Charitable Tax Reform For the 21st Century

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Charitable Tax Reform For the 21st Century
Charitable organizations play a fundamental role in American society, fulfilling functions that would otherwise fall to government, providing creative solutions to society’s most pressing problems, and serving our highest ideals. The federal government has long provided generous tax incentives for charitable donations, with current benefits reaching up to 74 percent of the amount of the gift. Unfortunately, however, the design of the tax incentives is now woefully out of step with their purpose and the realities of charitable fundraising today, resulting in a system that is incoherent, ineffective, and on the verge of failure.

Taking a broad view, we believe that there are two overarching policy goals of the charitable tax incentives. The first is to promote actual charitable work and the second is to foster a strong culture of charitable giving with broad participation.

The fundamental purpose of providing charitable tax benefits is to support charitable work. If the good work of charities never gets done, tax benefits are wasted, costing the government significant revenue but providing no benefit to the public. In order to encourage actual charitable work, Congress based the giving incentive on donors giving up dominion and control of their donations. Only when donors give up control are funds fully available for charities to deploy in support of their mission.

The goal of promoting actual charitable work was strongly reflected in the last major legislative effort on charities — the Tax Reform Act of 1969. The act drew a distinction between organizations directly engaged in charitable work (like schools, museums, churches, and food banks) and donor-controlled organizations that do not engage in charitable work but instead provide funding for work done by others. Congress categorized the first type as public charities and the second type as

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1 These savings are possible for a gift of appreciated property in which the donor has a zero cost basis. The charitable deduction will save the donor 37 percent of the value of the gift; an additional 20 percent of the value of the contributed property if it is subject to capital gains taxes; and, if the donor is subject to estate taxes, another 17 percent (40 percent of the remaining 43 percent) that would otherwise be remaining in the estate if no gift had been made. The tax benefits can be even more if the property is overvalued, a recurring issue for non-publicly traded assets.
private foundations. To encourage the availability of funds for current charitable work, Congress provided greater tax benefits for contributions to public charities than to private foundations. Further, recognizing the perils of donor-controlled entities actually getting charitable work done, Congress imposed a wide array of rules on private foundations to make sure they would spend their funds for charitable use. These include payout rules, strict self-dealing restrictions, greater disclosure obligations, and tough anti-lobbying rules. In short, the 1969 act drew bright legal lines to increase the availability of funds for active charities and to tightly regulate passive, donor-controlled foundations to ensure their operation in the public interest.

The other goal of charitable tax incentives is to foster a strong culture of giving in America to achieve a robust and dynamic charitable sector reflective of our pluralistic society. Implicit in subsidizing donations to charity is that giving itself is a public good, apart from the actual work any particular charity does. The more people participate in giving, the broader the base of public support for the charitable sector as a whole, and a more dynamic and pluralistic sector results. If only a few voices are encouraged to support the charitable sector, charities will have to cater to a narrow set of interests and lose a main source of strength and legitimacy — widespread public support.

Today, two major developments strike at the heart of both policy goals and serve as a clarion call to update and reform the charitable tax benefits. First, the increase in the standard deduction by the Tax Cuts and Jobs Act has meant that far fewer Americans have incentives to give. The drop has been dramatic. In two years, the participation rate among taxpayers taking the deduction has gone from 25 percent to just 8.5 percent. This dramatic change has the potential not only to reduce giving but also to undermine the legitimacy of the charitable sector as representing a wide swath of the public. We have already begun to see the effect of these changes on donation totals and in patterns of giving, which have become concentrated among the wealthiest Americans.

Second, the growing use of donor-advised funds (DAFs) is undermining the basic tenet of the charitable tax system that tax benefits should be based on making funds fully available for charitable use. DAFs are financial accounts legally held by a public charity sponsor, but effectively controlled by donors. Donors get maximum tax benefits upon contribution to the DAF sponsor, yet funds held in DAFs are not truly available for charitable use until the donors release their advisory privileges. When donors use DAFs, Congress can no longer count on the public charity label to provide assurance that donations formally made to public charities are actually available for charitable use.

The public charity cloak of DAFs also allows individual donors and private foundations to avoid long-standing rules on payouts, disclosure, and lobbying, which are all designed to promote the public good. For example, a private foundation can satisfy its payout obligation by making a grant to a DAF, even though the money remains in the DAF subject to the foundation’s advisory privileges. The same grant also avoids meaningful disclosure because the money coming out of the foundation’s DAF will not be publicly sourced to the foundation — creating a new kind of dark money. Moreover, DAFs enable any individual to create his own public charity simply by funding it through a DAF, thereby avoiding the anti-lobbying, self-dealing, and disclosure rules otherwise applicable to organizations financed by a small number of funders. The ability to opt out of private foundation status at will makes a mockery of our tax system and the complex statutory rules providing different treatment for private foundations and public charities.

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1 James Andreoni and Jon Durnford, “Lost Your Charitable Deduction in 2018? You Are Not Alone,” in “The Effects of the 2017 Tax Reform on Itemization and the Charitable Deduction” (July 15, 2019). The participation rate is not the same as the percentage of itemizers, which dropped from 30 percent to 10 percent. *Id.* The rates of 25 percent and 8.5 percent reflect itemizers who claimed the charitable deduction.


To summarize our concerns, the system of charitable tax benefits is failing on three main fronts: (1) current rules provide no giving incentive for 90 percent of American taxpayers, leaving charities reliant on a shrinking and narrow base of support; (2) current rules no longer provide any assurance that tax-benefited donations will ever be made available for charitable use; and (3) long-standing rules designed to promote the public good (for example, on payout, disclosure, and lobbying) are easy to avoid through the use of DAFs.

Both of us have written numerous articles and opinion pieces on ways to improve the tax rules to make them fairer and work better for the people who rely on charitable efforts, and there are many ways to approach these complex issues. In this article, we outline five proposals that we believe provide the best ways to fix the problems facing the charitable sector:

1. replace the current charitable deduction with a credit for charitable giving available for all taxpayers who give more than a designated floor;
2. reform the rules applicable to DAFs so that some tax benefits are conferred upon transfer to a DAF while others are deferred until the donation is no longer subject to the donor’s advisory privileges;
3. reform private foundation payout rules to close the loophole that allows a charity to avoid private foundation status by funding the charity through a DAF;
4. prohibit private foundations from counting a grant to a DAF as satisfying their 5 percent payout requirement, require disclosure of foundation to DAF grants, and bar foundations from counting payments to insiders (such as travel and compensation) as payments for charitable purposes; and
5. reform the excise tax applicable to private foundations to provide incentives for them to increase their charitable expenditures.

Expand Availability of Charitable Tax Benefits

The charitable deduction has long been criticized as unfair. As a deduction, the value of the tax benefit increases with income. The higher the marginal rate of the donor, the larger the tax benefit, meaning that the wealthier the taxpayer, the less they must pay for each dollar of their charitable gifts. Thus, for a gift of $1,000, a taxpayer in the 37 percent bracket gets $370 in tax savings while a taxpayer in the 15 percent bracket gets just $150 — a $220 difference in the size of the tax benefit for the same gift. In addition, as an itemized deduction, only a small fraction of taxpayers actually have a tax incentive to give, further increasing unfairness. Thus, millionaires can get a return of 37 percent on their charitable contributions, while a middle-income taxpayer who claims the standard deduction gets no tax benefit at all for a contribution of the same amount. Such middle-income taxpayers thus have no incentive to give, and when they do, their gift is not acknowledged by the tax system even though their sacrifice is likely greater relative to their wealth.

These problems have been exacerbated by the TCJA’s extraordinary increase to the standard deduction. By reducing the number of itemizers by two-thirds, just over 10 percent of taxpayers are now eligible to claim the charitable deduction. This will in all likelihood get worse as taxpayers understand they can no longer claim the charitable deduction. This is of great concern. A main strength of the charitable sector is widespread public support that is fostered by tax incentives. Although it is even political, organizations.

Although causation is always difficult to prove, the most recent statistics — showing a significant drop in charitable giving in the wake of the TCJA — seems to be evidence of this decline. Andreoni and Durnford, supra note 2, at 5.

A related concern is that nonprofits increasingly will opt out of charitable status altogether and become more privately focused, and even political, organizations. For additional discussion, see Colinvaux, supra note 3.
true that the base of support historically has been tied to taxpayers who itemize (and thus to higher-income taxpayers), before 2017 that base still amounted to roughly 30 percent of taxpayers — a significant (and changing) segment of the population. With only the wealthiest of the wealthy among us now likely ever to claim a charitable deduction, the fundamental public character of charities is under threat.

Accordingly, to address the increased inequity of the tax incentive and the danger to the sector from increasingly narrow taxpayer participation, we believe it is time to make the charitable giving incentive available to all taxpayers by replacing the deduction with a credit. A uniform credit percentage, applicable to all, would provide a fair and more transparent tax benefit. A gift of $1,000 would provide the same benefit, regardless of the income level of the donor. To reduce the cost of the expanded incentive, only gifts above a designated floor would receive the tax benefit. A floor would reduce the inefficiency of the current incentive, which rewards each dollar of charitable giving, but retain the incentive to give when it can have the most impact: the point at which donors actually need an incentive to give more. A floor would also reduce administrative costs and tax evasion. In sum, a tax credit for the charitable giving of all taxpayers, subject to a floor, would be an important step in favor of fairness, transparency, and efficiency and would promote a more robust charitable sector that reflects the interests of all Americans.

Reform Tax Rules Applicable to DAFs

DAFs have grown from obscurity to dominance in charitable giving. In 2017 (the most recent year for which data are available), Fidelity Charitable was the largest charitable fundraiser in the United States, raising $6.83 billion, more than twice as much as United Way. In 2017 the top four DAF sponsors raised more than the top 10 non-DAF public charities combined.

DAFs are popular because they provide donors with the double benefit of (1) effective ongoing control over donated funds, and (2) tax benefits that can be far greater than would be achieved by donating to a private foundation.

DAFs can be confusing because there is a disconnect between their legal structure and how they operate in practice. Legally, when a donor transfers property to a DAF sponsoring organization, the transfer is just like an outright transfer to the Red Cross or a local food bank. The donor technically gives up all control over the donated property, including the right to direct charitable transfers of the donated funds. In legal parlance, the gift is considered complete because the donor formally relinquishes dominion and control over the property, thus enabling donors to obtain full tax benefits for their transfer. But in fact, despite the formal transfer of ownership from the donor to the sponsoring charity, the nature of the DAF is that the sponsoring charity effectively allows the donor to retain ongoing control over the charitable disposition and investment of the donated assets. That ongoing control is the reason why donors make contributions to DAFs instead of making outright non-DAF gifts to charities.

Because a donor to a DAF can give away property while also retaining effective control, the transferred property is functionally “between ownership.” The donor has committed the property to eventual charitable use and so can no longer use the property to buy a yacht or for other personal consumption, but the donor’s ongoing advisory privileges prevent the property from being truly available for use by any particular charity. Moreover, under our current system donors are under no obligation, and have no incentive, ever to release their advisory privileges to make the funds available for charitable use. The problem is that DAFs effectively sever the link

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9 Id.
10 These ongoing advisory privileges are built into section 4966(d)(2), which defines a DAF as (1) a fund or account owned and controlled by a sponsoring organization (2) that is separately identified by reference to contributions of the donor or donors, and (3) the donor (or a person appointed or designated by the donor) has or reasonably expects to have advisory privileges over the distribution or investments of the assets.
between the granting of charitable tax benefits and the provision of benefits to charities.\(^\text{11}\)

Given the current popularity and dominance of DAFs in the charitable fundraising world, it is easy to forget the controversy that surrounded their emergence and the conditions for their acceptance. At the heart of the conflict was how to characterize the DAF and the nature of donor advice. If a DAF was a “donor-directed” fund, whereby the donor could tell the sponsor how to spend the money, no deduction would be allowed because of retained control by the donor. But if a donor’s role was truly advisory in nature, whereby donors could offer suggestions and guidance but not direct the distributions, a deduction would be allowed. The IRS cautiously accepted industry arguments that donors to DAFs would not be allowed to direct distributions, and on that basis allowed contributions to DAFs to qualify for current charitable tax benefits.\(^\text{12}\) We believe, however, that competition for funds among DAF sponsors has made the distinction between direction and advice formalistic and without substance. Nobody transfers property to a commercial DAF sponsor so that the sponsor can make distributions on its own from the donor’s DAF. Sponsors know that if they were to exert significant control over DAF funds, the “adviser” could simply “advise” that the funds be transferred to another, more compliant, DAF sponsor.\(^\text{13}\) As a result, DAFs are operated for all intents and purposes at the donor’s direction.

Accordingly, we believe that to reflect the reality of DAFs, current law should be revised to restore the connection between the timing of the charitable deduction and the availability of donated funds for charitable use. We propose that donors be given the estate and gift tax and capital gains tax advantages when transferring funds to a DAF (reflecting that DAF funds are no longer available for personal use), but that the income tax deduction be suspended until the funds are no longer subject to advisory privileges and therefore are available for charitable use.\(^\text{14}\) Once a distribution from a DAF to a qualified charity occurs (and advisory privileges are released), the donor (if alive) would be allowed a charitable deduction equal to the amount of the distribution. Under this new rule, donors to DAFs would have an incentive (the income tax deduction) to make DAF funds fully available for charitable use by making distributions from the DAF or releasing advisory privileges. A donor may decide to wait and accumulate funds tax free in a DAF before distribution, in which case the charitable deduction will also be postponed until the donor is prepared to make a decision.

By returning the timing of the deduction to the point at which a charity has effective use of the donated funds, this change would promote the purpose of the charitable deduction — to provide funds for charitable use. Further, a deferred deduction rule also ties the amount of the deduction to the amount of cash ultimately made available for charitable use. This has important additional policy benefits, largely regarding donations of property.

Among the main sources of DAF contributions are property, including publicly and privately traded stock, real estate, and a wide variety of other items (for example, limited liability company interests, cryptocurrency, and grain).\(^\text{15}\) This is because donors get significantly more...

\(^\text{11}\) There are many reasons why well-meaning donors may fail to make significant distributions from their DAFs, including that (1) charitable decisions are difficult and many donors have busy lives and want to defer decision-making; (2) as noted by behavioral economists, donors can feel good watching their DAF accounts grow (similar to people’s feelings about retirement funds) and may experience a sense of loss when their DAF accounts decrease as a result of charitable distributions; and (3) DAF sponsors and financial advisors benefit financially when assets remain in the DAF, which may cause them to subtly encourage donors to think of DAFs as accounts to hold rather than as funds to disburse (e.g., by encouraging donors to think of DAF funds as a charitable legacy to be passed on to younger generations).

\(^\text{12}\) Concerned about donors abusing DAFs for personal benefit, Congress in 2006 defined a DAF in terms of donor advisory privileges and required a formal acknowledgment by DAF sponsors of their independent ownership of donated sums. An unintended consequence of codifying the DAF, however, has been largely to mute arguments by the IRS that gifts to a DAF sponsor are not complete.

\(^\text{13}\) This might explain why The Economist found that the largest recipient of donations from DAFs sponsored by Fidelity Charitable, Schwab Charitable, and Vanguard Charitable was Fidelity Charitable.\(^\text{16}\)

\(^\text{14}\) We have both argued previously for a change to the law that would impose a payout term on DAFs. Although we continue to believe that a strong payout rule would be a great improvement over current law, we also think our current proposal (suspending the deduction until advisory privileges are released) is a better solution because it more accurately captures the economic realities of DAFs and avoids the valuation problems associated with contributions of complex assets.

more tax benefits by making contributions of appreciated property instead of cash and DAF sponsors are eager to act as brokers to liquidate the property. Although a contribution of cash can save the donor as much as 37 cents for each dollar donated, a contribution of appreciated property can save the donor 57 cents for each dollar donated (taking into account both capital gains taxes and income taxes but not potential estate taxes). Moreover, DAFs are especially attractive for contributions of property other than publicly traded stock (the industry refers to these as complex assets) because if those assets are donated to a private foundation, the donor’s deduction is limited to basis. By donating complex assets to a DAF, the donor can claim a deduction based on the appraised fair market value of the property at the time of gift.

Appraisals, however, are difficult to perform accurately and can result in overvaluation of the property, as well as excess (if not fraudulent) deductions. Valuation is more an art than a science and there is often a considerable range of defensible values for property that does not have a ready market. Being dependent on donors for their fees, appraisers feel a natural pressure to come up with higher values that will afford donors better tax savings. Moreover, because of the expense and difficulty of valuing property that has no ready market value, it is virtually impossible for the IRS to provide sufficient oversight on valuation of those types of interests, particularly when taking into account the explosion of contributions that has occurred with the rise of DAFs.¹⁶

Further, the current-law deduction for the value of the appraised property, even when accurate, allows donors to claim a tax benefit for funds that will be spent on the preservation and conversion of the asset to cash, rather than on the amount of funds that are available for distribution to charity. This means that a donor’s deduction is likely to be greater than the amount that ends up being available for distribution. Depending on the time that it takes to sell the property and the expenses associated with the sale, there can be a significant gap between those two numbers.¹⁷

Delaying the deduction until the actual distribution of cash avoids the need for appraisals¹⁸ and bases the deduction on the net benefit to charity, thus solving two of the principal problems with DAF property donations: the uncertainty and administrative cost associated with appraisals, and the facilitation of deductions greater than the amount available for charitable use. Importantly, our proposal would allow donors a deduction based on the distributed amount, whether the value increases or decreases from the time of the donation. Donors could then reap the benefits if the property (including cash invested after donation) increases in value over time.

End Use of DAFs to Create Phony Public Charities

As noted previously, Congress in 1969 created a clear division in charity law between public charities and private foundations. Public charities would be more lightly regulated than private foundations and treated better for purposes of the charitable deduction. The reasons were to recognize the fundamental purpose of the charitable deduction to increase the availability of funds for charitable use, and the concern that private foundations were more prone to abuse given the opportunity for ongoing donor control.

One way the law categorizes organizations as public or private is based on their sources of support. If an organization is funded by a small number of individuals, it is a private foundation. Alternatively, if an organization can show that it gets a lot of support from a variety of donors, it

¹⁶ The many problems associated with donations of property (not just with DAFs) has led one of us to question whether we should allow charitable deductions for contributions of property (see Colinvaux, “Charitable Contributions of Property: A Broken System Reimagined,” 50(263) Harv. J. on Legis. (2013)) and, if deductions are allowed, whether the amount of the deduction should be reduced to account for some of the deducted appreciation (see Colinvaux, “Donor Advised Funds,” supra note 5).

¹⁷ Consider the case of a donor that has a condominium in an area where the market is currently depressed. Assume the condominium has an appraised value of $500,000. After donation, the DAF sponsor may have to pay significant fees associated with the property, such as property taxes, utilities, and condominium fees, and the eventual sale of the property will require payment of transfer taxes and real estate brokerage fees. After all those expenses are paid, only $400,000 is allocated to the donor’s DAF even though the donor was allowed to take a tax deduction based on a $500,000 appraised value. See Madoff, “Three Simple Steps to Protect Charities and American Taxpayers From the Rise of Donor-Advised Funds,” Nonprofit Quarterly, July 25, 2018.

¹⁸ Our proposal would base the amount of the deduction on the amount of cash distributed from the DAF. If the DAF distributes noncash property, the deduction would be zero.
passes the public support test and qualifies as a charity. In meeting this test, contributions from existing public charities count as public support. This rule has created the opportunity for individuals to create their own public charities simply by making their donations through DAFs.

Treasury has become concerned about this use of DAFs to create phony public charities by disguising the source of an organization’s support.29 With public status, the charity can avoid foundation restrictions on lobbying, self-dealing, and public disclosure of donors. The ploy is easy to execute: a donor contributes to a DAF and funds a new (or existing) charity from the DAF instead of directly. Because the DAF contribution technically is a contribution from a public charity (and not from the donor-adviser), the DAF contribution automatically counts as public support. By contrast, if the contribution is sourced to the individual donor-adviser, only some of the support would be regarded as public and the charity would need to show contributions from many other donors to avoid being treated as a private foundation.20

The potential for abuse is considerable, particularly when it comes to lobbying. Although private foundations are generally prohibited from lobbying,21 public charities can (with some limitations) spend up to $1 million a year on lobbying without penalty. If a donor wants to lobby with tax-deductible funds, one way to do so is to fund a DAF with a large contribution (say $20 million) and advise a $20 million grant to New Charity created by the donor. New Charity automatically qualifies as a public charity under the support test because all its support is from a public charity (the DAF sponsor). As a public charity, New Charity makes an election under the tax law (a section 501(h) election), which may allow it to spend $1 million on lobbying depending on its budget and expenses. New Charity for the year spends $1 million on lobbying and, to show that it has a charitable function, $19 million in a grant to a DAF, where it is ready to be deployed to a new New Charity. The same pattern can recur innumerably, with the $19 million grant money being used over and over to establish a base for the lobbying activity.

Other similar abuses are possible. One widely reported use of a DAF to avoid private foundation status involved former acting Attorney General Matthew Whitaker. Before his appointment, Whitaker was well compensated as the head of a new charity that spent much of its money attacking Hillary Clinton. The charity was funded entirely by a DAF. Had the organization been a private foundation, the public would have known the source of Whitaker’s support, but as a public charity the paper trail reveals only that the donor is a DAF.22

Questionable uses like these of public charities not only skirt the law but also cause serious harm to the reputation of the charitable sector. We agree with the Treasury Department that a common-sense approach would be to provide that contributions of DAF assets do not count as support from a public charity.23

Close Payout Loophole for Private Foundations

In 1969 Congress became concerned that private foundations were providing too many tax benefits to donors without any assurances that donated funds would benefit the public in a timely manner. As a result, it enacted a rule that required private foundations to distribute roughly 5 percent of their assets each year to public charities.24 Sensibly, the payout rule could not be evaded by a private foundation making distributions to other private foundations, because the funds would simply await further distribution by that foundation.

Since the rise of DAFs, some private foundations have been meeting their payout

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29 Notice 2017-73, 2017-51 IRB 562.
20 Under reg. section 1.170A-9(f)(6)(i), support from any one individual counts as public support only to the extent that it does not exceed 2 percent of the organization’s total support.
21 This prohibition is created through section 4945(d)(2) by imposing an excise tax on all lobbying activities.
23 Treasury proposes a similar approach in Notice 2017-73.
24 Qualifying distributions also include funds spent directly for charitable purposes.
requirements by making grants to DAFs that are established by the foundation. The foundation can then advise distribution of the grant from the DAF to an active charity at a later date. This can have multiple benefits for the foundation: the transfer counts for purposes of the foundation’s payout (because the DAF sponsor is a public charity), and the foundation can disguise the source of the funding by flowing the funds through a DAF.

Neither of these benefits is consistent with the spirit of the rules that have governed private foundation conduct since 1969. The payout is intended to measure distributions to active charities, not to other investment funds. Moreover, because of the potential for abuse, foundations are held to higher standards of transparency. Allowing foundation-to-DAF transfers to count for payout purposes is inconsistent with the policies behind the private foundation payout and disclosure rules.

To address these concerns, we believe Congress should provide that foundation-to-DAF transfers are not qualifying distributions for purposes of a private foundation’s payout requirement. Further, to the extent foundations continue to fund causes through DAFs, sponsors should have to publicly disclose the foundation donors on grants from the foundation-advised DAFs. If Congress wants to preserve the use of DAFs for private foundations (to allow them to pool resources with other foundations), it should require contributions from private foundations in satisfaction of payouts to be distributed within 15 months of contribution. This is similar to the rule applicable to distributions from a private foundation to another private foundation.

Further, Congress should also close the loophole that allows private foundations to meet their 5 percent payout requirement by paying compensation and travel expenses for family members. Under current law, a foundation paying family insiders compensation or reimbursing their travel costs is treated the same as if the foundation made a grant to a public charity performing actual charitable work. This is wrong. Allowing family compensation and travel to be treated as charitable creates an incentive for family members who control the foundation to spend money on themselves for their personal benefit and convenience, and to reduce distributions to public charities. Setting aside whether it is appropriate for foundations to pay for the reasonable compensation and foundation-related travel of family members, those expenses should not be equated with a payment for the benefit of an independent charity. Accordingly, we believe the definition of a qualifying distribution should be changed to exclude any payment for the benefit of a foundation donor (or related party) that is related to compensation or travel.

Amend Excise Tax to Spur Foundation Grants

Under current law, private foundations generally are subject to a 2 percent excise tax on their investment income. However, if a private foundation increases its annual distribution over its historic distribution rate, the excise tax is reduced to 1 percent for that year. This two-tiered system was intended to reward private foundations that make progressively larger grants.

Private foundations have long sought to repeal the two-tiered excise tax in favor of a single 1 percent excise tax. Their argument is that the two-tiered system is complicated and, paradoxically, can sometimes discourage large distributions because it can make it harder for the private foundation to qualify for the lower excise tax rate in subsequent years.

Although those arguments have merit, we believe that there is a better solution that simplifies the excise tax and fixes the design flaw, while still providing an incentive for private foundations to increase their distributions. To that end, Congress could provide that private foundations are subject to a 2 percent excise tax but the tax will be reduced to 1 percent for any year in which their qualifying distributions are 6 percent or greater. The tax could be reduced

25 *The Economist* found that some private foundations distribute 90 percent or greater of their qualifying distributions to DAFs. "A Philanthropic Boom: 'Donor-Advised Funds,'" *The Economist*, May 23, 2017.

26 See section 4942(g)(3).

27 See e.g., H.R. 2386, Private Foundation Excise Tax Simplification Act of 2017 (115th Cong.).
further to zero when qualifying distributions are at least 8 percent. A mechanism like this would simplify the excise tax while retaining an incentive in the tax code for private foundations to make qualifying distributions above the statutory minimum of 5 percent, which has often served as a ceiling on private foundation annual grant-making.

Conclusion

The charitable sector is in peril. Too few taxpayers have incentives to participate in charitable giving, and too many donors can claim tax benefits without truly relinquishing control of their donations to an independent charity. On our current path, the result will be a charitable sector that reflects the voices of the wealthiest donors, and where working charities are starved for resources waiting for foundations and DAF advisers to release their funds. Fortunately, solutions are at hand: Expanding the incentive to all taxpayers in the form of a credit (subject to a giving floor), suspending the income tax deduction to DAF sponsors until the contribution is released from advisory privileges, closing loopholes that enable foundations and donors to skirt long-standing legal requirements, and modifying incentives to foundations to foster more spending will restore sanity and legitimacy to the law and establish a strong platform for our 21st-century charitable sector.

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