

## Why Donor Advised Funds and Supporting Organizations Are a Gift Planner's Friend

By

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*"Our major donors are giving to their donor advised funds instead of giving to our charity!"*

*"Donor advised funds and supporting organizations are taking all the gifts away from us!"*

*"I can't ask for a bequest from a donor advised fund, can I?"*

We have noticed that these sentiments run throughout the gift planning community. At their core, however, donor advised funds and supporting organizations are grantmakers. They are relatives of their more famous cousin, the private foundation. And yet, we seldom, if ever, hear anyone complain that private foundations are taking gifts away from public charities. In addition, donor advised funds and supporting organizations may be ideal vehicles for receiving complex assets whose stewardship and liquidation may impose a burden on the charity receiving the gift.

While donors have been contributing assets to donor advised funds for many years, donor advised funds were only formally recognized in 2006 with the tax law changes under the Pension Protection Act. Since that time, the use of donor advised funds has soared in popularity. According to the 2018 Donor-Advised Fund Report, published by the National Philanthropic Trust, donor advised funds have steadily increased in popularity from 2010 through 2017.<sup>1</sup> The increased use of donor advised funds is reflected not only in the total dollar amount that donors have contributed but also in contributions expressed as a percentage of total individual giving. According to the report, contributions to donor advised funds in 2017 totaled \$29.23 billion, with a compound annual growth rate of 15.7 percent from 2012-2016. The report also noted that grants from donor advised funds to charities rose to \$19.08 billion in 2017. It is for this reason that fundraisers and gift planners should have a working understanding of donor advised funds from a legal and tax perspective, as well as a familiarity with, if not an understanding of, the common rules that apply to grants distributed from donor advised funds. With an understanding of donor advised funds, fundraisers are well-positioned to approach donors who use donor advised funds as their vehicle for charitable giving.

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<sup>1</sup> <https://www.nptrust.org/reports/daf-report/>

Supporting organizations are not as common as donor advised funds, but they frequently function as grantmaking vehicles and offer a fair amount of flexibility to donors looking for an alternative or additional philanthropic vehicle.

In this paper, we explore donor advised funds and supporting organizations from a legal perspective and consider some case studies that demonstrate the similarities between these gift vehicles and private foundations, as well as ways in which these vehicles are entirely compatible with the work of a gift planner. The case studies presented are geared toward gift planners and are meant to be representative of the kinds of issues that might arise in connection with donor advised funds and supporting organizations. The case studies also address some common traps for the unwary.

### Donor Advised Funds (DAF)

#### Legal Structure

A donor creates a DAF by making a gift to a public charity (the sponsoring organization), for which the charity separately accounts and over which the donor (or a designee) has an advisory privilege as to the use or investment of the fund. Importantly, the fund is simply part of the sponsoring organization and not a separate legal entity. The fund must be a component part of the sponsoring organization in order to qualify as a contribution to the sponsoring organization. When a donor retains too much control over the contribution, the fund is not a component part of the sponsoring organization and risks being treated as a private foundation.<sup>2</sup> While many donors refer to the fund as "my DAF," the donor's ongoing relationship to the fund is in an advisory capacity only.

As with other gifts to charity, the donor can impose a use restriction (e.g., "use this to support secondary education") and can create an endowed fund by imposing a timing restriction (e.g. "preserve this as an endowment and spend or accumulate in accordance with the Uniform Prudent Management of Institutional Funds Act."). Sponsoring organizations, like most charities, may have minimum gift requirements to endow a fund.

DAFs are defined in Section 4966 of the Internal Revenue Code ("Code") as:

- i. a fund (or account);
- ii. separately identified by reference to contributions of a donor or donors;
- iii. owned and controlled by the sponsoring organization; and
- iv. with respect to which a donor (or any person appointed by the donor) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in the fund or account by reason of that person's status as a donor.

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<sup>2</sup> Treas. Reg. 1.170A-9(f)(10) – (12).

When the donor relinquishes ownership and control over the assets, the gift is treated as a charitable contribution to the sponsoring organization and the donor is entitled to the income tax charitable contribution deduction. This is an important concept to keep in mind when discussing a prospective gift with a donor who has created a DAF. The donor will not be making a new charitable gift to your organization; rather, the donor will be recommending or advising a distribution from a fund that is already owned by a charity (the sponsoring organization).

In addition, Code Section 4967 provides that donors and donor advisors are prohibited from receiving a more than incidental benefit due to a distribution from a DAF. The legislative history indicates that, in general, a more than incidental benefit is a benefit that would have reduced the donor's charitable contribution deduction had the donor received the benefit as part of the original contribution to the sponsoring organization.<sup>3</sup> Some practitioners, including the authors, interpreted Section 4967 to mean that a more than incidental benefit would arise if the donor used a DAF to purchase tickets to a charity-sponsored event, such as a gala, or to pay an enforceable pledge with DAF funds. Others, maintained that the law was unclear on these points.

In late 2017, the IRS issued Notice 2017-73 to provide interim guidance on these and other issues.

*Charity-sponsored events.* The Notice confirms that a donor or donor advisor receives a more than incidental benefit if he / she receives tickets to a charity-sponsored event as a result of advising a grant from a DAF. The Notice also confirms that the donor also receives a more than incidental benefit if she advises a grant for the charitable portion of the ticket and pays for the non-deductible portion from personal funds. We have included a case study, below, to illustrate this point.

*Pledges.* The Notice provides more favorable guidance on the topic of pledges. Whereas a donor cannot pay a binding pledge from a private foundation, the Notice states that a donor does not receive a more than incidental benefit, in a situation where a DAF pays a pledge, if three requirements are satisfied:

- i. the sponsoring organization does not refer to the pledge when making the DAF distribution;
- ii. the donor or donor advisor does not receive (directly or indirectly) a more than incidental benefit on account of the DAF distribution (i.e., the donor cannot receive gala tickets); and
- iii. the donor or donor advisor does not attempt to claim a charitable contribution deduction with respect to the DAF distribution (because the donor is not making

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<sup>3</sup> Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," page 350.

a new charitable contribution, merely advising a grant from funds already owned and controlled by a charity).

If you are thinking that the rules on return benefits from charity-sponsored events and pledges are inconsistent, you are not mistaken. However, the Notice explained the rationale for permitting donors to pay pledges from a DAF. In the Notice, the IRS acknowledged that whether paying a pledge results in a more than incidental benefit turns on whether the pledge was legally enforceable or not, and that it would be extremely difficult for the sponsoring organization to determine whether a pledge is legally binding or simply a statement of intent.<sup>4</sup>

### Practical Applications

#### *What Donors Like About DAFs.*

Contributions to DAFs are eligible for the more favorable income tax charitable contribution deduction for gifts to public charities as contrasted to the deductions allowed for gifts to private foundations. DAFs allow donors to contribute in the year or years when the donor wants or needs the tax benefit of the contribution without having to commit to the specific charity or charities to receive grants. In addition, because a DAF is not a separate legal entity, donors do not have any administrative responsibilities with respect to a DAF. Finally, for donors who wish to make charitable gifts anonymously, the sponsoring organization can serve as a firewall between donors and the charities to which the donors advise grants.

DAFs are grantmaking funds, similar to a typical private foundation. Grants from a DAF to most public charities (which include churches, schools, hospitals, publicly supported charities government entities, and Indian tribal governments) and private operating foundations are uncomplicated and very common.<sup>5</sup> Grants from a DAF to entities other than those described in the preceding sentence may require expenditure responsibility.<sup>6</sup>

Sponsoring organizations of DAFs generally honor the requests of their donors, and except in rare circumstances will make the grants the donor advises. Common reasons why a sponsoring organization might decline to make a grant that a donor advised include situations where the proposed recipient organization is not, or no longer is, tax-exempt

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<sup>4</sup> A note of caution: there may continue to be some uncertainty about whether the pledge rules are a true safe harbor or if there are some situations where a donor might not be able to pay a pledge with DAF funds. Until regulations are issued, however, the IRS has stated that donors and charities can rely on the interim guidance in the Notice.

<sup>5</sup> Grants from a DAF to an organization that qualifies as the foreign equivalent of a US public charity are also relatively straightforward and common, though the DAF sponsor will need to follow certain procedures to determine that the foreign recipient qualifies. Equivalency determinations are outside the scope of this paper.

<sup>6</sup> Expenditure responsibility refers to oversight, monitoring, and reporting requirements to ensure the grant is spent for a proper exempt purpose and requires strict compliance with the tax regulations. A discussion of expenditure responsibility is outside the scope of this paper.

under Code Section 501(c)(3) or the proposed recipient's charitable purposes are outside of the scope of the sponsoring organization's charitable purposes.

The gift officer's continued stewardship of donors who have funded DAFs is just as important as the continued stewardship of donors who have made grants to the organization from private foundations or who have made outright gifts to the organization. The gift officer is asking the donor to advise a grant rather than make a direct gift, however the fundamental relationship is the same. One might even argue that it is a little easier to ask a donor to advise a grant from a DAF because those assets have already been set aside by the donor for the specific purpose of supporting the charitable community and they are not resources that would otherwise be used to pay for other expenses of the donor.

DAFs may be a good alternative for donors who are considering creating a private foundation but who do not want the administrative burden of running a private foundation. Because a DAF is "just" a fund on the books of the sponsoring organization and not a separate legal entity, the sponsoring organization is responsible for all of the tax and other reporting required by the IRS and state regulatory or oversight agencies.

### *Bundled Gifts*

New for 2018 and future years, Donors may also use DAFs so that they can alternate the years in which they make charitable contributions in order to maximize the income tax charitable contribution deduction. The Tax Cuts and Jobs Act of 2017 nearly doubled the standard deduction for individuals and married couples to \$12,000 and \$24,000, respectively. The standard deduction is subject to annual inflation adjustments. In 2019 the standard deduction amounts are \$12,200 for individuals and \$24,400 for married couples.<sup>7</sup> In addition, certain deductions were either eliminated or limited under the 2017 Act. According to the Joint Committee on Taxation's estimate, only about 10% of taxpayers will itemize in 2018.<sup>8</sup> The income tax charitable contribution deduction is only applicable when a taxpayer itemizes.

As of the time of publication, it is still unclear exactly how this change will affect the charitable giving behavior of individuals. It is anticipated, however, that many people might simply take the standard deduction and forgo making charitable gifts because making a charitable gift will not have any impact on reducing taxes.

On the other hand, bundling multiple years' worth of charitable contributions could mean the difference between itemizing (and taking advantage of the charitable contribution deduction) and taking the standard deduction. For these donors, a DAF could be the perfect vehicle to make larger gifts in every second or third year, allowing the donor to advise grants out over two or three years. Below is an example that illustrates this concept:

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<sup>7</sup> A different standard deduction is available for individuals over 65 and individuals who are blind. See IRS Publication 17, updated annually, for current standard deduction amounts.

<sup>8</sup> [https://www.jct.gov/publications.html?func=download&id=5093&chk=5093&no\\_html=1](https://www.jct.gov/publications.html?func=download&id=5093&chk=5093&no_html=1)

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- Donors typically make a contribution of \$12,000 to their DAF every year. In 2019, in addition to their state and local tax deduction of \$10,000, they decide to combine two years' worth of charitable dollars together to add to their DAF. Instead of adding \$12,000 to their DAF they add \$24,000 to their DAF.
- Their total deduction for 2019 comes out to be \$34,000 (\$10K state and local taxes + \$12K DAF addition + \$12K DAF addition)
  - This amount is \$9,600 more than the standard deduction (\$34,000 - \$24,400) so it makes sense for them to itemize.
- In 2020 they will work with you to make grant recommendations from their DAF and take the standard deduction.
- In 2021 they will add \$24,000 to their DAF again.

### *Bequests from a DAF*

Typically, donors and/or advisors give ongoing grant recommendations until they are no longer able or willing to do so. What happens if there are assets remaining in the DAF at the death, resignation, or incapacity of the advisor to the fund and no successor advisor is named?

The answer to this question largely depends on the sponsoring organization's policies. Some sponsoring organizations require that any funds that are remaining in a DAF be allocated to the sponsoring organization's general fund. Other sponsoring organizations allow and even encourage donors to leave advice - essentially grant recommendations - to be implemented after the donor advisor's death, resignation, or incapacity if any funds remain in the DAF at that time.

For example, post-advisory advice might be a grant recommendation for one or more organizations to receive equal shares of the remainder of the assets in the DAF (much like a bequest) or could include a recommendation that the balance remaining in the DAF be used for a particular restricted purpose (much like a field of interest fund). In addition, if the donor had endowed the DAF when it was funded, then the post-advisory advice might include granting out the spendable amount to one or more nonprofits, in perpetuity, on a pre-set schedule.

Gift officers have an opportunity to ask donors with DAFs what the sponsoring organization's policies are on making final grant recommendations from DAFs. If the sponsoring organization is amenable to allowing final recommendations, then gift officers could ask donors to consider naming their organization as the recipient of this final grant. This process is similar to asking a donor to consider including a certain nonprofit as a beneficiary of the donor's estate. This is a key example of why it is important for gift officers to continue to forge strong relationships with donors who have funded DAFs.

### *What Donors Don't Like About DAFs:*

You can't use the DAF to conduct an active charitable program. A frequent complaint we hear about DAFs centers around the inability to run an active charitable program out of a DAF. This is one way in which a DAF is not a perfect alternative to a private foundation. First, most DAF sponsors will not permit a donor to use the DAF to enter into contracts for services to operate a program.<sup>9</sup> In addition, the tax law imposes excise taxes on distributions to any natural person. This can make it difficult to hire a program director from a DAF, for instance.

You can't use the DAF to pay for chicken dinners. As noted above in the discussion of IRS Notice 2017-73, donors and donor advisors cannot use DAF funds to attend a charity-sponsored event. This rule extends to memberships as well as gifts that would grant "preference points" to donors seeking to purchase tickets for athletic games at colleges and universities.

Paying a binding pledge. As discussed above, the Notice also provided interim guidance on the use of a DAF to fulfill a donor's pledge. Pledges can be legally binding and enforceable contracts to contribute, or they can be a simple expression of an intent, but not an obligation, to contribute.

Prior to Notice 2017-73, most advisors advised against using a DAF to satisfy a pledge. The Notice creates a temporary safe harbor but leaves uncertainty over whether the use of DAF funds to pay a legally binding and enforceable pledge agreement might still confer a more than incidental benefit on the donor / donor advisor.

IRA Charitable Rollovers. Qualified charitable distributions (QCDs) from individual retirement accounts (IRAs) cannot be transferred to DAFs.<sup>10</sup> QCDs allow individuals who are 70.5 years old or older to transfer up to \$100,000 directly from their IRA to a qualified charity without having first to recognize the transfer as income. The amount of the QCD also counts towards the IRA owner's required minimum distribution.

## Case Studies

### Active Program

PART I. Donor created a DAF and then asked the sponsoring organization to make payments to an independent contractor that the donor wanted to hire as a program manager to operate a program serving underemployed youth. The program manager also anticipated hiring additional contractors who would deliver services to the individuals participating in the program.

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<sup>9</sup> Instead, a DAF sponsor may suggest that the donor create a fiscally sponsored project to conduct an active program, however not all DAF sponsors provide fiscal sponsorship.

<sup>10</sup> Code Section 408(d)(8).

*Is this a problem?* As noted above, the law prohibits distributions to natural persons. Without Treasury Regulations, we do not definitively know whether a "distribution" for these purposes is limited to a donative gift or whether it also includes payments for services rendered. Therefore, it may not be possible to pay the program manager in the case study from the DAF.

PART II. As a variation on Part I, the donor wishes to advise a general support grant to the local Youth Charity that operates a program for disadvantaged youth. The donor is also the executive director of Youth Charity and is paid a reasonable salary for her services.

*Is this a problem?* As noted above, the law prohibits a "more than incidental benefit" to the donor, the donor advisor, and family members. With a general support grant to Youth Charity where the donor is paid staff, it is probable that some of the grant will go toward the donor's salary.<sup>11</sup> The sponsoring organization should consult legal counsel to explore whether or how to make a grant to Youth Charity.

### Gala Dinner

Each year your charity hosts a gala dinner to raise money. Each ticket is \$1,000, of which \$100 is the value of the return benefit (the dinner) and \$900 is a charitable contribution. As you start to receive \$1,000 grants from various DAFs, you realize that a number of donors are advising grants to pay for the gala tickets.

*Is this a problem?* Yes. Notice 2017-73 states that the donor and/or advisor receives a more than incidental benefit when she receives the right to attend the event as a result of a grant advised from a DAF. Sometimes the donor and/or advisor asks to pay the non-deductible portion of the ticket while advising a grant for the remainder from the DAF. This structure is sometimes referred to as bifurcation. In bifurcation, the donor advises a \$900 grant from the DAF and pays the \$100 value of the return benefit personally. Unfortunately, this does not work because the right to attend the gala requires a \$1,000 donation – the donor is essentially getting something for \$100 for which he/she would otherwise have to pay \$1,000, were it not for the gift from the DAF.

As a solution, some charities make the gala ticket available for the cost of the return benefit that is separate from the larger donation amount.

### Binding Pledge

You have been working with a donor on a gift for a capital campaign and you ask the donor to make a pledge to support the project. The pledge agreement states that the donor understands that she is creating a legal obligation to pay the pledge. The charity books the

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<sup>11</sup> This scenario may also be prohibited as an excess benefit transaction under Code Section 4958(c)(2)(A), which generally prohibits payment of compensation from a DAF to a donor or donor advisor.



pledge as a receivable. A month later, your charity receives a grant from the donor's DAF at the Community Foundation for a gift in exactly the same amount as the pledge. On the same day, you receive a handwritten note from the donor that reads, "I just advised a grant from my DAF to pay my pledge. I am so glad to support this project!"

*Is this a problem?* Under Notice 2017-73, provided that the payment satisfies the three requirements for paying a pledge with a DAF grant, then this probably works. However, there could be circumstances where the transaction could be treated as an excess benefit transaction under Code Section 4958.<sup>12</sup> For the gift planner, we advise caution when accepting a gift from a DAF that you know is meant to satisfy a pledge. A strategy is to avoid the use of legally enforceable pledge agreements and to prioritize non-binding intents to give.<sup>13</sup>

### Impact Investment Opportunity

You work for an organization that is looking to expand its physical space through a renovation project because its programming for the community has been well-received and an increasing number of people are coming to the organization to use its services. You have been able to raise awareness of this need for a larger space among the organization's supporters and, as a result, you have successfully raised 75 percent of the funds required to complete the capital project. At this point, you are confident that you will be able to raise the remaining 25 percent and your organization is anxious to begin construction. Among the supporters is a donor who agrees with the organization's mission but has reservations about making donations towards capital projects. She wants to contribute in a meaningful way and looks to you for suggestions on how she can help with this priority without directly giving money to the capital project. She mentions that she has established a DAF at a local community foundation.

*How can you make this work?* Recall that a DAF is a fund from which the donor has or expects to have advisory privileges with respect to the distribution **or investment** of amounts held in the fund.<sup>14</sup> Many DAFs receive recommendations related to investment strategies for the DAF. In addition, Donors are increasingly looking for opportunities for impact through investments. Impact investing is a broad term and a discussion of the different ways that it is implemented is beyond the scope of this article. What is important for

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<sup>12</sup> For instance, if relieving the donor of the obligation to pay the pledge is considered to a grant, loan, or other similar payment, like a reimbursement, Code Section 4958 could apply to treat the payment as an excess benefit transaction.

<sup>13</sup> A note of caution. A pledge that is not binding may not be booked as a receivable. When deciding as a policy matter whether your organization will accept non-binding intents to give instead of legally enforceable pledges, it is best to involve the finance and accounting staff early in those conversations.

<sup>14</sup> DAFs are subject to the limitation on excess business holdings under Code Section 4943 in the same manner as a private foundation.

gift planners to know in the context of a DAF is that advisors may recommend not just grants, but also investments. The standards of prudence for investing and managing charitable funds such as DAFs generally include permission to consider a particular investment's relationship to the charitable mission of the investor.<sup>15</sup> If gift planners have donors who are interested in supporting their organizations with an investment, such as a low-interest loan, it would be well-worth the planner's time to discuss with the donor and the DAF sponsor what options might be available.

In our example above, the gift planner could suggest that the donor recommend a low-interest loan from her DAF. This way, she would not be going against her principles by directly supporting a capital project, but she could help with the organization's cash flow as it continues to raise funds for the remaining 25 percent of the project, which would go toward repaying the loan from the DAF. Since the assets in the DAF legally belong to the DAF sponsor, it would be up to the DAF sponsor to negotiate the specific terms of the loan with the organization.

### Supporting Organizations (SO)

#### Legal Structure

A SO is a separate legal entity, formed as a corporation or a trust, that is organized and operated for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified public charities.<sup>16</sup> SOs come in four types and often function as grantmaking organizations.<sup>17</sup> The type of SO informs the relationship between the SO and the charity(ies) it was formed to support (generally known as the "supported organization"). For the purposes of this paper, we focus only on Type I SOs.

A Type I SO must be controlled by the organization(s) that it is formed to support. Disqualified persons to a Type I SO cannot control the SO. Disqualified persons include a substantial contributor, certain family members of the substantial contributor, and certain related entities of the substantial contributor or family member. In practice, this means that if a SO has a board of three, one of whom is the donor, the other two must be unrelated to the donor and must be appointed by the publicly supported organization, which is often, but not always, a community foundation.

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<sup>15</sup> The Uniform Prudent Management of Institutional Funds Act has been adopted in all states except Pennsylvania and generally permits a charity to consider an investment's relationship to its mission. However, exactly how the Act was adopted in each state may vary. DAF sponsors should consult their state's rules when considering an impact investment.

<sup>16</sup> Code Section 509(a)(3). "Specified public charity" in some instances can mean a class of public charities. A SO can also obtain public charity status by supporting the charitable activities of a publicly supported organization that is tax exempt under Code Sections 501(c)(4), (5), or (6); a discussion of this is beyond the scope of this paper.

<sup>17</sup> An in-depth discussion of the types of supporting organizations is beyond the scope of this paper.

### Practical Application

#### *What Donors Like About SOs.*

Donors appreciate that this is a separate legal entity that can exist in perpetuity. Because a SO is a public charity, the enhanced income tax charitable contribution deduction for gifts to public charities is available. This is in contrast to the more limited deduction available for gifts to private foundations. Many donors appreciate having a seat on the board and the ability of the SO to hire staff to conduct and manage the SO's grantmaking or direct charitable programs. This allows donors to become much more engaged in the programmatic aspects of grantmaking and program operations, such as conducting research and running a competitive grant program. SOs, unlike private foundations, can also make grants to individuals without needing to obtain prior IRS approval of the grantmaking program, as long as the individual grantees are members of the charitable class benefitted by the publicly supported organization.

SOs, like DAFs, make ideal vehicles for contributions of unmarketable assets such as closely held business interests and real estate. Since the board of the SO is responsible for making decisions around how the assets of the SO are to be held and when they should be liquidated, a donor with experience working with a certain type of asset might want to sit on a board where s/he can give input to the rest of the board on how to manage the SO's assets. This scenario is covered in more detail in the case study below.

While a SO is a separate legal entity with its own tax and other compliance filings, the supported organization typically performs those tasks. This effectively allows the donor to focus on the grantmaking and programmatic elements of the SO.

#### *Bypassing the Public Support Test*

*What Donors Like.* Organizations that are tax-exempt under Code Section 501(c)(3) are further classified as public charities and private foundations. To qualify for public charity status, the organization must either be one of the statutory public charities (e.g., churches, hospitals, schools), or it must satisfy a public support test. This generally means that the organization must receive at least one-third of its support from a broad donor base as opposed to just one or two donors.<sup>18</sup> A SO, on the other hand, obtains its public charity status by piggy-backing on the public charity status of the organization(s) it was formed to support. Thus, a SO bypasses the public support test entirely.

*What Some Charities Like.* Charities that have difficulty satisfying the public support test because they frequently receive large gifts from one or a few benefactors, or that receive a substantial gift that would negatively impact the charity's ability to satisfy the public support

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<sup>18</sup> Public support can be in form of donated income or exempt function income. When public support is below one-third, a special rule applies if the organization has at least ten percent public support and satisfies certain conditions. A detailed discussion of public support is outside the scope of this paper.

test, may benefit from creating a SO. Because the SO relies on the public charity status of the organization(s) that it supports, this is a way for donors to contribute large donations without jeopardizing the recipient's status as a public charity.

### *What Donors Don't Like About SOs:*

A SO cannot compensate a substantial contributor, family member, and related entities. This is in contrast to a private foundation, which can hire a disqualified person to provide reasonable and necessary personal services to the foundation. In addition, the donor cannot control the SO. Finally, unlike a private foundation or a DAF, a SO is permitted to support only the charity or charities named in its charter documents.<sup>19</sup>

Forming a SO may require an outlay of resources by the donor in the form of legal expenses to incorporate the SO and establish its tax-exempt status. In addition, the supported organization may charge a fee to oversee the administration of the SO. Donors willing to take these steps generally do so because they see benefits in a SO as compared to a DAF or a private foundation.

As with a DAF, SOs are also not permitted to be the recipients of qualified charitable distributions from IRAs.

### **Talking to Donors About DAFs and SOs**

Sometimes, a donor has already funded a DAF or formed a SO and the gift planner's role is continued stewardship of the donor and grant solicitations from the DAF or the SO. As noted above, for a DAF, this may include discussing "bequest" advice for a grant after the donor advisor ceases to serve.

Other times, however, a gift planner meets a donor with a particular philanthropic goal or with a complicated asset and the donor is looking for advice on what sort of entity or fund to establish. Sometimes it may make sense for the gift planner to suggest a DAF or a SO to a donor, as shown in the following case studies. The gift planner will continue to steward the donor, as before, even if the donor makes an initial gift to a DAF or a SO.

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<sup>19</sup> Many Type I SOs mitigate this issue by naming a class of publicly supported organizations instead of, or in addition to, naming specific organizations they support.

### Case Studies

#### Closely Held Stock

The donors propose to make a gift of stock in a closely held corporation (the Company) that is owned by the donors and several close family members. During conversations with the donors, you learn that the Company has relatively low cash assets, but it owns half of all the commercial office spaces in town. All of the Company's available rental spaces are occupied and there are plans to increase rent on current tenants and to reinvest some of the available cash into purchasing additional office space. All of the shares in the Company are voting shares. Each shareholding party has the right to demand that the Company purchase up to \$100,000 of its shares each calendar year, so long as the other financial obligations of the Company have been met.

*Should the Charity accept this gift?* In doing diligence on this gift, the charity will need to think about a number of factors, such as cost of holding the asset, potential for income generation, voting concerns as the only non-family member shareholder, and exit strategy.<sup>20</sup>

*Is there a "right" vehicle for this gift?* This gift could be made directly to the charity, to a sponsoring organization for inclusion in a DAF, or to a SO.<sup>21</sup> If made to a DAF or a SO, this would alleviate the risks to the charity of being a shareholder in the company, yet still results in the possibility of the assets being used to further your organization's work. If your organization has the capacity to control a SO, then you can do this in-house; alternatively, you may refer this donor to a community foundation to open a DAF or form a SO, with your charity named as a supported organization of the SO.

#### Family's Long-Term Philanthropy

The donor is in her seventies and owns stock purchased at an initial public offering 40 years ago. The stock is highly-appreciated and the donor would like to donate and liquidate it so that her family can make grants to support a number of philanthropic interests. The donor would like to involve her children and grandchildren in identifying charities to support. While the donor is unfazed by the idea of hiring staff and attending board meetings, her son and daughter-in-law have school-aged children and little time to manage a charitable organization. They are, however, interested in pursuing family philanthropy from a joint fund to which all members of the family could add and from which they could make grants.

*Should the Charity accept this gift?* Unlike the asset described above, this is publicly traded stock that can be easily liquidated. Many of the concerns about the gift in the example above are not present in this gift.

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<sup>20</sup> The charity's gift acceptance policy should include these considerations.

<sup>21</sup> Recall that DAFs are subject to the excess business holding rules of Code Section 4943. In addition, in limited situations, a Type I SO may also be subject to Code Section 4943. See Code Section 4943(f).

*Is there a "right" vehicle for this gift?* The donor seems to want to form a stand-alone entity, such as a SO or a private foundation, to engage the family in both grant-making and board service. The next generation worries that this is more than they can reasonably take on at this point in their lives, though they fundamentally like the idea of shared family philanthropy. As the gift planner, you might suggest a DAF at the local community foundation for this family.

### Conclusion

Donors have a number of ways to support charities that are meaningful to them. In addition to making gifts outright to their charity or charities of choice, donors may choose to donate first to DAFs or SOs due to tax planning advantages. Donors may also choose these forms over traditional charities due to their ability to accept and liquidate certain complex or unmarketable assets. As stated in the introduction, at their core, DAFs and SOs are grantmaking vehicles and using these vehicles allows donors to advise grants to charities that may not otherwise have been able to receive the original funding asset directly from the donor.

For these reasons, it is incumbent on gift planners to understand that donors who have chosen to use a DAF or a SO are fundamentally still their donors and that these giving vehicles complement, rather than hinder, their work. Good stewardship of these donors, which includes having an understanding of how DAFs and SOs function and when it is permissible to receive gifts from them, will increase the likelihood that additional grants will be recommended from these vehicles by donors to the gift planners' organizations.