



**Private Foundation Grants to DAFs
Attorney General Charitable Trust Oversight Calls for Disclosure of Use of Funds**

Authors: Kari Aanestad, Kerry Gibbons, Jon Pratt
Minnesota Council of Nonprofits

Paper presented at the 2020 Public Policy Symposium of the Association of Research on Nonprofit Organizations and Voluntary Action (ARNOVA) and Independent Sector

May 18, 2020

With special thanks to: The University of Minnesota Law School and John D. Mooty Law Fellowship for supporting this research

Table of Contents

ABSTRACT	3
I. INTRODUCTION	4
II. CONTRIBUTIONS TO DAFS—PARTICULARLY THOSE HELD BY COMMERCIAL SPONSORS—ARE INCREASING	4
III. PRIVATE FOUNDATION GRANTMAKING TO COMMERCIAL DAF SPONSORS CREATES A SUPERVISORY GAP FOR STATE ATTORNEYS GENERAL ENFORCEMENT OF CHARITABLE TRUSTS	6
IV. STATE ATTORNEYS GENERAL GENERALLY POSSESS THE ENFORCEMENT AUTHORITY TO INVESTIGATE BREACHES OF CHARITABLE PURPOSE AND OTHER BREACHES OF TRUST	13
V. POLICY OPTIONS AND RECOMMENDATIONS	18
ABOUT THE AUTHORS	20
APPENDIX A: INTERVIEW METHOD AND PROTOCOL	21
APPENDIX B: PRIVATE FOUNDATION GRANTS TO TOP 5 COMMERCIAL DAF SPONSORS BY STATE (2010-2018)	22

Abstract

\$3 billion was transferred from over 2,200 U.S. private foundations to five donor advised fund (DAF) sponsors between 2010 and 2018. Within this universe, a growing number of private foundations have made a *single* grant during a reporting year to a commercial DAF. Looking just at transfers to the top five commercial DAF sponsors, 35 foundations transferred the entirety of their annual grantmaking to DAFs between 2010 and 2018.

These transactions offered no tax benefit, but in effect excused private foundations from two legal requirements for U.S.-based private foundations derived from the Tax Reform Act of 1969: reporting grant recipients¹ and the 5 percent annual payout requirement.² Such grantmaking, while facially charitable and in-line with the requirements put forth in the 1969 legislation, not only risks breaches of restrictions established by the foundations' founding documents but also obscures all aspects of the recipients of private foundation funding by providing no context for *when* or *where* the charitable dollars will be used.

Private foundation-to-DAF transfers frustrate state attorneys general's ability to fulfill their supervisory duties to monitor and ensure that charitable dollars held by charitable trusts are used for their intended purpose.

This paper examines the governing authority and practices of state attorneys general offices as relating to a special problem of charitable trust enforcement: private foundation grantmaking to commercial DAFs. The authors examine the regulatory challenges based on interviews with both current and former attorneys from nine attorney general offices, as well as interviews with commercial DAF sponsors. Charities regulators' ability to fulfill their supervisory duties related to private foundation-to-DAF grantmaking is blocked by the **lack of transparency on the use of funds transferred to DAFs**. Thus, charities regulators cannot ensure that private foundations' grantmaking fulfills restrictions on their charitable giving, and the public is unable to see charitable activity ordinarily subject to public inspection.

In order to equip charity regulators to effectively enforce state charitable trust requirements, the paper concludes with two recommendations:

1. Charitable trusts should be required to report to state attorneys general all grants made or approved for future payment from DAF accounts to which they have transferred funds, subject to public inspection, and
2. Attorney General's offices should respond to the growth of charitable funds held in trust by devoting increased resources to monitoring charitable trusts and donor advised funds.

¹ Code of Federal Regulations - 26 CFR § 1.6033-3 – Additional provisions relating to private foundations —(a) “The foundation managers of the private foundation shall set forth in the annual report required (990PF) . . . (2) An itemized list of all grants and contributions made or approved for future payment during the year, showing the amount of each such grant or contribution, the name and address of the recipient (other than a recipient who is not a disqualified person and who receives, from the foundation, grants to indigent or needy persons that, in the aggregate, do not exceed \$1,000 during the year), any relationship between any individual recipient and the foundation's managers or substantial contributors, and a concise statement of the purpose of each such grant or contribution.”

² Internal Revenue Code §4942

I. Introduction

The rapid growth in contributions to donor-advised funds (DAFs) represents one of the most dramatic developments in U.S. charitable giving and has garnered the attention of nonprofit fundraisers, philanthropists, policymakers and scholars across the United States. DAF sponsors have aggregated \$121 billion in DAF assets,³ proving attractive to high-net-worth individuals for numerous reasons—serving as a quick, user-friendly, and relatively inexpensive mechanism to manage charitable contributions, and DAFs remain less regulated and less transparent than private foundations. However, as funds handled by DAF sponsors grow, public interest in how the funds are used, and how much of the funds are being put to work once they move into DAFs, has led to proposals for greater transparency.

One aspect of DAF activity that has received little attention is the movement of funds from private foundations to DAFs—a transfer from one fund required to be spent for charitable purposes to another, from an entity which has already delivered a tax benefit, moved with no further tax advantage. Using Candid’s Foundation Directory Online database (the most comprehensive resource available), the authors identified 2,203 private foundation grants totaling \$3 billion transferred from private foundations to just five of the largest DAF sponsors from 2010 to 2018: Fidelity Investments Charitable Gift Fund, Schwab Charitable Gift Fund, the National Philanthropic Trust, Vanguard Charitable Endowment Program, and Goldman Sachs Philanthropy Fund.

Three examples illustrate how funds transferred to DAFs eclipse the ultimate destinations of its charitable funds:

1. The Manitou Fund, a White Bear Lake, MN, private foundation with \$42 million in assets, reported on its IRS Form 990-PF in 2017 and 2018 that it expended \$4.2 million in grants for charitable purposes. All of the \$4.2 million went to a DAF account at the Charles Schwab Charitable Gift Fund, but no further information was reported on the recipients of funds, purposes or amounts, or relationship to its foundation managers.⁴ (In 2019 the Manitou Fund received an addition of nearly \$1 billion in assets from the estate of its founder, Donald McNeely.)
2. The Zoom Foundation, a private foundation in Fairfield, CT created by hedge fund founder Stephen F. Mandel, Jr., reported \$999,999,999 in assets on its Form 990-PF for 2017, and \$58 million in grants paid. The Zoom Foundation’s single 2017 grant for \$58 million went to Fidelity Charitable Gift Fund for the purpose of “charitable to fund programs,” with no further information about recipients, amounts, or purposes.
3. The Douglass Brandenburg Family Foundation, a Minneapolis private foundation with \$47 million in assets, reported on its 2017 and 2018 IRS Form 990-PF that it expended \$4.2 million in grants and allocations. The Brandenburg Foundation’s 2016 amended and restated articles of incorporation set out a special emphasis on improving the health, education, and welfare of disadvantaged people, with a grantmaking focus on “Educational, Shelter/Care, Emergency Assistance and Human Development.” \$1.8 million, or 43% of the foundation’s grantmaking, went

³ National Philanthropic Trust 2019 Annual Donor Advised Fund Report, <https://www.nptrust.org/reports/daf-report/>, accessed August 27, 2020.

⁴ Defined as an officer, director or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors or trustees of the foundation).

to the Charles Schwab Charitable Gift Fund, with no further information reported on the recipients or uses of funds, including whether they were consistent with the foundations restated articles of incorporation.

This paper examines the challenge of state trust law enforcement by state attorney general offices responsible for supervision of charitable trusts, including enforcement of trust restrictions for funds they can no longer see, with larger implications for the transparency and expenditure intentions of the federal Tax Reform Act of 1969.

II. Contributions to DAFs—Particularly Those Held by Commercial Sponsors—Are Increasing

Under the Internal Revenue Code, a donor-advised fund (DAF) is an irrevocable designated fund administered by a public charity and created for the purpose of managing charitable donations on behalf of an organization, family, or individual. DAFs have proven to be a popular giving vehicle, particularly among high-net-worth individuals, for a number of reasons. DAFs:

- offer an immediate tax benefit to the donor in the form of a charitable contribution eligible for a tax deduction from an individual, corporate or estate tax return;
- require far less administration by the donor than a private foundation (including less regulation and greatly reduced reporting requirements);
- can accept a broad array of contributions of complex assets (ranging from cash to non-marketable securities, real estate, etc.), facilitating greater tax advantages;
- can be invested and grow tax-free charitable assets over time;
- allow the donor to advise payout from the fund at any time to charitable beneficiaries and/or appoint successors for future charitable contributions (even perpetually, depending on the sponsor); and
- while the sponsoring organization holding the DAF funds has full legal title over the DAF accounts it holds, industry practice is to fully defer to DAF “advisor” direction, generally on the condition that the recipient be an organization currently recognized as a public charity by the IRS, and even to allow the donor to direct the choice of investments for the funds in the DAF account.

DAFs can be sponsored and held by any public charity, but are generally seen as being located in three major categories of sponsors (described below using terms favored by the DAF industry):

- national or commercial sponsors (which collectively hold 60 percent of all DAF assets)⁵ such as Fidelity Investments Charitable Gift Fund,
- community foundations (holding 28 percent of all DAF assets)⁶ such as the Silicon Valley Community Foundation, and

⁵ National Philanthropic Trust 2019 Annual Donor Advised Fund Report, <https://www.nptrust.org/reports/daf-report/>, accessed August 27, 2020.

⁶ *Id.*

- single-issue charities (collectively holding 13 percent of all DAF assets),⁷ such as the Nature Conservancy or the Jewish Community Federation and Endowment Fund.

While first established by community foundations in the 1930s, DAFs didn't experience their major growth until the 1990s, with the arrival of specialized entities affiliated with the financial services industry. From 2014 to 2018 contributions from donors to DAFs grew by 86 percent—and grantmaking from DAFs in 2018 alone totaled \$37.12 billion.⁸ These funds, held by public charities for future allocation to charitable activities, reached \$121.42 billion in assets by the end of 2018.⁹ In addition, contributions from donors to DAFs accounted for 12.7 percent of all charitable contributions in 2018—up from 7.1 percent five years before. As a result, 13 percent of charitable dollars given in 2018 did not get put to work in nonprofit organization but are pending processing in intermediary vehicles.

III. Private Foundation Grantmaking to Commercial DAF Sponsors Creates a Supervisory Gap for State Attorneys General Enforcement of Charitable Trusts

Within the broad realm of charitable activity vis-à-vis DAFs, this paper addresses one activity in particular—the movement of funds from private foundations to DAFs held by commercial sponsors. A significant amount of tax exempt dollars are being granted from private foundations to the top five commercial sponsors of DAFs. Between 2010 and 2018, 2,203 private foundations granted \$3 billion to these DAF sponsors.¹⁰ One key question is: “Why would a private foundation, overseeing dollars that have already been given a tax exemption for a charitable purpose, grant those dollars to a DAF sponsor?”

A. Private Foundations See DAFs as Flexible, Discreet Vehicles for Charitable Giving: The authors interviewed a dozen community foundation and national sponsors on instances where they encountered private foundations making grants to DAFs. Broadly, they found that private foundations grant money to commercial DAFs because doing so:

- Allows the private foundation to count the grant to a DAF sponsor as a qualifying distribution to **meet the requirement to pay out 5 percent of the value of assets for a charitable purpose (over a five year average).**
- Can provide greater **flexibility in grantmaking as compared to** cumbersome internal foundation practices, and may allow for funding beneficiaries or geographies that may be outside of the current scope of the private foundation's funding priorities.¹¹

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ Authors used Candid's Foundation Directory Online database to search for private foundation grant contributions to Fidelity Charitable Gift Fund, Schwab Charitable, the National Philanthropic Trust, Vanguard Charitable, and Goldman Sachs Philanthropy Fund from 2010–2018.

¹¹ Authors' note: Using a DAF to make grants outside of the current scope of a private foundation's funding priorities risks breaching trust restrictions

- **Tapping into DAF sponsor expertise and relationships may complement a private foundations' charitable work**, as it allows board members to tap into local expertise of a community foundation sponsoring DAFs with respect to issues and work being conducted locally.
- Can serve as **a means to mentor and support the transition of a family foundation's board of trustees from one generation to the next**. DAFs require less administrative support than a private foundation and can be used as an introduction to family philanthropy, providing an educational opportunity to learn operational aspects around decision-making, grants, and community relations.
- In some cases DAFs may be a tool used by a private foundation to **spend down its assets and wind down its operations**. A private foundation may decide to do this because:
 - Expense of operations not worth the long-term investment.
 - Differing views of family members involved in governing the private foundation, so splitting up the private foundation into separate DAFs gives each person/group separate funds to advise.
 - Generational change where older generation does not want to (or is not) involved anymore and they want to split it up so kids and their families can carry on with separate funds.
- Some organizations report that grants to certain organizations or causes might be personally embarrassing or create a potential controversy for individual board members, and particularly in cases where they use their foundation board positions to express their personal beliefs and interests. A private foundation using a DAF to make grants **obscures** the recipients and timing of contributions, as the organizations ultimately receiving grants from the private foundation's DAF are not disclosed on the foundation's 990-PF.
- Other reasons could include the role of financial advisors, helping explain the remarkable growth in DAF-to-DAF granting, which accounted for 4.4% of DAF grantmaking from 2012-2015.¹²

B. Convenient for the Private Foundation, Opaque to the Public: DAFs' Lack of Transparency Evades a Key Objective of the Tax Reform Act of 1969, and frustrates charitable trust supervision: The concept that "sunshine is the best disinfectant" has been embraced by nonprofit representatives and online public services such as Candid and ProPublica's Nonprofit Explorer, which make charitable organizations' form 990 publicly accessible. State and federal charity regulators have avoided direct control of charitable activities as improperly intrusive, and outside of prosecuting charitable fraud, have preferred disclosure requirements to regulatory controls, going back to the Schaumburg decision:¹³

In suburban Chicago, the Village of Schaumburg adopted a municipal ordinance requiring that 75 percent of an organization's revenues be expended for "charitable purposes" as a condition for a solicitation permit. This was a condition that Citizens for a Better Environment, an

¹² Giving USA Special Report, The Data on Donor Advised Funds, 2018, Giving USA and IUPUI Lilly Family School of Philanthropy, p. 29.

¹³ Village of Schaumburg v. Citizens for a Better Environment, 444 U.S. 620 (1980).

environmental group with a door-to-door canvass, could not meet. In *Village of Schaumburg v. Citizens for a Better Environment* (1980), the Supreme Court nullified the ordinance (and similar state laws around the country that restricted charitable organizations to specific efficiency percentages) and rejected the argument that soliciting contributions was purely commercial speech, citing previous cases on canvassing by religious and charitable organizations. While the municipality had an interest in protecting its citizens from fraud, its remedy was an overly broad prophylactic measure. Instead, the court's opinion suggested that making information about organizations publicly available was a preferred route. The court's dicta on the benefits of public education could be seen as spurring regulators and watchdog groups to invest resources in educating donors to ask about fundraising and administrative costs, and, ultimately, for charitable organizations to have their IRS 990 forms posted on the Internet at multiple sites—and ideally also at individual organizations' own websites.

Private foundation-to-DAF transfers avoid two requirements for U.S.-based private foundations derived from the Tax Reform Act of 1969: reporting grant recipients¹⁴ and the 5 percent annual payout requirement.¹⁵ By granting funds to a DAF, private foundations avoid the requirement to disclose who receives grants once paid from the DAF, and private foundations can claim that DAF funds are just like grants to working charities for purposes of the 5 percent payout requirement.

These more stringent requirements were intended by Congress to clearly set private foundations apart from public charities. By granting charitable dollars to DAFs, private foundations can satisfy the 5 percent payout requirement while only reporting the name of the DAF receiving the charitable dollars—not the name of the organization that *ultimately* benefits from its charitable giving. Such activity, while facially charitable and in-line with the requirements put forth in the 1969 legislation, obscures all aspects of the recipients of their funding and provides no context for *when* or *where* the charitable dollars will be used.

DAF sponsors report a summary of DAF activity on IRS Form 990 Schedule D. While total funds contributed into, granted out of, and held by DAFs are reported on Schedule D, the specific grants or amount of activity from individual funds are not:

efile GRAPHIC print - DO NOT PROCESS		As Filed Data -	DLN: 93493135014789
SCHEDULE D (Form 990) Department of the Treasury Internal Revenue Service	Supplemental Financial Statements ▶ Complete if the organization answered "Yes," on Form 990, Part IV, line 6, 7, 8, 9, 10, 11a, 11b, 11c, 11d, 11e, 11f, 12a, or 12b. ▶ Attach to Form 990. Information about Schedule D (Form 990) and its instructions is at www.irs.gov/form990.		OMB No 1545-0047 2017 Open to Public Inspection
	Name of the organization FIDELITY INVESTMENTS CHARITABLE GIFT FUND	Employer identification number 11-0303001	
Part I Organizations Maintaining Donor Advised Funds or Other Similar Funds or Accounts.			
14 Code of Federal Regulations, 26 CFR § 1.6033-3. Additional provisions relating to private foundations operated by the foundation managers of the private foundation shall set forth in the annual report required (990PF) . . . (2) An itemized list of all grants and contributions made or approved for future payment during the year, showing the amount of each such grant or contribution, the name and address of the recipient (other than a recipient who is not a disqualified person and who receives, from the foundation, grants to indigent or needy persons that, in the aggregate, do not exceed \$1,000 during the year), any relationship between any individual recipient and the foundation's managers or substantial contributors, and a concise statement of the purpose of each such grant or contribution."			

¹⁵ Internal Revenue Code §4942

When DAF sponsors report to the IRS on Form 990, used by non-private foundation public charities, and they are also required to report grants and allocations on Schedule I. Schedule I effectively requires DAF sponsors to report grants to organizations, governments and individuals in the U.S., including the name and address of the organization, its employer ID number, amount of the grant, and the purpose of the grant or assistance:

Form 990, Schedule I, Part II, Grants and Other Assistance to Domestic Organizations and Domestic Governments.							
(a) Name and address of organization or government	(b) EIN	(c) IRC section if applicable	(d) Amount of cash grant	(e) Amount of non-cash assistance	(f) Method of valuation (book, FMV, appraisal, other)	(g) Description of non-cash assistance	(h) Purpose of grant or assistance
PALISADES CHARTER HIGH SCHOOL 15777 BOWDOIN ST PACIFIC PLSDS, CA 90272	92-0184898	501 (C)(3)	20,050		N/A	N/A	FOR GRANT RECIPIENT'S EXEMPT PURPOSES
NEW YORK LEGAL ASSISTANCE GROUP INCORPORATED 7 HANOVER SQUARE 18TH FLOOR NEW YORK, NY 10004	13-3505428	501 (C)(3)	13,050		N/A	N/A	FOR GRANT RECIPIENT'S EXEMPT PURPOSES

17

Making the connection between the Schedule I list of recipients and contributors to DAFs is not possible, however, since it is presented as a single list with no indication of which DAF is linked to which grant, and some lists are presented alphabetically, geographically, by size or purpose, and (due to frequent incomplete Schedule I reporting) many only report some of the required items. Making the connection between the Schedule I list of recipients and contributors to DAFs is also not practical given the volume and size of some DAF sponsors. Fidelity Charitable's 2017 Form 990 is 17,316 pages long (17,244 pages of which is the list of grant recipients including those from 114,245 DAFs).

Private foundations intermittently use DAF sponsors as an additional charitable giving vehicle alongside their regular grantmaking to a variety of public charities. However, as in the case of the Manitou Fund in Minnesota and the Zoom Foundation in Connecticut, a growing number of private foundations have made a *single* grant during a reporting year—to a commercial DAF. Looking just at transfers to the five national DAF sponsors, 35 foundations transferred the entirety of their grants to DAFs between 2010 and 2018, avoiding all reporting of individual recipients, and making attorney general oversight impossible.

The ability of private foundations to transfer funds to DAFs and continue to direct the use of funds without public report effectively breaks the system of accountability through disclosure established by the Tax Reform Act of 1969. Transparency advocates increasingly argue that the current repurposing and concealment of private foundation dollars through DAFs violates the intent of private foundation disclosure and payout

¹⁶ Excerpt from Fidelity Charitable's 2017 Form 990 Schedule D

¹⁷ Excerpt from Fidelity Charitable's 2017 Form 990 Schedule I, Part II, Grants and Other Assistance to Domestic Organizations and Domestic Governments

regulations.¹⁸ Indeed, the policymakers who crafted the reporting requirement intended for it to act as a public trust; by requiring foundations to disclose grant recipients and relationships via 990-PF forms, a legislative sponsor theorized, members of the public could hold private foundations accountable.¹⁹

C. Commercial DAF Sponsors Ask Few Questions of their Clients—including the status of Restricted Funds: To better understand the client side of DAF grantmaking, the authors interviewed representatives from four of the top five commercial DAF sponsors: Fidelity Charitable Gift Fund, Schwab Charitable, the National Philanthropic Trust, and Vanguard Charitable.²⁰ In these interviews, the authors aimed to learn *how* the DAF grantmaking process works in practice, what kinds of questions or information DAFs require from their clients, and, particularly, how private foundation grantmaking to DAFs functions.

For each commercial DAF sponsor interviewed, the process of setting up an account was framed around ease and speed for the donor. All of the interviewed commercial DAF sponsors allow users to open an account online; by the authors' estimate, the time necessary may be as little as 5-10 minutes. The DAFs require minimal personal information (such as social security number, date of birth, and address) to open an account. Most accounts—with the exception of Vanguard—do not require grantors to set up a succession plan when initially opening an account. While commercial DAFs differ in their minimum initial donation requirement (i.e., \$5,000 at Fidelity Charitable versus \$25,000 at Goldman Sachs), all commercial DAFs are similar in that they do not require an initial contribution to *open* an account.

Similarly, the process for granting charitable dollars from a private foundation seems nearly identical to that of an individual's grantmaking; commercial DAFs ask few questions and emphasize that minimal paperwork (aside from the forms necessary to send to the IRS) is necessary. Based on the authors' interviews, it does *not* appear that commercial DAFs request articles of incorporation or other filings that may delineate subject-matter, geographic, or beneficiary restrictions on charitable donations.

This process was largely echoed when the authors asked commercial DAF sponsors about donations taken from charitable trusts or other restricted funds. Most commercial DAF representatives seemed unfamiliar or unprepared to answer this question. The general consensus seems to be that there is no way to track any sort of restriction on the fund when it goes into the DAF, and if there *was* an initial restriction on the fund, it goes away once the money is held in the DAF. The process for accepting funds from a charitable trust does seem more onerous than accepting funds from a private foundation, however. The National Philanthropic Trust requires a copy of the trust agreement when accepting funds from a trust, while Vanguard explicitly stated that they do not accept funds from charitable trusts.

¹⁸ Ruth McCambridge, *Do Donor-Advised Funds Require Regulatory Attention?*, NONPROFIT Q. (Aug. 27, 2019), <https://nonprofitquarterly.org/do-donor-advised-funds-require-regulatory-attention/>.

¹⁹ *IRS Oversight of Tax-Exempt Foundations: Hearing Before a Subcomm. of the H. Com. on Government Operations*, 98th Cong. 1 (1983) (statement of Johnny C. Finch, Ass't Dir. General Government Division, General Accounting Office).

²⁰ Goldman Sachs Philanthropy Fund declined to speak with our team. Instead, relevant information is derived from its 2017 Program Circular (located here: <https://gspf.goldman.com/gspf/Portals/29/docs/2017.11%20GSPF%20Program%20Circular.pdf>).

Finally, while all commercial DAFs can provide documentation (via letter or email) of grantmaking from the sponsor's account, all interviewed DAFs emphasized that there's no *need* for the donor to track this, because the initial charitable donation has been conferred and the tax benefit has already been provided. Because of existing IRS regulation, there is no current legal reason for the DAF donor to retain or track grantmaking distributions from their DAF account.

In sum, commercial DAFs do not play a role in enforcing private foundations' and charitable trusts' restrictions on charitable dollars, largely because there is no legal requirement for them to do so. This sentiment was echoed through conversations with an expert on the IRS 990-PF form; because there is no legal requirement for DAFs to ensure that fund restrictions get fulfilled, the fault would likely be on the private foundation managers for failing to disclose or failing to fulfill such restrictions.

Key Findings from Interviews with Top Commercial DAF Sponsors					
	Fidelity	Vanguard	Schwab	National Philanthropic Trust	Goldman Sachs
Succession plan required	No	Yes	No	No	No
Min. req. to open an account	\$5,000	\$5,000	\$5,000	\$25,000	\$25,000
Fees	0.6% BP (basis points), up to a certain point	0.6% BP (basis points), up to the first \$500k in the account	0.6% BP (basis points), up to the first \$500k in the account	0.85% BP to the first \$250k in the account	0.6% BP (basis points) up to the first \$500k in the account
Asks about restrictions on funds being transferred from a private foundation	No	Not necessarily. Does not accept donations from a charitable trust.	No	No	No
Confirmation of Distribution from DAF Account	Donor/advisor receives a letter detailing the source alongside confirmation of the check to a charitable organization. Donor/advisor can check receipts/confirmation of disbursement on Fidelity's website, but "you don't have to worry about keeping up with that" because you receive your tax benefit <i>at the time</i> of the transfer to Fidelity.	The account holder receives notifications when the grants are sent out and submitted (donor chooses to receive notifications via hard copy or email). Notifications do not focus on the purposes of grant payouts but rather the contribution receipts at the time money is donated to the DAF.	The donor/advisor will just receive an email when the contribution to the DAF has been received and can select to receive emails about the DAF's grantmaking. Donors/advisors can request a copy of the grant letter, if they prefer and can download gift receipts for initial DAF account contributions on the sponsor's website.	Once grants are made, donor/advisor receives a copy of the grant confirmation (depending on preferences). It's always available on the online portal.	Donor receives a letter acknowledging contributions into the DAF, including an estimate of the fair market value of the securities contributed on the date the contribution is received. Donors should keep the acknowledgement letters with tax records. Donors also receive a letter to confirm grants made out of DAF accounts. Both of these letters are typically provided within 5-10 business days after a contribution has been received or grant has been made. Donors also receive quarterly statements showing all account transactions.

IV. State Attorneys General Generally Possess the Enforcement Authority to Investigate Breaches of Charitable Purpose and Other Breaches of Trust

A. State Attorneys General Have the Power to Protect Charitable Assets: In the United States, state attorneys general are assigned the responsibility to protect charitable assets as representatives of the public interest (as *parens patriae*—parent of the fatherland), to prevent waste or diversion of charitable assets. In Minnesota, for example, the attorney general is given broad powers to investigate and require trusts to provide information under the Supervision of Charitable Trusts and Trustees Act.²¹ The act requires charitable trusts with more than \$25,000 in assets to register and file with the attorney general a copy of its articles of incorporation or the instrument that created the charitable trust, and annually file a copy of its federal tax or information return, including all schedules and amendments, submitted by the charitable trust to the Internal Revenue Service for the period covered in the trust's accounting year last completed.

This regulatory approach requires sufficient reporting to the attorney general's office to equip it with appropriate information to effectively exercise supervision over whether funds are being properly spent. These records and reports are open to public inspection, so that members of the public have an opportunity to see the uses of charitable funds, and if necessary note their concerns. If a private foundation breaches the charitable purpose created by its articles of incorporation or founding charitable trust instrument, such a breach can be addressed by the attorney general from the state where the private foundation is located.

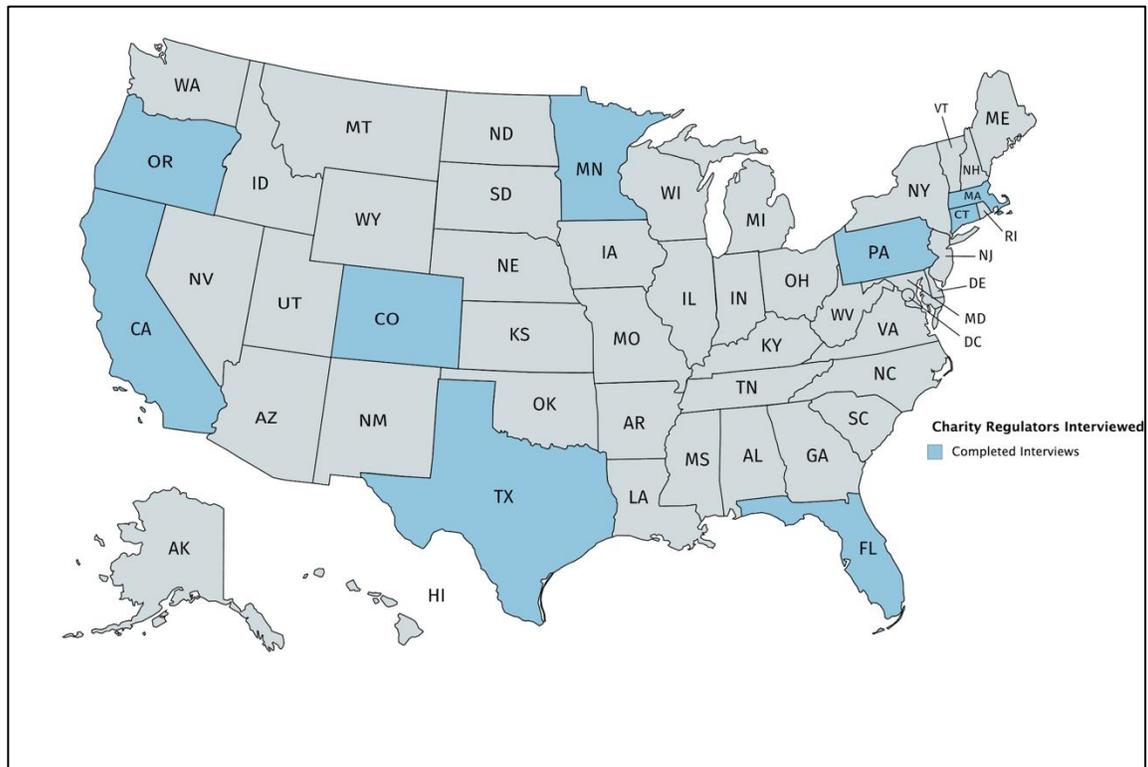
For context, it is useful to review the process for creating a foundation, trustee duties, and state attorneys general enforcement powers. Foundations can be created as either corporations or trusts, and corporate charters are generally easier to amend than a trust. A trust is often difficult to change, requiring attorney general involvement in most states, and a court proceeding may also be necessary to amend or modify a trust through a *cy pres* process.²²

A trustee of charitable trusts, including private foundations, must act within the confines of certain common law standards. These standards include the duty to invest and to make trust property productive, the duty to secure and safeguard the trust estate, and the duty to exercise care, skill, and prudence in administering the trust. For the purposes of this paper, the authors are especially interested the duty of loyalty to the trust itself, to ensure that funds are used for the established purposes of the trust.

B. Charities Enforcers Want to Prevent Breaches of Restricted Giving—But Run Into Barriers: To better understand the scale and scope of state charitable trust and DAF enforcement across jurisdictions, the authors interviewed eleven current and former attorneys from state attorneys general offices across nine states: California, Colorado, Connecticut, Florida, Massachusetts, Minnesota, Oregon, Pennsylvania, and Texas.

²¹ Minn. Stat. Ann. §§ 501B.33 to 501B.45.

²² “The *cy pres* doctrine is a principle of law that courts use to save a charitable trust from failing when a charitable objective is originally or later becomes impossible or impracticable to fulfill.” (<https://www.irs.gov/pub/irs-tege/eotopice81.pdf>)



Overall, most respondents interviewed voiced awareness and concern about both the *enforcement* and *public benefit-related issues* surrounding DAFs. This awareness stemmed from multiple sources: their own work in the space, reporting and scholarship on DAFs, and past National Association of State Charity Officials (NASCO) presentations. Respondents noted that DAFs present multiple **challenges to effective enforcement**, including:

1. Obfuscating a charitable gift's intended purpose (e.g., an original fund restriction).
2. Frustrating the ability of attorneys general to follow the trail of charitable funds because of the lack of reporting requirements.
3. Lacking clarity on what *can* be called a DAF—for example, the Oregon Department of Justice investigated a case where a small organization claimed to be a DAF but an individual used donations for personal benefit.²³

Respondents also raised several concerns about the issues DAFs pose to **ensuring that the public benefits from charitable giving**, including:

1. A lack of incentive for DAFs to pay out the funds—as one senior assistant attorney general noted, “If the money is going to a Fidelity or Schwab, what incentive to they have to spend it?”
2. Making it more difficult for nonprofits to ask for and receive donations; as commercial DAFs become more popular, nonprofits cannot identify the original donor and request funding.

In particular, respondents noted that DAF giving allows for a substantial time lapse between the benefit received by the donor (an immediate tax benefit) and the benefit received by the public (i.e., grantmaking from the DAF to a charitable organization). As

²³ Steve Duin, *Oregon DOJ and the Limits of Charity*, OREGONIAN (Feb. 8, 2019), <https://www.oregonlive.com/opinion/2019/02/steve-duin-oregon-doj-and-the-limits-of-charity.html>.

one former associate attorney general explained, “[DAFs] seem like more of a tax break for folks as opposed to an alternative path for philanthropy.” Even if there was no restriction on the original gift, DAFs prevent charities regulators from knowing when and where the DAF grantmaking occurs. In these cases, one respondent noted, “Where does society benefit from these bounced-around tax benefits?”

Beyond respondents’ high-level concerns about DAFs, most respondents have not yet dealt with a case concerning private foundation-to-commercial DAF grantmaking. Many respondents voiced awareness of the issue and problems that such transfers may pose, especially if the original purpose of the donation is diverted. However, once discussed, several respondents echoed the uncertain nature of such transactions. In particular, respondents brought up several concerns:

1. DAFs being used as a way to work around a restricted charitable purpose
2. A lack of transparency regarding the dollar amount of grants being distributed by each commercial DAF sponsor
3. The potential for DAFs being used as a way around the private foundation payout rate and mandatory disclosures

While many respondents voiced a keen awareness of the many issues posed by private-foundation-to commercial DAF transfers, they also noted several roadblocks to begin investigating the issue—namely, challenges in accessing charities registration documentation; under resourced charities regulator offices; and a lack of precedent and guidance.

The First Barrier: Accessing Charitable Trust Documents

Charitable trust supervision varies widely across U.S. jurisdictions and often depends on charitable trust filing and registration laws within each state. Some states require, by statute, that charities register with the AG’s office and file periodic reports. For example, in Oregon, the AG’s office is considered a qualified beneficiary;²⁴ this office receives an estimated 50 notifications regarding restricted gifts²⁵ per month. In other states where trusts or charities are not required to register,²⁶ attorneys within charities division offices do not receive any sort of notice when it comes to charitable trusts or other restricted gifts. Often, these offices might only receive notice when a trust or gift comes through probate court or if an individual files a complaint. One former associate attorney general noted that in such states, the approach is much more “ad hoc” than it is in states with more robust registration systems, such as California.

Even for states with some reporting requirements, charity regulator offices run into additional barriers, including lack of directive and large amounts of paperwork. One former associate attorney general noted that, while federal law requires private foundations to send annual 990-PF filings to the AG’s office in all 50 states²⁷, their office did not have a clear directive for what to *do* with the documents from an enforcement

²⁴ Or. Rev. Stat. Ann. § 130.040.

²⁵ This includes gifts made from charitable trusts, restricted trusts, or restricted gifts within a corporation.

²⁶ Many states that require charities to register do so to regulate charitable solicitation, which lies outside of the scope of this paper.

²⁷ 26 CFR § 1.6033-3 (c)(1) The foundation managers of a private foundation shall furnish a copy of the annual return required by section 6033 and § 1.6033-2 to the Attorney General of: (i) Each State which the foundation is required to list on its return pursuant to § 1.6033-2(a)(2)(iv), (ii) The State in which is located the principal office of the foundation, and (iii) The State in which the foundation was incorporated or created.

point of view. This lack of clear directive made proactive enforcement a challenge. Sifting through vast quantities of paperwork also proves challenging. One respondent's office supervises about 100,000 charities; the office, despite being one of the largest in the country, does not have the capacity to fully review *all* annual returns. However, if discrepancies arise when looking at documentation, they can require organizations to respond to investigative demands.

States that do require charitable trusts to register with their offices vary in how accessible these registration documents are to the public. For example, in California all charitable trust and registered charities' documents are scanned and made available to the public on the AG's website.²⁸ In other states, such as Minnesota, such documents are officially publicly available but must be requested individually from the AG's office.²⁹

The Second Barrier: Available Resources in AG Charities Divisions

Offices that oversee charities regulation (which, depending on jurisdiction, may be the attorney general's office, the secretary of state's office, or a combination of both) vary in size and breadth of focus. A 2016 study published by the Urban Institute found that about one-third of state charity offices employ *less than* one full-time-equivalent (FTE) employee dedicated to charities oversight. More than *half* of the state charities offices that responded to the Urban Institute survey employ fewer than three FTEs.³⁰

The authors' interviews with charities regulators affirmed this and underscored the difficulties that a small charities enforcement bureau poses to effective regulation. Due to the larger number of registered charities soliciting funds, the need to protect the public from charity solicitation fraud tended to be a greater focus than charitable trusts or private foundations. Several respondents noted that because of the small size of their office, they felt a need to respond to the priorities of the current attorney general and the political party in power.

Another respondent noted that because of their small office size, their investigations tended to be more "reactionary" and less strategic—and because of this, they have not been able to focus any action around DAFs yet. Finally, regulators from small offices noted that they simply do not have the resources to conduct random inspections; if they receive a complaint, then they look at the financial reports on file. However, without concrete evidence, "it can be difficult to take these private citizen complaints seriously." By contrast, a respondent from a larger-than-average office noted that because of the division's size, they felt empowered to lay the groundwork to begin looking more closely at the money held in DAFs; they did this largely on their own initiative, stating that: "It doesn't seem like the state is getting their fair share of the bargain."

The Third Barrier: Lack of Transparency-Focused Regulation and Judicial Precedent

²⁸ <https://oag.ca.gov/charities/reports#crr>

²⁹ <https://www.ag.state.mn.us/Charity/Search/Default.asp>

³⁰ CINDY M. LOTT ET AL., STATE REGULATION AND ENFORCEMENT IN THE CHARITABLE SECTOR 8 (Urban Inst., Ctr. On Nonprofits and Philanthropy, Sept. 2016), <https://www.urban.org/sites/default/files/publication/84161/2000925-State-Regulation-and-Enforcement-in-the-Charitable-Sector.pdf>.

Respondents explained that some of the greatest challenges to DAF investigation and regulation lie with the lack of coordination, reporting requirements, and precedent caselaw. Because the DAF expansion is a relatively new phenomena, few states have allocated resources to evaluating activity around DAFs. Multiple respondents noted that their offices just “are not there yet” when it comes to the DAF issue. In the same vein, several charities regulators repeatedly called out two states—California and New York—as being more progressive on such issues and said that they would likely follow the lead of the California and New York Attorneys General. In addition, misused DAF funds lack a singular “victim.” Such misused funds harm the general public, rather than an individual or even a single organization. This presents an issue for smaller charities divisions, which historically tend to focus more on fraudulent charitable solicitations. Because DAF funds aren’t a “live problem,” some attorneys general offices may be reticent to address the issue. Several respondents noted that because the DAF issue is so expansive, better coordination between state attorneys general and secretary of state offices—facilitated via NASCO, NAAG, or other venues—would be helpful to brainstorm, develop better regulation, and investigate any potential misuse of charitable funds via private foundation-to-DAF grantmaking.

Currently, DAFs are only required to comply with the same reporting requirements as other charitable organizations—the IRS Form 990. However, while these forms do list out each charitable organization receiving funds from the DAF in the previous calendar year, they are cumbersome in practice. Because of the nature of how the IRS catalogues DAF grantmaking, charities regulators cannot connect the dots between an initial contribution from a private foundation to a commercial DAF—which would be noted on the foundation’s 990-PF—and the commercial DAF’s eventual grantmaking—which would be noted on the DAF’s 990, without any mention of the original contributor.

In opposition to calls for greater transparency, foundations and commercial DAFs frequently cite that more substantive administrative burdens would lead to steeper fees and may make DAFs less democratic. One charities division chief voiced concern about these arguments, noting that “there would not be any reasonable basis” to constrain calls for greater transparency. In addition, the same respondent explained that greater transparency “increases eyes and ears,” allowing citizens or nonprofit groups to monitor the flow of charitable funds for potential misuse.

Right now, charities regulators most frequently investigate DAFs through citizen complaints, probated court, or if the attorney general’s office is a qualified beneficiary to the proceedings. Some states benefit from case law that directly involve the attorney general’s office into such proceedings; for example, in Massachusetts, *Massachusetts Charitable Mechanics Association v. Beede* requires charities to seek court approval if transferring a large portion of their assets to another party.³¹

However, without specific reporting requirements, charities regulators in states without caselaw that directly involves their offices may find it difficult to carry out their duties when it comes to private foundation-to-commercial DAF grantmaking. Enforcing charitable trust restrictions is a basic duty of charity oversight, but ultimately requires

³¹ *Massachusetts Charitable Mechanics Ass’n v. Beede*, 320 Mass. 601 (1947). See also Attorney General Guidelines on Requirements Imposed by Massachusetts Charitable Mechanics Association v. Beede, The Commonwealth of Massachusetts Office of the Attorney General, <https://www.mass.gov/files/documents/2016/08/pm/beede-memo-.pdf>.

specific information on what trust restrictions exist, and where the charitable funds go, for what purpose, and what relationships it has to foundation managers.

V. Policy Options and Recommendations

Public interest in the growing asset value of DAF accounts and what portion of the funds are being put to work once they move into DAFs has led to a variety of proposals for greater transparency, including California Assembly Bill 2936. This 2020 legislative proposal (supported by the state nonprofit association CalNonprofits) would have required DAF sponsors with more than \$300 million in assets held in DAFs to report (without attribution) activity within these funds.^{32 33} (As noted previously, while total funds contributed into, granted out of, and held by DAFs are reported on IRS Form 990 Schedule D, the specific grants or amount of activity from individual funds are not, though aggregated grants and allocations from public charities are reported on Schedule I of Form 990.)

This paper does not suggest federal reform recommendations of DAF regulation but instead focuses on two state-level policy recommendations.

Two Policy Recommendations

- 1. Charitable trusts should be required to report all grants made or approved for future payment from donor advised fund accounts to which they have transferred funds, subject to public inspection.**

Legislation to strengthen charitable trust reporting on transfers to donor advised accounts would address a gap in AG oversight, reinforce public trust and discourage potential abuses. The fundamental purpose of tax-exempt dollars held by a private foundation or DAF is to benefit the public good. When a lack of transparency or information makes uses of charitable funds inaccessible to the public, the current practices of DAF sponsorship undermine the fundamental public purpose of the money's tax exemption. Improving transparency regarding private foundation to DAF grantmaking would shine a light on a murky area of philanthropy. It would allow charities regulators to fulfill an essential component of their job—to trust, but verify, ensuring that charitable dollars are used according to donor intent and that they benefit the public. Moving \$3 billion in charitable funds out of the view of the attorneys general charity oversight should not be continued.

Since DAF sponsors make use of all of the modern tools of the financial services industry, with secure interactive online customer accounts, regular reporting, and immediate digital access to transactions, the administrative burden for private foundations to produce reports of their activity from DAF accounts would be minimal. Routine reports generated by DAF sponsors are fully capable of satisfying the comparable requirements for private foundations under 26 CFR § 1.6033-3 (*recipient, name and address; if recipient is an individual, relationship to foundation manager; foundation status of recipient, purpose of grant or contribution, and amount*). Improving

³² On July 23rd, 2020, the legislation was put on hold in committee during COVID-19 reductions in legislative activity.

³³ *CalNonprofits Sponsors Bill for Transparency in Donor Advised Funds*, CalNonprofits, <https://calnonprofits.org/publications/article-archive/636-calnonprofits-co-sponsors-bill-on-donor-advised-funds>.

disclosure in this way would impose no financial or administrative burden on DAF sponsors.

2. Attorney General's offices should respond to the growth of charitable funds held in trust by devoting increased resources to monitoring charitable trusts and donor advised funds, insuring that adequate staffing, technology and online access to charities information is available.

The United States has a remarkable tradition of charitable giving and volunteering that other countries envy, but that shared spirit cannot be taken for granted. Underneath the generosity of small donors and large is the trust that the charitable funds and organizations will be used properly, and that someone is watching to make sure that happens. The role of 50 state attorneys general is critical to support (and when necessary supervise) a nonprofit and philanthropic sector that is open, honest, accountable and effective. To carry that out requires a solid professional presence and legal footing, which exists in many states, but needs to expand to adjust to changes in the field.

The next several years will be a severe challenge for every state, and the charitable sector will surely be tested and stretched. The authors recognize that the role of charity offices in the state attorney general structure is not solely law enforcement, but also to serving as a resource to the community to educate volunteers and board members to help their local organizations succeed at their charitable missions, to understand responsible governance, financial accountability and legal compliance and reporting. From interviews the authors observed a clear benefit to accountability of increasing staff capacity and technology resources. Given the growth of charitable assets under their jurisdiction, budgeting for additional attorneys general charity office staff and attorneys, and improving accessibility to charitable organizations' filings and reporting, such as charitable trust documents, would be a wise investment.

= = =

About the Authors

Kari Aanestad is Director of Advancement for the Minnesota Council of Nonprofits, and serves as Co-Director of GrantAdvisor.org.

Kerry Gibbons is a second year student at the University of Minnesota Law School and brings five years' experience in qualitative policy research.

Jon Pratt is Executive Director of the Minnesota Council of Nonprofits, is an attorney and student of DAFs, and is a Contributing Editor for the Nonprofit Quarterly.

The [Minnesota Council of Nonprofits](#) (MCN) is a statewide association of more than 2,300 Minnesota nonprofit organizations. MCN was founded in 1987 to meet the increasing information needs of nonprofits and to convene nonprofits to address issues facing the sector. It is the largest state association of nonprofits in the United States. Through MCN, nonprofits join together across interest areas to work on issues of common concern to all. Through its website, publications, workshops and events, cost-saving programs and advocacy, MCN works to inform, promote, connect and strengthen individual nonprofits and the nonprofit sector.

Appendix A: Interview Method and Protocol

Qualitative data for this project was collected between May and August 2020. Researchers built an outreach list of charities regulators from sixteen states; this list included both current and former employees at secretary of state offices and state attorney general offices. This list was built based on size and activity of state's charities bureaus, with the input of several experts on state attorney general enforcement powers. Of the sixteen offices contacted, interviews were conducted with eleven individuals representing nine states. The interview data were analyzed using qualitative methods, and the responses were grouped by major themes. Because of the sensitive and new nature of DAF regulation, all interview respondents were guaranteed anonymity in terms of their name, title, and jurisdiction, and all interview data was treated as confidential.

Interview Questions

Managing Trust Instruments

1. How many charitable trusts are supervised by your state AG office?
2. How does your office track and store foundation or trust instruments (i.e., paper copies, digitized, etc.)?
 - a. Do charitable trusts register and report their finances?
 - b. How accessible are their instruments to members of the public?
 - c. Is there a process for the public to access these instruments?
3. How often does your office inspect these trust instruments?
4. What suggestions do you have for making these trust documents available?

Private Foundation-to-DAF Transfers

1. How frequently is your office asked to examine a foundation's trust instruments/restrictions after a transfer of foundation funds to a DAF?
 - a. Does your office enforce private trust restrictions otherwise? What prompts this enforcement or investigation?
2. What sort of activity might prompt your office to take a examine one of these transfers?
5. Have you or others in your office enforced charitable trust restrictions in the past?
 - a. In such cases, what prompted your enforcement?
6. What would you say is the level of attention in your state regarding the flow of money from private foundations to DAFs?
7. As mentioned earlier, we're interested in the potential breach of trust that may occur when a foundation transfers funds to a DAF. Does your office ever monitor funds once they've been transferred from a private foundation to a DAF?

Suggestions

1. What sort of reporting requirements (if any) would you find helpful in terms of maintaining AG oversight of foundation-to-DAF transfers?
 - a. *Probe on: list of recipient organizations? Timing of transfers from DAFs to working charities?*
2. How can members of the public or outside organizations be helpful to AG's offices in working on these issues?

Appendix B: Total Private Foundation Grantmaking to the Top 5 Commercial DAF Sponsors By State (2010 – 2018)

State of Private Foundation	Number of Grants	Sum of Grant Amounts
Alabama	5	\$1,428,000
Arizona	9	\$2,651,144
California	293	\$901,653,003
Colorado	20	\$5,502,703
Connecticut	91	\$437,652,808
Delaware	120	\$78,295,115
District of Columbia	18	\$47,769,363
Florida	106	\$57,093,842
Georgia	40	\$9,332,464
Illinois	110	\$46,043,635
Indiana	14	\$5,175,860
Iowa	36	\$1,064,000
Kansas	15	\$2,006,973
Kentucky	15	\$2,426,404
Louisiana	5	\$73,962
Maine	1	\$94,258
Maryland	31	\$9,863,230
Massachusetts	192	\$91,093,476
Michigan	58	\$44,967,457
Minnesota	63	\$34,039,099
Mississippi	2	\$373,000
Missouri	23	\$3,489,659
Montana	1	\$5,500
Nebraska	1	\$370,000
Nevada	33	\$11,621,999
New Hampshire	20	\$12,195,454
New Jersey	76	\$30,017,137
New Mexico	5	\$92,056
New York	418	\$959,643,497
North Carolina	41	\$7,860,863
Ohio	37	\$8,200,274
Oklahoma	1	\$9,500
Oregon	5	\$2,890,467
Pennsylvania	95	\$122,875,689
Rhode Island	6	\$1,143,796
South Carolina	11	\$1,009,284
Tennessee	18	\$7,096,980
Texas	72	\$31,494,156
Utah	2	\$1,192,406
Vermont	7	\$7,655,160

Virginia	50	\$71,869,368
Washington	24	\$11,523,333
West Virginia	1	\$61,000
Wisconsin	10	\$313,400
Wyoming	2	\$175,000
Grand Total	2,203	\$3,071,405,774