



DAF Reporting Requirement: Protecting Minnesota Funds Held in Charitable Trust

This paper describes the need for an amendment to Minnesota's Supervision of Charitable Trusts and Trustees Act¹, to require that if a charitable trust has made transfers of funds to a donor advised fund (DAF), they must include in their annual trust filing with the office of the attorney general an itemized list of all grants and contributions made or approved for future payment during the year from that DAF.

This reporting requirement would address the lack of oversight over charitable funds moved from Minnesota charitable trusts to national commercial DAF sponsors – over \$34 million from 2010 to 2018. These transfers occurred with no opportunity for attorney general supervision over whether they were in compliance with trust restrictions on their funding. Requiring charitable trusts to report the use of funds they transfer to DAFs would correct this gap in Minnesota charitable trust oversight.

There are many good reasons Donor Advised Funds have become one of the most popular ways for individuals to set aside charitable funds for making contributions, including making gifts to charities in future years. DAFs have made it easier and cheaper than ever, provide an immediate tax deduction, and they are the fastest growing way to give to charity, reaching \$121 billion in assets nationally.

However, one aspect of the growth of DAFs deserves special attention, since it presents a barrier to enforcing the law that requires charitable funds be used for the purpose that was designated when the dollars became a tax-exempt asset for public benefit. This special situation is the transfer of charitable funds from private foundations to DAFs, a transfer from one tax exempt entity to another, with no tax advantage, but now approaching \$1 billion/year eclipsed from charitable trust oversight.

¹ Minn. Stat. Ann. §§ 501B.33 to 501B.45.

An example illustrates the problem.

A donor bequeaths \$100 million to establish the ABC Foundation, a private foundation in Minnesota, in a will specifying that the proceeds are to be devoted exclusively to advance the educational attainment of low income children and young adults living in the state of Minnesota. The ABC Foundation devotes \$5 million in proceeds from its assets each year for charitable grants, which it reports as required by federal and state law in a list of Grants and Contributions Paid during the Year, as required on its IRS Form 990 at Part XV, line 3². In this example, the ABC Foundation makes a single grant to Fidelity Investments Charitable Gift Fund for the purpose of “charitable to fund programs,” with no further information about recipients, amounts, or purposes. While directing Fidelity Investments to divide the \$5 million in its DAF between St. Jude Children’s Research Hospital and UNICEF USA would qualify as valid charitable contributions, they would be in breach of the ABC Foundation’s charitable purpose.

Under Minnesota’s charitable trust law, Supervision of Charitable Trusts and Trustees Act³ the restricted purpose of the ABC Foundation’s assets, which specifies the geographic location Minnesota, the subject purpose education, and the beneficiary group low-income children and young adults living in the state of Minnesota, is required to be implemented by the trustees of the foundation, under supervision of the office of the Minnesota Attorney General, Charities Division (to which the ABC Foundations files an annual trust report, including its IRS Form 990).

Yet in this situation, once the ABC Foundation’s funds are transferred to Fidelity Investments Charitable Gift Fund, the funds become the property of and in the control of Fidelity as the DAF sponsor (this transfer is considered an irrevocable gift). Neither the public nor the Office of the Attorney General has notice of the subsequent use of the funds, including whether they comply with the ABC Foundation’s restricted purpose or are in breach of trust.

² Code of Federal Regulations - 26 CFR § 1.6033-3 – (Additional provisions relating to private foundations) —(a) “The foundation managers of the private foundation shall set forth in the annual report required (990PF) . . . (2) An itemized list of all grants and contributions made or approved for future payment during the year, showing the amount of each such grant or contribution, the name and address of the recipient (other than a recipient who is not a disqualified person and who receives, from the foundation, grants to indigent or needy persons that, in the aggregate, do not exceed \$1,000 during the year), any relationship between any individual recipient and the foundation's managers or substantial contributors, and a concise statement of the purpose of each such grant or contribution.”

The tremendous growth of funds transferred to DAFs was not anticipated by federal and state charity regulators, but is now seen as an important development requiring their attention. In particular, the gap in charitable trust oversight presented by private foundation transfers to DAFs was widely acknowledged in interviews with representatives of nine attorney general offices⁴ and private attorneys practicing in exempt organization law.

Requiring charitable trusts to report the use of funds they transfer to DAFs would correct a gap in Minnesota charitable trust oversight, including the \$34 million transferred out of the state to just five commercial DAF sponsors, sight unseen by the office of the attorney general (or by the public, which has a right of public inspection under the Charitable Trusts Act).

Four points are important to understand how this would affect private foundations:

- The proposed reporting requirement would not restrict in any way the decisions of private foundations to use their funds for any lawful purpose (consistent with any charitable restrictions for their funds);
- The administrative burden to submit this report is minimal, simply an automated report generated by the DAF sponsor;
- The itemized list to be filed is identical to what is currently required for private foundation grant reporting to the IRS and the Attorney General; and
- The primary reasons private foundations report making transfers to DAFs is to better achieve philanthropic objectives and administrative efficiency, not concealment of the destinations of their funds. Highly respected private foundations have told MCN that they are proud of the charitable activities that they support and would have no problem reporting how their funds benefit the community.

To maintain public trust that charitable funds are properly used, and deserve the favorable tax treatment these contributions receive, the Minnesota Council of Nonprofits is holding conversations to explore potential 2021 legislative action to strengthen Minnesota's charitable trust law.

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