Promise and Peril: Philanthropy at the Precipice

A White Paper on Philanthropy Reform

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In conjunction with the Charity Reform Initiative

of the Institute for Policy Studies
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Table of Contents

Introductory Narrative ............................................................................................................. 5
Brief Overview ........................................................................................................................ 7
The Historical Origins of Philanthropic Oversight .............................................................. 7
Ramifications of the Philanthropic History of the United States ........................................ 12
Wealth and Philanthropy in the 21st Century ..................................................................... 14
  The Two Main Instruments Wealthy Donors Use to Support Charitable Causes .......... 16
  The Need for Philanthropy Continues to Increase ............................................................. 17
  The Delivery and Distribution of Philanthropic Resources ............................................. 17
    Donor-Advised Funds (DAFs) ......................................................................................... 18
      DAFs as Vehicles for Charitable Giving ....................................................................... 18
      Concerns Arising from DAF Use ................................................................................. 19
    Foundations .................................................................................................................. 21
      Concerns Regarding the Abundance and Pace of Grant Funding .............................. 22
      Issues Pertaining to Foundation Governance ............................................................. 23
Examining the Way Philanthropy Operates in Our Society Today .................................... 24
  The Origins of Inequality ................................................................................................. 24
  Risk Shifting in U.S. Society ............................................................................................. 25
  The Pre-Distribution of Wealth ....................................................................................... 25
  The Role of the Law in Generating, Protecting and Deploying Philanthropic Resources .... 26
Laudable Intentions, Adverse Outcomes: When Philanthropy Impairs the Healthy Functioning of Society ................................................................. 28
Particular Areas of Concern ................................................................................................. 30
  Tax Avoidance by Donors and Its Impact on Societal Equity ........................................ 30
  The Undue Influence of Wealthy Donors and How This Affects Democracy ............... 31
  Top-Heavy Philanthropy ................................................................................................. 33
  Political Considerations .................................................................................................... 35
  Institutional Limitations of the Current Oversight System ............................................ 35
  Reductions in Funding for Nonprofit Organizations ....................................................... 36
  Transparency .................................................................................................................... 37
Changes in Philanthropy Now and in the Coming Age ....................................................... 39
  Corporate Philanthropy .................................................................................................... 39
  Adopting New Legal Structures ...................................................................................... 40
  Financialization ................................................................................................................ 41
Policy Proposals to Address the Problems Identified..........................................................42
  Reforms to Discourage the Warehousing of Charitable Funds ...........................................42
  Reforms to Protect the Integrity of Our Tax System..........................................................43
  Reforms to Encourage Broad-Based Giving.................................................................43
Conclusion ...............................................................................................................................43
Colossal, influential and capable of great works, United States philanthropy offers humanity and the natural environment a bountiful array of benefits—many of which would otherwise be unavailable. From investment in ecosystems to breakthroughs in international health, from nurturing culture and education to challenging harmful economic policies, philanthropy can bring about transformative change where governments and the private sector cannot.

Philanthropy reflects the prodigious capacity of our system to reward individual initiative and inspire generosity. Yet it also demonstrates the perils of the inequality this very system engenders. Philanthropy’s ultimate effectiveness rests on resolving the fundamental problems it is designed to address. The wealth that funds philanthropic work is often unaccountable in our democratic system, however, posing challenging paradoxes.

Indeed, disparities in wealth and power are growing increasingly stark, and many wonder what can be done to foster greater equity. One way to stem the flow of resources upward is to mobilize sequestered charitable funds. Vast repositories of such funds, compiled using tax deductions, are lying fallow in the treasuries of philanthropic organizations rather than being expended to support good works and alleviate suffering. Moreover, whereas charitable giving was once practiced by a broad cross-section of the population, it is now funded primarily by a tiny group of wealthy donors. This is in large part because the legal measures governing philanthropy, including the tax code, are so much more conducive to giving by those at the top than by the rest of the population.

In fact, the laws governing philanthropy have not kept pace with economic and social changes. There are divergences between the original intent of the applicable legislation and the way it is currently applied. In addition, there have been oversights and unintended consequences whose importance has only become evident over time. For these and a host of other reasons, the legal framework is ripe for reforms designed to help philanthropic funds flow more quickly and abundantly, to make the tax code fairer and to broaden the base of public support for charitable causes.

U.S. philanthropy has also evoked other concerns. Much of the criticism the sector encounters has emerged repeatedly over the years. It centers on charges that donors are trying to: redeem themselves from the harm their fortune-generating activities have caused; buy influence and achieve grandeur in posterity; displace or overpower government; impose their visions on the populace and sway public policy; or distract from or counter condemnation of their business practices. They may also face censure for undermining democracy, possibly inadvertently, by making decisions unilaterally that the broader citizenry should make.
Moreover, a deaf ear to the aspirations of those philanthropy benefits, duplicative or overlapping effort on the part of donors and insufficient funding for human needs mean philanthropy can fail both the everyday people whose taxes and voluntary efforts support charitable causes and the people they are intended to benefit.

Addressing the full range of issues raised above will be part of any serious effort to bring about reform. Yet it is crucially important not to let awareness of philanthropy’s drawbacks obscure the immense benefits it can confer. There are ways to remedy philanthropy’s shortcomings while retaining its advantages. At present, there are grounds for optimism, given that most philanthropists have a genuine desire to support worthy causes with the resources they devote to their philanthropic endeavors. Many of them acknowledge shortcomings in the way grant-funded activities are governed and are willing to entertain ideas for reform.

It is worth noting that the public strongly favors reform. For example, a recent study found that most people across the political spectrum believe U.S. taxpayers should not have to subsidize perpetual legacy foundations that make grants to charities chosen by the founders.¹ Thought leader Chuck Collins suggests that people of all political persuasions are increasingly seeing charitable giving “as a way private organizations and individuals use their wealth to dodge taxes and short-circuit the public-policy process.” He also notes that “lobbying by philanthropic organizations to protect current policy could backfire because the more that charitable giving is seen as a protected class of activity without public accountability, the more that populist pushback is going to emerge.”²

Thus, for large philanthropic donors, the wisest course of action would be to back—even advocate—reform. There are donors who currently do support such efforts, even though it could somewhat constrain the freedom they now enjoy. This is because they recognize that current provisions and practices do not adequately deliver the public benefits they could and should.

Moreover, supporting reform enhances the integrity and credibility of the philanthropic sector’s major players at a moment when their power and hegemony are undergoing greater scrutiny by those who seek to correct inequities in our systems of law and governance. Ultimately, participating in reform efforts will give such donors greater power to help shape the changes that are becoming all but inevitable as public awareness awakens the sleeping giant of broad-based societal demands for philanthropic reform.

This white paper evaluates the case for comprehensive reform of the philanthropic sector. It aims to assess the extent to which current law and regulation of the sector govern philanthropy adequately and effectively while reflecting national principles of fair play, democracy and equity. In addition, it recommends, where appropriate, changes capable of rectifying problems related to these concerns. These policy proposals’ purpose is to ensure that the way our system of philanthropic governance operates is fair to all. Indeed, if philanthropic institutions and practices are appropriately managed, there should be no impetus to question individual intent or assail the motives for philanthropic acts. Nor should average people have grounds for feeling that the wealthy alone enjoy privileges that should be available to all citizens. Reforming philanthropy to reflect our national values and remedy its legal shortcomings will benefit everyone, and it is to that end that the policy proposals are offered.¹

¹ The policy proposals were also issued separately as “Policy Proposals for Charitable Reform” by the Institute for Policy Studies on August 9, 2023.
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Brief Overview

Given its founding doctrines’ focus on human values, the United States has always provided a hospitable environment for philanthropy. At its best, philanthropy aligns those who give, those who receive and the interests of our broader society. Philanthropy grew and evolved dramatically during the 20th century and continues to do so today. Indeed, the assets of the independent nonprofit sector have grown ninefold since 1980. The country contributes more of its GDP to philanthropy than does any other; in 2021 alone, Americans contributed $485 billion to charity. Ten percent of our workforce and 6 percent of our GDP are devoted to the independent nonprofit sector, which plays an important role in our social fabric. Moreover, in the third quarter of 2022, the entire nonprofit sector contributed $1.5 trillion to the economy.

 Historically, philanthropic support has come from individuals and families, who tend to contribute directly to charitable organizations, and from the wealthy, who tend to contribute via intermediaries such as foundations and donor-advised funds (DAFs). In recent years, however, this balance has been disrupted. Charitable giving has become dominated by these intermediaries, largely as a result of increasing inequality in the economy, the tax code and certain features of the legal structure governing the philanthropic sector. As of 2021, it is estimated that DAF assets totaled $234 billion and private foundation assets totaled more than $1.3 trillion.

 While the grants that DAFs and private foundations make fund much that is praiseworthy, the government has done little to update the legal and regulatory sphere in which they operate. In other ways as well, legal measures intended to cover philanthropic giving have not kept pace with changes in society that affect the way the resources to fund that giving are amassed and delivered. This white paper evaluates the case for reforming the legal underpinnings of the philanthropic sector to bring governance into alignment with the current state of philanthropic giving. It also aims to assess the extent to which the relevant aspects of our current legal system reflect national values of democracy, equity and fair play in view of recent, large-scale economic and social changes. This white paper also proposes changes to rectify the legal system where it falls short, given those changes and other long-standing problems.

The Historical Origins of Philanthropic Oversight

Science has confirmed what many people feel intuitively: altruism, the belief in or practice of disinterested and selfless concern for the well-being of others, is a primary human trait. Philanthropy, borne of our altruistic impulses, aims to improve human society.

Philanthropy has ancient origins, yet it has also been subject to periodic controversy. There have been two primary sources of tension throughout its history. The first is whether helping the poor benefits or harms society. This issue was more prominent in the country’s early history. The second is whether elite philanthropy (wealthy individuals, couples and families conducting voluntary giving
which intrinsically reflects the interests of the wealthy, undermines democracy and fair play. This question is more dominant in the United States at present. It is also important to note at the outset that philanthropy and systems to pass on and perpetuate intergenerational wealth have been intertwined throughout history and remain so today.

Bequeathing wealth to successive generations can be traced back to the Ice Age. At Sungir, a site east of Moscow, hunter-foragers who lived at least 30,000 years ago left artifacts such as spears, art, furs and an abundance of painstakingly carved beads with their buried children. Experts estimate that it took nearly 45 minutes to carve each bead, so one child could be adorned with the fruits of a year’s worth of labor by another individual—a prehistoric version of a trust fund.\(^7\)

The drive to leave wealth to one’s progeny taps deeply into human emotion and is motivated by innate desires and appetites. There are also biochemical advantages to being at the top of the hierarchy; high levels of mood-enhancing serotonin and testosterone have been documented in high-ranking chimpanzees. In addition to ensuring their comfort and safety, parents want to secure their children’s status and education levels, which also memorializes the parents’ standing. “Perpetuity, after all, is priceless. ‘The fortune is the monument you build to yourself,’” notes Evan Osnos, quoting Dartmouth sociologist Brooke Harrington.\(^8\)

Philanthropic activity is evident in virtually all societies throughout history, and there is a long history of exhorting the faithful to be generous in the Judeo-Christian and Islamic, as well as in many other, religions.

The word “philanthropy” was first used by the Greeks in the fifth century B.C.E. to describe gifts from the gods and later to describe wealthy citizens who gave to the less fortunate. The early laws of Athens entwined the notions of philanthropy and democracy, suggesting it was their union that made self-government possible.\(^9\)

In this country, the Puritans believed that worldly activities such as the acquisition of money could serve spiritual ends. Indeed, John Winthrop held that one must share one’s wealth with others—even if it could not be repaid. Some viewed the independent groups that delivered goods and services to the less fortunate as a valuable check on the monarchy.\(^10\) And we could say that the Puritans’ attitude toward giving complemented their work ethic—the ability to sacrifice personal ambitions for larger goals—another idea that retains great currency and relevance.\(^11\) On the other hand, Winthrop believed there should be a spirit of obedience by the poor toward the wealthy. Generosity by those with means was part of a larger system of categorizing people’s roles in society in ways we may find either inspiring or distasteful, and perhaps still prevalent, today.

Mixed motives and attitudes run throughout the entire history of philanthropy.\(^12\) Alongside support for the practice, there has long been a contrary view of charitable conduct that reasserts itself from time to time. Eighteenth century French philosopher Anne Turgot thought that charity could perpetuate poverty by subsidizing idleness. He deemed wealthy donors vainglorious, cloaking their vanity in virtue as they perpetuated the plight of the poor. Similarly, Denis Diderot’s *Encyclopédie*, published between 1751 and 1772, stated that while philanthropy’s intent was admirable, it caused its subjects to be needy. Even Alexis de Toqueville, notwithstanding his praise for the good works of U.S. associations, wrote a memorandum on pauperism, in which he opined that charity neglected the
underlying causes of suffering and fostered an idle and lazy class. At the same time, the practice self-aggrandized its donors.\textsuperscript{13}

Colonial Philadelphia also cultivated the growth of philanthropy. William Penn gave instructions to take care of widows and orphans. Yet here too this philosophy was accompanied by his belief that one of the ends of government was to “cherish those who do well”—a sentiment many find remains all too true, and others find unacceptable, today.\textsuperscript{14} Many Philadelphians had an expansive commitment to moral responsibility, helping their neighbors and the needy through the work of their voluntary associations. Indeed, “acts of benevolence were evidence of civic responsibility.”\textsuperscript{15} French sociologist Marcel Mauss observed that throughout history, in times of prosperity, the wealthy have been viewed as obligated to the poor.\textsuperscript{16}

U.S. poverty was not viewed as a social problem to be addressed by corrective action until the 19th century, when both government and private groups began providing assistance and services in a systematic manner.\textsuperscript{17} Professional, trade and business associations emerged in the United States. These 19th century organizations were primarily joint or group efforts. The philanthropic landscape was then dramatically altered by the introduction of the foundation in the early 20th century. This new vehicle for pursuing altruistic interests grew out of the charitable trust and became popular among wealthy industrialists. One way foundations differed from previous organizations was that they were funded and controlled by a single person or family rather than representing a joint effort.\textsuperscript{18}

It was in this context that Andrew Carnegie emerged. Many persons of wealth contributed to charity before Carnegie, but he was perhaps the first to state publicly that the wealthy have a moral obligation to give away their fortunes. Yet he too reflected the age-old ambivalence toward philanthropy. While he predominantly represented the positive view of charity, he also commented on its dangers. His 1889 essay, \textit{The Gospel of Wealth}, venerated the virtues of using all excess wealth toward helping others to help themselves, thereby benefiting them and the whole community. “The man who dies rich dies disgraced,” he is famous for saying. Carnegie believed that because heirs tend to squander their inherited wealth, the wealthy should try to exhaust their fortunes on charity during their lives. He also cautioned against indiscriminate giving, however, saying, “Of every thousand dollars spent in so-called charity today, it is probable that nine hundred and fifty dollars is unwisely spent—so spent, indeed, as to produce the very evils which it hopes to mitigate or cure.”\textsuperscript{19} He put this belief into practice by focusing on self-helping interventions such as his libraries, which enabled people to develop skills and knowledge rather than receive direct goods and services.

The income tax was first enacted in 1862. This opened the way for the tax deduction, which was first granted to the charitable and voluntary sector in 1894. For the following 75 years, Congress developed and refined the exemption’s basic principles and requirements. Deducted funds had to support charitable causes and could not inure to the benefit of any related individual. The exemption was also intended to encourage charitable giving.\textsuperscript{20} Charitable tax deductions brought into focus the tension between immense private wealth and democracy.

One reason for the charitable deduction was Congress’s “commitment to private modes of governance.” This meant devolving to individuals decisions regarding and actions fostering the public good. “New income tax policies initiated an unprecedented intimacy between tax policy and philanthropy. Changing ideals about the proper balance between public and private governance in a
healthy democracy shaped tax policy and philanthropic structures.” The early phase of the tax deduction yielded a flourishing environment of experimentation with different types of philanthropic organizations, most of which were readily accepted. Yet for most of the 19th century, creating a private foundation to carry out private aims with private wealth, unmonitored by public authorities, was not possible; authorization and incorporation by a democratic body were required. Thus, the type of organization that elicited concern was the private foundation, funded and driven by one person or family.

The early struggles of the Rockefeller Foundation are emblematic of the ongoing controversy regarding philanthropy and democracy. Having donated $50 million to his new entity, John D. Rockefeller sought a federal charter in 1910 because he thought the State of New York might impose limits on his global philanthropic ambitions. Yet he encountered fierce opposition in Washington, D.C., where legislators thought the powerful new foundation would corrupt democracy. One reverend testified before Congress that “the very idea of a foundation ‘was repugnant to the whole idea of a democratic society.’” Indeed, the fact that foundations needed to be authorized by a democratic body reflects the tension between plutocracy and democracy, notes Rob Reich, a political science professor at Stanford University. Quoting Turgot, Reich also observes that the state’s perceived right to involve itself in private philanthropic efforts was not new. “Public utility is the supreme law,” Turgot had observed approximately 200 years before.

Despite repeated attempts, and offering major concessions, including limits on his foundation’s size, transparency in reporting its activities and clear public oversight, Rockefeller failed to secure a federal charter. Ironically, the provisions Rockefeller introduced, had Congress approved the revised charter, would have established a template far more restrictive than the one that prevails today—and far more in line with current reform efforts, including those proposed in this white paper.

The Rockefeller Foundation was also noteworthy in that it was one of the first institutions to practice philanthropy with a scientific focus. The Carnegie Corporation and other industrialists-turned-philanthropists also adopted this approach. Emphasizing organization, efficiency and rationality, foundations began to treat social problems in a fully secular, systematic fashion. This differed greatly from earlier efforts that focused on philanthropy as a form of redemption by practicing Christian almsgiving. In addition, the heads of foundations believed their wealth, status and business acumen qualified them to grasp international and domestic social problems and develop appropriate measures to address them.

Observers may note the similarity between this view and the stance of many wealthy donors today—both in the scientific, business-inspired approach they apply and in the personal confidence of philanthropic organizations’ founders and executives. Such philanthropists may be overconfident, believing that the qualities that brought them the remarkable success they enjoyed in business can “simply be transferred to more complex social situations.”

Foundations and other nonprofit organizations continued to develop throughout the 20th century, operating with little oversight and accountability. To remedy this, the Tax Reform Act of 1969 (the 1969 Act) and the Peterson Commission that followed soon afterward established the framework that remains in place today. It introduced the distinction between nonprofits, or public charities, and foundations. Foundations were divided into two types: operating and nonoperating. Most foundations are nonoperating, which means they are devoted primarily to grantmaking. The 1969 Act also established payout rules, which required foundations to expend a certain amount (later fixed
at 5 percent) on grants, minus administrative and other allowable expenses. Excise taxes on foundation investment income were enacted as well.

This framework, deemed the “Grand Bargain” by authors Dana Brakman Reiser and Steven A. Dean in their 2023 book *For-Profit Philanthropy: Elite Power and the Threat of Limited Liability Companies, Donor-Advised Funds and Strategic Corporate Giving*, provided the means for wealthy individuals, couples and families to conduct elite philanthropy.

In exchange for targeting contributions to nonprofit groups under rules also including grant timing and requiring a certain amount of transparency, foundations may operate largely independently with scant oversight. The system has worked well for foundations, which have remained free to characterize society’s challenges as they see them and design interventions to fill the gaps they identify—regardless of what others might think. This has had profound impacts on society. Whether the arrangement has served the public is a more complicated question, as subsequent sections of this white paper will reveal.

Meanwhile, another means of grantmaking has emerged, rapidly becoming the charitable vehicle of choice: the donor-advised fund (DAF). A DAF is a way for donors to make donations of funds or nonliquid assets, such as securities, artwork and real estate, into a kind of nonprofit checking and savings account managed by a sponsor. The donor officially relinquishes control over the DAF when it is established and receives a tax deduction at the same time, even though no grants have been made. The donor retains advisory rights over the account, which the sponsor virtually always honors. DAF sponsors, which must be registered with the Internal Revenue Service (IRS) as 501(c)(3) organizations, are generally divided into three types: single-issue charities, community foundations (CFs) and national sponsoring organizations.28

First used in the 1930s as a way for CFs to aggregate donations, the use of DAFs exploded in the early 1990s, when commercial financial services companies established nominally nonprofit arms for the purpose of sponsoring DAFs. Commercial sponsors manage a greater portion of DAF assets than any other sponsoring group, controlling approximately $150 billion in DAF resources out of a total of $234 billion in 2021.29

DAFs offer donors many advantages, including no limits on the timing of and amounts to be expended on grants, no excise fees, the ability to donate noncash assets and the prospect of using the instrument as an element of a donor’s investment portfolio and estate planning. From the perspective of public interest, however, DAFs have a number of disadvantages.

Much of this white paper is devoted to DAFs, whose widespread use has given rise to several issues meriting scrutiny and reform. One additional point bears mention here, however. As noted, the Grand Bargain relies on foundations following three precepts in exchange for tax deductions: targeting, timing and transparency. DAFs are required to comply with only the targeting requirement, however, and there are exceptions even there! To wit, DAF grants are generally made only to qualifying nonprofit charitable organizations, otherwise known as 501(c)(3)s. But DAF grants are sometimes made to other DAFs—a tenuous interpretation of the targeting requirement, albeit technically legal. Indeed, while there is no specific language to this effect, scholars generally believe that Congress envisioned DAFs as short-term vehicles to hold donations that would be made promptly; legislators do not appear to have imagined that DAF funds could remain
sequestered for substantial lengths of time or even permanently. The provision that DAF grants may go only to 501(c)(3) organizations is in fact co-opted by DAF intermediaries. By deeming themselves the nonprofit recipients of the DAF funds, they meet the technical requirement but not the intent of the legislation. Thus, long-term retention of DAF funds relies on this fiction.30

Underlying all tax-exempt donations is the idea that because philanthropic activity benefits the public, the funds that support it may be deducted from the donor’s taxes. The Tax Expenditure Concept (TEC) was introduced in 1969 in conjunction with the broad discussions surrounding reform at that time. The TEC holds that because such funds would otherwise be directed toward taxes, they can be counted as government subsidies. Accordingly, the public has a direct interest in seeing that they are directed toward public purposes.31 The TEC was never formalized, yet the idea behind it retains currency today.

Clarifying the status of tax-exempt funds is a very important component of efforts to bring about reform of and accord regarding the philanthropic sector. This is because establishing widely accepted common standards is key to ensuring that the rules regarding government-granted tax relief are fair. Moreover, public resentment toward wealthy donors is more likely in the absence of such standards.

There have been two significant recent attempts to pass legislation addressing some of the loopholes, deficits, oversights and perceived shortcomings in the governance of philanthropy. (There have also been less visible efforts to include reforms in White House budget proposals.) The Emergency Charity Stimulus (ECS), propounded at the height of the COVID-19 epidemic in the spring of 2020, would have remained in effect for the ensuing three years. The ECS would have doubled the mandated foundation payout requirement from 5 percent to 10 percent. It also would have imposed a 10 percent DAF payout. The ECS was never formally introduced to Congress, despite support from a broad cross-section of donors, legislators and prominent citizens.

The Accelerating Charitable Efforts (ACE) Act, which was introduced in the Senate in 2021, would make several modest changes to DAFs and introduce other commonsense reforms. Specifically, it would establish three types of DAFs, impose time limits on DAFs of 15 to 50 years, depending on their type, and increase foundation payouts to 7 percent in exchange for waiving the excise tax on foundation investment income. Excise taxes would also be waived if a foundation spent down its endowment within 25 years. In addition, the ACE Act would tighten requirements on nonliquid assets and foundation-to-DAF transfers, as well as rectifying other issues.

**Ramifications of the Philanthropic History of the United States**

Philanthropy is unique because it represents personally driven solutions to public problems. Whether filling a void government once filled then abandoned, addressing problems never previously tackled, fortifying existing efforts, creating innovative activities or products that benefit the public or performing any number of other roles, philanthropy offers many advantages no other sector can provide. It has myriad ways of assisting, intervening, transforming and cultivating whatever aspects of our society that it chooses to address. Some invariably criticize these undertakings, either because they think philanthropists are exercising too much power or because they disagree with the subject activity. In a similar vein, it is true that public gifts can be, and often are, a sign of status and a confirmation of one’s place at the top of the social hierarchy.32
Yet given current resistance to the welfare state and government abdication from attempting to solve many of the problems it was once willing to address, such as the environment and poverty, philanthropy may be the only option the public has open to it in any number of contexts.  

Philanthropy can propel societal advancement in ways that may stir controversy, acclaim or both. For example, philanthropists have funded minimum basic income programs in several regions. Philanthropy belongs to the world of social institutions that mediate between individuals, the market and the state, performing many important functions.

Philanthropy has much to offer, accomplishing its objectives with levels of freedom and an abundance of resources unavailable elsewhere in society. Moreover, the idiosyncratic and varied character of philanthropy in this country offers the benefit of cultivating a rich tapestry of grassroots organizations that involve ordinary people in geographically and culturally based solutions to local problems. In addition, because it is not subject to outside pressure, philanthropy can devise long-term solutions for which other institutions could not sustain support, given the exigencies under which they operate.

Until recently, the Grand Bargain operated with broad public trust. Indeed, it is only that trust that has enabled the system to work. Yet it is now being eroded across the political spectrum, yielding increasing calls to reform the rules governing philanthropy.

If current substantive flaws in the system are reformed effectively and fairly, that trust may be restored. Throughout the history of philanthropy, the motives of both those giving and those receiving have been scrutinized, analyzed and criticized. Beneficiaries are examined to determine their worthiness and industriousness because many societies are loath to tolerate what they perceive as dissolute or lazy recipients of philanthropic largesse. (In this country, this sentiment recurs mostly in connection with government benefits.) Even more attention has been directed toward donors. Are they trying to absolve themselves of past sins, aggrandize themselves or deter criticism of their wealth-building practices? One reason for regulating philanthropy is to obviate such inquiries.

In general, people are apt to turn to moral assessments when formal strictures fail to govern conduct adequately and fairly. Given the high priority our society places on freedom of thought and expression, it follows that we tend to leave people alone with their thoughts as much as possible, limiting our judgment of them to their conduct. Notable exceptions include criminal law, family law and the analysis of certain contractual provisions—in these, intent is all-important—but for the most part, people are judged by their actions more than their motives.

Accordingly, appropriate governance in the philanthropic sphere could drastically reduce questions regarding philanthropy’s motives and donors’ moral fitness. In fact, quieting mistrust with clear, just rules may be just the right bargain for this moment in history. The arrangement could go a long way toward allowing the sector to flourish with the freedom and autonomy it seeks and, under the appropriate circumstances, deserves. Society could then enjoy philanthropy’s copious benefits and endorse its investments in a better world for all.
Wealth and Philanthropy in the 21st Century

Recent history has witnessed the decreasing role of democratic processes in developing and implementing public policy at every level of government. The fact that these changes are not yet reflected in the way broad problems are addressed has many effects on society. The areas most affected include environmental degradation, workers’ health and consumer safety, which leave voids to be filled by the private or independent sector. Foundations have played an increasingly important role in this regard. This is not a new phenomenon. In the early 20th century, foundations often debated social issues and designed programs to address them. Today, about a third of foundation funding remains devoted to projects in public policy. Accordingly, their current involvement in such issues is consistent with historical precedent.

Large-scale philanthropy can seek long-term, wide-ranging solutions that go beyond concrete problems into the realm of broader social factors. Moreover, the sector can do so in a more streamlined manner than public institutions must use to take action.

“Anticipate charity by preventing poverty,” said Maimonides, the early Jewish philosopher. At its best, philanthropy aspires to address or eliminate the root causes of the social ills it is designed to tackle. It not only envisions a better world, it finds new modalities of giving that create leverage. This is yet another way its impact can be strengthened and multiplied. Whether through new funding mechanisms, such as using intermediaries and challenge grants, or establishing new institutions, such as Carnegie’s public libraries, large-scale giving can excel at maximizing its resources for the public good.

Yet it is important to bear in mind that while most foundations support the idea of democracy, in practice most of them exist to carry out the vision and goals of one person or family. Thus, even if their programs support democratic ideals, it is rare to find democratic consultation or interaction regarding whether or how those programs should proceed. This singular focus of a foundation’s founder is sustained by its board, which exists to honor and carry out the founder’s wishes. Peter Goldmark, former president of the Rockefeller Foundation, noted that the self-perpetuating board exists “to change some aspect of the larger society in accordance with a view held only by a minority or even a single person. Its job is not to reflect, protect or govern according to a majority.”

Money talks, so people, including public officials, listen to philanthropists. This power can cut both ways. It can facilitate broad coalitions and consensus when used responsibly. Yet it can also transgress the appropriate bounds of private power if, for example, it is used to impose conditions on public institutions in a way that leaves the public out of important decision-making processes. This is what happened when the City of Detroit received grant funding to help it emerge from bankruptcy proceedings; funders imposed strictures on the city that should have been considered in consultation with citizens. Private funding is also used to support public schools, giving rise to similar concerns. A school board is far more likely to honor the wishes of a major donor than it is to consider the viewpoint of an average citizen who merely pays taxes. This issue is covered in greater detail in the following section.
Foundations can engage in ambitious experimentation without concern for failure, apply evidence-based techniques toward solving problems in novel ways, meet humanitarian needs and foster behavioral change and institutional transformation in ways that few, if any, other institutions can. In fact, Reich sees experimental means of solving societal problems as one of the most worthwhile contributions foundations can make. For example, the 911 system was developed from an experiment funded by the Robert Wood Johnson Foundation with a $15 million grant made in April 1973.

DAFs have even more freedom to operate and even less accountability than foundations. Yet what they do, how they accomplish their aims (to the extent they have articulated them) and the results of DAF-funded efforts are all a mystery to the government, the public and even to the DAF holders themselves, given that very little, if any, reporting is generally required. Moreover, DAF activities are generally funded in a scattershot manner, so the strategic planning, professional grantmaking and monitoring foundations typically do is rare, with little planning or oversight used in their stead.

Even more important, there are critical problems associated with the ways DAFs operate that are of profound concern. The foremost among these is that DAFs can sequester vast amounts of wealth, diminishing, or even eliminating, their usefulness to society, which has granted their donors generous tax subsidies without society at large receiving any benefits from that largesse. DAFs’ lack of transparency allows a number of ills described in the following section. In addition, DAFs can be used by foundations to park funds, thereby allowing foundations to avoid the time and transparency requirements that would otherwise apply. Finally, examining DAFs in detail, we find other specific problems enumerated below.

Another issue arising in connection with both foundations and DAFs is the lack of accountability our system allows. The government is accountable to the public. Private companies are accountable to shareholders and customers or clients. Nonprofit grantees are accountable to their funders. But to whom or what are foundations and DAFs accountable? Apart from the IRS requiring that grants be made to 501(c)(3) entities, state attorneys general requiring that grants be made without malfeasance and several state reporting requirements, they are accountable to no person or institution. The policy proposals made below seek to address this in part by proposing new oversight mechanisms funded by using the excise taxes that foundations pay on their endowments’ investment earnings.

Moreover, as noted previously, although there was an attempt to adopt the Tax Expenditure Concept (TEC), which held that tax-exempt donations funding philanthropy ought to be viewed as subsidies, the TEC was never formalized. As mentioned above, the only requirement governing tax-exempt donations is that they be granted to organizations founded under Section 501(c)(3) of the Internal Revenue Code (Tax Code). No other formal requirements—let alone broadly accepted ones—have emerged to date. Yet the private use of funds for public purposes continues to challenge the balance between public versus private, and plutocratic versus democratic, values. In particular, concern remains when “the public is disenfranchised from deciding how tax expenditures in the form of charitable donations are spent.”
There is active debate on this issue at present, some of which falls along intra-partisan lines, with populist Republicans seeking more government intervention to tame what they view as liberal causes funded by taxpayers, and establishment Republicans preferring that the philanthropic sector be largely left alone. In any case, the TEC could not be definitively adopted until and unless a clear and widely accepted definition of the “public interest” in this context were to be adopted.

Another attempt to grapple with how to ensure charitable deductions are used to fund charitable activities has been proposed by academic Roger Colinvaux. He believes that the IRS has the right to monitor the tax-exempt status of charities with a “commensurate-in-scope” test. This would verify that charitable deductions are used to finance charitable work commensurate with the amount of the exemption granted. Those DAFs that lie dormant, or grant out less than the amount of tax deductions they receive, would fail the test.

Thus, the question of how much authority the government and public have or should have in determining whether donors are benefitting the public with the tax-subsidized funds they control remains unresolved at present. If other areas of philanthropic regulation are developed and clarified, however, there will be significantly less need to apply either the TEC or the commensurate-in-scope test.

The primary question this white paper and its policy proposals’ attempt to answer is how we can take advantage of the benefits philanthropy offers without diminishing the roles of democracy, equity and fair play in charting the course of society. As noted, because philanthropy seeks to solve public problems with private resources, the power to channel those resources resides with a few wealthy individuals and institutions.

How can we temper that power so that it does not usurp public prerogatives, while continuing to allow philanthropic institutions to use the creativity and freedom they enjoy to devise innovative and effective programs? In short, without delving into the technicalities of the way foundations accomplish their work, this white paper attempts to establish a legal framework capable of balancing the interests on all sides in a just and sensible manner. The policy proposals break down the larger concerns just mentioned, along with a host of other considerations, into concrete legislative measures.

To understand the way philanthropy operates, it is important to analyze the kinds of vehicles and organizations that fund charitable work and the instruments these organizations use to carry out that work. Examining these aspects will provide the background for evaluating philanthropy’s impact on society.

The Two Main Instruments Wealthy Donors Use to Support Charitable Causes

As indicated, the funding used to create both DAFs and foundations has been amassed on the condition that the resources are to be used for philanthropic aims. The more than $1.3 trillion held in DAFs and foundations represents an utterly colossal public investment. Taxpayers may well ask why up to 74 cents of every tax-exempt dollar that would lie in the public treasury were it not subject to these deductions is instead allowed to languish.

Wealthy donors use two primary means to make gifts to charitable causes: foundations and DAFs. Both can deliver philanthropic funds to beneficiaries effectively. Yet a review of foundations and
DAFs reveals two key problems: the amount of funding that reaches charity is often less than it could be, and the speed at which that funding is distributed may be slow or, in some cases, indefinitely delayed. Moreover, the amount of charitable deductions granted in any given year may be less than the amount distributed in grants.

The Need for Philanthropy Continues to Increase

Recent economic changes have conferred ever more gargantuan resources upon a tiny number of top philanthropists. At the same time, living standards continue to diminish on the other side of the spectrum. Indeed, as philanthropic treasuries overflow with additional wealth, the demand for mobilizing those funds to address human needs is increasing in volume and urgency. These needs range from acute hardship at the individual level to the most sweeping problems facing society today.

Ever-growing hunger drives more people to food banks, more young people need scholarships for college, stretches of highway in need of repair or maintenance seek individual benefactors and run-down schools struggle to provide unpolluted drinking water to students. Among the lingering effects of the pandemic are depleted nonprofit organization coffers, municipal reserves and disaster relief funds. Moreover, substantial deficits left in the wake of the COVID-19 pandemic have become permanent. For example, many have lost housing, childcare and other support they have been unable to restore. On a larger societal level, enormous problems are calling for large-scale interventions, such as converting unused office space into housing for the swelling numbers of the unsheltered and those struggling to find affordable housing.

One solution to this array of challenges would be the prompt, abundant, efficient and widespread distribution of charitable funds at all levels. For a variety of reasons elucidated in this white paper, however, this relief is not being delivered to the extent it could and should be.

The Delivery and Distribution of Philanthropic Resources

It is also important to note that the tax exemptions and deductions that provide the financing for foundations and DAFs are available only to wealthier members of the population. Most people do not itemize their income taxes, so they cannot claim charitable deductions. Moreover, few average U.S. taxpayers have the retinues of tax professionals, philanthropic advisors and private bank accounts that usually accompany and enable the formation of foundations and DAFs.

Wealthy donors increasingly direct more funding of charitable organizations through foundations and DAFs in their capacity as intermediaries than those donors provide directly to such organizations. Many of the financing techniques donors use to pass funding through these vehicles are discussed later in the paper. This section pertains to the operation of foundations and DAFs and discusses the many troubling aspects of the arrangement.

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iii Indeed, that is what the proposed Emergency Charity Stimulus (ECS) proposal tried, but was unable, to achieve.
iv Please see “Policy Proposals for Charitable Reform: Reforms to Discourage the Warehousing of Charitable Wealth, A. Reforms to Donor-Advised Funds,” which pertains to the following discussion.
Donor-Advised Funds (DAFs)

DAFs are a key conduit for donors to make grants to working nonprofit organizations without having to formally establish foundations. Setting up and maintaining a foundation is more complex than the requirements for establishing a DAF, whose requirements are minimal and permissive. Another advantage DAFs offer is that funds can be moved out to grantees quickly by avoiding the usually time-consuming process foundations use to process grant applications.

The rise in the use of DAFs has been dramatic. There are currently nearly 1.3 million individual DAF accounts in the country. In contrast, there are between 100,000 and 120,000 foundations. Indeed, DAFs are growing faster than any other vehicle for delivering charitable gifts. DAF assets grew by 40 percent from 2020 to 2021. There is now $234 billion held in DAFs, up from $167 billion the previous year. In 2020, 22 percent of all charitable giving by U.S. individuals went into DAFs, whereas only 15 percent went into foundations.

DAFs as Vehicles for Charitable Giving

As noted, DAFs offer donors many advantages. There is no timeline within which the donor must decide grantees will receive their DAF resources. Nor is there any required minimum amount that must be directed toward grants. In contrast, foundations must pay out 5 percent of their assets in grants or allowable expenses each year. In addition, sponsors report DAF expenditures to the IRS in aggregate; neither the sponsor nor the donor must submit detailed reports to the IRS, as foundations are required to do. In addition, donors may place nonliquid assets in their DAFs. These assets are valued by the donor at the time of donation; their value is not independently verified and may be inaccurate. In contrast, it is much more difficult to donate complex assets to foundations. Moreover, DAFs allow donors to time their donations so that they occur in the year most advantageous to alleviate their tax burdens. And donors may deduct a higher percentage of their adjusted gross income when contributing to DAFs than they are permitted when giving to foundations. In short, DAFs offer donors many advantages over foundations.

Authorities, professional groups and scholars are increasingly concerned about the problems associated with DAFs. At a conference of the National Association of State Charity Officials (NASCO) in 2022, California Supervising Deputy Attorney General Elizabeth Kim raised several concerns in connection with their rising use, including the distribution rate, delays in distribution, the transfer of funds from private foundations to DAFs and transfers from one DAF to another DAF. These concerns, in addition to the concern over permanent sequestration of DAFs, are covered below.

Endowed DAFs present additional challenges. Sponsors hold these DAFs in perpetuity, with only the earnings on their principal going to grants. Endowed DAFs are becoming wildly popular. They also double as valuable estate-planning tools, becoming “legacy” DAFs passed on to heirs upon the donor’s death. It is also regrettable that donors are more and more inclined to view endowed DAFs as part of their investment portfolio rather than as a means to provide funds to worthy causes. Also troubling is that endowed DAFs cement the erroneous notion that they are solely the donor’s property, rather than belonging partly to the public, which has granted the donor’s resources a tax deduction under the condition that they will be given to charitable causes.
Concerns Arising from DAF Use

As noted, retention of DAF funds, while inconsistent with legislative intent as indicated, is becoming ever more significant; many DAFs lie at least partially fallow rather than being used for charity. Indeed, overall, 84 percent of available DAF assets remain in the accounts rather than being disbursed to charity. Moreover, the National Philanthropic Trust found that 57 percent of DAFs paid out less than 5 percent of their assets. Similarly, a report by the California Attorney General revealed that an average of 42 percent of DAFs paid out less than 5 percent. While precise figures are unavailable, DAF payout rates have gone down in recent decades.54

We have little statistical information about the reason for this moribund rate of disbursement, although most DAF sponsors have adopted policies to address dormant DAFs. Some donors cite health or personal problems.55 Inertia most likely plays a role as well. Another possible reason DAF funds lie dormant may be that retaining them provides a sense of affluence and power to the DAF holder. Once a DAF is depleted, its donor may no longer be sought out by potential grantees or enjoy the prestige of having a large DAF.

Given these problems, it is troubling to consider that tax deductions are granted when funds are deposited into a DAF rather than when those funds are distributed to charity. This makes it painless to retain DAF funds instead of disbursing them. It has been true since DAFs were introduced, although it is only recently that donors have fully realized the benefits and are taking advantage of them across the board. As noted, legislators who drafted the measures governing DAFs never imagined that the funds would be retained for more than a short period. Indeed, long-term retention of DAF funds is neither authorized nor recognized in the Tax Code.56

DAF sponsors now receive more than $72 billion in annual contributions. This means that DAF sponsors “rank among the largest recipients of charitable revenue in the country.”57 Nominally nonprofit organizations housed in for-profit investment companies are prevalent as DAF sponsors. These sponsors, which exist solely to manage DAFs, depart from the historical norm of DAF sponsors having a distinct charitable mission.58

Commercial DAF sponsors manage approximately $100 billion in DAF assets. Not only do these sponsors lack any incentive to encourage and facilitate DAF distributions, the relationship between the nonprofit and for-profit arms of the investment companies provides a powerful incentive to encourage the retention of DAF funds, since both arms earn handsome fees. Moreover, commercial DAF sponsor staff often have little or no experience in philanthropy. These factors raise questions regarding the extent to which these organizations benefit the public at all, given that their interests and practices are often diametrically opposed to those of society. While the donor’s and the sponsor’s interests are served immediately upon the establishment of a DAF, society’s interests are served only when the DAF’s funds are disbursed.59 Reinforcing this point is that financial advisors are often rewarded both for steering clients toward opening DAFs and for retaining funds in those DAFs once they are established.60

Another concern is that complex assets are counted as DAF donations before being liquidated, so their actual value is speculative. This formula risks depriving taxpayers if the assets are overvalued. If such assets were required to be sold before they were counted, this could not happen. In 2013, approximately 28 percent of DAF contributions were noncash, so the scale of the problem is significant. Indeed, Fidelity Charitable reported that noncash assets constituted fully two-thirds of
their 2015 DAF contributions. Moreover, even if donated securities, artwork or real estate decline in value after transfer to a DAF, the donor retains the original tax deduction, shifting market risk to the public. In one example, a donation of stock was valued at $500 million when it was made, rendering the donor eligible for a tax deduction in that amount. Yet the stock later fell from $86 per share to $6 per share, resulting in a dramatic loss to the public purse. In addition, noncash assets may be very difficult for subsequent holders to liquidate.

As noted above, the rise of endowed DAFs presents a number of issues. And they are becoming ever more popular. The instrument explicitly calls for the indefinite retention of DAF assets, with earnings on those assets being used for charitable gifts. This arrangement is an even more flagrant violation of legislative intent than merely allowing DAF funds to lie dormant, given that sequestration of DAF funds is enabled only by “a wink and a nod” when donors pass funds to the DAF intermediaries housing the endowed DAF resources. Moreover, endowed DAFs are extremely lucrative for commercial DAF sponsors because they generate fees for both managing the endowment and investing the endowed funds. In addition, the advent of endowed DAFs promotes the financialization of philanthropy by treating endowed DAFs as part of DAF holders’ portfolios and grouping them with those clients’ other investments. Endowed DAFs also provide opportunities for commercial DAF sponsors to cross-pollinate with other financial products, which further entrenches the image of endowed DAFs as investment vehicles. For community foundations (CFs), endowed DAFs represent long-term security and fees for management of the endowed funds.

As DAFs become more prevalent, the lack of transparency becomes more problematic. Because so little information on DAFs is required, the public and government cannot oversee their use with specificity. Current requirements call for the DAF sponsor to report DAF donors in aggregate. This precludes identifying DAF donors in connection with the specific grants they make. Nor is valuable programmatic information available to scholars and other stakeholders. The lack of transparency also opens the door to dark money.

Another practice that merits scrutiny is that funds are being transferred from one DAF to another DAF. These transactions are opaque, raising additional concerns regarding transparency. Such transfers can obscure the identity of donors and preclude tracing the movement of assets into recipient organizations. Moreover, DAF-to-DAF transfers are growing exponentially. From 2012 to 2015, 4.4 percent of all DAF grants went to other DAFs rather than directly to charitable causes. In 2015, $209 million was transferred from one DAF to another DAF. The practice then grew by 409 percent over the subsequent five years, and in 2019 alone, approximately $1 billion was transferred between commercial DAFs. Accordingly, this figure does not capture DAF-to-DAF transfers in CFs or mission-driven DAF sponsors. Sponsors defend the practice as “an innocuous rejiggering of personal finances,” but DAFs are not “personal finances.” They are funds held in trust that bear an obligation to be given to charitable causes.

Other DAF practices are troubling as well. Foundations are permitted to channel payout funds into DAFs rather than directly into grants to charitable organizations. This defeats the purpose of both the transparency and time-limiting measures governing foundation grantmaking. To wit, in recent years, Google co-founder Larry Page transferred all but 0.000004 percent of his foundation’s grants to a DAF. Of the half-billion dollars hedge fund billionaire Stephen Mandel Jr.’s foundation has granted over the past decade, 99.9 percent went to a DAF. And since 2015, Elon Musk has given tens of millions of dollars—three-quarters of his foundation’s distributions—to a DAF. President...
Biden’s 2024 budget proposal includes a provision prohibiting such distributions from counting toward a foundation’s payout.67

Foundation-to-DAF transfers exacerbate the concerns with DAFs generally. They make it virtually impossible to trace how much is being distributed to nonprofit grantees and render the transferred funds even less transparent. This type of transfer can easily mask political activity as well.

Even hedge funds are using the foundation-to-DAF pipeline, further exacerbating the same concerns.68

DAFs are also allowed to fund impact investing. While these investments may be in the public interest, the DAF, as an instrument intended to be short-term, is not the appropriate vehicle for such investments. There are also questions regarding why funds that would otherwise be included in tax revenue should fund impact investments. These concerns notwithstanding, there are significant efforts to encourage DAF holders to make impact investments. In fact, potential impact investees and entrepreneurs view the enormous pots of money sequestered in DAFs as a perfect source of capital to fund their ventures and funds.69

Finally, many CFs have become reliant on DAFs. For example, DAFs constitute 88 percent of the asset base and account for 98 percent of both incoming contributions and outgoing grants for the Silicon Valley Community Foundation. CFs also earn fees for managing DAF investments.70 While CFs are generally thought to prioritize the interests of their communities over the demands of their donors, the presence of DAFs in CF portfolios provides a level of long-term security that may skew community interests.v

Foundations

Generally speaking, independent and corporate foundations are primarily grantmaking entities, whereas grantee nonprofit organizations actually carry out the grant-funded programs. There are four types of foundations: independent, family, operating and corporate. This paper focuses on independent and family foundations. Many foundations are required to pay an excise tax on their earnings and to disburse 5 percent of their endowments annually. This sum, known as the “payout,” is key to the regulation of foundations.

However, until the recent downturn, foundations were earning much more than the required payout in the capital markets, resulting in ever-larger endowments over time. In addition, the required payout funds may be used to finance administrative expenses, travel for members of the board of directors and other costs. These expenses can leave much less of the payout amount available for grants. For these and a host of other reasons, the amounts foundations distribute in grants is in many cases virtually insignificant when compared with their assets.

v Please see “Policy Proposals for Charitable Reform: Reforms to Discourage the Warehousing of Charitable Funds, B. Reforms to Private Foundations,” which pertains to the following discussion.
Concerns Regarding the Abundance and Pace of Grant Funding

The required foundation payout amount has remained stagnant since 1976, although endowment earnings since that time have skyrocketed during boom periods and continue to grow even in ordinary periods. According to economist Perry Mehrling, the 5 percent payout figure was a measure to “help private foundations rebuild their endowments” after a “decade during which payout had exceeded asset returns.” Concerns for the health of foundation endowments appear to have been overblown in hindsight, however. Indeed, since 1981, the value of U.S. foundations has tripled, yet the actual payout rate has dropped from over 8 percent to under 5 percent.

Defenders of the current payout rate argue that a low payout rate yields more funds for grantmaking in the long run. The problem is that the day when such funds should be used rarely seems to come. Granted, during the pandemic, a number of donors increased the amounts they donated. Foundation giving grew by more than 15 percent and DAF giving grew by 27 percent from 2019 to 2020. Yet should a situation need to be cataclysmic to warrant spending more than the required amount?

As noted, foundations may grant payout funds to DAFs rather than making grants directly to nonprofit organizations with those funds; once directed to DAFs, the resources may remain dormant indefinitely, subverting the intent of foundation payout requirements (although the practice has been legally permitted). Foundation grants to the top 45 commercial DAFs averaged $737 million per year from 2016 to 2018, including more than $934 million in 2018 alone. One troubling feature of this kind of giving is that when private foundations give to commercial DAFs, their gifts are much larger than are their gifts to other recipients. For example, from 2016 to 2018, private foundation gifts to commercial DAFs averaged about $605,000 each, whereas the same donors’ gifts to other recipients averaged just under a mere $119,000 each.

Significantly, Bloomberg Finance News has determined that without these foundation-to-DAF distributions, foundations would have failed to meet their 5 percent payout requirement in more than 1,000 instances.

As indicated, administrative expenses are allowed to count toward the 5 percent payout requirement. This can reduce the portion of the payout that foundations devote to grants. The practice is especially objectionable when expenses such as board travel and other expenses with only a tenuous relationship to a foundation’s actual grantmaking are deducted. Costs directly associated with grants, such as oversight or evaluation, are more justifiable. In any case, Rob Reich holds that the ability to satisfy the payout rule by deducting administrative expenses “constitutes an evasion of the rule’s purpose.”

Foundations may exist in perpetuity, notwithstanding the acute need for grant funding now. Moreover, this practice means that taxpayers are subsidizing donors’ long-term private interests, even though most citizens think the public should not have to do this. There is also good reason to solve public problems now rather than waiting for foundation endowments to grow; acting now would probably bring a higher return on the investments in the long run.

Foundations may count program-related investments toward their payout amounts and mission-related impact investments to reduce their excise taxes. Foundations are allowed to engage in impact
investing because the goal of such investments is social benefit rather than profit. Yet questions are arising in connection with such investments. For one thing, they are frequently being used as a substitute for direct charitable gifts—especially by technology-oriented donors. This has the potential to hurt the philanthropic sector overall. In addition, impact investments are not charitable gifts, so their eligibility to be included in payouts is questionable.57

Issues Pertaining to Foundation Governance

Foundation family members and staff are allowed to sit on foundation boards. Yet most professional boards, such as those that govern nonprofit organizations, are independent. In addition to the concerns regarding family compensation addressed below, foundations’ governance may suffer if their boards are insulated and have scant experience running philanthropic organizations.

Family members may receive compensation for serving on their foundation’s board. In fact, they are sometimes paid hundreds of thousands of dollars annually. This practice raises ethical concerns. In addition, there are instances in which trustees take out loans from their foundations, using that money for personal investments. For example, Ken Malecha, president of Best Brands Corporation, borrowed $800,000 from his foundation, whose total assets were only $1 million at the time. Investor Raymond Perelman gave his son Ronald a loan of more than $120 million from their family foundation. Similarly, Carl Icahn borrowed $100 million from his private foundation, invested the funds in businesses that brought handsome returns and then paid back the loan ten years later!80 President Biden’s 2024 budget proposal would preclude using family salaries to count toward a foundation’s payout. Yet it would not prohibit using foundation funds for excessive payments to family members.

If a philanthropist’s business interests are bolstered by the philanthropist’s charitable work, this means the public may be subsidizing for-profit, or even dishonorable, activities. For example, In February of 2021, Bill Gates published a book on reducing climate change entitled *How to Avoid a Climate Disaster: The Solutions We Have and the Breakthroughs We Need*. The book includes low-carbon cement alternatives as one of the solutions. Meanwhile, Terra CO2, a Colorado start-up, developed such a low-carbon cement alternative. Bill Gates led an investment fund that raised $46 million to support the start-up’s new facilities and speed up manufacturing processes.81 Because the book was published before the investment was made, Gates’s pecuniary interest in cement alternatives was not disclosed. Yet he touted the cement alternative when promoting the book—including recommending it to the highest level government and other leaders. This may have had an enormous impact on public policy and possibly also on procurement of cement alternatives. Such conduct significantly blurs the line between for-profit and philanthropic activities. If Gates used any charitable deductions to fund either the book or the start-up, this would raise more serious questions regarding why the public should subsidize his investments.

Another troubling business-related practice is when corporate donations are used to further the personal ambitions of a corporation’s executives. For example, the Morrison Knudsen Corporation made a contribution to a charity established by the CEO’s wife. Evidence emerged that the donation paved the way for corporate executives to be given prominent seats on the charity’s board. When corporate executives and managers “can exploit their control over corporate giving to serve their own purposes,” the corporation and the public bear the costs.82 “Those who perceive corporate philanthropy as this kind of fiduciary nest-feathering understandably oppose encouraging it through corporate and tax law.983
Examining the Way Philanthropy Operates in Our Society Today

Economic inequality has transformed our society structurally. Contributing factors include the shifting of the tax burden so that those at the top pay proportionately less than those below; the transfer of risks, losses and other burdens to individuals from institutions; and the greater difficulty generations face when they try to rise above their parents’ economic echelons.

As we examine philanthropy in view of these and other factors, we find many problems, both old and new, whose implications affect society fundamentally. Some of them have injurious effects so profound that they impede the very health of society at large, while others cause harm in more discreet ways. Many of the factors that underlie and perpetuate inequality have had corollary effects on the origins and practice of philanthropy.

The Origins of Inequality

Economic inequality has wrought extraordinary changes in the structure of our society by decreasing social mobility for the first time in U.S. history. “One particular worry is that the combination of high inequality and low mobility could influence the behavior of disadvantaged youth in ways that further diminish their chances of success. Then inequality begins to look like a vicious circle.” That quote is eight years old; circumstances have only become more pronounced since then.

Young people from more advantaged backgrounds also face daunting challenges as they try to rise above their parents’ economic echelons. Studies show that millennials are likely to become the first generation not to exceed their parents’ income or job status. Unless they inherit money from their baby-boomer parents, these young people’s prospects for retirement are poor. Meanwhile, they are delaying formation of their own households and delaying or even foregoing marriage.

The reallocation of tax obligations, which has shifted the tax burden so that those at the top pay proportionately less than those below, is one of inequality’s primary drivers. The rising share of investment income explains much of this, as such income is taxed at a substantially lower rate than labor income. Reductions in marginal tax rates have also been dramatic. Moreover, the wealthy protect their income and assets from taxes in myriad ways that are unavailable to people who earn their income through labor.

For example, the very wealthy use devices such as borrowing against assets to cover living expenses because loan proceeds are not taxed and “loss harvesting,” or selling stocks and then immediately purchasing similar stocks to take advantage of losses. In addition, they benefit from the exemption of “carried interest” from ordinary tax treatment and countless other schemes that are legal only because they employ technical loopholes to dodge applicable law.

Another way a small group of people benefit disproportionately is by inheriting wealth that is untaxed. The combination of preexisting resources and advantageous use of the law allows certain groups to give their offspring a significant leg up. “The estate tax essentially has become voluntary for the ultrawealthy, paid only if you’re unwilling to take the time and pay lawyers to plan around the tax,” says Alice Abreu, a tax law professor at Temple University. This chain of wealth enhanced by legal protections is perpetual, as future generations bestow upon their progeny resources undiminished by taxes upon each successive intergenerational transfer. Indeed, some of the 19th
century’s wealthiest families maintained their fortunes would never last through the generations. A century of tax avoidance later, however, dynasties such as the Mellons and the Marses endure and remain strong.⁹⁰

**Risk Shifting in U.S. Society**

Transferring the tax burden is far from the only way those with greater resources have benefited in recent years. In fact, there has been a wholesale transfer of risks, losses and other burdens to individuals from both public and private institutions. Employees are expected to absorb a greater share of health care costs and to go home without pay when business is slow. Consumer protections have weakened, shifting the burden of state regulation of irresponsible manufacturers to individuals who must now litigate product safety issues against massive corporations on their own. Insurance deductibles have skyrocketed while food safety oversight has waned.

Risk-shifting phenomena are also visible throughout the education sector. Elementary school teachers buy classroom supplies formerly funded by school districts. At the college level, individual instructors must purchase private liability insurance, as the burden of risk has shifted to them from their employing institutions. This change can threaten collective organizing and shared governance in education.⁹¹ In addition, the burden of tuition increases is shifting to poor families. This is because the amount remaining to be paid by poorer families after scholarships and grants is rising faster than the amount middle- and upper-income families pay.⁹²

While philanthropy picks up some of the slack, this divestment of responsibility for the welfare of citizens from the government and employers onto other shoulders has been dramatic and largely unfunded. Should the government abdicate and ask philanthropy to play a larger role in helping people bear burdens that they lack the wherewithal to contend with on their own? After all, grants are now available to cover the cost of pet health insurance, for example.⁹³

Alternatively, should taxes now foregone due to charitable deductions be reinstated so that the government can resume providing needed services and opportunities? While these questions are beyond this white paper’s scope, they are presented to illustrate how amorphous and unarticulated our institutions’ roles have become. Assessing the appropriate function of philanthropy would be far easier if we could answer them.

As we ponder the role of philanthropy and the tax policies that finance it, we ought to consider the full ramifications of the arrangements we adopt and accept. We have lived with the current structure for so long that we forget it could be changed. Indeed, even introducing the possibility of change presents myriad new ways of allocating society’s burdens, risks, responsibilities and liabilities.

**The Pre-Distribution of Wealth**

The factors discussed above cement and perpetuate inequality. The most significant factor underlying these concerns is the pre-distribution of capital. In other words, our legal system is set up to favor certain interests before they even create capital. The system then supports and protects those interests as they control, defend and retain their capital.⁹⁴ This is possible because those who possess the means of creating capital understand how to use, manipulate and even alter the legal system to their advantage—often to the disadvantage of the public.
Furthermore, once these interests form capital, the legal system shelters and furthers its growth, deployment and protection—often pursuant to highly specialized and arcane legal provisions that virtually no one outside the financial interests' areas of specialized expertise understands. This system, illuminated in Chuck Collins's 2021 book *The Wealth Hoarders*, enables the “plundering of the wealth of nations.” Moreover, it fosters criminal and kleptocratic behavior and the evasion of tax responsibilities, as well as contributing to the rapid growth of income inequality. Legislators who pass bills at the bidding of such interested parties rarely if ever understand the implications of these measures they enact. The fact that there are more financial sector lobbyists than any other kind illustrates the way this works. Indeed, the financial services industry leads all others in lobbying expenditures, having spent “$3,718,792,264 on lobbying between 1998 and 2009” and considerably more since then. This is a fruitful investment that yields even more and better safeguards of the resource-rich’s capacity to amass and retain capital.

Those with valuable property borrow against it to fund new businesses. The law declares practices such as securitization acceptable, and those who know how to structure the associated transactions gain handsomely as they shift the risk of losses to the public. Private equity firms use legal mechanisms to harvest capital from acquired companies and replace it with debt, shedding thousands of employees in the process. Oil companies book losses, drastically reducing their tax burden, as they reap enormous gains. Mortgage interest is deductible, whereas rent is not. Pre-distribution is the precursor to immense fortunes all over the world. A powerful and successful marriage of a favorable legal environment and economic resources, pre-distribution ensures that those with the wherewithal and access to legal expertise will triumph.

While scholarship on pre-distribution tends to focus on major, elite power and strict notions of capital, the idea of pre-distribution can be adapted to explain many other phenomena as well. Specifically, the combination of preexisting resources and the favorable application of legal or policy measures can create many kinds of value besides capital itself. This concept can apply in a variety of contexts. One example that has received much recent attention is the disparate treatment of black and white GIs under federal housing guarantees enacted after World War II and the corresponding differences in their generational wealth going forward. Using law and policy to enhance the value of existing resources is at the heart of much of the inequality with which society is replete.

Corollaries to pre-distribution occur at the micro level too. Chuck Collins's 2016 book *Born on Third Base: A One Percenter Makes the Case for Tackling Inequality, Bringing Wealth Home, and Committing to the Common Good* explores the ways a background of privilege, abundant resources, prestigious societal connections and proximity to major economic power predisposes a select few to be inured to financial and social hardships. Surrounded and supported by wealth and stature, they are showered with top educational, employment, business and social opportunities and fortified by solid, unwavering and perpetual personal security.

**The Role of the Law in Generating, Protecting and Deploying Philanthropic Resources**

Most importantly for purposes of this white paper, the concept of pre-distribution fits the philanthropic sphere very neatly. Using legal arbitrage, including legal loopholes and gaps, to increase or transform the nature of economic resources is foundational to the way philanthropy operates. Similarly, legal and regulatory measures may be stretched to an extent that violates the underlying spirit of the legal intent behind them. First, this kind of reasoning, applied to existing resources, can underlie the administration of foundations, the perpetuation of DAFs and the
establishment of other charitable vehicles, such as philanthropic limited liability companies (LLCs) and social investments. Second, it may support the growth and preservation of those philanthropic resources. Third, it fuels the seamless bequeathing of philanthropic assets to future generations. Nowhere is this interweaving of wealth, legal arbitrage and succession more evident than in the use of endowed DAFs.

The unprecedented recent transfer and aggregation of resources to the wealthiest members of society has enabled the formation of gargantuan philanthropic institutions and enhanced the size and capacity of existing ones. Because the top philanthropists are also the top recipients of increased investment gains and the possessors of ever-compounding fortunes, the philanthropic resources they control mirror their enhanced wealth, which owes much, if not everything, to the pre-distribution of capital.

Legal measures that serve the interests of the very wealthy also characterize the laws governing philanthropy. For example, tax laws make philanthropic contributions a very favorable way to avoid taxation. The more capital a person’s wealth generates, the more that person may rely on charitable giving to alleviate any tax burden that would otherwise ensue. This benefits philanthropic institutions, which are increasingly well funded as a result of the tax system. Moreover, the wealthier the donor, the higher that party’s tax subsidy is likely to be.

The advantages of the laws that govern philanthropy are also evident in the growth and perpetuation of foundation endowments. Because such endowments have tended to earn far more in the capital markets than they are legally required to expend on their payouts, they have grown dramatically in recent years.

In fact, approximately $1.1 trillion is currently held in foundation endowments. Foundation endowments continued to report higher gains than the payout rate until the recent downturn. Private foundations reported an average 10-year return of 8.4 percent, while community foundations reported a 10-year return of 7.6 percent.

DAFs also generate constant earnings before they are disbursed—especially given that they are not subject to distribution requirements. Thus, these types of philanthropic resources provide a font of capital because the legal conditions under which they exist foster such gains. It is important to note that while these funds must be channeled into philanthropy when and if they are distributed, possession of them even in unexpended form confers immense power, privilege and prestige upon their principals.

Moreover, as the previous section explains, the virtual dearth of taxation on intergenerational wealth ensures that philanthropists’ heirs automatically assume the privileges and power that accompany philanthropic wealth. They sit on the boards of influential family foundations, deciding the fate of beneficiaries who depend on their largesse. They inherit endowed DAFs that ensure they will perpetually possess the means to generate and dictate the disposition of grant funds. In these and many other ways, society and the laws that govern philanthropy bestow much power and influence on the legatees of philanthropic fortunes. Indeed, the inherited endowed DAF represents one of the best examples of how the law is being used to enhance and perpetuate philanthropic wealth.

Another variation of the legal measures used to protect wealth from taxation and pass it on to heirs to avoid estate, gift and generation-skipping taxes is the dynasty trust. This growing industry relies
on offshore tax havens to shield assets to the extent that they do not even need charitable deductions as a means of reducing or avoiding taxes. The increasing use of these vehicles presents obstacles to organizations that rely on charitable deductions, as the following section reveals.  

This white paper’s policy proposals are targeted toward curtailing legal arbitrage in philanthropy by clarifying existing provisions, replacing problematic measures and introducing new ones—all of which will serve to bring legal intent, democratic ideals, equity, fair play and philanthropic practice into harmony.

**Laudable Intentions, Adverse Outcomes: When Philanthropy Impairs the Healthy Functioning of Society**

The anthropologist Marcel Mauss believed that an awareness of justice is what transforms mere gift-giving into a genuine concern for the poor. Nevertheless, much well-intentioned philanthropic activity goes awry in implementation. We may well wonder why the huge increase in charitable giving between the 1970s and the 2000s correlates not with an increase in equality, but rather an increase in inequality. In fact, there are issues arising from the way philanthropy is currently conducted so significant that their effects extend beyond the charitable sector into society more broadly. These practices and structures can alter the fundamental functioning of society itself, undermining democracy, equity and fair play.

Moreover, because donors select and carry out their own philanthropic interventions, the sector’s aggregate impact is limited in scope and very spotty, leaving many needs unfulfilled. In fact, philanthropy has not been shown to reach lower economic groups as much as one might expect. For one thing, grants tend to be focused on geographic areas that are already wealthier. In addition, current policies favor institutions that are higher up the income scale, such as universities with large endowments and foundations.

Religious organizations are by far the largest recipients of charitable donations. Yet donations to such groups are declining rapidly as education and health are becoming more significant. These areas do not tend to channel wealth away from the groups that are doing the giving, however. In fact, they often cater to their very interests. Plato said that we feel compassion “not for those who are most in need, but rather for those who are most like us.” Indeed, when the wealthy and the affluent fund education, they are more likely to support schools their own children attend rather than schools for the less advantaged.

Wealthy donors also prefer not to give directly to working charities, favoring instead donations to DAFs and their own private foundations. In fact, 79 percent of the $25 billion in identifiable gifts the 50 top philanthropists made in 2021, or more than $20 billion, went either to private foundations or to DAFs. The wealthy in the United States routinely spend 3.5 percent of their investable assets on charitable giving and often enjoy the public acclaim that accompanies sponsoring buildings and enterprises named after them. This point touches on the issue of naming rights, which represent a quid pro quo in which the public typically has little say.

The wealthiest donors tend to focus their assistance less on basic human needs than do people lower on the income scale. Indeed, the higher one’s income, the less likely one is to channel assistance to the needy. Instead, the wealthy generally prefer to give to institutions that are already wealthy, such as their alma maters, hospitals, museums and other cultural organizations.
People of average means generally give more to serve traditional human needs. Now that fewer people in this category are giving to charity at all, however, these areas receive proportionately less funding than they did previously. Indeed, roughly 70 percent of households earning between $100,000 and $500,000 claimed charitable deductions before the 2017 Tax Cuts and Jobs Act (TCJA); that figure dropped to merely 29 percent thereafter.\textsuperscript{112}

Observers also worry about top-heavy philanthropy—the phenomenon of the wealthy giving an ever-greater share of charitable funds overall. IRS data reveals that households earning $200,000 or more accounted for only 23 percent of itemized contributions in 1992. By 2019, that share had grown to 67 percent! Households at the top of the income spectrum have also increased their use of the charitable deduction more than those with merely moderate wealth have. Deductible donations by households with incomes exceeding $1 million increased from 10 percent in 1993 to 40 percent in 2018. In fact, charitable giving by those ranking in the top one percent in income surged from 10 percent to 66 percent of all charitable deductions within a mere 26-year period!

This phenomenon provides people of wealth with significant advantages. They receive generous tax benefits as well as greater influence and power—both in determining which nonprofit organizations receive funding and in how those funds are deployed. They also assume a greater voice in which public policy issues are addressed and in what manner.\textsuperscript{113}

One of the ways elite philanthropy actually has promise is that it can take risks on challenges that entail leaps of imagination and commitments on a grand scale. The progress made by PEPFAR (the U.S. President’s Emergency Plan for AIDS Relief) in reducing the spread of AIDS in Africa demonstrated this. Beginning in 2003, enormous public and private institutions teamed up with smaller organizations that had imaginative ideas and community ties to fund risky, experimental and innovative solutions to the complex problems posed by AIDS. Importantly, they sustained those efforts over a lengthy period, which allowed them to accomplish outcomes never previously envisioned, including saving over 25 million lives and preventing untold millions of HIV infections.\textsuperscript{114}

Yet it is imperative that elite, or large-scale, philanthropy be tempered by concern for and, to the extent possible, involvement by, the public. The changes such large gifts can make should not be imposed on society without regard for their impact. It is important to bear in mind that philanthropy “combines genuine pity with the display of power [which] explains why the powerful are more inclined to be generous than to grant social justice.”\textsuperscript{115}

Ultimately, large-scale philanthropy is always an exercise of power. This power may support activities viewed as positive, such as nurturing poetry, or those viewed as negative, such as limiting voting rights, depending on one’s perspective. It often funds the donor’s whims and sometimes stands in for needed government action. In any case, it perpetuates donors’ hopes and nurtures them into the future.\textsuperscript{116} The legal system’s mandate is to ensure that the actions donors take to realize such hopes are compatible with a democratic, equitable and fair society. This white paper’s policy proposals support, strengthen and clarify that mandate.\textsuperscript{VI}

\textsuperscript{VI} Please see “Policy Proposals for Charitable Reform: Reforms to Encourage Broad-Based Giving,” which pertains to the following discussion.
Particular Areas of Concern

Tax Avoidance by Donors and Its Impact on Societal Equity

How can wealth advance civilization equitably while remaining in the hands, and under the dominion, of the few who possess it? Tax laws are the mechanism our society has adopted to address this issue. Yet most people would agree the system falls short of its aspirations—both because philanthropic programs often do little to spread the benefits of wealth throughout society and because the tax system does not operate as its architects envisioned. We have seen how little philanthropy serves to redistribute resources. The focus here is more on the way our tax laws permit, and even foster, inequity. This occurs both in substance and in perception.

Indeed, the aggregate effect of tax cuts, tax loopholes, the provisions of philanthropy-related tax law and other factors discussed above results in tax revenue from the top echelons falling far short of being just, equitable and sensible. Importantly, the public’s overall perception of these factors undercuts faith in our system and decreases trust in the ability and inclination of the government to tax the population adequately and effectively.

Devoting enormous amounts to charity is one way some avoid paying estate, capital gains and other taxes. These methods are technically legal and are subject to few restrictions. Yet the practice threatens fairness, equity and democracy because people of average income do not have equivalent privileges.

Again, when the wealthy appear to be using charitable giving as a means of dodging tax obligations, this may undermine confidence in the very rule of law. This is because it may appear as though the wealthy follow only the laws of their choosing, whereas the ordinary person lacks such options.

Behemoth organizations or funds—whose effects and impacts are indiscernible—can easily be formed and begin exercising power over public and civic life, undermining democracy and equity in several ways. There is no oversight roughly parallel to antitrust review that could deem such organizations too powerful or take steps to monitor or curb their influence; this exacerbates concerns over equity.

Furthermore, in an equitable society, people should not have to depend upon the largesse of philanthropists to make good on rights they enjoy as citizens. Philanthropy has been an invaluable supporter of justice and a generous provider of goods and services that improve the welfare of less advantaged citizens where there is no alternative source. It has played a mitigating or remedial role in circumstances where the government has failed its citizens. Yet it is an indictment of our society that only when an independent actor identifies and solves a civic problem are citizens’ rights honored.

Questions of equity also arise when philanthropists have sway over public officials in ways that Dennis Thompson and Lawrence Lessig call “institutional corruption,” or the “improper use of public office for private purposes.” They can contribute to the election of officials who support their positions. They can promise to undertake civic projects or adopt favorable public positions if officials back their solution to a particular problem. The concern is that such considerations
undermine institutions’ effectiveness by “diverting them from their purpose” or “weakening their ability to achieve their purpose.”

Similarly, the public should be concerned when a donor obtains tax relief to promote a cause that directly contradicts government policy or broadly accepted notions of the public interest. This occurred when Bernard Selz funded anti-vaccine campaigns and when the Koch brothers supported groups that suppressed evidence of climate change.

The Undue Influence of Wealthy Donors and How This Affects Democracy

In the United States, philanthropy creates friction with our democratic ideals when philanthropists are accorded deference in our society. This is demonstrated by the fact that most of us tend not to question donors’ philanthropic activities. Instead, we view these actions as private and defer utterly to donors’ selections of causes and the ways they choose to address them. Indeed, most people believe they have no right to voice grievances or even opinions on grantor conduct, notwithstanding the preferential tax treatment of their funds. Additionally, the law grants donors unencumbered discretion and confers generous advantages, especially tax benefits, upon them. In this way, public institutions accord philanthropy more deferential treatment than other forms of private capital enjoy. For example, there is virtually no government oversight of foundation and DAF grantmaking. Foundation boards meet in exotic locations, their travel costs at least partially funded by tax deductions. Public officials heed the word of large philanthropists—even when they lack professional expertise in the topic under discussion, as they did when Bill Gates wrote his book on climate change.

Moreover, deference can extend beyond the grave. Centuries after their demise, foundations can remain legally bound by the founders’ wishes. This is true of the Carnegie Endowment. Mr. Carnegie died in 1911, yet his wishes have, for the most part, been perpetuated without objection. On the other hand, the Buck Foundation, in Marin County, California, fought diligently, albeit unsuccessfully, to shed its founder’s edict that the endowment be used to fight poverty in Marin, where by 2021 only 3.8 percent of local families lived in poverty and the median household income was $131,000.

Our system is beset with tension between democracy and the practice of philanthropy. “The progressive nature of most national tax systems is being contravened by a concept which eludes any democratic involvement,” said researcher Ben Whitaker, referring to the Buck Foundation. Indeed, the very nature of a foundation can subvert our democratic system when it uses tax-exempt funding to solve social problems without consulting or considering those who will be affected.

There have been proposals to involve communities, academics and potential beneficiaries in foundations’ decision-making processes to make them more democratic. These efforts can certainly help at the margins. Indeed, consulting with affected communities should undoubtedly be part of any grant-funded project that has profound effects on them. Yet any such efforts must be voluntary on the part of foundations under current law. In any case, applying the idea more broadly would pose formidable administrative obstacles. Most important, however, the power imbalance between the donor and the community cannot be rectified through consultation alone.

In fact, because the largest, most powerful donors tend to be the most powerful business tycoons, their ability to set the agenda, dictate which policy areas should receive priority and ignore or
suppress problems they find irritating or damaging to their business interests gives them disproportionate authority and influence over the philanthropic sector at large and, indeed, the overall economy. Moreover, the public subsidizes this dominance by funding the realization of influential donors’ objectives with resources deducted from the tax coffers.

The context in which this problem has been most on display is in aggressive attempts to reshape education in the United States without proper consultation and involvement of the subject communities. The charter school movement, whose record in retrospect when run by for-profit entities is “subpar,” represents one of the largest public experiments in U.S. history.\textsuperscript{126} The experiment was driven by Bill Gates and other major donors, who often failed to consider the views of parents and other stakeholders. Many charter schools were unsuccessful. “For Gates it’s fine to say, well, that was an interesting experiment and it didn’t work out, and walk away from it. But . . . those are real children that we’re talking about. For the folks in Seattle it’s an ‘oopsie,’ but for the folks in Milwaukee it’s a major disruption.”\textsuperscript{127} The lesson of this episode is that beneficiary communities need to be integrally involved in grant-funded projects that affect their lives if those projects are to succeed. Alas, this practice may not come naturally to large and powerful donors, however. That is why external pressure is essential.

The ability of wealthy donors to seize the public agenda and dominate societal discourse is magnified by the ascension of ultra-high-net-worth donors, who are worth $30 million or more. This group gave $85 billion to U.S. charities in 2020. That is more than one-quarter of all individual giving in the country.\textsuperscript{128} Mega-gifts, defined as gifts of $1 million or more, are also on the rise. The \textit{Chronicle of Philanthropy} reports that while gifts of $1 million or more from individuals totaled only $2.3 billion in 2011, by 2021 that figure had risen to nearly $10 billion.\textsuperscript{129} Moreover, “ultra-enormous mega-gifts,” defined by Giving USA as gifts requiring adjustments to its internal modeling system, have grown even faster. In 2011, the threshold for mega-gifts was $30 million, and mega-donors gave a total of just $2.7 billion. By 2021, the mega-gift threshold had risen to $450 million, with mega-donors providing $14.9 billion as a group.\textsuperscript{130}

When such massive amounts of philanthropic funds are available, their donors often wield undue influence. For example, governmental and quasi-governmental entities may fawn over potential donors, groveling to please them. In pursuit of such resources, the public entities may give away public goods in the form of tax benefits or waivers of regulations or both. In doing so, they may relinquish public power in exchange for funds without consulting the public making the concessions. This is yet another example of how the public bears the costs of donors’ personal and business interests.

Large public policy-oriented projects, such as public facilities, parks and open spaces, public education and community programs, allow large donors to drown out the voices of ordinary citizens, undercutting democracy. This problem can easily extend to the donor’s heirs, who, upon coming of age, may appear in a public setting and assume control of the agenda as regular people are shunted aside.

Dark money exacerbates and aids the undermining of democracy because it allows organizations with powerful political, antiregulatory, educational and antidemocratic agendas to exercise
clandestine power. It allows donors to drive and bolster efforts to disempower and diminish the influence of the public and public institutions without disclosing their identities. Dark money can even target individual groups that are devoted to causes the donors oppose. For example, dark money funded the “Honest Elections Project,” which has in fact worked to roll back voting rights nationwide.\textsuperscript{131} Similarly, democrats criticized the political right’s use of dark money until the 2020 election, when they too embraced it.\textsuperscript{132}

Foreign policy, too, may be heavily influenced by large donors, especially when they are compensating for inadequate government resources being targeted at a problem. This can occur domestically as well. Whenever the government neglects an area for which it is formally responsible, the resulting deficits may be filled by actors neither chosen by nor accountable to the public. One of the Greater Horn of Africa initiatives in the mid-1990s was borne in part from the virtual absence of government influence in the region. Nongovernmental and international organizations had filled that space to such an extent that the international community decided action should be taken to restore government domain in areas such as health.\textsuperscript{133}

The wealthy may also displace government action in democracies because their interests are not closely aligned with the choices of democratically elected governments and their values are “demonstrably different” from those of the rest of the population.\textsuperscript{134} Thus, the ways the wealthy spend their charitable funds may in fact undermine the preferences of the general populace. For example, the U.S. population overwhelmingly supports sensible gun safety legislation. Yet some wealthy donors suppress the public’s wishes and curb its reach, power and influence, lavishly funding Second Amendment protection campaigns that keep remedial legislation from ever reaching fruition.\textsuperscript{VII}

**Top-Heavy Philanthropy**

Charitable giving has risen dramatically in recent years. Giving USA’s 2022 Annual Report states that charitable contributions by individuals constituted 67 percent of all giving—an increase of 5 percent from the previous year—for a total of $326 billion. Furthermore, there has been a major change in the origins of these funds: a dramatically increasing percentage of overall giving can be attributed to a small number of high-income, high-wealth donors. One result of this trend is that charities receive an ever-diminishing amount of revenue from those at the lower- and middle-income levels.\textsuperscript{135} The expiration of temporary COVID-era tax incentives for charitable gifts has exacerbated this trend.

This “top-heavy” philanthropy is reshaping the philanthropic sector and diverting massive amounts of revenue from public tax coffers. It also means increased volatility and unpredictability in charitable funding by placing organizations in a position of greater risk. When a small organization relies on funding from one large donor, that organization will be in crisis if the large donor stops providing funds. In contrast, if an organization has many small donors, losing one of them will have only a minimal impact. Grantee organizations must also invest heavily in cultivating large donors; garnering their attention alone requires concentrated effort, let alone securing and perpetuating funding.

\textsuperscript{VII} Please see “Policy Proposals for Charitable Reform: Reforms to Encourage Broad-Based Giving, F. Reforms to Reverse Top-Heavy Philanthropy,” which pertains to the following discussion.
There are perils for the wider civil society as well. “Concentrated wealth philanthropy has the potential to form blocks of private unaccountable power—essentially serving as an extension of personal power, privilege and influence for a handful of wealthy families.”

This kind of power also tends to creep into paternalism; donors believe that because they are powerful and successful in some areas, they know what is best in philanthropic interventions as well. Yet this belief in their superior judgment disempowers both the grantees and the beneficiaries of charitable funding. Moreover, there is evidence that grants developed in partnership among grantees, donors, beneficiaries and other involved parties are more effective than top-down approaches. In addition, addressing the overwhelming challenges of the 21st century requires partnerships among philanthropy, government and the private sector. All parties need to be humble and cooperative for such alliances to be successful, which can be difficult for people accustomed to being in charge. These are even more reasons for concern over the increasingly top-heavy nature of philanthropy in this country.

Another problem with the increasing dominance of colossal donors in philanthropic funding is its similarity to invasive species taking over ecosystems. The existing variety and abundance of nonprofit organizations as well as the generation of new philanthropic practices and actors are being inhibited as those who seek philanthropic funding try to mold themselves to fit the desires of the largest donors. Behemoth donors’ dominance of philanthropic discourse and practices may also limit the influence, power and scope of smaller foundations within the philanthropic community.

The United States has a long and rich tradition of charitable contributions—of both time and money—at all levels of civic life. Yet small-scale donors may be discouraged by the prevalence of large-scale donors because their contributions seem insignificant in comparison. Similarly, notwithstanding the country’s history and ongoing practice of volunteering time for worthy causes, when huge sums are being hurled at a problem, individuals may feel their volunteer efforts are so dwarfed by the major programs that they are not worthwhile.

Small organizations or small programs of larger organizations may easily be overlooked when available resources are increasingly concentrated among a few donors. Not only do these smaller efforts absorb administrative time and resources, their focus on ancillary issues can seem irrelevant and unimportant to those committed to large programs with significant outcomes.

Concentration of resources among philanthropists at the top has other deleterious effects that can be overcome only with fundamental systemic change. For example, large donors may favor a certain approach to addressing a disease that ultimately displaces alternative measures that could have been fruitfully pursued. For example, philanthropic funders played an important part in limiting Alzheimer’s research to one particular hypothesis for decades. All the time and money invested was for naught, however.

At present, there are no lifetime caps on giving to reduce estate taxes or to make charitable gifts. Thus, the very wealthy may use philanthropic resources to discharge tax obligations so enormous that the practice merits further examination. Given the prevalence of top-down philanthropy, the tax laws present one of the only avenues toward reversing the trend.

The way the system treats gifts, bequests and donations of appreciated assets allows several practices that reflect undesirable public policy. For example, donors are allowed to avoid capital gains taxes and even do so using stepped-up bases that provide heirs with dubious advantages.
There are no wealth taxes on DAFs and closely held private foundations. Given how much wealth escapes taxation via the protection such vehicles provide, there is little justification for also allowing the sequestered funds to remain undisbursed with few tax consequences.\textsuperscript{VIII}

**Political Considerations**

501(c)(4) organizations are permitted to engage in political activity. The transparency of such organizations is problematic because dark money can easily be deployed through them without any oversight. The public and authorities may have no way of knowing that anti-abortion forces are funding ostensibly neutral maternal health clinics, for example.

The use of 501(c)(4) organizations clouds legal lines between philanthropy and politics. Thus, for example, the public has no means of knowing why advertising regarding a ballot issue is framed in a way that attempts to slant support toward the dark money’s favored position. Exacerbating the problem is that a donation to a 501(c)(3) organization, which is not allowed to conduct political activities, may be transferred to a 501(c)(4), which is. Foundations and DAFs are also allowed to contribute to 501(c)(4) organizations, provided they “exercise ‘expenditure responsibility.’”\textsuperscript{141} Presumably, doing so can guard against improper political use of the funds, but, given that the 501(c)(4) designation applies to politically engaged organizations, this seems to be a contradiction in terms. Furthermore, 501(c)(4) organizations are being allowed to venture ever more aggressively into the political realm.\textsuperscript{142}

New uses of existing legal entities, such as forming LLCs to carry out philanthropic activities, are not subject to any restrictions on political activity. While such activity may be harmless, whenever the public assumes an institution has a neutral position when in fact its position is being promoted by a special interest, there are grounds for concern.

The Johnson Amendment to the Tax Code prohibits religious organizations from opposing or supporting candidates for political office. This measure may need protection, strengthening or both.\textsuperscript{15}

**Institutional Limitations of the Current Oversight System**

At present, only the IRS and state attorneys general (AGs) are charged with oversight of philanthropic activity. Their mandates are narrow: The IRS monitors tax law compliance, whereas state AGs focus on malfeasance. These entities are neither adequately staffed nor sufficiently knowledgeable about philanthropic practices to perform the kind of broad-based, substantive oversight that the philanthropic sector needs.

There have been proposals for the IRS to institute a “more robust and well-resourced audit function,” which would allow it “to move away from the bright-line rules that have proven to be overbroad and exceedingly complex.”\textsuperscript{143} While this might be possible, an independent, separate

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\textsuperscript{VIII} Please see “Policy Proposals for Charitable Reform: Reforms to Protect the Integrity of Our Tax System, D. Reforms to Increase Transparency,” which pertains to the following discussion.

\textsuperscript{15} Please see “Policy Proposals for Charitable Reform: Reforms to Protect the Integrity of Our Tax System, C. Creation of a New Oversight System for Foundations and Charities,” which pertains to the following discussion.
entity to oversee charitable activity makes more sense. Indeed, the understaffed and overburdened IRS has neither the time nor the mandate to apply current rules pragmatically and develop new rules that are concise and address real-world situations effectively. The philanthropic sector needs a more thoughtful and mission-based approach to its regulation and oversight.

Excise tax revenue is abundant enough to provide funding for much-increased oversight by federal authorities over collecting charitable tax revenue, holding the philanthropic sector accountable and increasing its effectiveness.

Most states lack adequate resources to fund charitable donation oversight. Historically under common law, and now under state law, state charity office oversight often remains opaque to the philanthropic sector as well as to policymakers and other regulators. These offices’ dual role of prosecutorial discretion and confidentiality impedes the kind of transparency that could aid understanding. Moreover, the many sensitive issues involved, combined with scant staff and resources, undermine the effectiveness of these offices. In addition, they lack the data needed to analyze and undertake the changes essential to improving their performance.

Reductions in Funding for Nonprofit Organizations

A healthy sphere of working nonprofits is vital to maintaining our philanthropic sector overall. Yet recent developments in charitable giving patterns have resulted in reduced funding for these organizations, with several factors impeding their ability to thrive. First, because DAFs are so popular, funding has migrated to them from individuals, especially those of high income, and foundations. This means less direct funding goes to nonprofits at the outset. Indeed, the increasing use of DAFs—especially those that are never disbursed—means fewer grants probably go to nonprofits than they would receive if the funds were donated to foundations, because foundations have a required payout. Moreover, it is very difficult for organizations to secure DAF funding on their own. DAF sponsors rarely issue grant applications, so individual organizations cannot draw attention to themselves in that way. Moreover, the virtually impenetrable world of commercial DAF sponsors raises barriers small organizations can scarcely traverse. Many, if not most, DAF holders prefer to maintain a low profile so that even if they are identified, approaching them is not easy. Indeed, whether because their DAFs are endowed or because they simply prefer not to disburse funds, many of these donors do not welcome entreaties from would-be grantees.

Furthermore, public support for individual nonprofits has declined—mostly as a result of inequality. Many households have less disposable income than they once did, which has had a deleterious effect on nonprofit organizations that depend upon direct public support.

The Tax Cut and Jobs Act (TCJA), which showered wealthy individuals and corporations with tax cuts, also contributed to the decline in contributions by those lower on the income spectrum. The TCJA increased the standard deduction to $12,000 for singles and $24,000 for couples. It also capped the local tax deduction at $10,000 (also affecting wealthier households) and eliminated other itemized contributions, which made the charitable deduction irrelevant for those taking the standard deduction. Indeed, the tax code as currently written favors taxpayers who itemize by allowing only

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Please see “Policy Proposals for Charitable Reform: Reforms to Discourage the Warehousing of Charitable Funds, A. Reforms to Donor-Advised Funds,” and “B. Reforms to Private Foundations,” as well as the section titled “Reforms to Encourage Broad-Based Giving,” which pertain to the following discussion.
that group to deduct charitable giving. This leaves people who do not itemize without any tax incentives or rewards for making charitable contributions.

The dynasty trust poses yet another threat to the ongoing funding of independent working charities. As noted above, the rising popularity of these vehicles, which protect capital from taxes and ensure it is passed on tax-free to heirs, raises an ominous specter for the nonprofit community. This is because such trusts render the charitable deduction irrelevant. Wealth is fully protected without using charitable tax deductions as a means of avoiding the inheritance tax. Thus, the increased use of dynasty trusts is virtually certain to reduce revenue for nonprofit organizations—both directly and indirectly through DAFs and foundations.¹⁴⁵

The higher relative proportion of large donors in current philanthropic activity has another negative impact: such donors may deem smaller grants to be too administratively burdensome and insignificant in impact to warrant any attention. This can greatly lessen support for small organizations, thus compounding negative trends; for example, fewer nonwealthy individuals donate to charity overall, yet those very small donors were more likely to give directly to working charities, including small ones. In addition, large mechanisms, whether they are DAFs, foundations or large direct grants to nonprofit organizations, are less likely to reach small entities.¹¹

**Transparency**

The concept of transparency has become a significant consideration, much emphasized in contemporary society. From government secrecy to environmental justice, people want, and increasingly feel they have the right, to know the origins and details of issues affecting their lives. Gatekeepers, in turn, resist divulging sensitive information for a variety of reasons—some legitimate, others not. In philanthropy, one way competing objectives can collide is that donors need freedom to deliberate in privacy about prospective grants, while prospective grant applicants need to know what factors donors consider in making their decisions.

Concerns regarding transparency also arise when donors seek to keep private the origins of their wealth. For example, the principals of TGS Management, the world’s first quantitative hedge fund, developed an elaborate “matrix of secrecy” surrounding their philanthropic activities, which may not have been entirely altruistic. Rather, they appear to be attempting to avoid public scrutiny about both the sources of their fortunes, derived at least in part from statistical arbitrage, and the ways they distribute their wealth.¹⁴⁶

LLCs and other organizations that do not receive tax deductions are not obligated to disclose their investors’ interests. This raises transparency concerns when those organizations fund public policy initiatives such as education programs because, absent disclosure, the public does not know the source of the programs’ support.¹⁴⁷ Without information on who or what interest benefits from an initiative, the public cannot make an objective determination regarding whether that initiative merits its endorsement. At the same time, requiring LLCs or other for-profit entities to divulge their roles and identities would violate societal norms about the freedom of private capital. Thus, this is a concern without any solution at present. Please also see the section entitled “Changes in Philanthropy Now and in the Coming Age.”

¹¹ Please see “Policy Proposals to Address the Problems Identified,” “Reforms to Protect the Integrity of Our Tax System, D. Reforms to Increase Transparency,” which pertains to the following discussion.
One of the greatest obstacles to donor transparency is the increasing use of DAFs, which operate with absolute discretion over what information, if any, is disclosed regarding their resources’ origins or disbursements. Once funds are deposited with a DAF intermediary, they become a kind of “black box” because of the fiction that the DAF intermediary is the 501(c)(3) recipient intended to be the beneficiary under the legislation. This means that the transaction has been consummated, and all information flowing from it ceases. After that point, there is no way to know if or how the DAF funds are used unless the donor or intermediary elects to make that information available. Indeed, the selection of grantees by DAF holders is completely opaque, as are the grants themselves. DAFs are known to have been secretly used to fund controversial causes, such as promoting Islamophobia. Transparency is also wanting in donations to DAFs that are channeled through shell companies, making identifying the donor all but impossible.

As indicated above, the problem has become even more serious since foundations have, of late, increasingly transferred resources to DAFs in lieu of making grants directly. Thus, as noted above, vast sums travel from one organization to another in utter obscurity notwithstanding the foundations’ legal transparency obligations. This lack of transparency has many negative consequences. Perhaps the most important among these is that the public has no means of knowing how, and if, the portion of these resources that would otherwise have been contributed to the tax coffers (which can exceed 70 percent) is spent. (If adopted, President Biden’s 2024 budget proposal would preclude this practice.)

Furthermore, no individual DAF account disclosure is required in connection with DAFs, foundation-to-DAF transactions and DAF-to-DAF transactions; information on DAFs is reported only in aggregate by the sponsoring organization. This means, among other things, that the public never learns details about individual DAF donations, whether DAF grants are effective and whether they contribute to long-term change or inure to the benefit of society at large.

One deficit in U.S. philanthropic governance is that there is virtually no oversight or overview of the way the system operates. Because philanthropy is governed primarily under tax law, funders operate largely independently, with the government relying on their skeletal reporting of activities. The state attorneys general are charged with rooting out malfeasance but, given how scant their resources are, they scarcely have enough capacity to do this, let alone conduct any substantive oversight. Some believe more robust supervision could improve the philanthropic sector’s performance if a sound structure could be developed and adequately funded. Specific concerns that arise given the dearth of philanthropic oversight include grantees and the public expecting grantors to demonstrate that they are steering clear of excessively political activities and projects that benefit primarily private interests.

Nonprofit tax filings are theoretically available to the public, but the IRS is overburdened and cannot provide the kind of streamlined, timely and complete online access that the public should have. As noted, many donors are not transparent regarding their activities. Because the IRS is the only authority with oversight over grant-funded projects, if it does not provide information on tax-exempt expenditures, the public has no alternative sources for information.

Furthermore, when information regarding the projects that donors fund is unavailable, neither the public nor the government can perceive conflicts of interest and possible problematic relationships between donors and other partners (such as corrupt foreign governments).
Changes in Philanthropy Now and in the Coming Age

The rise of “philanthrocapitalism” augured the birth of a new age in philanthropy. The term came into common parlance in 2006 as a way to describe the view that philanthropy should mirror for-profit endeavors, using terms such as “investors” instead of donors and “social returns” instead of public benefits. Newly minted wealthy philanthropists, especially those from Silicon Valley, attempted to instill in their philanthropy a scientific and businesslike approach they thought would be more effective than the charitable giving they witnessed around them. This approach was not really new; as noted previously, John D. Rockefeller and Andrew Carnegie pioneered this notion approximately a century earlier. Yet because the idea caught on, its technological features were new and so much capital was deployed under its auspices, philanthrocapitalism became a major force in the ensuing years.

Over time, some began to view philanthrocapitalism as a social wedge issue because of the “increasingly uneasy relationship between markets, democracy and economic inequality.”150 The idea of applying business principles to philanthropy in our age also set the stage for other approaches to philanthropy that are emerging and quickly gaining traction.

At present, philanthropy is experiencing significant changes that are likely to become more pronounced and pervasive over time. Reduced tax rates make tax deductions less attractive and compelling to wealthy donors. Moreover, much philanthropy now focuses on the donor, the donor’s modalities of giving and the place of charitable giving in the donor’s portfolio more than it does on the beneficiaries.

While it is too soon to evaluate the practices, vehicles and instruments on which the new alterations in the philanthropic landscape are based, it is important to be aware of their advent. Then, looking forward toward what lies ahead, it will be easier to assess what merits attention and study. These new phenomena can be separated into three general categories: the evolution of corporate philanthropy, the adaptation of different legal structures to carry out philanthropic programs and the increasing financialization of philanthropy.

Corporate Philanthropy

From scattershot, uncoordinated philanthropic efforts to highly developed strategies that mirror and integrate the business side of their affiliated corporations’ practices, corporate philanthropy is accomplishing new goals in a much-evolved manner.

Historically, corporations practiced philanthropy primarily as a means of demonstrating their good citizenship. The problems that arose in connection with such giving hark back to a simpler time. For example, Occidental Petroleum Corp. Chairman Armand Hammer used the company’s charitable funds to finance art purchases for his private collection.151 The amount of charitable giving corporations were allowed to deduct from taxes increased over time, culminating in 25 percent in 2020 and 2021. This has made the practice attractive in and of itself.152 Meanwhile, the change in corporations’ motivation for charitable giving has evolved to become a means of promoting their corporate interests by melding their philanthropy and primary business activities.
The trend has several worrisome features. Like other taxpayers, corporations may give freely to 501©(3) organizations. Yet the intertwining of businesses’ charitable and for-profit objectives raises concern regarding transparency and other issues. For example, a real estate developer may give a city a plot of land for a park that abuts property the developer wishes to turn into a massive mixed-use project. The park may induce the city to grant permissions, rights and zoning variances it would not otherwise issue. If the public does not know the reason for the gift, citizens cannot evaluate whether their assent is worth the sacrifices they must make in exchange. Or a corporation might fund a campaign to make feminine products available for free in disadvantaged schools. Yet such a project would entail the school district’s purchase of the products at a good profit, even if the corporation offers a large discount, because of the bulk involved. This example of a win-win situation for the “donor” can leave the observer feeling rather queasy.

“In a business world saturated by win-win discourse, linking profit-making and social good generation has made corporate philanthropists simply writing checks to anodyne charities an anachronism.” Increasingly, corporate philanthropy improves supply chains, develops local communities and fosters employee satisfaction. Strong performance in the environment, social and governance (ESG) areas signals to all the beneficial impact of a company’s strategically designed blends of philanthropy and core business factors, maximizing profit and augmenting share prices. Yet these new ways of combining business and charity can also take advantage of unsophisticated citizens and run roughshod over community concerns that do not have strong financial backing. Indeed, “transforming corporate charitable contributions into an aspect of shareholder primacy might produce a kinder capitalism, but at what price?”

Adopting New Legal Structures

As noted, because tax rates for the wealthy have diminished substantially in recent years, organizational tax deductions are not as important to many of them as they once were. Thus, wealthy donors have become willing to experiment and sometimes forsake the organizational tax deductions that have long supported philanthropic practice. For example, shedding the constraints foundations endure in exchange for organizational tax deductions, many new philanthropists are now using philanthropic LLCs instead. This designation leaves them free to operate as they choose. Moreover, given that individual LLC partners are permitted to take tax deductions on their personal tax returns for their portion of an LLC’s charitable contributions, they still benefit from the tax code’s provisions. As indicated in the section on transparency above, the most troubling issue these entities pose is that no transparency requirements apply to them.

Philanthropic LLCs may become as heavily involved in politics or religious questions as they wish, without making any public disclosures. They may fund public health, gun use or gambling regulation

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XII This is similar to what happened when Paul Allen attempted to grant land to the City of Seattle. Voters rejected the gift because the land’s upkeep would have been too expensive. But in that case, voters at least had the opportunity to evaluate the transaction. They often do not.

XIII Transparency is important in public discourse because it is one of the only ways the public can evaluate the reasons why entities take certain positions. Given that the tax savings organizations and individuals enjoy would be directed to the tax coffers were it not for the charitable deduction, it is reasonable for the public to have an idea of how the tax-exempt funds are being spent. For example, the fossil fuel industry’s funding of public campaigns in support of gas stoves, notwithstanding their knowledge that such stoves are harmful, illustrates why it is important for the public to know the source of advertising and other public information.
campaigns that favor interests they do not have to disclose. They may make contributions to nonprofit organizations that indirectly support their other business interests. In addition, they might sponsor massive, groundbreaking scientific studies in areas so new they are not properly regulated or might conduct artificial intelligence experiments that could pose harm to public discourse. They can also involve themselves in debates over local public schools without members of the subject community knowing their identity or true objectives. At present, there exist no means for the public to address these and other concerns regarding philanthropic LLCs. Introducing requirements that philanthropic LLCs disclose their activities would likely be unwelcome, in large part because of this country’s norm that capital should be free to travel, fund and participate in whatever activities it chooses. (Please also see the section entitled “Transparency.”)

Financialization

Financialization refers to a broad-based trend in the U.S. economy during the past several decades in which financial activities—rather than services generally—have become increasingly dominant. Scholars point to the U.S. government’s abdication in governing and controlling the economy as one of the factors that has allowed finance to assume a greater role in everyday life. Finance merges with other businesses and activities, partly filling voids and doing so partly inadvertently. This is also occurring within philanthropic practices.

From endowed DAFs to naming rights, from new ways of merging estate planning with philanthropic instruments to employing business practices in new contexts, this phenomenon seems to be taking the philanthropic world by storm, rendering the stuffy foundations of yore quaint and limited in scope. Donors often see little or no difference between the way they view their investment portfolios and their philanthropy. “Their vocabulary is full of terms like ‘rigorous due diligence, scalability, return on investments and agreed targets,’” notes fundraising consultant Susan Raymond.

The increasing view of philanthropic vehicles as constituting part of an investment portfolio is consistent with the trend. Endowed DAFs are a perfect example of financialization in philanthropy. In addition, impact investments, philanthropic LLCs, forms of corporate philanthropy and the professional management of endowments and DAFs by major investment houses also attest to how financialization has affected the field of philanthropy.

An interesting case in point is the issue of naming rights. When a donor negotiates for prominent placement of their name on an institution, for example, the donor is seeking a quid pro quo for the donation. Yet the institution’s granting of the naming right overlooks the fact that the public will be inescapably subjected to viewing the donor’s name without having had any say in the matter. Recent turmoil over the Sackler family’s past donations and the withdrawal of their name from a number of institutions because of their role in starting and perpetuating the opioid epidemic illustrate that there are interests beyond the physical space allotted to a donor’s name that should be considered.

Naming rights can also exemplify the financialization of philanthropy, in that financing does more than funding a grant or other benefit for another person or group; it also purchases other things of value, such as name recognition and prestige for the donor.
Policy Proposals to Address the Problems Identified

This white paper reveals a host of problems with the legal structures governing philanthropy. Much legislation currently in force is outdated. Moreover, there are deficits in the legislation's coverage, loopholes in the way it has been implemented and limits on its scope that make it inadequate to meet current circumstances and reflect recent economic and social changes. Our institutions are ill-equipped to perform adequate oversight of the massive amounts of philanthropic resources for which tax deductions have been granted and in which, as a result, the public has a vital interest.

In particular, the discussion has revealed that a mere fraction of the philanthropic resources available via tax deductions ever reach the beneficiaries legislators had in mind when they made the applicable laws. In addition, in a broad range of settings and circumstances, the citizenry is excluded from decision-making processes regarding the accrual and disposition of charitable funds. Most taxpayers are also disqualified from the tax-advantaged giving the wealthy enjoy. Finally, the tax system that grants those advantages is inadequate at best and debased at worst.

People across the political spectrum share this view of the current situation. Thus, the time is ripe for significant bipartisan legal reform, which should focus primarily on foundations and DAFs. The specific aim of the reforms this white paper recommends is to forge a new set of legal mechanisms that encourage and support democratically designed and delivered, broad-based and justly funded philanthropy, while rectifying the unfair and undesirable consequences of the current system. The following set of policy proposals is directed toward correcting these imbalances in power and establishing the legal underpinnings for a system of philanthropic governance that is inclusive, effective, transparent, equitable, fair and democratic.

Although the origins of the system’s problematic features vary, their solutions can be grouped into several general areas. Thus, the reforms fall, respectively, into the following three general categories. (The individual reforms, along with details on their scope and coverage, are accessible in the document entitled “Policy Proposals for Charitable Reform,” originally issued by the Institute for Policy Studies on August 9, 2023.)

Reforms to Discourage the Warehousing of Charitable Funds

As noted previously, extensive warehousing of funds has resulted from oversights in drafting the legislation currently in force, loopholes that avert and subvert its intent, inadequate governance of grant funds and practices that stretch beyond reason the meaning of measures currently in place. This set of policy proposals would ensure that the large quantities of charitable funds currently lying fallow flow to their intended beneficiaries without delay. The policy proposals would also foster greater accountability and curb abuse by the many indirect giving mechanisms foundations and DAFs have devised and are using to slow and even halt the distribution of tax-exempt funds.

For DAFs, the first set of policy proposals would require payouts, allow tax deductions only upon distribution of charitable funds, exclude impact investments, increase transparency and reporting and prohibit perpetual, or endowed, DAFs. They would also establish new requirements for DAF sponsors. For foundations, the policy proposals would increase annual payout requirements, reform payout exclusions and improve and update foundation governance.
Reforms to Protect the Integrity of Our Tax System

We have seen the ways the tax system permits and even encourages many inequitable and undemocratic practices, as well as violating our notions of fair play. Moreover, many problematic practices have proliferated because our system uses the tax code to govern areas extending far beyond its proper purview and current capacity. In addition, widespread tax avoidance characterizes and funds the philanthropic sector, raising concerns regarding the proper formulation and execution of public policy.

Thus, the second set of policy proposals targets the tax code, deploying its provisions and introducing new measures to make needed reforms. The policy proposals would close loopholes permitting tax avoidance and create a new system of oversight funded with the excise taxes foundations pay annually. The new entities the proposals seek to establish would oversee and increase the accountability of donors by enforcing applicable law and regulation as well as participating in the development and dissemination of philanthropic policy. In addition, this set of policy proposals would increase transparency and prevent the politicization of charitable organizations.

Reforms to Encourage Broad-Based Giving

The rise of economic inequality, the decline in economic security for the middle class and the advent of top-heavy philanthropy have decimated the generous giving for which average people have been known in this country. Expanding and improving the fortunes of those in the middle would be the best way to address this. Yet that is out of reach at present. Thus, the next best, and probably the only feasible, way to make charitable giving more broad-based is to target tax incentive structures. This is needed because households in the top 10 to 20 percent of income and assets enjoy generous incentives to make tax-deductible gifts, whereas taxpayers who do not itemize enjoy none.

Accordingly, this set of policy proposals includes introducing a universal charitable tax deduction as well as establishing a lifetime cap on charitable gift deductions and a cap on the charitable estate tax deduction. In addition, the policy proposals incorporate reforms in the treatment of gifts of appreciated assets and apply a wealth tax on DAFs and closely held private foundations.

Conclusion

There has always been a tremendous gap between the few who can support large-scale philanthropy and virtually everyone else. Now that gap threatens to become an untraversable precipice into which our society may irrevocably fall. If prospects continue to diminish steadily for those at the bottom as resources continue to swell for those at the top, our ability to salvage the shrinking number of those in the middle and raise those below them from their plight becomes increasingly challenging. Moreover, as these divisions are perpetuated, they also become more difficult to change.

At this juncture, many organizations are struggling because of inadequate funding, exacerbated by the poor performance of financial markets in 2022. Moreover, the available resources are poorly distributed; they are concentrated in some areas and suffering from neglect in others. There is much charitable activity that is laudable and carries with it ample commitment of support, but it is in danger of becoming eclipsed by gargantuan resources that are not accompanied by such responsible
intentions. What the sector needs is a thorough rethinking of the way it is treated under the law and, to some extent, a revision in the way it operates.

As this white paper noted at the outset, one way our current predicament could be alleviated dramatically would be to unleash the billions of dollars that lie warehoused in philanthropic entities. These funds could go a long way toward alleviating poverty, meeting other human needs and supporting cultural development. Combined with the other reforms this white paper proposes, the changes would have a profound and significant impact on society. Success depends on implementing a range of actions that together form the basis for such changes.

Why hasn’t philanthropy been more effective in combatting inequality? In addition to the factors outlined above, the scale of the problem is overwhelmingly large. Moreover, the technological development and globalization that have yielded so much of the capital donors devote to philanthropy have also driven inequality. Public voices supporting the status quo have been louder than those advocating for change. Philanthropists who are concerned about poverty tend to make grants that merely alleviate its symptoms; they do little to address its causes. In addition, despite millions of workers being stuck in dead-end jobs that make a mockery of the belief that if one works hard in the United States, one will get ahead, philanthropists have been reluctant to fund broad-based and public policy solutions to the problems such workers face.

Finally, regulation of the financial industry could go a long way toward reducing inequality. The financial services industry consistently fights regulatory reform efforts, however, having spent close to $2 billion on lobbying during the 2017–2018 election cycle alone. Yet scant philanthropic resources have been directed toward strengthening oversight of the financial industry, according to David Callahan, founder and editor of Inside Philanthropy.

Critics of Carnegie and his cohort lamented that social justice did not appear in their agenda. William Jewett Tucker, a professor of religion and president of Dartmouth College, held that, as laudable as Carnegie’s philanthropic efforts were, he was sidestepping the real question of the day, which was the “distribution rather than the redistribution of wealth.”

For all these reasons, philanthropy needs additional rules and guidance, structural reforms and increased public awareness if it is to fulfill its promise. Our failure to provide the sector with these improvements would certainly pose peril to our society. Building concerns for democracy, equity and fair play into the fabric of philanthropy’s governance rather than relying on the sector to remediate inequality on its own should yield a system that greatly reduces the need for redistributive solutions. If philanthropy has the freedom to deploy its abundant resources and grand ambitions within a just framework, its positive effects will be tangible throughout society.

Given that so much philanthropic activity is funded with tax deductions, the public deserves a handsome return on that investment. A rich and thriving sphere of philanthropic activity may be nurtured and expanded if certain steps are taken now. For example, we need to correct imbalances of power, concentrations of capital, failures in the way funds flow through the system, unfairness in taxation, skewed distribution of privileges and inequality in the economy because these factors negatively affect charitable giving practices. This transformation would win public acclaim and result in much-needed improvements in the lives of many citizens. The key to success will ultimately lie in creating a system that is fair to all involved in the process, from the donor to the ultimate beneficiary and, most of all, to the public that so generously supports philanthropy in the United States.
“The best philanthropy is constantly in search of finalities—a search for cause, an attempt to cure evils at their source,” said John D. Rockefeller. Philanthropy should address the problems that make it necessary in a society—thereby aiming to make itself unnecessary. For example, given the mandate to improve public health, a grant maker can go beyond traditional solutions to consider the issue’s social determinants, funding new leverage points that lift the aspirations of the intervention higher into the realm of improving society. When philanthropists try to alleviate or ameliorate the conditions that give rise to the ills they are addressing, philanthropy can become transformative rather than simply reparative.

“Democratic nations care little for what has been, but they are haunted by visions of what will be; in this direction their unbounded imagination grows and dilates beyond all measure,” observed de Tocqueville. Let us ponder the new heights the country could reach if philanthropy thrived under a regime of governance balancing all interests wisely and supporting innovation wholeheartedly. Such a regime would present possibilities for change and transformation that would yield benefits exceeding our most optimistic expectations.

Adopting the full panoply of policy proposals this white paper proposes will galvanize and sustain the reforms we have identified as necessary precursors to achieving our goals. Relying on the principles of democracy, equity and fair play ensures that these changes reflect our national values and perpetuate systems that support the kind of society most citizens agree is worth striving toward. If people across sectors, economic echelons, professions, regions, religious or belief systems and political persuasions come together to work toward these ends, success is virtually assured.

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