Donor Advised Funds- Back in Court

Quick-Take: Yet another case has been filed in federal court that claims that an advisor's privilege to suggest or recommend grants to the donor advised fund sponsor, while not binding, must still nonetheless be honored by the sponsor in good faith.

Background: Donor advised funds (DAFs) have been a frequent topic of these missives in the past. A DAF is owned and controlled by a tax exempt organization, (the *sponsor.*) [IRC 4966(d)(2)(A)(ii).] A donor to the DAF is entitled to claim an immediate charitable deduction to the DAF, but only so long as the sponsor acknowledges that is has *exclusive legal control* over the assets held in the DAF. [IRC 170(f)(18)(B).]

Advisory Privileges: The contribution by the donor to a DAF normally also contains advisory privileges by the donor, but the document containing the *advisory privileges* also makes it clear that those privileges are not binding on the sponsor. In short, the ability to make a recommendation to the sponsor is not, standing alone, a legally enforceable right held by the donor/advisor to the DAF.

Legislative History: The legislative history to DAFs, found in the Joint Committee's Technical Explanation, makes it clear that any agreement between the DAF sponsor and the donor that confers enforceable rights on the donor with respect to his/her contribution of assets to the DAF, goes well beyond *advisory privileges* and will thus disqualify the fund from the DAF classification, and prevent the donor from claiming a charitable income tax deduction. [August 3, 2006.]

Not a Property Right: Accordingly, an *advisory privileges* retained by a donor with respect to grants or distributions from the DAF are not treated as an enforceable property right in the assets that were contributed to the DAF. While such retained privileges are legally recognized of some contractual nature, e.g., granting legal standing to the donor, those *advisory privileges* do not rise to the level of an enforceable legal property right in the DAF's assets.

Fairbairn v. Fidelity: This was a federal court case that was previously reported back in 2021, There, the donors gave $100 million to a DAF of highly appreciated company stock. The donors sued Fidelity because Fidelity shortly after receipt of the stock sold it, contrary to what the donors claimed was a promise to not sell the stock unless directed by the donors. The trial court held for Fidelity, noting that while a 'special relationship' between the donor and the DAF sponsor could exist, the donors could not reasonably rely on statements made by the DAF sponsor sufficient to support any economic loss claim, and thus no legal duty existed with Fidelity that could support a claim of its negligence. However, this case did not directly address the legal status of the donor's *advisory privileges* over the DAF; rather, it focused solely on the economic impact of the drop in value of the DAF caused by the sponsor's abrupt liquidation of all of the stock gifted to the DAF.

Pinkert v. Schwab Charitable: This federal court decision arose the following year after *Fairbairn*. There, the donor alleged that the sponsor charged excessive fees and mismanaged the DAF that ultimately mismanaged the value of the DAF. The trial court dismissed the lawsuit finding that the donor lacked legal standing to bring the lawsuit, inasmuch as the donor had irrevocably transferred the assets to the DAF, had taken the charitable deduction for that gift, had only retained *advisory privileges* over the DAF, and consequently no longer held a property interest in the fund sufficient to support legal standing to recover economic losses. On appeal, the appellate Court distinguished between the advisor's claim of mismanagement of the fund by the sponsor and the donor's alleged *advisory privileges*. In doing so, the Court seems to have implicitly concluded that having *advisory privileges* regarding a DAF might constitute a legally enforceable right, but because it was not expressly argued that it was infringed, the donor lacked legal standing to pursue his claim. Thus, the Court did not directly address what the legal consequences would be if the sponsor interfered with the donor's express *advisory privileges*.

Peterson v. Christian Community Foundation, d/b/a WaterStone: This lawsuit was filed earlier in January in a federal court in Colorado. The donor gave $21million to a DAF controlled by a Christian nonprofit that sponsors DAFs. The donor's claim is that the sponsor wrongfully impaired and suspended the successor advisors (to the original donor-advisor) *advisory privileges*. According to the facts in the complaint, a detailed written Purpose Statement was created at the same time as the DAF; the Statement identified specific doctrinal objectives (based in scripture) along with evangelical missions, media outreach, and Christian education. A prioritized charitable recipient list was also

incorporated into this Statement. This arrangement worked well for 15 years between the DAF's creation and the death of the donor's spouse (the initial advisor) who died in 2021. The donor's son was the next advisor to the DAF. Three years later the son claims that the sponsor revoked his online access, stopped communicating with him, suspended his *advisory privileges*, and refused to process his grant recommendations. Apparently, so the complaint says, that the sponsor also refused to process a grant recommendation of about $1 million to Operation Mobilization, a long-time grantee consistent with the DAF's stated evangelical mission. Finally, the complaint states that the sponsor declined to provide accountings or copies of the governing documents to the son, including the original DAF agreement. Several other claims are included in this complaint which I'll will ignore.

What is interesting, though, is that the complaint also asked for a declaratory judgement that defines the legal status of an advisor's *advisory privileges.* Accordingly, unlike the *Fairbairn* case that dealt with the diminution of sales proceeds held in the DAF due to the abrupt liquidation of the gifted stock, and unlike the *Pinkert* case that dealt with the donor's claim of economic damages and injury to his reputation, *Peterson* centers on the advisory relationship, and in particular whether the sponsor can simply unilaterally suspend, or ignore, those privileges.

Conclusion: Unlike the earlier court decisions that dealt with statutory formalities or the impact of the sponsor's decisions on the value of the assets held in a DAF, *Peterson* seems to directly focus on the nature and legal effect of a DAF agreement that contains the donor/advisor's retained *advisory privileges.* Most DAF sponsors are good at honoring *advisory privileges*, because they have a business incentive to do so. It will be interesting to see how much legal enforceability (if any) the federal court will give to the donor's retained *advisory privileges* in *Peterson,* and if it ultimately provides guidance to DAF sponsors on what to include, or exclude, in their Agreements with donors.

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