The DAF Dilemma: Will the Pressures Created by COVID-19 Force the Federal Government to Revisit the Rules for Controversial Donor-Advised Funds?

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When Annabelle White received a large inheritance 12 years ago, she knew she wanted to give money to environmental causes. Having previously sat on the board of her grandmother's foundation, she was wary of the complexity and attention that running her own foundation would involve. "When you start a foundation, you get pitched a lot, and saying 'no' is hard for me," White says.

Instead, she opted to set up a donor-advised fund (DAF) through MakeWay (formerly Tides Canada), a national foundation that supports nature conservation and environmental sustainability. Foundation representatives make recommendations based on her interests and White selects the programs she wants to fund. Unlike many DAFs, where the donation forms an invested endowment with grants paid largely from the returns, White's Dragonfly Ventures fund disburses 100% of its annual docket. "Every single cent I put in goes out the door," she says.

When the pandemic hit, she set up a separate $1 million DAF which MakeWay uses to funnel money to multiple charities. But White has resisted the more-common investment-oriented DAFs. "With money, there is this long-standing belief in perpetuity, and I don't believe in that," she says. "Financial institutions are man-made and may not last forever. Instead of hanging on to money, make things happen now."

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While DAFs have been offered in Canada for almost 60 years, they remain controversial and poorly understood. DAFs enable a group or an individual to give money to a charitable foundation while retaining the right to recommend which registered charities or qualified donees will receive the funds. The foundation handles all administrative, reporting, and governance matters for which it charges a fee, generally a percentage of total assets. The donor gets a tax receipt upon creating the DAF, but the money doesn't immediately have to be spent. In fact, most DAFs invest the upfront donation and the funds grow, tax-free. Some compare DAFs to personal charitable savings accounts, but there is a major difference: donors don't control the DAFs, and the foundations holding them can reject their advice.

DAFs' major selling point is that they are less costly and complex to establish than a private foundation. They can be opened with as little as $5,000 and donors can lean on the expertise of the foundation's management to guide their giving. As well, someone who receives a cash windfall from the sale of a business or inheritance can shelter some of the money from tax by putting it into a DAF.

"If you have a substantial tax bill, I don't understand why people would give it all to the government instead of giving it to charity," says Windsor resident Bob Little, who, with his wife Debra, opened a DAF with some of the proceeds of his company's initial public offering. The DAF donation is irrevocable but, unlike private foundations that must disburse a minimum of 3.5% of their assets annually, the donor need not make grants right away.

After the Vancouver Foundation established the first Canadian DAF in 1952, community foundations embraced these instruments and today hold more than half of all Canadian DAF assets. In the early 2000s, financial institutions saw DAFs as an opportunity to help clients manage estate planning and charitable giving.Ever since, the popularity of DAFs has soared. Today, more than 250 Canadian foundations have donor-advised funds holding more than $4.5 billion worth of assets, up from $3.2 billion in 2016, according to Keith Sjögren, managing director of consulting services at Investor Economics. Although almost 90% of donations in Canada are still given directly, DAFs have become the fastest-growing form of charitable giving, contributing in recent years between $800 million and $1 billion annually. In the US, DAF foundations dwarf all other charities. *The Chronicle of Philanthropy*'s 2016 survey included six DAFs among the top 10 charities by donations.

This impressive growth has attracted both more scrutiny and debate. Proponents of DAFs say they democratize philanthropy, giving average people tools typically reserved for those wealthy enough to establish non-profit foundations. Critics view them as sops to the rich – tax shelters disguised as philanthropy that reduce, or at least delay, donations that would otherwise be made directly to charities.

"The donor is under no obligation, and [has] no incentive, to ever make charitable distributions from his donor-advised fund," Ray Madoff, director of the Boston College Law School's Forum on Philanthropy, told Canada's Special Senate Committee on the Charitable Sector in 2018. "This failure to require payout means that donor-advised funds have effectively severed the ties between charitable tax benefits and benefits to charities."

Others point to a lack of transparency about the funds' sizes, the sources of the money, and where and when the money is put to charitable use. "It's not clear to what extent there is a disbursement of funds," says Mark Blumberg, a leading charity lawyer with Blumberg Segal

LLP. “Some DAFs try hard to push money out and others play games trying to retain the funds as long as possible.” DAFs need to up their game in terms of due diligence, he warns, or they may face a backlash and regulatory action by Canada Revenue Agency (CRA).

At a time when charities are reeling under unprecedented burdens, the lack of disclosure has caused concern that money is sitting in DAF investments instead of helping those affected by the pandemic. Even DAF supporters agree that now is the time to open the taps. Given the tremendous need, writes Hilary Pearson, founding president of Philanthropic Foundations Canada, in a recent blog, “granting *much* more than the minimum disbursement if a foundation, and definitely more if you advise a DAF, is a *must*.” But numerous misconceptions persist, leading various parts of the charity ecosystem to point fingers at others – self-serving financial institutions, inattentive foundation boards, tax-dodging donors – as the reason these valuable instruments of philanthropy are getting a bad name.

Community foundations versus financial institutions

When TD Waterhouse launched the first commercial DAF in Canada in 2004, it started a mini revolution. Some in the community foundation world, which until then had a monopoly on DAFs, felt that financial institutions’ DAF programs represented unfair competition for donor dollars. With their large marketing budgets, sophisticated back-office functions, and economies of scale, financial giants could offer lower fees on DAFs than many community foundations.

Some also point to an inherent conflict of interest: wealth managers earn fees on the DAF investments they handle. “The fact that DAF sponsors and financial advisors benefit financially when assets remain in the DAF may cause them to subtly encourage donors to think of DAFs as accounts to hold rather than as funds to disburse,” Madoff told the senate committee.

Philanthropy is not what motivates investment advisors, critics argue. Leanne Burton, MakeWay’s director of partnership development, points out that community foundations aren’t interested in amassing large pools of assets; rather, they want to keep the money flowing to those in need. By contrast, she says, “[for] many DAF-sponsoring foundations that serve financial institutions, their main purpose isn’t moving funds into the charitable sector.”

Financial professionals who work with DAF donors strenuously disagree. Carol Bezaire, vice-president of tax, estate, and strategic philanthropy at Mackenzie Investments, argues that DAFs serve as incentives for financial advisors to encourage their clients’ philanthropy. “Before, [financial planners] might think that if their client gives to charity, they don’t get paid,” she says. “With a DAF, it stays on their books. They become agents of the foundation itself.” If a client designates a mutual fund as the source of the DAF, money flows every year to charity, but the original donation has time to grow – and it is management of that underlying fund for which Mackenzie earns a fee. “We’re trying to facilitate more donations,” she says. “It’s just another way of promoting charity.”

Additionally, financial advisors can give individuals a more holistic perspective on their philanthropy and estate-planning options and, through a DAF, simplify the giving. When the husband of one of Bezaire’s clients died, leaving a large investment portfolio, the woman was concerned about the tax implications. It turned out the couple had been making annual direct donations to 23 different charities. “Don’t you get tired writing all those cheques?” Bezaire asked the widow. The client ended up establishing a DAF and the Mackenzie Charitable Giving

Program now handles the work for her.

To Blumberg, the argument about self-interest is specious. “Most of Canada’s community foundations have DAFs and, for some, the annual fees they make on the endowed DAFs is an important source of operating funds,” he says. DAFs represent approximately one-third of total community foundation assets, according to Investor Economics. Accordingly, those foundations have an interest in keeping the money in their endowments – particularly in the case of large donors’ funds. “In my experience, donors who have made large DAF gifts, which are sometimes a large proportion of the total assets of the DAF, are more likely to face impediments when they wish to move those funds out compared to smaller DAF accounts.” Blumberg represented one client who faced pushback from a foundation when they wanted to disburse the DAF money after the donor who had established the DAF had died.

Some donors prefer the relative anonymity a financial institution provides. When John Grant (not his real name) and his wife decided to set up a DAF to support a couple of educational charities, they opted for Scotiabank’s Aqueduct Foundation, which focuses solely on DAFs. “We could tell them we want to fund these two things, then negotiate the fee and once they established a process, hit ‘repeat’ each year,” says Grant. “It was important to us to not get entangled on a personal level in [the recipients’] lives.” Representatives of a local community foundation had approached them, he says, but “we’re pretty private. We don’t want newspaper articles or exposure and the community foundation lists everything.” The fact that several families involved with the foundation were high profile also made the couple uncomfortable. “It was too close-knit a circle,” says Grant. “We don’t need our business to be their business.”

Keeping funds invested versus disbursing them to charities

The fact that donors receive an immediate tax receipt even though the funds may not flow to charities for years has long been a point of contention around DAFs. A wealthy donor may put $100 million into a DAF, but need not give $3.5 million a year to charity, as would be the case with a conventional foundation because the 3.5% disbursement minimum applies to the foundation, not individual DAF accounts it holds.

However, during the past few months, some donors have sought to raise their DAFs’ disbursement rates to fund pandemic-related giving – and were surprised to discover they couldn’t. When a DAF is designed to flow money through to recipient charities, accelerating the grants is not a problem. But when the funds are part of a community foundation’s overall endowment, the foundation can opt to keep disbursements at a pre-set level.

For example, two-thirds of the funds that the Calgary Foundation holds are in DAFs. “Calgary is a very entrepreneurial city and people like to follow where their funds go,” says Janeen Webb, vice president of donor engagement. The foundation has a 4% annual disbursement allocation for its endowed funds, and it decided to stick with that rate during the pandemic. Did some donors object? “Of course,” Webb admits. “We had good conversations with donors, we heard them, but we look at the Calgary Foundation as a resource for the community. It’s not the first crisis that we’ve experienced. If we encroached on the capital, we’re not sure we would have been able to support the community to the extent we have been.”

Instead, the foundation mobilized its unrestricted funds, in combination with government money and un-invested DAFs whose donors chose to top up or accelerate their grants, resulting in total

disbursements more than doubling from the previous year, says Webb. Some of those grants have gone towards issues that tend not to appear on DAF donors' radars, such as organizations serving Indigenous communities. "We're trying to address the blind spots," says Tim Fox, vice-president, Indigenous relations and equity strategy. "Indigenous populations are not beneficiaries of donor advised funds . . . We've adapted our granting procedures, so they are more inclusive and make more sense to Indigenous populations."

Many foundations do impose minimum yearly disbursement rates for DAFs. In fact, Investor Economics' research suggests that average annual disbursements from DAF-sponsoring foundations are three times or more what regulations require, and well above those of private foundations (although those averages may cloak the reality that while some individual DAF accounts make large annual grants, others make none). Industry members interviewed for this article consistently said it's rare for DAF holders not to make annual disbursements; if they don't, it's typically because they are planning a large gift, such as equipment for a hospital.

To keep DAFs from becoming holding tanks for charitable dollars, Senator Ratna Omidvar, who served as deputy chair of the special senate committee, has floated the idea of extending the 3.5% disbursement minimum to each DAF account, delaying the issuance of tax receipts until the funds have been distributed to operating charities, and setting a time limit for payouts of five or 10 years. Charity sector insiders, however, suggest that provisions for distributions would be difficult to administer and potentially counterproductive. Pearson, for one, opposes disbursement quotas. "I don't believe in regulating charitable behaviour," she says. "Putting a disbursement figure suggests that's what you aim for while it's actually just a minimum."

DAF supporters also worry that legislation could discourage people from establishing such funds. With increased wealth, smaller family sizes, and people living longer, "we have a perfect storm around significant philanthropy today," says Malcolm Burrows, head of philanthropic advisory services at Scotia Wealth Management. "Many of these donations wouldn't happen unless there was some way of slowing down the interval between giving and distributing [funds]." He also argues that DAFs are being unfairly targeted, pointing out that universities, hospitals, and other foundations also hold millions of dollars that are not utilized right away.

At the same time, ensuring that money moves through and out of these accounts is essential, especially now. "Whether funds are languishing is within the authority of the foundation that holds the DAF," Burrows says. "Foundation boards should be monitoring the spend-down and putting polices in place that encourage money to get out to the charities. We don't need new laws; we need to ensure that regulators are paying attention to the existing ones to avoid undermining the charitable sector."

Privacy versus secrecy

The way DAFs are marketed can create confusion about what rights donors have. When a foundation encourages donor John Doe to put his name on a DAF, that implies he controls the John Doe Foundation when, in fact, control rests with the board of the foundation that holds the DAF. Moreover, where lies the line between a donor's "advice" and direction? In the US, for example, Fidelity Charitable is being sued by two DAF donors after it sold US$100 million worth of thinly traded shares held in the DAF at depressed prices in contravention of the couple's wishes.

Or what if the donor grows uncomfortable with the causes supported by the foundation where he or she created a DAF? A DAF is a long-term relationship, like a marriage. You could marry into the wrong group – and would not be able to move the funds to another DAF unless a special provision was specified up front.

Additionally, the lack of publicly available information about DAFs makes it hard to validate that the foundations' boards are doing sufficient due diligence to ensure that funds aren't going to sponsor golf tournaments, fund summer camps where the donor hopes to hold a wedding, or support hate groups – all of which have been reported. Indeed, the anonymity DAFs afford is an important selling point for some donors. Unlike private foundations, DAFs need not disclose their gifts or directors. If a foundation with 500 DAFs gives money to a charity that works to oppose abortion, curb immigration, lower taxes for the rich, or combat alleged left-wing bias in the media, the public will not know which individual donor is responsible. That privacy can help people avoid being hassled for donations, but it can also disguise the origins of funding for controversial causes.

Bringing more transparency to DAFs has support among both proponents and critics. A recent study by *The Charity Report* notes that the "information void" around DAFs makes it impossible to know whether they are growing the philanthropic pie or diverting dollars from operating charities. Several industry members interviewed for this story want CRA to ask more questions about DAFs on its registered charity information return form: for example, how many DAFs does a foundation hold; how much money or other assets is in those funds; and how much has been disbursed from each fund.

More disclosure would also serve to confirm that DAF granting rates are, indeed, high and donor anonymity is rare, argues Sjögren of Investor Economics. Webb, whose Calgary Foundation is one of very few community organizations that publishes the DAFs that it holds (with the exception of those whose donors specifically request anonymity), says transparency inspires others to give and "assuages people's concerns that these funds are being utilized in the community."

Philanthropic democracy versus tax shelter for the rich

What most concerns some critics is that DAFs allow the wealthy to avoid taxes on which all Canadians rely – including charities. "Some people don't realize that two-thirds of charity sector funding comes from governments," says Blumberg. "With COVID, the needs of the community have increased dramatically, and many people wonder if we would be better off raising taxes to pay for social programs rather than offering large donation incentives for the wealthy to encourage giving."

He thinks the crisis is a testing ground for how well DAFs serve social needs. "People say it's good to have the DAFs for a rainy day, but it's raining pretty heavily now, so is the idea to grant more funds to operating charities that will use them to benefit the community today or keep assets in an investment account?"

Annabelle White, for one, says she was shocked to discover that some foundations refused to raise disbursements from DAFs to assist in relief efforts. "If an organization did that, I would be extremely upset," she says. Such grey areas in the rules and ethics of DAFs only reaffirm her focus on creating a living legacy. "Donation dollars in circulation are dollars much better spent

than those in fees paid to money managers.”