

# THE Good Advisor

## Donor Advised Funds: Giving Without Giving Up Control

Where will you vacation this year? Vacation club members simply check their club options to plan their escape. While timeshares usually involve ownership at one location, vacation clubs offer more flexibility by providing access to attractive holiday properties—hotels, condos, resorts, even free-standing homes. There are annual fees and club limits, but in exchange, members don't have to worry about property taxes, maintenance, or locking in to a single destination upfront.

Philanthropically minded clients who favor a similar mix of control and flexibility may appreciate the many advantages of a donor advised fund (DAF). Donors contribute to a DAF maintained and administered by a sponsoring organization (a qualified charity), take an immediate tax deduction and, at some point in the future, advise the fund on which charities will receive distributions. The fund offers professional management and maintains ultimate control over asset distribution.

Donor advised funds are a popular fixture in charitable giving—so much so that their numbers continue to accelerate. The National Philanthropic Trust reports total DAF assets under management at over \$70 billion in 2014.<sup>1</sup> The popularity of donor advised funds deserves attention, and understanding the ground rules ensures that donors will not run afoul of IRS guidelines.

In this issue of *THE GOOD ADVISOR* we highlight DAFs—what they are, what sets them apart from other types of charitable giving, and common pitfalls to avoid.

- **The Nuts and Bolts**
- **Why Donors Love DAFs**
- **Legally Speaking: Defining a Donor Advised Fund**
- **General Concerns**
- **Impermissible Uses and Penalties**

### The Nuts and Bolts

A donor advised fund is a giving account established and maintained by a “sponsoring organization”—in other words, a charity. The primary advantage of these funds is that they are easy to use. Briefly, here is how they work:

- The donor makes an irrevocable contribution to a donor advised fund. Many DAFs have policies in place regarding the types of property suitable for donation—for example, they may not accept securities with transfer restrictions.
- The donor takes an immediate charitable income tax deduction for the contribution. A DAF is a 50% organization, which means the donor can deduct up to 50% of adjusted gross income (AGI) for a cash contribution to a DAF in the year of the gift and up to 30% of AGI for a non-cash contribution.<sup>2</sup>
- Contributed assets are maintained in a segregated account, where they are professionally managed and grow tax free. Donors cannot choose how assets are invested, but sponsoring organizations typically offer investment categories intended to appeal to mainstream investment styles.
- The donor recommends grants from the account to qualified charities according to the guidelines established by the fund—however, the sponsoring organization retains the right to control the donated property (including the right to sell and invest the assets) and retains the right to reject the donor's recommendation concerning the timing or propriety of a distribution. The donor can recommend grants at the time of the initial contribution to the fund or at future dates according to fund guidelines.

A donor cannot do any of the following:

- Satisfy a legally binding pledge to a particular charity with a DAF distribution,
- Direct distributions to a private foundation, or
- Appropriate any other use that accompanies a donor benefit (such as tickets or sponsoring a table at a charitable event).

## Why Donors Love DAFs

Ask participating donors about these funds and most would say, “What’s not to like?” DAFs offer customized control, the ability to support specific targets, the capacity to time donations, and professional asset management. These features motivate charitably minded individuals to seek out this giving arrangement. But that’s not all...

- **Delayed gift with immediate tax benefits.** Because a DAF ultimately benefits a public charity, the donor may claim an immediate tax deduction for the contribution, despite the fact that the DAF may not make a distribution to a particular charity for some time.
- **Flexibility in choosing charitable beneficiaries.** While the donor’s gift is irrevocable, the charitable beneficiary is not locked in at the time of contribution. The donor can wait to choose one or more charitable beneficiaries to receive grants from the DAF. Of course, the sponsoring organization will have rules concerning distributions and will always retain the right to reject a donor’s suggestion.
- **Relief from administrative burdens.** If a donor holds funds with the intention of giving them to charity later, the donor is responsible for the burdens of maintaining and growing the assets—everything from recordkeeping for tax purposes to monitoring investment performance. By contributing funds to a DAF, the donor is relieved of these burdens.

## Legally Speaking: Defining a Donor Advised Fund

The Internal Revenue Code (IRC) outlines three defining characteristics of a DAF. The fund must contain all three elements to qualify as a DAF:

- The DAF must be **solely owned and controlled** by the sponsoring organization.
- The DAF must be separated from the sponsoring organization’s general fund and **separately identified** with specific reference to the contribution of a donor (or donors).
- The donor (or “donor advisor” appointed or designated by the donor) must have, or reasonably expect to have, advisory privileges with respect to the

## What Is a Sponsoring Organization?

The IRC defines a “sponsoring organization”<sup>3</sup> as an organization that:

- Is described in IRC §170(c)—typically a non-governmental entity organized for religious, charitable, scientific, literary, or educational purposes, which need not be organized in the United States
- Is not a private foundation,<sup>4</sup> and
- Maintains one or more donor advised funds.

distribution or investment of assets held in the fund or account.<sup>5</sup>

Advisory privileges are distinct from legal rights or obligations. For example, if a donor executes a gift agreement with a sponsoring organization that specifies certain legally enforceable rights with respect to the gift, these rights preclude the gift from being treated as subject to “advisory privilege” under the DAF rules. The best evidence for the presence of an advisory privilege is a written document describing the arrangement between the donor (or donor advisor) and the sponsoring organization. The document should specify the procedures that govern the advisory process, including a description of how the sponsoring organization will invest and distribute funds in the event the donor does not exercise the advisory privileges.

The donor can designate a “donor advisor” to advise on fund investments. The donor advisor may, in turn, be allowed to further delegate advisory privileges. In some situations, a donor may recommend that a certain individual be named to a committee or other body that will advise a sponsoring organization on fund disbursements. If such an individual makes recommendations based on objective criteria related to their own expertise, they will not be considered a donor advisor if they are selected to advise the fund.

## General Concerns

Despite the many advantages that donor advised funds provide, there are some general concerns about this method of giving, including:

- **Significant fees.** Though DAF fees may be lower than those associated with private foundations, DAFs can still impose high administrative and investment fees, reducing what the charity ultimately receives.
- **No government-imposed safeguards.** Some critics contend that the donor holds too much control over the funds—much like a private foundation,

but without the government-imposed restrictions applicable to private foundations. Consequently, it's possible that a DAF might not be used for the charitable purposes for which the donor claimed a charitable deduction.

- **Lack of ultimate control.** Conversely, some feel the donor holds too little control. Although the donor may advise on distributions, and such recommendations are often followed, final discretion regarding the distribution of assets rests with the organization.

## Impermissible Uses and Penalties

Donor advised funds are easy to use—the donor can simply send instructions to the sponsoring charity as to where a distribution should be sent. However, if assets are improperly distributed (for example, made to an entity that is not a qualified charity under IRC 170(c), or used to satisfy a legally binding pledge), problems arise that could lead to IRS excise tax penalties for the donor. Because there are many available DAFs, donors should research which sponsoring organizations offer assistance regarding proper and improper distributions from the DAF, and, if desired, advice about philanthropic choices.

Let's look at several potential problems and their associated penalties:

**Improper Distribution.** The IRS will impose excise taxes on a distribution from a DAF to any person for a purpose not specified under IRC §170(c)(2)(B).<sup>6</sup> The DAF sponsoring organization is taxed 20% on any improper distribution. An additional 5% tax (not to exceed \$10,000 per distribution) can be imposed on any fund manager who knowingly permits an improper distribution.

**More-Than-Incidental Benefit.** This miscue occurs when the donor (or donor advisor or related party) receives personal benefits resulting from the contribution to the DAF that are more than “incidental.” For example, while a coffee mug or calendar would be considered incidental, school tuition would not. If a donor receives a benefit determined to be more than incidental, the IRS imposes a tax equal to 125% of the benefit received on either the person who advises on the distribution or the person who receives the benefit as a result of the distribution. Any fund manager<sup>7</sup> that knowingly approves such a distribution can be taxed up to 10% of the amount of the charitable distribution itself (not to exceed \$10,000).<sup>8</sup>

**Excess Business Holdings.** The excess business holdings rules outlined under IRC §4943 apply to DAFs. When the combined ownership of a business interest by both the donor advised fund and “disqualified persons”

exceeds the permitted limits, the DAF is subject to a 5% tax on those excess business holdings. The DAF is permitted to hold up to 20% ownership in a business (minus the voting stock held by disqualified persons) or up to 35% if no disqualified persons hold ownership interests.

With respect to a DAF, disqualified persons include:

- A donor or a donor advisor.
- A member of the family of a donor or donor advisor, including spouses, ancestors, children, grandchildren, and great grandchildren; and the spouses of children, grandchildren, and great grandchildren.
- A 35% controlled entity—a corporation, partnership, trust or estate in which more than 35% of the combined voting power (or partnership profits interest or the beneficial interest in the trust or estate) is possessed by donors, donor advisors, or family members.

## Conclusion

“Good advice is like a useful tool, yet it requires hands to make it work.”

PANO GEORGE KARKANIS,  
*Thoughts for Meaningful Life*<sup>9</sup>

Sound advice implemented through the hands of a capable administrator sums up the workings of a donor advised fund. It is this opportunity to both contribute and influence disbursements over time that makes donor advised funds so popular today. Many benefits exist for those interested in taking advantage of DAF participation—professional management, immediate tax deduction and tax-free growth on contributions. Advisors can play an important role for philanthropically minded clients by providing timely advice designed to help donors sort through the benefits of giving using a donor advised fund.

## ENDNOTES

1 <http://www.nptrust.org/daf-report>

2 See 26 CFR §1.170A-8.

3 IRC §4966(d)(1).

4 As defined in IRC §509(a).

5 IRC §4966(d)(2)(A).

6 IRC §4966(a).

7 A fund manager is an officer, director, or trustee of the sponsoring organization, or an individual having similar powers or responsibilities; or with respect to any act or failure to act, an employees of the sponsoring organization having authority or responsibility with respect to such act or failure to act. See IRC §4966(d)(3).

8 IRC §4966(b)(2).

9 [http://www.notable-quotes.com/a/advice\\_quotes\\_iii.html](http://www.notable-quotes.com/a/advice_quotes_iii.html)

### **Access more information now!**

An electronic copy of our companion booklet with a more in-depth treatment of donor advised funds as well as additional information on the key elements of DAFs, the nuances of advisory privilege, arrangements related to DAFs, a comparison with private foundations, excess benefit transactions, and reporting and disclosure information may be accessed in the Professional Advisor section of our website at [www.catholicfoundation.com](http://www.catholicfoundation.com).

You can download this PDF and store it on your PC or tablet for easy access.

This newsletter is only for professional advisors and only for their information and discussion. It is intended only to provide general information about charitable gifts and charitable-gift planning. This newsletter is not (1) legal, tax, accounting, or financial advice, (2) any solicitation of legal, tax, accounting, or financial services, (3) any securities or investment advice, or (4) any solicitation of securities or investment advisory services. Each professional must evaluate the tax and financial consequences of each individual situation.

Although The Catholic Foundation has been diligent in attempting to provide accurate information, the accuracy of the information in this newsletter cannot be guaranteed. Laws and regulations change frequently and are subject to differing legal interpretations. Accordingly, The Catholic Foundation shall not be liable for any loss or damage caused or alleged to have been caused by the use or reliance upon the information in this newsletter.

**T H E**  
**CATHOLIC**  
**F O U N D A T I O N**

1222 Merit Drive, Suite 850 • Dallas, TX 75251 • Phone 972-661-9792 • Fax 972-661-0140

[www.catholicfoundation.com](http://www.catholicfoundation.com)

## Giving Without Giving Up Control: Donor Advised Funds

### **In This Issue:**

---

- The Nuts and Bolts
- Why Donors Love DAFs
- Legally Speaking: Defining a Donor Advised Fund
- Donor Advised Funds and Their Distant Relations
- General Concerns
- Impermissible Uses and Penalties
- Reporting and Disclosure

## Giving Without Giving Up Control: Donor Advised Funds

Where will you vacation this year? Vacation club members simply check their club options to plan their escape. While timeshares usually involve ownership at one location, vacation clubs offer more flexibility by providing access to attractive holiday properties—hotels, condos, resorts, even free-standing homes. There are annual fees and club limits, but in exchange, members don't have to worry about property taxes, maintenance, or locking in to a single destination upfront.

Philanthropically minded clients who favor a similar mix of control and flexibility may appreciate the many advantages of a donor advised fund (DAF). Donors contribute to a DAF maintained and administered by a sponsoring organization (a qualified charity), take an immediate tax deduction and, at some point in the future, advise the fund on which charities will receive distributions. The fund offers professional management and maintains ultimate control over asset distribution.

Donor advised funds are a popular fixture in charitable giving—so much so that their numbers continue to accelerate. The National Philanthropic Trust reports total DAF assets under management at over \$70 billion in 2014.<sup>1</sup> The popularity of donor advised funds deserves attention, and understanding the ground rules ensures that donors will not run afoul of IRS guidelines.

In this issue, we highlight DAFs—what they are, what sets them apart from other types of charitable giving, and common pitfalls to avoid.

### The Nuts and Bolts

A donor advised fund is a giving account established and maintained by a “sponsoring organization”—in other words, a charity. The primary advantage of these funds is that they are easy to use. Briefly, here is how they work:

- The donor makes an **irrevocable contribution** to a donor advised fund. Many DAFs have policies in place regarding the types of property suitable for donation—for example, they may not accept securities with transfer restrictions.
- The donor takes an **immediate charitable income tax deduction** for the contribution. A DAF is a 50% organization, which means the donor can deduct up to 50% of adjusted gross income (AGI) for a cash contribution to a DAF in the year of the gift and up to 30% of AGI for a non-cash contribution.<sup>2</sup>
- Contributed assets are maintained in a segregated account, where they are **professionally managed** and grow tax free. Donors cannot choose how assets are invested, but sponsoring organizations typically offer investment categories intended to appeal to mainstream investment styles.
- The donor **recommends grants** from the account to qualified charities according to the guidelines established by the fund—however, the sponsoring organization retains the right to control the donated property (including the right to sell and invest the assets) and retains the right to reject the donor's recommendation concerning the timing or propriety of a distribution. The donor can recommend grants at the time of the initial contribution to the fund or at future dates according to fund guidelines.

#### What Is a Sponsoring Organization?

The IRC defines a “sponsoring organization”<sup>3</sup> as an organization that:

- Is described in IRC §170(c)—typically a non-governmental entity organized for religious, charitable, scientific, literary, or educational purposes, which need not be organized in the United States
- Is not a private foundation,<sup>4</sup> and
- Maintains one or more donor advised funds.

A donor cannot do any of the following:

- Satisfy a legally binding pledge to a particular charity with a DAF distribution,
- Direct distributions to a private foundation, or
- Appropriate any other use that accompanies a donor benefit (such as tickets or sponsoring a table at a charitable event).

## Why Donors Love DAFs

Ask participating donors about these funds and most would say, “What’s not to like?” DAFs offer customized control, the ability to support specific targets, the capacity to time donations, and professional asset management. These features motivate charitably minded individuals to seek out this giving arrangement. But that’s not all...

- **Delayed gift with immediate tax benefits.** Because a DAF ultimately benefits a public charity, the donor may claim an immediate tax deduction for the contribution, despite the fact that the DAF may not make a distribution to a particular charity for some time.
- **Flexibility in choosing charitable beneficiaries.** While the donor’s gift is irrevocable, the charitable beneficiary is not locked in at the time of contribution. The donor can wait to choose one or more charitable beneficiaries to receive grants from the DAF. Of course, the sponsoring organization will have rules concerning distributions and will always retain the right to reject a donor’s suggestion.
- **Relief from administrative burdens.** If a donor holds funds with the intention of giving them to charity later, the donor is responsible for the burdens of maintaining and growing the assets—everything from recordkeeping for tax purposes to monitoring investment performance. By contributing funds to a DAF, the donor is relieved of these burdens.

## Legally Speaking: Defining a Donor Advised Fund

The Internal Revenue Code (IRC) outlines three defining characteristics of a DAF. The fund must contain all three elements to qualify as a DAF:

- The DAF must be **solely owned and controlled** by the sponsoring organization.
- The DAF must be separated from the sponsoring organization’s general fund and **separately identified** with specific reference to the contribution of a donor (or donors).
- The donor (or “donor advisor” appointed or designated by the donor) must have, or reasonably expect to have, **advisory privileges** with respect to the distribution or investment of assets held in the fund or account.<sup>5</sup>

Let’s examine each of these elements.

### Ownership and Control

The sponsoring organization must own and control the fund. To the extent that a donor or person other than the sponsoring organization owns or controls contributed amounts, the fund or account is not a DAF. In cases where a donor retains complete control of an asset provided to a sponsoring organization, there is no completed gift for purposes of the charitable deduction.

### Separate Identification

To meet this requirement, the fund or account must specifically refer to the contributions of a donor (or donors). For example, the sponsoring organization might name the fund after a donor, or treat the fund in its records as being attributable to a specific donor. A sponsoring organization’s general fund will not be treated

as a DAF because the assets in the general fund are anonymously pooled, not separately identified. Likewise, any fund or account that is distinct from the sponsoring organization's general fund but pools contributions from multiple donors will not meet the definition unless the contributions of specific donors are accounted for within the pool. For example, a fund dedicated to the relief of poverty within a specific community that does not separately identify contributions from multiple donors is not a DAF, even if a donor has advisory privileges with respect to the fund.

## **Advisory Privileges**

Advisory privileges are distinct from legal rights or obligations. For example, if a donor executes a gift agreement with a sponsoring organization that specifies certain legally enforceable rights with respect to the gift, these rights preclude the gift from being treated as subject to “advisory privilege” under the DAF rules. The best evidence for the presence of an advisory privilege is a written document describing the arrangement between the donor (or donor advisor) and the sponsoring organization. The document should specify the procedures that govern the advisory process, including a description of how the sponsoring organization will invest and distribute funds in the event the donor does not exercise the advisory privileges.

Since this characteristic gets to the heart of what makes donor advised funds different from other giving vehicles, let's look at a few of the nuances related to the advisory privilege.

### **Conduct**

Since an advisory relationship can be established on a “facts-and-circumstances” basis, it may be evident through the conduct of the donor (or donor advisor) and the sponsoring organization. For example, even in the absence of a written directive, if a donor regularly provides advice to a sponsoring organization and the organization regularly acts on the advice, the donor is considered to have advisory privileges—even if these advisory privileges were not specified at the time the donor contributed the funds.

For example, let's assume that Bernard has been a regular and generous donor to a number of charities. He contacts the sponsoring organization of his favorite charity to suggest that a distribution of \$10,000 be made to a specific charitable organization. Although the act of suggesting a course of action does not establish advisory privilege, if the sponsoring organization distributes the \$10,000 to the specified organization as a consequence of Bernard's advice, and communicates with him in such manner as to suggest that they would seriously consider his advice in the future, this is sufficient to establish Bernard's advisory privileges.

Again, both the donor and the sponsoring organization must take affirmative actions that clearly indicate an advisory relationship. It is not enough for a donor to believe that he or she has advisory privileges with regard to the contribution, or even to offer advice. Through affirmative actions, both parties must have reason to believe that the donor will provide advice and the sponsoring organization will consider it.

### **Donor Status**

To establish advisory privileges under the statute, the individual must have actual status as a donor. If a donor's expectations are due solely to providing service to the organization (e.g., as an officer, employee, director, etc., of the sponsoring organization), this does not satisfy the statutory requirement.

For example, Lillian is a member of the board of directors for the sponsoring organization. She assumes that providing advice on the distribution of funds gives rise to advisory privilege—but it does not. But, to further illustrate how facts and circumstances can subtly influence this determination, if Lillian's position with the sponsoring organization came as a result of a contribution she made as a donor or donor advisor, she may have a reasonable expectation of advisory privileges, notwithstanding that she is advising on fund disbursements in her official capacity as board member of the sponsoring organization.

### **The Donor Advisor**

The donor can designate a “donor advisor” to advise on fund investments. The donor advisor may, in turn, be allowed to further delegate advisory privileges. In some situations, a donor may recommend that a certain



individual be named to a committee or other body that will advise a sponsoring organization on fund disbursements. If such individuals make recommendations based on objective criteria related to their own expertise, they will not be considered donor advisors if they are selected to advise the fund.

In addition, for purposes of the DAF exceptions, to the extent a donor recommends to a sponsoring organization the selection of a committee member that will advise as to distributions of amounts in a fund of the sponsoring organization, the member is not treated as appointed or designated by the donor if the recommendation is based on objective criteria related the member's expertise.

For example, Alfred, a donor, recommends that Dr. Carolyn Watson serve on the committee that advises the sponsoring organization on scholarship grants in science at Alma Mater University. Carolyn has her PhD and is head of the science department at a local secondary school in Alfred's school district. Due to her clear scientific expertise, she is not considered Alfred's duly designated donor advisor.

## **Donor Advised Funds and Their Distant Relations**

Certain arrangements bear a strong resemblance to donor advised funds, but are explicitly excluded<sup>6</sup> from the DAF definition:

- A fund or account that distributes only to a "single identified organization" or government entity (for example, a university-sponsored fund, set up in the name of a donor, that exclusively supports activities of that university)<sup>7</sup>
- A fund or account whose donor advises on which individuals receive grants for travel, study or other similar purposes, where the following conditions are in place:
  - The donor (or donor advisor) is part of a committee appointed by the sponsor
  - The donor does not control the committee (whether it is the donor alone or in concert with related persons), and
  - Grants are awarded on an objective, nondiscriminatory basis

The IRS may also establish rules from time to time excepting certain types of committee-advised funds from the DAF definition (such as a fund established exclusively for disaster relief).

## **A Comparison with Private Foundations**

A donor advised fund also resembles a private foundation in that it acts as a charitable holding company of sorts, permitting a donor to contribute now but distribute later. However, DAFs bear notable differences to private foundations. The following is a list of advantages that a DAF holds over a private foundation.

- A donor can deduct the fair market value of appreciated property contributed to a DAF.
- A DAF donor can deduct a larger percentage of adjusted gross income as compared to a donor to a private foundation.
- There is no need for the donor to seek an IRS ruling on the tax-exempt status of a DAF.
- The set-up and administrative costs of a DAF are typically lower.
- A DAF may realize better investment returns because of the consolidated investment management over different funds.
- A DAF is not required to report its contributors, meaning the donor may remain anonymous while making grants.
- A DAF is not required by law to make distributions.

## General Concerns

Despite the many advantages that donor advised funds provide, there are some general concerns about this method of giving, including:

- **Significant fees.** Though DAF fees may be lower than those associated with private foundations, DAFs can still impose high administrative and investment fees, reducing what the charity ultimately receives.
- **No government-imposed safeguards.** Some critics contend that the donor holds too much control over the funds—much like a private foundation, but without the government-imposed restrictions applicable to private foundations. Consequently, it's possible that a DAF might not be used for the charitable purposes for which the donor claimed a charitable deduction.
- **Lack of ultimate control.** Conversely, some feel the donor holds too little control. Although the donor may advise on distributions, and such recommendations are often followed, final discretion regarding the distribution of assets rests with the organization.

## Impermissible Uses and Penalties

Donor advised funds are easy to use—the donor can simply send instructions to the sponsoring charity as to where a distribution should be sent. However, if assets are improperly distributed (for example, made to an entity that is not a qualified charity under IRC 170(c), or used to satisfy a legally binding pledge), problems arise that could lead to IRS excise tax penalties for the donor. Because there are many available DAFs, donors should research which sponsoring organizations offer assistance regarding proper and improper distributions from the DAF, and, if desired, advice about philanthropic choices.

Let's look at several potential problems and their associated penalties:

**Improper Distribution.** The IRS will impose excise taxes on a distribution from a DAF to any person for a purpose not specified under IRC §170(c)(2)(B).<sup>8</sup> The DAF sponsoring organization is taxed 20% on any improper distribution. An additional 5% tax (not to exceed \$10,000 per distribution) can be imposed on any fund manager who knowingly permits an improper distribution.

**More-Than-Incidental Benefit.** This miscue occurs when the donor (or donor advisor or related party) receives personal benefits resulting from the contribution to the DAF that are more than “incidental.” For example, while a coffee mug or calendar would be considered incidental, school tuition would not. If a donor receives a benefit determined to be more than incidental, the IRS imposes a tax equal to 125% of the benefit received on either the person who advises on the distribution or the person who receives the benefit as a result of the distribution. Any fund manager<sup>9</sup> who knowingly approves such a distribution can be taxed up to 10% of the amount of the charitable distribution itself (not to exceed \$10,000).<sup>10</sup>

**Excess Business Holdings.** The excess business holdings rules outlined under IRC §4943 apply to DAFs. When the combined ownership of a business interest by both the donor advised fund and “disqualified persons” exceeds the permitted limits, the DAF is subject to a 5% tax on those excess business holdings. The DAF is permitted to hold up to 20% ownership in a business (minus the voting stock held by disqualified persons) or up to 35% if no disqualified persons hold ownership interests.

With respect to a DAF, disqualified persons include:

- A donor or a donor advisor.
- A member of the family of a donor or donor advisor, including spouses, ancestors, children, grandchildren, and great grandchildren; and the spouses of children, grandchildren, and great grandchildren.
- A 35% controlled entity—a corporation, partnership, trust or estate in which more than 35% of the combined voting power (or partnership profits interest or the beneficial interest in the trust or estate) is possessed by donors, donor advisors, or family members.

**Excess Benefit Transactions.** An excess benefit transaction is any grant, loan, compensation, or other similar payment (such as an expense reimbursement) from the DAF to a disqualified person.

For example, Joe donates securities to a DAF. He then purchases those same securities from the fund for \$10,000 less than the amount he claimed they were worth for the purposes of his charitable income tax deduction. This purchase is subject to the excess benefit transaction rules because Joe, as the donor, is a disqualified person with respect to the fund. Thus, Joe must pay a penalty tax equal to 25% of the \$10,000 excess benefit (here, \$2,500). If Joe does not correct the excess benefit transaction within the taxable period, he is subject to an additional tax equal to 200% of the benefit (here, \$20,000). Note that if this tax applies, the incidental benefit tax does not.

But what if the fund distributed the securities to the sponsoring organization first, prior to Joe's purchase? This would raise the question of whether the fund's distribution to the sponsoring organization was intended to circumvent the disqualified person rule. If so, the IRS may disregard the distribution, with the result that the purchase is treated as being made from the DAF and not from the sponsoring organization, so the tax penalties would apply. A tax equal to 10% of the benefit is imposed on any organization manager who knowingly participated in the excess benefit transaction unless the participation is not willful and is due to reasonable cause. Amounts repaid to correct an excess benefit transaction cannot be held in any DAF.

## Reporting and Disclosure

A sponsoring organization must disclose this data on its information return:

- The total number of DAFs it owns
- The aggregate value of assets held in those funds at the end of the organization's taxable year
- The aggregate contributions to and grants made from those funds during the year

In addition, when seeking recognition of its tax-exempt status, a sponsoring organization must disclose whether it intends to maintain DAFs. The intention is for the organization to provide information regarding its planned operation of DAF funds, including, for example, a description of procedures it intends to use to:

- Communicate to donors and donor advisors that assets held in DAFs are the property of the sponsoring organization
- Ensure that distributions from DAFs do not result in more than incidental benefit to any person<sup>11</sup>

## Conclusion

"Good advice is like a useful tool, yet it requires hands to make it work."

PANO GEORGE KARKANIS,  
*Thoughts for Meaningful Life*<sup>12</sup>

Sound advice implemented through the hands of a capable administrator sums up the workings of a donor advised fund. It is this opportunity to both contribute and influence disbursements over time that makes donor advised funds so popular today. Many benefits exist for those interested in taking advantage of DAF participation—professional management, immediate tax deduction and tax-free growth on contributions. Advisors can play an important role for philanthropically minded clients by providing timely advice designed to help donors sort through the benefits of giving using a donor advised fund.

## **Endnotes**

- 1 <http://www.nptrust.org/daf-report>
- 2 See 26 CFR §1.170A-8.
- 3 IRC §4966(d)(1).
- 4 As defined in IRC §509(a).
- 5 IRC §4966(d)(2)(A).
- 6 IRC §4966(d)(2)(B).
- 7 Joint Committee Report, Technical Explanation of H.R. 4, “The Pension Protection Act of 2006,” page 345.
- 8 IRC §4966(a).
- 9 A fund manager is an officer, director, or trustee of the sponsoring organization, or an individual having similar powers or responsibilities; or with respect to any act or failure to act, an employees of the sponsoring organization having authority or responsibility with respect to such act or failure to act. See IRC §4966(d)(3).
- 10 IRC §4966(b)(2).
- 11 IRC §503.
- 12 [http://www.notable-quotes.com/a/advice\\_quotes\\_iii.html](http://www.notable-quotes.com/a/advice_quotes_iii.html)

T H E  
CATHOLIC  
F O U N D A T I O N

12222 Merit Drive, Suite 850 • Dallas, TX 75251 • Phone 972-661-9792 • Fax 972-661-0140  
[www.catholicfoundation.com](http://www.catholicfoundation.com)

---

This booklet is only for professional advisors and only for their information and discussion. It is intended only to provide general information about charitable gifts and charitable-gift planning. This booklet is not (1) legal, tax, accounting, or financial advice, (2) any solicitation of legal, tax, accounting, or financial services, (3) any securities or investment advice, or (4) any solicitation of securities or investment advisory services. Each professional must evaluate the tax and financial consequences of each individual situation.

Although The Catholic Foundation has been diligent in attempting to provide accurate information, the accuracy of the information in this booklet cannot be guaranteed. Laws and regulations change frequently and are subject to differing legal interpretations. Accordingly, The Catholic Foundation shall not be liable for any loss or damage caused or alleged to have been caused by the use or reliance upon the information in this booklet.

---