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Tax Write-Off Now, Charity Later

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THE failure of the bipartisan debt reduction committee to reach agreement means there are likely to be drastic cuts in federal spending that will result in many more Americans looking to the charitable sector to meet their needs. In the meantime, President Obama and Congressional Republicans have both proposed cutting the tax deduction for charitable giving as a way of generating much-needed federal revenue. But neither side is addressing a growing problem with charitable donations.

When most people think about charitable giving, they envision money going to support local food banks or educational organizations, or donations to the Red Cross that can be put to work immediately on disaster relief. But it is increasingly common for charitable donations to take a significant detour before ever being put to charitable use.

More and more charitable dollars are now being directed to what are called “donor-advised funds.” Many of these funds are affiliated with large financial institutions like Fidelity, Schwab and Goldman Sachs, and hold, invest and eventually distribute dollars for charitable purposes. In the meantime, they generate significant management and investment fees for the institutions that house them, which have little incentive to speed up the distribution of resources to the charitable sector. Most important, there is no payout obligation; while donors receive the tax deduction as soon as they make their contribution, their money can languish in these charitable holding pens for decades or even centuries (these funds are frequently marketed for their ability to allow donors to create a legacy for future generations).

Why do people choose to give to these funds over traditional charities? Some like the flexibility of being able to claim a deduction now, while delaying the decision of which charities will eventually receive the money. Others like the fact that they don't have to keep track of receipts for multiple donations. But the bulk of these donations come from the wealthy, who often donate appreciated property — thereby benefitting from a deduction for the full value of the property, while avoiding taxes on capital gains. Private foundations also use donor-advised funds. By law, private foundations are obligated to spend 5 percent of their assets every year for charitable purposes, and contributing to donor-advised funds is an easy way to fulfill that obligation.

Donor-advised funds are the fastest-growing charitable vehicle in the United States; they hold an estimated $25 billion. There are twice as many as there are private foundations. The largest of these funds, Fidelity Charitable, is the third largest charity in the country. And yet most Americans are not even aware that donor-advised funds exist.

Proponents of the funds point to their growth as a sign that they are adding resources to the charitable sector. However, data from the last 40 years show that charitable giving has remained remarkably constant, at around 2 percent of disposable income regardless of the economic climate. It appears more likely that the fund contributions are simply replacing what might otherwise have been outright contributions to charity. But instead of providing immediate relief to the needy and fuel to the economy by paying for goods and services, much of this money does nothing at all for an indefinite period. This is particularly troubling at a time when government cutbacks are going to make more people dependent on the charitable sector.

Congress long ago recognized that there is a difference between organizations that engage in charitable work and receive broad public support (public charities) and the private foundations that hold money for eventual charitable use. In 1969 it enacted rules to limit the tax advantages for contributions to private foundations and to establish minimum annual distribution requirements. But donor-advised funds are under no such limits or obligations, and even help private foundations to get around theirs.

Regardless of the level of deductions allowed for charitable giving, President Obama and Congress should take steps to ensure that money qualifying for the deduction goes to serve charitable causes within a reasonable period of time. The problem is not with charitable donors, who are simply following the rules provided for them, but rather with laws that fail to provide adequate guidelines for distribution.

To that end, Congress should enact rules that require donor-advised funds to distribute all of their assets to real public charities within seven years of their contribution. In addition, Congress should make clear that private foundations cannot meet their payout obligations by making gifts to donor-advised funds. Then we can have a real conversation about the best way to feed all those hungry people.

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