GETTING DONOR-ADVISED FUNDS REGULATION RIGHT: CLOSING THE PUBLIC SUPPORT TEST LOOPHOLE

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Donor-Advised Funds ("DAFs") have been the subject of vigorous critical scholarship in the past two decades. This Article addresses two timely issues in DAF regulation: the theoretical justifications for extra strict regulation of DAFs, and, in light of those justifications, how to close a major loophole in the regulatory scheme. DAFs have been called "virtual private foundations" because they are similar in some respects to private foundations, but until two decades ago, they were treated for legal purposes as public charities. In 2006, Congress enacted legislation that both formally recognized DAFs for the first time and subjected them to several new regulatory burdens that do not apply to other public charities, although they remain classified as public charities for legal purposes. In some cases, Congress subjected DAFs to the same regulatory burdens that apply to private foundations, while in others, it continued to permit DAFs to enjoy the more lenient regulatory burden and generous tax benefits that apply to public charities. But for certain situations, Congress crafted a new regulatory regime for DAFs that was more restrictive than the one that already existed for private foundations. There has been commentary about the justifications for subjecting DAFs to the private foundation rules and continuing to permit DAFs' public charity treatment, but to date, there has been no significant scholarly discussion of the justifications for holding DAFs to a higher standard than private foundations. This issue has become

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urgent because the Treasury Department released Proposed Regulations in November 2023 that included new, especially strict rules for DAFs.

This Article argues that this extra strict regime for only some aspects of DAFs is beneficial, not because DAFs are especially susceptible to abuse the way private foundations are, but because these rules provide bright lines that enable DAF providers to reduce costs and make charitable giving more efficient. Understanding this benefit of the extra strict regime has implications for the regulation of DAFs. Specifically, there is an egregious remaining loophole—the "public support test" or "conduit" loophole—in the regime that enables donors to pass donations through DAFs to privately controlled charities. It is essential for forthcoming Treasury Regulations or new legislation to close this loophole. This Article examines how this loophole should be closed.

Introduction

Donor-Advised Funds ("DAFs") are the fastest growing charitable vehicle in the nonprofit sector. Since they were first formally recognized in the Internal Revenue Code in 2006, they have grown from relative obscurity to prominence. In 2023, assets in DAF accounts grew to an all-time high of $326 billion, and contributions were at an all-time high of $89.64 billion.[1] This growth is remarkable at least partially because DAFs arguably do not actually do anything themselves. They are a "fund" held by a sponsoring organization ("sponsor"), into which people make charitable donations and out of which the sponsor makes grants to other charities.[2] The sponsor is the owner of the fund and formally makes the grants out of it, but the donor retains the right to "advise" the sponsor on when to make a grant and to which charity, with the sponsor almost always following the donor's advice. Until a donor advises the sponsor to make a grant, the donated funds generally are invested by the sponsor and retained in the DAF, growing in value. So, a DAF is really nothing more than an intermediary between the person's charitable donation and the ultimate charitable recipient of the funds. It appears to be just an extra step, which raises the question: Why is it so popular?

DAFs have been around since the early part of the twentieth century, but for decades they were largely the province of community foundations, and they muddled along as a relatively small segment of overall charitable giving. In the 1990s, huge consumer-facing financial services companies, starting with Fidelity, created affiliated charitable organizations to sponsor DAFs. They began marketing these DAF sponsors to their retail clients as a streamlined and tax efficient way to give to charity. These commercially affiliated DAF sponsors produced explosive growth in the sector, and critics began to sound alarms that these entities, which were effectively virtual private foundations, could be used to get the benefits of private foundations without the enhanced regulation to which private foundations are subject. In 2006, Congress responded with provisions in the Pension Protection Act ("2006 PPA") that subjected DAF sponsors to rules about self-dealing and noncharitable distributions that are more stringent than those that apply to private foundations and rules with respect to excess business holdings that are equally stringent.[3] In other words, Congress responded to certain

1. *See* DAF RSCH. COLLABORATIVE, THE ANNUAL DAF REPORT 2025, at 17, 15 (2025) [hereinafter 2025 DAF REPORT]; *see also* H. Daniel Heist et al., *Understanding the Donor-Advised Fund Giving Process: Insights from Current DAF Users*, 51 NONPROFIT & VOLUNTARY SECTOR Q. 327, 328 (2022) ("DAFs are the fastest growing form of philanthropy in the United States.").

2. Just to be clear, I use the term "donor-advised fund" or "DAF" to refer to the *fund*, even though that is likely just an accounting practice in the financial records of a charitable organization. The organization is called the "DAF sponsor," the "sponsoring organization," or just the "sponsor."

3. The 2006 PPA also addressed so-called "jeopardy investments" by DAFs, but those provisions are beyond the scope of this Article. *See* Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780.

perceived abusive uses of DAFs by constraining their flexibility more than, or as much as, private foundations. But at the same time, Congress chose to retain certain benefits for DAF sponsors that are not available to private foundations. Most notably, compared to private foundations, it did not require that DAFs (and DAF sponsors) make grants on any particular timetable, permitted donors of illiquid property to DAFs to get a more favorable tax deduction, and permitted DAF donors to maintain their anonymity more easily. This bargain that Congress made in 2006 has not appeared to slow the growth of DAFs. On the contrary, their growth accelerated in the years following the 2006 PPA.[4]

Sponsoring organizations and DAF boosters have good explanations for why so many people make their charitable contributions through DAFs. They argue that DAFs make contributing to charities easier, and therefore more efficient, for many people for a number of important reasons. For very large donors, many of these benefits can be obtained by creating a private foundation. But for somewhat smaller donors, the administrative costs of running a private foundation are high enough that it is inefficient to create and manage one. DAFs create the ability for a large organization to provide administrative services—some quite complex and specialized—at a low cost. Indeed, one pragmatic reason that DAFs have grown in recent years is that some of the largest asset management firms in the country, like Fidelity, Vanguard, and Schwab, have begun offering products that streamline the creation of DAFs for their clients. In this sense, DAF sponsors create value for donors in the same ways that large retail investment management companies provide value for their customers—by centralizing complicated functions and competing to provide high-quality, low-cost services. One example of a benefit to donors is the way that DAFs facilitate the donation of publicly traded stock.[5] If the donor ultimately wants to support many charities

4. I know of no evidence that the enactment of the 2006 PPA *caused* the rapid growth of the DAF sector.

5. *See* James Andreoni, Nat'l Bureau of Econ. Rsch., The Benefits and Costs of Advised Funds 9 (2017). As discussed below, the tax treatment of publicly traded stock is the same for donors to public charities and private foundations, so donors could obtain the tax benefits associated with donating publicly traded stock by creating a private foundation if it were economically efficient for them to do so. However, the donation of *illiquid* property (other than publicly traded stock) does not produce the same tax benefits when made to private foundations. So the preference for DAFs in those donations involves not just the savings obtained by forgoing the costs of creating a private foundation, but also a kind of regulatory arbitrage (for want of a better term) in using a DAF, i.e., a "private-foundation-like" entity that functions akin to a public charity in its ability to get a more beneficial tax treatment of contributions of illiquid property. The treatment of donations of illiquid property other than publicly traded securities is beyond the scope of this Article, though I hope to address it in future work.

with relatively small donations, it may be much simpler to donate a single block of stock to a DAF sponsor and then make smaller distributions to individual operating charities, rather than to try to persuade each charity to accept and convert individual stock donations.[6] One study found that DAF donors value other perceived benefits of DAFs. For example, many DAF donors cited the ability to give to charities anonymously as a benefit, expressing a desire to avoid "subsequent solicitations" from charitable beneficiaries, other charities, or even scammers.[7] That same study cited the ability to separate the choice to donate money (and the timing and amount of such donations) from the choice of ultimate beneficiary as a benefit.[8] Some donors may want to use DAFs to create an institutional charitable funding vehicle "as a tool to encourage next generation participation in family philanthropy."[9] Finally, one obvious benefit—at least with respect to those DAF sponsors who are affiliated with major commercial money management firms—is that having affiliated DAF sponsors creates incentives for the money management firms to market charitable giving to their clients and to make it as easy as possible to transfer assets under their management to their DAF sponsor affiliate.[10] Some argue that this close link between charity and money manager smooths the giving experience for donors and may even increase overall charitable giving, although there does not appear to be any rigorous support for the idea that it actually does this.[11]

Critics of DAFs also have explanations of what makes DAFs so popular, but their explanations are more sinister. In the early 2000s, DAF critics argued that DAFs were being used by donors to avoid

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6. *See id.* at 4 (describing how DAFs accept non-cash contributions and then convert them into cash for distribution to smaller active charities).

7. Heist et al., *supra* note 1, at 338–39 (quoting one respondent as saying, "I think once your name gets out there having given a certain amount, the number of people that start calling you is really overwhelming"). This benefit is largely unavailable to donors to private foundations.

8. *Id.* at 341–42.

9. *Id.* at 343.

10. Obviously, this benefit is also a potential detriment, since the incentive is presumably for the money management firm to keep those assets under management in the DAF sponsor once they have been distributed to it. *See, e.g.*, Alan Cantor, *Who Is Blocking DAF Reform?*, PHILANTHROPY PROJECT (Mar. 28, 2023), https://philanthropyproject.net/who-is-blocking-daf-reform/ [https://perma.cc/C6Y2-3AWZ].

11. *See* ANDREONI, *supra* note 5, at 16–17 (arguing that DAFs are only beneficial if donors give more or give sooner because of them).

restrictions on private foundations in a sort of regulatory arbitrage. They argued that DAFs are functionally similar to private foundations, but treated as public charities under the law, thus creating a "loophole" to avoid the restrictions that were put in place more than five decades ago to prevent abuses by private foundations. These criticisms included concerns that donors were using DAFs to enrich themselves or their families out of their charitable contributions, to make improper expenditures that private foundations would be prohibited from making, and to maintain continuing control over family business assets.[12] Critics also complained about the fact that donors can make tax deductible contributions to DAFs without their contributions making their way to actual operating charities on any mandatory timeline, avoiding the distribution requirements that apply to private foundations—a problem Roger Colinvaux has called the "delayed benefit problem."[13] They also expressed concern about a variety of ways that DAFs facilitate anonymous giving more easily than private foundations and the fact that they have more generous tax deductions for contributions of illiquid property. The 2006 PPA vigorously addressed some of the non-temporal abusive uses of DAFs (self-dealing, noncharitable expenditures, excess business holdings) but did not impose any new rules on when or how quickly DAF sponsors were required to distribute assets held in DAFs, nor did it apply the private foundation rules with respect to donor anonymity or tax treatment of donations of property. Critics dramatically increased their calls for reform, and while some continued to argue that DAFs were vehicles for nontemporal abuses,[14] the vast majority of scholarly

12. *See, e.g.*, *Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities: Hearing Before the S. Fin. Comm.*, 108th Cong. 93 (2004) [hereinafter *Charity Oversight and Reform Hearing*] (statement of Diana Aviv, President & CEO, Indep. Sector) ("A few individuals and corporations have, however, taken advantage of the lack of clear legal requirements for donor-advised funds and used those funds for personal gain."). Ms. Aviv additionally mentioned that both Presidents Bush and Clinton "offered legislative proposals . . . to make it easy to use donor-advised funds, encourage the growth of these philanthropic vehicles, and minimize possible abuses with regard to benefits to donors and their advisors." *Id.*; *see also id.* at 142 (statement of Mark Everson, Comm'r, I.R.S.) ("[W]e are aware that some promoters [of donor-advised funds] encourage clients to donate funds and then use those funds to pay personal expenses, which might include school expenses for the donor's children, payments for the donor's own 'volunteer work', and loans back to the donor. We have over 100 individuals under audit in connection with such cases.").

13. Roger Colinvaux, *Speeding Up Benefits to Charity by Reforming Gifts to Intermediaries*, 63 B.C. L. Rev. 2621, 2632 (2022) [hereinafter Colinvaux (2022)]; *see also* Samuel D. Brunson, *"I'd Gladly Pay You Tuesday for a [Tax Deduction] Today": Donor-Advised Funds and the Deferral of Charity*, 55 Wake Forest L. Rev. 245, 247 (2020).

14. *See, e.g.*, Helen Flannery & Brian Mittendorf, Reshaping Charity Channels: How Assets Flow in and out of Donor-Advised Funds 2 (Fisher Coll. Bus., Working Paper,

and popular criticism of DAFs since 2006 has focused on the delayed benefit problem and, to a lesser degree, on anonymity.[15]

So, which is it? Are donor-advised funds primarily beneficial funding vehicles designed to make donating more appealing and efficient, and therefore increase the total amount of money available to charities? Or are they primarily mechanisms to take advantage of a loophole in the regulation of charities so donors can capture for themselves an excessive benefit when they use this vehicle? While there are not (yet) good data to support a conclusion, one possibility is that DAFs currently function as both things—usually the dominant benefit is good old economic efficiency, but sometimes it is abusive regulatory arbitrage. In other words, for regular retail donors (generally, those whose annual donations are in the low six figures), DAFs offer significant, legitimate benefits because they reduce the transaction costs of charitable giving. But for some donors, DAFs may provide opportunities to improperly avoid certain aspects of the private foundation rules in ways that undermine the charitable giving legal regime. It is surely not always the case, but it is likely that abusive donors are almost exclusively to be found among those who are donating very large amounts, that is, those for whom it would be relatively economically efficient to create a private foundation to serve as their charitable contribution intermediary entity.

2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4683236; Ann Charles Watts, *The Wolf in Charity's Clothing: Behavioral Economics and the Case for Donor-Advised Fund Reform*, 43 U. DAYTON L. REV. 417, 424 (2018).

15. Scholarly attention includes ANDREONI, *supra* note 5; Roger Colinvaux, *Donor-Advised Funds: Charitable Spending Vehicles for 21st Century Philanthropy*, 92 WASH. L. REV. 39 (2017) [hereinafter Colinvaux (2017)]; Ray Madoff, *The Five Percent Fig Leaf*, 17 PITT. TAX REV. 341 (2020); Ray Madoff & Roger Colinvaux, *Charitable Reform for the 21st Century*, 164 TAX NOTES 1867 (2019); Ray Madoff, *5 Myths About Payout Rules for Donor-Advised Funds*, CHRON. OF PHIL. (Jan. 13, 2014), https://www.philanthropy.com/article/5-myths-about-payout-rules-for-donor-advised-funds/?sra=true [https://perma.cc/6GEQ-4V94]; MOLLY F. SHERLOCK & JANE G. GRAVELLE, CONG. RSCH. SERV., R42595, AN ANALYSIS OF CHARITABLE GIVING AND DONOR ADVISED FUNDS (2012); Edward A. Zelinsky, *A Response to the Initiative to Accelerate Charitable Giving*, TAX NOTES (Feb. 1, 2021), https://www.taxnotes.com/featured-analysis/response-initiative-accelerate-charitable-giving/2021/01/28/2l7qh [https://perma.cc/JLH6-8QKR]; Edward A. Zelinksy, *The Biden Proposals on Private Foundations Should Go Further*, TAX NOTES (May 3, 2023), https://www.taxnotes.com/tax-notes-today-federal/charitable-giving/biden-proposals-private-foundations-should-go-further/2023/05/03/7g8yn [https://perma.cc/E96X-MWRY]. Examples of attention to the delayed benefit problem in the press include David Gelles, *How Tech Billionaires Hack Their Taxes With a Philanthropic Loophole*, N.Y. TIMES (Aug. 3, 2018), https://www.nytimes.com/2018/08/03/business/donor-advised-funds-tech-tax.html. [https://perma.cc/9MYH-2W2Z]. For a systematic discussion of the tax treatment of contributions of property, see Roger Colinvaux, *Charitable Contributions of Property: A Broken System Reimagined*, 50 HARV. J. ON LEGIS. 263, 329 (2013) [hereinafter Colinvaux (2013)].

In this Article, I avoid a detailed discussion of the issue that has received the most scholarly and popular attention—the delayed benefit problem. Instead, I focus on other pressing areas of concern. First, I explore the most traditional form of abuse of the charitable sector: self-dealing. Self-dealing occurs when people who are in a position to influence a charity use the charity or its assets to enrich themselves or their family. Second, I turn my attention to noncharitable expenditures. Noncharitable expenditures resemble self-dealing in that the charity is used to advance some purpose other than its specific charitable mission, but they differ because that other purpose is not the enrichment of anyone who influences the charity. An important example of a noncharitable expenditure is an expenditure made to influence legislation (i.e., lobbying) by a charity. Finally, I briefly discuss excess business holdings, referencing the rule that prevents private foundations from owning significant stakes in their donors' businesses. In U.S. charity law, the rules about self-dealing, noncharitable expenditures and excess business holdings depend on the form of the charity, with generally stricter laws applying to private foundations and laxer rules applying to public charities. In 2006, Congress chose to apply some of the private foundation rules to DAFs; to impose new, stricter rules on some acts of self-dealing and noncharitable expenditures, creating a new heightened regulatory regime for DAFs; and to leave in place the permissive public charity rules about distribution timing, anonymity, and tax benefits for contributions of property with respect to DAFs.

I argue that the heightened regulatory regime that the 2006 PPA applies to DAF self-dealing and noncharitable distributions is beneficial for donors who do not plan to use DAFs in abusive ways. For these donors, extra strict laws provide bright lines that enable DAF sponsors to make clear rules that reduce costs and make charitable giving more efficient. But the application of these rules is still very much a work in progress, especially as the 2006 PPA directed the Treasury Department to issue regulations interpreting this strict regime and it is only starting to release these regulations now. A literal reading of the 2006 PPA leaves some "loopholes" or omissions in the application of the "extra strict" regime that prevent it from functioning effectively. The clearest example of a remaining regulatory omission is the so-called "public support test" (or "conduit strategy") loophole. This loophole must be closed to protect against abuse of the DAF sector by those who seek exactly the kinds of personal benefits that the limits on self-dealing, noncharitable expenditures, and excess business holdings seek to prevent. The conduit strategy enables donors to avoid the regulatory regimes that apply to both private foundations and donor-advised funds merely by passing their donations *through* a donor-advised fund. The charity that receives their donation after it has passed through the donor-advised fund can be completely controlled by the donor but is treated under current law as if it were broadly supported by the general public. This strategy obviously distorts the regulatory regime. Public reporting has identified at least one example of a prominent political donor who appears to have leveraged this loophole to his benefit.[16]

But even with respect to this urgent reform, there are multiple ways to close the loophole, and understanding the theoretical justifications for extra strict regulation of DAF abuse—and a sensitivity to the significant benefits of DAFs—helps one evaluate which specific way is best. Closing this loophole in ways sensitive to the purposes of the anti-abuse regime could constitute an improvement on the "new bargain" that the 2006 PPA instituted without changing its essential character. The IRS and Treasury Department, through proposed regulations, and members of Congress, through proposed legislation, have suggested one mechanism for closing the loophole. But their proposals have been opposed by others, including the American Institute of CPAs.[17]

This Article proceeds in four parts. Part I provides a background to the regulation of donor-advised funds, rooting them in the history of regulatory reforms of the tax-exempt sector, especially the regulation of private foundations. Part II explores in greater detail the benefits of DAFs for retail donors and distinguishes those benefits from some that arise from regulatory arbitrage. Part III explains in detail the current law as it relates to abuses of donor-advised funds. Finally, Part IV discusses how to close the public support test loophole consistent with the theoretical framework presented in this Article. In this final part, I explain and analyze three potential mechanisms for closing the loophole and endorse the mechanism that has been proposed by the IRS, Treasury Department, and Congress.

I. Background

To understand DAFs and their sponsors, it is necessary to understand the distinction made by Congress between "private foundations" and "public charities." This is because DAFs occupy a sort of middle ground between the two, generally treated under the law as public charities, even as they have been designed to offer many of the benefits traditionally associated with private foundations. In general, DAF sponsors, like private foundations, function as charitable

16. *See infra* Section III.D.2
17. *See infra* Section IV.C

intermediaries, not charitable actors.[18] Unlike private foundations, DAF sponsors have multiple unrelated funders (although each individual DAF is likely to have one or a few related funders). That means that, at least theoretically, the organization itself is not beholden to any single donor, while the choice of grant recipient is largely delegated to the funders of each DAF account with respect to the funds they have donated. Since 2006, some (but not all) of the restrictions that apply to private foundations have been extended to DAFs, and some new even more restrictive rules have been created, accentuating the complexity of DAFs' hybrid legal treatment.

The story is well told how Congress grew wary of certain charities controlled by wealthy philanthropists and, starting in 1950,[19] began carving out a separate legal category of charities called "private foundations."[20] Most of these legislative changes appeared in the Tax Reform Act of 1969, and they subjected private foundations to substantially different legal treatment from other "public" charities.[21] Dana Brakman Reiser and Steven A. Dean explain that, by 1969, Congress responded to "blistering criticism of the philanthropic sector" by distinguishing two categories of charities. It largely preserved the autonomy and loose regulation of what came to be called "public charities," but it subjected "private foundations" to stricter regulation. The general characteristics of private foundations were that they were "supported by a small number of donors, substantial investment

18. *See* Johnny Rex Buckles, *Should Private Foundation Excise Taxes on Failure to Distribute Income Generally Apply to 'Private Foundation Substitutes? Evaluating the Taxation of Various Models of Charitable Entities*, 44 New Eng. L. Rev. 493 (2010) (creating a typology of private foundations, public charities, and private foundation substitutes that emphasizes both extent of public support and whether the entity provides charitable services directly or acts as an intermediary). Some DAF sponsoring organizations both conduct substantial charitable activities directly and hold DAFs as philanthropic intermediaries. For example, Stanford University (among many other universities) holds DAF accounts as well as runs a university. *See, e.g.*, *Donor Advised Funds*, Stan. Giving, https://giving.stanford.edu/planned-giving/donor-advised-funds/ [https://perma.cc/59B3-LG6K].

19. For a discussion of the history of these reforms, see Thomas A. Troyer, *The 1969 Private Foundation Law: Historical Perspective on its Origins and Underpinnings*, 27 Exempt Org. Tax Rev. 52, 53–54 (2000).

20. *See* Dana Brakman Reiser & Steven A. Dean, For-Profit Philanthropy: Elite Power and the Threat of Limited Liability Companies, Donor-Advised Funds, and Strategic Corporate Giving 7–8, 113–46 (2023) (calling the new regulatory regime for private foundations the "Grand Bargain"); Harvey P. Dale, *Standards for Exemption: Inurement, Private Benefit, and Excess Benefit Transactions*, 59 Real Prop., Tr. & Est. L. J. 1 (2024); James J. Fishman, *The Private Foundation Rules at Fifty: How Did We Get Them and Do They Meet Current Needs?*, 17 Pitt. Tax Rev. 247 (2020).

21. *See* Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487 (1969).

income, or both and pursu[ed] charitable purposes through grantmaking rather than direct operations."[22] Congress wanted to balance the good that was done when these philanthropic vehicles provided resources to the charitable sector against the "grave threats" that legislators perceived from their "freedom from public control and entanglement with business."[23] Legislators were less concerned about public charities because they believed that such organizations needed less government oversight since their diverse stakeholders provided a greater degree of private oversight.[24] In order to balance the good with the bad, Congress enacted what Reiser and Dean describe as three categories of new restrictions on private foundations: *timing* rules that require private foundations to distribute or spend a percentage of their assets every year,[25] *targeting* rules that prevent perceived abuses associated with self-dealing and noncharitable uses of funds, and *transparency* rules that facilitate greater public accountability of these more dangerous charitable entities. These reforms sought to protect the public interest, but, nonetheless, through them, "elite donors retained substantial philanthropic autonomy and a powerful tool to bolster their reputations."[26]

Under current law, legal rules that apply to private foundations but not public charities include: a lower cap for private foundations on the percentage of income a donor can deduct as contributions in any year;[27] an even lower cap on contributions of certain capital gain

22. *See* Reiser & Dean, *supra* note 20, at 7.

23. *See id.*

24. *See, e.g.*, Buckles, *supra* note 18, at 511 ("[A public] charity's reliance on support from the general public obviates the need for the tax system to restrict or otherwise regulate distributions beyond the most basic requirements of tax exemption."); Roger Colinvaux, *Charity in the 21st Century: Trending Toward Decay*, 11 Fla. Tax Rev. 1, 54 (2011) [hereinafter Colinvaux (2011)] ("The theory is that all such 'public' organizations will be overseen effectively by their donor or service-based community."); Jill S. Manny, Unbashing the DAF 5–6 (June 5, 2023) (unpublished manuscript), https://ssrn.com/abstract=5045671 ("So, in a sense, the public polices public charities but not private foundations."). *See also*, Benjamin Moses Leff, *The Case Against For-Profit Charity*, 42 Seton Hall L. Rev. 819 (2012) (explaining the theory that nonprofit agency costs are reduced when organizations have diverse interested stakeholders including multiple donors).

25. With respect to the "bargain" over timing, Thomas Troyer has explained that Senator Albert Gore Sr. "pressed vigorously for a 25 year limit on the lives of foundations" but that a lively debate on the floor of the Senate led to a "decisive defeat[]" to any limit on the perpetuity of foundations. *See* Troyer, *supra* note 19, at 62.

26. Reiser & Dean, *supra* note 20, at 8 ("Philanthropists also beat back pressure to limit foundations' lifetimes, safeguarding the privilege of perpetuity for donors keen to use philanthropy to achieve immortality.").

27. I.R.C. § 170(b)(1)(B).

property;[28] an inability for donors to deduct the fair-market value of donated capital gain property other than publicly traded securities;[29] a small tax on investment returns;[30] more restrictive treatment of self-dealing transactions;[31] a requirement to make minimum distributions to operating charities every year;[32] a prohibition on perpetual ownership of a substantial interest in any business;[33] a limitation on certain "risky" investments;[34] a mandatory due diligence process when making grants to individuals or any organization that is not a public charity;[35] an absolute prohibition on influencing legislation;[36] special strict rules for voter registration drives, even if nonpartisan;[37] special strict rules for grants to individuals, including scholarships, which require precertification with the IRS;[38] and a more comprehensive annual information return.[39] In sum, there are multiple ways that the Internal Revenue Code favors public charities over private foundations. The Treasury Department summarized the difference by saying, "[g]enerally, in exchange for less restrictive rules governing transactions with insiders, more generous charitable contribution deduction limits, and no distribution requirements, donors to public charities give up all control over the donated assets and generally do not control the charity."[40]

But, of course, donors don't give up *all* control over assets donated to public charities; there are many ways they continue to influence, if not directly control, the use of those assets.[41] Sometimes donors continue to influence public charities by having direct positions of power in them,

28. *Id.* § 170(b)(1)(D).
29. *Id.* § 170(e)(1); *id.* § 170(e)(5) (exception for publicly traded securities).
30. *Id.* § 4940.
31. *Id.* § 4941.
32. *Id.* § 4942.
33. *Id.* § 4943.
34. *Id.* § 4944.
35. *Id.* § 4945(d)(4)(B).
36. *Id.* § 4945(d)(1).
37. *Id.* § 4945(f).
38. *Id.* § 4945(g).
39. I.R.S. Schedule B (Form 990). For a succinct summary of the differences between the regulation of public charities and private foundations, see U.S. Dept. of Treas., Report to Congress on Supporting Organizations and Donor Advised Funds 12–13 (2011).
40. *Id.* at 13; *see also* Colinvaux (2011), *supra* note 24, at 55 ("Operationally, a comprehensive anti-abuse regime—a series of negative restrictions—applies to private foundations, and is enforced by stiff excise taxes. The anti-abuse rules target four areas: self-dealing between the foundation and foundation insiders, excessive ownership of a for-profit business, the making of risky investments, and spending for non-charitable purposes.").
41. *See generally* Roger Colinvaux, *Strings Are Attached: Shining A Spotlight on the Hidden Subsidy for Perpetual Donor Limits on Gifts*, 56 Loy. L.A. L. Rev. 1169 (2023).

like being directors, officers, or managers of them. Sometimes donors influence the use of donated assets by having express gift agreements that limit the ways those donated assets can be spent, for example by restricting their gift to use only in "endowments," which bind the recipient from using the vast majority of the donated funds forever. The most common way that donors influence the use of donated assets is by choosing to make future donations to organizations that use previous donations in ways the donor likes. It's remarkable (but should not be surprising) how effective this softest kind of "control" can be. Finally, donors sometimes use legal entities that blur the line between private foundations and public charities in order to maximize the benefits available to them under the law.

One long-standing instrument that blurs the line between private foundations and public charities is the donor-advised fund.[42] The New York Community Trust is credited with inventing the donor-advised fund in 1931, but many large community foundations were created in the first half of the twentieth century, and many of them had structures like modern donor-advised funds.[43] Thanks to lobbying by these community foundations, DAF sponsors were not included in the definition of private foundations in the 1969 legislation.[44] DAFs were largely the province of community foundations until 1987 when the National Foundation, Inc. (NFI) persuaded the U.S. Claims Court to declare that it qualified as tax-exempt,[45] after which the DAF model was increasingly adopted by organizations other than community foundations.[46] Fidelity was the first major consumer-facing financial services company to create a donor-advised fund sponsoring organization, the Fidelity Charitable Gift Fund,

42. The other important "intermediate" legal entity is the "supporting organization." *See* I.R.C. § 509(a)(3). Any discussion of supporting organizations is beyond the scope of this Article, but Buckles, *supra* note 18, provides an excellent discussion of both supporting organizations and donor-advised funds. Other possible private-foundation substitutes include for-profit entities, like philanthropic LLCs, purpose trusts, and others, which are also beyond the scope of this Article. *See generally* REISER & DEAN, *supra* note 20.

43. *See* REISER & DEAN, *supra* note 20, at 53. Much credit is also often given to the Cleveland Jewish Community Federation. *See, e.g.*, LILA CORWIN BERMAN, THE AMERICAN JEWISH PHILANTHROPIC COMPLEX 75–80 (Princeton U. Press 2020); REISER & DEAN, *supra* note 20, at 55 (citing the private letter ruling obtained by the Cleveland Jewish Federation in 1970).

44. *See* REISER & DEAN, *supra* note 20, at 54 ("Their liminal status arguably should have resulted in private foundation treatment for community foundations, but a little luck and a lot of advocacy prevented that."); Treas. Reg. § 1.170A (1969).

45. Nat'l Found., Inc. v. U.S., 13 Ct. Cl. 486 (1987).

46. REISER & DEAN, *supra* note 20, at 61.

in 1991, which has grown into the largest charity in the country.[47] But other financial services companies were close behind in creating their own DAF sponsors,[48] and two others, Schwab and Vanguard, are now among the five largest charities by annual donation.[49] The rise of these "commercially-affiliated" DAF sponsors spawned increased concern among DAF critics in the early 2000s, and these criticisms joined growing concern about a host of other abuses in the nonprofit sector.[50]

Congress held hearings in 2004,[51] which led to extensive legislation in the 2006 PPA.[52] In general, "[t]he rules are animated by concerns about donor control and the abuse that can result."[53] In effect, Congress addressed many (but not all) of the areas that warrant additional regulation of private foundations over public charities.[54] For example, the 2006 PPA addressed potential self-dealing by tightening treatment of "excess benefit transactions" for DAFs and their sponsors. It addressed concerns about noncharitable distributions by curtailing

47. For a chart showing $15,197,000,000 in contributions to the Fidelity Charitable Gift Fund in 2022, the most to any charity in that year, see Helen Flannery, *Ten of America's 20 Top Charities Are Donor-Advised Funds*, INST. FOR POL'Y STUD. (May 8, 2024), https://ips-dc.org/ten-of-americas-20-top-public-charities-are-donor-advised-funds/ [https://perma.cc/EMU9-5DEW].

48. REISER & DEAN, *supra* note 20, at 63 (noting that Vanguard (1997), Schwab (1999), and Goldman Sachs (2001) were early adopters).

49. Charity sizes are measured by annual donations in 2022. *See* Flannery, *supra* note 47.

50. MARION FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS 13 (Harv. U. Press 2004) ("A resurgence of criticism of foundations in 2003 was reminiscent of the concerns expressed in the 1960s."). Note that after the Senate Finance Committee hearings in 2004, Independent Sector convened an industry panel (at the request of Senator Grassley), which Marion co-chaired. Colinvaux provides a description of the pre-reform critique: "[T]he donor advised fund is not subject to the private foundation anti-abuse legal regime. Accordingly, it is a magnet for potential abuse. Without proper oversight by the charity housing the fund, donors may be able to use a donor advised fund to pay personal expenses, compensation, and even to dilute the meaning of charity. . . . [T]hey had long been a subject of discussion in government and by legal practitioners, and increasingly had become a tool of promoters trading in tax schemes." Colinvaux (2011), *supra* note 24, at 33.

51. *Charity Oversight and Reform Hearing*, *supra* note 12. For a discussion of the hearings that preceded the enactment of the 2006 PPA, see Lisa G. Page, *Donor-Advised Funds and Disqualified Persons: Understanding the Logic of Code Section 4958(c)(2)*, 59 REAL PROP., TR., & EST. L. J. 45, 52–54 (2024).

52. Colinvaux (2017), *supra* note 15, at 50 (providing a list of the changes to the I.R.C. relating to DAFs made by the 2006 PPA: §§ 170(f)(18), 508(f), 2055(e)(5), 2522(c)(5), 4943(e), 4958(c)(2), 4958(f)(1)(F), 4958(f)(7), 4958(f)(8), 4966, 4967, 6033(k), and 1226). For a very concise description of the changes made by the 2006 PPA to DAFs, see ERIKA LUNDER, CONG. RSCH. SERV., RS22503, PROVISIONS IN THE PENSION PROTECTION ACT AFFECTING TAX-EXEMPT ORGANIZATIONS 5–6 (2006).

53. *See* Colinvaux (2017), *supra* note 15, at 49–50.

54. *See id.* at 53 ("Congress . . . applied some of the private foundation rules (or close analogs) to DAFs.").

the types of expenditures that can be made by a DAF and imposing a penalty on distributions to anyone other than a public charity unless the DAF sponsor engages in "expenditure responsibility." It addressed concerns about continuing control of businesses by extending the private foundation limitations on "excess business holdings" to DAF sponsors. It also required DAF sponsors to include some additional information on their annual information return and required the Treasury to study and issue a report about DAFs.[55] Notably, the 2006 PPA did not include any new requirements on the timing of DAF distributions or extend the private foundation payout rules to DAFs, even though the version of the bill passed in the Senate did include such provisions.[56] It also permitted donors to DAFs to continue to enjoy the more favorable rules about charitable contributions of certain property and protection of donors' privacy that apply to public charities but not private foundations.[57]

The 2006 PPA directed the Secretary of the Treasury to conduct a study of DAFs and report its findings to the tax committees within one year of enactment.[58] The report was finally submitted in December of 2011,[59] and proposed regulations were released by the IRS in November of 2023.[60] These proposed regulations relate to the restrictions on "noncharitable distributions" under Section 4966 of the Code.[61] The IRS's Priority Guidance Plan for 2024-25 included three sets of additional regulations to be forthcoming at some point: those relating to self-dealing under Section 4967, those relating to the excess benefit transactions governed by Section 4958 of the Code, and those relating to the calculation of the "public support computation" for distributions from donor-advised funds.[62] But all three of these additional regulatory projects have been removed from the 2025-26 Priority Guidance Plan.[63]

55. Pension Protection Act of 2006, Pub. L. No. 109-280, § 1235, 120 Stat. 780, 1101.

56. *See* Colinvaux (2017), *supra* note 15, at 50.

57. Donors to private foundations of certain long-term capital gain property can only deduct the "basis" of that property, rather than the full fair-market value. I.R.C. § 170(e); Treas. Reg. § 1.170A-4 (2025). Whereas donors of that same property to public charities or DAF sponsors can deduct the full fair-market value. Treas. Reg. § 1.170A-1(c)(1) (2025). Also, private foundations are required to disclose publicly their donors on Form 990-PF, whereas public charities (including DAF sponsors) are not required to make their donors' identities public. I.R.C. § 6104.

58. Pension Protection Act § 1226, 120 Stat. at 1094.

59. U.S. DEPT. OF TREAS., REPORT TO CONGRESS ON SUPPORTING ORGANIZATIONS AND DONOR ADVISED FUNDS 27 (2011).

60. Taxes on Taxable Distributions from Donor Advised Funds Under Section 4966, 88 Fed. Reg. 77,922 (proposed Nov. 14, 2023) (to be codified at 26 C.F.R. pt. 53).

61. *Id.*

62. I.R.S. PRIORITY GUIDANCE PLAN 2024-2025, at 8 (Oct. 3, 2024).

63. I.R.S. PRIORITY GUIDANCE PLAN 2025-2026 (Sep. 30, 2025).

In other words, the 2006 PPA directed the Treasury to issue regulations about the issues discussed in this Article, and the first set were proposed only recently, with no current information about when the rest may be forthcoming.

Largely because it did not address the "delayed benefit problem" arising from the unregulated timing of donations from DAFs, the 2006 PPA did not satisfy DAF critics.[64] But there is surprisingly little discussion of whether and to what degree the 2006 PPA successfully addressed the non-temporal abuses that concerned those critics.[65] Currently, reform efforts have coalesced around proposed legislation: the Accelerating Charitable Efforts Act ("ACE Act").[66] As its title suggests, the ACE Act seeks to fix the delayed benefit problem, but it also contains a few provisions seeking to fix other perceived abuses, including a provision that closes the "public support test" loophole.[67] This Article explores in detail the current legal regime for three non-temporal abuses of DAFs, identifies the public support test loophole as a significant flaw in the current regulatory regime, and compares the pros and cons of various methods for closing the loophole.

II. Benefits of DAFs for "Retail" Donors

Donor-advised funds are the fastest growing charitable giving vehicle in the nonprofit sector. In 2024, DAFs took in $89.64 billion in contributions.[68] Six of the ten biggest charities in the United States are DAF sponsors.[69] There are good reasons why donating to DAFs is

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64. Reiser & Dean, *supra* note 20, at 69–70 (describing reform efforts after the 2006 PPA, including those by Roger Colinvaux, Ray Madoff, and "billionaire philanthropist John Arnold").

65. Treatments of the 2006 PPA's provisions on non-temporal issues include Michael J. Hussey, *Avoiding Misuse of Donor Advised Funds*, 58 Clev. St. L. Rev. 59 (2010) (summarizing 2006 PPA excise taxes but then largely addressing the delayed benefit problem); Terry W. Knoepfle, *The Pension Protection Act of 2006: A Misguided Attack on Donor-Advised Funds and Supporting Organizations*, 9 Fla. Tax Rev. 221 (2009); Page, *supra* note 51.

66. Accelerating Charitable Efforts Act, S. 1981, 117th Cong. (2021) (introduced in Senate by Sen. King and Sen. Grassley); *see also* Colinvaux (2022), *supra* note 13.

67. *See* S. 1981 § 6 (adding subsection (g) to I.R.C. § 509, which treats contributions from a DAF sponsor as coming from one person instead of from a public charity unless certain exceptions are met). For discussion of the way the ACE Act would close the public support test loophole, see *infra* text accompanying notes 200–01.

68. *See* 2025 DAF Report 2025, *supra* note 1, at 15. The estimate of contributions is taken from IRS Forms 990 and therefore represents the amounts contributed in each DAF sponsor's fiscal year rather than in calendar year 2024. *See id.* at 10.

69. *See* Flannery, *supra* note 47 (providing data on contributions to DAF sponsors for 2022); *see also* Helen Flannery & Brian Mittendorf, *Reshaping Charity Channels: How Assets Flow Into and Out of Donor-Advised Funds*, *in* Nonprofit Operations and Supply Chain Management: Theory and Practice 47, 48 (Gemma Berenguer &

so popular, although DAFs may well be popular with different donors for different reasons. For example, it might be that DAFs are generally popular with what might be called "retail donors" for very legitimate reasons, while they may be popular with a small set of larger donors for different reasons, some of which may be abusive.[70] While there is no precise definition, I am using the term "retail donors" to refer to donors who make regular, sizeable annual charitable contributions, but not those donors who make contributions so large that their giving might warrant the creation of their own private foundations. As a somewhat arbitrary line, let's consider retail donors to be those who give somewhere between $10,000 and $250,000 in charitable contributions in a single year. If they are likely to give more than that in any year (perhaps other than the year they die), we will not consider them retail donors anymore. Obviously, even at the low end of that giving spectrum these donors are likely to be relatively wealthy, but they are not the kind of philanthropists one reads about in the newspaper—putting their names on buildings or creating perpetually endowed institutions. Professor Jill Manny has called these regular donors, who I'm calling "retail donors," the "merely wealthy."[71]

As discussed above, DAF giving really took off when huge consumer-facing investment management firms, like Fidelity, Vanguard, and Schwab, created affiliated charities to sponsor DAFs. So, in a simplistic sense, one of the causes of the growth of DAFs is almost certainly the fact that they are marketed by these large firms to their own customers.[72] But it is not just that they are marketed. They also provide for charitable giving many of the same benefits that these firms already provide to their retail investing clients. Namely, these firms have become behemoths for retail investors because they dramatically reduce

Milind G. Sohoni eds., Springer Nature Switzerland 2025) (calling the growth of DAF contributions "sufficiently phenomenal that DAF sponsoring organizations have leapt to the top of the charity heap").

70. The "more complicated" reasons may include avoiding private foundation rules by making use of the public support conduit loophole discussed in this paper, but also may include strategies that are generally only available or valuable to very large donors, such as valuation abuse of illiquid property, avoiding private foundation payout rules on contributions that would otherwise be subject to them, and some features of anonymous giving.

71. Manny, *supra* note 24, at 14.

72. Of course, these investment management firms benefit financially from continuing to charge fees to manage their customers' money, even after these customers transfer the money to affiliated charities. This potentially creates perverse incentives for the firms (and potentially their employees). Evaluating the advisability of regulations to prevent or mitigate these potentially perverse incentives is beyond the scope of this Article. *See, e.g.*, Cantor, *supra* note 10 ("The first set of culprits protecting the DAF *status quo* are the *financial services firms*.").

the costs of administering an investment portfolio. With innovations like low-cost index mutual funds, self-administered trading, centralized and computerized record-keeping, easy-interface account maintenance, and others, these firms have competed to bring down the administrative costs associated with maintaining an investment portfolio and have thrived because of it. Some of these benefits may well be what makes DAFs so popular among retail investment firms' clients. For example, even for donors who exclusively donate cash (not property) to a number of charities over the course of each year, donating through a DAF means that they can decide how much they want to give for the year and write a single check to the DAF sponsor. As they decide which charities to support throughout the year, they simply go to their account and "advise" the DAF sponsor to make the distribution (or "grant") out of their account. To fulfill their own income tax filing obligations, they only need to retain the record of their single annual contribution to the DAF, which the sponsoring organization will send them at the end of the year anyway. They do not need to keep track of multiple donations to individual charities.[73]

For some taxpayers, there may be an additional tax benefit to giving through DAFs that was magnified when Congress changed the federal income tax treatment of individual deductions.[74] Generally, the only way for taxpayers to receive the tax benefit of making a charitable contribution is to forgo the "standard deduction" and instead "itemize" their deductions. In 2017, Congress almost doubled the standard deduction and simultaneously reduced the ability of taxpayers to take some very popular itemized deductions, like state and local taxes and so called "miscellaneous itemized deductions."[75] Because of these changes to the law, the percentage of taxpayers who itemized went from around 30% in 2017 to fewer than 10% in 2018 and after.[76] Many taxpayers who formerly itemized were advised to "bunch" their charitable contributions from two (or more) years into one year, and then take the

73. *See* Heist et al., *supra* note 1, at 341 ("Participants also used their DAF to conveniently keep track of their giving, which helped for both the grantmaking process and for tax-filing.").

74. *See generally* Joint Committee on Taxation, 115th Cong., General Explanation of Public Law 115-97 (2018).

75. *Id.* at 42 (doubled standard deduction), at 67 (reduced availability of state and local tax deductions), at 72 (reduced availability of other itemized deductions).

76. *See, e.g.*, *How Did the TCJA Change the Standard Deduction and Itemized Deductions?*, Tax Policy Center (updated January 2024), https://taxpolicycenter.org/briefing-book/how-did-tcja-change-standard-deduction-and-itemized-deductions (reporting that the TCJA reduced "the number of taxpayers who itemize deductions. In 2017, 31 percent of all individual income tax returns had itemized deductions, compared with just 9 percent in 2020.").

standard deduction in non-giving years, to maximize the tax benefit of giving. DAFs dramatically simplify this giving strategy, since donors can give two or more years' worth of charitable contributions in a single year, itemize their deductions in that year to receive the tax benefit, and then distribute donations out of the DAF to the operating charities of their choice over the following two or more years. So, DAFs enable donors to cluster giving for tax purposes while smoothing giving from the charitable recipients' point of view.

For donors who want to donate property instead of cash, the benefits of giving to a DAF increase substantially. What counts as property for tax purposes can be quite diverse, including pretty much anything other than cash. But it is worth starting by discussing what is, for some donors, the most attractive and simple kind of property to donate: publicly traded securities.[77] Publicly traded securities, including shares in mutual funds, are attractive as charitable donations because the tax law permits donors to deduct the full fair market value of the property without having to pay tax on the capital gains resulting from any appreciation in that value.[78] So, imagine that Ben has shares in a mutual fund that he paid $10,000 to acquire many years ago, but is now worth $100,000. Ben has never paid tax on the $90,000 growth in the value of his shares, but if he were to sell them, he would owe a long-term capital gains tax of either 15% or 20%, depending on his tax bracket. If he instead donates the shares to charity, he can deduct the full $100,000 that his shares are currently worth *and also* avoid paying the tax on the $90,000 of gain.[79] This double benefit is preferable to giving cash since Ben probably already paid tax on the cash when he earned it. But donating securities to charity is administratively complicated—much more complicated than writing a check or paying with a credit card. Ideally, Ben would like to make one bulk donation of his shares instead of making multiple individual donations to each charitable recipient. And perhaps even more importantly, Ben would like to transfer his shares to an entity that is administratively competent to receive them, perhaps because they specialize in that kind of thing. Even better if Ben is familiar with the recipient, perhaps because he has used them many times before and has an account with them. DAFs provide exactly

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77. A discussion of the donation of illiquid assets (i.e., property that is not publicly traded securities) to DAFs is beyond the scope of this Article. *See generally* Colinvaux (2013), *supra* note 15.

78. I.R.C. § 170(e)(1), (5).

79. This claim is subject to several limitations. For example, Ben must be an itemizer and he must not have exceeded the income limitations on the charitable deduction.

that kind of low-cost, administratively simple treatment of donations of publicly traded securities.[80]

Another reported benefit of DAFs for retail donors is that some donors value having an easy mechanism to make donations to charity without the charity knowing their identity. The vast majority of charitable donors do not give anonymously,[81] and recognition from charities or others is often a motivator for charitable giving. However, some donors prefer anonymity, at least some of the time, and DAFs give donors the opportunity to keep their identities hidden from the charitable recipients of their contributions.[82] One motivation for anonymity may come from donors' personal values, since some religious traditions value anonymous giving as the highest of all forms of charity. But more pragmatic concerns may motivate the desire for anonymity as well. For example, some donors may fear or dislike the constant stream of charitable appeals that follows a major donation, either from the charity itself, from some charity with whom the recipient charity shared its donor list, or from someone who monitored the charity's public statements about its donors, in annual reports for example.[83] Elderly donors may especially appreciate the anonymity that DAFs can provide since they are even more likely to become overwhelmed by the sheer volume of this quasi-junk mail.[84]

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80. *See* ANDREONI, *supra* note 5, at 4 (describing how DAFs accept non-cash contributions and then convert them into cash for distribution to smaller charities).

81. Daniel Hemel, Joseph Bankman & Paul Brest, *Are Donor-Advised Funds Good for the Nonprofit Sector?*, 87 EXEMPT ORG. TAX REV. 287, 300 (2021) ("the vast majority of DAF grants are not anonymous").

82. A donor who wishes to remain anonymous *to the public* does not need to use a DAF for their contribution because there is no legal requirement that public charities report to the public the names of their donors. I.R.C. § 6104(b). They are required to report their donors to the IRS. *Id.* § 6033(b)(5). Some state attorneys general also require donor information, although the Supreme Court recently struck down a California law that required charities to report their donors to the California Attorney General, at least partially because the lower court found that California was not sufficiently protecting the information from inadvertent disclosure to the public. Ams. for Prosperity Found. v. Bonta, 594 U.S. 595, 604, 611 (2021). Thus, a DAF is unnecessary to make donations that are anonymous to the public, but it may be useful to remain anonymous to the government and to the recipient charity. For a detailed discussion of anonymity issues in nonprofit organizations, see Roger Colinvaux, *Associational Rights Versus Nonprofit Transparency: Information Reporting in the Internet Age*, 2025 U. ILL. L. REV. ONLINE 1353, 1356–57 (2025).

83. *See* Heist et al., *supra* note 1, at 338–39 (quoting one respondent as saying, "I think once your name gets out there having given a certain amount, the number of people that start calling you is really overwhelming."). This benefit is largely unavailable to donors to private foundations.

84. *See* Benjamin Leff, *Some Benefits of Donor-Advised Funds for the Merely Rich*, NONPROFIT L. PROFESSORS BLOG (May 11, 2023), https://www.nonprofitlawprofblog.com/

Finally, a host of other miscellaneous benefits may be provided by DAFs. For example, some DAF donors report that they like having a separation between the decision to give to charity and the decision about which specific charity to support.[85] The considerations that go into deciding how much to give are different from those about whom to support, and combining them in a single act is confusing or distracts from one or the other. If donors want to commit themselves to a certain level of giving, especially if they are trying to increase their charitable giving, making a single donation to a DAF may facilitate that choice. Some donors might appreciate the DAF's online interface, which often gives all the information in a simple dashboard, with the ability to give to repeat charities via a simple drop-down list. This interface makes it simpler to memorialize how much donors contributed to certain organizations in the previous year so they can make sure to support all the organizations they want to support. Some DAF sponsors may provide information about possible charitable beneficiaries that is more objective or credible than the information that comes from charities themselves, or it may provide this information more cheaply or efficiently than individual charities. Some donors might also like the ways that their DAF creates the sense that they have a lasting charitable fund or foundation. This can be a psychological effect for the individual donor from the sense that they are creating an endowment for future good or a way to actively involve future generations of the donor's family in charity. While the purely psychological benefit is somewhat at odds with the position of critics who believe that present needs should be prioritized over endowing the future, it appears to be a strong motivator of charity, as it has been throughout history.[86]

Donors could obtain all of these benefits of DAFs (except possibly anonymity) by creating a private foundation. But creating a private foundation is complicated and costly. Some person needs to manage the money, keep good records, and perhaps most importantly, observe regulatory requirements, which can be complicated and unknown to non-experts. The complication and cost of running a private foundation creates real problems for small foundations, especially those with less than $5 million of assets. Foundations this small are notoriously under-resourced and poorly managed, often leading to egregious abuses, sometimes not even arising from bad intent but simply from ignorance

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2023/05/some-benefits-of-donor-advised-funds-for-the-merely-rich.html [https://perma.cc/79HK-Q4H7].

85. Heist et al., *supra* note 1, at 344.

86. For a concise list of DAF benefits, see, e.g., Hemel, Bankman & Brest, *supra* note 81, at 287–88.

or neglect. Given the fact that private foundations provide the ability for donors to control future charitable distributions, it is not surprising that donors would jump at the opportunity to have "virtual" private foundations that can provide the same benefits but are able to decrease administrative costs through economies of scope and scale. That is what DAFs provide. Extending these benefits of private foundations to retail donors—i.e., donors who do not make large enough annual contributions to warrant the creation of a private foundation—has been heralded as "democratizing" the benefits of private foundations by extending them to more potential donors.[87]

Furthermore, these benefits of DAFs (again, except anonymity) arise from the standardization, centralization, and professionalization of the DAF sponsor rather than the avoidance of the legal limitations on private foundations. That is, they arise not because private foundations are under a stricter regulatory regime than public charities, but because DAFs provide private-foundation-like benefits without the administrative complexity or costs of private foundations. For a donor choosing between creating a private foundation and opening a DAF at a DAF sponsor, we should want that donor to choose the most administratively simple and lowest cost option. That is called economic efficiency, and it is exactly the kind of innovation that we expect well-functioning markets to provide, even a market in "altruism."[88] If a substantial part of the popularity of DAFs comes from people choosing them over private foundations for these "market" reasons, the government should be very wary of creating impediments to this choice.[89]

Some donors, however, may use DAFs for very different reasons than the ease of administering their charitable portfolio or making donations of appreciated publicly traded securities. For larger donors whose annual contributions are substantial enough to potentially warrant the cost and effort of creating a private foundation, DAFs may be appealing not only because of the benefits that are sought by retail donors, but also because of differences in *legal treatment* between DAFs and private foundations. That is, some major donors may be seeking not only "market" benefits, but also some form of "regulatory arbitrage." Regulatory arbitrage generally refers to situations in which people can achieve their goals by using different legal strategies or structures and

87. *See, e.g.*, *id.* at 296 ("DAFs can thereby democratize the tax advantages of appreciated-asset donations").

88. *See* Buckles, *supra* note 18, at 511.

89. *See* Manny, *supra* note 24, at 21 ("Excessive regulation of [donor-advised fund sponsors] is likely to precipitate the demise of [them] and send philanthropy back to the dark ages of the private foundation only charitable arena for endowments.").

choose to use a particular structure to avoid regulatory costs associated with the other ones.[90] In this case, I use the term "regulatory arbitrage" to refer to the choice to use a DAF over a private foundation motivated by a desire to avoid particular regulatory requirements that apply only to private foundations. Critics of DAFs normally point to four differences between the legal treatment of private foundations and the legal treatment of DAFs that might drive some major donors to use DAFs rather than private foundations as their philanthropic intermediary of choice:[91] (1) Private foundations are generally required to distribute five percent of the value of their assets to public charities every year, while DAFs and their sponsors have no such distribution requirement; (2) Donors who give appreciated property other than publicly traded securities to private foundations generally can only deduct the "basis" of that property for their individual income tax purposes, rather than the "fair-market value," so they do not get the double benefit of deducting market value and excluding capital gains; (3) Grants out of DAFs are not subject to certain public disclosure requirements that apply to grants out of private foundations, so DAFs make anonymous giving easier; (4) DAFs and private foundations are subject to different rules about transactions that provide private benefits, whether financial or otherwise, to donors or their families. Of these four types of legal differences, this Article focuses on the last one—what I call self-dealing, noncharitable distributions, and continued control over business assets. But before discussing the focus of the Article, it is worth pausing to briefly introduce the first three instances of potential regulatory arbitrage and explain why they are *not* the focus of this Article.

First, the most common critique of DAFs is what has been called the "delayed benefit problem."[92] Nonoperating private foundations generally are required to distribute at least five percent of their assets to public charities every year.[93] This requirement does not apply to other charities and was not extended to DAF sponsors in the 2006 PPA. That

90. *See, e.g.*, Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227, 230 (2010) (defining "regulatory arbitrage" as "the manipulation of the structure of a deal to take advantage of a gap between the economic substance of a transaction and its regulatory treatment."); *Arbitrage*, BLACK'S LAW DICTIONARY (10th ed. 2014); *see also* Hemel, Bankman & Brest, *supra* note 81, at 289 ("DAFs may facilitate gaming of some restrictions on private foundations, allowing such foundations to comply with the letter of the law while contravening the spirit."). The term often has a negative connotation, but when described this broadly, regulatory arbitrage is often a completely legitimate and unavoidable practice.

91. *See generally* Colinvaux (2022), *supra* note 13; Flannery & Mittendorf, *supra* note 14; Madoff & Colinvaux, *supra* note 15.

92. *See* Colinvaux (2022), *supra* note 13, at 2633.

93. I.R.C. § 4942.

means that donors who wish to create charitable endowments that have no distribution requirement have the option of doing so in DAFs, as well as in other public charities such as universities. Donors to private foundations and other charities are permitted to take a tax deduction for their contributions in the year they make it, but because DAFs are not required to distribute any money in that same year, critics generally argue that DAFs therefore either inherently delay the benefit of those donations or have the potential to do so. To the degree to which donors choose DAFs because they wish to avoid the distribution requirement that applies to private foundations, this differential treatment between private foundations and DAF sponsors constitutes a form of regulatory arbitrage. But other commentators are unpersuaded that DAFs actually delay contributions to operating charities, at least as compared to private foundations.[94] They generally cite estimates of the payout rates of DAF sponsors, which suggest that, far from distributing less than the five percent required of private foundations, DAF sponsors distribute more like 9.7% to 23.9% annually.[95] This issue has garnered substantial debate, scholarly and otherwise, some of which revolves around beliefs about whether charitable funds are currently being excessively saved for future generations or excessively spent on the present one.[96] The most substantive provisions of the ACE Act subject DAFs to payout requirements substantially higher than those that apply to private foundations. As mentioned, this Article avoids joining that debate on

94. *See* Manny, *supra* note 24, at 20 (arguing that the ACE Act provisions requiring minimum annual distributions from DAFs "address a problem (failure to distribute assets by [DAF sponsors]) which no data can be marshalled to substantiate.").

95. This very dramatic range of estimates for a number that should be easy to quantify illustrates disputes over the proper methodology to compute it. The leading analysis by a DAF critic estimates a median sponsor-level payout rate across all DAF sponsor types at 9.7% in 2023. *See* Charity Reform Initiative of the Inst. for Pol'y Stud., The Independent Report on DAFs 9 (2025). The leading DAF-friendly analysis calculates an average payout rate across all DAF sponsor types at 23.9% in 2023. *See* Nat'l Philanthropic Tr., 2024 Donor-Advised Fund Report 34–35 (2024). It also cites methodologies under which the payout rate for 2023 is calculated as 17.9%, 26.2%, and 30.5%. It is important to understand that these payout rates are calculated based on the aggregate payouts from each sponsor since DAF sponsors are not required to report payout rates from individual DAFs. Because of that, the aggregate data may be hiding individual DAFs that make no distributions, potentially over long periods of time. Interestingly, the Treasury Department reported that, in the first year payout data was available from tax reporting, the payout rate across all DAFs was 9.3%, and that "it would be premature to make a recommendation regarding distribution requirements for DAFs on the basis of this first year of reporting." U.S. Dept. of Treas., Report to Congress on Supporting Organizations and Donor Advised Funds 81–82 (2011).

96. *See, e.g.*, Brian Galle, *Pay It Forward? Law and the Problem of Restricted-Spending Philanthropy*, 93 Wash. U. L. Rev. 1143, 1180 (2016).

either side, given the complexity of the issue and the depth with which it has been addressed elsewhere.

Second, donors to DAFs receive more generous treatment of their donations of appreciated property (other than publicly traded securities) than donors to private foundations. As discussed above, donors to DAFs receive a "double benefit" when they donate publicly traded securities to charity. They can deduct the full fair-market value of the security and also avoid the capital gains tax on the appreciation.[97] This benefit is equally available when donors give to operating charities, donor-advised funds, or private foundations. However, when donors give property other than publicly traded securities (i.e., "illiquid" assets) they can receive that same double benefit if they make the donation to an operating charity or a DAF, but *not* if they make the donation to a private foundation.[98] That is because private foundations are subject to a special rule that permits donors of illiquid assets to only deduct the *basis* of that property, not its fair market value.[99] So, if our sample donor Ben bought stock in a closely-held corporation for $100,000 many years ago, and that stock has risen in value to $1,000,000, the basis of that stock is the $100,000 he paid for it. If he chooses to donate it to a private foundation instead of a DAF or other public charity, he can only deduct the $100,000 basis not the $1,000,000 fair market value. His deduction is $900,000 less when made to a private foundation. One can imagine that this particular kind of regulatory arbitrage would be valuable to certain donors, namely, those who make contributions of illiquid assets that have appreciated significantly in value.[100] Just like the delayed

97. *See* I.R.C. § 170(e)(1), (5).

98. *See* Flannery & Mittendorf, *supra* note 14, at 7 ("Noncash gifts that are not publicly traded set DAFs apart even more, since deductions for such gifts to private foundations are limited to tax basis but face no such limitation if given to DAFs."). The authors call these types of contributions "*extra-favored* noncash gifts." *Id.* at 10.

99. I.R.C. § 170(e)(5). Avoiding this rule may create valuation issues that can be manipulated by donors, since the private foundations rule—by denying a fair-market value deduction—eliminates the benefit of inflating the claimed value of the asset for tax purposes. *See, e.g.*, Hemel, Bankman & Brest, *supra* note 81, at 289 ("[Valuation gaming] does not generally arise for foundations because gifts to foundations of assets that are not publicly traded are valued at their basis.").

100. The DAF Research Collaborative has an estimate of contributions of illiquid assets (categorized as "other") to DAFs of 8% of the value of all contributions made between 2014 and 2022. DAF Rsch. Collaborative, The National Study on Donor Advised Funds 28 (2024). Flannery & Mittendorf estimate the percentage of "extra-favored" noncash contributions to DAFs to range between 8% (for community foundation DAF sponsors) to 14.8% (for National Sponsors). Flannery & Mittendorf, *supra* note 14, at 11. For a thoughtful and thorough discussion of taxpayer abuse of the "fair-market value" rule as applied to illiquid assets, see generally Colinvaux (2013), *supra* note 15, at 271–80. *See also* Hemel, Bankman & Brest, *supra* note 81, at 287 ("For a donor, the main advantages of a DAF include: [a] DAF can reduce a donor's

benefit problem, this Article does not discuss in detail the differing legal treatment of donations of illiquid property to DAFs versus to private foundations, even though it is likely a significant motivator of DAF donations for some donors.

Third, another benefit of DAFs is that they enable donors to give to a charitable recipient without that charitable recipient knowing their identity.[101] This anonymous distribution is not possible for private foundations, who must disclose both their contributors and the recipients of their charitable distributions on their Form 990-PF.[102] Therefore, donor anonymity to the recipient charity is a kind of regulatory arbitrage when comparing distributions out of a DAF to distributions out of a private foundation. The ability to donate anonymously is often cited as a significant problem with DAFs, with one of the most thoughtful critics of DAFs calling disclosure the "biggest arbitrage area right now."[103] With respect to *public* knowledge of the identity of charitable donors, it should be understood that, generally, donations directly to operating charities are not disclosed to the public—only those distributions that are made out of private foundations are subject to public disclosure. So, a donor choosing between donating directly to an operating charity or routing that donation through a DAF does not face any difference with respect to public knowledge of their identity. Like with mandatory payout rates and the larger deduction for donations of appreciated illiquid assets, the arbitrage opportunity only applies to donors choosing between donating to private foundations and DAFs, not those choosing between DAFs and other public charities. Again, this Article does not discuss in depth this kind of regulatory arbitrage, not because it is

tax liability by enabling the donor to claim a fair market value deduction for gifts of appreciated securities and complex assets, which then can be liquidated inside the DAF free of capital gains tax.").

101. *See* discussion *supra* notes 82–84 and accompanying text.

102. *See* I.R.C. § 6104.

103. Brian Galle, *Donor Advised Funds are Swell. We Should Still Regulate Them Lots.*, MEDIUM (Aug. 6, 2018), https://medium.com/whatever-source-derived/donor-advised-funds-are-swell-we-should-still-regulate-them-lots-ee84d99df924 [https://perma.cc/WQ9X-NG5S] (explaining that this regulatory difference means that "any existing private foundation can whitewash its donation list simply by first routing its money through a DAF intermediary, in effect repealing the rules that require transparency for family-controlled philanthropic wealth."). On the other hand, the issue is contested, with other thoughtful academics concluding that "[w]e are not persuaded that [donor anonymity] is a valid criticism." Hemel, Bankman & Brest, *supra* note 81, at 299; *see also* Manny, *supra* note 24, at 12 (pointing out that "[t]hese criticisms are somewhat misguided, as anonymity easily can be achieved even for individuals and private foundations" and citing the use of "grantor trusts or LLCs with anodyne names.").

not worthy of scholarly attention, but because it is a multifaceted and complicated issue that deserves its own extensive treatment elsewhere.

All three of these examples of the regulatory arbitrage available when using DAF sponsors over private foundations are most likely to be used by donors who have the means to create their own private foundations because they are the ones who are making a choice between the two forms. As discussed above, because of the large administrative burden of creating a private foundation, that category of donors is unlikely to include many retail donors. But, for donors who contribute more than $250,0000 in a year, for example, the costs of administering a private foundation are relatively small compared to the magnitude of annual donations, so it is possible that the problems of regulatory arbitrage are largely confined to these very large donors. It is very important to understand that two of these arbitrage opportunities—delaying distributions and avoiding disclosure of the identities of donors to specific recipient charities—can be used not only by donors who contemplate creating a private foundation, but also by private foundations *themselves*. In other words, a private foundation that is faced with a mandate to distribute 5% of its assets to recipient charities can instead distribute its assets to a DAF that it controls, effectively avoiding the distribution requirement that applies to private foundations.[104] Likewise, an existing private foundation that wishes to make secret distributions can avoid the statutory mandatory disclosure rules by routing its distribution *through* a DAF. By using a DAF, private foundations can avoid disclosing the recipients of their grants both to the general public and to the government. I hope it is obvious that the fact that arbitrage opportunities are probably almost exclusively enjoyed by very large donors and existing private foundations does not in any way diminish the importance of studying these potential problems with the regulatory system and addressing them when warranted. But ideal regulation would address those issues in ways that do not negatively impact the benefits of DAFs for those donors who are not benefiting from arbitrage.

These three forms of regulatory arbitrage are important issues that merit further debate. This Article, however, is focused on another

104. Even committed DAF boosters, like Jill Manny, argue that this problem should be solved. *See* Manny, *supra* note 24, at 17 ("The first legislative reform to be added to the agenda should be an absolute prohibition on qualifying distributions from private foundations to [DAF sponsoring organizations] … because they violate the purpose of the private foundation minimum distribution requirements[.]"); *see also* Hemel, Bankman & Brest, *supra* note 81, at 302 ("If the public charity/private foundation distinction is justified, the use of DAFs to circumvent the restrictions on private foundations is worrisome. So too is the use of DAFs to maintain public charity status at organizations that otherwise would fall into private foundation classification.").

form of regulatory arbitrage that was most pressing as DAFs gained prominence in the first half of the 2000s—the issue of self-dealing. The question was: Could DAFs be used to undermine the heightened regulatory scrutiny that applied to private foundations? That question is important because the features that DAFs share with private foundations (e.g., control of distribution choice by a single individual or family) are the ones that justify the extra regulation of private foundations. But that very issue was at least purportedly addressed by Congress in 2006 in the 2006 PPA. The focus of this Article is exploring whether Congress's application of extra strict rules around potentially self-dealing transactions to DAFs is justified, as well as if it is effective in meeting its goals and not just an example of excessive regulation. Ideally, the self-dealing regulatory regime would permit (or even encourage) DAFs when they are beneficial to the charitable sector while curbing uses that are abusive.[105]

III. "Abuses" Under Current Law

Even after the 2006 PPA, critics continue to argue that DAFs are being used abusively.[106] While many of the criticisms focus on the delayed benefit problem and (to a lesser degree) donor anonymity, which were largely ignored by the 2006 PPA, this Article addresses the three types of abuse that the PPA sought to address: (A) self-dealing, (B) noncharitable uses of funds, and (C) excessive continuing control of business assets by donors. In this section, I assess the degree to which donor-advised fund sponsors are potentially tools under current law for donors seeking to commit these abuses. I argue that the 2006 PPA creates a framework that is even more restrictive than the framework that applies to private foundations, but that it contains an all-purpose loophole that potentially facilitates abuse of the strict regime.[107] Once the primary remaining loophole in the restrictive regime is closed, the

105. Manny, *supra* note 24, at 1 ("[DAF sponsors] are a positive development for philanthropy, and every effort should be made to keep them available, efficient, and easy to access and understand in order to avoid the flight of charitable dollars back to family foundations.").

106. *See, e.g.*, Helen Flannery & Chuck Collins, Inst. for Pol'y Stud., Fixing What's Broken with Donor-Advised Funds: Rewiring a Design Flaw that Encourages Warehousing of Charitable Assets (2021).

107. I know of no examples of good empirical work that would enable one to estimate with any accuracy the extent to which this loophole is actually being used, but because it is such a glaring potential distortion of the regulatory regime created by Congress in the 2006 PPA, it is worth discussing whether or not it is widely used. Nonetheless, I hope in future work to attempt an estimate based on publicly available information.

framework should do a relatively good job of preventing abuse, at least as compared to public charities and private foundations.[108]

A. *Self-Dealing*

I use the term "self-dealing" rather broadly in this Article to refer to any time a donor, or other person with substantial influence over an organization, produces a material benefit to themselves or someone related to them.[109] In charity law, a financial benefit provided to someone who exercises substantial control over the charity is generally called "inurement," and inurement disqualifies a charity for tax-exempt status.[110] Congress passed two excise tax regimes to penalize individuals and organizations who engage in these types of transactions: one that applies to private foundations and one that applies to public charities.[111] This section briefly describes the ways that self-dealing is limited under federal law for public charities, private foundations, and donor-advised fund sponsors.

1. *Self-Dealing in Public Charities and Private Foundations*

The very definition of a charitable entity—for example, as described in I.R.C. § 501(c)(3) and I.R.C. § 170(c)—includes a prohibition on private "inurement."[112] The prohibition on inurement is the part of the definition of a charitable entity that requires it to be a "nonprofit" organization. It cannot have shareholders who receive or

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108. For example, the Treasury Department concluded in 2011 that "[t]he PPA appears to have provided a legal structure to address abusive practices and accommodate innovations in the sector without creating undue additional burden or new opportunities for abuse." U.S. DEPT. OF TREAS., REPORT TO CONGRESS ON SUPPORTING ORGANIZATIONS AND DONOR ADVISED FUNDS 7 (2011).

109. The term "self-dealing" is sometimes used in the law narrowly to refer to any action by a fiduciary that prioritizes their own financial self-interest over that of the entity or person to whom they owe the duty. *Self-Dealing*, BLACK'S LAW DICTIONARY (10th ed. 2014) (defining "self-dealing" as "[p]articipation in a transaction that benefits oneself instead of another who is owed a fiduciary duty"). Because the premise of charity law is that donors give up their beneficial interest in property when they donate it to charity, financial benefit to donors who control the charity to whom they donate is a special concern of charity law. Therefore, the term "self-dealing" is usually used in the charity-law context to include donors who are important enough to a charity to exert influence over the charity, even if these donors may not formally hold any position that creates a fiduciary duty.

110. *See* I.R.C. § 501(c)(3).

111. *See id.* § 4941 (calling the penalized transactions "self-dealing"); *id.* § 4958 (calling the penalized transactions "excess benefit transactions").

112. In addition to federal law, state laws protect against self-dealing, largely by requiring charities to have trustees or directors who have a fiduciary duty with respect to the organization and its charitable mission. The "duty of loyalty" is the state law duty most directly related to self-dealing.

have a right to any of the profits of the firm. So, the inurement doctrine prevents a charity from paying dividends or distributing its assets upon dissolution. It also covers situations in which an insider receives any payment that exceeds the value of the goods or services they provide to the organization. So, for example, if an officer is paid an excessive wage, that is inurement. If a director or trustee is paid an excessive amount, lends money to the organization at an above-market rate, borrows at a below-market rate, or charges an above-market rate for use of office space, those are all likely inurement.[113]

As discussed above, fear about self-dealing in private foundations was one of the primary motivations for creating a more restrictive regime for them in 1969 in the legislative changes that Reiser and Dean call the "grand bargain."[114] In 1969, Congress enacted I.R.C. § 4941 specifically to address self-dealing by private foundations, but the provision did not apply to public charities.[115] At the time, there was no detailed statutory provision that applied to public charities. Instead, self-dealing by public charities was governed primarily by the inurement prohibition until 1996, when Congress enacted I.R.C. § 4958 to penalize so-called "excess benefit transactions" for public charities.[116] Since 1996, there has been a bifurcated self-dealing penalty regime: I.R.C. § 4941 applies to private foundations, while I.R.C. § 4958 applies to public charities. Both provisions apply only to transactions between the organization and a "disqualified person," which generally means someone who exercises significant influence or control over the organization.[117] So, for example, if a charity pays too much for fundraising services, thus potentially depleting their charitable resources, that would not be covered by either provision unless the fundraising firm was affiliated with a disqualified person.[118]

113. *See* Bruce Hopkins, The Law of Tax-Exempt Organizations 476 (12th ed. 2019) ("the private inurement doctrine requires that these transactions be tested against a standard of reasonableness . . . an approximately equal exchange of benefits between the parties").

114. Reiser & Dean, *supra* note 20.

115. *See* I.R.C. § 4941 (only applying to private charities).

116. Hopkins, *supra* note 113, at 43 (concluding that the scope of I.R.C. § 4958 and the private inurement doctrine "should be interpreted to be closely identical"); *see also id.* at 33 (explaining that, technically, I.R.C. § 4958 has been in effect since September 14, 1995, as it was made effective retroactively to that date when it was enacted in 1996).

117. *See* I.R.C. § 4943(e)(2).

118. *See, e.g.*, United Cancer Council v. Comm'r, 165 F.3d 1173, 1176 (7th Cir. 1999) (finding that a fundraising organization did not have control over a charity and thus inurement under § 503(c) did not occur; no discussion of § 4958).

In general, I.R.C. § 4941 is more restrictive than I.R.C. § 4958, so private foundations are more constrained in the kinds of transactions they can engage in than public charities are.[119] For example, I.R.C. § 4941 prohibits private foundations from borrowing money from a disqualified person unless there is no interest on the loan, whereas I.R.C. § 4958 permits a public charity to borrow money from a disqualified person as long as the interest rate is not more than could be obtained elsewhere at "fair market value."[120] Similarly, I.R.C. § 4941 generally prohibits private foundations from purchasing "goods, services, or facilities" from a disqualified person unless they are provided "without charge," whereas the rule for public charities is, again, that they must be provided at fair market value.[121] Both types of organizations can hire disqualified persons to provide services to the organization, so long as the compensation is not excessive.[122] As discussed above, the distinction between the treatment of private foundations and public charities is presumably justified because of a belief that the stakeholder protections against self-dealing described above are weaker in the case of private foundations than in the case of public charities. In other words, when an organization does not have multiple unrelated donors (and the need to continue to seek additional new donors), or other significant interested stakeholders, there is more risk that it will be abused for the benefit of insiders who control it.[123]

2. Self-Dealing Transactions in DAFs

As a formal matter, DAF sponsors are treated as public charities for the purposes of I.R.C. §§ 4941 and 4958.[124] That is, I.R.C. § 4941 *does not* apply to them because they are not private foundations and I.R.C. § 4958 *does* apply to them for the same reason. Thus, prior to 2006, DAFs were subject to the less restrictive provision protecting against

119. *See, e.g.*, Ellen P. Aprill, *The Private Foundation Excise Tax on Self-Dealing: Contours, Comparisons, and Character*, 17 Pitt. Tax Rev. 297, 298, 310 (2020).

120. I.R.C. § 4941(d)(1)(B), (2)(B).

121. *Id.* § 4941(d)(1)(C), (2)(C). The inclusion of "services" in this list might be confusing because the payment of compensation to a disqualified person "for personal services which are reasonable and necessary to carrying out the exempt purpose of the private foundation" is permitted so long as the compensation is "not excessive"—the same rule for public charities. *Id.* § 4941(d)(2)(E).

122. *Compare id.* § 4941(d)(2)(E), *with id.* § 4958(c)(1)(A).

123. *See* Reiser & Dean, *supra* note 20, at 138; Buckles, *supra* note 18, at 514 n.94.

124. *Compare* I.R.C. § 4941(d)(1) (defining "self-dealing" between a disqualified person and a private foundation), *with* I.R.C. § 4958(e) (defining an "applicable tax-exempt organization" as any organization described in § 501(c)(3) other than a private foundation).

self-dealing that applies to public charities. Fear that DAFs could be used by donors to engage in self-dealing was one of the primary motivations for the 2006 PPA's DAF provisions.[125]

Congress could have chosen to treat DAFs as private foundations in the 2006 PPA, but instead, it enacted new rules for DAFs and their sponsors that are *even more* restrictive than those that apply to private foundations. These rules are contained in new provisions in Section 4958 and in a new section, Section 4967, which applies only to DAFs and their sponsors. First, the rules before the 2006 PPA defined a disqualified person as "any person who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization."[126] Prior to 2006, a transaction that excessively benefited a DAF donor-advisor—for example by paying the donor or their children excessive compensation—was plausibly not subject to the penalties provided by Section 4958 because these donor-advisors were not in a position to influence the affairs of the sponsor, which had hundreds or thousands of donors. Congress expressly closed that loophole in 2006 by defining "disqualified person" to include donors to, and donor-advisors of, donor-advised funds.[127]

But the PPA went further in preventing self-dealing than merely closing the loophole that made it hard for the IRS to apply the excess benefit rules to DAF donors and sponsoring organizations. In addition, the 2006 PPA provided a special definition of "excess benefit" that applied only to DAF donors and sponsors. Rather than excess benefit being a benefit that was excessive (as it is for other public charities),[128] it was defined for DAFs as "any grant, loan, compensation, or other similar payment from such fund to a [donor or donor-advisor.]"[129] In other words, *any* payment from a DAF to a donor or related person was an excess benefit transaction, and the "excessive benefit" was defined as the whole amount of the transaction.[130] This new standard went beyond even the self-dealing regime that applies to private foundations, since it

125. *See Charity Oversight and Reform Hearing*, *supra* note 12, at 141–43 (statement of Mark Everson, I.R.S. Comm'r).

126. I.R.C. § 4958(f)(1)(A) (2005).

127. *Id.* § 4958(c)(2), (f)(7) (defining "excess benefit transactions" to include transactions with donors, donor-advisors, their family members, and entities they control).

128. *See id.* § 4958(c)(1)(A) ("if the value of the benefit provided exceeds the value of the consideration").

129. *Id.* § 4958(c)(2)(A).

130. *Id.* § 4958(c)(2)(B).

prohibits even reasonable compensation or expense reimbursement to donors, donor-advisors, or their families.

If that was not enough, *in addition* to the newly expanded Section 4958, the 2006 PPA includes a special self-dealing penalty regime that applies only to DAF sponsors and donors: Section 4967, which imposes a penalty tax on "prohibited benefits." Under Section 4967, the penalty tax applies if the advice of a donor results in a distribution in which the donor or a related party[131] receives "a more than incidental benefit as a result of such distribution."[132] This "more than incidental benefit" standard is very broad, much broader than the "excess benefit" standard that applies to other public charities, and even broader than the more restrictive self-dealing rules that apply to private foundations. It is not entirely clear what kinds of transactions are covered by Section 4967 and what kind of transactions are covered under the new 4958(c)(2), but both provisions appear to cover reasonable compensation provided to donors and their families, as well as reasonable expense reimbursement. To avoid duplicative sanctions, Congress provided that the new Section 4967 could not be applied to "any distribution if a tax has been imposed with respect to such distribution under Section 4958."[133]

To illustrate the self-dealing rules that apply to DAFs, some examples might be worth exploring. Imagine that Ben wants to donate to charitable causes but would also like to use tax-deductible funds to benefit himself and his family. He could give a million dollars to a public charity, like his alma mater for example, and then request that the university fund a "donor trip" to Las Vegas, all expenses paid, for him, his spouse, his children, and his grandchildren. Because none of these people are "disqualified persons" with respect to the university, the trip would not trigger Section 4958 and would therefore, by definition, not be an excess benefit transaction. It could constitute a "private benefit" under the private benefit doctrine, but generally a private benefit will not result in any sanction unless it is substantial, and a single donor trip is unlikely to reach that standard under the IRS's (admittedly vague) guidance.[134] But of course, it might be that his alma mater does not want to fund a donor trip for him and his family for any number of

131. I have used the shorthand "donor or related party" to stand for the formal definition in the Code, which is as follows: I.R.C. § 4967 defines the persons subject to this provision with reference to § 4958(f)(7), which in turn references § 4966(d)(2)(A)(iii). *Id.* §§ 4958(f)(7), 4966(d)(2)(A)(iii), 4967.

132. *Id.* § 4967(a)(1).

133. *Id.* § 4967(b).

134. *See generally* John D. Colombo, *In Search of Private Benefit*, 58 FLA. L. REV. 1063, 1068 (2006); *see also* Benjamin M. Leff, *Preventing Private Inurement in Tranched Social Enterprises*, 45 SETON HALL L. REV. 1, 27–35 (2015).

reasons, including that its trustees believe that spending funds for such a trip is a misuse of the charitable assets entrusted to their care. The logic behind the permissive regime that applies to public charities is that charities with multiple unrelated stakeholders, like universities, are unlikely to want to provide excessive benefits to their donors, or at least that these multiple unrelated stakeholders will keep truly abusive benefits in check.[135]

If his alma mater declined, or if he just wanted more continuing control of the charitable assets he contributed, Ben could create a private foundation, and use that vehicle to fund a trip for his family to Las Vegas. In that case, he would presumably style the trip as an "annual meeting" at which the foundation's corporate business is enacted and possibly the board (his family members) gives its advice or makes decisions about grant recipients for the year. In this case, Section 4941 *would* apply because Ben and his family are disqualified persons, both because Ben is such a substantial contributor to the foundation and also because they all are on the foundation's board of directors. But so long as the expense reimbursement is not excessive, it would likely fall under the exception to self-dealing transactions for compensation for personal services that is not excessive, given that he also followed some reasonable procedures. If instead of wanting to fund a family trip to Las Vegas, Ben had wanted to share the expenses of his family office, or obtain a loan for himself or his child, he would be blocked by the self-dealing rules that apply to private foundations even if the office space or the loan were genuinely provided at market rates.

If Ben tried to use a DAF for any of these same purposes, he would be unambiguously thwarted by the rules enacted in the 2006 PPA. First, Section 4958 (the excess-benefit transaction rules) would apply to Ben because the new sections, Section 4958(c)(2) and Section 4958(f)(7) expressly define transactions between DAFs and donors as excess benefit transactions. Section 4958(c)(2)(A) would then *absolutely prohibit* the expenditures because it defines excess benefit transactions in such a way as to remove the argument that the payment

135. *See* Reiser & Dean, *supra* note 20, at 150 ("Operating charities . . . pursue their charitable goals directly, very much out in the open, led by volunteers and employees unrelated to each other beyond a shared commitment to their cause."). *But see College Admissions Scandal: Your Questions Answered*, N.Y. Times (Mar. 14, 2019), https://www.nytimes.com/2019/03/14/us/college-admissions-scandal-questions.html, [https://perma.cc/78JW-HY8J] (showing that even large operating charities under the scrutiny of unrelated stakeholders can succumb to abuse by powerful donors). The regulatory regime is not based on the idea that public charities will be free from abuse by having multiple stakeholders, just that the existence of these stakeholders increases the chances that such abuses will be corrected.

was reasonable compensation for services (or office space or loans) provided. And again, the new Section 4967 provides a seemingly redundant absolute prohibition on the transactions because they would presumably constitute "distributions" that conferred a "more than incidental benefit" on a donor, again even if all were at market rates.[136]

In other words, the 2006 PPA goes beyond applying the private foundation regime to DAFs and their sponsors; instead, it absolutely prohibits transactions that could give rise to self-dealing, even when those transactions could plausibly obtain for the charity goods or services at market or below-market rates. In assessing whether DAFs are an attractive vehicle for abusive self-dealing, one must recognize that they are governed by the strictest anti-self-dealing regime there is.[137]

B. Noncharitable Distributions

In the previous section, I discussed self-dealing, which occurs when disqualified persons use a charity to provide financial benefits to themselves or their family. In this section, I discuss "noncharitable distributions," which are made when charitable assets are used for any *other* noncharitable purposes. The laws relating to noncharitable distributions apply to direct expenditures from charitable entities, but they also provide rules about distributions from a charitable entity to a noncharitable entity or natural person, even if the intent of those distributions is charitable. For example, when a private foundation makes a grant to an individual, it must employ special procedures (called "expenditure responsibility") to ensure that the grant is used by the individual for the charitable purposes intended by the private foundation. The 2006 PPA introduced I.R.C. § 4966, which provides a more restrictive regime with respect to noncharitable distributions for donor-advised funds than even the one that applies to private foundations.[138]

In order to illustrate the three legal regimes governing noncharitable distributions—one for public charities, one for private foundations,

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136. When a taxpayer contributes illiquid property to a charity, there is always a possibility of abuse in the taxpayer inflating the value of the property. It is very hard for the IRS to police such abuse, so it is hard to design an optimal charitable contribution system that permits a deduction for the full fair-market value of donated illiquid property. *See* Colinvaux (2013), *supra* note 15, at 305.

137. REISER & DEAN, *supra* note 20, at 69 (contending that the Treasury Report "reassured Congress, [that the law] would suffice to prevent abusive distributions from DAFs for noncharitable purposes or to donors themselves").

138. One interesting example of a noncharitable use of funds that could be relevant to DAFs is payments made to student-athletes by NIL Collectives. *See* I.R.S. CHIEF COUNS. MEMO. AM 2023-004 (May 23, 2023).

and one for donor-advised funds—I focus on an especially important example of noncharitable distributions: those made for certain political purposes, such as lobbying or election-related expenditures, that public charities, private foundations, and DAF sponsors are all prohibited or restricted from engaging in.

1. Political Restrictions on Public Charities and Private Foundations

Section 501(c)(3) of the Internal Revenue Code provides two distinct restrictions on the political activities of charities. First, it provides that an organization cannot qualify as tax-exempt unless "no substantial part of the activities of [the organization constitutes] carrying on propaganda, or otherwise attempting[] to influence legislation."[139] This so-called "lobbying limitation" restricts (but permits a certain amount of) activities for the purpose of communicating to legislators or the general public the benefits or detriments of existing or proposed laws. Second, Section 501(c)(3) provides that an organization cannot qualify for tax exemption unless it "does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."[140] This second restriction absolutely prohibits charities from attempting to influence elections. Other activities by charities, even if "political" in a wider sense, may well be within their charitable mission, as long as they do not fall within the definitions of either lobbying or campaign activities. Both lobbying and campaign activities, therefore, constitute "noncharitable" activities, even though public charities are generally permitted to engage in a limited amount of lobbying.

Generally, public charities can engage in lobbying activities in two ways. First, they can lobby directly, so long as these activities are not "a substantial part" of their overall activities. Prior to 1976, the substantiality of lobbying was measured only under the "substantial part" test, but Congress enacted a special expenditure-based safe harbor in that year that charities could use if they chose.[141] The safe harbor permits public charities to spend about 20% to 30% of their budget on lobbying activities.[142] But, if a public charity wants to wield

139. I.R.C. §§ 501(c)(3), 170(c)(3).
140. *Id.*
141. *See id.* § 501(h).
142. The calculation is complicated since the percentage gets smaller as the overall budget gets larger. See I.R.C. § 4911(c)(2) for the schedule of "lobbying nontaxable amount." Also, expenditures for grassroots lobbying are subject to a lower threshold. *Id.* § 4911(c)(4). Expenditures between 20% and 30% of overall expenditures are subject to a very reasonable tax, and it is only expenditures over 30% (or the lower threshold for

greater legislative influence, it can create a wholly-controlled affiliate organization (most commonly one exempt under Section 501(c)(4)) which can raise its own funds, on a non-deductible basis, for unlimited additional lobbying. The United States Supreme Court has held that this so-called "alternate means" for lobbying with unlimited funds is a necessary component of the constitutionality of the lobbying limitations on charities.[143]

Unlike lobbying limitations, campaign activities are (at least theoretically) absolutely prohibited to all 501(c)(3) organizations, including public charities, under the so-called "Johnson Amendment."[144] The IRS has taken the position that this campaign-intervention prohibition prevents public charities not only from making contributions to candidates or otherwise spending funds for or against candidates, but also prohibits them from communicating their views on the qualifications of candidates for office, sharing mailing lists or other resources with candidates, holding voter education forums unless they are nonpartisan, and other less visible campaign-related activities.[145] On the other hand, a 501(c)(3) organization may make a grant to a 501(c)(4) organization for general use that is then used by the 501(c)(4) organization for campaign intervention, with no required tracing by the grantor charity.[146]

Private foundations are subject to much more restrictive legal rules with respect to their lobbying and campaign activities.[147] In addition to the general rule that they may not engage in substantial lobbying that

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grassroots lobbying expenditures) that are problematic for the charity. *Id.* §§ 4911(a)(1), 501(h)(1).

143. *See* Regan v. Tax'n with Representation of Wash., 461 U.S. 540, 548 (1983).

144. Samuel D. Brunson, *A New Johnson Amendment: Subsidy, Core Political Speech, and Tax-Exempt Organizations*, 43 YALE L. & POL'Y REV. 354, 357 n.6 (2024).

145. *See* Rev. Rul. 2007-41, 2007-25 I.R.B. 1421.

146. While the Supreme Court has never ruled on the issue, the United States Court of Appeals for the D.C. Circuit has held that the Johnson Amendment is constitutional, just like the lobbying limitations, so long as the "alternate means" structure is available. *See* Branch Ministries v. Rossotti, 211 F.3d 137, 143 (D.C. Cir. 2000).

147. The concern with political expenditures by private foundations is well illustrated by the testimony presented in the 1969 hearings in the Ways and Means Committee in the leadup to the 1969 private foundation law. Thomas Troyer describes testimony by Congressman John Rooney (D-NY) about his political opponent making a speech at a church gathering and then donating to the church from his private foundation and testimony by McGeorge Bundy, the director of the Ford Foundation, about private grants to individuals that were purportedly used in voter registration and school (de)segregation efforts in its attempts to combat racism. *See* Troyer, *supra* note 19, at 60. Thus, the fears about political activities by private foundations were very much present in the motivation to make the noncharitable distribution regime stricter for private foundations than for public charities. *See id.* at 61 ("[I]t imposed penalty tax on any foundation expenditure for a noncharitable purpose. It thereby, for foundations, eliminated a latitude which other charities retained.").

applies to all 501(c)(3) organizations, private foundations are subject to a special excise tax on "taxable expenditures," which include all lobbying expenditures and campaign intervention.[148] Since the excise taxes are quite large, they serve as a prohibition on any lobbying directly by private foundations. In addition, unlike public charities, which may make grants to 501(c)(4) organizations that end up getting used for lobbying or even campaign intervention (as described above), private foundations must use "expenditure responsibility" to ensure that any grant they make to an organization that is not a public charity is not used for a noncharitable purpose, including lobbying.[149] Therefore, private foundations cannot use their funds for lobbying either directly or indirectly through an organization that is not a public charity. If, instead of lobbying directly or making a grant to a non-public-charity, a private foundation makes a grant to a public charity, it is *not* required to trace its funds. So the recipient public charity could use funds for lobbying as long as the lobbying is not too substantial a part of their overall activities.[150] On the other hand, the private foundation could not make a grant to a 501(c)(3) organization that was "earmarked" for lobbying.[151]

2. *Political Restrictions on DAFs*

Prior to 2006, DAFs were treated like public charities and therefore avoided the restrictions on noncharitable distributions (like lobbying) that apply to private foundations. However, the 2006 PPA included a new section, Section 4966, which imposed a penalty tax on "taxable distributions" by DAFs.[152] Rather than just mirror the restrictions that applied to private foundations at the time, these new DAF restrictions went further. For example, the new provision defined taxable distribution to include any distribution from a donor-advised fund to a natural person, effectively prohibiting donor-advised funds

148. *See* I.R.C. § 4945. Also explicitly covered in the definition of "taxable expenditures" are grants to individuals and grants to non-public-charity organizations, unless the foundation follows a series of procedures known as "expenditure responsibility" with respect to those grants. *See id.* § 4945(d)(3)–(4), (h).

149. The expenditure responsibility rules are described in Treas. Reg. § 53.4945-5(b)–(e) (2025).

150. *See, e.g.*, Robert J. Desiderio, Planning Tax-Exempt Organizations § 22C.06(6) (2024).

151. *See* Treas. Reg. § 53.4945.2(a)(6) (2025).

152. I.R.C. § 4966; *see* Colinvaux (2011), *supra* note 24, at 63 (summarizing this provision in the PPA by stating, "with respect to donor advised funds, Congress determined that bright lines backed by sanctions were necessary to control abuses in the expenditure of charitable assets").

from giving scholarships or grants to individuals directly.[153] Private foundations are permitted to give grants to individuals so long as they exercise expenditure responsibility, but DAF sponsors are absolutely prohibited from giving grants to individuals directly.[154] However, with respect to other expenditures, including lobbying, the 2006 DAF provision mirrors the treatment of private foundations. For example, just like private foundations, DAFs are not permitted to make any lobbing expenditures directly. When DAFs make distributions to noncharitable organizations, the distributions must be for a charitable purpose, and the sponsoring organization must exercise expenditure responsibility to make sure that the distribution is used for such purposes.[155] So, like private foundations, DAFs cannot make distributions to non-public charities that are then used for lobbying. Finally, just like for private foundations, the exception to this rule involves grants or distributions made to public charities. If a DAF makes a general-purpose grant to a public charity, there is nothing that prevents that public charity from using that grant for lobbying or other noncharitable purposes, and there is no requirement that the DAF sponsor exercise expenditure responsibility with respect to that grant.[156]

Because the Treasury released proposed regulations for I.R.C. § 4966 on November 14, 2023, we now have more information on the government's proposed interpretation of the scope of I.R.C. § 4966.[157] Most importantly for our purposes, the proposed regulations make

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153. I.R.C. § 4966(c)(1)(A). The provision actually permits grants to individuals by creating an exception to the definition of donor-advised fund for any fund or account that gives grants "for study, travel, or other similar purposes," so long as the fund has a committee to choose the recipients of the grants, the sponsoring organization appoints all the members of the committee, the donor-advisors do not control the committee, and the grants are given on a nondiscriminatory basis using procedures approved in advance by the board of the sponsoring organization. *Id.* § 4966(d)(2)(B)(ii).

154. *Compare id.* § 4966(c)(1)(A) ("The term 'taxable distribution' means any distribution from a donor-advised fund . . . to any natural person"), *with id.* § 4945(d)(3) ("the term 'taxable expenditure' means any amount paid or incurred by a private foundation . . . as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirements of subsection (g)").

155. *Id.* § 4966(c)(1)(B), (c)(2). Section 4966(c)(1)(B) requires that all permissible distributions from a DAF to be made for charitable purposes and that expenditure responsibility be exercised to ensure that the distributions are used for such purposes. Section 4966(c)(2) provides exceptions for public charities, sponsoring organizations, or other donor-advised funds. Taken together, these provisions require that expenditure responsibility be exercised whenever the DAF makes a distribution to a noncharitable organization.

156. *Id.* § 509(d)(4)(A)(i) (exempting grants to public charities from the definition of "taxable expenditure").

157. *See* Taxes on Taxable Distributions from Donor Advised Funds Under Section 4966, 88 Fed. Reg. 77,922 (Nov. 14, 2023).

it very clear that a distribution to an organization that is not a public charity is a taxable distribution if it is used for "attempting to influence legislation." In other words, if a DAF makes a distribution to a 501(c)(4) organization, it must exercise expenditure responsibility to make sure that the distribution is not used for lobbying, even though other public charities are permitted to make expenditures for lobbying directly or as a distribution to a 501(c)(4) organization.[158]

The legal regime that applies to noncharitable distributions, therefore, is somewhat more restrictive for donor-advised funds than for private foundations, although much of it mirrors the rules that apply to private foundations. Section 4966 requires donor-advised funds to refrain from making distributions to organizations that are not public charities unless they exercise expenditure responsibility to ensure that the funds are used for proper charitable purposes, and lobbying does not count as a charitable purpose.

C. Continued Control Over Business Assets

At the heart of Congress's concerns in the 1950s and 60s about abuse of charities was the perception that "so-called charitable foundations or trusts . . . serve as a cloak for controlling businesses."[159] The fact that there was a robust estate and gift tax at that time meant that the cost of passing on large family businesses between generations was high. One way to avoid the tax was to donate a controlling interest, or an interest that was controlling when combined with other interests held by the family, to a charitable foundation that was controlled by the family. By structuring the charity so the heirs controlled it, family control of the business could be maintained in perpetuity.[160] This "type of device" was perceived to be an abuse of the tax system, but it was not until 1969 that Congress attempted to shut it down as part of a sweeping reform of private foundation law.[161]

158. The proposed regulations contain some additional requirements for distributions to noncharitable organizations, like the fact that the recipient organization is required to "either separately account for the grant funds on its books or to segregate the grant funds." *Id.* at 77,941.

159. Troyer, *supra* note 19, at 53 (Treasury Secretary Snyder's comments to the House Ways and Means Committee).

160. *See id.* ("Frequently families owning or controlling large businesses set up private trusts or foundations to keep control of the business in the family after death. . . . Your committee believes that denial of deductions in such cases is simply a recognition of the fact that where such control exists no completed gift for which a deduction should be granted has been made.").

161. *Id.* Despite these concerns, the 1950 legislation did not prevent continued control of family business interests by private foundations. This feature continued to be a significant selling point for the creation of private foundations, as evidenced by

The 1969 Act included Section 4943, which effectively placed a cap on the portion of a business a private foundation could own.[162] It did that by imposing a tax on the value of "excess business holdings," and "[t]his confiscatory tax is so high that no rational foundation would ever pay it."[163] The general rule is that a private foundation, together with all "disqualified persons" (a category including substantial contributors, foundation managers, and persons related to them), cannot own between them more than 20% of the voting stock of a business.[164] There are exceptions to the general rule that permit greater ownership of nonvoting interests in a company where control is not vested in disqualified persons.[165] This provision was designed to close the abusive use of private foundations to extend family control of family-owned businesses while avoiding the estate or gift tax that might otherwise be due on such dynastic control.[166] Generally these provisions have prevented (or seriously dampened) the use of foundations for the purposes decried in the 1960s—avoiding the estate tax while continuing family control of a family business.

Public charities are not subject to any such limitation, since the "excess business holdings" regime does not apply to them. They may own a majority interest in a private business and may even own and control the whole business. There are good reasons to permit charities to engage in business activities with wholly owned subsidiaries. For example, sometimes a wholly owned subsidiary is the best way for a charity to engage in mission-driven business activities, sometimes called "social enterprises."[167] As long as subsidiaries are not being used to advance the private financial interests of a donor or other insider, they can be utilized to engage in business activities which advance the organization's mission but are insufficiently charitable to be conducted by the charity itself. Presumably they are prohibited for private foundations because the risk of donor benefit was perceived to be too high.

an article in Business Week published on May 7, 1960. *Id.* at 54 (reprinting the article, which reads: "[D]o you have a sizable family business that you want to pass control to your heirs, despite crippling Federal estate taxes? . . . If properly set up . . . [a private foundation] pays no Federal taxes at all; yet it can be kept entirely under the control of its founder and his family.").

162. I.R.C. § 4943.

163. *See* Dana Brakman Reiser, *Foundation Regulation in Our Age of Impact*, 17 PITT. TAX REV. 357, 360 (2020).

164. *See* I.R.C. § 4943(c).

165. *See id.* § 4943(c)(2).

166. *See* Troyer, *supra* note 19, at 53–54 (discussing the same provision in a 1950 bill which "first sounded a theme that has governed the development of the law in the field from that day").

167. *See, e.g.*, Leff, *supra* note 134, at 2–4.

Prior to 2006, DAFs were treated the same as other public charities and were not subject to any restriction on excess business holdings.

The 2006 PPA generally applied the private foundation excess business holdings rule to DAFs.[168] In doing so, it defined "disqualified persons" with respect to DAFs to include anyone who expects to have advisory privileges with respect to the DAF, members of their family, and certain corporations under their control.[169] By making reference to the donor-advised fund itself, as opposed to the DAF sponsor, the law treats each individual DAF as its own virtual private foundation with respect to the application of the excess business holdings rule. To the degree to which the private foundation excess business holdings rule is effective at preventing the kind of abuses that were common prior to 1969, the extension of the rule to DAFs in 2006 would be effective at preventing similar abuses by DAFs. The law is designed to prevent donors who control business entities from giving interests in those entities to their DAFs while continuing to benefit from controlling them.[170]

It is important to note that the excess business holdings rule prevents private foundations or DAFs from *holding* excessive interests in businesses controlled by donors, but it does not prevent them from *acquiring* such interests. Regulations provide that no tax will be imposed on any excess business holdings if those holdings are disposed of within 90 days.[171] So, a person who owns a controlling interest in a closely-held business may donate any portion of that business to a DAF, take a charitable tax deduction for the value of that donation, and then advise that the DAF dispose of that interest within 90 days, either by sale or a further charitable contribution. The rule is designed to prevent donors from maintaining family control of closely held businesses in perpetuity, not to prevent them from getting a tax deduction for donating interests in their businesses to charity.

The history of legislation addressing excess business holdings followed a very similar trajectory to that of the legislation addressing self-dealing and noncharitable distributions discussed above. Prior to 2006, the fact that DAF sponsors were treated like public charities rather than private foundations created opportunities for abuse. But the

168. Pension Protection Act of 2006, Pub. L. No. 109-280, §§ 1212(c), 1233(a), 1243(a), 120 Stat. 780, 1074, 1099, 1105; I.R.C. § 4943(e).

169. *See* I.R.C. § 4943(e)(2).

170. *See, e.g.*, Benjamin M. Leff, *Charity Fraud in the News – Michael Meyer and the Family Office Foundation*, NONPROFIT L. PROFESSORS BLOG (Aug. 17, 2023), https://www.nonprofitlawprofblog.com/2023/08/charity-fraud-in-the-news-michael-meyer-and-the-family-office-foundation.html [https://perma.cc/8HB5-4QFG] (exemplifying an obvious abusive misuse of DAFs that includes continuing control of businesses).

171. Treas. Reg. § 53.4943-2(a)(1)(ii) (1986).

2006 PPA imposed a new, strict standard on DAFs. In the case of excess business holdings, it simply applied the private foundation regime to DAFs and defined donor-advisors as disqualified persons with respect to their DAFs. The 2006 PPA dealt with these three issues related to DAFs by putting them all under a heightened regulatory regime: the same as private foundations in the case of continuing control of businesses, slightly more restrictive than private foundations in the case of noncharitable distributions, and significantly more restrictive than private foundations in the case of self-dealing.

D. Avoiding the Restrictions on DAFs Using the Public Support Test "Conduit" Strategy

As discussed above, the 2006 PPA imposed a quite restrictive penalty regime to prevent self-dealing, noncharitable distributions, and continuing control of businesses by DAFs. But there is a loophole in the regime that could open the door wide for these types of abuse. That loophole is for the DAF advisor to use the DAF as a "conduit" to pass charitable assets through the DAF to a 501(c)(3) organization that they control.[172] DAFs already function as an intermediary by which donors make charitable contributions to the DAF sponsor that are only used for charitable purposes when they are distributed from the DAF to "operating" charities. The conduit strategy does not involve this normal intended use of a DAF as a charitable contribution intermediary. Instead, it involves passing charitable contributions through the DAF to a charity controlled by the donors, thereby moving charitable funds to an entity that formally qualifies as a public charity, subject to the least restrictive regime, even though the charitable recipient functionally resembles a private foundation. This controlled charity could even be an intermediary, just like a DAF or a private foundation, that does nothing other than make grants to operating charities. This strategy is arguably permitted under current law.[173]

1. Understanding the Public Support Test Loophole

In order to understand how the conduit strategy works, it is worth starting with the way that Congress defined private foundations in 1969. As discussed above, Congress was worried about charities that were

172. *See* Benjamin M. Leff, *Donor-Advised Funds Abuse*, NONPROFIT L. PROFESSORS BLOG (June 27, 2023), https://www.nonprofitlawprofblog.com/2023/06/donor-advised-funds-abuse.html [https://perma.cc/5F6S-26XB]. It is unclear how widespread this strategy is.

173. The legality of this strategy, and certain firms' policies against it is further addressed below. *See infra* section 2.

overly controlled by their donors, so they chose to define a private foundation primarily with reference to a concept called the "public support test." Some traditional kinds of charities like churches, schools, and hospitals qualify as public charities no matter where their financial support comes from. The theory is that these organizations generally have multiple stakeholders like parishioners, students, and patients that prevent them from being prone to abuse by their donors.[174] But for most organizations, the test for determining whether the organization is a private foundation or a public charity involves calculating how much "public support" the charity receives.[175]

The public support test is a mathematical equation in which the total amount of financial resources received by the organization over the year is classified as "total support," with a portion of that total support qualifying as "public support." Public support generally must be at least one-third of the total support for the organization to be considered a public charity.[176] Focusing specifically on contributions or grants, contributions from any single family can generally count as public support to the degree to which the contributions do not exceed 2% of total support, but any contributions in excess of the 2% threshold do not count as public support.[177] So, if a charity receives total support of $1 million in a single year, any single donor (or group of related donors) can only give $20,000 of "public support."[178] But, because the organization only needs one-third of its total support to be public support, that same single donor can give another $666,000 of *non*-public support without causing the organization to fail the public support test. As long as the charity receives $314,000 of public support from other donors, its total public support ($334,000) would exceed one-third of its total support, satisfying the public support test.[179] In other words, the

174. I.R.C. § 509(a)(1) (citing I.R.C. § 170(b)(1)(A)(i)-(iv)).
175. *Id.* §§ 170(b)(1)(A)(vi), 509(a)(2).
176. Technically, there are two public support tests: (1) I.R.C. § 509(a)(2) and (2) I.R.C. § 509(a)(1) (referencing I.R.C. § 170(b)(1)(A)(vi)). The second test has been called the "donative" public support test. *See* Shane T. Hamilton & Bruce R. Hopkins, The Law of Tax-Exempt Organizations 302 (13th ed. 2025). In this Article, the description of the law is drawn from the donative public support test.
177. Under the donative public support test, any donor's contribution of up to 2% of total support can count as public support, but any amount in excess does not. *See* Treas. Reg. § 1.170A-9(f)(6)(i).
178. *See id.*
179. The math is like this: $20,000 + $314,000 = $334,000, which is greater than a third of $1,000,000, qualifying the organization for public charity status. The test is even more lenient than this math implies because an organization can opt to qualify as a public charity using a "facts and circumstances" test that permits public support to be as low as 10% rather than the regular 33.3%. *See id.* § 1.170A-9(f)(3).

public support test is not hard to meet for organizations that get their support from contributions.[180]

Importantly, when making the public support calculation, grants from private foundations are treated as if they come from an individual donor, so only 2% of total support can count as public support, while the entire amount of grants from public charities count as public support.[181] In calculating the public support test, contributions from public charities count as public support even if a contribution from any one charity exceeds 2% of total support because public charities are not considered individual donors for the purposes of the calculation. So, to take an extreme example, if a single public charity provides all the support for a recipient charity, that recipient charity would pass the public support test and be classified as a public charity even though all of its funds came from a single source, because that single source is itself a public charity. That is not true of funds received from a private foundation.[182] The 2006 PPA did not make any changes to the public support test with respect to donations from DAFs, so DAF sponsoring organizations are treated as public charities (which they formally are under the law) rather than as private foundations when recipient charities are calculating their public support.

To illustrate the conduit strategy being used to abuse the public support test, imagine a donor named Ben who first opens a DAF at a DAF sponsoring organization (let's call it the Community Foundation) and donates money or property to it (let's say, a million dollars). Second, Ben creates a charity (let's call it the "Giving Fund") for any legitimate charitable purpose(s). This purpose could be as simple as receiving funds to donate to other existing charities, since serving as a charitable intermediary is a proper charitable purpose under existing law. Third, Ben advises the Community Foundation to distribute his million-dollar donation to the Giving Fund. Under current law, there is no legal impediment preventing the Community Foundation from making the distribution as requested by Ben, and again under current

180. Importantly, investment income also does not count as public support, *see* I.R.C. § 509(d)(4) (including "gross investment income" in the definition of "support" but not "public support"), so organizations with very large endowments would not be able to accept such a large donation (relative to total support) from a single donor without risking failing the public support test. *See also* Treas. Reg. § 1.170A-9(f)(9) (Example 5 describing an organization that is not publicly supported in part because of too much investment income).

181. *See* Treas. Reg. § 1.170A-9(f).

182. Contributions to a charity from a business corporation or a 501(c)(4) organization also do not count as inherent public support, but instead are subject to the 2% rule for disqualified persons. *Id.*

law, it is proper for the Giving Fund to treat the distribution from the Community Foundation as "public support" when it is determining whether it is a private foundation or a public charity. In other words, the DAF sponsor is not committing any legal wrong when it distributes the funds to a charity controlled by Ben, and the recipient charity isn't committing any legal wrong when it treats the distribution as if it is coming from a public charity instead of from Ben directly. That means that even if the *only* funds the Giving Fund receives is this single grant from the Community Foundation (ultimately, but not directly, from Ben), the Giving Fund has 100% public support, easily qualifying for public charity status. If instead the money came directly from Ben or came from a private foundation, it would not count as public support, and the charity would be classified not as a public charity but as a private foundation. Therefore, if Ben passes his contributions *through* a DAF to a charity he controls, the private foundation restrictions on self-dealing, noncharitable distributions, and excess business holdings do not apply to the Giving Fund, as it is instead governed by the much more permissive regime that applies to public charities, even though it has only one donor, Ben, and is fully controlled by Ben.

More importantly, the Giving Fund is also not a DAF or a DAF sponsor, even though all of its funds (indirectly) come from a single donor who has the ability to control how the Giving Fund spends its money. So, the restrictions on self-dealing, noncharitable distributions, and excess business holdings that apply to DAF sponsors don't apply to the Giving Fund. Instead, the Giving Fund is subject to the least restrictive rules. In this example, Ben is a disqualified person with respect to the Giving Fund because he controls it, but this relationship is controlled by the rules that govern all public charities, not private foundations or DAF sponsors. That means, for example, that the Giving Fund can pay its executive director, Ben, reasonable compensation for the services he provides to it, like analyzing potential recipient charities or making investment choices for the giving fund. This compensation would still be permissible if the Giving Fund were a private foundation, but not if it were a DAF sponsor. It could pay compensation to his children or spouse, so long as they provide personal services that are "reasonable and necessary" to the operation of the Fund. He could be reimbursed for travel expenses to attend meetings of the Fund in fun locations, as could his family if they were providing services to the Fund, again just like he could if it were a private foundation, but not if it were a DAF. Ben could share office space with the Fund and allocate the costs of such space between him and the Fund on any reasonable basis, which he would be prohibited from doing if the Fund were a private foundation or if it were a DAF sponsor. Or, the Fund could borrow money from or lend money to Ben at market rates, which would not be permissible for either a private foundation or a DAF sponsor. Therefore, Ben has much more ability to legally benefit himself or his family using funds in the Giving Fund than he would have if those funds were housed in a private foundation or a DAF.

If Ben is willing to give up direct control over the Giving Fund, and exercise his control solely through his donations, he would not even be subject to the least restrictive rules on insider transactions because he will not be a disqualified person at all with respect to the Giving Fund.[183] In addition to directors and officers being disqualified persons, "substantial contributors" (those who give more than 2% of the organization's support) are also disqualified persons in recognition of the fact that people who make substantial contributions to an organization often exercise substantial control over the organization, just like those who hold formal control. But because Ben has provided his funds through a DAF, the Fund can treat the funds as coming from the DAF sponsor, not Ben. They can therefore decide that Ben is not a substantial contributor, and thus not a disqualified person. So, he is not subject to the penalties on excess benefit transactions.

Similarly, Ben could use his funds held by the Giving Fund for noncharitable purposes, like lobbying, to the extent permitted to any public charity, even though he is the only donor and controls it.[184] Remember, if Ben wanted to get a charitable tax deduction for money used for lobbying activities, he would have to give his money to a public charity, which presumably would be subject to the influence of the other stakeholders and donors. He could not donate to a private foundation and use the money for lobbying because private foundations are prohibited from doing so. Nor could he use money in a DAF to lobby.[185] But, if he directed his DAF to distribute his donations to a charity he controls, that charity could lobby with the money even if Ben is the only donor to it and Ben controls it. If Ben wanted to use charitable funds to engage in campaign activities, he could use a similar strategy to direct his funds to the Giving Fund, and then the Giving Fund could make a general use grant to a 501(c)(4) organization, even one controlled by Ben, which

183. *See* I.R.C. § 4958(f).

184. Taxes on Taxable Distributions from Donor Advised Funds Under Section 4966, 88 Fed. Reg. 77,922, 77,940 (Nov. 14, 2023).

185. If he wanted to distribute money from his DAF to a 501(c)(4) organization, the DAF would be required to exercise "expenditure responsibility" with respect to the distribution, just as a private foundation would, to ensure that the distribution was not used for lobbying or other noncharitable purposes.

could then use the money to intervene in an election. Neither a private foundation nor a DAF sponsor can do that either. Ben has contributed *through* the DAF sponsor to end up with his charitable money held in the least restrictive form. I think it is fair to describe this "conduit" strategy as an abusive loophole in the self-dealing and noncharitable distribution regimes that apply to public charities, private foundations, and DAF sponsors.

Likewise, the conduit strategy makes a complete mockery of the excess business holdings rule that applies to DAFs. While neither a private foundation nor a DAF sponsor can hold an excessive interest in a single business, especially if any of that business is owned by a disqualified person, a public charity can. So, Ben could make a donation of a 30% interest in his company to a DAF (while retaining a 21% interest himself). He could then advise the DAF to distribute the entire interest to a controlled charity like the Giving Fund within 90 days. Through these two transactions, Ben made a donation of 30% of his company and is thus entitled to a charitable deduction for the value of that donation. But because he retains a 21% interest and he controls the public charity that now owns an additional 30% of the company, he effectively controls a 51% interest in his company, even though he received an income-tax deduction for his "contribution" of the 30% interest. He also avoids any estate tax that might have been due on the value of that interest had he retained it or tried to pass it on to his children. Moreover, the controlled public charity can hold on to that asset indefinitely, since Section 4943 (the excess business holdings rule) does not apply to public charities.[186]

2. *Responses to the Public Support Test Loophole*

This loophole did not escape the attention of the IRS and Treasury, which addressed it in 2017 by issuing Notice 2017-73.[187] An IRS Notice does not itself provide a current IRS interpretation of the law, but it puts taxpayers on notice that the agency is contemplating issuing guidance, possibly in future regulations. In Section 5, the Notice expressly addresses "preventing attempts to use a DAF to avoid 'public support' limitations."[188] It proposes that the Treasury Department and the IRS,

186. Lack of robust reporting rules for DAFs makes it very difficult for the IRS to monitor or enforce excess business holdings rules against DAF sponsors. I.R.C. § 4943(e)(2) defines "disqualified persons" with respect to a DAF, but there is no requirement that a DAF sponsor report all of the disqualified persons on a fund-by-fund basis.

187. I.R.S. Notice 2017-73, 2017-51 I.R.B. 562.

188. *Id.* at 565.

"solely for the purposes of determining whether the distributee charity qualifies as publicly supported, [treat] a distribution from a DAF as an indirect contribution from the donor (or donors) that funded the DAF rather than as a contribution from the sponsoring organization."[189] The government is aware that some contributions from a DAF are made anonymously, so the Notice proposes treating all anonymous contributions from a sponsoring organization to a distributee charity as if they came from a single person.[190] The Notice does not specify exactly where the guidance describing this treatment would appear, but this treatment of the public support test is mentioned separately from other DAF guidance in the IRS's 2024 Priority Guidance Plan. In defense of such treatment, the Notice states that "[s]uch treatment would better reflect the degree to which the distributee charity receives broad support from a representative number of persons."[191]

Some large DAF sponsoring organizations have enacted policies or procedures that purport to prevent donors from using them as conduits to create controlled public charities, although these policies do not generally go as far as the regulations the Notice proposes.[192] However, even if these policies are sufficient to close the loophole with respect to the DAF sponsoring organizations that have adopted them, presumably some DAF sponsors do not have or enforce any policies that prevent this loophole from being used, permitting the most abusive use of this loophole for any donor who finds a compliant DAF sponsor.[193]

Some recent coverage of the billionaire and conservative political activist Leonard Leo illustrates how a donor can use the conduit strategy to have continued control over charitable assets and thereby avoid the restrictions placed on both private foundations and

189. *Id.* at 566.
190. *Id.*
191. *Id.*
192. *See, e.g.*, FIDELITY CHARITABLE, PROGRAM GUIDELINES 9 (2025), https://www.fidelitycharitable.org/content/dam/fc-public/docs/programs/fidelity-charitable-program-guidelines.pdf [https://perma.cc/6BG2-MW6U] ("Fidelity Charitable reserves the right to perform additional due diligence and to decline to make a grant . . . where Fidelity Charitable is unable to determine in its sole discretion . . . that the Account Holder, Authorized Person, and related persons do not control the organization.").
193. Even the AICPA, in its criticism of the Treasury's proposal, concedes that "[a] significant form of abuse would possibly occur where a controlling donor prefers to structure an organization as a public charity rather than a private foundation, but the donor does not intend to seek broad public support." Am. Inst. of Certified Pub. Accts., Comment Letter on I.R.S. Notice 2017-73 – Request for Comments on Application of Excise Taxes With Respect to Donor Advised Funds in Certain Situations 7 (July 24, 2019) [hereinafter AICPA Letter].

donor-advised funds.[194] Dan Petegorsky reports that Leo transferred funds from the Marble Freedom Trust, a 501(c)(4) organization that he controls, to a donor-advised fund at Schwab Charitable (now called "DAFgiving360"), one of the largest donor-advised fund sponsors.[195] He then advised Schwab Charitable to distribute the funds to the 85 Fund, a 501(c)(3) organization controlled by Leo. This use of Schwab Charitable as an intermediary between the Marble Freedom Trust and the 85 Fund "allow[s] the 85 Fund to maintain its status as a public charity even though it's controlled and funded by Leo."[196] If the 85 Fund received its money directly from the Marble Freedom Trust, it would fail the public support test and be classified as a private foundation because transfers from a 501(c)(4) organization do not count as public support. Similarly, if the Marble Freedom Trust is largely funded by a single donor,[197] then contributions from that donor to the 85 Fund would also not count as public support. Yet, the 85 Fund has avoided this despite the fact that the "donor-advised funding from Schwab now constitutes almost all of the 85 Fund's revenue."[198]

As discussed, this conduit strategy is formally legal, but Schwab Charitable (now DAFgiving360) has a policy against it. Its guidelines explain that it "generally will not approve a grant recommendation to an organization that is controlled by" the DAFgiving360 donor-advisor.[199]

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194. *See* Dan Petegorsky, *How One Donor-Advised Fund Helps Leonard Leo Weaponize Philanthropy*, INEQUALITY.ORG (Sept. 26, 2024), https://inequality.org/article/leonard-leo-donor-advised-fund/ [https://perma.cc/HJ45-FVLR]; Emily Birnbaum, *Schwab Charity Funnels $250 Million to Right-Wing Causes*, BLOOMBERG (May 1, 2024), https://www.bloomberg.com/news/articles/2024-05-01/charles-schwab-donor-advised-fund-fuels-leonard-leo-s-network [https://perma.cc/2AVA-ZBSX].

195. Petegorsky, *supra* note 194. This is an unusual transaction because the money first flows from individual donors to a 501(c)(4) organization, which prevents the individual donors from getting a charitable tax deduction for their contributions. Then the money flows from the 501(c)(4) organization into a donor-advised fund, and then from there into a 501(c)(3) charity controlled by Leo. Thus, there is no tax advantage (that I know of) to using the DAF structure, whereas if the money had flowed directly from donors into the DAF and then out to the Leo-controlled charities, the donors would have been able to deduct the contributions. For a study of the use of DAFs for politically motivated charities, see Helen Flannery & Brian Mittendorf, *Are Donor-Advised Funds Facilitating Opaque Giving to Politically Engaged Charities?* (Fisher Coll. of Bus., Working Paper, 2024), https://ssrn.com/abstract=4744533.

196. Petegorsky, *supra* note 194.

197. It appears that the Marble Freedom Trust is primarily or exclusively funded by Barre Seid, the conservative founder of Tripp Lite, an electronics company. *See Marble Freedom Trust*, WIKIPEDIA, https://en.wikipedia.org/wiki/Marble_Freedom_Trust [https://perma.cc/2FZD-68RZ].

198. *Id.*

199. DAFGIVING360, PROGRAM POLICIES 25 (2024), https://www.dafgiving360.org/resource/dafgiving360-program-policies [https://perma.cc/WQ7U-LENS]. Also, Petegorsky reports that "Schwab Charitable generally will not approve grants to

Of course, the word "generally" means that the policy does not bind DAFgiving360 to take action in any individual case. But whether this is a case of one of the largest donor-advised fund sponsors ignoring its own policies or departing from its "general" practice for a major donor, the effect is the same: The DAF sponsor's policies did not prevent at least one major donor from using the conduit strategy to avoid both private foundation and DAF restrictions on the use of funds. Once these funds are in the control of the 85 Fund, they can be spent to influence legislation, so long as the limits on lobbying spending are observed. Possibly more importantly, they can be transferred to a 501(c)(4) organization to be spent on lobbying or campaign intervention without the need to exercise "expenditure responsibility" so long as the funds are not "earmarked" for those noncharitable purposes.

Some members of Congress have recognized this loophole in the public support test and proposed to fix it as a part of the Accelerating Charitable Efforts Act.[200] Section Six of the Act would codify the treatment described in Notice 2017-73: Distributions from a DAF sponsor would be treated as coming from the donor-advisor if the sponsoring organization identifies the donor-advisor. If the sponsoring organization does not identify the donor-advisor, then all unidentified distributions would be treated as coming from a single person.[201]

There is an irony to the conduit loophole with regards to what Roger Colinvaux calls the "delayed benefit problem," which refers to the ability of donors to warehouse charitable contributions in DAFs without any required distribution to operating charities. Because the conduit loophole involves transferring charitable assets out of DAFs and into recipient charities that legally qualify for public charity status, it would appear to an outside observer that the charitable assets are

organizations that would likely be considered non-operating foundations absent the Schwab Charitable grant." This policy is a little squirrely (intentionally or not) because, under its terms, it would permit a grant that would cause the recipient to be classified as a nonoperating foundation if it were treated as coming from a single individual as long as the organization would have sufficient public support if the grant weren't made. A single dollar of public support would presumably suffice even if the grant from the DAF was for a hundred million dollars. Petegorsky, *supra* note 194.

200. *See* Accelerating Charitable Efforts Act, S. 1981, 117th Cong. (2021).

201. *Id.* § 6. For discussion of this solution, see *supra* notes 187–91 and accompanying text. The only exception in the bill to this treatment is that any distribution from a DAF sponsor not made pursuant to advice from a donor-advisor is not counted as coming from a donor-advisor. Because many DAF sponsors do not *only* have funds that are in DAF accounts, they can make distributions for which no person has advisory privileges, and these distributions should properly not be attributed to any advisor. For example, if a community foundation receives contributions that do not go into any DAF, then, upon subsequent donation, those non-DAF funds are properly attributed to the community foundation itself, not any donor-advisor.

being used for charitable purposes in a timely way. If the donors want, they could contribute charitable assets to the DAF and transfer them back out of the DAF as soon as the original transaction cleared. While reformers like Colinvaux and the legislative sponsors of the ACE Act have proposed rules requiring DAF sponsors to transfer some portion of their assets out of the DAF to public charities every year, the conduit strategy (if the loophole is not closed) would make a mockery of these reform efforts since they could be avoided by simply transferring DAF assets to controlled public charities. The public charities could then warehouse the assets for as long as they desired since there is no legal requirement for public charities to spend their funds on any particular timeline. Even worse for present purposes, it is difficult to assess what portion of DAF distributions every year go to public charities with actual broad support and what portion go to controlled charities that only count as public charities because of this flaw in the public support calculation.

The landscape of DAF abuses is therefore not quite as it has been described by DAF critics *or* by DAF supporters. On one hand, the statutory regime enacted under the 2006 PPA imposes quite strict rules that should be sufficient to prevent most self-dealing, noncharitable distributions, and continued control of businesses. The regime is significantly stricter than the private foundation regime, preventing a variety of quasi-self-dealing and noncharitable uses that are actually permitted for private foundations.[202] On the other hand, loopholes in the law, like the conduit strategy, undermine the statutory regime in ways that dramatically reduce the efficacy of the restrictions. Presumably, the number of donors making use of the conduit strategy is small compared to the millions of donors using DAFs, but there may still be a significant amount of money being transferred through DAFs under the strategy, warranting correction. In the next section, I argue that closing the public support test loophole in a way that is sensitive to the benefits of donor-advised funds is the key to better regulating DAFs.

IV. Preventing DAF Abuses

As discussed above, DAFs potentially provide two very different types of benefits. For retail donors, they provide some of the benefits

202. Examples of "quasi-self-dealing" permitted for private foundations but denied to DAFs include putatively reasonable compensation paid to the donor or family members, the expenses associated with travel for the donor or family members, or the sharing of expenses with a family office, as described *supra* Part III.A.2. Examples of "noncharitable uses" permitted for private foundations but denied to DAFs include distributions to individuals or for scholarships, as described *supra* Part III.B.2.

of private foundations without the complexity or administrative cost. For these donors, the fact that DAFs are restricted from providing certain quasi-self-dealing and noncharitable expenditures even more strictly than private foundations is a feature, not a bug. As long as these donors are not looking for those kinds of more complicated benefits, DAF sponsors can reduce transaction costs by not offering them, and the law serves as a signal and commitment mechanism to back up the limitation on benefits provided. Perhaps counterintuitively, the extra strict limitations on self-dealing and noncharitable uses *facilitate* these benefits of DAFs for retail investors. One common story about over-regulation is that it adds costs to the provision of a desirable service without sufficiently providing benefits to warrant the costs. For example, the stricter regulation of private foundations than public charities is warranted because the fact that private foundations are largely controlled by their donors makes them especially susceptible to self-dealing or noncharitable uses. For retail donors to DAFs, it is hard to imagine how the DAF structure, which includes large professional companies with hundreds or thousands of individual account holders, would make the risk of self-dealing or noncharitable uses *worse* than in private foundations, especially small foundations with no professional staff or public profile. If anything, one would think this structure would be less risky, and so the traditional regulatory narrative would suggest that at most DAFs should be subject to the same regulatory burden as private foundations, not a *stricter* regime. But a plausible argument could be made that the stricter regime adds value not because DAFs are more subject to abuse than private foundations, but because the extra strict rules make it easier for DAF sponsors to streamline the services they provide to their customers and make credible commitments to their customers and the public that there is no self-dealing (even quasi-self-dealing of the type permitted to private foundations) or noncharitable uses in any of their accounts. In other words, requiring DAF sponsors to provide solely plain, vanilla DAFs to their customers forces them to compete only on cost and convenience and to forgo customers seeking accounts from which they can engage in quasi-self-dealing and noncharitable uses. This limitation on the uses of DAFs creates value for retail donors seeking the benefits described above. Anyone who wants the benefits permitted to private foundations but not DAFs is forced to spend the extra money to create and run a private foundation.

But in order for the extra strict regime to be effective at enhancing the value of DAFs for retail donors, it must not be easily abused. The most obviously abusive strategy to avoid the extra strict DAF regulatory regime is the public support test loophole. As discussed above, it permits the avoidance of both the DAF and private foundation restrictions on self-dealing, permitting donors to control charitable assets completely under the most permissive self-dealing regime. It also facilitates the avoidance of both DAF and private foundation restrictions on noncharitable expenditures, again giving donors complete control over charitable assets under the most permissive regime. Finally, the loophole is alarmingly effective at avoiding the excess business holdings regime that applies to DAFs and private foundations by permitting a donor to control a charity that holds any portion of a company indefinitely. This Article has largely avoided any discussion of the delayed benefit problem, but it is worth mentioning that the conduit strategy allows donors to use DAFs to pass money into a completely controlled charity that has no obligation to spend that money on any particular timeline, while their donation can leave the DAF with lightning speed. Perhaps even worse, the conduit strategy allows existing private foundations to avoid their existing payout requirements by making grants to DAFs that are then distributed to controlled charities, which can then hold those funds without spending or distributing them indefinitely.

Therefore, in order for the restrictions contained in the 2006 PPA to be effective, it is essential that the conduit loophole be closed. But there are multiple possible approaches to closing the conduit loophole, and so it is worth asking: Which way is best? It is important for the crafting of good regulation to recognize the legitimate benefits of DAFs for retail donors. It is also important to recognize that regulatory bright lines may be more beneficial to retail donors than regulatory flexibility. This section evaluates three possible rules to facilitate the use of donor-advised funds by retail investors while simultaneously preventing their use as conduits to donor-controlled public charities: (A) prohibiting distributions from DAFs to donor-controlled charities; (B) implementing an "anti-abuse" rule to cover certain distributions from DAFs to charities; and (C) requiring recipient charities to calculate public support as if a distribution from a DAF came directly from the donor-advisor. The third approach is the one proposed by the Treasury in Notice 2017-73 and contained in the ACE Act, and it is arguably the best suited to the proper goals of DAF regulation.

A. Prohibit Distributions to Controlled Charities

As discussed above, many DAF sponsors have policies that some claim should prevent the exploitation of the conduit strategy.[203] For example, DAFgiving360 (formerly, Schwab Charitable) has a

203. *See supra* notes 192–93 and accompanying text.

policy that it "generally will not approve grants to organizations that would likely be considered non-operating foundations absent the Schwab Charitable grant."[204] Obviously, a policy that is only applied "generally" provides very little assurance that it will be enforced by the organization consistently enough to prevent abuses, so the rule would have to apply to all distributions, not just "generally," and not just to those DAF sponsors who chose to implement such a rule. In order to apply the rule consistently, the Treasury could adopt the DAFgiving360 policy as a strict rule: DAF sponsors would be prohibited from making distributions to charities if the recipient organization would fail the public support test without the benefit of the distribution. This rule seems like a simple way to close the public support loophole. But, in fact, it would be very hard to enforce and would probably increase compliance costs considerably if the DAF sponsor were to actually try to implement a system to enforce it.

Remember, an organization passes the public support test as long as at least one-third of its financial support counts as coming from the public. Under current law, a distribution from a DAF sponsor counts as public support even if it all comes from one person. Presumably, DAFgiving360's policy means that it will generally not approve a grant if the recipient organization is relying on counting the grant as public support in order to have more than one-third of its total support count as public support. Again, imagine Ben wants to give a million dollars to a recipient organization, the Giving Fund. One reasonable interpretation of the DAFgiving360 policy is that it will approve a grant if the Giving Fund already had $500,000 of public support (one-third when combined with Ben's $1 million gift).[205]

The rule presumably would create administrative costs for DAF sponsors because the rule is directed at them, not at the recipient organization, even though it is the recipient organization that generally has the information necessary to conduct the public support test. So, for the rule to be operationalized, the DAF sponsor would need to collect sufficient information from the recipient charity so the DAF sponsor can determine the effect on the recipient of treating the DAF's distribution as public support. What kind of minimal diligence could

204. *See* Petegorsky, *supra* note 194.

205. Another possible interpretation is that the policy means that DAFgiving360 will approve the grant so long as at least one-third of DAFgiving360's support other than the grant is public support. So, technically, if the Giving Fund had 51 separate $1 donations from individuals unrelated to Ben and no other support at all for the year, DAFgiving360 could approve the million dollar grant from Ben's DAF because the Giving Fund would have 100% public support "absent the DAFgiving360 Grant." But I think it is fair to assume that DAFgiving360 does not intend that interpretation.

the rule require? One possibility would be that it could require a review of each recipient organization's prior year Form 990 to determine whether the proposed distribution from the DAF could affect the public support test. Forms 990 are publicly available and would enable DAF sponsoring organizations to do at least a rough assessment of the effect of the distribution on the recipient charity's public support calculation. Probably in the overwhelming majority of instances, this review would support a conclusion that the distribution would not affect the organization's public support calculation. But a requirement to review the Form 990 of every charity receiving a distribution from any of the sponsor's DAFs would add a potentially significant compliance cost to DAF sponsors' administration of distributions.

Also, a review of the recipient charity's *prior* year Form 990 would not actually enable the sponsor to evaluate the effect of the distribution in the current year. Since the current year's public support test is calculated based on all support received that year, it is actually not possible to know the effect of any particular distribution until the end of the organization's fiscal year. Would a DAF sponsor hold all distributions to recipient charities until the end of each charity's fiscal year so it can collect the information from each recipient to adequately conduct the review necessary to determine the effect of the distribution on the recipient's public support test? And what if the recipient charity were receiving grants from multiple DAF sponsors? Would each sponsor have to coordinate with all the other sponsors to collect information about proposed grants in order to decide whether they could approve the grant from their DAF? Obviously that kind of diligence would be too awkward and expensive. The point is, working out the level of diligence required for the sponsor to show compliance with the rule is complicated since "full" compliance seems almost impossible. That kind of regulation would raise the cost of administering DAFs even for retail donors who have no interest in the conduit strategy (and have probably never dreamed that other donors are that sneaky).

If the rule did not demand any diligence by the DAF sponsor and only applied if the sponsor happened to have *actual* knowledge of the effect of the distribution on the recipient's public support test, then it would be completely ineffective.[206] It's not clear how to operationalize an "actual knowledge" standard with respect to a large organization like a DAF sponsor anyway, and coming up with systems to operationalize an actual knowledge standard would likely be costly to the DAF sponsor.

206. Implementation would be so obviously costly that it seems implausible that DAFgiving360 does anything to actually apply its own rule. I hope to address "industry self-regulation" of DAFs in a future project.

If a donor-advisor provides advice about a distribution, would each distribution have to be approved by a string of DAF sponsor employees and stakeholders to ensure that none of them have actual knowledge that the distribution could affect the recipient charity's public support test? What if a board member had such knowledge? If that was a problem, then by implication each distribution out of every DAF under the sponsor's control would have to be approved by every single board member. That rule obviously could not be operationalized without the DAF sponsor's activities grinding to a halt. So, it seems clear that DAFgiving360's method for closing the conduit loophole is not a good one.

B. Implementing an "Anti-Abuse" Rule

If it would be too costly to implement a rule akin to the DAFgiving360 policy, another possibility would be to impose an "anti-abuse" rule that only applies to distributions that are purposely made to make use of the conduit strategy. The benefit of an anti-abuse rule is that it would presumably involve lower compliance costs because there would be no need to collect financial information about every recipient charity, only those that could plausibly be used in a conduit strategy scheme. One example of an anti-abuse rule that could be used to combat the conduit strategy is the one that is contained in the Proposed Regulations for noncharitable distributions from DAFs that were released in November 2023. The proposed regulations state that a distribution from a DAF to a public charity that is made "pursuant to a plan" to avoid the restrictions on noncharitable distributions will be treated as a distribution directly from the individual donor.[207] In that context, an example might be a distribution used for a lobbying expenditure. The DAF is not permitted to make the expenditure directly, so a distribution made to a charitable recipient "pursuant to plan" to avoid the restriction on the DAF, that is then used by the charitable recipient for lobbying (which would be permissible), would be treated as if it was made directly from the DAF (which is impermissible). The Treasury Department could include a similar "anti-abuse" rule to

207. *See* Taxes on Taxable Distributions from Donor Advised Funds Under Section 4966, 88 Fed. Reg. 77,922, 77,940 (Nov. 14, 2023) ("If a series of distributions is undertaken pursuant to a plan that achieves a result inconsistent with the purposes of Section 4966 of the Code, the distributions are treated as a single distribution for the purposes of Section 4966. For example, if a donor advises a distribution, that the sponsoring organization subsequently makes, from a donor advised fund to Charity X and the donor or the sponsoring organization arranges for Charity X to use the funds to individuals recommended by the donor, the distribution will be a taxable distribution from the sponsoring organization to individuals.").

prevent the conduit strategy from being used to avoid the self-dealing rules. It would treat a distribution to a charity as coming directly from the donor-advisor if the distribution was made "pursuant to a plan" to use the DAF as a conduit to change the outcome of the public support test for the recipient.[208]

The problem with this rule in this context is the same as the problem with the rule described in subsection A above. It is a rule that applies to the DAF sponsoring organization, not the recipient, and therefore requires the sponsoring organization to create a diligence method to implement the rule. What would an adequate diligence method look like? First, it would be necessary to have a theory about what "pursuant to a plan" means. One possibility for the sponsoring organization is to make sure that none of its employees engage in conduct that could constitute a "plan" to implement the conduit strategy. So, it would train its employees both to explain the strategy to donor-advisors and to provide some kind of counter-message if donor-advisors ever communicate that they have a "plan" to use the DAF in that way. But a policy with such minimal mandatory diligence is similar to the "actual knowledge" standard described previously. As long as no one at the DAF sponsor knows about a donor-advisor's plan, then the rule is not implicated. Of course, this policy then suffers from the same flaw described above: it would plausibly catch very little of the conduct it is meant to catch, since many donor-advisors will be well informed by persons other than employees of the DAF sponsor and are well equipped to implement their "plan" without the actual knowledge of the DAF sponsor or its employees. Also, implementing even this rudimentary policy would have costs, since employees would have to be trained and monitored, and some mechanism would have to be created for dealing with situations in which an employee is informed by a donor about a "plan" or improperly communicates the possibility to a donor-advisor.

Because an anti-abuse rule would require employing some kind of "actual knowledge" standard, and such a standard would be ineffective at identifying abusive behavior, it is probably insufficient to implement an anti-abuse rule. DAF sponsors would have to be liable for "plans" by donor-advisors in some circumstances in which the DAF sponsor had constructive, not actual, knowledge. Therefore, the DAF sponsor would be required to engage in some amount of diligence to ascertain if donor-advisors are using a requested distribution to carry out a plan. For example, if donor-advisors recommend a donation to a charity

208. *See* Benjamin Leff, *More on the Proposed DAF Regulations*, NONPROFIT L. PROFESSORS BLOG (Dec. 4, 2023), https://www.nonprofitlawprofblog.com/2023/12/more-on-the-proposed-daf-regulations.html [https://perma.cc/42KU-VT8V].

they control, it may be that the sponsoring organization should inquire into whether the controlled charity has any contributions from anyone other than the donor-advisors. But that inquiry would require: (1) a mechanism for the DAF sponsor to determine whether a recipient charity is controlled by the donor-advisor; and (2) a mechanism to check the other support, if any, that the recipient charity received in the current year. These inquiries are costly and impractical for the same reasons as for collecting sufficient information to assess the effect of the distribution on the public support test, as described above. Obviously, if the sponsoring organization could ignore charities that are not controlled by the donor-advisor, that would simplify things immensely, but it would still have to determine in each instance who controls the recipient and then employ the more costly assessment in those (presumably rare) cases when the recipient is controlled. But it would also be very easy for the donor-advisor to avoid this rule simply by not controlling the organization directly. Being a substantial contributor to a charity is understood to provide substantial influence anyway, and it would be costly for a sponsoring organization to identify all of the substantial contributors to a recipient charity since they are not listed on the public portions of the Form 990 (and since the conduit strategy distribution could be the means through which the donor-advisor *becomes* a substantial contributor). So, implementing an "anti-abuse" rule to combat the use of the conduit strategy seems ineffective too.

C. Simple Rules for Recipient Organizations

A third option is to forgo rules that require additional diligence from DAF sponsors and instead apply a simple rule to recipient organizations, which are already required to calculate public support under current law. This approach is the one that the Treasury has suggested in Notice 2017-73 for proposal in future regulations,[209] and it is the approach that members of Congress have proposed in the ACE Act.[210] The Notice points out that, generally, distributions from public charities (like DAFs) count as public support for the recipient charity when calculating its public support.[211] However, existing Treasury Regulations provide an exception to this rule for contributions "earmarked" for distribution to a particular charity.[212] A charity may not count funds distributed from a public charity as public support if those funds were "earmarked" by a donor when distributed to the donor charity. In that case, the recipient

209. *See* I.R.S. Notice 2017-73, 2017-51 I.R.B. 562, 566.
210. *See* Accelerating Charitable Efforts Act, S. 1981, 117th Cong. § 6(a) (2021).
211. I.R.S. Notice 2017-73, at 565.
212. *See* Treas. Reg. §§ 1.170A-9(f)(6)(v), 1.509(a)-3(j).

charity should "look through" the transaction and treat the funds as if they came from directly from the initial donor. The Notice proposes "treating, solely for the purposes of determining whether the distributee charity qualifies as publicly supported, a distribution from a DAF as an indirect contribution from the donor (or donors) that funded the DAF rather than as a contribution from the sponsoring organization."[213] It is a simple solution to a potentially significant problem. For the vast majority of recipient organizations, treating DAF distributions as coming from the initial donor rather than the DAF sponsor would have no impact on the public support test. After all, a charity can pass the public support test as long as a third of its support is public, meaning that two-thirds of its support can come from a single substantial donor. Especially for retail donors, there are likely vanishingly few charities that pass the public support test *only* because the support they receive from a single DAF is treated as public support rather than non-public support. As long as the recipient charity is being notified about the identity of the DAF donor-advisor, there is no additional work for it to perform. It simply needs to calculate the public support test using the donor-advisor rather than the DAF sponsor as the donor.

In order to implement this rule, however, the recipient charity would need to know the identity of donor-advisors who advise distributions to the charity. For the vast majority of distributions from DAFs to recipient charities, this does not pose a problem because donor-advisors usually *want* the recipient charity to know who they are.[214] But, as discussed above, some donors want to hide their identity from recipient charities, and one of the reported benefits of DAFs for some donors is the ability to make charitable contributions without the recipient charities knowing the identity of the donor.[215] Under current law, the DAF is under no obligation to share the identity of donor-advisors with the recipient charity. The fact that DAF sponsors can distribute grants anonymously creates some complexity in the application of the relatively simple rule described in Notice 2017-73 because the requirement that recipient charities treat distributions from DAFs as coming from the donor-advisor for public support test purposes requires that recipient charities

213. I.R.S. Notice 2017-73, at 566.

214. *See* Hemel, Bankman & Brest, *supra* note 81, at 300 ("the vast majority of DAF grants are not anonymous").

215. *See* discussion *supra* note 82. Just to be clear, the issue here is whether the recipient charity knows the identity of the donor-advisor, not whether the public has such knowledge. Public charities report their donors to the IRS, but that information is not disclosed to the public. So, even if DAF sponsors were required to report the identity of donor-advisors to recipient charities, that would not result in those identities becoming known to the public. *See* I.R.S. Schedule B (Form 990).

know the identity of donor-advisors. A simple solution to this problem would be to require DAF sponsors to notify recipient charities of the identity of donor-advisors of DAFs that make a distribution to those charities. But that solution would destroy the purported benefit of anonymous donation, which is not necessary in order to close the public support test loophole.

In fact, Notice 2017-73 and the ACE Act propose continuing to permit anonymous distributions to recipient charities, just as they are permitted under current law. Instead of banning anonymous distributions, they propose requiring the recipient charity to treat all anonymous donations from a single DAF sponsor as coming from one person for the purposes of the public support test.[216] This proposed solution has the benefit of simplicity for the recipient and for the sponsor, since no additional record-keeping or diligence is required by the sponsor when making a distribution from a DAF. It is exactly the kind of "bright-line" rule that is desirable for retail DAF donors and the sponsoring organizations that serve them.

The rule proposed by Notice 2017-73 and the ACE Act creates some choices for a recipient charity with respect to anonymous distributions from DAFs. First, if the recipient charity will still pass the public support test when all anonymous donations from DAFs are treated as coming from one person, they can simply treat them as non-public support and forgo requesting any information about the donor-advisor(s).[217] In the vast majority of distributions to operating charities, that should be the case. It is rare for publicly supported charities to pass the public support test by such narrow margins that a few anonymous donations make the difference. In the few cases in which an organization is so dominated by non-public support, or that the anonymous donations from DAFs under control of a single DAF sponsor are such a large percentage of its total support, the recipient charity can request the names of the DAF donor-advisors. But the DAF sponsor is under no obligation

216. *See* I.R.S. Notice 2017-73, at 566; Accelerating Charitable Efforts Act, S. 1981, 117th Cong. § 6(a) (2021). There is an exception for distributions that do not come from any DAF. Presumably that exception is needed to permit distributions from DAF sponsors that are made solely at the discretion of the DAF sponsor without any "advice" from a donor-advisor.

217. *See* I.R.S. Notice 2017-73, at 566 (noting that donor identification information "would only be needed if the donee organization intends to treat a distribution from a sponsoring organization as public support"). Note that since most organizations need only one-third of their total support to be public support, that means that a donor-advisor could provide two-thirds of the total support a recipient organization receives, and the recipient organization would still pass the public support test.

to provide them.[218] It is possible that sponsoring organizations may want to communicate this issue to donor-advisors seeking anonymity to see if they are willing to forgo anonymity in these highly unusual circumstances. These communications might be an administrative burden, but they would be completely optional. It would be the choice of the sponsoring organization if it thought the cost and complexity of such communication was warranted. If the sponsoring organization chose not to communicate with donors under these circumstances, or if donors refused to waive their anonymity, then it would be possible for recipient charities to fail the public support test and be classified as private foundations because of anonymous donations. But, again, this would be an extremely unusual outcome.[219]

The comments to Notice 2017-73 that were submitted by the American Institute of CPAs ("AICPA") may give some insight into the objections major DAF sponsors might have to the government's proposed

218. A donor seeking to use the conduit strategy to make excessive contributions to a recipient charity without causing it to fail the public support test could still use anonymous distributions from DAFs to do it. For example, our donor Ben would simply have to set up DAF accounts at multiple DAF sponsors and advise each sponsor to distribute to the same recipient charity. Anonymous donations from each sponsor would be treated as if coming from a single person, but the distributions from different sponsors would not be aggregated together. Therefore, each distribution could count as public support up to two percent of total support, allowing a recipient charity to pass the public support test even if all its contributions ultimately came from a single donor. *See* Treas. Reg. 1.170A-9(f)(6)(i). So, if Ben gave $20,000 to sixteen different DAF sponsors and advised them to distribute the whole amount anonymously to a single recipient, say the Giving Fund, and then he also gave the Giving Fund $680,000 (bringing the Giving Fund's total support to $1 million), the Giving Fund would qualify as a public charity. Of the $680,000 Ben gave to the Giving Fund directly, $20,000 would count as public support and the remainder would be non-public support. The anonymous donations from the sixteen separate DAF sponsors would each count as coming from a single person, but they would not be aggregated. Because each distribution did not exceed two percent of total support, they would count as public support. So, all $320,000 of anonymous contributions would count as public support, meaning the Giving Fund would have $340,000 of public support, which is more than one-third of its total support, making it a public charity. A donor wishing to go to such lengths to use the conduit strategy would hopefully be pursued by IRS enforcement under a theory that they are engaging in an abusive scheme to evade the law. Alternatively, the rule could be changed to avoid this problem by requiring recipient charities to treat all anonymous donations from all DAF sponsors combined as if they were coming from a single donor. That would be equally simple from an administrative perspective, still be very rare, and prevent the elaborate abusive strategy described, but it would probably cause some charities that would have passed the public support test if they knew the identities of their donors to fail the test. Either version is a reasonable solution to the public support test loophole.

219. It seems likely that the only instances in which a recipient charity would fail the public support test because of anonymous donations would be if the donor was using anonymity in order to more effectively make use of the conduit strategy. In that case, the recipient charity should fail the public support test, since that is the purpose of closing the public support test loophole.

regulations to close the public support loophole.[220] These comments argue that the "complex provisions" in the government's proposal for dealing with anonymous donations "create an undue burden on public charities [that] could [be] overlooked by smaller organizations."[221] As discussed above, the benefit of a rule like the one proposed by the IRS and Congress is that it avoids any substantial administrative burden on DAF sponsors since it merely shifts the way recipient charities compute public support. The burden on recipient charities is also relatively low, however. Recipient charities need to compute the public support test anyway. A mere change of rule that they treat donations from DAFs as donations from donor-advisors and that they aggregate all anonymous donations from a single DAF sponsor as if coming from one person does not create substantial extra complexity. They would have to learn the new rule, of course, but once they understood it, their compliance burden would be quite similar to the current rule.

The AICPA proposes, instead, that the Treasury adopt existing "controlling donor rules" to DAF sponsors, rules that currently apply to supporting organizations (another type of "intermediate" legal entity between private foundations and public charities, as discussed *supra* note 42).[222] Under these rules, a supporting organization is not permitted to accept donations from anyone who (alone or together with other related persons or entities) "controls . . . the governing body" of its supported organization.[223] The AICPA Letter proposes that this rule be applied to DAFs by requiring that a charity that receives a contribution from a DAF "that was created or substantially funded by" a person who controls the recipient charity must look through the DAF to the original donor when calculating their public support.[224] This solution would permit recipient charities to count DAF contributions as public support as long as they were not made by persons who control their governing body. This solution is substantially more administratively complicated than the rule proposed by the IRS because it still requires that the recipient charity know the identity of all donor-advisors so they can determine if any are on the governing board. But then it additionally requires that recipient charities differentiate treatment of donations

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220. *See* AICPA Letter, *supra* note 193, at 7.
221. *Id.*
222. *See id.* at 6–7 (arguing that the Treasury should apply Treas. Reg. § 1.509(a)-4(f)(5) to DAF sponsors).
223. Treas. Reg. § 1.509(a)-4(f)(5)(i). The Regulations do not define "control" in this context, but they expressly reserve the ability to issue future regulations to do that in Section 4(f)(5)(ii).
224. AICPA Letter, *supra* note 193, at 7. "Control" would be determined in the same way it is determined under § 1.509(a)-4(f)(5).

depending on whether the donor-advisor is on their governing body. More importantly, this proposal ignores the fact that the whole premise of the public support test is that a major donor to an organization exerts influence over the organization whether or not that donor directly controls the organization's governing body. So, a rule that permitted donors to use the conduit strategy to move money to recipient charities so long as they do not formally control the governing board of the charity is presumably insufficient to vindicate the regulatory interests at stake in the public support test.

Therefore, the rule proposed by the IRS is the simplest solution that leaves in place the benefit of anonymous distributions to recipient charities. It permits DAF sponsors to do nothing, if they choose, and requires recipient charities only to change the way they compute public support, including understanding the new treatment of anonymous donations.

There is additionally an even simpler solution to the anonymous donor issue, which is to forgo the purported benefits of anonymity by requiring the DAF sponsor to notify the recipient charity of the identity of the donor-advisor. But this seems like regulatory overkill unless prohibiting anonymous donations is an end in itself. The benefits of anonymity for retail donors, described above, include a simple desire to give anonymously, as well as the benefit of avoiding unwanted charitable solicitation, attention, or even fraud. If Congress or the Treasury were to introduce a rule that completely removed the possibility of anonymity in distributions from DAFs to charities, this change would result in a loss of DAF functionality for donors without any added benefits, unlike the changes made by the extra strict anti-abuse rules, which created net benefits. As Professor Jill Manny has pointed out, the significant benefits of DAFs, especially for "merely wealthy donors," warrant a regulatory approach that earnestly avoids overregulation.[225] She urges that, "it is important to determine what regulation is necessary and what regulation will only serve to kill an important philanthropic vehicle."[226] Unless removing anonymity is itself a desirable outcome, either for retail or much larger donors, it is an example of overregulation that is not justified by the desire to close the conduit loophole.

So, how should the Treasury close the public support loophole? If the benefits of anonymous giving to retail donors are to be preserved, then a rule that forces DAF sponsors to identify donors to recipient

225. Manny, *supra* note 24, at 15.

226. *Id.* Professor Manny agrees that ending anonymous giving through DAFs is not a regulatory goal in itself but that closing the public support loophole is, as is ending the use of DAFs by private foundations to satisfy the five percent distribution requirement. *Id*. at 17–18.

charities is undesirable. The proposal contained in Notice 2017-73 preserves anonymity in virtually every case that would apply to a retail donor. Unless the charity relies on those anonymous donations qualifying as public support to pass the public support test, there is no need for the DAF sponsor to do anything. If it does rely on anonymous distributions (beyond two percent of total support) to pass the public support test, then the recipient charity could request the identity of the donor from the DAF sponsor. But if the donor-advisor is unwilling to be identified to the recipient, the DAF sponsor need not do anything. This solution preserves the benefit of anonymous giving in almost every circumstance and imposes no additional record-keeping or compliance burdens on the DAF sponsoring organization. It will prevent very large donors from using the conduit strategy to undermine the regulatory goals of the 2006 PPA, preventing self-dealing, noncharitable uses, and excess business holdings by DAFs. It may also prevent some attempts by very large donors to use DAFs to make anonymous donations. However, the private foundation regime is the one designed by Congress to provide the right balance of benefits and burdens to very large donors wishing to continue to control their charitable contributions, so preventing them from using DAFs to obtain the anonymity not available under the private foundation regime is a legitimate regulatory goal in itself.

Conclusion

Donor-advised funds are the fastest growing part of the charitable sector and are arguably the most important new development in philanthropy in decades. In recent years, major financial institutions have streamlined the process of creating DAFs, opening the vehicle up to a wider range of potential charitable donors. Because of this, a critical analysis of DAFs is warranted. Contrary to the story told by some critics, the dominant story about their success is arguably their ability to provide valuable services to retail philanthropists that reduce the cost and complexity of charitable giving and therefore add value to the philanthropic sector. It is perhaps counterintuitive that the anti-abuse provisions that Congress added to the law in 2006—extra strict treatment of self-dealing, noncharitable uses, and excess business holdings—actually improve the features of DAFs that make them so valuable to retail donors, but they plausibly do. On the other hand, there remain loopholes in the regulatory regime that prevent these anti-abuse rules from being effective, most notably the public support test loophole. Therefore, the challenge of regulating DAFs is to preserve the legitimate benefits that make DAFs so popular among retail donors while closing the loopholes that potentially make them a vehicle for abusive regulatory arbitrage by some very large donors and existing private foundations.

The proper regulation of DAFs can only be understood in the context of the overall regulation of the charitable sector and the theoretical grounds on which it is based. At the heart of the regulation of the nonprofit sector is a set of theories about which types of organizations demand what types of regulatory limitation. Because DAFs share features with both private foundations and public charities, each benefit they receive or provide and each burden that is imposed on them should be evaluated in the wider context of these other types of organizations. This Article has focused on self-dealing partially because it is the area that Congress chose to regulate in 2006, and about which the Treasury is currently writing regulations. Further, public reporting suggests that at least some high-profile figures are utilizing the "public support test" or "conduit" loophole that I identify. But even beyond these urgent and concrete concerns, self-dealing is also the area that is most intimately connected to the overall legitimacy of the nonprofit sector, and to the substantive purpose for which private foundations were subjected to a heightened regulatory regime more than fifty years ago. The functional ways that donor-advised funds borrow from aspects of both private foundations and public charities are exactly why the proper regulation of the potential abusive uses of donor-advised funds for self-dealing transactions is so urgent.

This Article has analyzed three potential mechanisms for closing the "public support test" or "conduit" loophole. One possibility is to prohibit DAF sponsoring organizations from making distributions to recipient charities if the charity only passes the public support test because grants from a DAF are treated as public support. This solution creates undue compliance burdens on DAF sponsors and is practically unworkable. A second possibility would be to implement an anti-abuse rule like the one contained in proposed Treasury Regulations regarding noncharitable distributions. This solution likewise would impose significant compliance costs for DAF sponsors, particularly if its required compliance practices are sufficient to make it effective. The final proposed solution is to change the way recipient charities calculate their public support, requiring them to treat distributions from a DAF as if they were made directly from the donor-advisor rather than from the DAF sponsor. This solution, which has been proposed both by the IRS and by members of Congress, is the simplest and least burdensome on the charitable sector. It is also relatively simple for the IRS to enforce and does not require the collection of any new information by charities. In short, it brings DAF regulation into line with the overall regulatory scheme both from a practical and theoretical perspective.