THE RISE OF DONOR-ADVISED FUNDS:  
WHY CONGRESS SHOULD NOT RESPOND

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Abstract: Should Congress respond? No. It would be wrong for Congress to respond to the “rise”. Why should a “rise” arouse Congressional action when a “rise” is precisely the expected outcome following Congress’s “legitimization” of donor-advised funds in 2006 by incorporating them into the Internal Revenue Code? We do not even have Treasury Regulations addressing permissible distributions yet. Depending on how those regulations turn out, we could see significant changes in distribution policies. Why would Congress act now when we have not yet seen donor-advised funds firing on all cylinders because we still await the much-anticipated operating guidance?

The sponsoring organization of donor-advised funds is the entity that is recognized as a 501(c)(3) and that reports on Form 990, not the individual donor-advised funds. The totality of the sponsoring organization’s operations must comply with the tax code’s “exclusively organized-and-operated” rules. By law, the sponsoring organization is the exclusive legal owner of assets in donor-advised funds, not the donors. The sponsoring organization manages interactions with its donor-advisors through its internal operating policies and procedures.

Nowhere does the tax code prescribe penalties on 501(c)(3)s based on under-distribution of individual contributions. For example, the existing penalty on private foundation under-distributions is calculated on an entity-wide, not a contribution-by-contribution, basis. Stated differently, the law does not force the Bill and Melinda Gates Foundation to track, distribute, and potentially penalize the Gates’ contributions separately from Warren Buffett’s contributions. Sponsoring organizations should be reviewed on the totality of their operations, not on the timing or amount of distributions of individual donor-advised fund accounts or contributions.

Evidence shows that sponsoring organizations have been, are, and remain high distributors. All reputable sponsoring organizations administer policies addressing timing, distributions, and inactivity and retain variance or transfer powers. The IRS National Office reviewed and approved model

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policies in 1998 as part of its review of the exemption application of Vanguard Charitable. Other sponsoring organizations voluntarily adopted the model policies as “good practices” or rely on their exclusive legal control and variance and transfer policies as they interact with their donor-advisors. Sponsoring organizations report not having to rely on their policies often because donor-advisor recommendations already result in a high distribution rate.

Representative Camp’s discussion draft proposed for all sponsoring organizations’ donor-advised funds a mandatory pay-or-penalize regime to be calculated contribution-by-contribution on a FIFO method. A 20 percent excise penalty tax would be payable annually by the sponsoring organization on any portion of a contribution and its earned income that has not been distributed by the beginning of the sixth taxable year beginning after the taxable year in which the contribution was made. Given high distribution percentages by sponsoring organizations, what is the justification for singling out donor-advised funds from all other public charities for this treatment?

The justification may be based on two assumptions voiced by the critic cohort.

The first assumption is that assets contributed to a sponsoring organization are assets that would otherwise be contributed currently to non-sponsoring-organization charities. We’ll call this the “substitute-giving assumption.” Professor Roger Colinvaux has written, “To the extent DAF contributions are not substitutes for other charitable giving, the policy concerns with DAFs are diminished.”

The second assumption is the critics’ assertion that the timing sequence of contributing first to a public charity that operates as a sponsoring organization and then advising distributions to other public charities is “not what Congress intended” when it enacted the charitable-giving deduction. We’ll call this the “what-Congress-intended assumption.” My review of the legislative history of the charitable-giving deduction has not yet revealed any legislative history showing that Congress intended any particular timing sequence or any preference for one public charity over another.

I believe the “substitute-giving” and “what-Congress-intended” assumptions to be unproven. Further, they are contrary to my experience as a legal counsel, as a donor, and as a student of exempt-organization law and practice.

Let’s unpack the critics’ assumptions.

As to substitute giving, my personal and client experience is that a majority of assets donated to donor-advised funds are not assets that would otherwise have been currently contributed to a different charity. That is because people give to donor-advised funds for many reasons that do not di-
rectly involve their past grantees: to build a charitable-giving reserve to spend in retirement (including to past grantees); to train their families in strategic philanthropy (including to past grantees); to accelerate bequests into charitable solution years before they might otherwise be paid thereby protecting for charity (including past grantees) assets that might otherwise be diverted to expenses or heirs; to monetize complex assets for distribution to charity (including past grantees); to avoid having to administer a private foundation; to accept memorial gifts in honor of a deceased person; and other legitimate reasons. One reason that donors might prefer to give even current donations (including to past grantees) through a sponsoring organization is to simplify and consolidate record-keeping (and sometimes to shield the donor’s identity for religious or other valid reasons).

As for interpreting *nunc pro tunc* what Congress intended when it enacted the charitable deduction in 1917, the critic cohort urges Congress to enact a law to substitute Congress’s judgment for the donor’s judgment. This substituted-judgment outcome would be achieved by enacting a behavior-modifying pay-or-penalize regime that would apply whenever a donor elects to contribute to a public charity that is a sponsoring organization. If this differentiation is what Congress now intends after 98 years of experience with the charitable deduction, what is the tax-policy reason for limiting the new penalty just to contributions to sponsoring organizations rather than extending the new penalty to contributions to endowments or to capital funds or to reserve funds at any public charity?

There are good and valid reasons for donor-advisors to advise grants at different rates. Nonetheless, the critic cohort argues that Congress should substitute its and the cohort’s judgment for the judgment of each of America’s more than 217,000 donor-advisors and of each of about 1200 sponsoring organizations as to the timing of charitable distributions. In so doing, the critic cohort is urging Congress to overturn two bedrock principles of American philanthropy, i.e., that the donor won’t be penalized for choosing to contribute to one public charity over another public charity, and that the recipient charity knows better than government what policies to apply as to how and when to spend a donor’s contribution.

We must also consider the law of unintended consequences: Tax policy should not drive donor-advised funds to become small private foundations. Doing so would needlessly waste on costs dollars that should otherwise be paid out as charitable distributions—not as fees to family, administrators, or service providers. Having to oversee 200,000 or more new small foundations would increase administrative burdens and costs for the IRS. Instead, tax policy should do the opposite: drive donors to reputable sponsoring organizations that administer policies on timing, distributions, inactivity and variance and transfer powers. Reputable sponsoring organizations already
administer grant procedures that are as or more restrictive than a private foundation’s. From a regulatory perspective, it would be much more efficient for the IRS to regulate a small number of sponsoring organizations (1250?) rather than a large number (200,000?) of small private foundations. An IRS audit of a few sponsoring organizations could result in administrative changes being delivered to tens of thousands of donor-advised funds, whereas the cost of auditing tens of thousands of private foundations would be prohibitive. A result of a tax policy driving donors to DAFs over small foundations would be a reduction in IRS’s regulatory burden and costs.

There is no tax-policy reason for Congress to interfere with the success that its 2006 actions helped to create. Substituting government judgment for charity boards’ and each donor’s judgments is not “the American way” of philanthropy. Instead, Americans “let 1,000 flowers bloom” rather than having government direct which charities it prefers to see watered with contributions. As Representative Utt said in the 1969 legislation history, “Private philanthropy has shown imagination and creativity in dealing with many of our pressing problems . . . [the Tax Reform Act of 1969] may result in many activities that are now reserved to our private sector becoming the responsibility of Government . . . . These results would not be healthy for our free-enterprise system.”

A. Why should a “rise” arouse Congressional action when a “rise” is precisely the expected outcome following Congress’s “legitimization” of donor-advised funds in 2006 by incorporating them into the Internal Revenue Code?

The term “rise” in the title of this conference is not defined. I assume that the term “rise” refers to any or all of the increase in the number of donor-advised fund accounts (“DAFs”), the increase in the grants paid out by sponsoring organizations of DAFs, or the increase in contributions to sponsoring organizations over some period of time. No matter which, isn’t a “rise” predictable when authorizing and legitimizing legislation is passed by Congress and signed into law by the President?

DAFs existed for 65 years before being added to the Internal Revenue Code\(^1\) by the Pension Protection Act of 2006 (the “PPA”). Donors and their advisors who had concerns about DAFs before the PPA were now reassured post-PPA by seeing in the Code explicit authorization and detailed operating rules for sponsoring organizations, all of which “legitimized” DAFs. That legitimization by Congress spurred creation of new accounts.

As Rick Cohen has written,

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1 Internal Revenue Code of 1986, as amended (the “Code”).
Back in 2004, Sen. Chuck Grassley (R-Iowa) launched Senate Finance Committee hearings into charitable abuses and found an example of donors using DAFs to pay their personal expenses. Such abuses regularly landed DAFs on the IRS’s annual “dirty dozen” list. But with the passage of the [PPA] . . . , this kind of abuse has subsided and, to the extent that we can tell, is not tolerated among . . . DAF managers. As a result, the IRS dropped DAFs from the dirty dozen list a couple of years ago and they haven’t reappeared there.²

Similarly, Howard Husock has observed,

In previous years, legal uncertainty had limited DAF growth; but from 2007 to 2013—the first year of high-quality data for DAF sponsoring organizations reporting via Forms 990—the number of DAF accounts grew by 34 percent.³

There is no tax policy reason that the predicted and expected “rise” following enactment of the law calls for Congressional response.

B. We do not even have Treasury Regulations addressing permissible distributions yet. Depending on how those regulations turn out, we could see significant changes in distribution policies. Why would Congress act now when we have not yet seen donor-advised funds firing on all cylinders because we still await the much-anticipated operating guidance?

The PPA was signed into law on August 18, 2006. The Blue Book and the Joint Committee on Taxation Technical Explanation both discuss operating questions for DAFs and their sponsoring organizations. But we don’t even have Treasury Regulations yet interpreting the PPA. Depending on how those regulations come out, we could see some eye-popping changes in donor-advisor grant advising. Why would Congress respond now when we haven’t yet seen donor-advised funds firing on all cylinders because they are still waiting for the anticipated operating guidance?

Among the most important questions on which guidance is expected are the following:

• “What is a more-than-incidental return benefit?”
• “Can a donor-advisor bifurcate a gala dinner or other ticket purchase with a DAF?”
• “If not, what is the meaning of the reference in the legislative history to a contribution that ‘would not have reduced or eliminated the donor’s deduction’?”
• “Can a DAF satisfy a donor-advisor’s legally binding pledge?”

Lacking answers to all four of these questions, sponsoring organizations have generally refused such grant recommendations, pending guidance.

In an August 12, 2015, opinion piece, my co-panelist Alan Cantor wrote that the “legal restrictions on how grants from donor-advised funds can be distributed . . . are increasingly causing headaches and inefficiencies for nonprofits, while giving rise to misunderstanding and resentment between those organizations and their donors.” The “strings” to which Mr. Cantor refers are the “good governance” restrictions that Congress placed on DAFs in the law, not nasty inventions of sponsoring organizations. His complaint reinforces the point just made: The field does not yet have Treasury Regulations answering these key questions which Congress punted to the regulation-writers so don’t blame sponsoring organizations for asking public charities for certifications to help avoid potentially penalty-raising grant recommendations until the law is clarified.

In that regard, I have long urged public charity fundraisers to be part of the solution. Those who have done so have increased the number and amount of donor-advised distributions they receive. How do fundraisers do this? For example, they include DAF-compliant “pledge” lines on their pledge cards, and they offer DAF-compliant membership categories in their membership marketing materials. That way, the soliciting charities cooperate with the sponsoring organizations in educating donor-advisors about

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5 Blue Book and Technical Explanation of H.R. 4, the “Pension Protection Act of 2006”, as passed by the House on July 28, 2006, and as considered by the Senate on August 3, 2006, JCX-38-06, at pages 642-643 and pages 348-350, respectively.
DAF-compliant grant recommendations, and they help themselves by offering and then easily certifying their ability to accept complying DAF grants.

C. The sponsoring organization of DAFs is the entity that is recognized as exempt under Code section 501(c)(3) and reports on Form 990, not the individual DAFs. The totality of the sponsoring organization’s operations must comply with the Code’s “exclusively organized-and-operated” rules. By law, the sponsoring organization is the exclusive legal owner of assets in donor-advised funds, not the donors.

I remember speaking in 1998 with an official of the IRS National Office who was convinced that sponsoring organizations were massively non-compliant because they had failed to file a Form 990 annual information return for each DAF. He was strangely relieved when I explained that, in a sponsoring organization formed as a corporation, each DAF is just an account owned by the sponsoring organization where the donor is granted the privilege of naming a person who may advise about grants and investment allocations within specific parameters established by the sponsoring organization. Similarly, it is the sponsoring organization not the DAFs that applies for and is granted recognition of exemption. It is the sponsoring organization that will be held accountable on audit for the totality of its operations satisfying continuously the “organized and operated” requirement of Code section 501(c)(3). This legal structure was confirmed by the 2006 Congress in enactment of Code sections 4966, 4967, and amendments to Code sections 170, 4958, and 4943. Congress could have enacted even more changes but it elected not to.

D. Nowhere does the Code prescribe penalties on section 501(c)(3) organizations based on “under-distribution” of individual contributions. For example, the existing penalty on private foundation under-distributions is calculated on an entity-wide, not contribution-by-contribution, basis. Stated differently, the law does not force the Bill and Melinda Gates Foundation to track, distribute, and potentially penalize the Gates’ contributions separately from Warren Buffett’s contributions.

The effort is afoot to prescribe penalties on an account-by-account basis or even a contribution-by-contribution basis. Even where the Code prescribes under-distribution penalties for private foundations, they are calcu-

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8 Code section 4942, requires an annual distribution of assets in an amount approximately equal to 5 percent of the non-charitable use assets managed at the end of the prior year. The law permits the required distribution to be reduced by the amount of qualifying administrative expenses and also by carried-forward excess distributions from prior years. It also permits certain amounts to be “set aside” for payment within the next 5 years, rather than currently.
lated on an entity-wide basis. As noted above, the Code does not force the Bill and Melinda Gates Foundation to track, distribute, report, and potentially penalize the Gates’ contributions separately from Warren Buffett’s contributions.

What about memorial-fund DAFs, which are typically set up between the death and the funeral of the person to be honored so that the memorial fund can be announced in the obituary and in the funeral program? These DAFs may receive contributions from over 100 unrelated donors, many or most of whom may not itemize deductions. What are the cost-benefit and policy arguments for tracking, distributing, and reporting each memorial-fund contribution individually?

A DAF-based pay-or-penalize tax regime would be a radical change if Congress were to impose it on donors and charities, especially in the absence of documented abuse.

We know that Congress considered testimony on distributions in the run-up to the enactment of the 1969 Tax Reform Act, which enacted Code Section 509 and its definition of a private foundation and Code Section 4942, which penalizes under-distribution by private foundations.

The fact that Congress twice chose not to enact specific spending rates for colleges and universities, hospitals, churches, museums and cultural institutions, and other publicly supported charities—including sponsoring organizations of DAFs—suggests that Congress did not find a compelling reason to do so on either occasion (1969 or 2006). What is the compelling reason now?

E. Evidence shows that sponsoring organizations have been, are, and remain high distributors. All reputable sponsoring organizations administer their policies addressing timing, distributions, and inactivity and may also employ exclusive legal control, variance and/or transfer policies. The IRS National Office reviewed and approved model policies in 1998 as part of its review of the exemption application of Vanguard Charitable. Other sponsoring organizations voluntarily adopted the model policies as “good practices”. But sponsoring organizations report not having to rely on their policies often because donor-advisor recommendations already result in a high rate of distributions.

We know that annual sponsoring organization distributions have exceeded 20 per cent of assets for the past 7 years. Each sponsoring organization’s distribution rate varies annually with its advisors’ recommendations.

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and the methods it uses to calculate its distribution rates. The data on distributions is annually reported by each sponsoring organization on Form 990 Schedule D and republished by The Chronicle of Philanthropy and National Philanthropic Trust, so I will not repeat them here. Suffice it to say that sponsoring organizations have high distribution percentages.

F. Representative Camp’s discussion draft proposed for all sponsoring organizations’ DAFs a mandatory pay-or-penalize regime to be calculated contribution-by-contribution on a FIFO method. Given high distribution percentages by sponsoring organizations, what is the justification for singling out donor-advised funds from all other charities for this treatment?

In February 2014, former Representative Dave Camp (R, MI) proposed for all DAFs in his discussion draft a mandatory pay-or-penalize regime to be calculated contribution-by-contribution on a FIFO method. A new excise tax would be imposed on the “Failure to Distribute Contributions Within 5 Years”. New Code section 4968 would require a 20 percent excise tax to be paid annually by the sponsoring organization on any portion of a contribution from each donor and income earned on that contribution that has not been distributed by the beginning of the sixth taxable year beginning after the taxable year in which the contribution was made.

Since many DAFs accept multiple contributions from a single family or contributions from multiple donors to a single DAF (as with a memorial DAF), the practical question arises whether each contribution would need to be contributed to its own DAF in order to handle more efficiently the potentially costly FIFO accounting and reporting on each contribution and its

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10 Recently my co-panelist, Alan Cantor, raised questions as to which is the correct denominator to use in calculating DAF-distribution percentages and criticized Fidelity Charitable for using in 2015 a rolling-average method used by colleges, universities, cultural institutions, and other public charities. In response to Mr. Cantor’s complaints, CPA Frank Monti published a comment to Mr. Cantor’s article in which Mr. Monti analyzed three possible methodologies for calculating sponsoring organization distribution percentages. He referred to those methodologies as the “traditional method”, the “NPT method”, and the “rolling average method”. Depending on which method is used, Mr. Monti calculated for the Fidelity Charitable Gift Fund in 2014 distribution rates of 19.5%, 21.9%, or 28%. See Frank Monti July 22, 2015, response to Alan M. Cantor, “A Closer Look at a Donor-Advised Fund’s Payout Numbers,” Inside Philanthropy, Jul. 20, 2015, (www.insidephilanthropy.com). This interesting discussion shows that no particular method is “right” or “wrong”. Instead, Mr. Monti points out that each method is useful for sake of comparison of sponsoring organization distributions to the sector that uses each particular method.


earned income? If so, proposed Code section 4968 could cause the number of new DAFs to multiply exponentially.

An “elgible distribution” would be one to a charity described in Code section 170(b)(1)(A) other than one described in Code section 509(a)(3) (supporting organizations) or 4966(d)(2) (sponsoring organizations). DAFs in existence on January 1, 2015, would be subject to distribution penalties as if they had been created by a contribution received on January 1, 2015.\(^\text{13}\) According to the Joint Committee on Taxation, Camp’s Discussion Draft of the Tax Reform Act of 2014, section 5203 would yield less than $50 million in additional tax revenue from 2014 through 2023.\(^\text{14}\) Since that is a small amount for a tax change, the proposed Code section 4968 is presumably conceived of as a governance provision.\(^\text{15}\)

The Discussion Draft thrilled Mr. Cantor because Rep. Camp’s proposed 5-year distribution requirement was even stricter than the one he and Boston College Law School Professor Ray Madoff had promoted. Mr. Cantor wrote:

I support the proposal by Professor Ray Madoff . . . that money contributed to [DAFs] needs to be distributed to charity within seven years . . . . When Madoff and I were two of the very few people in the country who were advocating for this required spend-down, we were gently ridiculed . . . . Then . . . a man named Dave Camp publically agreed with us. In fact, he said the required pay-down should be completed in five years, not seven.\(^\text{16}\)

The Discussion Draft’s pay-or- penalize provision has elicited strong criticism from many individuals and organizations represented at this conference.

For example, the Council on Foundations wrote:

DAFs are one of many invaluable philanthropic tools that community foundations use to engage donors and connect them with important local causes. . . . The Council respectfully requests that

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\(^{13}\) Id.


\(^{15}\) The Technical Explanation is silent on the specific rationale. Technical Explanation of the Tax Reform Act of 2014, A Discussion Draft of the Chairman of the House Committee on Ways and Means to Reform the Internal Revenue Code: Title V—Tax Exempt Entities, prepared by the staff of the Joint Committee on Taxation (February 26, 2014) JCX-16-14.

the Working Group recommend that current law with respect to DAFs be preserved . . . .17

The Independent Sector wrote of the proposed distribution regime, “[i]t appears that this concern is more theoretical than real,” citing many reasons that a delay in payout beyond 5 years can be warranted.18

The Community Foundation Public Value Awareness Project wrote:

The effect of the Committee’s proposal, however, would be to make a DAF very unattractive for donors and (1) potentially reduce overall giving substantially; (2) drive many wealthy donors to start private foundations, where they will likely give a maximum of 5 percent; and (3) add administrative burdens to community foundations and other DAF sponsors . . . . What the five-year payout proposal for DAFs says to these families is this: ‘The very wealthy can set aside their money in a private foundation, maintain family control, grant 5 percent a year, and keep the foundation active in perpetuity; but the upper-middle class family who wants to engage in philanthropy by opening a donor-advised fund must spend out all gifts made to the fund within five years, with no possibility to engage their children in a lifetime of giving. 19

On April 24, 2014, Gene Steuerle posted an essay entitled “Dave Camp’s Tax Reform Could Kill Community Foundations”, in which he said:

I doubt seriously that Chairman Camp’s staff saw fully how they would wipe out most community foundations and confine endowment giving only to the rich. By making it more complicated and expensive to engage in [DAF] activity, they would move almost all endowment decision-making to the elite, often established institutions where the average citizen has little or no voice and where the operational expenses are greater.20

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Similarly, Howard Husock has written about the Camp and Madoff proposals:

The time-sensitive distribution requirement embraced by Madoff and other DAF-critics cannot obscure the fact that money that goes to donor-advised funds has been given irrevocably to charity. Therefore, it is difficult to understand why distribution within an arbitrary five-year period is preferable. At present, roughly 21 percent of [national donor-advised funds] are distributed annually—a trend that, if extrapolated, means that virtually all DAF deposits are disbursed, voluntarily, within five years. 21

Mr. Husock also wrote in “Does Dave Camp Hate Mark Zuckerberg? The Surprising Attack on Donor Advised Funds” that:

Among the less-than-pleasant surprises to be found in House Ways and Means Committee chair Rep. Dave Camp’s generally thoughtful and constructive tax reform proposal is one targeting donor-advised funds (DAFs)—an important section of the tax code for those who think it’s better for the country if more funds go to philanthropy and charities than to the government.22

The critic cohort is unmoved and wants more out of sponsoring organizations.

From Alan Cantor: “Yes, I write a lot about donor-advised funds. That’s because their surge in popularity is the biggest story in philanthropy—and to my mind, a growing threat to an already-battered nonprofit sector. 23

And from Professor Madoff:

I and many other critics of the laws governing the funds are concerned that donors and the people who manage their money have been the primary recipients of benefits from the growth of donor-advised funds, while charities and the people they serve are being starved of resources. 24

23 alancantorconsulting.com/tag/commercial-donor-advised-funds (last reviewed on August 6, 2015).
G. The argument that charities are being “starved” by DAFs may be based on two assumptions by the critic cohort.

The first assumption is that assets contributed to a sponsoring organization are assets that would otherwise be contributed currently to non-sponsoring-organization charities. We’ll call this the “substitute-giving assumption.” Professor Roger Colinvaux has written, “To the extent DAF contributions are not substitutes for other charitable giving, the policy concerns with DAFs are diminished.”

The second assumption is the critics’ assertion that the timing sequence of contributing first to a public charity that operates as a sponsoring organization and then advising distributions to other public charities is “not what Congress intended” when it enacted the charitable-giving deduction. We’ll call this the “what-Congress-intended assumption.” My review to date of the legislative history of the charitable-giving deduction has not revealed any timing sequence intended by Congress.

I believe the “substitute-giving” and “what-Congress-intended” assumptions to be unproven. Further, they are contrary to my personal and client experience as a legal counsel, as a donor, and as a student of exempt-organization law and practice.

The argument that charities are being “starved” by contributions to DAFs is premised on an assumption that DAFs are accepting contributions that would otherwise be paid currently to non-sponsoring organizations. As noted above, Professor Colinvaux has properly noted that “To the extent DAF contributions are not substitutes for other charitable giving, the policy concerns with DAFs are diminished.”

Therefore, let’s unpack Professor Madoff’s and Mr. Cantor’s assumptions.

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H. As to substitute giving, my experience is that a majority of assets donated to donor-advised funds are not assets that would otherwise have been currently contributed to a different charity, particularly a past grantee. That is because people give to donor-advised funds for many reasons that do not directly involve their past grantees: to build a charitable-giving reserve to spend in retirement (including to past grantees); to train their families in strategic philanthropy (including to past grantees); to accelerate bequests into charitable solution years before they might in the interim have been paid thereby protecting for charity (including past grantees) assets that might otherwise be diverted to expenses or heirs; to monetize complex assets for distribution to charity (including to past grantees); to avoid having to administer a private foundation, as a memorial fund following a death, and other legitimate reasons. One reason that donors might prefer to give current donations (including to past grantees) through a sponsoring organization is to simplify and consolidate record-keeping (and sometimes to shield the donor’s identity for religious or other reasons).

First, sponsoring organizations are themselves public charities. Congress amended the Code in 2006 expressly to require that a sponsoring organization be a public charity.26 Like every other charity, sponsoring organizations have to satisfy the “organized and operated” test of Code section 501(c)(3). Contributions to sponsoring organizations are irrevocably committed to charity, rather than to taxes or heirs. Therefore, charity clearly is not being “starved”. To the contrary, charity is being fed.

But that’s not the critics’ real point is it? What Professor Madoff is expressing in that statement is her preference for contributions from donors to be given to charities that are not sponsoring organizations. She has written that the 5 percent payout for private foundations was “based on the idea that foundations should be allowed to operate in perpetuity. However, advised funds are essentially charitable checking accounts . . . and there is no reason for them to last forever.”27

Stated differently, her view is that some charities are more worthy recipients of deductible contributions than are other charities because of how

26 Code section 4966(d)(1).
27 Madoff’s 5 Myths About Payout Rules. As numerous articles have pointed out, most donor advisors have no desire for their DAFs to last “forever”. There is a big difference between a short 5 or 7-year duration and “forever”, hence the various distribution rates that lead to sponsoring organization-wide annual distribution rates of 13 to 28 percent. Fidelity Charitable reports that “most contributions . . . are granted out to charities within 10 years . . . .” Fidelity Charitable 2015 Giving Report at 2. Further, would Professor Madoff argue that her rationale extends to all public charities that are, like DAFs, in the NTEE classification of “promoting philanthropy”, including other public charities that are grant-makers?
they use the contributions. She calls these “real charities.” This is a controversial and dangerous view, in my opinion. Many of us old-timers have had those conversations with government officials in the past; this is the slippery slope of government telling donors which contribution merits the better treatment, the contribution to the food pantry or the contribution to the ballet or the contribution to the DAF? Government may favor contributions to poverty-relieving charities as they could help to reduce the obligations of the government. To date, however, Congress has wisely avoided ranking the relative worth of charitable missions.

Second, there is strong anecdotal evidence that a majority of contributions to DAFs are “new money” or “accelerated bequests” or “set asides” for charity that would, for a variety of reasons, not otherwise have been paid at the same time the DAF contribution is made. (Many donor-advisors, however, will continue to give in the future to past grantees and want to pre-fund their capacity to do so.)

A very common reason that donors give for opening DAFs is to fund the arc of their grant making by contributing during earning years and recommending out during retirement until funds are depleted. Fidelity Charitable reports that “[d]onors establish Giving Accounts as they approach retirement age and 62 percent say they are using these donor-advised funds as a way to sustain giving through retirement.”

Teaching children and grandchildren to give is another. Dedicating to charity proceeds from a current realization event is a third. Accelerating what might otherwise be a bequest is a fourth reason.

But how do sponsoring organizations get the critics to believe that DAFs aren’t “a vacuum for dollars that would otherwise be spent right away for charity”? This is impossible to do except by asking donors whether they would otherwise have given their DAF contributions at the same time to other charities.

28 Madoff’s 5 Myths About Payout Rules.
29 For more on this subject, see Howard Husock, “Philanthropy Under Fire,” Encounter Broadside No. 34 (2013).
31 Alan Cantor criticizes a regular donor he approached for a client for turning down a capital gift request in favor of building up a family DAF. “Donor-Advised Funds Let Wall Street Steer Charitable Contributors,” www.philanthropy.com (Oct. 12, 2014). I understand his disappointment but note that the donor has every right to switch his priorities, especially since he has already given generously to Mr. Cantor’s client in the past and may do so again in the future from the family DAF.
32 For a sampling of the variety of ways new grants were conceived and advised, see the Urban Institute’s “Donor Advised Fund Stories State by State” at http://www.cof.org/sites/default/files/documents/files/Urban-Survey-Stories.pdf.
33 Colinvaux, supra note 25, paraphrasing Alan Cantor, supra note 31.
In fact, many sponsoring organizations have asked this question of current and prior donors. When asked, a large majority of donors say their DAFs contain “new” not “substitute” contributions. Mr. Husock reports that in “surveys of account holders conducted by Fidelity Charitable, about two-thirds of respondents indicated that the use of a DAF account likely increases their charitable giving.”

The assumption of “substitute giving” is not true in my personal experience. The 5 DAFs that I have personally opened have each received exclusively “new” and not “substitute” funding. The first at the New York Community Trust was opened on behalf of my law firm, Simpson Thacher, to facilitate disaster relief grant recommendations. The second was at the Fidelity Charitable Gift Fund to smooth my husband’s and my charitable giving as we ease into retirement. And the third, fourth, and fifth were opened naming each of my three siblings as advisors, with my Mother as donor to the four DAFs advised by her four children. The last were funded in response to a transition gift-claw-back in New York State estate tax law that would otherwise have negatively impacted gifted proceeds from the sale of the family homestead. All four of these family DAFs received “new money” that would not otherwise currently have been given to charity. Had the NYS claw-back not excepted charitable gifts, this high six-figure amount would have been distributed to the four children as taxable gifts with the money split between the children and the federal and state governments; none would have gone to charity at that time.

Instead, all four children are charitably inclined and were happy to accept DAF-advisory privileges in place of outright personal gifts. No one wanted to have to identify recipient charities during the stress of cleaning out and closing the sale of the family homestead. Rich people have had this timing capacity for years, but DAFs are the low-cost way that middle class people can support charity in a reasoned and thoughtful way, without rushing decisions during a family stress event (sale of the homestead, a parent’s illness, receiving a bequest, a disaster). There is absolutely nothing nefarious about different family members from 4 different parts of the country advising grants to new and different and past charitable grantees at different rates, and none of us seeks a perpetual fund.

Third, inter vivos contributions to DAFs by definition come sooner in time than do bequests. From my perspective, the sooner the DAF is funded, the sooner the money is irrevocably designated for charity and starts growing tax-free for charity, and the sooner grant recommendations start rolling in to the sponsoring organization. Waiting for bequests to be paid to charity means delay for the money coming into charitable solution and risks that

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changes in the will in favor of heirs will be encouraged in the interim, in which case money will go to heirs and taxes and not to charity at all.\textsuperscript{35} A current gift to a DAF in lieu of a bequest commits all the money to charity while allowing the donor-advisor to keep or change his or her choices of charitable beneficiaries over time. Being locked into specific charities while still identifying one’s favorites is one of the worries that inhibits donors from naming charities in wills in the first place.

Fourth, all reputable sponsoring organizations have and administer policies on timing, distributions and inactivity. Some of those policies include the “variance power” wielded by community foundations and “transfer powers” wielded by others in the rare event that they were to be confronted with a truly inactive account.

Because of high distribution activities, sponsoring organizations report rarely having to invoke their policies. For example, Silicon Valley Community Foundation reports,

Of the 158 [DAFs] at SVCF with balances over $1 million, 96 percent—or all but seven of them—made grants during the two-year period that ended December 2014. SVCF has an active policy of contacting donor advisors if they’ve made no grants in two years and encouraging them to recommend grants . . . . In SVCF’s history, only one [DAF] was ‘orphaned,’ meaning we were unable to contact the donor to advise grants. Per our policy, that fund was transferred to our community endowment.\textsuperscript{36}

I want to emphasize my belief that all reputable sponsoring organizations do have policies and do use them if needed. This is consistent with the “organized-and-operated” criteria under Code section 501(c)(3).

\textsuperscript{35} “Most obviously, someone who decides to save and give later might not actually follow through with it . . . There’s a simple solution to this problem: putting the money into a donor-advised fund . . . Because the money can be paid out only to registered charities, there is no temptation to renege on the commitment.” William MacAskill, “Why Giving Now Multiplies the Value of a Donor’s Dollar,” The Chronicle of Philanthropy, August 2015, 32, 33.

I. There are good and valid reasons for donor-advisors to advise grants at different rates. Nonetheless, the critic cohort argues that Congress should substitute its and the cohort’s judgment for the judgment of each of America’s more than 200,000 DAF donor-advisors and of each of about 1200 sponsoring organizations as to the timing and amount of charitable distributions. In so doing, the critic cohort is urging Congress to overturn two bedrock principles of American philanthropy, i.e., that the donor won’t be penalized for choosing to contribute to one public charity over another public charity, and that the recipient charity knows better than government what policies to apply as to how and when to spend a donor’s contribution.

There are good and valid reasons for donors contributing at different rates and for donor-advisors advising grants at different rates.

Nonetheless, the critic cohort argues that Congress should substitute its and the cohort’s judgment on charitable-distribution rates for the judgment of each of America’s more-than-200,000 DAF donors.

J. If this is what Congress now intends after 98 years of experience with the charitable deduction, what is the tax-policy reason for limiting the new penalty just to contributions to sponsoring organizations rather than extending the new penalty to contributions to endowments or to capital funds or to reserve funds?

The critics’ authority for this policy position is their interpretation of the speed or preferred target intended by Congress for Code section 170 deductibility. For example, Professor Madoff has written that “It’s time to . . . ensure that charities and those who depend on them get the benefit Congress intended when it created the charitable deduction.”

I have reviewed the legislative history to Code section 170 when it was “created”, its amendments, and articles about its history. I still have not found a distribution-timing or preferred-charity requirement in the legislative history. If it exists, I am sure that we would all like to review it.

I did find that the deduction for charitable contributions is one of the oldest deduction provisions in the tax laws and that it was enacted in the War Revenue Act of 1917 as an incentive for donors to keep giving despite

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37 Mr. Cantor’s Violent Opposition (“The notion behind the charitable deduction is that these donations are for the public good . . . It’s hard to understand how a gift to Fidelity Charitable is for the public good.”).
38 See Madoff’s 5 Myths About Payout Rules (emphasis added).
40 Id. at 848.
high wartime tax rates.\textsuperscript{41} The legislative history indicates that this provision was prompted by the concern that, without a deduction, wealthy taxpayers would no longer contribute to charitable organizations.\textsuperscript{42} Professor Aprill writes that Senator Hollis feared that the war would affect colleges “more seriously than it does any other character of institution,” both by taking students to be soldiers and by reducing financial support due to high taxes.\textsuperscript{43}

The legislative history quoting Senator Hollis continues:

\begin{quote}
Usually people contribute to charities and educational objects out of their surplus. After they have done everything else they want to do, after they have educated their children and traveled and spent their money on everything they really want or think they want, then if they have something left over, they will contribute it to a college or to the Red Cross or for some scientific purposes. Now, when war comes, . . . that will be the first place where wealthy men will be tempted to economize, namely in donations to charity.\textsuperscript{44}
\end{quote}

Thus, this legislative history envisions the deduction as an incentive for taxpayers to continue to donate their “left over” money to charity. As Mr. Alexander Reid has written,

\begin{quote}
If Congress had intended to use the charitable deduction as a subsidy, it seems likely Congress would have said what it intended to subsidize and why, and periodically reviewed whether the subsidy was effective. There is no legislative history to that effect.\textsuperscript{45}
\end{quote}

K. One-size-fits-all solutions are not good tax policy for charitable distributions.

The compelling truth is that data compiled from many sources shows that sponsoring organizations pay distributions at remarkably higher percentages of assets than do private foundations or almost all reserve funds or endowments at public charities.\textsuperscript{46} The critic cohort prefers donors to con-

\textsuperscript{41} Alexander Reid, “Renegotiating the Charitable Deduction,” 71 Tax Analysts No. 1 (Jan. 2013)(which includes the legislative history as an appendix).
\textsuperscript{42} Aprill, supra note 39 at 849.
\textsuperscript{43} Id.
\textsuperscript{44} Id., citing 55 Cong. Rec. 6728 (1917).
\textsuperscript{45} Reid, supra note 41 at 26.
\textsuperscript{46} CPA Frank Monti has noted that DAFs are distributing money to charity at a faster rate than any other past entity and because of that the DAF “has been a positive development in the charitable funding world.” www.insidephilanthropy.com (July 23, 2015 comment) (last visited July 23, 2015).
tribute only to what Mr. Cantor calls “operating charities” and Professor Madoff calls “real charities.” But not all “operating charities” spend contributions immediately either, nor should we impose requirements that they do so. Our law generally leaves to the Boards and management of charities the decisions on what and when to spend. Dictating a pay-or-penalize regime to the Boards of and donors to sponsoring organizations is an unhappy and unnecessary variant of a “one-size-fits all” mandate.

Professor Madoff writes that,

the reason current law allows endowments [sic] to let charities decide for themselves how to finance their missions. If an organization believes that creating a fund for hard times or spending frugally now better supports its charitable mission over the long haul, then we defer to its judgment.” But, she continues, “This same justification does not extend to people who contribute to advised funds, nor should it. Donor-advised funds don’t have a charitable purpose; they are simply a holding pen where people can put money before deciding where to give. If a donor wants to create a perpetual endowment for a particular cause, she can always do so within an existing charity or by creating a foundation.

Professor Madoff’s argument ignores that fact that DAF assets are by law the property of and under the exclusive legal control of the sponsoring organization. Every sponsoring organization has its own mission involving promoting philanthropy and has qualified as a public charity under longstanding rules. Many grant-making public charities have been recognized as exempt, not just sponsoring organizations. This short-term, account-by-account proposal contradicts, rather than defers to, the judgment of the sponsoring organization Boards who have decided to permit donors to advise grants in a rhythm consistent with each sponsoring organizations’ distribution policies. If a donor wants to advise slower than Professor Madoff’s proposed timing, why should the donor have to go to “an existing charity or by creating a foundation?” The donor might not want the costs and management obligations of a private foundation or to create a perpetual endowment but instead just to distribute grants annually during her retirement till the money runs out, as I and so many donors desire to do. Professor Madoff’s timing preference admits no justification for a slower-than-7-year payout rate. While most sponsoring organizations distribute faster than this,

47 “It’s easy to understand how a gift to a food pantry is for the public good.” Alan Cantor, “Donor-Advised Fund Reform Faces Violent Opposition for Now”, at 1.
48 Id. 5 Myths About Payout Rules.
49 Id.
I believe that good and valid reasons exist for some to have slower distribution rates and do not violate the letter or spirit of existing law.50

L. We must also consider the law of unintended consequences: Tax policy should not drive DAFs to be replaced by an outbreak of small private foundations. Doing so would needlessly waste on administrative costs dollars that should otherwise be paid as charitable contributions—not as fees to family, administrators, or service providers. Having to oversee 200,000 or more new small foundations would increase administrative burdens and costs for the IRS. Instead, tax policy should do the opposite: drive donors to reputable sponsoring organizations that administer policies on timing, distributions, and inactivity. Reputable sponsoring organizations already administer grant procedures that are as or more restrictive than a private foundation’s. From a regulatory perspective, it would be much more efficient for the IRS to regulate a small number of sponsoring organizations (1250?) rather than a large number (200,000?) of small private foundations. An IRS audit of a few sponsoring organizations could result in administrative changes being delivered to tens of thousands of DAFs, whereas the cost of auditing tens of thousands of private foundations would be prohibitive. As a result, IRS’s regulatory burden and costs should be reduced by driving donors to sponsoring organizations over small foundations.

The law of unintended consequences should be evaluated in light of the ease with which a public charity can migrate into a private foundation classification, despite increased costs for entity administration and for government administration, thereby leaving less for grant distributions.

Tax policy should promote tax administration by government and compliance with law by taxpayers. When laws add undue complexity or compliance expense, taxpayers should be expected to decamp to a lower-cost and less-onerous alternative. Clearly, if burdens on sponsoring organizations become too onerous, sponsoring organizations could potentially migrate into private operating foundations, thereby maintaining public-charity deductibility and lower private-foundation-entity-wide distribution rules, or into private non-operating foundations.51 In the alternative, each future DAF could be formed as a small separate private foundation and managed by an overseer, the model now used by, among others, Foundation Source.

50 For more discussion of the pace of distributing, see Husock’s 2015 Civic Report at Section IV, “Giving Patterns” at 6-8.

51 Code section 4942 allows private operating foundation rates to expend approximately 3.5 percent, while private non-operating foundation rates are 5 percent of non-charitable use assets reduced by administrative expenses, carryforwards, and set asides.
Fidelity Charitable reports that in 2014, 60 percent of Giving Accounts had balances of less than $25,000. The median Giving Account balance was $16,097. Out of 72,170 Giving Accounts only 5,584 had balances of more than $250,000. Of the 1,047 advised funds at Silicon Valley Community Foundation, 340 had balances below $25,000 and 575 had balances below $100,000. Foundation percentage and deductibility limitations are not likely to deter donors at these levels if they give cash or qualified appreciated stock to private foundations because they are not likely ever to exceed the lower foundation percentage limitations. If they do, they can carry the excess deduction forward for 5 years.

Clearly tax administration is aided by having fewer rather than more Series 990 Forms for government to administer, review, and examine. Therefore, tax policy should strongly favor driving donors to DAFs at reputable sponsoring organizations because the sponsoring organizations are charged with monitoring the activities of their hundreds or thousands of DAFs, donor-advisors, and their disqualified persons or they or the donors will face already-existing penalties.

Similarly, it would be much easier for the IRS to accept, review, and examine the 990 Forms of a small universe of 1,012 sponsoring organizations than it would be for the IRS to accept, review, and examine the Form 990-PFs of a universe of more than 200,000 mostly small private foundations.

Tax policy should not drive DAFs to become small private foundations because doing so will needlessly waste on administrative costs dollars that should be paid as charitable distributions—not as fees to family, administrators, or service providers—and increase IRS workload and costs.

Tax policy should also drive donors to DAFs at reputable sponsoring organizations over private foundations because, in addition to lower operating costs for sponsoring organizations and the IRS, DAFs have more restrictive grant requirements than do private foundations. This comparison is already being advertised. See, for example, the content of this recent ad published by a firm that administers small foundations:

“Private foundations let you stay in control of your [sic] assets, pay expenses, and even compensate family members for their charitable work—DAFs do not.”

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52 2015 Fidelity Charitable Giving Report at 4, 5.
53 The Facts About Donor Advised Funds at SVCF, supra note 36.
54 NPT reports that it collected data from 1,012 sponsoring organizations of which 43 were national charities, 606 were community foundations, and 363 were single-issue charities. The NPT 2014 Report identified 217,367 DAFs and 84,350 private foundations in 2013.
“Some of the kinds of grants that are routine for private foundations, such as grants to individuals, are impermissible with a DAF.”

M. There is no tax-policy reason for Congress to interfere with the success that its 2006 actions helped to create. Substituting government judgment for charity boards’ and each donor’s judgments is not “the American way” of philanthropy. Instead, Americans “let 1,000 flowers bloom” rather than having government direct which flowers should be watered with contributions. As Representative Utt said in the 1969 legislation history, “Private philanthropy has shown imagination and creativity in dealing with many of our pressing problems . . . [the Tax Reform Act of 1969] may result in many activities that are now reserved to our private sector becoming the responsibility of Government . . . . These results would not be healthy for our free-enterprise system.”

Let’s be clear about what is happening here: Members of the critic cohort are urging Congress to override two bedrock principles of American philanthropy, i.e., that (1) the donor knows better than government to which public charity to give her contribution, and (2) the recipient charity—here the sponsoring organization—knows better than government what policies to apply as to how and when to spend that contribution once it is received.

I have worked in France, Switzerland, England, and other countries trying to make their charitable-giving laws more like America’s. During those meetings I have heard over and over again that our charitable sector is deeply admired. In October 2014 in Geneva, I spoke on a multi-country panel to educate Swiss government and policy officials. We compared aspects of charitable giving law in the U.S., France, England, and Switzerland. All of the speakers mentioned the balance struck by U.S. law to encourage contributions of cash, securities, real estate, and tangible personal property by donors to charities while at the same time creating reasonable performance requirements for the charities that receive those contributions. The speakers pointed out that in other countries, government bears the costs of much of what nonprofits do in the United States. In contrast, the American third sector is seen as generous, innovative, and diversified, traits universally admired as the gold standard of global philanthropy.

U.S. tax law governing charitable deductions and operations has existed for almost a century now and been flexible enough to let philanthropy develop and flourish, including the flourishing of DAFs over the past 65 years. Clearly, today’s post-PPA donors are giving more through DAFs, making DAF-giving one of American philanthropy’s greatest successes.

And the magic is that DAF grants come in all sizes from donor-advisors all across our country and from all strata of our society. Public charities in my experience welcome DAF grants.

I asked the Senior Vice President for Development of Robin Hood, a public charity that funds the most effective grassroots organizations fighting poverty in New York City, about Robin Hood’s experience with DAFs over time. She wrote back:

Since 2009, Robin Hood has seen a 330% increase in the number of donors giving from DAFs, more than doubling total funds received from these accounts.

In the aftermath of Superstorm Sandy, the majority of relief money Robin Hood received was from the 12/12/12 concert. Of the $21.1M in non-concert Sandy-relief gifts, $1.7M was from DAFs. In 2009, 82 donors gave 106 gifts from DAFs for a total of $6.7M.

In 2014, 271 donors gave 328 gifts from DAFs for a total of $17.5M.\(^{56}\)

We all agree that the online ease and convenience of DAF grant making is a more and more popular way for donors to respond to charitable solicitations (sometimes anonymously for religious reasons or to be shielded from solicitors) and sometimes to avoid having to collect, file, and produce a myriad of substantiation letters.

DAF apps and widgets like “Donor Direct” are further simplifying and speeding up grants from DAFs. By clicking on a public charity’s website’s “Donor Direct” button, a donor-advisor can electronically advise a great to the pre-vetted charity if she is moved to donate at a charity event or in response to an ad or to a solicitation email. These efficiencies appeal to today’s donors who are used to shopping, paying bills, keeping tax records, and banking online.

Numerous smaller donors can quickly and non-bureaucratically provide funding to charities when elite institutions can’t or won’t act. For example, we are all aware of the increasingly urgent cries for help in 2014 from Doctors Without Borders on the spread of Ebola in Africa. So what charity was the most-advised recipient at the Fidelity Charitable Gift Fund in 2014? It was Doctors Without Borders. Doctors Without Borders appealed worldwide for immediate cash to fight the epidemic. Fidelity Charitable reports that Doctors Without Borders received grants advised from more than 4,000 different DAF accounts.\(^{57}\)

\(^{56}\) Email from Krissy Sudano to the author dated Aug. 12, 2015.

\(^{57}\) 2015 Fidelity Charitable Giving Report at 6 and note 8.
have been given currently from those 4,000+ donors’ individual checking accounts? I think that having the money already committed to charity in a DAF allowed the average donor to respond to news reports with a click or a tap, immediately launching an advised grant to meet this extraordinary need, to which agencies and governments were so late to respond.\footnote{For more on DAFs in charitable rapid response, see Howard Husock, “Nepal Response Shows Why Donor-Advised Funds Are a Boon to Philanthropy,” The Chronicle of Philanthropy (May 1, 2015).}

By and large Congress, the federal government, and state charities officials have allowed charities to be governed by their Boards with interventions by regulators only when a small percentage misbehave (such as National Heritage, a sponsoring organization which lost its tax exemption) or under-perform (as Senator Grassley has asked about the American Red Cross’s expenditure of funds in Haiti). Similarly, government has longstanding rules governing the timing of and limits on charitable contribution deductions that vary not on the mission of the recipient charity but on whether it is classified by law as a public charity or as a private foundation.

Since 2006 and the clarification of the law applicable to DAFs, sponsoring organizations and their donors do not appear to be an area the press or the field have identified as ripe with misbehavior.\footnote{See text accompanying footnote 3 for Rick Cohen’s comments on this point.}

So, let’s get DAF Treasury Regulations and watch DAFs operate under those regulations before we let anyone experiment with this wonderful means of charitable giving. Let’s let DAF giving continue its success, not penalize it for having been successful and legitimized by Congress. Let’s let regular people feel empowered to choose and use DAFs. Let’s not over-regulate the middle-class way to give strategically, forcing everyone who wants the advantages of DAFs into private-foundation-like or actual private-foundation solutions. Let’s not assert in the absence of proof that DAF donors want perpetuity.

In closing, it is useful to consider how our predecessors viewed Congressional intervention in charitable giving. Reflecting on enactment of the Tax Reform Act of 1969, Representative James B. Utt (R, CA) offered the following “Separate View” attached to the House Ways and Means Committee Report:

“The committee’s action in connection with charitable gifts may have an adverse impact on private philanthropy. Private philanthropy has shown imagination and creativity in dealing with many of our pressing problems.

“The growing reliance on Government to solve all our problems is not healthy. The committee’s bill may result in many activities that are now re-
served to our private sector becoming the responsibility of Government . . . These results would not be healthy for our free-enterprise system.”

DAFs have resonated over the decades with hundreds of thousands of Americans and resonate now more than ever in our online age. DAFs make low-cost strategic philanthropy available to all Americans. Giving to and advising from DAFs has never been higher. Congress should not interfere with the success that its 2006 actions helped to create.

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