Pledges and donor advised funds – the changing landscape

Can a donor fulfill a personal pledge to a charity from his/her donor advised fund?

Published on August 24, 2018
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According to the National Philanthropic Trust's 2017 Donor-Advised Fund Report, there were approximately 285,000 active individual donor-advised funds (DAFs) in 2016, with aggregate charitable assets of more than $85 billion. The year-over-year growth in DAF accounts for 2016 was 7.6%; as a result, nonprofit charitable organizations are seeing an increase in contributions from their donors' DAFs.

This increase has presented a recurring issue for charities: if a donor intends to pay a personal pledge by recommending grants from his/her DAF, does this preclude the recipient organization from recording the promise and crediting it to the donor? Until now, IRS rules prohibited a donor from fulfilling a legally enforceable pledge with payments from a donor advised fund (DAF), and here's why: when a donor makes a contribution to a DAF, the sponsoring organization then has legal control over it. This allows the donor to take a charitable tax deduction for the completed gift. The donor retains advisory privileges with respect to both the distribution of funds from the DAF and the investment of assets in the account, but these may be recommendations only. While most sponsoring organizations will routinely approve a donor's request, there is no legal requirement for the organization to comply with a donor's request to grant funds to specific organizations.

Since the donor has advisory privileges over distributions from his/her DAF, many donors believe they can simply request a distribution from their DAF to fulfill their legally-enforceable personal pledge to a charity. But the money held in the DAF belongs to the sponsoring organization - not the donor - and the donor cannot legally obligate the DAF.

The IRS's current interpretation is that the donor is receiving a "more than incidental benefit" if funds paid by the DAF relieves the donor of his/her personal obligation to fulfill a pledge. In fact, a tax of 125% of the prohibited benefit resulting from the distribution may be imposed on the donor who received the prohibited benefit.

One commonly-used "work-around" for this dilemma has been for the charity to set up procedures to record a non-binding gift intention. This is not a legal or binding commitment, but rather a courtesy acknowledgment that the donor intends to recommend future grants to the organization from his/her DAF. The donor would need to submit a grant request to their DAF's sponsoring organization each time he/she wishes to make a contribution to the charity (based upon any schedule reflected in their non-binding commitment); however, the donor has no legal obligation to do so, and there is no obligation on the part of the DAF's sponsoring organization to agree to the request.

This strategy may no longer be necessary. On December 4, 2017, the IRS released a Notice of Proposed Regulations (2017-73) that addresses several aspects related to a donor's use of a DAF, including the fulfillment of personal pledges. (The Notice states that, until further guidance is issued, taxpayers may rely on the rules described in the Notice with respect to certain DAF distributions permitted without regard to a charitable pledge) The proposed regulations state that the use of a DAF to fulfill a personal pledge would not be treated as a "more than incidental benefit" under section 4967 of the Internal Revenue Code (i.e., this would be allowable and not taxable to the donor) if all of the following requirements are satisfied:

- The DAF's sponsoring organization makes no reference to the existence of a charitable pledge when making the distribution from the donor's DAF;

- No donor/advisor receives, directly or indirectly, any other benefit that is more than incidental as a result of the DAF distribution; and

- The donor/advisor does not claim a charitable contribution deduction for the DAF distribution, even if the charity receiving the distribution mistakenly sends the donor/advisor a tax acknowledgement.

While a donor still cannot bind the DAF to establish a promise to give/pledge, this change allows a donor to enter into a personal pledge agreement with a charity and the charity can record the intention as any other pledge (in accordance with the charities gift acceptance policies). Knowing that a donor has requested (or intends to request) his/her DAF to make a grant distribution as payment in settlement of a pledge would no longer prevent a charity from recording a receivable. However, if the pledge agreement explicitly includes contingent wording, such as "assuming my DAF honors my directions to make payments" (or other similar wording that suggests the commitment resides with the DAF, rather than with the individual) or if the donor implies in any way that payment of his/her personal pledge is conditioned upon the DAF making payment on his/her behalf, the pledge would not qualify to be recorded. (Of course, as with any donor agreement, individual facts and circumstances will vary and must be considered by the charity when deciding whether a promise to give should be recorded consistent with GAAP.)

Charities should routinely review their policies for recording pledges to ensure that legally-enforceable promises to give are appropriately recorded. While the proposed IRS regulations don't explicitly prohibit donors from using grants from their DAFs to satisfy personal pledges, any written or verbal statements that a DAF will be relied on for payments would likely render the promise "conditional" in the eyes of the IRS. Charities that use forms or template documents for pledge agreements should review them and consider removing any reference to whether donors intend to use a DAF to satisfy their pledges.

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