The Case for an Emergency Charity Stimulus

An IPS Inequality Briefing Paper

Chuck Collins & Helen Flannery
May 4, 2020
Authors:

Chuck Collins is director of the Charity Reform project of the Institute for Policy Studies where he directs the Program on Inequality and the Common Good and co-edits Inequality.org. He is author of numerous reports and books about philanthropy and charitable giving. Books include: with Bill Gates Sr., Wealth and Our Commonwealth (2003) Born on Third Base (2016) and, with Pam Rogers and Joan Garner, Robin Hood Was Right: A Guide to Giving Your Money to Social Change (2000)

Helen Flannery is an Associate Fellow at the Institute for Policy Studies. She is a long-time data analysis professional who has provided nonprofits with reporting, analytics, and industry benchmarking through her work at Target Analytics and now at ROI Solutions. She has written extensively on charitable sector trends, including direct marketing fundraising, sustainer giving, and economic factors affecting donor behavior.

Acknowledgements: The authors would like to thank Alan Davis, Ray Madoff, Scott Wallace, Scott Ellis, and Sophia Paslaski, who have read components of this briefing paper.

The Institute for Policy Studies (www.IPS-dc.org) is a multi-issue research center that has been conducting path-breaking research on inequality for more than 20 years.

The IPS Inequality.org website (http://inequality.org/) provides an online portal into all things related to the income and wealth gaps that so divide us, in the United States and throughout the world. Subscribe to our weekly newsletter at Inequality.org or follow us on Twitter and Facebook: @inequalityorg

The IPS Program on Inequality and the Common Good was founded in 2006 to draw attention to the growing dangers of concentrated wealth and power, and to advocate policies and practices to reverse extreme inequalities in income, wealth, and opportunity. The program has been investigating the intersection of inequality and race, taxation, philanthropy and the problem of hidden wealth.

Institute for Policy Studies -National Office
1301 Connecticut Ave NW, Suite 600
Washington, DC 20036
www.ips-dc.org, Twitter: @IPS_DC
Facebook: http://www.facebook.com/InstituteforPolicyStudies

Institute for Policy Studies –New England Office
30 Germania Street, Building L
Jamaica Plain, MA. 02130
Email: chuck@ips-dc.org

© 2020 Institute for Policy Studies
Contents

KEY RECOMMENDATION: EMERGENCY CHARITY STIMULUS ACT .......... 4
  PROPOSED NEW RULES FOR PRIVATE FOUNDATIONS.......................... 4
  PROPOSED NEW RULES FOR DONOR-ADvised FUNDS.......................... 4

INTRODUCTION: A DESIGN FLAW IN THE CHARITY SYSTEM ................ 5

TRENDS IN PHILANTHROPY: THE FACTS........................................ 7

CASE STUDIES: PRIVATE FOUNDATION PAYOUT ................................ 9

REVENUE ESTIMATES FROM INCREASING FOUNDATION PAYOUT ...... 10

THE TAX PAYER SUBSIDY FOR CHARITABLE GIVING.......................... 13

Q & A: CHARITY STIMULUS LEGISLATION........................................ 15

CONCLUSION...................................................................................... 20
KEY RECOMMENDATION: EMERGENCY CHARITY STIMULUS

Summary

• Congress should institute an emergency temporary three-year mandate to increase payout from private foundations and donor-advised funds.
• This policy change would stimulate over $200 billion over three years in additional giving to direct charities in the independent nonprofit sector.
• This stimulus would require no new tax dollars, as it has already been paid for by previous tax deductions taken primarily by wealthy donors.

Policy Objectives

• In this time of national emergency, increase the movement of resources from private, taxpayer-subsidized funding institutions to independent nonprofits directly engaged in charitable work and emergency COVID-19 response.
• Discourage the warehousing of essential charitable funds during this national crisis.
• Eliminate design flaws in rules governing charities to prevent abuses such as self-dealing and asset value manipulations.

PROPOSED NEW RULES FOR PRIVATE FOUNDATIONS

Emergency three-year 10 percent mandated annual payout. This would be an increase from the existing 5 percent mandated annual payout for foundations.

Exclude non-charitable contributions, investments, and expenses from counting towards annual payout rates. The following would be excluded from counting towards the mandated 10 percent annual payout:
• Contributions to donor-advised funds
• For-profit investments even when considered social impact oriented
• Foundation overhead and operating expenses above 0.5 percent of assets

PROPOSED NEW RULES FOR DONOR-ADVISED FUNDS

Emergency three-year 10 percent mandated annual payout. Donor-advised funds should have an emergency minimum annual 10 percent payout applied on a per account basis, matching that required of private foundations. Currently, DAFs are under no annual distribution requirements to move funds to active charities. Payout rate would be calculated using the method applied by the Internal Revenue Service.¹

Exclude distributions to other donor-advised funds from counting towards annual payout rates.
Allow tax deductions for future DAF donations only upon the distribution of funds from the DAF to active charities. Currently the tax deduction occurs upon donation to the DAF, and is therefore subject to abuse from donations of complex assets.

**INTRODUCTION: A DESIGN FLAW IN THE CHARITY SYSTEM**

We are living through a time of unprecedented challenges: a major public health crisis, a deepening recession, and widespread trauma and hardship. To get through it, and to recover, we will need unprecedented resources.

Congress has already authorized trillions in bailouts and stimulus funds. But as the record lines at local food banks attest, millions of Americans are still relying on the support of hardworking local nonprofits.

These nonprofits are going to need major infusions of support from charitable donations and foundations. Fortunately, Congress can help them come up with $200 billion—without costing taxpayers another dime.

We have heard many heartening stories of charitable foundations and individual donors stepping up to fund emergency responses to the COVID-19 pandemic. But this moment has also unmasked a basic design flaw in the U.S. charity system: donors can contribute to charitable intermediaries that then may sideline the funds for years—or forever.

Right now, there is an estimated $1.2 trillion in wealth warehoused in private foundations and donor-advised funds. While the donors to these funds have already taken substantial tax breaks for their contributions—sometimes decades ago—there are few incentives to move the money out to charities doing urgent, necessary work.

In fact, America’s 728,000 donor-advised funds, or DAFs—which hold an estimated $120 billion—aren’t legally required to pay out their funds at all, ever. While some DAFs, especially those administered by community foundations, pay out in a timely way, other accounts can languish for years.

Complicating matters, the largest DAFs are administered by Wall Street giants, such as Fidelity, Charles Schwab, and Goldman Sachs. These firms have a financial incentive to encourage their donor-advisors to maintain a perpetuity or legacy mentality in relation to their funds, since they levy management fees and allocate staff bonuses based on the amount of funds in charitable accounts.

America’s 86,000 foundations which hold over $1 trillion in assets are mandated by tax law to pay out 5 percent of their assets each year. But this payout calculation includes foundation overhead expenses, donations to donor-advised funds (which, again, have no
payout requirement), and even investments in profit-making companies that the donor claims make a positive impact on society.

Some foundations pay out substantially more than 10 percent, including the Walton Family Foundation, the Simons Foundation, and the Bill and Melinda Gates Foundation. But many more treat the 5 percent minimum payout as a ceiling, not a floor—and some fall below the floor. The John Templeton Foundation, for example, with $3.2 billion in assets in 2018, had a payout rate of just 4.2 percent that year.

Bloomberg Philanthropies—the foundation funded by former New York mayor and presidential candidate Michael Bloomberg—paid out at relatively high rates of 5.6 and 8.6 percent in 2017 and 2018. But Bloomberg’s foundation paid out at an average rate of just 4.2 percent over the previous seven years before that (from 2010 through 2017).³

Remember: the deductibility of these funds is subsidized by ordinary taxpayers. For the wealthiest donors, every dollar parked in their foundation or DAF reduces their tax obligations by as much as 74 cents, leaving people of more modest means to cover public programs.

These wealthy donors have already claimed their tax breaks. Now—in a crisis—ordinary taxpayers need to see the benefit of the funds they subsidized flowing to charities on the ground.

Over 700 foundations have signed a pledge to “act with fierce urgency” to support nonprofit partners and communities hit hardest by COVID-19. And the community foundation sector has set up emergency response systems in all 50 states to channel donations to COVID-19 response efforts.

These are inspiring voluntary efforts, but it’s not clear how many funds frontline nonprofit organizations will actually receive as a result. In this unprecedented emergency, it’s time to mandate an increased flow of funds.

As part of the CARES Act stimulus, Congress increased incentives for charitable giving. In the same spirit, we urge Congress, as part of its next relief bill, to support an “Emergency Charity Stimulus” to inject more than $200 billion into the economy, protect jobs in the nonprofit sector, and help fight the coronavirus disaster.

Congress should enact a three-year emergency mandate requiring private foundations to double their annual required payout, from 5 percent to 10 percent. For each one percent increase in payout, an estimated $11 billion to 12.6 billion will flow to charities annually.

To avoid abuses, we would exclude three things from what is counted as payout: donations to DAFs, investments in for-profit companies, and anything more than a modest percentage of overhead expenses. We propose that a payout requirement apply to DAFs accounts as well, which currently have no mandatory payout.
We laud the foundations and donor-advised funds that are already paying out substantially more than required. We urge them to support this emergency effort to ensure that all charity funds get off the sidelines, as they have done.

America’s taxpayers have already effectively paid for these funds through deductions taken by foundation and DAF donors. Now we need them deployed to working charities.

**TRENDS IN PHILANTHROPY: THE FACTS**

Finding comprehensive information about charitable giving, foundations and donor-advised funds is not always easy. While some information is abundant, easy-to-access information about the size of the sector, giving distribution information, and payout rates is harder to come by. This section includes an overview of the philanthropic sector, with a key summary of statistics relevant to the payout debate.

**Total Giving.** According to *Giving USA 2019*, total charitable giving in the U.S. in 2018 was $427.77 billion. This giving includes gifts from individuals, corporations, foundations, and bequests. Giving slowed slightly in 2018 after a decade of significant growth, due in part to volatility in the stock market at the end of the year, and in part to the 2017 tax reform bill, which greatly reduced the number of itemizing households.

**Top Heavy Philanthropy.** In the early 2000s, households earning $200,000 or more made 30 percent of all charitable deductions. By 2017, this high-earner group accounted for 52 percent of donations. And the total share of charitable deductions from households making over $1 million dollars grew from 12 percent in 1995 to 30 percent in 2015, according to IRS data.

**Small Donor Declines.** Meanwhile, donations by low- and middle-income givers have been declining steadily over the last 10 to 15 years. Almost all the growth in giving, reported by *Giving USA* over the last decade, has been the result of growing mega-gifts, donations over $1 million. Meanwhile, the percentage of households that give to charity has declined significantly. Between 2000 and 2016, the proportion of households giving to charity dropped from 66 percent to 53 percent.

**Foundation Giving vs. Individual Giving.** Giving by foundations more than tripled between 1998 and 2018, growing by more than 346 percent (from $17.01 billion to $75.86 billion). In comparison, giving by individuals grew only 92 percent over the same twenty years (from $137.68 billion to $264.58 billion). Foundations made up only 10 percent of all giving in 1998; they make up 18 percent of all giving today.

**FOUNDATIONS**

**Foundation Assets and Grants.** In 2015, foundations held $890 billion in total assets, and distributed $58 billion in grants (Hauser Institute for Civil Society, *Giving USA Foundation*). By
2018, foundation assets had risen to an estimated $1.2 trillion, and foundation distributions that year were $75.86 billion.¹⁰

**Growth in Foundations.** Wealthy families have created foundations at a rapid pace. The number of grant-making foundations grew from 64,845 in 2002 to 86,203 in 2015, a 28 percent increase. And the assets held in those foundations doubled over that same period, from $432 billion to $868 billion.¹¹

**Foundation Payout.** In 2018, the Foundation Source reported that foundations distributed grants at an estimated average rate of 7.3% of assets.¹² However, this average rate camouflages a wide disparity in distribution rates by foundation size, with the largest foundations tending to pay out at much lower rates. Small and mid-size foundations with assets less than $1 million paid out at 14.2%, while larger foundations with assets over $50 million paid out at 5.9%.

The most recent reliable source for typical payout rates is an analysis done by the Foundation Center in 2012. The Center analyzed grants from a sample of 979 foundations from 2007 to 2009 and found that their median annual distribution rate was 5.8% over that time period. The study agreed with the Foundation Source findings that larger foundations paid out at lower rates than smaller ones. The study also found that the very largest foundations, those with assets over $500 million, paid out at only 5.4% – just over the 5.0% minimum (Foundation Center).¹³

**Giving While Living.** Some foundations actively choose to spend down their assets over one or two decades. The John Olin Foundation, founded in 1953, gave its last grant in 2005, after a deliberate sunset strategy.¹⁴ The $8 billion Atlantic Philanthropies are closing their doors this year after decades of intentional grant-making to “build up” their grantees (their preferred alternative language to “spend down”).¹⁵ There is now a large cohort of similarly “time-limited” foundations, and their ranks are growing in the face of climate change and the economic shock resulting from the COVID-19 pandemic.¹⁶

**DONOR-ADVISED FUNDS**

**Donor-Advised Fund Assets and Grants.** Donor-advised funds (DAFs) have seen explosive growth over the past two decades, and particularly over the past five years. In 2018, there were an estimated 728,000 donor-advised funds in the United States—55 percent more than there were the previous year, and triple the number that there were in 2014 (National Philanthropic Trust).¹⁷ In 2018, DAFs held $121 billion in total assets and gave out $23 billion in grants (National Philanthropic Trust)¹⁸.

**Explosion in Donor Advised Funds.** DAFs are now the fastest-growing recipients of charitable giving in the United States. Donations to DAFs increased from just under $20 billion in 2014 to $37 billion in 2018—a growth of 85 percent over five years.¹⁹ In contrast, charitable giving by individual donors nationwide grew by just 16 percent over the same five years.²⁰
DAFs Are Biggest Recipients in Charity Funding. In 1992, the biggest recipients of charitable gifts in the US were the American Red Cross, the American Cancer Society, and the United Way. Starting in 2016, however, the largest recipient of charitable giving in the US was the Fidelity Charitable Gift Fund.

In 2018, the Chronicle of Philanthropy stopped including donor-advised funds in their list of top recipients of charitable donations, and chose instead to rank only direct, “cause-related” charities. But that year, two DAFs—the Fidelity Charitable Gift Fund and the Schwab Charitable Fund—both received more private donations than the United Way, the top cause-related charity. And three other DAFs each received more donations than the second-ranked direct charity on the Chronicle’s list, the Mayo Clinic.  

Donor-Advised Fund Payout. The National Philanthropic Trust reported an average payout rate from DAFs of 20.9 percent in 2018. It should be noted, however, that DAF payout calculations are highly contentious. NPT’s calculation arguably inflates payout by excluding any additional donations, income, or asset growth that the DAF has gained over the course of the year. The IRS and the Chronicle of Philanthropy include all incoming revenue during the year in their payout rate calculations, which we believe more accurately reflect the true payout from these funds. In recent years, payout rates calculated by the IRS and the Chronicle have tended to be eight percentage points lower than those reported by the National Philanthropic Trust.

In addition, reporting a single average rate masks a wide variation in rates across separate funds. While some individual funds in a DAF may have very high rates of payout, other funds managed by the same sponsor may pay out nothing at all. In 2012, for example, the IRS reported that roughly one fifth of all sponsoring organizations made no grants from their DAF accounts.

CASE STUDIES: PRIVATE FOUNDATION PAYOUT

Many private foundations have exemplary payout rates. These include the Walton Family Foundation (20.2%), the Susan Thompson Buffet Foundation (15.3%), the Foundation to Promote Open Society (15%), the Simons Foundation (12.8%), and the Bill and Melinda Gates Foundation (11%). The Wallace Global Fund just announced it is raising its payout to 20% in the face of the COVID-19 pandemic.

Many more foundations treat the 5% payout as a precise ceiling and appear to plan their distributions around it. For example:

- Between 2010 and 2018, the Robert W. Woodruff Foundation, the Harry & Jeanette Weinberg Foundation, the Gordon and Betty Moore Foundation, the Helmsley Charitable Trust, and the Andrew W. Mellon Foundation—all among the largest
Foundations in the United States, with billions of dollars in assets—had average payout rates of between 4.8 and 5.0 percent over those nine years.\(^{27}\)

- Just barely outdoing the minimum payout requirement, the Robert Wood Johnson Foundation, the John D. and Catherine T. MacArthur Foundation, and the Rockefeller Foundation all had an average payout rate of 5.1 percent over the same nine years.\(^{28}\)

Some foundations appear to have unusually low payouts, at least in the early 2010s. These include:

- The Lilly Endowment, with $15.1 billion assets in 2018, had an average payout rate of just 4.5 percent from 2010 to 2018. The foundation never paid out at a rate greater than 4.9 percent during any of those nine years, and in some years paid out at as little as 4.2 and 4.3 percent.\(^{29}\)

- Bloomberg Philanthropies had among the worst payout rates of the largest foundations in the United States between 2010 and 2016. The former New York mayor’s foundation averaged a payout rate of just 4.2 percent over those seven years, from a high of 5.1 percent in 2016 to a low of 2.8 percent in 2014. In 2018, when Michael Bloomberg likely knew he could be making a run for the presidency, Bloomberg Philanthropy’s payout rose to 8.6 percent (with $767 million in grants made from $8.9 billion in assets).\(^{30}\)

**REVENUE ESTIMATES FROM INCREASING FOUNDATION PAYOUT**

How much money would be raised if we increase foundation payout? And can we estimate how much in additional funds would flow if donor-advised funds had a minimum payout requirement? Given the importance of this policy question, there is a dearth in recent research on this topic. Here is our analysis based on the data that exists. We will continue to update and refine these estimates, as further data becomes available.

**Foundation Payout Rates**

In 2018, Foundation Source reported in their *Annual Report on Private Foundations* that foundations paid out at an estimated average rate of 7.3 percent of assets.\(^{31}\) However, this average rate camouflages the fact that there is a wide disparity in distribution rates by foundation size, with the largest foundations tending to pay out at much lower rates. According to Foundation Source, small and mid-size foundations with assets less than $1 million paid out at 14.2 percent, while larger foundations with assets over $50 million paid out at 5.9 percent.

The most recent reliable source for typical foundation payout rates is “Understanding and Benchmarking Foundation Payout,” an analysis done by Loren Renz for the Foundation Center’s Issue Lab in 2012. Renz analyzed grants from a sample of 979 foundations from 2007 to 2009 and found that their median annual distribution rate was 5.8 percent over that time period.\(^{32}\)
Renz found, as did Foundation Source, that larger foundations tend to pay out at lower rates than smaller ones. And the very largest foundations, those with assets over $500 million, paid out at 5.4 percent—just over the 5.0% minimum. This means that a hike in the payout rate requirement would result in disproportionately more revenue from larger foundations.

**Foundation Overhead Rates**

Most of the reliable data available on overhead included in payout rates is dated as well. The National Committee on Responsive Philanthropy (NCRP) did an analysis in 2003 that estimated that $3.2 billion would be spent on overhead that year by foundations. According to the Giving USA Foundation, foundations gave out $26.84 billion in 2003. This means that in 2003, according to NCRP’s numbers, overhead accounted for roughly 12 percent of total foundation distributions.

The Urban Institute, Guidestar, and the Foundation Center did a joint report in 2004 where they analyzed foundation grants from 2001 to 2003. They reported that in their sample, overhead in the form of administrative expenses made up a median 7 percent of foundation distributions over those three years. Their analysis varied considerably by staff size, however; small foundations with 1-9 staff members had 5 percent overhead, while large foundations with 20 or more staff had 10 percent overhead.

Clearly these numbers are dated and difficult to pin down. But we believe it is accurate to presume that overhead accounts for at least 7 percent of distributions for all foundations, and likely 10 percent or more for the very largest.

**Projections Based on Higher Payout Rates**

Here are our preliminary projections for 2019 giving, using the percentages above, and estimates of foundation assets from FoundationMark.com.

<table>
<thead>
<tr>
<th>2019 Estimates</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Foundation Assets</strong></td>
</tr>
<tr>
<td>Assets held by foundations in December 2019 (from FoundationMark.com)</td>
</tr>
<tr>
<td>Payout rate (median rate from 2014 Foundation Center analysis)</td>
</tr>
<tr>
<td>Amount given in distributions by foundations (using 5.8% rate above)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2019 Estimates</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Effects of Changes in Payout</strong></td>
</tr>
<tr>
<td>Additional revenue gained from each percentage point increase in payout rate</td>
</tr>
<tr>
<td>Additional revenue gained from increasing the payout rate to 7%</td>
</tr>
<tr>
<td>Additional revenue gained from increasing the payout rate to 10%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2019 Estimates</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Effects of Changes in Overhead</strong></td>
</tr>
<tr>
<td>Overhead as a percentage of distributions (median rate from 2004 Urban Institute analysis)</td>
</tr>
<tr>
<td>Payout rate with overhead excluded (using payout and overhead rates above)</td>
</tr>
<tr>
<td>Amount of overhead counting towards distributions (using overhead rate above)</td>
</tr>
<tr>
<td>Amount of distributions if overhead was excluded from payout</td>
</tr>
</tbody>
</table>
Caveats and Qualifications

Determining foundation assets is hard to quantify; they are a moving target, because of constant changes in portfolio value. And determining payout and overhead for a significant enough number of foundations requires going through each foundation’s IRS Form 990-PF individually, so researchers do not undertake this exercise very often.

Independent sources such as the Giving USA Foundation and the Council on Foundations do not publicize data on overhead or payout rates. So the data above relies heavily on our own analysis of IRS Form 990-PF data, as well as reporting from academic researchers, the Chronicle of Philanthropy, and by foundation umbrella organizations.

Donor-Advised Fund Payout

There is considerable disagreement on how to calculate donor-advised fund payout. The key points of disagreement involve whether to use the amount of assets held in the fund at the beginning of the year or the end of the year, and whether to include any contributions made to the fund during the year as well.

The National Philanthropic Trust, which produces an annual report on the state of donor-advised fund giving in the United States, calculates DAF payout rates using the amount of assets held in the fund at the beginning of the year. Their most recent report shows that DAF payout rates remained relatively constant from 2014 to 2018, hovering around an average of just over 22 percent over those five years.

The IRS, however, calculates payout rates using the assets held in the DAF at the end of the year, and also includes any contributions made to the fund during the year. We feel that this is a more valid method, as it more properly reflects the amount of funds that the DAF had available to distribute during the year.

The IRS’s calculations result in payout rates that are, on average, 8 percentage points lower than those reported by NPT. This leads us to estimate that the actual average payout rate by DAFs in the United States has been about 14 percent over the past five years.

One concern that has been raised about donor-advised fund payout rates, particularly for large national DAFs, is that reporting a single average rate for an entire sponsoring organization can mask a wide variation in rates across separate funds managed by that sponsor. While some individual funds in a DAF may have very high rates of payout, other funds managed by the same sponsor may pay out nothing at all. In 2012, for example, the IRS reported that roughly one fifth of all sponsoring organizations made no grants from their DAF accounts.

This means that although a sponsoring organization may report a relatively high average payout rate overall, that likely camouflages the fact that a significant segment of its funds may be paying out nothing.
For this reason, we propose implementing an emergency three-year 10 percent mandated annual payout for donor-advised funds, which would be applied on a per account basis.

Here are our preliminary projections for 2018 giving, based on a mandated 10 percent payout rate, using the data above.

<table>
<thead>
<tr>
<th>DAF Assets and Grants</th>
<th>2018 Estimates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of DAFs in the United States (from NPT report)</td>
<td>728,563</td>
</tr>
<tr>
<td>Amount in DAF assets (from NPT report)</td>
<td>$121,420,000,000</td>
</tr>
<tr>
<td>Amount given in grants by DAFs (from NPT report)</td>
<td>$23,420,000,000</td>
</tr>
<tr>
<td>Average assets per DAF (calculated using NPT data above)</td>
<td>$166,657</td>
</tr>
<tr>
<td>Average amount in grants per DAF (calculated using NPT data above)</td>
<td>$32,145</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Effect of Changes in Payout Requirements</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated number of DAFs who paid out nothing (one-fifth of total, using IRS analysis)</td>
<td>145,713</td>
</tr>
<tr>
<td>Additional revenue to charity gained from mandating 10% payout from non-paying DAFs</td>
<td>$4,684,000,000</td>
</tr>
</tbody>
</table>

**Transparency in Donor-Advised Funds**

Another drawback to allowing DAF giving by foundations is that it significantly reduces transparency and accountability. Foundations must disclose where their grants go, but DAFs do not. If a foundation donor wanted to mask their giving, it would be easy for them to do so by transferring their money from their foundation to a DAF, and then directing the DAF to make the grants instead. As industry consultant Alan Cantor says, “Donor-advised funds give foundations a way of technically meeting the 5-percent distribution requirement while essentially hiding their grant making from public view...the public has no idea where the money eventually goes, or even if it goes to a charity at all.”

**THE TAX PAYER SUBSIDY FOR CHARITABLE GIVING**

One important reason that Congress is justified in mandating an increased payout is that donors to foundations and donor-advised funds reap significant tax benefits.

Donations by wealthy individuals are subsidized by the rest of taxpayers, anywhere between 37 cents and as high as 74 cents, depending on how much income, capital gains and estate taxes were reduced by the donation. In other words, for every $1 a billionaire gives to charity, the rest of us chip in as much as 74 cents in lost tax revenue.
As Ray Madoff writes in the Nonprofit Quarterly, “missing from the conversation regarding DAFs is how these donations may impose significantly greater costs—in terms of foregone tax revenue—than the public receives in terms of charitable benefits. This loss of revenue burdens all American taxpayers, who must pick up the slack.”

The starting point is that donors get significantly more tax benefits by making contributions of appreciated property rather than cash to a charity. Where a contribution of cash can save the donor as much as $0.37 on each dollar donated, a contribution of appreciated property can save the donor as much as $0.57 for each dollar donated (taking into account both capital gains tax savings and income tax savings).

In a paper for Tax Notes, Roger Colinvaux and Ray Madoff expand their analysis to include lost estate tax revenue resulting from charitable giving. They write, “The federal government has long provided generous tax incentives for charitable donations, with current benefits reaching up to 74 percent of the amount of the gift.”

“Although a contribution of cash can save the donor as much as 37 cents for each dollar donated, a contribution of appreciated property can save the donor 57 cents for each dollar donated (taking into account both capital gains taxes and income taxes but not potential estate taxes.”

In explaining the estimate, “reaching up to 74 percent,” Colinvaux and Madoff note;

These savings are possible for a gift of appreciated property which the donor has a zero cost basis. The charitable deduction will save the donor 37 percent of the value of the gift; an additional 20 percent of the value of the contributed property if it is subject to capital gains taxes; and, if the donor is subject to estate taxes, another 17 percent (40 percent of the remaining 43 percent) that would otherwise be remaining in the estate if no gift had been made. The tax benefits can be even more if the property is overvalued, a recurring issue for non-publicly traded assets.

The wealthiest donors, those in the top 0.1 percent of income and asset holders, are most likely to donate appreciated non-cash assets to charities. They are most likely to donate stock that has a low or zero cost basis.

For further reading:


Q & A: CHARITY STIMULUS LEGISLATION

Q: Do we really need this? Aren’t foundations and DAFs already stepping up through their own voluntary initiatives to increase foundation payout and move money out of DAFs?

Some are, some aren’t. But for many, the actions are not sufficient to the needs of the times.

The largest DAF sponsor, Fidelity Charitable, has announced that they have already given out $100 million in March and are looking to double that by May. But $200 million is less than 1% of the $27 billion in DAF assets they hold according to their most recent filing.35

A group of philanthropy sector leaders has called on colleagues to significantly increase their giving during the crisis, and not just seek to safeguard their endowments. As one sector leader put it, "if yours is a perpetual foundation, you have literally forever to get back to whatever your endowment was at its peak."36

Q: Why is it important to extend these recommendations for three years?

Large endowments should enable foundations to provide counter-cyclical funding in emergencies. But if history repeats itself, without any intervention we can expect giving to drop dramatically next year. A recent analysis of foundation giving after the Great Recession showed that domestic giving by the 1,000 largest foundations dropped 11% by 2009 and didn’t return to 2007 levels until 2013. Half gave less in 2009 than they had in 2007, and the very largest were even worse: 63 of the top 100 foundations gave less in 2009 than in 2007.37

Q: Is it appropriate for the government to dictate standards for private philanthropies?

The law already imposes requirements on philanthropies, such as the five-percent payout mandate, in return for the significant tax breaks given to donors. And the wealthier the donor, the more tax breaks they generally take for charitable giving. Wealthy Americans can already save as much as 74 cents for each dollar then donate.35 In other words, we taxpayers provide the matching funds for a private donor’s choice. Since we are subsidizing charitable gifts, there is a public interest in ensuring that the money is not stuck in the system or warehoused in a donor-advised fund, especially at a time of unprecedented crisis like this.

Q: Aren’t the funds raised insignificant? $200 billion isn’t a lot of money, compared to the trillions of dollars required to fix the economy.

$200 billion is a lot of money if it flows into the nonprofit sector. Charities helped will include community-serving organizations that are on the front lines of COVID-19 responses and are about to face an alarming drop in philanthropic support. Donations from individuals are still significantly larger than foundation gifts, but as unemployment rises, donations from low- and
middle-income donors will decline. Increasing the flow of funds from private foundations and DAFs will help offset the inevitable decline in individual giving.

**Q: Would an Emergency Charity Stimulus Save Jobs?**

Yes. The nonprofit independent sector accounts for over 12 million jobs and 10 percent of the private sector workforce. Representing the third largest workforce in the U.S., behind only retail trade and accommodation and food service, and on a par with manufacturing, it is reeling from job losses in the face of COVID-19. Charities ranging from Boys and Girls Clubs, Meals on Wheels, to local social service and arts and culture organizations are preparing for further declines in charitable donations and public support. Moving billions of wealth off the charity sidelines will help sustain this vibrant sector.

**Q: If we mandate an increase in funds, how can we be sure the funds will address the current emergency?**

Private foundations and community foundations are mobilizing in an unprecedented way to respond to the COVID-19 crisis. They are sharing best practices and forming local, state and federal response networks. At the regional level, Community Foundations and United Ways, with their fingers on the pulse of local needs, have set up emergency response funds in every state in the country. Donors seeking to channel additional funds have to look no further than these effective grant-making intermediaries.

While Congress should mandate an increase in emergency payout, it would not be appropriate to specifically direct charitable entities to fund particular organizations, solutions and responses. One of the benefits of an independent nonprofit sector in a pluralistic society is that charitable organizations can pursue a variety of strategies, serving as laboratories for innovative response.

**Q: Why should we double the minimum foundation payout requirement as part of a stimulus plan?**

The CARES act provided some increased tax incentives for charitable giving this year, including an above-the-line deduction of up to $300 for non-itemizers (section 2204) and lifting the percentage of the “adjusted gross income” (AGI) cap on cash gifts for itemizers (section 2205). As with past relief bills, new gifts to private foundations and donor-advised funds do not qualify, since it may be years before those funds ever get to working charities. But new gifts aside, those foundations and accounts are currently sitting on over $1 trillion dollars in assets for which the donors have already received tax deductions. Facing this unprecedented global pandemic, we need to move those funds off the sidelines now.

**Q: Aren’t endowed foundations reeling from having their asset values go down? Why require a greater payout at this time?**
It is true that many foundations will see their investments take a hit. But based on the 2009 experience, financial investments and Wall Street are going to bounce back much faster than the rest of the economy. The stock market will rebound faster than the unemployment rate, home values, and worker wages.

**Q: Won’t this hurt foundations that want to be around in 100 years?**

Even in normal times there is a debate as to whether our tax laws should encourage the creation of perpetual private foundations. But in these extraordinary times, this emergency provision encourages foundations to balance their interest in creating a perpetual institution with the urgent needs of the current crisis. One justification for creating a perpetual institution is to have funds set aside for a “rainy day.” The rainy day has arrived. As one nonprofit leader put it, “Imagine if there’s a famine, and you have seeds for crops that would feed people. Would it be ethical to give out only five percent of the seeds, because you want to save 95% for future famines?” It is appropriate for taxpayers and the government to require donors who have already taken significant tax breaks to move funds more urgently in a time of extreme crisis.

**Q. How have annual foundation payout requirements been addressed in past times of crisis, like World War Two? Is there anything we can learn from the past?**

This is an unprecedented situation. The era of mass organized philanthropy is relatively recent. The current framework of rules governing charitable giving and private foundations was passed in 1969. It is time to modernize these rules both in terms of changing distributions of wealth and the current emergency.

**Q: What would be included in the increased payout? What would be excluded?**

A 10 percent payout rate should boost the flow of money to active charities engaged in charitable missions. In determining what is counted toward payout, we propose to exclude: 1) donations to donor-advised funds; 2) impact investments and program-related investments, and 3) overhead that exceeds 0.5 percent of foundation assets (or more than one-twentieth of the funds being paid out). These activities are not prohibited but won’t be counted toward the 10 percent payout.

**Q: Why are you concerned about foundation overhead and program expense?**

To prevent self-dealing and abuse. Currently, private foundations can include overhead and program expenses in their five percent payout. Our research indicates that payout is an estimated 0.7 percent of annual foundation assets, but in some foundations it is much higher. And some foundations have abused this provision by having the foundation purchase expensive properties and cars, or provide salaries to family members, reducing the amount of funds that flow to qualified charities.
Q: Why include foundation overhead at all in payout?

Because foundations have legitimate operating expenses both in terms of professional staff and important programs implemented by the foundation. The goal is simply to prevent extravagant expenses being counted toward payout.

DONOR ADVISED FUNDS

Q. The imposition of a minimum distribution requirement for donor advised funds (DAFs) is new. Why is it necessary?

Donors to DAFs receive preferential tax advantages compared to private foundation donors, since they can deduct based on the appreciated value of donated non-cash assets. Yet those DAFs are under no legal requirement to distribute funds at a certain rate or within a certain period. The largest sponsor that houses donor-advised funds reports that over 60 percent of donations are in the form of non-cash assets, including crypto-currencies, real estate, art, and stakes in limited partnerships.42

Q: Don’t Donor-Advised Funds already voluntarily payout more than 10 percent?

Some clearly do but due to insufficient reporting requirements we have no idea about the distribution practices of individual DAF accounts. DAF sponsors report their distributions on an overall basis and include such things as DAF to DAF distributions. We know some DAFs, especially those run by community foundations, encourage their donor-advisors to move funds in a timely manner. Other funds can sit warehoused for years, long after the tax breaks have been taken.

Q: Isn’t a 10 percent mandate low for DAFs?

We think so. But it’s a start. Some in the sector believe that DAF payout requirements should be much higher. DAFs were not designed to be perpetual institutions like some foundations. When they were started, they were considered temporary holding funds and short-term intermediaries. A DAF gave some donors who experienced a windfall and wanted to donate a lot to charity a temporary holding account while they figured out a thoughtful giving strategy.

DAFs have changed from when they were largely housed at community foundations. Large financial industry firms, such as Fidelity, Goldman Sachs, Vanguard and Charles Schwab, all have created DAFs for their clients. They have an incentive to promote a “perpetuity mentality” with DAFs. Some encourage donor-advisors to do “impact investing” through their DAFs. The longer funds sit in their managed accounts, the greater the fees they collect.

Q: Shouldn’t we reform DAFs whether in an emergency or not?
Yes. The fact that donors can claim a full deduction at appreciated asset values and then not have to move the funds to an active charity is a fundamental design flaw in DAF incentives and should be fixed permanently. DAFs have also become attractive for donations of appreciated complex assets, such as art, real estate, jewelry and private business equities. This has allowed for the gaming of appraisals and deductions and potential abuses of DAFs.

There are two ways to fix this: 1) mandate a payout within, say, three years, and; 2) allow the tax deduction only when the funds exit the DAF. This would change the incentive system problem and reduce the gaming of donations of complex assets.
CONCLUSION

As part of the next several debates over economic stimulus, Congress will consider other incentives to boost charitable giving, inducements that will cost the U.S. Treasury lost revenue. Lawmakers should consider a bold incentive that will increase the flow but that has already been effectively “paid for.”

The Emergency Charity Stimulus has a simple elegance to it. It slightly tweaks the incentive dial, turns a valve, and boosts payout. At a time of national emergency, with many nonprofits groups facing insolvency, it is a prudent measure.


3 Based on IPS analysis of IRS Form 990-PF for these foundations, publicly available on ProPublica.org.


5 The size of the $200K+ group in 2000 was 2,771,579 taxpaying units or households. In 2016, this group with incomes over $200K grew to 6,900,372 $200K+ group in 2016 (2016 tax year, 2017 filing year is the most recent data available). Households in the $1 million donation group have increased from 110,912 in 1996 to 423,335 in 2015. 1995 data appears not available, earliest IRS makes available is 1996 Note: Dollars not adjusted for inflation.


7 Public data prepared by Xiao Han using survey data from the Philanthropy Panel Study, a project of the Indiana University Lilly Family School of Philanthropy, and a module of the University of Michigan’s Panel Study of Income Dynamics (PSID). The PSID is a biennial survey of the same 9,000 households over time. https://blog.philanthropy.iupui.edu/2019/10/24/changes-to-the-giving-landscape-giving-before-and-after-the-great-recession/.


“Giving by foundations had a record-breaking year, reaching its highest-ever dollar amount even when adjusted for inflation, and growing to its largest share (18%) of total giving to date in 2018.”


15 Atlantic Philanthropies, “Zero is the Hero,” https://www.atlanticphilanthropies.org/insights/insights-books/zero-is-the-hero

16 Time Limited Foundations, Duke Sanford Center for Strategic Philanthropy & Civil Society, maintains a list of “time limited foundations.” https://cspcs.sanford.duke.edu/time-limited-philanthropy/time-limited-foundations


Based on IPS analysis of IRS Form 990-PF for these foundations, publicly available on ProPublica.org.

Based on IPS analysis of IRS Form 990-PF for these foundations, publicly available on ProPublica.org.


41 Vu Le, “The ethical argument for foundations to increase their annual payout rate beyond 5%,” August 4, 2019, Nonprofit AF. https://nonprofitaf.com/2019/08/the-ethical-argument-for-foundations-to-increase-their-annual-payout-rate-beyond-5%