Donor Advised Funds: Benefits, Costs, and Questions

Thursday, May 14, 2020
11:30 am – 01:00 pm PDT

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Improve the practice and effectiveness of philanthropy and social innovation

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Former Dean
Professor Emeritus (active)
Stanford Law School

Joseph Bankman
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Daniel Hemel
Assistant Professor of Law
University of Chicago Law School

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Donor-Advised Funds: Benefits and Costs

May 2020

RESEARCH TEAM
Courtney COOPERMAN (BA ’20)
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Ralph M. Parsons Professor of Law and Business
Professor Paul BREST
SLS Dean Emeritus and Director of the Law and Policy Lab
Professor Daniel HEMEL
Edwin A. Hearst Visiting Professor of Law
RATIONALES FOR THE FEDERAL INCOME TAX DEDUCTION

- Encourages donations to nonprofit organizations that provide services not provided by the private marketplace or by governments.
- Allows taxpayers to direct public funds (tax subsidy) to organizations of their choice, allowing them a voice in the decisions.
- Promotes the social value of giving.
- Supports civil society.
# Today’s Agenda

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Timing of Deduction and Payout

Drew Edwards (JD ‘22)

Alex Simoes Gomes (MS ‘20)
**Timing of Deduction and Payout**

- DAF holders receive immediate tax deduction and face no annual payout requirement.
- Concern: assets could remain in a DAF forever, without ever going to an operating charity.
- DAFs pay out approximately 20% of their assets per year.

### Rationales for delaying payout

1. Donor effectiveness
2. Cause effectiveness
3. Building a legacy
4. Inertia

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Timing of Deduction and Payout (cont’d)

• Additional considerations related to timing
  • Rate of return of philanthropy vs. rate of return of assets in a DAF
  • Social investing
  • Smoothing donations during economic downturns

• Existing proposals
  • Roger Colinvaux and Ray Madoff proposed shifting timing of deduction
  • Nudging DAF holders to recommend grants
  • Requiring DAF holders to make distributions
Gifts of Complex Assets and their Valuation

Michelle Zhao (JD ‘21)
Gifts of Complex Assets and Their Valuation

- DAFs are able to receive gifts of complex assets from donors and distribute those gifts to nonprofits that may not be able to process the complex assets on their own
  - Expanding the pool of donation recipients

- Concern: Tax deduction for a donation may be overvalued
  - Note that this is no different for DAFs than for donations to any public charity
Gifts of Complex Assets and their Valuation (cont’d)

- The IRS has a means of checking on valuation claims
  - The complex asset donor fills out a form on annual tax return claiming a value for the asset (with approval by an independent appraiser)
  - If a DAF sells the asset within three years, must then submit a complementary form stating sale price
- Most litigation focuses on the process behind the claimed deduction rather than the amount claimed
- Among the largest DAFs, complex assets account for just 5% of the total value of all contributions
- Valuation concerns ought not drive public policy toward DAFs
Effects on Charitable Giving and Operating Charities

Fernando Rodriguez Silva Santisteban
(MS / MPP ‘21)
Effects on Charitable Giving

- Direct evidence on the effects of DAFs on charitable giving is inconclusive
  - Limitations of data
  - Empirical studies interpreted based on strong assumptions
- Looking at economic theory gives us a clue of the potential effects
Effects on Charitable Giving (cont’d)

- DAFs may reduce transaction costs of charitable giving
  - Easier to give non-cash assets
  - Less administrative costs compared to foundations
  - Donors can “bunch” their gifts to obtain an itemized deduction

- DAFs may reduce after-tax price of charitable giving
  - Donor’s near indifference point of donation have additional incentive
  - Amount donated is also elastic to price
  - Desirability of increased amount is arguable (due to fiscal subsidy)
Effects on Operating Charities

- DAFs change power dynamics between donor and donee
  - Project-specific vs. unrestricted funds
- DAFs make available asset contributions to smaller operating charities
- DAFs potentially influence liquidity of operating charities
  - Could delay contributions to operating charities
  - Could smoothen contributions in times of recession
ESG and Impact Investing

Alyssa Epstein (JD '21)
ESG AND IMPACT INVESTING

● ESG Investing: Values-Based Investing in Publicly Traded Securities
  ○ Promise market rate returns, but actual returns net of fees are uncertain
  ○ Rarely have positive impact on ESG companies or negative impact on non-ESG companies

● Impact Investing: Investment in Private Markets designed to advance a tangible social goal (quasi-PRI)
  ○ Returns may be at or below market
  ○ Do in fact have impact
ESG and Impact Investing (cont’d)

- Values-based Investment Strategies at DAFs
  - Many DAFs have ESG options
  - Impact options are available at some DAFs, but usually only to very large donors

- Benefits of ESG at DAFs
  - “Clean Hands” Option
  - Advocacy Potential

- Benefits of Impact Investment at DAFs
  - Social Impact + Financial Return
  - Good venue for risk taking

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ESG and Impact Investing (cont’d)

Conclusions:

ESG options should still be available at DAFs, but not advertised as providing social impact opportunity

Impact Investments should be more widely available at DAFs
Advice Given by DAFs to Donors

Courtney Cooperman (BA ‘20)

Kavya Shankar (MBA ‘20)
ADVICE GIVEN BY DAFs TO DONORS

• Advice is important to DAF sponsors: 1) differentiation; 2) shaping donor decisions
• National, single-issue, and community DAFs are all offering some form of advice today
• Quality of sponsor advice does not appear to be driving donor choices among our sample
• Opportunities exist to benefit both donor and DAF sponsor through enhanced donor education and advice offerings

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Restrictions on Grantees and Donor Anonymity

Erinn Andrews
PACS Director of Philanthropy Research and Education
Restrictions on Grantees and Donor Anonymity

- DAF sponsors have absolute discretion; donors have advisory privileges.
  - National sponsors: most take a cause-neutral approach to grantees
    - Might block donations to NPOs under investigation
    - Might flag NPOs with negative press
  - Community foundations and special-issue sponsors: more likely to impose restrictions on grants
    - To nonprofits with certain points of view
    - To specific organizations
  - Restrictions could be:
    - Disclosed upon opening the DAF
    - Imposed after the sponsor conducts due diligence on an organization.
Restrictions on Grantees and Donor Anonymity (Cont’d)

- Donor anonymity
  - Anonymity to the public to protect the donor from retaliation
    - Donors can shield preference from public view
  - Anonymity to the nonprofit
    - Recipient organizations worry gift might be “tainted” by donor’s conduct/ideology
    - Nonprofits worry about losing the chance to steward the gift
    - Vast majority of donations are not anonymous
    - Recommendation: DAF sponsors include donor’s name in default setting
TRANSPARENCY

- Lack of data on individual DAFs impedes research and accountability
- Could sponsors provide de-identified information for the large majority of DAFs without breaching anonymity?
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Discussion

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Q & A

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Thank you!

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## DAF-to-DAF Transfers

<table>
<thead>
<tr>
<th>IRS Form IRS Form observed</th>
<th>Total grants ($MM)</th>
<th>Grants to Fidelity, Vanguard or Schwab ($MM)</th>
<th>% of total grants</th>
</tr>
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<tbody>
<tr>
<td>Vanguard Charitable Endowment Program - FY 2017</td>
<td>758.22</td>
<td>17.15</td>
<td>2.26%</td>
</tr>
<tr>
<td>Schwab Charitable Fund - FY 2019</td>
<td>1,869.79</td>
<td>19.09</td>
<td>1.02%</td>
</tr>
<tr>
<td>Fidelity Investments Charitable Gift Fund - FY 2019</td>
<td>4,798.37</td>
<td>28.24</td>
<td>0.59%</td>
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