

## Just What Do Charitable Endowments, Advised Funds, & the Mutual Fund Industry Provide? (Part 1 of 2)

### Part One: A New Democracy of Endowment Giving

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In recent years, mutual funds have opened up their services in new and potentially exciting ways to individuals making charitable contributions. Among the large "families" of funds, Fidelity has led the way but has now been followed by others such as Vanguard. What these investment companies—as well as a number of trust companies and community foundations—offer is the possibility of setting aside charitable contributions into "donor-advised funds" from which later, long-term, gifts may be made. Once set aside in an endowment, however, the gift is eligible for an immediate charitable contribution deduction.

In one quick step, the mutual fund industry has expanded dramatically the number of endowed programs in society and fundamentally changed the nature of philanthropic or endowed giving. In many respects, donor-advised funds can look, taste, and feel like non-operating foundations. But foundations face all sorts of rules, ranging from an excise tax on investment income to a payout rate and, perhaps most importantly, elaborate and often needlessly complex reporting requirements. As one consequence, the inconsistent treatment of similar organizations under the tax laws will almost inevitably force Congress to eventually review the rules and laws regarding foundations.

What the mutual funds and trust companies offer is not entirely new; a similar device for setting aside contributions irrevocably for future transfer to charitable causes has been available for some time through community foundations, among others. Community foundations, however, traditionally have had contact with only a limited number of citizens—nothing on the order of the tens of millions who own mutual fund assets.

The entry of the mutual fund industry has done nothing less than to democratize the giving of charitable endowments. In many of these funds, the minimum endowment need only be \$25,000. The average household net worth, by contrast, is in excess of \$200,000.

Admittedly, much of household wealth for the average family is tied up in homes and pensions. There come points, however, in almost everyone's life when the house is sold, withdrawals are made from pensions, or wealth is left in an estate. Indeed, the vast expansion of different forms of retirement plans, such as 401(k) plans, profit-sharing plans, and similar vehicles, make it especially simple for an individual to transfer payments out of a plan directly into a donor-advised fund. Once the endowment is set up, little more is required than a phone call to the mutual fund handling the retirement plan.

Non-operating foundations, on the other hand, are regarded by most individuals, rightly or wrongly, as vehicles only for those with substantial wealth. That view is supported by enough complexity in dealing with the IRS that for decades advisers have recommended against forming foundations unless the amount of giving is substantial. One hurdle is the cost of advice, including legal and accounting fees, which potentially could eat away at the charitable activities of the foundation.

In my view, the complexity complaint was always a bit exaggerated by those who lobbied the government to reduce it. The Tax Reform Act of 1969, in particular, hit hard at what was then viewed to be the inappropriate behavior of some foundations, such as accumulating foundation assets in a firm owned by the contributor without either diversifying to help reduce risk or paying out much of the endowment for charitable purposes. In complaining about those rules, however, the foundation sector simultaneously passed on a negative message to potential contributors. Whatever the reason—increased complexity, exaggerated complaining, or simply a weak stock market—in the period following 1969, the foundation sector went through a period in which formation of foundations was meager. Today, a more balanced public view has been obtained, and rate of formation of new foundations has recovered.

Still, while the foundation rules are not that onerous for the wealthy giver, they are still quite substantial for the more moderate giver. The forms filed by foundations (990PF) are a nightmare for the uninitiated, and there are no simplified versions for foundations that might do nothing more than accept contributions and make an occasional grant. One reason is that the law contains all sorts of twists and turns and interlocking requirements. A rule on required foundation payout rates is needlessly complex. There is an excise tax on investment income that operates in a variety of strange ways and depends partly on the amount of payout made. Income and expenses are tabulated in multiple ways depending on how various items can be counted or not counted toward meeting some standard such as the minimum payout. And so on.

Not only do the tax code and the IRS do little to simplify filing or minimize excise taxes for foundations with no paid staff and quite simple operations, but no private intermediary institution has been set up to try to handle some of the filing requirements more automatically. In the age of computers, it is not hard to imagine that with a couple of simple designations on checks, a mutual fund or a bank trust department could easily fill out most of the 990PF for a foundation with simple affairs. Still further simplification would be possible if the intermediary were to take on some of the fiduciary responsibilities (e.g., diversification of assets) so that certain proscribed activities automatically could not occur. Perhaps the one exception to this lack of help for the smaller endowment has been the attempt to provide to smaller charities the investment advice available to larger ones, as in common-fund types of entities, such as The Investment Fund for Foundations (TIFF).

In one quick move, however, the mutual fund industry has not only pulled down many of the hurdles, it has shortened the track as well. The givers to donor-advised funds have almost no filing requirements whatsoever; what few that exist are handled by the mutual funds themselves. As former IRS Commissioner Fred Goldberg stated (see edited transcript of the July 31 ABA Exempt Organization Committee Meeting; Doc 98-30340 (53 pages) or 98 TNT 198-45), "donor advised funds...move very much in the direction of 'simplification' in the sense that they put recordkeeping burdens, reporting burdens, on institutions that are more able to carry those responsibilities, and can achieve economies of scale and efficiency in discharging those responsibilities." At the same time, the endowments avoid altogether the excise tax on foundation investment income and minimum payout rates, although Fidelity and others voluntarily are ensuring that a minimum is paid.

Despite some possible problems, the democratization of endowment giving is an exciting prospect. It offers many possibilities for families to pass on giving habits across generations. It simplifies the means by which individuals can set aside portions of their income for charitable purposes on a regular basis. My own research tends to reveal that many individuals are inconsistent in their giving patterns, at least implying that organizational improvements can sustain a higher rate of giving. In the end, however, the expansion of donor-advised funds through the mutual fund industry will probably succeed only if the public feels confident that new abuses of charitable giving will not arise.

| [Part Two: Reconsidering the Foundation Rules](#) |

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