Form 1023 on July 15, 1987, and for all private foundations that filed after that date). These materials must be made available at a foundation's principal office and any regional or district office having three or more employees. In addition, a private foundation will be required to provide copies, upon request, of these materials. If the request for copies is made in person, a private foundation will have to provide the copies immediately; if the request is made in writing, a private foundation will have thirty days to comply. In either case, a private foundation may charge only a reasonable fee for reproduction and mailing costs. The proposed regulations would allow a private foundation to charge \$1.00 for the first page and \$.15 for each subsequent page plus actual postage, although these amounts may change when final regulations are published.

A private foundation will be relieved of these public inspection and copying requirements if, in accordance with regulations to be issued by the Secretary of the Treasury, it has made the requested documents "widely available," or the Secretary of the Treasury has determined, upon the organization's application, that it was

subject to a harassment campaign such that a waiver of the obligation to provide copies would be in the public interest. One way to make these documents widely available will be by posting them on the foundation's World Wide Web page on the Internet. Other methods are likely to be included in the final regulations, when published. It is not clear at this time whether a foundation's return being available at the Foundation Center libraries will satisfy part of the "widely available" test.

When complying with a request for inspection of materials, a private foundation is required to disclose the name of every substantial contributor. (This is noteworthy because public charities are not required to disclose the names of their contributors.) Also, private foundations will no longer be subject to the special publication requirements of section 6104(d). This provision requires that a private foundation publish a notice, in a newspaper having general circulation in the county where the foundation's principal office is located, stating that its annual information return is available for public inspection upon request and providing certain contact information.

These provisions will apply to requests made after the date that is 60 days after the Treasury Department issues final regulations for private foundations defining when requested documents have been made widely available or when a request is part of a harassment campaign. Final regulations for public charities are effective June 8, 1999. Proposed regulations with regard to private foundations were published on August 9, 1999.

V. WHAT IS A SUPPORTING ORGANIZATION?

A supporting organization is the third subcategory of public charity and therefore not a private foundation. Unlike the first two categories of public charity, however, a supporting organization is only indirectly “public.” That is, the public constituency that monitors a supporting organization’s operations does so through the filter of an intervening public charity. It is to that public charity or charities that the supporting organization must respond regarding organization, operation and on-going relationship with the supported public charity or charities.

While the supporting organization is attractive because it is a public charity, it is less attractive to a control-minded donor: By definition, a supporting organization must give a donor less control over the organization’s assets—both investment and expenditure—than would be the case with a private foundation. Some donors combine the investment advantages of a supporting organization with the grant-making convenience of a donor-advised fund by creating supporting organizations to a donor-advised fund.²⁵ In addition, the supporting organization has

25. See Rochelle Korman and William F. Gaske, “Supporting Organizations to Community Foundations: A Little-Used Alternative to Private Foundations,” 10 *E.O.T.R.* 1327 (Dec. 1994). It is also possible to make payments from a charitable lead trust to a donor-advised fund. See PLR 9604031 (Nov. 5, 1995) and PLR 8146072 (undated). Professor Chris Hoyt has also reminded me that the IRS has permitted an individual to “disclaim” an inheritance to a donor-advised fund that the disclaiming individual would advise, whereas the same result would not apply to a disclaimer to a private foundation. See PLR 9532027 (May 12, 1995) and PLR 9635011 (May 23, 1996). Email from Professor Hoyt (Aug. 19, 1999).

fairly cumbersome organizational and operational rules that some donors find as or more onerous than those applicable to private foundations.

In narrative summary, a supporting organization is organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more public charities; is operated, supervised or controlled by or in connection with one or more public charities; and is not controlled directly or indirectly by any disqualified person.²⁶ Note that the removal of control dominates every part of this definition.

The IRS will find that a supporting organization is organized exclusively for the purposes of the benefitted public charity(ies) only if its certificate of incorporation or articles:

- (1) limit the supporting organization's purposes to the purposes of one or more benefitted public charities (which, as a practical matter, can curtail the donor's future philanthropic activities),
- (2) do not expressly empower the supporting organization to engage in activities that do not further the purposes of the benefitted public charity(ies) (which confirms that the donor is to be given no special latitude if she errs in choosing beneficiaries whose purposes may someday be narrower or different from her then-goals),

- (3) identify the public charities to be benefitted (although this designation may not have to be in the incorporation papers, it must be answered to the satisfaction of the IRS), and
- (4) do not authorize the supporting organization to benefit any other public or private charities.

The IRS will find that a supporting organization is operated exclusively for the benefitted public charities only if it engages solely in activities that benefit the public charity(ties) by making payments to or for the use of or by providing services or facilities for members of the charitable class benefitted by the supported organizations.

The IRS will find that a supporting organization is not controlled by a disqualified person so long as the disqualified persons²⁷ have less than 50% of the voting power of the board or other controlling body AND do not have the ability to veto any action.²⁸ Compared with a private foundation, the donor and her family have much less capacity to govern the organization than they would with a private foundation. Further, the attribution rules applicable to disqualified persons guarantee that a donor can involve only a limited number of relatives, including chil

26. Section 509(a)(3)(A),(B) and (C).

27. Determined by reference to section 4946 and not including foundation managers and publicly supported organizations.

28. Treas. Reg. § 1.509(a)-4(b)-(i).

dren and grandchildren, and must look more to sharing power with persons outside close family and business ties.²⁹

The IRS will find that a supporting organization is qualified only if it can demonstrate one of three types of relationships with benefitted public charities:

- (1) the Type 1 supporting organization is “operated, supervised, or controlled by” one or more benefitted public charities, which the regulations liken to a “parent-subsidiary” relationship,³⁰
- (2) the Type 2 supporting organization is “supervised or controlled in connection with” the benefitted public charity(ies), like brother-sister corporations,³¹ or
- (3) the Type 3 supporting organization is “operated in connection with” the benefitted public charity(ies).³²

The chart at Appendix B summarizes these Treasury Regulations applicable to supporting organizations.

29. Regarding attribution, *see* section 4946(a)(1) and the regulations promulgated thereunder. *See also* rulings and cases regarding effective control by a donor causing the failure of supporting-organization classification with default reclassification as a private foundation.

30. Treas. Reg. § 1.509(a)-4(g)(1).

31. Treas. Reg. § 1.509(a)-4(h)(1).

32. Treas. Reg. § 1.509(a)-4(i).

Donors comparing a supporting organization to a private foundation will likely consider the “operated in connection with” option the best supporting-organization alternative because it requires the least supervision of the three by the benefitted public charity(ies). In exchange for that relative independence, however, this type of supporting organization must still demonstrate to the IRS its connection to an existing public charity by satisfying a responsiveness test and an integral-part test. It is these two tests that clarify the supporting organization’s difference from a private foundation.

To satisfy the responsiveness test, the supporting organization must show the IRS how it is responsive to the needs and demands of the benefitted public charity(ies). If the supporting organization is a trust, the responsiveness test will be satisfied if the supported organization is a named beneficiary of the trust and has enforcement powers as to the trust under state law. If the supporting organization is a corporation or association, it must authorize officials of the benefitted public charity(ies) to have a significant role in governing the supporting organization’s investment policies, the timing and terms of grants, the selection of recipients and other decisions concerning income or assets.

To satisfy the integral-part test, the supporting organization must maintain a significant involvement in the operation of the benefitted public charity(ies) and the

supported organization must be dependent on the supporting organization.³³ This requires additional proof as to the intent of the supported organization to carry on a particular program “but for” the supporting organization’s willingness to pay for it or that the supporting organization pays over at least 85% of its income to or for the use of the supported organization so long as that amount is sufficient to ensure the supported organization’s attentiveness to the operations of the supporting organization.³⁴

Personal and anecdotal experience suggest that organizing and operating a supporting organization is no less complicated than organizing and operating a private foundation. This is true for three reasons. First, the supporting organization rules are less familiar to most people than the private foundation rules. As the chart at Appendix A also shows, the applicable regulations are detailed and nuanced. Thus, for example, it is not uncommon for major public charities to have policies (if they have thought about it at all) against permitting any of their officers to serve on the governing board of a supporting-organization. If discovered too late, such a refusal could destroy qualification, thereby causing the would-be supporting organization to be classified by the IRS as a private foundation anyhow.

33. See, e.g., *Windsor Foundation* (77-1 USTC ¶ 9709), where the organization was classified as a private foundation instead of a supporting organization because it failed the integral-part test since the supported organizations had no interconnection with the foundation and it failed the responsiveness test because the supported organizations had no voice in investments.

34. For a fuller discussion of the rules governing supporting organizations, see Virginia Sikes, “Supporting Organizations Have Advantages of Private Foundations, but Fewer Headaches,” 4. *J. of Tax Exempt Orgs.* 20-23 (November/December 1992).

Second, the donor may find the supporting organization rules unduly restrictive if the donor truly desires control. Therefore, the supporting organization option may be most practical where a donor has (i) a particular public-charity beneficiary in mind and that public charity is motivated to cooperate, (ii) a group of friends suitable to be directors without violating the control rules, and (iii) sufficient assets to make a stand-alone entity worthwhile. Third, even well-intentioned and well-advised donors may not be able to articulate the “control” differences between a private foundation and a supporting organization.³⁵ Therefore, competent legal advice from a lawyer who knows supporting organizations is important, as the consequence for making a mistake is private-foundation classification.

VI. WHAT IS A MEDICAL RESEARCH ORGANIZATION?

A little-known Code provision³⁶ authorizes creation of a hybrid entity known as a medical research organization. In summary, a contribution to this type of organization generally will be treated as favorably as a gift to a public charity even where the donor retains a degree of control comparable to that exercisable over a private foundation. Where a donor is otherwise interested in medical research and that research can be conducted continuously, actively, and “in conjunction with” a not-for-profit or government hospital, this hybrid can provide an at

35. See, e.g., Monica Langley, “Gimme Shelter: The SO Trend: How to Succeed in Charity Without Really Giving – A ‘Supporting Organization’ Lets the Wealthy Donate Assets, Still Keep Control – Carl Icahn’s School Project,” *The Wall St. J.*, May 29, 1998 at A1.

36. Section 170(b)(1)(A)(iii) and Treas. Reg. § 170A-9(c)(2).

tractive alternative to a private foundation, supporting organization or a donor-advised fund.³⁷

VII. WHAT IS A COMMUNITY FOUNDATION?

Despite the word “foundation” in its name, a community foundation is classified as a public charity, rather than a private foundation, for federal income tax purposes. This is because, by aggregating its component funds (if separate trusts) and carrying on a fund-raising program through banks, lawyers and other professionals, a community foundation can satisfy the mechanical public support test.³⁸ This ability to aggregate multiple trusts and funds rather than treat those “component funds” as separate private foundations³⁹ is a distinguishing feature of community foundations. Most new community foundations, however, are formed as corporations which manage segregated accounts, rather than as separate trusts subject to the component-part tests. The component-part rules are not coherent when applied to corporations with segregated accounting entries rather than component entities. Nonetheless, many corporate community foundations have voluntarily adopted the rules applicable to community foundations in trust form.

37. For a detailed discussion of a medical research organization, *see* Marvin Goodson, “Private Medical Research Organizations: Long-Term Research Funding Source for Non-Profit Hospitals,” 20 *Tax Management Estates, Gifts and Trusts Journal* 75 (March 9, 1995).

38. Section 509(a)(1) and section 170(b)(1)(A)(vi) and the applicable regulations. Community foundations have a modified “facts and circumstances” test in Treas. Reg. § 1.170A-9(e)(10).

39. Treas. Reg. § 1.170A-9(e)(11)(ii).

Community foundations may be the fastest-growing subset of the U.S. philanthropic sector, thanks in large part to their donor-advised fund accounts for which the Fidelity Charitable Gift Fund's advertising campaigns can take part of the credit. In 1995, there were more than 500 community foundations in the United States, up from approximately 400 in 1992.⁴⁰

The first community foundation was created in 1914 by Cleveland lawyer and banker Frederic H. Goff, who created The Cleveland Community Foundation. Goff intended the community foundation to do good locally by awarding grants from charitable trust funds to local organizations. Goff was also concerned about the problem of obsolescence of charitable trusts, that is the inability of a trust to function as a grantmaker because its stated charitable purpose has become obsolete or impossible to carry out. Such trusts did no good on behalf of the donor or for the community. Therefore, the model community foundation trust instruments included a so-called "variance power" to enable the community fund trustees to use the fund for other purposes as close as possible to the donor's original purpose in the event that such a purpose became obsolete with the passage of time.

40. Cynthia Jones Eiseman, "Value Added: Donor-Advised Funds at Community Foundations," *Trusts & Estates* 16 (March 1997); Council on Foundations, *Building Successful Community Foundations* (1992).

The variance power would avoid the need to go to court for a costly *cy-pres* proceeding.⁴¹ The Boston Foundation was created as “The Permanent Charity Fund of Boston” in 1914 and The New York Community Trust was formed in 1923.

A distinguishing characteristic of a community foundation is its separation of the investment function from the disbursement function. According to one commentator, this separation of functions allows each side to do what it does best: The trustee banks do best at making investments and the management committees do best at making grants that address the needs of the particular community. For example, The New York Community Trust currently has seventeen banks acting as its trustees and a large program staff and committee acting as its grantmakers. Community foundations may do more than make grants: they may act as facilitators of charitable know-how in their communities, galvanize resources to respond to local problems, and incubate new charities to address local needs.⁴²

Many community foundations were created in the 1920s and 1930s on the multiple trust model.⁴³ Legal title to the assets of the multiple trusts is not in the community foundation’s name but with the trustees. Nonetheless, the community

41. *Id.* at 16. For a fascinating new decision invalidating use of the variance power by the New York Community Trust, *see* In the Matter of Application of the Community Service Society of New York to compel...Members of the Distribution Committee Trust...to Make and Settle an Intermediate Account (Oct. 15, 1999, Surrogate Preminger).

42. Christopher R. Hoyt, *Legal Compendium for Community Foundations* (Washington, D.C.: Council on Foundations, 1996) at 4. This book is a “must-have” for any lawyer planning to form or work with a community foundation.

43. Hoyt at 3.

foundation does not have to file a separate information return for each component fund. Instead, a single return is filed aggregating information for all the component funds.⁴⁴ Newer organizations may be organized as corporations with commingled common funds, but which retain the variance power and use the traditional grant-making instruction categories: unrestricted funds, designated funds (*e.g.*, for the benefit of a particular named charity), field-of-interest funds (*e.g.*, to promote libraries in public schools) and donor-advised funds. Some organizations, such as the New York Community Trust, also have a corporate affiliate that manages donor-advised funds as segregated accounts.

The first donor-advised fund is reported to have been created at the New York Community Trust around 1931. Others report the concept's creation as the result of a practical need:

In July 1924, when Ralph Hayes founded the New York Community Trust, the consent of advised funds was introduced mostly to reduce Mr. Hayes' workload. Hayes was the volunteer president with minimal staff. No one had the time to determine philanthropic needs carefully as is now done by paid executive directors and professional staff. Hayes depended on his donors to suggest worthy recipients. Thus the donors provided the workforce.⁴⁵

44. This capacity is authorized in Treas. Reg. § 1.170A-9(e)(14)(i) (last sentence).

45. E. Beckwith; D. Marshall; J. Edie; and R. Edgar, *Establishing an Advised Fund Program*

This history is noteworthy in the face of current criticism that donor-advisors are somehow less competent than professional staff.⁴⁶ Even though the donor-advised fund existed before the 1974 regulations, the regulations do not directly prescribe requirements for launching an advised-fund program. While community foundations have been the traditional home of the donor-advised fund, there have long been donor-advised funds at other public charities, e.g., the Jewish Communal Fund, which was formed in 1972.

A. Summary of Treasury Regulations I – The Component-Part Rules.

As mentioned above, many older community foundations were formed under the “component-fund” rules as aggregations of multiple trusts. These rules are found in the regulations governing qualification as a “community trust,” which also apply to aggregations of nonprofit corporations or unincorporated associations.⁴⁷ As noted above, many newer community foundations which are formed as single corporations that manage segregated donor accounts choose voluntarily to comply with these rules. Following is a summary of the section 1.170A regulations governing organizations seeking component-part treatment:

(Washington, D.C. Council on Foundations, 1992) at 20.

46. See, e.g., Steven L. Katz, “Piñata Philanthropy; The IRS Must Reexamine Charitable Gift Funds in the Marketplace,” *Foundation News & Commentary*, September/October 1998 at 24 (“accountability [is] found in traditional grantmaking, including the availability of research and staff to evaluate potential grantees....”).
47. Treas. Reg. § 1.170A-9(e)(11)(i). This structure is distinguishable from an organization structured as a corporation which manages aggregations of accounts, each of which exists solely as an entry in the corporation’s books, not as a separate entity. See also Hoyt at 20.

1. To qualify as a public charity, a community trust is required to meet one of two public support tests: the 33-1/3 percent of support test⁴⁸ or the facts and circumstances test.⁴⁹ A community trust can satisfy the second test by seeking gifts from a wide range of potential donors through banks, trust companies, or attorneys, or in other ways which call attention to the community trust as a potential recipient of gifts made for the community's benefit. It is not required to engage in "community-wide . . . campaigns directed toward attracting a large number of small contributions."⁵⁰

2. "The organization must be commonly known as a community trust, fund, foundation or other similar name conveying the concept of a capital or endowment fund to support charitable activities . . . in the community or area it serves."⁵¹

48. Treas. Reg. § 1.170A-9(e)(2).

49. Treas. Reg. § 1.170A-9(e)(3).

50. Treas. Reg. § 1.170A-9(e)(10). Note: It is not clear whether an organization operating as a community foundation, but not seeking component-fund treatment, may take advantage of this modified facts and circumstances test.

51. Treas. Reg. § 1.170A-9(e)(11)(iii).

3. All funds of the organization must be subject to a common governing instrument, and the organization must have a common governing body or distribution committee.⁵²
4. The governing body must possess and be committed to exercising the following powers:
 - (A) To modify any restriction or condition on the distribution of funds if, in the governing body's sole judgment, such restriction or condition becomes unnecessary, incapable of fulfillment, or inconsistent with the community's charitable needs;
 - (B) To replace a trustee, custodian, or agent for breach of fiduciary duty; and
 - (C) To replace a trustee, custodian or agent for failure to produce a reasonable return of net income.⁵³
5. The governing body must take steps to see that each component trust or fund is administered in accordance with the terms of its governing instruments and accepted standards of fiduciary conduct to produce a rea

52. Treas. Reg. § 1.170A-9(e)(11)(iv), (v)(A).

53. Treas. Reg. § 1.170A-9(e)(11)(v)(B), (E).

sonable return of net income, with due regard to safety of principal, in furtherance of the community trust's exempt purposes.⁵⁴

6. The organization must prepare periodic common financial reports, treating all funds as funds of the organization.⁵⁵

If an organization meets the requirements outlined above, it will be treated as a single entity, rather than as an aggregation of separate funds. A trust or fund which meets the following requirements will be treated as a "component part" of the single entity:

- (A) It must be created by a gift, bequest, legacy, devise or other transfer to an organization treated as a single entity; and
- (B) It may not be directly subjected by the transferor to any material restriction or condition (within the meaning of Treas. Reg. § 1.507-2(a)(8)) with respect to the transferred assets.⁵⁶

If the component-part requirements are not met, the failed component part will be treated as a separate trust, corporation or association, and would likely be

54. Treas. Reg. § 1.170A-9(e)(11)(v)(F).

55. Treas. Reg. § 1.170A-9(e)(11)(vi).

56. Treas. Reg. § 1.170A-9(e)(11)(i). *See* discussion below of the material-restriction regulations.

treated as a private foundation because, standing alone, it would fail the public-support test.⁵⁷

B. Summary of Treasury Regulations II – The Private Foundation Termination Rules.

Transfers of assets to the entities that comprise the component parts of a community trust are governed by the “material-restriction” regulations. Originally drafted to govern the termination of private foundations, the standards outlined in these regulations have traditionally been applied to donor-advised funds (whether or not affiliated with a community foundation). There has, however, been controversy over whether and to what the extent these rules apply to donor-advised funds which are in corporate form or not seeking “component-fund” treatment under the component-part regulations discussed above. Note that the rules also address behavior of the donor and whether the donor has made a completed gift. A summary of the material-restriction regulations follows:

1. To transfer “all right, title and interest” in an asset, the donor “may not impose any material restriction or condition that prevents the transferee organization ... from freely and effectively employing the transferred assets, or the income derived therefrom, in furtherance of its exempt pur

57. Treas. Reg. § 1.170A-9(e)(14).

poses.” Whether a particular restriction is “material” is determined from the facts and circumstances.⁵⁸

2. Four Factors Test. Some of the more significant facts and circumstances are:

(A) Whether the transferee public charity (for purposes of this summary the “PC”) is the fee owner of the assets received;

(B) Whether the assets are held and administered by the PC in a manner consistent with one or more of its exempt purposes;

(C) Whether the governing body of the PC has the ultimate authority and control over the assets and the income derived from them; and

(D) Whether the governing body of the PC is independent from the donor.⁵⁹

3. Non-Adverse Factors. Some or all of the following factors may be present without preventing the PC from freely and effectively employing the assets or income:

(A) A fund is given the name of the donor or donor’s family.

58. Treas. Reg. § 1.507-2(a)(8).

59. Treas. Reg. § 1.507-2(a)(8)(i)(A)-(D).

- (B) The income and assets are to be used for a designated purpose or for one or more PCs and such use is consistent with the transferee PC's own exempt purposes.
- (C) The transferred assets are administered in an identifiable or separate fund, some or all of the principal of which is not to be distributed for a specified period, if the PC is the legal and equitable owner of the fund and its governing body exercises ultimate and direct authority and control over such fund, as, for example, to endow a chair at a university or a medical research fund at a hospital. In the case of a community trust, the transferred assets must be administered in or as a component part of the community trust within the meaning of § 1.170A-9(e)(11), discussed above.
- (D) If the donor restricts disposition by the transferee PC, the asset retention must be important to the achievement of charitable purposes in the community because of the peculiar features of the property, as, for example, where a donor transfers a woodland preserve which is to be maintained by the PC as an arboretum for the benefit of the community. "Such a restriction does not include a restriction on the disposition of an investment asset or the distribution of income."⁶⁰

60. Treas. Reg. § 1.507-2(a)(8)(iii)(A)-(D).

4. The Adverse Factors. The Treasury regulations recite that the presence of any of the following seven factors (as well as subparagraph A's nine subfactors) will be considered as preventing the PC from freely and effectively employing the assets and income:

(A) Distributions—The donor reserves the right, directly or indirectly to name the persons to which the PC must distribute, or to direct the timing of such distributions.⁶¹

In a facts and circumstances review, the IRS will determine if a right was indirectly reserved: “In any such case, the reservation of such a right will be considered to exist where the only criterion considered by the PC in making a distribution on income or principal from a donor’s fund is advice offered by the donor.”

The following five subfactors (some or all) indicate that a right is NOT reserved:

(i) an independent investigation by the PC’s staff evaluated whether the donor’s advice is consistent with specific charitable needs most deserving of support (as determined by the PC);

61. An exception exists for designations as to persons or timing contained in the instrument of transfer to the PC. Treas. Reg. § 1.507-2(a)(8)(iv)(A)(1).

(ii) the PC has promulgated guidelines enumerating specific charitable needs consistent with the PC's charitable purpose and the donor's advice is consistent with those guidelines;

(iii) the PC has an educational program telling about the guidelines;

(iv) the PC distributes funds in excess of amounts distributed from the donor's fund to the same or similar types of organizations as the donor recommends; and

(v) the PC's written or oral solicitations specifically state that the PC will not be bound by the donor's advice.⁶²

The following four subfactors (some or all) indicate that the reservation of a right by donor DOES exist:

(vi) the written or oral solicitations state or imply, or a pattern of conduct by the PC creates the expectation, that the donor's advice will be followed;

(vii) the advice of a donor is limited to amounts from the donor's fund and the independent investigation or guidelines discussed above do not exist;

(viii) only the advice of the donor as to distributions from the donor's fund is solicited by the PC and no procedure is provided for consid

ering advice of persons other than the donor as to the donor's fund;
and

(ix) for the taxable year in question and all prior taxable years the PC follows the advice of all donors substantially all the time.⁶³

(B) Other action or withholding of action. Through the terms of the transfer agreement or through some other understanding, the donor requires the PC to act or not act in a way that does not further its exempt purposes (and an excise tax would result if the act or withholding was done by a transferor private foundation);

(C) Assumption of leases, etc. The PC assumes leases, contractual obligations, or liabilities of the donor or takes the assets subject to such liabilities, for purposes not in the best interests of the PC.

(D) Retention of investment assets. The PC is required expressly or impliedly to retain any investment, except as required by law or regulatory authority; retention of assets with low annual returns of income will be examined carefully.

(E) Right of first refusal. Donor transfers the property subject to a right of first refusal to herself or her "disqualified persons."

62. Treas. Reg. § 1.507-2(a)(8)(iv)(A)(2)(i)-(v).

63. Treas. Reg. § 1.507-2(a)(8)(iv)(A)(3)(i)-(iv). To address this provision, The Columbus Foundation has a policy of requiring that one-third of the income from each donor-advised

(F) Irrevocable Relationships. An agreement is entered into between the donor and the donee that establishes irrevocable relationships with banks, brokerage firms, investment counselors or others (other than a trustee or custodian acting as such).

(G) Other conditions. Any other condition is imposed to prevent the PC from exercising ultimate control over the assets for purposes inconsistent with its exempt purposes.⁶⁴

VIII. WHAT IS A DONOR-ADVISED FUND?

Up to this point, I have been making references to donor-advised funds without providing a clear definition of the term. In a sense, this reflects the current status of donor-advised funds in the nonprofit community: There has yet to be a clear consensus on what a donor-advised fund is or should be, even among people who work with them on a daily basis.

One set of commentators has written, “Among the forms of gift vehicles available to the charitable gift planner, one of the least familiar is the donor-advised fund.”⁶⁵ There are many reasons for this lack of familiarity. First, there is no statute that defines what is or is not a donor-advised fund or how one qualifies for ex

fund account be expended at the recommendation of the Foundation’s staff and board without any involvement of the donor as to that portion.

64. Treas. Reg. 1.507-2(a)(8)(iv)(B)-(G).

65. *12 Charitable Gift Planning News*, 4 (March 1994).

emption or how one should be operated. Second, the term “donor-advised fund” is not to be found in the Treasury regulations. Third, the term “donor-advised fund” has been used in only five private letter rulings and one general counsel memorandum.⁶⁶ If not a creature of the tax law, then, what is a donor-advised fund in practice?

A donor-advised fund is one where the donor or her designees exercises the privilege of making nonbinding recommendations to the governing body suggesting which charitable entities⁶⁷ should receive grants from that particular fund. Clearly

66. They are: PLR 9807030 (Nov. 19, 1997, holding that assets transferred by a private foundation to a donor-advised fund will be considered a component part of a community trust); PLR 9532027 (property as effectively disclaimed into a donor-advised fund and the estate could claim a charitable contribution deduction under section 2055); PLR 9412039 (private foundation can establish a donor-advised fund for a director with different grant making interests from those of other directors, to be funded with proceeds from the sale of timberlands); Tech. Adv. Memo. 8936002 (May 24, 1989, finding that donor involvement in funds did not provide more than incidental benefit to the donors, fund administration was related to charity’s exempt purposes, and fees received for administration were not unrelated business taxable income); PLR 8836033 (June 14, 1988, private foundation can pay over all its assets into a donor-advised fund at a community foundation but stay in existence as a corporate entity for the sole purpose of making grant recommendations); Gen. Coun. Memo. 39748 (Aug. 3, 1988, finding that earmarked contributions and contributions to donor-advised funds could be counted in the public support test of a public charity so long as the public charity is not merely acting as the agent of the donor). Other rulings approve of donor-advised funds without using that term, including : PLR 9250041 (September 17, 1992, holding that the creation of an “Advise and Consult Fund” by a public charity, which is not required to follow the recommendation of donors as to the identity of possible distributees and the possible timing and amounts of distributions, will not adversely affect the sponsoring organization’s status as a public charity); PLR 7827015 (March 31, 1978, holding that a university can hold a donor’s contributions in a separate account or commingled with other funds and make distributions out of the fund to other organizations selected by a committee, taking into account “solely advisory” recommendations by the donor); PLR 7821096 (February 27, 1978, holding that a donor’s contributions to a fund similar to the one described in PLR 7827015 will be considered gifts “to” and not merely “for the use of” the university). None of these three rulings cites to either the component-fund or material-restriction regulations. *See also* PLR 8134046 (May 26, 1981) (Proposed recommendation to make grant from donor-advised fund to pooled common fund would cause the retroactive reclassification of the donor-advised fund as a private foundation.)

67. Grantee entities are almost always public charities or private operating foundations. This has

donor control is sacrificed in the donor-advised fund because the donor's recommendations can be advisory only and the right to advise is often limited by lifespans of the advisor(s). For that reason, a donor-advised fund is the term life insurance of charitable giving: naked grant making. Donors are attracted by the administrative ease of grant making, no need to collect and retain substantiation letters, and no need to prepare and/or file information returns, state reports, or other exemption applications or filings. Administrative costs are borne by all funds managed by the same administrator with the result that costs per advised-fund are usually significantly lower than for private foundations or supporting organizations. The boards of public charities offering donor-advised funds generally choose their own operating guidelines and fees.

It is also instructive to compare the donor-advised fund with its cousins, the pooled common fund and the Type 3 supporting organization. This is especially true because much of the current public debate about donor-advised funds asks whether funds should be classified as public charities or as private foundations based on two factors: (1) indices of control retained by the donor and (2) whether following a donor's advice should lessen deductibility. A number of individuals have indicated concern that commercially-initiated funds are more "donor di

not always been the case and the change is due largely to operating policies adopted voluntarily by most, but not all, donor-advised funds. The policy is appropriate because, if the advisees are private non-operating foundations, questions could be raised about the donor improperly circumventing charitable deduction and private foundation excise-tax provisions, e.g., by means of a private foundation grant advised back to the same private foundation that made a qualifying distribution to the advised fund.

rected” than donor-advised.⁶⁸ IRS officials have mused from time to time whether donor-advised accounts that are actually directed accounts are ineligible for component-fund treatment, with the default position being the classification of each account as a separate private foundation.⁶⁹ That result might equalize deductibility and operating rules with the rules that apply to private foundations but it is not legally compelled: the component-fund rules do not apply to organizations that do not elect to be community trusts. The IRS has homed in on “donor-designated funds” as distinguishable from “donor-advised funds” and has published an essay entitled “Donor Control.”⁷⁰ The Council on Foundations has also focused on donor involvement, including publishing a “best-practices” guidebook.⁷¹

In its FY 2000 CPE text, the IRS has stated that “[t]o qualify under IRC 501(c)(3), a donor-advised fund must have appropriate control over the donated assets....The Service applies the material restriction provisions (relating to the ter

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68. See, e.g. Ronald J. Shoemaker and Amy Henchey, “Donor Directed Funds,” Topic M, 1996 Ex. Org. Continuing Professional Education Technical Instruction Program Textbook, reprinted by Tax Analysts; Topic O, Part I, “Gift Funds-A New Direction in Charity,” FY 1999 EO CPE Textbook; Topic P, B. “Update on Donor-Advised or Gift Funds,” FY 2000 EO CPE Textbook. See also, “Hill Meetings on Advised Funds and Supporting Organizations,” 40 *Foundation News & Commentary* (March/April 1999) at 10.
69. One practical problem with this approach is that each account, unlike community-foundation aggregation of trusts, has no separate existence, directors, or officers so a break off would be inoperable under current law.
70. Ron Shoemaker, Debra Kaweck, Sadie Copeland, and David Jones, *O. Donor Control*, 297 Exempt Organizations Continuing Professional Education Technical Institution Program for FY 1999.
71. See, *Guide to Donor Involvement: Basic Considerations and Best Practices—A Resource for Community Foundations*, from the Committee on Community Foundations Legal Advisory Subcommittee of the Council on Foundations (Washington, D.C.: 1996), which includes sample guidelines.

mination of private foundation status) in Reg. 1.507-2(a)(8) to measure the level of control. The criteria in this regulation are applied to donor-advised funds held in trust that seek to be treated as a component fund of a community trust that is a public charity. See Reg. 1.170A-9(e)(11).”

“Designation” is difficult to distinguish from “advice” as a practical matter. Presumably the right to specify in the governing documents that the donor’s advice shall govern the expenditure of principal and income is a “designation” with anything less constituting only a right to advise. The Code contains only one provision that addresses classification based on a retained right to designate a recipient and it is not in the component-part or private-foundation termination provisions. Instead, it is in section 170 (charitable deduction), where the pooled common fund is identified as one of three types of private foundation eligible for the more favorable public charity deductibility limitations.⁷² The pooled common fund is in effect a defective supporting organization. The statute says that it “would be described in section 509(a)(3) [that is, a supporting organization] but for the right of any substantial contributor . . . or his spouse to designate annually the recipients from among organizations” that are public charities within section 509(a)(1).⁷³

Thus, the Code explicitly recognizes the concept of donor designations (as opposed to the “non-binding” advice traditionally rendered by a donor advisor of a

72. I.R.C. § 170(b)(1)(E)(iii).

73. The reasons for exclusion of gifts to public charities described in 509(a)(2), (3), (4), and pri-

donor-advised fund) and penalizes that control by classifying the pooled common fund as a private foundation subject to the Chapter 42 excise taxes discussed above. Note, however, that the Code simultaneously blesses the donor to a pooled common fund with public-charity-level deductibility. In summary, the deductibility of gifts is favored while the operations of the entity are held to a higher standard through application of Chapter 42 of the Code.

Compare that private-foundation operations treatment of the pooled common fund with the Type 3 supporting organization formed as a trust. There the donor can name the trustees, and so long as the donor and her disqualified persons do not “control” the supporting organization, the trust will be classified as a public charity.⁷⁴ But what does “control” mean in this context? For example, the donor could name herself and two siblings as trustees, name 50 charities in the trust, participate with her siblings in managing the investments (which neither the donor-advised fund donor-advisor⁷⁵ nor the pooled-common-fund donor can do) and the trust will still enjoy public charity status. In the Type 3 trust, the named charities must have the right to enforce the trust under state law but query whether one of 50 named beneficiaries would risk the donor’s ire or the cost to sue to compel en

vate operating foundations are not readily apparent.

74. I.R.C. § 509(a)(3).

75. *See, Fund for Anonymous Gifts v. Cmr.*, No. 95-1629, 1997 U.S. Dist. LEXIS 7771 (D.C.D.C. April 15, 1997), *vacated and remanded in part by Fund for Anonymous Gifts v. IRS*, 1999 U.S. App. LEXIS 8307 (D.C. Cir. 1999).

forcement. That assumes that the charity even knows it has been named in the trust, as notice is not required by the statute or regulations.

I have not seen the same problems with the Type 3 corporation because the responsiveness test as applied to a Type 3 corporation (but not to a Type 3 trust) requires that the supported organization have a “significant” voice in the supporting organization by electing a member of the supporting organization’s governing body, sharing one or more board members or officers with the supporting organization, or maintaining a close and continuous working relationship with the supporting organization.⁷⁶ This comparison demonstrates just how blurred the advice-versus-designation and public charity-versus-private foundation classification have become.

IX. ADVANTAGES AND DISADVANTAGES OF THE DONOR-ADVISED FUND

1. Summary

The donor makes an unconditional and outright gift to a donor-advised fund. In exchange, the donee grants to the donor the privilege of making non-binding suggestions to the donor-advised fund about how, where, and when funds should be spent but the donor-advised fund is the owner of principal and in

76. Treas. Reg. § 1.509(a)-4(i)(2).

come and can decline to follow or only partially follow the donor's suggestions, without any obligation to the donor.

2. Advantages from the Fund's Perspective

Any organization described within Section 501(c)(3) can create a donor-advised fund program to further its exempt purposes by (1) adopting a resolution creating the program, (2) creating documentation and procedures for soliciting and considering donors' advice, and (3) creating separate accounts and payout procedures. An existing public charity or private foundation should advise IRS of a not-previously-reported activity on Form 990 in the year it launches a donor-advised fund program. The board of the managing charity should consider whether a portion of each grant or of the fund balance must be given to the sponsoring charity. In addition, the board of the charity must consider whether its charitable purposes allow it to make grants to other organizations and whether its mission is broad enough to allow grants to all kinds of organizations.

Any new organization can create a donor-advised fund program and donor-advised funds can be the organization's exclusive activity.⁷⁷

77. See Treas. Reg. § 1.170A-9(e)(11)(ii).

3. Advantages from Donor's Perspective

The donor-advised fund embodies much of what is attractive to givers in the 90's: efficiency and involvement. In addition, the donor makes a gift to a public charity eligible for most favorable rules on deductibility. The donor obtains and retains only one substantiation letter documenting her gift to the donor-advised fund and is freed from needing substantiation letters from each recommended public charity. The gift is complete so long as the donor does not make it subject to any material restriction (*i.e.*, this is the distinction between a donor-advised gift which is currently deductible and a gift which is not because it is not a completed gift). The donor must notify the charity whose name the donor wants on the fund account and who is authorized to offer advice on making gifts from the account. Depending on the policies of the charity, the donor may be permitted to let the fund build up tax-free over a period of years before making recommendations (*e.g.*, to create a fund for a grandchild's recommendations on or after her twenty-first birthday) or toward an anticipated goal (*e.g.*, to fund a 25th or 50th reunion gift).

4. Disadvantages

Some donor-advised funds (especially those at community foundations) may be limited geographically to giving to a particular community or state. Others have policies against funding public charities unfamiliar to staff members or that do not support certain core beliefs (this is especially true of religious donor-advised funds).

In my opinion, all should have policies against making grants to private foundations (except to private operating foundations because they already offer public-charity-sized deductibility so a donor would gain no incremental deduction by advising to a private operating foundation from a donor-advised fund) or to individuals. The practical result is that the donor finds herself somewhat more limited philanthropically in return for the ability to contribute to a donor-advised fund but such limitations may be an acceptable tradeoff for the reduced costs and administrative ease of a donor-advised fund over a private foundation or supporting organization. I also believe that the donor should *not* have control over investment of donated funds (except, perhaps, at the time the donation is made to choose among one or more options, but not on an on-going basis), or other “operating” matters more properly within the purview of the board, not the advisor. In that regard, I concur completely with the IRS and the lower court in the Fund for Anonymous Gifts: If a donor wants to control investment policy, she should use a private foundation, not a donor-advised fund, as her giving vehicle.

A disadvantage of the donor-advised fund is the lack of clear rules governing their operation. The private foundation definition is a negative construction, that is, it is the default classification for organizations not specifically carved out. The supporting organization definition is a tangle of tests set out in detail in the Code and regulations. In contrast, as discussed above, the most significant rules addressing donor-advised funds are buried in the section 507 private foundation-

termination provisions and the section 170 public-support test calculations and these are set in the context of defining community trusts. But these rules are not exclusive and donor-advised funds are nowhere limited to community trusts. Also, it is questionable whether following donor advice should ever be penalized where the advice is reasonable. Shouldn't the problematic regulations be revised to shift the focus to abusive recommendations and lack of proper policies?

X. ISSUES INVOLVING COMMERCIALY-INITIATED DONOR-ADVISED FUNDS

With the creation of the Fidelity Charitable Gift Fund in 1991 came a development new to the field: mass marketing. All of the sudden, magazines like *Worth* (which is owned by Fidelity's parent) were carrying glossy ads and factoid-laden information sheets. The public charity benefits of the donor-advised fund were laid out side-by-side with the private foundation for all the world to see. A brochure was free for the asking or by calling a 1-800-number. Casual statements were made about saving costs by staffing lean. The community foundation world was variously appalled (Jack Shakely and the California Community Foundation) or enthralled (new community foundations around the country that found donor-advised funds to be their most successful fund-raising vehicle). Both groups drew more media attention to the donor-advised fund by alternately praising or damning the commercially-initiated donor-advised funds.

(A) The California Community Foundation View

What is the source of the tension between some community foundations and commercially-initiated funds? In a nutshell, a number of community-foundation officials believe that donor-advised funds at traditional public charities and commercially-initiated donor-advised funds should be subject to the section 507 material-restriction and section 170 component-part provisions reviewed above. This position has been championed by Jack Shakely, President of the California Community Foundation, who expressed these views in a letter which was headlined “Commercial Gift Funds Flout Spirit of the Law,” quoted below:

To the Editor: In your thoughtful and comprehensive lead article on proprietary donor funds (‘Financial Titans Move Into Charity,’ November 28 [1996]), many of those quoted, both within the investment companies and in the community-foundation field (including myself), might have led your readers to believe that the conflict between Fidelity’s Charitable Gift Fund and community foundations is simply a matter of competition, market share, and marketing budgets. It is much more than that.

It is a matter of law, and the adherence to the spirit, as well as the letter, of that law.

Community foundations are the most strictly regulated of all public charities. In addition to complying with all other rules of public charities, community foundations have special regulations that, among other things, define best practices in such things as board tenure and composition, require the power to remove a trustee or investment manager (do you believe Fidelity has the power to remove itself?), and establish a series of nine tests for donor-advised funds to insure that they are not materially restricted by their donors.

As the Charitable Gift Fund is a self-described donor-advised fund, it was surprising to see Jamie Jaffee admit that they don't conduct donor education, one of the nine tests. Her admission that she has 'not built a big program staff' is a little modest. In fact, the Charitable Gift Fund has no program officers whatsoever. As all of the other eight tests revolve around independent investigation of grantees, assessment of community needs, promulgation of grant guidelines, and reliance on advice from donors, it is clear that not only does the Charitable Gift Fund not meet one of the tests, it can't really meet any of them.

If the Charitable Gift Fund is to hold donor-advised funds, it should adhere to the same nine tests that are defined for community foundations.

The Charitable Gift Fund may claim that it is not legally mandated to meet these tests or to adhere to other best practices which inform community-foundation donor-advised funds. There is, however, a moral adage that honors the spirit of the 1977 Treasury regulations for community foundations that the Charitable Gift Fund is flouting. If the Charitable Gift Fund can meet all nine tests, welcome. We'll compete and complement each other as best we can. If it cannot meet these tests, its compact with the donor and the philanthropic community is broken, and it makes a mockery of the public-charity regulations that were designed to guide it.⁷⁸

(B) The Rodriguez View

To inform its views, the California Community Foundation then sought a legal opinion from its counsel regarding tax-exempt status for commercially-initiated donor-advised funds. In summary, the firm of Rodriguez, Horii & Choi issued an opinion which concluded that recognition of exemption under section 501(c)(3) was improper where the donor-advised fund furthered a substantial non-exempt purpose, namely profits for a commercial “sponsor.”⁷⁹

78. Letters to the Editor, *The Chronicle of Philanthropy* (February 6, 1997).

79. For an outline of the opinion, see Rodriguez, Choi and Mittermaier, “The Tax-Exempt Status of Commercially Sponsored Donor-Advised Funds,” 17 *E.O.T.R.* 95 (July 1997). The actual opinion is available on the firm’s Website at www/thelaw.com.

In a telephone conversation with the author on November 25, 1997, Albert R. Rodriguez stated that his firm's opinion and the subsequent article arose from their work on the issues outlined in Mr. Shakely's letter. Specifically, their work initially focused on whether a commercially-initiated fund was legally obligated to comply with the material-restriction regulations and, if so, what kind of oversight and review the fund had to provide.

From their study of the restriction provisions, the Rodriguez firm moved on to the conclusion that the real problem was not so much with a failure of oversight and review but rather with the collateral benefits being received by the commercial initiator. Hence, the opinion issued to the California Community Foundation focused on the benefits, primarily management fees, being received from the captive client.

This is an interesting and well-argued position. As of yet, however, no court seems to have addressed this point. In addition, I have seen no evidence that an investment advisor to a commercially-initiated donor-advised fund enjoys any greater benefit than, for example, a lone investment advisor to a community foundation. In addition, having a lone advisor has generally been a state-law fiduciary duty issue until now. It seems to me that the missing link in this analysis is generally a lack of evidence of improper benefit in the major commercially-initiated donor-advised funds. More compelling may be a concern for diversification among a fund's investment advisors. But the number and qualifications of investment advisors has

also traditionally been a state-law, fiduciary-duty concern, not a matter of tax classification.

(C) The Hoyt View

Professor Christopher Hoyt has offered an alternative analysis that can be summarized as follows.⁸⁰ There are two parties to a charitable gift: the donor and the charity. If a donor makes an incomplete gift, the donor can be punished by deferral of her deduction until such time as the gift is complete. If the charity is a public charity, the IRS can apply three sanctions. First, the IRS can revoke the organization's tax-exempt status, a rarely-invoked penalty. Second, the IRS can levy so-called intermediate sanctions on excessive-benefit transactions (section 4958), but it is unclear how these sanctions would apply to donors and charities in the donor-advised fund context unless the donor tried to advise grants to herself. Third, if and only if the public charity is a community foundation with separate funds, the IRS could break off one of its "component-part" funds and treat it as a separate private foundation. This would be the likely punishment for failing the material-restriction regulations under section 507. If the donor-advised fund is relying on bookkeeping entries in a single organization, and not on the component-part test, the third sanction would appear not to apply. This fact is what makes some community foundations angry.

80. This summary is based on the text *Legal Issues: Parameters in Fund Development*, text of presentation outline, November 1997, provided to the author by Professor Hoyt.

(D) The Case Law

Essentially we have only two decided cases ten years apart that discuss the donor-advised fund. The first, *National Foundation, Inc. v. U.S.*⁸¹ involved an organization that the IRS declined to recognize as a tax-exempt public charity because, among other things, the organization paid commissions to ministers, insurance agents, and others to refer donors to the organization and exercised minimal review of the donor's recommendations. In a sharply worded opinion, however, the court made clear its view that donations to National Foundation were destined for charitable recipients and the costs were not excessive to achieve that goal. Therefore, the court ordered the National Foundation to be recognized as exempt.

Ten years later, the IRS won in *Fund for Anonymous Gifts v. U.S.*,⁸² only to have the decision vacated by the United States Court of Appeals on April 12, 1999. The District Court for the District of Columbia was ordered to enter summary judgment to the Fund for Anonymous Gifts on the section 501(c)(3) determination. The District Court on remand was told to determine whether the Fund should be classified as a public charity or a private foundation under section 509, an issue that is at the heart of the donor-advised fund public debate.

81. 13 Cl. Ct. 486 (1987).

82. 1997 WL 198108, 79 A.F.T.R. ¶ 97-874 (U.S. D.C. for the District of Columbia, Number 95-1629 (April 15, 1997)), vacated in part by *Fund for Anonymous Gifts v. IRS*, ___ F.3d ___, 1999 WL 334519, D.C. Cir. No. 97-5142; *E.O.T.R.*, May 1995, p.415; Doc 1999-13695 (4 original pages), or 1999 *TNT* 71-5 (D.C. Cir. Apr. 12, 1999).

In this instance, attorney William Lehrfeld filed an application for exemption for a trust to administer donor-advised funds wherein the donor would instruct the sole trustee to distribute funds on an anonymous basis and the donor could direct the trustee to invest her funds in particular ways. The IRS argued successfully that these positions gave too much control to the donor. The district court reached its conclusion based on the donor's control over the investments without ever reaching the matter of the donor's control over the grant distributions. In *dicta*, the court contrasted the Fund with the Fidelity Charitable Gift Fund, which the court said did not allow its donors too much control over investments.

Mr. Lehrfeld retroactively amended the Fund's governing instrument to delete provisions allowing donor control over investments or other conditions subsequent and then appealed.

On appeal, the IRS argued that the amendment did not adequately address the deficiencies in the Fund's operations that prompted rejection of the Fund's request for tax-exempt status. The IRS argued further that the Fund was merely "an administrative conduit" for a donor's contributions, which it described as "another nonexempt function." Finally, the IRS objected to the Fund's trustee considering himself "to be bound by the donor's wishes, not only at the time the donation is made but until the funds and all income earned thereon are ultimately distributed."

In its decision, the appellate court said that it was “baffled by the government’s apparent intransigence” and called “incoherent” the IRS position on donor control. The appellate court wrote, “The government was unable at oral argument, and is unable a year later, to offer any understandable reason why, apart from the control provision (now removed), [the Fund] is not a section 501(c)(3) organization.”⁸³

William Lehrfeld, counsel to and sole trustee of the Fund, commented, “I feel like the cat’s meow.” He said of the Justice Department attorneys who argued the IRS position, “[t]hey’re not certain about what the boundaries are.”⁸⁴ In another publication Lehrfeld was quoted as saying, “The primary purpose of the litigation was to get the government to articulate in a sufficiently reliable form the way designated funds should be treated as to both donor and donee. The government has chosen to make tax policy through litigation rather than through regulation.”⁸⁵

The IRS discussed this case in its FY 2000 CPE Text.⁸⁶ Saying that the IRS “Continues to contend with...donor-advised or gift funds,” the author emphasized

83. *Tax Notes Today*, April 14, 1999, 1999 TNT 71-5.

84. *Id.*

85. “Court Approves Exemption for Anonymous-Gift Fund,” *Tax Watch, The Chronicle of Philanthropy*, April 22, 1999.

86. “Topic P-Public Charity Classification and Privation Foundation Issues: Recent Emerging Significant Developments,” Exempt Organizations FY 2000 Continuing Professional Education Text, Tax Analysts Website (August 1999), pp. 219-220. *See* this text for details of other donor-advised fund litigations by the IRS, including the following. On October 5,

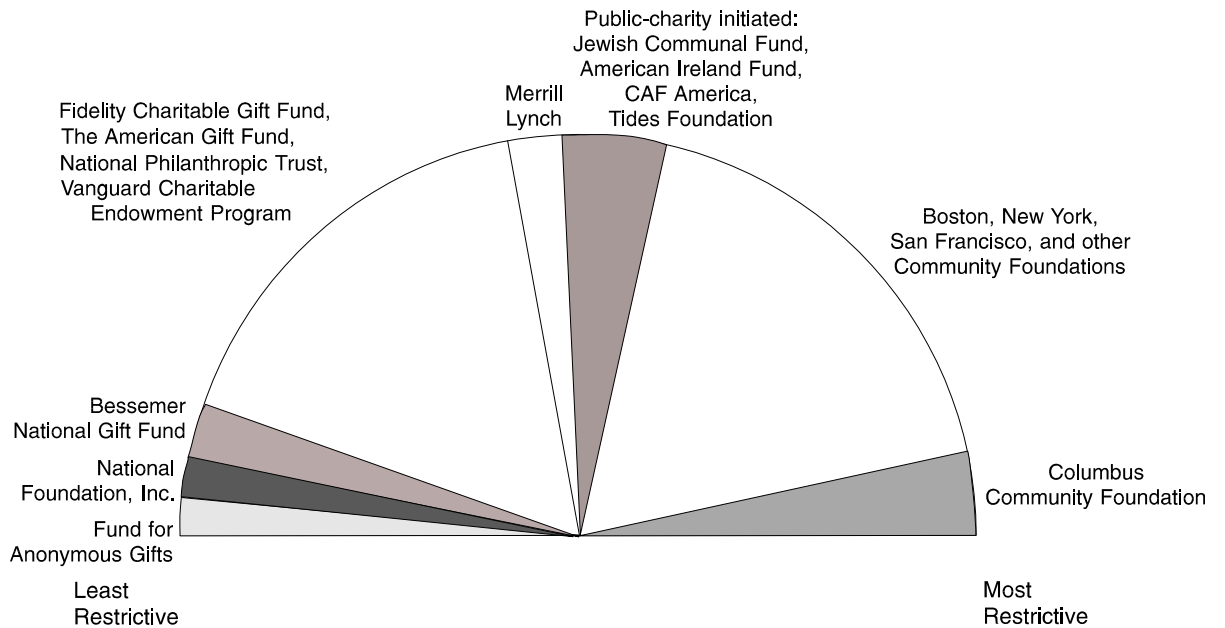
that “the Service will continue to review the issue of donor control in donor-advised funds.”

(E) The Author’s View

The chart below sets out the author’s totally subjective and unscientific spectrum of donor-advised fund options with regard to one feature of donor-advised funds, i.e., the degree to which the donor may be involved as grants advisor or make grant recommendations that will be respected. This is not meant to be a complete list of funds or a representation of their respective merits. It is meant merely to suggest that not all funds are subject to the same policies and operating rules as to advising or designating grant recipients.

1998, the IRS obtained an injunction in California in *U.S. v. Estate Preservation Service*, which used donor-advised funds in conjunction with split-dollar life insurance arrangements that also benefit the donors’ heirs. On April 5, 1999, a declaratory judgment was sought in Claims Court for the district of Columbia by *New Dynamics Foundation (99-197T)*, which the IRS viewed as an abusive donor-directed fund.

SPECTRUM OF DONOR-ADVISED FUNDS



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As this chart suggests and the *Fund for Anonymous Gifts* appellate decision affirms, the flashpoint of popular analysis remains the idea of excessive donor control. But emphasis on this idea may be a red herring. Maybe other issues are much more important than whether a donor’s advice is followed all the time. For example: What is the practical difference between “donor directed” and “donor advised” gifts? If the advice-vs.-control issue runs to investments as well as gift distributions, where else does it apply? What about postponing the donor’s deduction because too much retained control negates a completed gift? Is there impermissible private benefit if a fund has one investment manager? Does the answer change if the manager is a for-profit sponsor? What if the fund is in a community foundation

with a for-profit corporate sole trustee? Is it proper to have a single individual as sole trustee? What if the fund is managed by a not-for-profit church that does not file Form 990?

The proliferation of donor-advised funds is probably a very good development for philanthropy. As with all good things, however, imitators can be legitimate or illegitimate. The lack of official guidance and boundary-drawing on the advice-versus-control and similar questions means that there is more room for imitators to maneuver. The lack of official guidance, however, begs another question: Why is donor direction bad so long as the direction is to a recognized section 501(c)(3) public charity or private operating foundation not controlled by the donor-advisor and the donor-advisor receives no direct or indirect benefit?

It is important to note that in July 1998 the Fidelity Charitable Gift Fund voluntarily adopted (and reported to the IRS) operating procedures that put the Gift Fund much closer to the operation of donor-advised funds at community foundations. These operating rules will vastly reduce the potential for abuse by the Gift Fund's donor advisors. Among other things, the Gift Fund took steps to educate its donors about impermissible private benefit (*e.g.*, by declining to purchase tables for fundraising dinners), to avoid advised-gifts back to an advisor's own private foundation (or gifts to any other private foundation or foreign charity), or to allow an advised fund to avoid expenditure in perpetuity. The Gift Fund also adopted a policy mandating that its aggregate annual giving exceed 5% of the Gift

Fund's average net assets.⁸⁷ The Gift Fund and its advisors are to be commended for having taken these steps and, in consultation with the IRS and with interested practitioners, for setting the standards against which new commercially-initiated and other advised-fund applicants for exemption are to be judged. Anecdotal evidence suggests that the IRS is now requiring most (and should require all) new donor-advised funds voluntarily to comply with these standards.⁸⁸ This standardization will go a long way toward avoiding potential abuses on the gift and management sides of advised funds. Competition should reduce the risk of abuse on the fee and investment sides of advised funds, although donors should pay attention to whether fees are being paid for referral to a particular fund and whether that bothers them. What remains is for the IRS through the education and examination process to identify and work constructively with those donor-advised funds (whether commercially-initiated, community-foundation sponsored, or otherwise) that still have not updated their operational procedures. In this regard, examination guidelines from the IRS for donor-advised funds would be instructive. Of course, I also

87. "Whither or Whether Donor-Advised Funds," Edited Transcript of the July 31, 1998, ABA Ex. Org. Comm. Meeting, 22 *E.O.T.R* 101 (Oct. 1998); Allan R. Clyde, "Government Update," *Foundation News & Commentary*, Sept./Oct. 1998 at 9; Monica Langley, "Fidelity Plans to Limit Donor's Ability to Benefit from Gifts to Public Charity," *The Wall St. J.*, July 14, 1998 at A4. See also the Gift Fund's website at www.charitablegift.org.

88. For example, in the year prior to the Gift Fund's voluntary adoption of the standards described in the text, the Vanguard Charitable Endowment Program (affiliated with The Vanguard Group, Inc.) and the American Gift Fund (affiliated with American Guaranty and Trust Company) both received exemptions from the IRS. In both cases, the organizations — like the Gift Fund — adopted policies mandating annual distributions of at least 5% of their net assets, and established procedures whereby donors would be educated about the impermissibility of using grant funds for private benefit. The Vanguard Charitable Endowment Program was granted its exemption in December 1997, and the American Gift Fund was granted its exemption in May 1998. For reprints of the complete IRS administrative files of their applications for exemption, see *Paul Streckfus' EO Tax Journal*, May 1998, at 33ff (Vanguard), and *Paul Streckfus' EO Tax Journal*, June 1998, at 37ff (American Gift Fund).

endorse the IRS pursuing those funds at the edge that do not deserve to be called donor-advised because they are insurance of other scams.

With its new policies, the Fidelity Charitable Gift Fund has arguably made itself less attractive to the few donor advisors who wish to push the edge of the charitable-giving envelope. Experience suggests that those donors may turn to the new eager community foundations who may have staff no more numerous, attentive, or able to spot potential abuse than Fidelity's staff. As discussed below, I believe that the IRS could promulgate required operating procedures for all donor-advised funds seeking to obtain or maintain public-charity classification. Such rules might be the best way to address the newest and least-known donor-advised funds being quietly formed today far from the Fidelity spotlight, perhaps with an individual as sole trustee, and, thus, more vulnerable to the potential for abuse.

A final but critical boundary-drawing question is the proper classification of donor-advised funds as public charities or private foundations. This issue may be addressed by the District Court for the District of Columbia in the remanded *Fund for Anonymous Gifts* case. If so, it will require the District Court to answer a question not addressed by the Congress, the Treasury Department, the IRS, and discussed only by the most ardent fans of sections 507 and 509.

Proponents of community foundation donor-advised funds would argue that only their funds should be treated as public charities because only they abide vol

untarily by the component-part rules of section 507. Proponents of commercially initiated funds would argue that both their funds and those of community foundations should be treated as public charities because neither (unless in the less popular trust form) is subject to the section 507 rules.

For its part, the IRS in August 1998 stated the following on this topic:

“The Service is not the arbiter between these two groups. Rather, its mission is to even-handedly administer the tax law. The 1996 [EO CPE] article discusses commercially-sponsored donor directed funds and whether they offered potential for tax abuse. It should be clearly understood, however, that both groups are subject to the same rules and both raise many similar issues.”⁸⁹

The IRS is correct that both groups are subject to the same rules. Specifically, those that want to be component-part funds or community foundations subject themselves to more strict rules than do those that don't want that treatment. For this reason, I believe that an important focus by the IRS should be on public education for all advised funds as to proper operation of advised-fund programs, with specific attention to avoiding more than incidental advisor benefits. While the self-dealing rules might argue for treating advised funds as private foundations, I believe that such an approach is too harsh and not necessary. The intermediate

89. Ron Shoemaker, Debra Kawecki, Sadie Copeland and David Jones, *O. Donor Control*, 297 Exempt Organizations Continuing Professional Education Technical Institution Program for FY 1999.

sanctions rules are also not likely to apply at present because the donor-advisor is not likely an “insider” as to the advised fund. Thus, examination pressure on the advised funds to voluntarily adopt and abide by anti-abuse operation policies should permit continued operation as public charities. If examinations were to uncover extensive advisor or manager abuses at the major commercially-initiated funds(which I think is unlikely), then one alternative would be to treat any abusive donor-advised fund as a pooled common fund described in section 170(b)(1)(E)(iii). This would result in the application of the section 4941 self-dealing penalties while still permitting public-charity level deductibility. The main drawback to this approach is not application of section 4941, but of sections 4940, 4942, 4943, 4944, and 4945. Without careful consideration of how and why those provisions should apply to advised funds, I am hesitant to recommend the pooled common fund as an appropriate classification.

In summary, the proper classification of donor-advised funds as public charities or pooled common funds or private foundations requires an analysis of both section 509 and of Chapter 42. In the absence of such a comprehensive review of the need for change (*e.g.*, whether excessive donor or manager benefit exists except where it has been identified at the edge and, if so, whether it is widespread), it would appear fairer to continue to classify advised funds as public charities but for the IRS to provide more public education information on more-than-incidental benefits, to publish examination guidelines covering anti-abuse operating

procedures, and to require all new advised funds to adopt such procedures as a condition precedent for recognition or maintenance of exemption.

XI. A PROPOSAL FOR LEGISLATIVE REFORM

What is the proper classification of a donor-advised fund? Is it more properly a public charity or a private foundation? A few analogies can be drawn. As noted above, the Code in pooled common funds recognizes public-charity-level deductibility even where a donor designates (rather than advises) grants. Similarly, the classification rules have traditionally been read to treat advised funds as public charities unless and until a donor's material-restriction action causes private-foundation treatment of a failed component part. Finally, neither the private foundation self-dealing penalties nor the public-charity intermediate sanctions currently reach abusive donor advisors.

After weighing the merits of public-charity versus private-foundation classification, it seems to me that the equities favor public charity status. For purposes of stimulating discussion, I consider below what kind of adjustments might need to be made in current law. One option would be to explicitly classify donor-advised funds as public charities. This option would require an amendment to section 509(a) (or to section 170(b)(1)(a) or to section 509(a)(1)). Such an amendment might take the form of a new subparagraph (5) under section 509(a), which might read as follows:

(5) a corporation described within section 170(b)(1)(A)(vi) the primary purpose of which is to be a donor-advised fund by maintaining segregated accounts for the contributions of one or more donors (herein referred to as donor-advisors), who may advise the corporation as to the distribution of the assets in the funds to one or more organizations described in subparagraphs (1), (2), or (3), of this paragraph, or to a private operating foundation described in section 4942(j), so long as the donor-advisor has not placed a material restriction or condition (within the meaning of paragraph (a)(8) of section 1.507-2 of the regulations, without giving effect to the adverse factors set out at Treas. Reg. section 1.507-2(a)(8)(iv)(A)(2) and (3)) that prevents the corporation from freely and effectively employing the transferred assets, or the income derived therefrom, in furtherance of an exempt purpose and so long as the corporation makes grants only to organizations described in subparagraphs 1 and 2 of this paragraph 509(a) or in 4942(j)(3) and which distributes annually an aggregate amount equal to the minimum investment return as calculated in section 4942.

This possible subparagraph 509(a)(5) includes a reference to the material-restriction regulations, but, as the discussion above indicates, it is debatable whether these regulations should apply in full to donor-advised funds. Because a

section 509(a)(5) donor-advised fund would not seek qualification as a single entity under the component-fund regulations, but rather would rely on bookkeeping entries to keep track of donor accounts, the reliance on the material-restriction regulations seems inapposite – there are no separate entities to be subject to the component-part test, as there would be in a multiple-trust-form community foundation.

Beyond this structural distinction, however, there is also the question whether, for the purpose of distinguishing a donor-advisor from a donor to a private foundation, it is truly necessary for the donor-advisor to give up control over her contribution to the extent mandated by the material-restriction regulations. The current debate has largely focused on whether the donor-advisor retains excessive control over the advisory function. In my view, there is little practical difference between “advising” (which is perceived as good) and “designating” (which is perceived as bad). Even if a donor-advisor were to be given greater control over the distributions from her fund, she would (and, in my view, should) still lack two significant abilities possessed by the donor to a private foundation: she may not make investment decisions, and she may direct grants only to public charities and private operating foundations (not to private foundations, individuals or for-profit entities) thus avoiding a possible end-run around the charitable deduction limitations. So long as the donor cannot control investments or require that donated assets be maintained, the excess business holdings and jeopardizing investment provisions of sections 4944 and 4943 are unnecessary. So long as the donor gave to

public charities described in subsections 509(a)(1) or (2), excess benefit issues should be limited; advised gifts to a Type 3 supporting organization are more problematic.

Of course, such a new classification would not be limited in its application to commercially-initiated donor-advised funds. Corporate-form community foundations could be encouraged to opt for public-charity classification under section 509(a)(5) if management of donor-advised funds were their primary activity. Donor-advised funds that did not carry on other charitable programs commensurate with their advised-fund management could be required to rely on section 509(a)(5), instead of 509(1)(1), for public charity classification. The organization should still have to meet the section 170(b)(1)(A)(vi) public-support tests. This might require amendment of sections 170(b)(1)(A)(vi) and 509(a)(1) to pour-over “primary” donor-advised funds into section 509(a)(5). Of course, because the component-part rules would be irrelevant to section 509(a)(5) donor-advised funds, the section 509(a)(5) entity would file only one Form 990 reporting on all of its donor-advised funds and would experience no additional administrative costs. In fact, costs might be less since the administrators would be authorized, without uncertainty as to adverse effect, to follow donor advice all the time so long as the advised charities were confirmed as being public charities or private operating foundations. I would also permit grants to non-U.S. charities, so long as the donor-advised fund’s administrator exercised “discretion and control” as now is done by the administrators

of the advised-fund programs of CAF America and United Way International, among others.

If a donor-advised fund were to be classified as a public charity, then donor-advisors should be subject to the rules governing improper private benefit. The operating rules of many community foundations, the Fidelity Charitable Gift Fund, and the Vanguard Charitable Endowment Program, among others, acknowledge the importance of this limitation, and specifically bar a donor-advisor from recommending a gift that would result in a private benefit to the donor. Other donor-advised funds should be required to adopt the same operating standards. Examples of such standards in operation can be found in the three models at Appendix C. The application of section 4958 would properly put the onus on the advisor to advise properly or be subject to penalties and on the organization to educate the advisors about the organization's standards for appropriate advice.

Self-imposed standards, however, are meaningless unless the IRS has a corresponding enforcement tool. If a donor-advised fund is not a private foundation, then the self-dealing rules of section 4941 do not apply. If the donor-advised fund is classified as a public charity, then the section 4958 intermediate sanctions may not apply for lack of a disqualified person. Therefore, I recommend consideration of whether section 4958 or the applicable regulations need to be amended to include donor-advisors in the definition of disqualified person for purposes of the

intermediate-sanction rules. Section 4958(f)(1)(A) could be modified by adding a parenthetical clause (in bold type below) to the end of the subparagraph:

(f) Other definitions. – For purposes of this section –

(1) Disqualified person. – The term ‘disqualified person’ means,
with respect to any transaction –

(A) any person who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization (and, in the case of an organization described in subsections (a)(1) and (a)(5) of Section 509, a donor-advisor shall be deemed to exercise substantial influence within the meaning of this subparagraph),

In addition, or in the alternative, section 53.4958-3(a) of the regulations could be similarly modified, adding a sentence to the same effect after the first sentence of the paragraph:

53.4953-3 Definition of disqualified person.

(a) *In general.* Section 4958(f)(1) defines disqualified person, with respect to any transaction, as any person who was in a position to exercise substantial influence over the affairs of the organization at any time during the five-year period end

ing on the date of the transaction. **In the case of an organization described in subsections (a)(1) and (a)(5) of Section 509, a donor-advisor shall be deemed to exercise substantial influence within the meaning of section 4958(f)(1).**

It would be important to determine whether such a change would capture abuses seen to date by the IRS or whether the definition of an excess benefit transaction would have to be adjusted to cover advising for one's direct or indirect personal benefit. I believe that the intermediate-sanction rules and the advised-fund operating rules would best be clarified in tandem.

One of the practical consequences of classifying donor-advised funds as public charities and subjecting donor-advisors to the intermediate-sanction rules would be the need to educate both the fund managers and the donor-advisors about the requirements for reporting and paying the section 4958 excise tax. Chapter 42 excise taxes are reported on IRS Form 4720. Generally, the form is filed by the organization, and an individual who owes first-tier taxes and has the same tax year as the organization may report the taxes she owes on the organization's form. Individuals who do not have the same tax year or who do not sign the organization's form, however, must file a separate Form 4720.⁹⁰ Chapter 42 excise taxes are therefore self-assessed and voluntarily reported, unless they are the result of an IRS audit.

In 1998, 1,321 Form 4720s were filed, reporting on fiscal years ending in 1997. The total amount paid for all Chapter 42 excise taxes combined was \$1,249,227.⁹¹ With the number of active exempt organizations in the United States at 1,305,790 as of June 30, 1999,⁹² this translates into 0.01% of organizations reporting Chapter 42 excise taxes. There are two possible reasons for such a low number of filings: either organizations and individuals are modifying their behavior to avoid liability for excise taxes, or organizations and individuals are simply failing to report excise taxes for which they are liable.

Since few individuals have paid these taxes historically and since the taxes are avoidable, it appears more important to modify the behavior of donor-advisors by educating them as to the boundaries between appropriate and inappropriate donor-advice. In that regard, I note again that some commercially-initiated donor-advised funds and some community foundations have issued question-and-answer documents that could serve as the basis for new IRS authority. For example, I attach as Appendix C the question-and-answer documents prepared by the American Gift Fund, the Fidelity Gift Fund and the New York Community Trust. I have also attached a list of questions a potential donor-advisor should ask before creating a

90. 1998 Instructions for Form 4720.

91. No excess benefit transactions were reported. The total amount paid for self-dealing was \$76,526. No information was available on the number of returns on which self-dealing was reported. IRS Office of Employee Plans and Exempt Organizations, Master File Data, Monthly Statistical Summary, Table 2 C National Totals of Return Data (period ending December 31, 1998).

92. Telephone conversation with Ron Williams, IRS Office of Employee Plans and Exempt Organizations (July 7, 1999).

DAF (Appendix D); and descriptions of some community foundation-based, commercially-initiated, religiously-oriented and other DAFs (Appendix E).

In closing, I want to emphasize that I believe that donor-advised funds are an admirable giving model to be encouraged. But that encouragement requires boundary clarification. If the boundaries are clarified and publicized by the IRS and by the funds themselves, then the IRS's enforcement role should be made easier. This is also true because, by their very nature, donor-advised funds require much more publicity than does either a supporting organization or a private foundation. Publicity means better oversight by donors, the IRS, and the press. With such favorable transparency, the properly-administered donor-advised fund should be a favored model by all constituencies.

APPENDIX A
A MATRIX OF CONTROL

	Favorable Deduction Levels?	Donor Can Have Exclusive Control Over Grantmaking?	Donor Can Have Exclusive Control Over Investments?	Remarks
Endowed Private Foundation	NO	YES	YES	Deductibility limits and I.R.C. Chapter 42 excise-tax boundaries are the trade off for complete control over contributions (except for the completed gift rules), investments, expenditures.
Type 3 Corp SO	YES	NO	NO	SO must meet responsiveness test which requires one or more common officers or directors or close and continuous working relationship <i>and</i> the supported organization's managers have a "significant voice" in the supporting organization's investment policies, grant timing, grant making, selection of recipients, directing use of income or assets.
Type 3 Trust SO	YES	YES	NO	Special trust responsiveness test: Each public charity is named in and can enforce the trust and compel an accounting.
Pooled Common Fund	YES	YES	NO	A defective supporting organization: "would be described in section 509(a)(3) but for the right of any substantial contributor . . . or his spouse to designate annually" public charity recipients described in 509(a)(1) only.
Donor Advised Fund	YES	NO	NO	Component-part test has been voluntarily adopted by community foundations, although only component-part trusts must likely abide by it. Material-restriction rules look to lack of completed gift and excessive donor control for purposes of private-foundation terminations. Newly created DAFs generally provide in Forms 1023 that they will operate in accordance with "Vanguard Charitable Endowment" policies.

APPENDIX B



*PROFILE OF A SUPPORTING ORGANIZATION ("SO")
UNDER IRC ' 509(A)(3) AND TREAS. REG. ' 1.509(A)-4*

- I. IRC: A. Organized & operated test Operated, supervised, or controlled by or in connection with a public charity ("PC") and B. Not controlled directly or indirectly by disqualified persons or non-PCs

II. Treasury Regulations:

A. Organization Test¹ - Articles of organization (charter, trust, articles of association) must

1. Limit the purposes to 509(a)(3)(A) purposes: to benefit, perform functions of, or carry out purposes of specified PC(s),
2. Not expressly empower organization to engage in activities beyond those above,
3. State the specified PC(s) to be benefitted, and
4. Not expressly allow the SO to support any but the specified PC(s).

Operational Test²

- a. Permissible beneficiaries: payments to or for use of specified PC(s), providing payments, services, or facilities to individuals in charitable class benefitted by specified PC(s), and certain grants to organizations
- b. Permissible activities: pay income to specified PC(s) or use income for independent activity to benefit specified PC(s) or its charitable beneficiaries

B. Relationship Test³

All require: SO must be responsive to specified PC(s)'s needs, demands and SO will be integral part of or significantly involved in PC operations. Three types of relationships:

1. Treas. Reg. § 1.509(a)-4(c) and (d) (specified-organization rules).
2. Treas. Reg. § 1.509(a)-4(e).

TYPE 1

Operated, supervised, controlled *by* PC(s)

Analogy: Parent-subsidiary

Key Features: PC elects or appoints majority of SO's officers, directors, or trustees. PC can exercise power through its governing body, their designees, officers acting in their official capacity or membership

TYPE 2

Supervised or controlled *in connection with* PC(s)

Analogy: Brother-sister affiliates

Key Features: PC and SO are under common control of same persons who can thereby insure that SO will be responsive to PC's needs

TYPE 3

Operated *in connection with* PC(s)

Analogy: Responsive and significantly involved private foundation

Key Features: SO must prove responsiveness by having one or more of the SO's officers, director or trustees elected or appointed by PC(s); or overlap between PC(s)' and SO's officers, directors, trustees, or other important officers, or SO's officers, directors, or trustees maintain a "close and continuous working relationship" with PC counterparts AND PC managers have significant voice in SO's investment policies, grant timing, grant making, selection of recipients, directing use of income or assets.

Special trust responsiveness test: Each PC is named in trust and can enforce trust and compel accounting under state law.

Integral part test for all Type 3 SOs: PC(s) must depend upon SO for support -- (i) "but for" SO, PC would do what SO does or (ii) SO pays "substantially all" of its income to PC and amount is sufficient to assure PC's at

3. Treas. Reg. § 1.509(a)-4(f)-(i).

C. Disqualified Persons Do Not Control SO⁴

One or more disqualified persons under IRC ' 4946 cannot directly or indirectly control SO. IRC ' 4946 substantial contributors, 20%+ owner of corporation, partnership, or trust, their families and their corporations, trusts, or partnerships. Foundation managers who are not otherwise DQPs and PCs are not counted in testing for control. "Control" means DQPs can aggregate votes or positions of authority to require SO to perform or refrain from performing an act.

Indirect control: Facts and circumstances including asset analysis and appointment of a DQP's employees.

Church rule: Church SO won't be controlled by DQPs if governed by individuals each of whom is a substantial contributor if bishop or other church representative controls policies and decisions.

D. Non-PC SOs⁵

"Flush left" language in Code allows SOs for charitable, etc. purposes of organizations described in ' 501(c)(4) (social welfare or labor organizations); (c)(5) (agricultural organizations); or (c)(6)(business leagues) that meet the one-third support test of a ' 509(a)(2) PC.

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4. Treas. Reg. § 1.509(a)-4(j).

5. Treas. Reg. § 1.509 (a)-4(k).

APPENDIX C

*SAMPLE QUESTION-AND-ANSWER PUBLICATIONS
REGARDING DONOR-ADVISED FUND OPERATIONS*

1. The American Gift Fund
2. The Fidelity Charitable Gift Fund
3. The New York Community Trust

**Questions & Answers
The American Gift Fund**

Q. May I recommend that the Gift Fund make grants to any charity of my choice?

A. Yes, provided it is a public charity qualified under Section 501(c)(3) of the tax code.

Q. May I recommend grants from the Fund in lieu of completing a pledge that I have made to a charity?

A. No. The Fund will not be bound by such a pre-existing pledge. Also, the Fund may not make grants to provide a private benefit, pay dues or membership fees, purchase tickets to a benefit, or purchase goods at charitable auctions. Grants may not be used for lobbying, political contributions, or political campaigns. You should use the Fund to designate your requests for grants in which the only benefit returned to you is the satisfaction of giving.

Q. May I recommend grants from the Fund to a private foundation?

A. No. The Fund's Declaration of Trust, approved by the National Office of the Internal Revenue Service, specifically forbids such grants.

Q. May the Fund purchase life insurance on a donor's life?

A. No. Such an investment by the Fund would cause legal problems for the Fund.

Q. May I transfer to the Fund restricted or closely-held appreciated securities?

A. The Fund may accept such securities. The trustee will review the proposed donation and promptly notify the donor whether the gift is acceptable. If such a gift is accepted, the donor must determine the fair market value in a reasonable manner for the purpose of valuing the tax deduction. The IRS normally requires an appraisal and the filing of Form 8283 if the claimed value of such securities is more than \$5,000.

Q. May I change my mind regarding investments at a later date?

A. No. This is for your own protection. In order to claim a charitable tax deduction, the IRS requires that the gift be irrevocable and complete. If you retained the right to change investments after the initial election, you could lose your deduction.

Charitable Gift Fund: FAQs

Q: What information does the Gift Fund need to review a grant recommendation?

A: The Gift Fund requires a completed and signed grant recommendation form, submitted directly from a donor via mail or fax. The form has been designed to facilitate grantmaking, and ensure that donors are aware of our Grant Recommendation Guidelines. This is why it's imperative that the form be used each time you recommend a grant. In order to review a potential charitable recipient, the Gift Fund needs the charity's name, address, phone number and tax identification number. The Gift Fund notifies donors in writing when their grant recommendations are honored or rejected.

Q: What kind of grant recommendations does the Gift Fund not fulfill?

A: Grants from the Gift Fund may not be used for any pre-existing pledge or private benefit, such as school tuition, scholarships sent directly to individuals, dues, membership fees, benefit tickets, or goods bought at charitable auctions. Nor may grants be used for lobbying, political contributions, or to support political campaign activities. Grants may be made by the Gift Fund to a qualified organization that in turn helps needy or worthy individuals as long as it is not designated for a specific person. Please note that if any part of your contribution pays for goods, services or benefits a specific person, the Gift Fund will reject your recommendation. In cases of questionable grants, the Gift Fund will contact the charity first to determine if any private benefit is received as a result of the gift. A Gift Fund representative will then contact you if we find that we are unable to honor a grant recommendation as specified.

Q: Why can't the Gift Fund be used to fulfill a pledge?

A: The Gift Fund is a donor-advised public charity. The Gift Fund cannot be used to fulfill a personal obligation. Your contribution to the Gift Fund must not have any restrictions. The use of the word pledge implies a legal obligation on the part of the Gift Fund to satisfy a debt or that your contribution to the Gift Fund was "restricted" or earmarked for another charity. For this reason, the Gift Fund cannot be used to satisfy a pledge.

Q: Does the Charitable Gift Fund have specific restrictions that I should be aware of?

A: Yes, please carefully review our Program Circular.

Q: The local art museum has invited me to a benefit dinner. May I use my Gift Fund account to pay for the tax deductible portion of the ticket?

A: No. You have already received a full tax deduction for your contribution to the Gift Fund. You may not receive anything of value in exchange for a grant recommended from your account. Our transmittal letter clearly instructs charitable recipients that no tangible benefit, good or services are to be received by any private individual in exchange for the Gift Fund's grant. We include this message to better assist other charities as they grapple with the issues of private benefit themselves.

Q: May I use my Gift Fund account to support an event that I will not attend and where I receive no tangible benefit?

A: Yes. Since you are not receiving anything of value in exchange for the grant recommendation, you may use your Gift Fund account. Please clearly indicate on your grant recommendation form that you are not attending the event. If you do not specify this information, the request will be delayed while the Gift Fund investigates your recommendation.

Q: The IRS requires charitable organizations to issue a tax receipt for all donations of \$250 or more. This receipt must include a statement confirming that no goods or services were received in exchange for the donation. But in the Gift Fund's transmittal letter, charitable recipients are asked not to issue a tax receipt. How will they acknowledge the grant to me?

A: In our transmittal letter, we clearly request that the charity acknowledge the grantor. We instruct charitable recipients not to issue a tax receipt as an acknowledgment for any of our gifts, in order to eliminate any confusion, and ensure that you do not take a double deduction. The Gift Fund does not require a tax receipt because it is a public charity. Remember, when you make your contribution to the Gift Fund, you are donating to a public charity. Therefore, you receive a full tax deduction at that time, and are provided with a tax receipt. You do not receive an additional tax deduction when the Gift Fund issues a grant at your recommendation.

Q: I am a Charitable Gift Fund donor and the CFO of a company. I know how costly and complicated it can be to operate an effective corporate or business charitable giving program. Is it possible for a corporation to establish a Gift Fund Account?

A: Yes. Corporate Gift Fund accounts offer a variety of benefits. A Gift Fund account can help you maintain a steady program of corporate giving even if your companies earnings fluctuate from year to year. The administrative costs can be significantly lower than establishing and running a corporate foundation.

Even if your company has its own foundation, a Gift Fund account makes it possible for you to make additional donations of cash or securities above the limits set for corporate foundations. The minimum initial donation to open a corporate Gift Fund account is \$100,000.

Q: After establishing my gift fund account, do I need to fill out any special forms when I make an additional contribution?

A: A letter of instruction must accompany your transfer of securities or mutual fund shares when contributing to your Gift Fund account. The Gift Fund cannot process your request without it. The Gift Fund's Additional Contribution Form can assist you in completing your contribution.

Q: I am planning to transfer stock to open a Gift Fund account before 1998 is over. How can I be sure the transfer takes place before Dec. 31, 1998?

A: Because your broker controls the transfer, you can help by starting early and by communicating your wishes clearly in writing.

Then, follow up with a phone call to make sure your instructions have been acted upon. A Charitable Gift Fund account representative can answer questions and provide assistance on your behalf. However, your broker is responsible to you. Please

keep in mind that a transfer of assets can take several weeks. It's a good idea to plan your year-end schedule accordingly.

Q: Does the Charitable Gift Fund accept stock in which a tender offer has been extended?

A: Yes. However, to eliminate the capital gains tax owed on shares in a company that is being acquired, you should donate your stock prior to the conclusion of the tender. The Gift Fund will generally sell the shares you have donated and will fund your account with the proceeds. As a result, you will avoid the capital gains tax that would have been due on the stock and you will also receive a tax deduction equal to the stock's fair market value.

Q: What is the difference between a public charity and a private foundation?

A: Generally speaking, a public charity receives its support from a variety of unrelated donors and sources. A private foundation typically receives most of its money from a sole donor or family, that may also have a say in how the foundation operates and disburses its money. To qualify as a public charity, an organization must meet the rigorous criteria established by Section 509(a) and 501(c)(3) of the Internal Revenue Code.

Donations to both public charities and private foundations receive special tax benefits. However, you are able to take a larger deduction for cash contributions and appreciated securities to public charities, such as the Charitable Gift Fund. The IRS allows you to deduct cash contributions up to 50% of your adjusted gross income (AGI) for income tax purposes. You can deduct up to 30% of your AGI for contributions of securities.

Q: How can I find out my account balance between statements?

A: You can get up-to-date account balance information 24-hours a day, 7 days a week by calling 800-952-4438. Listen for instructions and enter your account number followed by the last four digits of your Social Security number.

Q: May I authorize someone to recommend grants from my account?

A: Yes. You may authorize another party, in writing, to recommend grants to charitable organizations from your account. You may simply write your instructions and send them to us. Once your written authorization is received, the person you have designated will have the same grantmaking rights and responsibilities that you have. Writ

ten notice is required to revoke the authority. You may also request that an individual be recognized for a grant by specifying so on the grant recommendation form.

Q: When I choose to recommend a grant from my Gift Fund account, how will the non-profit organization know that the grant is from me?

A: Grants to charities are accompanied by a letter recognizing the individual(s) recommending the grant. You may request that an individual(s) other than yourself be recognized for a grant. You may also remain anonymous if you wish. All options are available on the Grant Recommendation Form.

A DONOR CHECKLIST OF DO'S and DON'TS

DO:

- Do ask us to make a general support grant, or to support a capital campaign or a specific project of a charitable organization.
- Do ask us to send a contribution in lieu of tickets to a fundraiser.
- Do expect to receive a copy of the grant check, so you'll know it has been paid.
- Do ask us to send a copy of our grant check to the friend who solicited you or to some other interested person, where appropriate.

DON'T:

- Don't ask us to fulfill a pledge. Charitable dollars cannot be used to pay a personal obligation.
- Don't ask us to pay for a membership, a ticket to a fundraiser, or other contribution that provides a personal benefit to you.
- Don't ask us to send the check directly to you.

APPENDIX D

QUESTIONS TO ASK BEFORE CREATING A DONOR-ADVISED FUND

- (A) Commercially-Initiated Funds. Many commercial organizations including brokerage houses and banks have followed the Fidelity Charitable Gift Fund into the donor-advised fund business. Each commercially-initiated fund is different from the next with regard to fees, policies, staffing, and services.⁶ Questions to ask include:
1. Does it matter to me that the principal in my account is likely or possibly to be invested only in the sponsor's funds for which the sponsor takes fees for management, investment advisor, custody, and administrative services? What are those fees? How do they compare with fees at other funds or at my community foundation?
 2. Does a referring broker take a fee off the top of my charitable gift? Is that person registered to solicit charitable gifts in my state? Will she get fees for as long as I have money in my fund? Will she handle investment of my fund?
 3. Does the organization offer grantmaking advisory services? Do I want help in evaluating grant recipients before I give or do I already know my donees?
- (B) Any Donor-Advised Fund. Before creating a donor-advised fund, the donor or her advisor should ask the following questions:
1. Is there a minimum amount needed to open a donor-advised account? (Some require \$2,000 while others require \$100,000 to open an advised-fund account.)
 2. How often can I recommend grants? (Some funds limit the frequency of recommendations to two or three times per year, others to one grant per month.)
 3. Is there an annual minimum amount that must be expended? (Some recommend 5 percent per year of the total fund's market value and others recommend at least 5 percent per year of each component fund.)
 4. How large must recommendations be? (*E.g.*, the Boston Foundation requires grant suggestions to be at least \$250 per donee.)
 5. What is the maximum amount or percentage that I can recommend for expenditure in a single year? (The Boston Foundation permits the President to authorize grants of \$250 to \$100,000 on a monthly basis, but suggestions for

6. For a more detailed analysis of community vs. commercial, see Cynthia Jones Eiseman, "Value Added: Donor Advised Funds at Community Foundations," *Trust & Estates* (March 1997) 16.

grants over \$100,000 require approval of the Board. If principal is to be expended, the Boston Foundation strongly recommends that the payout in full be over no less than 5 years.)

6. Can I recommend grants to public charities outside of the community where the fund is headquartered?
7. What fees are charged for the fund's services?
8. Does any broker or other person get paid a referral fee for my gift? If so, is that person registered to solicit charitable gifts in my state or eligible for an exemption to registration?
9. What fees are charged for investment or management of my fund balance?
10. What happens to my fund at my death or the death of the designated advisor?
How long can a designation-right last?
11. Can I appoint a corporate advisor?
12. Does the fund have staff members who can help me to identify worthy recipients in my field(s) of interest? If so, is there an additional charge for that service?

APPENDIX E

WHERE TO FIND A DONOR-ADVISED FUND

1. **Community foundation.** The community foundation is the traditional home of the donor-advised fund. In 1994, combined assets of U.S. community foundations exceeded \$10.07 billion. The New York Community Trust alone manages assets in excess of \$1 billion. A donor can make her gift directly to open a donor-advised fund account or indirectly by creating a supporting organization to the community foundation donor-advised fund account. A private foundation may also terminate into a community foundation subject to favorable provisions in the section 507 rules. A potential donor can locate her nearest community foundation by consulting her financial or tax advisor or by contacting the Council on Foundations in Washington, D.C. ((202) 466-6512).

2. **A Selection of Commercially-Initiated Donor-Advised Funds.**⁷
 - a. **The Fidelity Charitable Gift Fund.** Now over eight years old, Fidelity is the first and the leader among the relatively small number of commercially initiated donor-advised funds. The Gift Fund maintains an excellent website at www.charitablegift.org.

Fidelity Charitable Gift Fund
82 Devonshire Street, F35
Boston MA 02109
1-800-682-4438

Minimum initial gift required by the fund is \$10,000.
 - b. **The National Philanthropic Trust Company (“NPT”).** NPT is a public charity initiated by Pitcairn Trust Company and organized as a Pennsylvania non-profit organization. It was recognized as a 501(c)(3) organization on July 10, 1996. Two of the five initial trustees are also directors and officers of Pitcairn. NPT aims for a middle ground between commercially initiated (*i.e.*, it doesn’t use the Pitcairn name and allows other investment managers besides Pitcairn) and community foundation models (*e.g.*, NPT sponsors grantmaking advice sessions). The organization does not have a minimum payout obligation, as opposed to private foundations which are required to payout a minimum of 5%. In the year ending June 30, 1997, National Philanthropic Trust received contributions in the amount of \$ 20 million and distributed \$ 1.4 million in grants.

The National Philanthropic Trust
Eileen Heisman, SVP
One Pitcairn Place
Suite 3000
Jenkintown, PA 19046
(888) 878-7900
www.nptrust.org

- c. **Vanguard Charitable Endowment Program.** The Endowment is organized as a corporation. The Board of Trustees is made up of primarily outside, independent parties. Only one of its three initial Trustees is affiliated with The Vanguard Group, Inc. Donor advisors have a few options for administration of their assets upon death. They may appoint a successor-advisor, or propose that the assets be distributed to one or more public charities that may designate that the assets be moved to an unrestricted fund; the latter is the default if no successor option is indicated by the donor advisor.

The fund's literature states that the fund has a minimum payout obligation. The Endorsement expects that "its grant distributions will exceed 5% of its average net assets on a fiscal five-year rolling basis. If this level of grant activity is not attained, [it] will identify each named account from which grants over the same five-year period totaled less than 5% of the account's average assets. [It] will then contact the donor-advisors of these accounts to request that they recommend grants of at least this amount. If a donor-advisor does not provide qualified grant recommendations within 60 days of such a request, the Endowment Program reserves the right to transfer up to 5% of assets from the donor-advisor's named account to the Endowment Program's unrestricted fund for discretionary grantmaking."

The fund does not allow payouts to private foundations; it allows grants only to nonprofit organizations that are public charities. The Endowment considers all grant recommendations made by donor-advisors to ensure that all assets are used for qualified charitable purposes. The Endowment reserves the right to transfer account assets which do not meet the guidelines. Grant review is implemented by the staff and the Board of Trustees.

Vanguard Charitable Endowment Program
The Vanguard Group
P.O. Box 3075
Southeastern, PA 19398-9917
Tel.: 1-888-383-4483
Fax: 1-888-426-3273

- d. **The American Gift Fund. American Guaranty and Trust Company.** The Fund, organized as a trust, became an exempt organization on May 20, 1998. The Fund has a three member Board of Trustees, the majority of whom must be independent of the Fund.

The Fund expects that “its grant distributions will exceed 5% of its average net assets on a fiscal five-year rolling basis. If that level of grant activity is not attained, the Fund will identify the named accounts from which grants over the same five-year period totaled less than 5% of each account’s average assets. The Fund will then contact the donor-advisors of these accounts to request that they recommend grants over the same five-year period totaled less than 5% of each account’s average assets. The Fund will then contact the donor-advisor of these accounts to request that they recommend grants of at least this amount. If a donor advisor does not provide qualified grant recommendations within 60 days of such request, the Fund reserves the right to transfer up to 5% of assets from the donor advisor’s named account to the Fund’s General Fund for discretionary grantmaking.”

The Fund provides that a donor may recommend grants only to charitable organizations which are exempt from federal income taxation under I.R.C. section 501(c)(3). The Fund does not allow gifts to be made to private foundations. The Fund will conduct an investigation when it believes grant funds are being used for the private benefit of the donor-advisor.

A donor may designate one or more family members or other persons to make recommendations in the donor’s place after the donor’s death. In addition, a donor may recommend to the Fund one or more charities to receive the balance of the donor’s account at the donor’s death.

The American Gift Fund
The American Guaranty and Trust Company
220 Continental Drive, Suite 401
Newark, DE 19713
Tel.: 1-800-240-4248
Fax: (302) 731-2828
Website: www.giftfund.org

- e. The Bessemer National Gift Fund. The Fund, organized as a trust, became exempt in July of 1998. The corporate trustee is Bessemer Trust Company. Bessemer accepted two to four unrelated and unaffiliated individual trustees, based upon their experience in the public philanthropic sectors, prior to accepting any contributions to the trust. The trustees will review grant recommendations to ensure that they are distributed to proper charitable recipients.

The donor may appoint a successor to make recommendations for grants. The Fund does not have a minimum payout obligation, and gifts may be made to private foundations or private charities.

Bessemer Trust
630 Fifth Avenue
New York, NY 10111
Tel: (212) 708-9100
Fax: (212) 265-5826
E-mail: wealth@bessemer.com.

f. **The Ayco Charitable Foundation**

The Ayco Company
L.P. Address P.O. Box 8009
Clifton Park, NY 12065-8009
1-800-335-5353

- g. **Barnett Charitable Foundation.** Barnett Bank/NationsBank/BankAmerica. The Foundation is based in Florida. It is currently on hold and under review by BankAmerica due to the recent mergers. There are no marketing materials available. Review was expected to be completed by the end of summer 1999.

Thomas A. Willner
NationsBank
715 Peach Tree Street, N.E., 8th Floor,
Atlanta, GA 30308-1215
404-607-3813.

h. **The Charitable Gift Fund**

Maxus Foundation
The Maxus Investment Group
1301 East Ninth Street
Cleveland, OH 44114.
Tel.: (216) 687-1004
Fax: (216) 687-1001
Website: www.maxusgroup.com.

i. **The Fund for Charitable Giving**

PNC Bank, New England
125 High Street
Oliver Street Tower
Boston, MA 02110-2713
Tel.: 1-800-225-2310.

3. **Public Charities With Substantial Advised Fund Programs.**

Many PCs have (or will create upon request) donor-advised funds dedicated to the furtherance of the PC's exempt purposes. For advice on setting up a program, *see* Establishing an Advised Fund Program (Washington, D.C.: Council on Foundations (202-466-6512), 1992), which includes sample documents; "The Donor-Advised Fund," 12 *Charitable Gift Planning News* 4 (March 1994).

- a. **The Funding Exchange.** The Funding Exchange (“FEX” for short) is a national membership network of community funds that fund grassroots groups working for social change. Between 1979 and 1993, FEX made over \$55 million in grants. FEX awards over \$3 million each year in donor-advised and activist-advised funds. The activist-advised funds are the Saguario Fund (grants to communities of color), the Paul Robeson Fund for Independent Media, and OUT: A Fund for Gay and Lesbian Liberation.

Funding Exchange
666 Broadway, Suite 500
New York, NY 10012
(212) 529-5300

Member funds include: Appalachian Community Funds, Bread & Roses Community Fund (Philadelphia & Camden), Chinook Fund (Colorado), Crossroads Fund (Chicago), Fund for Southern Communities, Haymarket People’s Fund (New England), Headwater’s Fund (Minneapolis/St. Paul), Liberty Hill Foundation (LA County), McKenzie River Gathering Foundation (Oregon), North Star Fund (NYC), Vanguard Public Foundation (northern California), Wisconsin Community Fund, The People’s Fund (Hawaii), and Three Rivers Community Fund (SW Pennsylvania).

- b. **The Tides Foundation.** Founded in 1976 by Drummond Pike, who is the Tides Foundation’s President, the Tides Foundation is organized like a community foundation but differs in that (i) it is national in scope, (2) provides financial and management services to more than 200 projects around the country, and (3) provides donor advisory services to other foundations, individuals and corporations. In 1996, the Tides Foundation created a sibling entity, the Tides Center, to conduct the public education programs previously conducted within the Tides Foundation. The Tides Foundation has component funds and donor-advised funds and a socially screened asset management policy. The grantmaking program promotes change toward a healthy society, founded on principles of social justice, broadly shared economic opportunity, robust democracy, and sustainable environmental practices.

The Tides Foundation
P.O. Box 29903
San Francisco, CA 94129-0903
(415) 561-6400

- c. **The Philanthropic Collaborative, Inc. (“TPC”).** TPC is a public charity established by several generations of Rockefeller family members in 1991 to facilitate philanthropy and to support the growth of a creative nonprofit sector. TPC assists donors by offering administrative, financial, and program development support. TPC also achieves its mission through donor-advised funds, which require an initial contribution of \$50,000 or more.

The Philanthropic Collaborative, Inc.
Room 5600
30 Rockefeller Plaza
New York, NY 10112
(212) 649-5949

- d. **CAF America.** A U.S. public charity, CAF America is the U.S. affiliate of the UK's Charities Aid Foundation. CAF America combines features of a donor-advised fund with those of an "American Friends of" organization for grant-making to non-U.S. charities. It charges fees for its administrative and grant-making services.

CAF America
King Street Station
Suite 150
1800 Diagonal Street
Alexandria, VA 22314
(703) 549-8931

- e. **The American Ireland Fund.** The American Ireland Fund administers an advised-fund program promoting peace, culture, and charity in Ireland, north and south, since 1976.

The American Ireland Fund
320 Park Avenue
Fourth Floor
New York, New York 10022
(212) 224-1286

- f. **The Giving Back Fund.** The Giving Back Fund specializes in advised funds for professional athletes such as Buffalo Bills quarterback Doug Flutie.

The Giving Back Fund
230 Congress Street
Boston, MA 02110
(617) 556-2820
Fax: (617) 426-5441
Website: www.givingback.org

4. **University Donor Advised Funds:**

1. Cornell University
The Cornell University Foundation
Website: www.alumni.cornell.edu/giving/Foundation

b. Harvard University
The Harvard Donor Advised Fund (HDAF)
Website: www.aad.harvard.edu/pgo

c. University of California-Los Angeles

d. The University of Colorado Foundation

e. Oklahoma State University Foundation

5. Religiously-Based Donor Advised Funds:

a. Christian Community Foundation

P.O. Box 4880
Woodland Park, CO
80866-4880
(719) 687-8784
Fax: (719) 687-8780

(N.B.: Some observers have linked CCF with National Foundation below, although I have not investigated whether a link exists.)

b. Jewish Communal Fund

130 East 59th Street, Suite 1204
New York, NY 10022
(212) 752-8277
Fax: (212) 319-6963

The JCF was established in 1972 and has over 1,100 donors and since its inception has made grants in excess of \$500 million to thousands of charities, sectarian and nonsectarian.

c. Jewish Community Foundation

5700 Wilshire Boulevard
Suite 2000
Los Angeles, CA 90036
(213)761-8700
Fax: (213)761-8720

2. Jewish Community Endowment Foundation

843 St. Georges Avenue
Roselle, NJ 07203
(908)298-8200
Fax: (908)298-8220

e. **National Catholic Community Foundation**

1210C Benfield Boulevard
Millersville, MD 21108
1-800-757-2998

6. **National Christian Charitable Foundation**

Terry Parker, Director and General Counsel
1275 Peachtree St. NE, Suite 700
Atlanta, GA 30309
(404) 888-7444
Fax: (404) 870-4843

NCCF will not honor donor advice contrary to its published doctrinal principles. Its material also states that it “is unique among Foundations because we offer our Donors the comfort and safety of a Private Letter Ruling from the IRS that “pre-approves” the NCCF Donor-Advised Fund.”

6. **Calling for Caution or Critical Investigation.**

a. **National Community Foundation**

101 Westpark Drive, Suite 160
Brentwood, TN 37027
1-800-535-2601 or
(615) 309-5030
Fax: (615) 309-5031

b. **The American Foundation**

4518 North 32nd Street
Phoenix, AZ 85018
1-800-788-8992
(602) 955-470
Fax: (602) 955-4707

c. **Charitable Alliance**

Charitable Advisors, Inc.

1 Turtle Creek Village
3818 Oak Lawn Avenue, Suite 606
Dallas, TX 75210-4471
(214) 523-3982
Fax: (214) 523-3929

d. **National Foundation, Inc.**
700 Valley View Drive, Suite D
Woodland park, CO 80863
(719) 687-8764
Fax: (719) 687-8780

e. **National Heritage Foundation**
6218 Beachway Drive
Box 1776
Falls Church, VA 22041
1-800-986-4483
Fax: (703) 820-4483