

The Charitable Gift Fund Phenomenon:

Is it a boon for nonprofits or a ploy for investors?

By Mary Williams Walsh

In an age when private enterprise is venturing into such traditionally public arenas as education and prison management, philanthropy has become the latest activity to lure profit makers.

Fidelity Investments' Charitable Gift Fund hybrid—part mutual fund, part foundation—is suddenly the hottest player in the good-works business. Last year it was America's largest grantmaking charity. It raised more money during the 12 months ending in June than the American Cancer Society, the American Red Cross and Harvard University—more than any institution except the Salvation Army and the YMCA.

“And we are very rapidly gaining ground on those organizations as well,” Charitable Gift Fund president Cynthia Egan says. The Charitable Gift Fund works simply enough: Individuals make tax-deductible contributions to the fund and earnings accumulate tax-free. Donors can bestow the money at any time on any of the more than 600,000 tax-exempt charitable organizations recognized by the IRS.

Donors benefit by getting a tax exemption before they have figured out what causes they want to support. Fidelity benefits by charging a fee for the money it manages in the Charitable Gift Fund. And thousands of charities benefit by getting grants through Fidelity.

But critics say these practices push the margins of the tax laws and potentially open new avenues of abuse. Will donors find ways to make their tax-deductible contributions help themselves, as well as the charities to which they give, thus depriving government of tax revenue? What's to stop holders of charitable accounts, critics ask, from using their tax-exempt funds to buy luxury goods at a fundraising auction run by a tax-exempt organization such as a private school? Or to pay their grandchildren's college tuition? Fidelity officials say they have in-house safeguards against such abuse; outside critics question whether they are sufficient.

The existing laws on tax-exempt gifts were enacted in 1969 to clamp down on wealthy “philanthropists” whose self-enriching gimmicks included setting up tax-exempt “charities,” which they headed and from which they drew

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magnificent salaries. Traditional nonprofits say they have been laboring diligently ever since to make sure their donors complied with the law.

“With a [traditional] fund, staff volunteers review all significant donations,” says Earl Taylor of the Omaha Community Foundation. “There is no evidence that Fidelity is providing that oversight. Everybody’s interested in loosening up the 1969 law, but Fidelity’s just gone ahead and ignored it.”

Fidelity’s breathtaking success has prompted other financial-services companies to create their own philanthropic mutual-fund hybrids. The Vanguard Group, Merrill Lynch, PNC Bank and American Guaranty & Trust have started charitable funds, and others have them in the planning stages.

“I don’t think there’s going to be a major financial-services company or bank that isn’t trying to develop a philanthropic-services division for its clients,” says Leslie Lenkowsky professor of philanthropic studies and public policy at Indiana University. “For high-dollar clients, being able to give them philanthropic advice may be a good marketing tool.”

Fidelity isn’t waiting for the rest of the industry to catch up. It recently expanded its Web site to make performing philanthropy as easy as clicking a mouse. It also is throwing its considerable weight behind a revision of the tax laws in Massachusetts, its home state, where charitable giving is not now deductible for purposes of state income taxes.

Admirers of what Fidelity is doing predict that by combining philanthropic virtue with mass market prowess, it will tap deep new wells of giving by people who might never otherwise have tried to sponsor social change or patronize the arts.

“When I started giving lectures on charitable giving 10 years ago, no one had ever heard of vehicles like the Fidelity Gift Fund,” says Victoria Bjorklund, a New York tax attorney and authority on philanthropic law. “The success of the Fidelity Charitable Gift Fund may be the biggest charitable-giving story of the 1990s.”

The Gift Fund has received donations of more than \$2 billion over the last eight years from more than 20,000 account holders. That’s still small potatoes compared with conventional mutual funds, of which the largest is Fidelity’s own \$92.2 billion Magellan Fund. But it’s big enough to make Fidelity a player in the foundation world, where the war chests of chests of the famed

Ford and Rockefeller foundations measured \$9.8 billion and \$3.3 billion at the end of the last fiscal year.

Egan, the Gift Fund's president, says she feels "honored" to be leading her organization into the realm of good works. She speaks excitedly about the countless worthy projects, large and small, that her organization has funded: the Sunday school classroom that got a new coat of paint; the remote neonatal clinic that got its first ultrasound equipment. She also cites the grandmother who is using Fidelity to train her 10 grandchildren as philanthropists.

"What mutual funds did for the stock market, opening it to thousands or millions of individuals who could not have participated before, we think the Charitable Gift Fund is leading the way in doing for charitable giving," Egan says.

Others don't see it that way. Some members of the philanthropic community worry that, far from tapping new sources of charitable money, financial-services firms are merely sucking existing money from conventional charities—groups with far more experience in delivering good works.

"Some of those people may have been giving money to charity all along and are just doing it through Fidelity now," says John Edie, general counsel for the Council on Foundations.

Edie says that as conventional charities rush to compete with commercial giants like Fidelity, the quality of giving may decline as traditional nonprofit values give way to such free-enterprise virtues as efficiency and high-octane marketing. He calls the mass-marketed, click-and-give ethos "bowling alone philanthropy."

Others note that the big, commercially launched charities, high-minded and law-abiding though they may be, have given new ideas to pitchmen for dubious tax shelters and shaky personal-finance plans. This is particularly worrisome at a time when the IRS is operating in a defensive posture and performing far fewer audits.

"There have always been scam artists out there, wherever there's a tax deduction involved," says Bjorklund, who approves of Fidelity's program but has been compiling a list of questionable new "charities" that claim to have modeled themselves after it.

One outfit on her list, the National Heritage Foundation of Falls Church, Va., calls itself “an experiment in charitable entrepreneurship.” It offers contributors two ways to use the money entrusted to it: not only to give it to traditional tax-exempt charities but also to operate their own good works.

J.T. Dock Houk, founder and CEO of the foundation, said his clients had repaired a Buddhist temple in Tibet, fed the hungry in Cairo and operated a soup kitchen in Philadelphia.

The foundation has also advised donors that they can legally use their tax-exempt money to pay salaries to themselves and family members who manage their charitable giving. Among the kinds of giving that have been sanctioned by the foundation is the construction of an Olympic-size swimming pool to train potential Olympic athletes.

The IRS closed National Heritage in 1983 for alleged tax violations, but the foundation bounced back after successfully suing the IRS in the U.S. Court of Claims. It now ranks 63rd on the Philanthropy 400, a ranking of nonprofit groups compiled by The Chronicle of Philanthropy according to the amount of funds raised. Far from imitating the Fidelity model, National Heritage claims to be the inventor.

Houk says he is not surprised that his foundation has become a target of criticism.

“A lot of the so-called outrage comes from charities that are feeling the pressure of competition, which is long overdue in the charitable sector,” he said.

Tax lawyer Bjorklund, referring to Houk’s foundation, said: “The good news is, outfits like that are few and far between. The bad news is, they ruin things for everybody else.”

Is there a place for private enterprise in the nonprofit world? Yes, say some, because society also benefits. “Fidelity makes a profit, but that’s the American way. We’re all profit-driven,” says William Lehrfeld, a Washington tax lawyer. “I think Fidelity has done a great thing for the gift-giving public. It’s saving an enormous amount of overhead.”

Others disagree. “They never should have received IRS approval in the first place,” Omaha Community Foundation’s Taylor says. “They have succeeded

in having a tax exemption for investing in their for-profit accounts. . . . Why should taxpayers be assisting the for-profit Fidelity Investments program?”

Of course, community foundations have long served as pipelines between donors and their favorite causes, but they maintain staffs of grant officers charged with evaluating nonprofit groups and sharing their findings with wealthy donors.

“I can think of 10 or 12 times in the last 12 months when we rejected a donor’s recommendation,” usually because the project didn’t meet legal requirements or was known to be mismanaged, says Allan Parachini, spokesman for the California Community Foundation.

Fidelity and its commercial cousins, by contrast, have no grant officers of their own: no one to second-guess an account holder for buying parquet floors for the art museum instead of building a Little League field. They typically allow nearly all requested contributions by their account holders, as long as the recipient is based within the United States and is one of the approximately 600,000 charities registered with the IRS.

Tax policymakers in Washington have been trying to determine whether new laws are needed to codify the operations of the commercial hybrids. Observers say issues on the table include the allowable size of tax deductions, the rate at which the hybrids pay out their assets, and the lack of full disclosure as to who is giving what to whom.

Facing such a threat, Fidelity retained former IRS Commissioner Fred Goldberg last year to draw up a set of voluntary guidelines. Gifts to charities in foreign countries are no longer allowed. In addition to being too hard to monitor, they raise questions about sending U.S. tax-exempt money overseas. Nor can Fidelity’s account holders use tax-exempt funds to buy items at silent auctions any more.

And to avoid the appearance of amassing a Klondike of tax-exempt money, Fidelity has promised to pay out at least 5% of its assets each year. In practice, it has been paying out much more than that.

Gift Fund president Egan says that even without a staff of full-time grant officers, Fidelity is now rejecting some donor advice on deserving projects. Though tax lawyers say this still leaves an oversized legal gray zone, other household-name financial services firms have written similar voluntary codes, and their charitable funds, like Fidelity’s, are winning IRS approval.