

Concerns may foil a tax break eyed by donor-advised funds

By [Sara Hansard](#)

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A movement to include donor-advised funds in charitable IRA rollovers may stall due to concerns at the IRS and among members of Congress.

According to the Internal Revenue Service, which is working on a report about the funds for Congress, it has seen problems at some smaller organizations that are using donor-advised funds as tax loopholes. The IRS said it hasn't seen that problem at the large financial institutions that sponsor the funds, however.

These fund sponsors, as well as financial advisers who work with clients on charitable contributions, are anxious to see donor-advised funds included in legislation that would continue to allow tax-free rollovers from individual retirement accounts to charities.

Unless Congress acts, the tax-free benefit of such rollovers will expire at the end of the year. They were part of the Pension Protection Act of 2006, which excluded rollovers to donor-advised funds and private charitable foundations.

A recently completed set of exams by the IRS of donor-advised funds found no problems in the way major commercial funds distributed and managed money, said Robert Fontenrose, a senior tax law specialist with the IRS who works in the agency's tax-exempt-organizations division. The problems were with smaller funds, which he referred to as "outliers."

"There were some funds, these outliers, that were not supervising the distributions, or intending to," Mr. Fontenrose said. "We're not really attacking donor-advised funds generally; our concern is abusive donor-advised funds."

Donor-advised funds allow contributors to make recommendations about charitable distributions.

Assets in the funds climbed 24% to \$21.6 billion last year, making the funds the fastest-growing vehicle for charitable donations, according to the National Philanthropic Trust, a public charity in Jenkintown, Pa., that promotes charitable giving (InvestmentNews, Sept. 17).

The funds are also increasingly popular with advisers who work with charitable donations, partly because the major financial institutions that sponsor the funds often allow advisers to manage the assets until the funds are distributed.

"I couldn't imagine why they weren't including donor-advised funds" in the Pension Protection Act when it was originally enacted, said Debbie Levenson, vice president of Braver Wealth Management Inc. of Newton, Mass., who works with clients who donate to donor-advised funds.

"It's a huge service for clients to do their giving through donor-advised funds," she said.

Sen. Byron Dorgan, D-N.D., Rep. Wally Herger, R-Calif., and Rep. Earl Pomeroy, D-N.D., have introduced legislation that would eliminate the current \$100,000 donation cap for IRAs, allow people to donate the money to donor-advised funds as well as private foundations, and lower the minimum age for making donations to 59½, from 70½. That is the same minimum age for taking penalty-free withdrawals from qualified retirement accounts.

Members of the Senate Finance Committee cited the IRS' inclusion of donor-advised funds on its list of "dirty dozen" tax scams in June and said the funds have experienced too many abuses to extend them a new tax break.

"We won't be comfortable until the IRS is comfortable with donor-advised funds," said a Senate Finance Committee aide who asked not to be identified.

Among the problems with donor-advised funds is the lack of a requirement that the money be distributed, the aide said.

"Why not just give the money to a charity? Why have it sit where fees are granted from it?" the aide asked.

Maybe it's because "people make more strategic decisions about charitable giving when they use a donor-advised fund," said Kimberly Wright-Violich, president of Schwab Charitable.

"If someone doesn't need this for retirement, they should be able to give [assets from the IRA] to charity without triggering income tax," she said. Her firm manages The Schwab Charitable Fund, an independent charity founded by The Charles Schwab Corp. of San Francisco and the second-largest donor-advised fund in the United States, with assets of \$1.8 billion.

The field is led by Fidelity Charitable Gift Fund of Boston, which has \$4.8 billion in assets.

More than 20% of the assets in the Schwab Charitable Fund, the Fidelity Charitable Gift Fund and the \$1.7 billion Vanguard Charitable Endowment Program are paid out annually, officials with those funds report.

"Our objective is to bring charitable giving to more people, and also to reduce the cost of charitable giving and increase transparency," said James Barnes, director of client relations and development for the charity program started by The Vanguard Group Inc. in Malvern, Pa.

Early this month, Vanguard announced that grants to charities from its program amounted to \$370 million, or 22% of the average annual assets for the year ended June 30. That was a 23% increase over the prior fiscal year's grants, the company said in a release.

However, some critics cite a lack of transparency for donor-advised funds as a problem that needs to be addressed.

"There's just not much information required to be filed publicly or made available" about the funds, said Aaron Dorfman, executive director of the National Committee for Responsive Philanthropy, a Washington-based organization that promotes philanthropy that benefits minority groups. "We're for extending the charitable rollover [directly to charities], but not to donor-advised funds — until we have a better handle on what's happening with those dollars."

Some advisers think that the negative publicity garnered by donor-advised funds is unwarranted.

Only a few donor-advised funds are commonly cited as abusing their tax-exempt status, said Bryan Clontz, a certified financial planner and president of Charitable Solutions LLC, a consulting firm in Jacksonville, Fla. The firm works with donor-advised funds.

Mr. Clontz is also a member of the board of the National Committee on Planned Giving in Indianapolis, an association for professionals in charitable-gift planning.

"Private foundations are required to pay out 5%" of assets annually, he noted, while public charities have no annual payout requirement.

"Vanguard, Schwab and Fidelity are paying out triple what the private foundations are. If you wiped out five of [the worst donor-advised fund abusers], 95% of the issues would be wiped out," Mr. Clontz said.

But not all advisers who work with charitable donations are convinced that clients would be well-served by expanding charitable IRA rollovers. Except for very large contributors, there are little tax savings for people who donate money to a charity directly from an IRA, compared with the savings they would get by taking the money out of an IRA and making a contribution, said Sherman Doll, managing partner of Capital Performance Advisors LLP in Walnut Creek, Calif.

Mr. Doll asked his clients if they were interested in rolling over assets from IRAs to charities

after the current provision was enacted in the Pension Protection Act in 2006. Only one client responded, he said.

"I'd rather have them make contributions from appreciated stock or a mutual fund" to charities, Mr. Doll said. "If you're making a charitable contribution, consumption should take place from your taxable account first."

Photo: Debbie Levenson: "It's a huge service for clients to do their giving through donor-advised funds."

Photo: Kimberly Wright-Violich: Funds help with strategic decisions, she says.

Sara Hansard can be reached at shansard@crain.com

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