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Report No. 1489
February 13, 2024

The Honorable Lily Batchelder
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Daniel I. Werfel
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William M. Paul
Principal Deputy Chief Counsel
and Deputy Chief Counsel
(Technical)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Report No. 1489 - Report on Proposed Regulations under Section 4966

Dear Ms. Batchelder and Messrs. Werfel and Paul:

I am pleased to submit Report No. 1489 of the Tax Section of the New York State Bar Association, which discusses proposed regulations under Section 4966.

We appreciate your consideration of our Report. If you have any questions or comments, please feel free to contact us and we will be glad to assist in any way.

Respectfully Submitted,

Jiyeon Lee-Lim
Chair

Enclosure

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Report No. 1489

New York State Bar Association Tax Section

Report on Proposed Regulations under Section 4966

February 13, 2024

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Report on Proposed Regulations under Section 4966

I. Introduction

The New York State Bar Association Tax Section[1] is submitting this report (the "**Report**") on the Proposed Regulations under Section 4966 of the Code[2] (the "**Proposed Regulations**")[3] dealing with donor advised funds ("**DAF**"s) that Treasury released on November 14, 2023.

This Report comments and provides recommendations on selected issues related to the Proposed Regulations, including the definition of a DAF and requirements for a fund to be treated as a DAF; when persons are considered to have advisory rights with respect to a DAF; the scope of regulatory exceptions to classification of funds as DAFs; and treatment of ordinary course expenses and certain other expenditures as other than taxable distributions from a DAF. The remainder of this Report is organized into three parts. Part II contains a summary of our principal recommendations. Part III provides a summary of the applicable statutory provisions and a general overview of the Proposed Regulations. Part IV describes our recommendations in detail and identifies certain additional issues.

II. Summary of Principal Recommendations

1. We recommend that Treasury add examples confirming that DAF status does not arise in certain common situations, where some, but not all, of the requirements of a DAF may be satisfied.
2. We recommend that Treasury remove the word "formal" from the Proposed Regulation governing whether a fund is separately identified. It should be sufficient if the sponsoring organization maintains records of any nature associating the fund with the donor.

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[1] The principal drafters of this Report were Austin Bramwell and Stuart Rosow. Comments were received from Philip Wagman, Andrew Walker, Jiyeon Lee-Lim, Michael Schler, David Miller, Stephen B. Land, Robert Cassanos, Jody Schwartz, Libin Zhang, David Schizer, Peter Faber, Kim Blanchard, and Bill Ackman. Research assistance was provided by Seo Kyung (Rosa) Kim, Gregory Zeien and Caroline Graif. This Report reflects solely the views of the Tax Section of the New York State Bar Association ("**NYSBA**") and not those of NYSBA's Executive Committee or its House of Delegates.

[2] Unless otherwise indicated, all references in this Report to "**Section**," "**Sections**" and "**§**" are to the Internal Revenue Code of 1986, as amended (the "**Code**"), and all references to "**Treas. Reg. §**" or "**Prop. Treas. Reg. §**" are to regulations or Proposed Regulations issued thereunder. References to "**Treasury**" are to the United States Department of the Treasury including, as applicable, the Internal Revenue Service (the "**IRS**").

[3] The preamble to the Proposed Regulations (the "**Preamble**") provides that the regulations are to apply for taxable years ending on or after the date final regulations are published in the Federal Register. REG-142338-07, 88 Fed. Reg. 77922 (November 14, 2023). The Preamble further provides that taxpayers may rely on the Proposed Regulations for taxable years before the date the final regulations are published in the Federal Register.

3. We recommend that Treasury provide exceptions from the separate identification rules for startup publicly supported charities and certain other organizations, such as medical research organizations, that are exempt by nature of the activities rather than nature of their funding. In each case, there may be a single large donor who may influence the direction of the organization, but such influence should not cause the fund to be viewed as a DAF.
4. We recommend Treasury modify the Proposed Regulations' treatment of investment advisors who provide advice with respect to investments of a DAF. We believe that arm's-length fees paid from a DAF for investment advice should in principle and as a policy matter not be considered an excess benefit transaction, provided that there are adequate assurances that such fees satisfy the arm's-length standard. We recognize that Treasury may have administrability concerns over policing whether fees are arm's length but recommend that Treasury consider a somewhat less restrictive approach to fees paid to independent advisors by the DAF. We provide some suggested ways to implement such a less restrictive approach, which we believe may be administrable. We also recommend that Treasury issue rules that limit arrangements with investment advisors treated as providing an indirect benefit to a donor.
5. We recommend that Treasury clarify the rules concerning when membership on a board or service as an officer of a sponsoring organization will cause a donor to be considered to have advisory privileges. In this regard, we recommend creating a presumption that the board member or officer, who is acting subject to fiduciary duties, will not be considered to have advisory privileges.
6. We recommend that Treasury revise the Proposed Regulations governing committee membership to eliminate the requirement of a special expertise. Additionally, we recommend Treasury consider adopting rules that exempt committee members who are not substantial donors from being considered as having advisory privileges if control of disbursements is vested in independent persons. We also recommend that committee members not be considered to have advisory privileges if their actions as a committee member are subject to approval of a board whose members are subject to fiduciary duties.
7. We recommend that the regulations include rules that enforceable rights under a gift agreement are not considered advisory privileges, subject to an anti-abuse rule.

8. We recommend that the term "single identified organization" include affiliated tax-exempt entities that are under common control for purposes of the exemption from DAF treatment.

9. We recommend Treasury permit organizations exempt under Section 501(c)(6) with broad-based membership to establish scholarship funds in the same manner as Section 501(c)(4) organizations. We also offer suggestions on determining when there is a broad-based membership.

10. We recommend that Treasury treat program related investments, as determined under the private foundation rules, as permissible investments and not taxable distributions for DAFs.

III. Applicable Statutory Provisions and General Overview of Proposed Regulations

A. Applicable Statutory Provisions

1. Donor Advised Funds

In general, a donor advised fund, or a DAF, is a separate fund or account, maintained by a tax-exempt charitable organization known as a "sponsoring organization," with respect to which the donor, or persons designated by the donor, are granted advisory privileges. The advisory privileges, which are legally nonbinding, allow the donor or other advisor to make recommendations regarding grants from and investment of the fund or account assets. In practice, to compete with other organizations offering DAFs, the sponsoring organization nearly always carries out the recommendations of the advisors. As a result, a DAF effectively allows the donor or advisor to pick which charities will receive distributions from the account. A DAF may also effectively allow the donor or advisor, within limits established by the sponsoring organization, to choose investments or an investment allocation for the DAF.

2. Pension Protection Act Reforms

The Pension Protection Act of 2006 (the "**Act**") enacted a suite of reforms aimed at curbing the potential for abuse in the administration of DAFs. Included in these reforms are several punitive excise taxes that are payable, depending on the nature of the taxable act, by donors, advisors, related persons, fund managers, and/or sponsoring organizations. First, Section 4967 imposes an excise tax with respect to the advice that a donor, advisor, or related person provides to the sponsoring organization, if the advice results in a distribution that confers a more-than-incidental benefit on the donor, advisor, or related person. The tax is payable by the donor, advisor, or related person who gives the advice, as well as the person who receives the benefit. Section

4967 also imposes a tax on a fund manager who agrees to make the distribution knowing that it would confer a more than incidental benefit.

Second, Section 4966 imposes a 20 percent excise tax, payable by the sponsoring organization, on "taxable distributions" from a DAF. (A separate tax is also payable by fund managers who knowingly make a taxable distribution.) A "taxable distribution" is defined to include any distribution from a DAF to a natural person. It also includes any distribution that is not made for a charitable purpose (defined by cross-reference to Section 170(c)(2)(B)) or with respect to which the sponsoring organization does not exercise expenditure responsibility. Although the general definition of "taxable distribution" is broad, taxable distributions do not include distributions to public charities (other than certain disqualified supporting organizations), the sponsoring organization, or other DAFs. Thus, standard charitable grant-making activity from a DAF, as well as payments of periodic or other fees charged by the sponsoring organization, are generally protected from this excise tax.

Importantly, Section 4966 contains definitions of "donor advised fund" and "sponsoring organization" that are incorporated, at least in part, by other Sections regulating DAFs. In general, subject to certain exceptions, an account is a DAF if it meets a three-pronged definition: (1) it must be separately identified by reference to contributions of a donor or donors, (2) it must be owned and controlled by a sponsoring organization, and (3) a donor or person appointed or designated by such donor (*i.e.*, an advisor) must have, or reasonably expect to have, advisory privileges with respect to the distribution or investment of amounts held in the fund or account by reason of the donor's status as a donor. Note that by prongs (1) and (3), the term "donor advised fund" is defined in part by reference to donors and advisors. Thus, Section 4966 is the source of the tax law concepts of "donor," "donor-advisor," "donor advised fund," and "sponsoring organization." Defining these concepts is central to the Proposed Regulations and regulation of DAFs more generally.

Third, the Act expands the scope of Section 4958, which imposes excises taxes on "excess benefit transactions," to include certain transactions involving DAFs. Generally, the tax under Section 4958 is paid by "disqualified persons" who receive an economic benefit from a tax-exempt organization (including tax-exempt charities) that exceeds the value of the consideration provided.[4] (A separate tax is also paid by organization managers who participate in a transaction knowing that it is an excess benefit transaction.) For example, a chief executive of a tax-exempt charity who is paid more than reasonable compensation will owe tax on the amount of the excess benefit. The excise taxes under Section 4958 are often referred to as "intermediate sanctions" because they enable the IRS to penalize abuses involving tax-exempt organizations without resorting to the drastic remedy of denying or revoking tax-exempt status altogether.

In the case of DAFs, the Act both imposes and modifies the intermediate sanctions regime. It adopts the regime by defining transactions between DAFs and certain "disqualified persons" as excess benefit transactions triggering excise tax. "Disqualified persons," for purposes of a transaction involving a DAF, are defined to include donors and donor-advisors, as well as family members and other persons who are related to donors and/or donor-advisors. The Act modifies the intermediate sanctions regime by providing that any grant, loan, compensation, or similar payment from a DAF to a disqualified person is treated *per se* as an excess benefit transaction. That is, it does not matter what consideration was provided in exchange for the payment or whether the value of the consideration was commensurate with the amount of the payment. On the contrary, the entire amount of a payment from a DAF to a disqualified person is automatically subject to this excise tax.

Finally, the Act modestly reforms how Section 4958 applies to sponsoring organizations. Excess benefit transactions engaged in by sponsoring organizations were, prior to the Act, and continue to be, subject to intermediate sanctions. The Act expands the list of disqualified persons with respect to a sponsoring organization by including the sponsoring organization's investment advisors who are compensated for managing DAF assets and their family members and other related persons. Thus, such investment advisors who, for example, are paid excessive compensation by a sponsoring organization are liable for a tax on the amount of the excess benefit.[5]

B. Overview of Proposed Regulations

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[4] Generally, for purposes of Section 4958, a "disqualified person" includes persons who are in a position to exert or have significant influence over the charitable organization and include officers and directors. Section 4958(f)(1).

[5] The definition of "donor-advisor" in Section 4958 does not automatically include investment advisors, as it cross references the definition to Section 4966, which provides that a donor is someone who "has or reasonably expects to have advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor's status as a donor." The inclusion of investment advisors as donor-advisors is an extension of such Code section as applied by Treasury.

1. Definition of Donor-Advised Funds and Requirements

Under Prop. Treas. Reg. §53-4966-3, a DAF means a fund or account: 1) that is separately identified by reference to contributions of a donor or donors; 2) that is owned and controlled by a sponsoring organization;[6] and 3) where at least one donor or donor-advisor has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in the fund or account by reason of the donor's status as a donor.[7]

A donor is defined as any person under Section 7701(a)(1) that makes a contribution to a fund or account of a sponsoring organization.[8] A donor-advisor is defined as a person appointed or designated by a donor to have advisory privileges regarding the distribution or investment of assets held in a fund or account of a sponsoring organization.[9] The term "donor" does not include public charities or governmental organizations, and any fund or account that is separately identified by reference solely to contributions from such organizations will not be a DAF.

2. Separate Identification by Reference to Contributions of a Donor or Donors

A fund is separately identified by reference to contributions of a donor or donors if the sponsoring organization maintains a "formal record" of the contributions.[10] If there is no formal record, a facts and circumstances test is used by balancing six factors: i) account balance reflecting contributions, distributions, expenses, and gains and losses; ii) naming of the fund after donor(s) or donor-advisor(s); iii) the sponsoring organization refers to the fund as a DAF; iv) an agreement or understanding exists between the sponsoring organization and the donor(s) or donor-advisor(s) that this is a DAF; v) the donor(s) or donor-advisor(s) regularly receive a fund or account statement from the sponsoring organization; and vi) the sponsoring organization generally solicits advice from the donor(s) or donor-advisor(s) before making distributions.[11] A fund or account will not

[6] A sponsoring organization is defined as any organization described in Section 170 without the requirement that it be created or organized, or subject to the laws of the United States. Prop. Treas. Reg. §53-4966-2(l). A sponsoring organization cannot be a private foundation as defined in the Section 509(a) and its accompanying regulations.

[7] Prop. Treas. Reg. §53-4966-3(a).

[8] Prop. Treas. Reg. §53-4966-1(f).

[9] Prop. Treas. Reg. §53-4966-1(h). No particular form of appointment or designation is necessary.

[10] Prop. Treas. Reg. §53-4966-3(b).

[11] Prop. Treas. Reg. §53-4966-3(b)(2).

fail to be a DAF simply because the assets within the sponsoring organization are commingled. As long as the sponsoring organization treats the fund or account as being attributable to a specific donor or donor-advisor, the facts will weigh for the fund or account being treated as a DAF.[12]

3. Advisory Privileges

A donor or donor-advisor is considered to have advisory privileges if the person may provide recommendations or advice regarding the distribution or investment of the assets in the fund.[13] Whether such advisory privileges exist is determined based upon all of the facts and circumstances including any agreement or understanding between the person and the sponsoring organization. Such privileges will be considered to exist if there is a right to exercise, even if they are not in fact exercised. Special rules govern whether an officer or employee of a sponsoring organization is considered to have advisory privileges. In addition, the Proposed Regulations contain detailed rules for determining whether members of a committee that control investment and distributions from a fund will be considered to have advisory privileges. Because advisory privileges include advice with respect to investments, the Proposed Regulations provide that an investment advisor (as defined in Section 4958(f)(8)(B)) that provides investment advice with respect to both the assets maintained in the DAF and the personal assets of a donor to that DAF will be considered a donor-advisor.[14]

4. Exceptions to DAF Treatment

i. Single Identified Organization

[12] Prop. Treas. Reg. §53-4966-3(b)(3).

[13] Advisory privileges can also be found regardless of whether such privileges are exercised if: i) the sponsoring organization allows a donor or donor-advisor to provide nonbinding recommendations on distributions or investments held in a fund or account; ii) a written agreement gives such advisory privileges to a donor or donor-advisor; iii) a written document or marketing material available to a donor or donor-advisor indicates they may provide advice regarding the distribution or investment; or iv) the sponsoring organization generally solicits advice from a donor or donor-advisor on distribution or investment held in a fund or account. Prop. Treas. Reg. §53-4966-3(b)(3).

[14] Prop. Treas. Reg. §53.4966-2(h)(3). Such investment advisors will be treated as donor-advisors to the respective DAF without regard to whether the donor appointed, designated, or recommended the personal investment advisor to the work.

A fund which will benefit a single identified organization is not considered a DAF.[15] To qualify, such fund or account needs to be established by written agreement to make distributions only to such single identified organizations, and must actually make these distributions.[16] The sponsoring organization must make distributions from the fund directly to such single identified organizations, and distributions cannot be made to third parties on behalf of single identified organizations.[17] A fund will not be considered to benefit a single organization if (1) the donor, donor-advisor, or related person has or reasonably expects to have the ability to advise regarding some or all of the distributions from the single-identified organization to other individuals or entities, or (2) when a distribution from the fund provides, directly or indirectly, a more than incidental benefit to a donor, donor-advisor, or related person.[18]

ii. Grants to Individuals for Study and Travel

DAFs do not include any fund or account as to which a donor or donor-advisor may advise regarding the selection of grant recipients for purposes of travel, study, or similar purposes, provided that certain requirements are met.[19] The requirements are: 1) the exclusive purpose of the fund must be to make grants to individuals for travel, study or similar purposes; 2) the donor or donor-advisor must provide advice exclusively in the capacity as a member of the selection committee; 3) all selection committee members must be appointed by the sponsoring organization; 4) no combination of donors, donor-advisors, or related persons directly or indirectly may control the selection committee;[20] 5) all grants must be awarded on an objective and nondiscriminatory

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[15] Prop. Treas. Reg. §53.4966-4(a). A single organization is an entity described in Sections 170(c)(2) and 509(a)(1), (2), or (3). This exception for single identified organizations would not apply if the organization is a private foundation, disqualified supporting organization, foreign organization, or non-charitable organization.

[16] *Id.*

[17] *Id.*

[18] *Id.* For this purpose, a sponsoring organization may rely on a certification from the donor that there is no benefit, absent knowledge to the contrary.

[19] Prop. Treas. Reg. §53.4966-4(b).

[20] The definitions of direct and indirect control are governed under Prop. Treas. Reg. §53-4966-4(b)(2). Control is established by substance over form. A committee will be directly controlled by donors, donor-advisors, or related persons if they can require the committee to take or refrain from taking any action, control more than 50 percent of the total voting power, or have the right to veto committee decisions. Prop. Treas. Reg. §53.4966-4(b)(2)(ii). Indirect control is determined by a facts and circumstances test, including the nature of any relationships among the committee members with any donor, donor-advisor, or related persons. Prop. Treas. Reg. §53.4966-4(b)(2)(iii).

basis that is written and approved in advance; and 6) the fund must maintain records adequate to prove such an objective and nondiscriminatory basis.[21]

iii. Funds Established by Section 501(c)(4) Organizations

DAFs do not include funds established by a "broad-based" membership organization under Section 501(c)(4) that establishes a recipient-selection committee which may advise as to which individuals receive grants, if the fund meets certain requirements.[22] The requirements include: 1) the single identified charitable purpose is to make grants to individuals for scholarships; 2) the selection of recipients is made using a selection committee with members nominated by the Section 501(c)(4) organization and approved in writing by the sponsoring organization; 3) the fund serves a charitable class; 4) selections are made on an objective and nondiscriminatory basis; and 5) no distribution is made from the fund for the benefit of any sponsoring organization's director, officer, or trustee, selection committee member, and member, honorary member, or employee of the Section 501(c)(4) organization, or any related persons to the abovementioned.[23] The Preamble specifically requests comments on how to identify a broad-based membership organization for purposes of applying this exception. Additionally, the Preamble requests comments on whether this exception should be extended to organizations exempt under Section 501(c)(5) and Section 501(c)(6).

5. Taxable Distributions

A taxable distribution is defined as any distribution from a DAF to any natural person, or to any person (natural or otherwise) if the distribution is for any purpose other than one specified in Section 170 regarding charitable contributions, or if the sponsoring organization does not exercise expenditure responsibility with respect to the distribution.[24] Two excise taxes will be imposed with respect to taxable distributions: a 20 percent tax will be imposed on the sponsoring organization and a 5 percent tax will be imposed on the fund manager or managers who agreed to the making of the taxable distribution knowingly.[25] The knowledge requirement is applied only if

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[21] *Id.*

[22] Prop. Treas. Reg. §53.4966-4(c).

[23] *Id.*

[24] Prop. Treas. Reg. §53.4966-5(a).

[25] Prop. Treas. Reg. §53.4966-2(b)-(c).

the manager either is aware that it is a taxable distribution or has knowledge of facts sufficient to determine that it would be a taxable distribution, or negligently fails to make reasonable attempts to determine whether it is a taxable distribution.[26] If there is more than one fund manager who is liable for the 5 percent tax, all managers are jointly and severally liable, up to a maximum aggregate amount of $10,000.[27]

The Proposed Regulations treat as taxable any distributions that are for a purpose not specified in Section 170(c)(2)(B). Such taxable distributions include those for an activity that is prohibited under Section 501(c)(3), or if it were a substantial part of the organization's total activities, would cause the organization to lose its tax exemption.[28] Grants to any organization, other than ones described in Section 501(c)(3) and Section 509(a)(4), are also considered taxable distributions unless the grantee agrees to either separately account for the grant funds on its books or to segregate such grant funds.[29]

Further, additional modifications to a grant that would give rise to DAF treatment are not allowed. Distributees would be required to agree not to: 1) make a grant to an organization that does not comply with the expenditure responsibility requirements; 2) make a grant to a natural person; or 3) make a grant, loan, compensation, or other similar payment to a donor, donor-advisor, or related person with respect to the DAF of the sponsoring organization.[30]

IV. Recommendations

A. Approach of Proposed Regulations

The Proposed Regulations generally adopt rules that include, within the definition of DAFs, arrangements pursuant to which a donor remains connected, even if indirectly, with the funds donated.[31] This approach is also followed by the Proposed Regulations in defining

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[26] Prop. Treas. Reg. §53.4966-2(c)(3).

[27] Prop. Treas. Reg. §53.4966-2(c)(4)-(5).

[28] Prop. Treas. Reg. §53.4966-5(b).

[29] *Id.*

[30] Prop. Treas. Reg. §53.4966-5(d).

[31] See, for example, Prop. Reg. §53.4966-(c)(2) for a list of factors sufficient to establish that a donor has advisory privileges. The Preamble specifically rejects comments that suggesting that a donor be considered to have advisory privileges only if exercised or where the donor has certain authority to approve a distribution. Moreover, the proposed regulations and preamble make clear that if any donor has privileges over a fund, even if there are multiple contributors, the fund will be a DAF (subject to other exceptions).

exceptions to DAF treatment narrowly. In general, the Proposed Regulations attempt to bring arrangements with some resemblance to an archetypal DAF within the scope of the definition of a DAF and subject the funds to the limitations on use set forth in the statute.

This approach can be supported by a view of DAFs that focuses on the practical reality of the understanding between donors and sponsoring organizations. Although sponsoring organizations legally own the assets in the DAF, many donors and organizations view the assets as "belonging" in a certain sense to the donor and behave accordingly in practice. For example, at least in some cases, reports to donors from investment affiliates of sponsoring organizations show assets under management as including the assets of the DAF together with the donor's personal assets. Additionally, sponsoring organizations often provide donors with some ability to select how the DAF's assets are invested, giving the donor some influence over decisions that may increase the value of the fund assets. And, finally, there is a general understanding, typically honored in practice, that even though the sponsoring organization actually disburses the funds, the donor may specify the time, amount and recipient of the distribution and that the donor's instructions will be followed. Any measure of influence of this nature makes the fund more like a separate trust in practice and therefore supports subjecting the arrangement to many of the restrictions that apply to closely funded or controlled private foundations. It does not make sense for DAF treatment to turn on narrow legal distinctions as to control and advisor rights when the premise of the DAF construct is that practical realities should be determinative.

An alternative approach would recognize that, regardless of the legally non-binding understanding that generally is honored in practice, the assets once transferred to the supporting organization are earmarked for charitable purposes. This view, which would respect the assets as being "owned" by a tax-exempt entity (the sponsoring organization) as to which the donor may suggest uses, supports a narrower scope for the regulations. In particular, such an approach would support modification of the proposed regulations in circumstances in which the donor's ability to influence the use of the funds is more limited, such as in circumstances where others not subject to the donor's direct influence are involved in the determination of how expenditures are made. In such a case, the arrangement accords far less effective discretion to the donor or donor-advisor than would be the case for most private foundations (even treating the practical reality of deference to donor requests as equivalent to a legal obligation of the sponsor) and therefore does not present the same risks of abuse at which the private foundation rules and somewhat narrower DAF restrictions were aimed.

As a general matter, we support the approach reflected in the Proposed Regulations. If DAFs and similar arrangements are not subject to the rules under Section 4966, the assets are then subject to the less onerous rules governing use of funds by public charities. Such rules generally permit distributions to individuals and non-tax-exempt entities if such disbursements are consistent or further the organization's overall charitable purposes or otherwise are transactions engaged in at market rates. We believe generally that in most circumstances it is appropriate to subject arrangements to DAF treatment where a donor retains any material influence over how and when the funds are used or invested.[32]

We are mindful, however, that because the funds are restricted for charitable purposes irrespective of precisely how much practical control a donor can exercise, that may be sufficient to justify less restrictive treatment, particularly in circumstances in which the relationship of the donor to the funds is very attenuated, such as because non-donors have substantial influence over their use. We have attempted to identify those situations in discussing our recommendations.

B. Common Situations that Do Not Create DAFs

We recommend the final regulations clarify the non-DAF status of certain common situations that should not be considered to satisfy the definition of a DAF. In our experience, the three-pronged statutory definition of a DAF tends to create confusion and worry as to whether common arrangements, which we believe should not be treated as DAFs, might still be characterized as DAFs. In particular, it is common, on first acquaintance with Section 4966(d)(2), to focus on one prong of the statutory test and overlook that an arrangement must meet all three conditions set forth in Section 4966(d)(2) in order to be treated as a DAF. Likewise, it is common to overlook the broad relief provided by the single identified organization exception, which

[32] This approach is consistent with our Report No. 1390 in response to Notice 2017-73, dated February 28, 2018. Our view is also guided by the view that DAFs and private foundations present similar policy issues. In both situations, the contributor to the organization has the ability or retains an implied ability to control or direct the use of the funds that have been donated for charitable purposes. While private foundations are generally subject to stricter rules to ensure the funds are used for charitable purposes and do not convey substantial benefits to the contributors, DAFs have been subject to more flexibility, despite posing similar policy issues of a contributor retaining some form of control over the disbursement of funds for a charitable purpose. In this regard, we note that the Proposed Regulations do not address use of DAF to avoid the private foundation rules, such as use of DAF contributions to attempt to establish public charity status. While addressing this issue is beyond the scope of this report, we reiterate our prior report recommendation that a look through approach be applied. Additionally, we note that general anti-abuse doctrines, such as the economic substance rule and conduit theory should apply.

excludes many arrangements created by and for the use of a single organization, even if they may involve separately identified accounts and advisory privileges.

Two situations in particular generate substantial confusion. The first involves a fund set aside by a charity in order to carry out a particular objective. For example, one or more donors might contribute to an account set aside by a church or school in order to raise funds to renovate its facilities. Often in that case, there will be an understanding that certain donors' wishes for the use of the account funds will be respected. If the account in that case were considered a DAF, then the account could not even be used to pay independent contractors without triggering an excise tax on taxable distributions. In our view, however, the fund in this circumstance should not be treated as a DAF. The reason is that the arrangement, even if it does involve a separately designated account and advisory privileges, is only used for the benefit of the very organization that owns the account. In other words, the arrangement should not be a DAF because it should be considered to qualify for the single identified organization exception. We recommend that the final regulations include examples confirming that conclusion.[33]

The second situation where confusion tends to arise involves a public charity whose primary activity is making grants to other organizations. An example might be a publicly supported organization that makes grants to support the arts in a certain community; other examples include charitable organizations, such as OxFam America or United Jewish Appeal, that function as networks of charities around the globe. Board members of such organizations are often major donors. Donor-directors typically will have both formal and informal influence, often very significant, over what grants are made and how the organization's funds are expended. Nevertheless, although donor-directors might indeed be considered to have advisory privileges, that fact alone is insufficient to create a DAF. On the contrary, a DAF is not created unless the organization also separately identifies a fund or account with respect to which the donor-director has the advisory privileges. If the donor-director's influence, though it may rise to the level of having "advisory privileges," extends to the organization's resources as a whole, without reference

[33] The Proposed Regulations on the single identified organization exception only illustrate the effect of a fund held by one organization for the use of another. To provide clarity, the final regulations should also address the effect of a fund held by one organization solely for its own use. A fund of that kind should not be a DAF and the final regulations should expressly so confirm. To reach that result, Treasury could consider revising Prop. Treas. Reg. §53.4966-4(a) in order to provide that a DAF does not include a fund or account (regardless of whether it is established by written agreement) that makes distributions solely for the use of the organization that holds the fund.

to the contributions of the donor-director, then no DAF is created. We recommend that the final regulations include an example confirming that conclusion.[34]

C. Separate Identification Requirement for a DAF

1. Overview of the Separately Identified Fund Rules

Under the Proposed Regulations, in general, a fund or account is separately identified by reference to contributions of a donor or donors if the sponsoring organization maintains a formal record of contributions to the fund or account relating to a donor or donors.[35] If there is no formal record, whether a fund or account is separately identified by reference to contributions of a donor or donors is based on all the facts and circumstances and the proposed regulations provide a nonexclusive list of factors to be considered. The Proposed Regulations do not define what constitutes a "formal" record. The Proposed Regulations also provide that a fund or account does not fail to be a DAF merely because the sponsoring organization commingles the assets attributed to the fund or account with other assets of the sponsoring organization, as long as the sponsoring organization treats the fund or account as attributable to contributions of a donor or donors.

2. Recommendations

i. "Formal" Record of Contributions to the Fund or Account Relating to a Donor or Donors

We recommend removing the word "formal" from this requirement. We believe it is unclear in the context of the Proposed Regulations what "formal" means, or what it is intended to add to the requirement. It should be sufficient if the sponsoring organization maintains records of any nature which would indicate that the sponsoring organization is associating the fund with the donor in order to enable the donor to exercise advisory privileges. As recordkeeping is the main factor used to determine if a fund is separately identified, it is essential that the regulations provide clear insight into what is sufficient to satisfy the threshold of a record of contributions to the fund or account relating to a donor or donors. Examples will give taxpayers that insight. A record

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[34] Prop. Treas. Reg. §53.4966(c)(1)(iv) addresses the narrow question of when a board member is considered to have advisory privileges of a sponsoring organization that maintains DAFs. As discussed below, we recommend that the final regulations adopt a presumption that a board member in that case is not considered to have advisory privileges if the board member is subject to fiduciary duties. If an organization does not set aside a fund that is separately identified by reference to the donor-director to begin with, however, then no DAF is created and no such presumption is necessary.

[35] Prop. Treas. Reg. §53.4966-3(b)(1).

could include a separate bookkeeping entry in the general ledger or any other records that track contributions, earnings and distributions and expenses. These records can be "informal" as long as they evidence tracking of the relevant information. For example, a spreadsheet tracking accounting records of the fund separately from the other internal bookkeeping would be sufficient.

More generally, we suggest the regulations make clear that if there is an understanding between the sponsoring organization and a donor that the donor has the ability to recommend uses of any portion of the organization's funds, then the funds are separately identified. Such understanding may be reflected in solicitations for distribution recommendations or statements that specify dollar amounts that may be available or subject to advice. In that regard, we believe that the presence of any of the factors set forth in the regulations should be viewed as establishing that the fund is separately identified, rather than merely constituting a consideration in the determination.[36]

ii. Commingling and Presumption of Separate Tracking

The broad general rules reflecting separate identification should also apply where the funds are commingled with other funds, including funds that have multiple donors. We recommend providing examples to illustrate what facts and circumstances would lead to the conclusion that the commingling of funds has or has not caused the fund to avoid DAF status. One such example would include the situation in which the donor's funds are commingled in the sponsoring organization's general account, but the donor is able to suggest uses for a portion of that general account. Such portion, for example, could be a specific amount or a percentage of the total funds in the general account. In this circumstance, the relevant portion of the account should be considered a DAF and subject to the rules (unless an exception, such as the single identified organization exception, applies). Another example would include the situation in which a donor (or group of donors acting together) overwhelmingly contributes most of the funds to an account. In that case, the regulations should presume that the sponsoring organization will track that fund separately, even if the funds are commingled with other sponsor organization funds.

iii. Exceptions

[36] For purposes of determining whether a donor has advisory privileges, the proposed regulations provide that the presence of any one of a list of factors would be sufficient. We believe that the same approach is appropriate with respect to separate identification and that any of the factors set forth in Prop. Reg. §53.4966-3(b)(2) should be sufficient for such purpose.

Although we generally support a broad standard for determining separate identification by reference to a donor, we believe that there are two situations in which that approach should be limited. These are the treatments of newly formed public charities and certain entities that are treated as public charities by virtue of their activities and not the nature of their funding.

a. Startup Publicly Supported Charities

As a practical matter, a newly formed public charity will typically be funded, at least initially, by a single individual, even if the organization intends to qualify as a publicly supported charity by attracting a broad base of support. Despite its limited initial support, the organization can qualify as a publicly supported charity, as permitted by Treas. Reg. §1.170A-9(f)(4)(v)(A), so long as it can reasonably be expected to meet the requirements of a publicly supported charity in its first five years. Meanwhile, before additional donors are found, the organization's general account unavoidably functions as a record of the initial donor's contributions. The startup charity should not in that early stage be at risk of becoming a sponsoring organization. The activities of startup publicly supported charities would be needlessly impeded if, for example, payments to natural persons for purposes of carrying out the startup organization's charitable activities were potentially subject to excise tax under Section 4966. To avoid that consequence, we recommend that the final regulations provide an account of a newly formed charity is not treated as "separately identified" by reference to contribution of a donor or donors, provided that the charity does not intend to establish a practice of maintaining separate funds or accounts identified by reference to the donor or donors. This exemption should be applicable only for a limited period of time.[37]

b. Per Se Charities

Some charities, known as "*per se* public charities," avoid private foundation status in virtue of their activities, even if at all times they are funded primarily or even exclusively by one person. Examples include educational organizations and medical research organizations. In the case of such organizations, the funds of the organization effectively function as a record of the donor's contributions; the donor may also as a practical matter expect to have his or her wishes regarding the organization's operations respected. Nevertheless, the organization should not be at risk of being considered a sponsoring organization. As with a startup publicly supported charity, the

[37] One approach would be to limit the duration of such exception to the 27 months period from formation , which is the period of time given to an organization from the date of formation to file its tax exemption application for retroactive recognition effective from to the date of formation.

possibility of inadvertent DAF status would needlessly impede the organization's charitable activities, such as by prohibiting payments to natural persons. Further, the requirements of maintaining the organization's status as a *per se* charity should effectively prevent the organization from acting as a sponsoring organization. Thus, we recommend that the final regulations add an exception providing that an account of a *per se* charity is not treated as "separately identified" by reference to contributions of a donor or donors, provided that the charity does not intend to establish a practice of maintaining separate funds or accounts identified by reference to donor or donors.

D. Advisory Privileges

The Proposed Regulations provide detailed rules explaining when one or more persons will be considered to have advisory rights with respect to a fund.[38] Specifically, the Proposed Regulation provides that a donor may have such privileges even if they are not actually exercised.[39] In general the existence of advisory privileges is based upon all of the facts and circumstances, including the actual conduct of the parties as well as any understanding or agreement among the donor and the sponsoring organization.

The Proposed Regulations identify and address a number of particular circumstances setting forth rules as to when a donor or another person will or will not be considered to have advisory rights. These include: 1) consequences from the use of donor's personal investment advisor to advise on investments: 2) service as a member of the board of a sponsoring organization; and 3) membership on a committee determining investments or distributions along with other persons.

In general, we support the rules set forth in the Proposed Regulations, with an exception for the treatment of investment advisors. Our recommendations set forth below address specific situations in which the regulations need further clarification and may be more restrictive than necessary in order to accomplish the statutory purposes.

1. Treatment of Investment Advisors

i. Overview

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[38] Section 4966(d)(2)(A)(iii) provides that at least one donor or donor advisor must have, or reasonably expect to have, advisory privileges by reason of the donor's status as a donor.

[39] Prop. Treas. Reg. §53.4966-3(c)(1)(i).

Prop. Reg. §53.4966-1(h)(3) provides that an investment advisor, as defined in Section 4958(f)(8)(B), who manages the investment of, or provides investment advice with respect to, both the assets maintained in a DAF and the personal assets of a donor to that DAF will be treated as a donor advisor with respect to the DAF while serving in that dual capacity, regardless of whether the donor appointed, designated, or recommended the personal investment advisor. The regulation provides an exception to this rule if the personal investment advisor is properly viewed as providing services to the sponsoring organization as a whole, rather than providing services to the DAF. The Preamble requests comments on this issue.

ii. Recommendation

We recommend that Treasury consider modifying its approach to this issue. In the preamble to the Proposed Regulations, Treasury identified three concerns leading to the conclusion that personal investment advisors should be treated as donor advisors. These concerns are: the donor having influence over the DAF's investments due to the close relationship between the donor and his or her personal investment advisor; the potential conflict of interest that could arise if personal investment advisors are incentivized to advise their clients to give through a DAF instead of giving directly to charity; and the potential for arrangements between the advisor and the donor that create a more than incidental benefit to the donor, such as reduced management fees for the a donor's personal assets because of the inclusion of DAF assets in total assets under management.

While we acknowledge Treasury's concerns, we believe the Treasury should be circumspect about rules that favor one category of market participant over others without a clear standard to justify why and when such rule would be appropriate.

Many financial organizations that offer personal investment advice or wealth management services have established charitable affiliates that serve as sponsoring organizations. Those situations present the very same issues Treasury identified, but would not be subject to the special excess benefit transaction rule because the financial affiliate would be considered to provide investment advice to the sponsoring organization as a whole. In that situation, the excess benefit would be limited to amounts paid in excess of the fair market value of the services. In other words, the excess benefit would be the amount paid that exceeds the arm's-length fee. As a result, the standard in the Proposed Regulations is both over- and under-inclusive, because it may not entirely limit abuses in the case of sponsor-affiliated advice while precluding the use of independent advisors in situations that present a low-risk of abuse. In addition, we believe there should be compelling reasons to adopt a proposed rule that favors some participants in the marketplace over others who may provide identical competitive services.

We believe that Treasury's concerns are presented when the payment of fees to an investment advisor is made using DAF assets. The rules should focus on that situation. Generally, as a matter of principle, we believe that an arm's-length fee paid by the DAF for investment advice in respect of the fund's assets should not constitute an excess benefit transaction. The need for expert high-quality advice that maximizes the assets that will ultimately be available to make charitable contributions is important. Conversely, we recognize that "excessive" fees unnecessarily reduce the assets ultimately available to fund charitable endeavors as Congress presumably intended. We understand the need for administrable standards to ensure that fees funded by DAF assets are on arm's-length terms that reflect the value added by the advisor. But equally, we note that rules that artificially restrict the advisors who in practice can compete for that business may also result in fees that are higher than might otherwise be the case with the opposite result. Balancing these considerations requires permitting such fees to be paid to the broadest universe of potential advisors subject to limits that provide adequate assurances that such fees are indeed arm's length without placing an undue and impractical burden on the IRS to examine and audit each of these arrangements.[40]

There are obviously a variety of somewhat broader approaches than exist in the current Proposed Regulations that Treasury and the IRS could consider. The payment of investment advisory fees by a DAF could be viewed as a payment from the DAF to the sponsoring organization, with the sponsoring organization being considered to have paid the investment advisor. Accordingly, it would be reasonable for reasons of administrability to impose on the sponsoring organization the responsibility to ensure that the fees charged are arm's length.

Although the Proposed Regulations' preamble did not expressly raise this as rationale, we note that allowing arm's-length fees to be paid by the DAF to sponsor affiliates does have the advantage, from the perspective above, of limiting the universe of arrangements to sponsor-affiliated providers who, in addition to advising DAFs, will invariably also provide substantially

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[40] We note that this concern at least indirectly supports the position of the Proposed Regulations exempting advisors that provide advice to the sponsoring organization as a whole. In that case, it may be presumed that the sponsoring organization will exercise its responsibilities as a charity and ensure that the fees charged are arm's length.

similar advice to investment portfolio not owned by DAFs by third party non-DAF accounts. There will therefore effectively be in-house "comparables" that should be more easily discoverable by the IRS that can identify (without the need for somewhat subjective transfer pricing analysis) whether the fees charged to the DAF are in fact arm's length. To the extent that is an advantage of the current rule, we believe that it could be extended. For example, advisory fees paid by the DAF to a non-sponsor independent advisor could be excepted from presumptive treatment as an excess benefit transaction as long as those fees do no exceed what would have been charged by the sponsor to manage the DAF assets. However, any amount in excess of that could be presumptively treated as an excess benefit transaction.

Alternatively (or in addition), the regulations could make clear that the determination of "arm's length" would be made by reference to the well-established principles of Section 482 and the applicable rules under Section 4958 for determining the value of the economic benefit received for the services rendered. These fees should also be analyzed in the context of the fees that the sponsoring organization typically pays for general investment advisory services. Excessive amounts paid to an investment advisor would then be subject to the excess benefit transaction tax. This would potentially permit a broader range of independent advisor arrangements and services than the particular DAF sponsor offers. On the other hand, we acknowledge this imposes a higher audit burden on the IRS than a more prophylactic, bright-line test. Were this broader approach adopted, we see no reason why it should not extend to arrangements with affiliated investment advisors as well as independent organizations. Under this approach, we would anticipate that there would be specific agreements between the investment advisor and the sponsoring organization that any fees charged to the DAF will comply with the rules applicable to the fees charged by an investment affiliate of the sponsoring organization and that donors will not benefit directly or indirectly from such fee arrangements. We recognize that using such arm's-length standard is a factual determination, but such determination in the first instance would be on the sponsoring organization who would have incentives to be conservative as to transfer pricing issues. The sponsoring organization would be better equipped and informed to police the arrangement in the same manner that it would be expected to police the arrangement with its investment affiliate. Excessive fees would be subject to the normal rules governing excess benefit transactions.[41]

[41] Under our suggested approach, there is no need for the IRS to examine the relationship between fees charged to a donor and the fees charged to the DAF. Instead, the examination, if any, focuses simply on whether the fees

We believe that either approach better addresses Treasury's concerns. First, it is already prevalent for donors to have influence over investments, as sponsoring organizations often offer a menu of choices to donors to specify how the assets are being invested. We do not believe that a donor merely influencing investments should be a primary concern; rather, the issue should be how the funds are expended, including whether fees are paid to an investment advisor, and in particular, whether a donor itself receives a benefit from such expenditures. Either of our suggested approaches would address that issue directly. Treasury's concern that donors would be encouraged to donate to a DAF, rather than a charity directly, is inherent in the statutory scheme that does not require any distribution to charity to be made from a DAF and permits taxpayers to choose to donate to a DAF for other, permissible, tax planning reasons, such as to offset a large gain. As the potential to prefer a DAF over a direct contribution to charity is present for all investment advisors, we see no advantage in the narrower approach of the current Proposed Regulations in that regard.

Our recommendation also addresses the benefit issue directly, rather than indirectly. Our recommendation suggests adoption of an arm's-length standard applicable to all investment advisors which would ensure that there is no benefit to the donor from the payment of fees to the investment advisor.

We also believe that the final regulations should address questions of indirect benefit where the DAF assets are taken into account in determining the fees payable by the donor. This situation would arise, for example, in situations in which the amount of funds in the DAF are taken into account in determining the overall fee charged by the investment advisor to the donor. This could be illustrated by the following. Assume that a donor has $10 million managed by an investment manager with a fee of 1 percent of assets under management, resulting in annual fees of $100,000. In addition, assume the donor establishes a DAF with $2,000,000, and that the amount in the DAF aggregated with the donor's personal asset to reduce the fee to 0.9 percent of assets under management. That would result in a total fee, including the portion attributable to the DAF of $108,000. First, in this situation, Treasury should make clear that any fees for investment advice paid by a donor from personal funds (and not withdrawn from the DAF) do not result in an indirect benefit.

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charged to the DAF are arm's length and that can be determined by reviewing fees charged to other DAFs and the fees charged to the sponsoring organization on its other assets.

The question is more difficult if the DAF funds an "appropriate" portion of the fees (determined under whichever approach above the final rules ultimately adopt). Generally, we believe that the regulations should provide that there is no indirect benefit to a donor merely to the extent assets in the DAF are included in determining the fees charged to a donor. In this situation, one view is that the DAF is still paying only an arm's-length fee for the assets held by the DAF and receiving the benefit of having those assets included with the donor's other assets under management. We also note that a contrary rule might increase the fees that would be charged to the DAF on arm's-length basis insofar as the DAF fees presumably need not take into account the fact that the advisor earns fees from services related to other assets of the donor not in the DAF. That view would support treating the indirect benefit to the donor as non-existing or not substantial and therefore not a taxable distribution or excess benefit transaction. A contrary view would be that the fees otherwise payable by the donor have been reduced by including the DAF assets in the determination and that the donor has received a specific financial benefit.

If Treasury rejects our suggestion to broaden the existing approach and retains the existing approach of the proposed regulations, we believe that further guidance should be given to help better identify objective parameters for measuring when advice is considered rendered to the sponsoring organization as a whole. For example, we believe the regulations should specifically provide that if a sponsoring organization either requires or permits a DAF to employ only a specified investment advisor (or a select few specified investment advisors), that investment advisor will be considered to be rendering services to the sponsoring organization as a whole if the investment advisor either provides investment advice to the sponsoring organization with respect to a significant portion of its assets that are not held in DAFs or provides advice to a significant portion of the DAFs held by the sponsoring organization. For this purpose, a significant portion of the sponsoring organization's assets would be determined under all the facts and circumstances, but would be required to include either a significantly large percentage of the organization's assets or a significant dollar amount.[42] Similarly, the determination of a "significant portion" of the DAFs would be determined under all of the facts and circumstances, but it would be expected to include a minimum percentage that is significant or a minimum percentage of the total aggregate assets in all of the sponsoring organization's DAFs. Under this approach, it would not be necessary

[42] In this regard, Treasury could include the assets of affiliates of the sponsoring organization that are under common control with the sponsoring organization, such as supporting organizations.

for the investment advisor to provide advice to all of the sponsoring organization's DAFs, although that would clearly satisfy the test.[43]

We also believe that an affiliate of a sponsoring organization should be considered to provide investment advice to the sponsoring organization as a whole in circumstances in which a donor is offered a limited choice of investments, such as mutual funds or other investment products administered by that affiliate. In addition, it should be clarified that the provision of such investment options may be included as part of the overall investment management services provided to the donor rather than as a separately contracted service. We believe that it would be helpful for Treasury to provide an example addressing these facts and concluding that the investment advisor would not be considered a donor advisor under these circumstances.

2. Board Membership

i. Overview

Prop. Reg. §1.53-4766-3(c)(1)(iv) states that advice provided solely in a person's capacity as an officer, director or employee of a supporting organization does not by itself give rise to advisory privileges by reason of being a donor. However, if such a person is allowed to advise as to investment or distribution of a fund "because of such person's contributions to the fund or account," the person will be considered to have advisory privileges.

It is not entirely clear how to apply these rules. The Proposed Regulations illustrate the rule with two examples. In Example 5, an individual who is a donor to the fund is also a director of the sponsoring organization and in that capacity provides investment advice for all funds at the sponsoring organization. Under those facts, the individual is not considered to have advisory privileges. In contrast, in Example 6 with the same basic facts, the individual is appointed to a committee that advised how to distribute the funds, the individual will be considered to have advisory privileges.

ii. Recommendation

We believe that these rules are not sufficiently clear to provide adequate guidance. It is not uncommon for a director or officer of a sponsoring organization to have contributed to a fund and to have some role with respect to distributions from that fund. For example, one would expect

[43] We note that the Preamble offers an example in which an investment advisor that provides advice to all 1000 DAFs of a sponsoring organization would be considered to advise the sponsoring organization generally, even if it is also a personal investment advisor to a donor.

that directors of sponsoring organizations would have oversight over all gifts to ensure compliance with general organizational policies or enforcement of the terms of the DAF. Such advice may include approving or rejecting certain recommended distributions and may also include suggesting others. The provision of this advice may be particularly prevalent in the case of smaller sponsoring organizations. The language of the Proposed Regulations does not clearly provide a method for determining whether such a person would be considered an advisor, although the language would appear to support that view.

We recommend that Treasury consider addressing this issue by creating a presumption that a person is not a donor advisor if the authority to influence investments or disbursements from a fund is derived solely from a person's status as an officer or director and that person is acting in a fiduciary capacity. This approach is consistent with the view that respects the assets of the DAF as assets of the sponsoring organization, a public charity. In that case, it would be presumed that the officers and directors are acting in accordance with their fiduciary duty to administer charitable assets (and would be subject to oversight of state and local authorities). Such a presumption could be overcome by showing facts and circumstances that a particular director, as donor, retains some measure of special or additional influence over the funds. Our recommendation would be more in tune with common industry practice where some board members are required to have made contributions to sit on the board of a public charitable organization.

Based on this approach, we disagree with the conclusion made in Prop. Reg. §53.4966-4(a)(6), Example 3 and urge Treasury to revise or remove the example. That example addresses a situation in which a donor established a fund at a sponsoring organization to benefit a specific charity. Under the example, the donor served on the board of the charity which therefore disqualified the fund from satisfying the single charity exemption. While the board member created the fund that was contributed to the sponsoring organization, the presumption that the member was taking action subject to constraints of fiduciary duty would allow the board member to sit on the board without converting the fund into a DAF. Because the power to advise or direct where or how the funds would be used is within the responsibilities of the board in its ordinary course of business, we urge Treasury to remove or revise Example 3.

3. Committee Membership

i. Overview

Under Proposed Regulation §53.4766-3(c)(1)(iii) a donor will be considered to have advisory privileges by virtue of membership on a committee unless (a) the appointment is based upon objective criteria related to the expertise of the appointee in the particular field; (b) the committee consists of three or more persons and not more than one-third are related persons to any member of the committee; and (c) the appointee is not a significant contributor to the fund or account.

The Proposed Regulations illustrate these rules through two examples. Example 7 describes a fund with more than 100 contributors, established to combat poverty in a community. The fund is advised by a 5-member committee of unrelated individuals, who are community leaders and other persons with special knowledge or experience in the relief of poverty. No person on the committee is a significant contributor.[44] The example concludes that no person is deemed to have advisory privileges as a result of being a donor to the fund. Similarly, in Example 11, an individual established a Fund at a sponsoring organization to fund scholarships grants for the advancement of science at local schools. The individual is the sole contributor to the fund and recommends two of the five members of the committee advising the fund on distributions. Both of those persons are heads of local science departments. The example concludes that the persons recommended do not have advisory privileges.

ii. Recommendation

We recommend that Treasury consider revising the rules in the Proposed Regulations to eliminate requirements that do not appear to be directly tied to evaluating whether a board member has advisory privileges.

In particular, we recommend that the special expertise requirement be eliminated. While special expertise is often useful in evaluating the distribution of funds, it is not always required and may serve to prevent the community involvement that the rules seem to be intended to foster. Consider the following. Assume instead of alleviating poverty, the purpose of the fund in Example 7 is to fund different community arts organizations. The choice among which organizations to fund would seem here not to require so much an ability to evaluate quality or worthiness of the arts organization (which may be largely or entirely a matter of taste) but rather a sensitivity to

[44] The term "significant contributor" is not defined. We believe that Treasury should consider rules for governing when a person is considered to meet this test. Such consideration could take into account both the absolute amount of the gift as well as the percentage of total gifts to a particular fund.

community standards and wishes. In that case, members of the community as a whole would seem to be appropriate choices, even if lacking in special expertise with respect to the arts. Subject to the discussion about independent control set forth below, we believe that the special expertise requirement should be eliminated.

In general, we believe that the purpose of the rules can be better served by using a standard that would vest control of disbursements with independent advisors. For these purposes, we believe "independent" means any person who is appointed by the sponsoring organization, is not a substantial donor nor related to a substantial donor, and has not been recommended by a substantial donor (or related person). If those persons are a majority of the committee determining disbursements and actually exercise that authority, then the members of the committee should generally not be considered donor advisors. We believe that such independent control would suffice even if a donor were to recommend for appointment certain members of the committee administering the fund. We would recommend a limitation on this approach such that a substantial contributor to the fund would be viewed as a donor advisor.

Similar to the recommendation for board membership treatment, we recommend that committee memberships and appointments should not be subject to strict multi-factor tests if the decisions made from the committee positions are in the ordinary course of business. As discussed in Section IV.D.2.ii, we recommend incorporating a presumption that board members who have made contributions to the sponsoring organization, then acting in their roles subject to fiduciary duties, should not create a DAF. With this presumption, a committee membership selection made by the board of directors is still subject to such fiduciary duty, and the committee members should thus be afforded the same presumption of acting in the ordinary course of business without inadvertently becoming subject to DAF limitations.

4. Gift Agreements

i. Overview

The Proposed Regulations do not address the treatment of certain gift agreements in which the donor retains the right to direct the use of the funds if the intended project does not go forward. Under the literal language of the proposed regulations, such a right to redirect the funds would convert the gift into a DAF, if the use of the funds would go beyond the single charitable entity.[45] The Preamble recognizes this issue and requests comments on the circumstances in which a gift agreement or advisory rights retained by a donor could create a DAF.

ii. Recommendation

We recommend the final regulations provide that enforceable rights under a gift agreement do not constitute advisory privileges. For example, if a donor makes a gift subject to conditions, and retains the enforceable right to compel the donee organization to pay over the funds to a different charity if the conditions of the gift are not satisfied, the retained rights no not constitute advisory privileges. The rule, however, should be subject to an anti-abuse provision to the effect that if a purpose of the arrangement is to avoid DAF treatment, the IRS would be permitted to recharacterize the transaction.

We anticipate that the treatment of enforceable gift agreements as not constituting a DAF should be a limited exception. The regulations should provide that all facts and circumstances will be taken into account in analyzing this arrangement. In particular, the rights of a donor to redirect the funds would need to arise only when conditions of the gift agreement are not met. The regulations should further provide that the failure to meet those conditions should be considered unlikely at the time the gift agreement is entered into. The anti-abuse rule should address circumstances in which it is not unlikely that the donor will be called upon to exercise its rights to redirect the use of funds. In that case, the IRS should have the ability to recharacterize the arrangement as a DAF and in appropriate cases as a private foundation.

E. Exceptions to DAF Treatment

1. Overview

Prop. Reg. §53.4966-4 provides exceptions to the definition of a "donor advised fund." These exceptions encompass funds that make distributions exclusively to a single identified organization, funds granting scholarships, including scholarships established by Section 501(c)(4) organizations, and disaster relief funds. We recommend first that the scope of the rules concerning a single identified charity should be clarified, and second that funds sponsored by other tax-exempt entities, such as those exempt under Section 501(c)(6), should be exempted. We also suggest a

[45] We would expect this situation to be relatively uncommon. Typically, the gift agreement would permit the donor to choose another use for the funds within the charitable organization that does not involve the distribution of the funds to another charity. There are circumstances in which this situation would arise, however.

safe harbor, as discussed below, for when a Section 501(c)(4) organization is considered a "broad-based membership organization."

2. Recommendations

i. Single Identified Organizations

Paragraph (a) of Prop. Reg. §53.4966-4 exempts from the definition of a DAF funds or accounts making distributions solely to a single identified organization. However, supporting organizations do not fall under the current definition of "single identified organization" under Sections 170(c)(2) and 509(a)(1), (2), or (3) of the Code.[46] Further clarification is needed regarding the definition of a "single identified organization," as many large public charities are organized as affiliated groups of formally separate organizations. Therefore, we recommend that charitable organizations that are under common control within the meaning of Section 509(a)(3)(B)(ii) be deemed "single identified organizations." Section 509(a)(3)(B) requires the organization to be "operated, supervised, or controlled by or in connection with one or more" publicly supported organizations, thus including only Type I (supervised or controlled by) and Type II (supervised or controlled in connection with) supporting organizations.[47] To provide clarity on the limits of this definition, we recommend that Prop. Reg. §53.4966-4 clarify that, like Section 509(a)(3)(B), only Type I and Type II supporting organizations may qualify as charitable organizations *under common control* and therefore only Type I and Type II supporting organizations may be included in the definition of "single identified organizations." We also recommend that Prop. Reg. §53.4966-4 should provide illustrative examples of single identified organizations. One such example might include a hospital and its supporting fundraising organization both of which share a common board of directors.

ii. Scholarship Funds Established by Social Welfare Organizations with Broad-Based Membership

Paragraph (c) of Prop. Reg. §53.4966-4 excludes a fund that provides scholarship grants from DAF status if it is established by "a broad-based membership organization described in

[46] Prop. Treas. Reg. §53.4966-4(a). A single organization is an entity described in Sections 170(c)(2) and 509(a)(1), (2), or (3). This exception for single identified organizations would not apply if the organization is a private foundation, disqualified supporting organization, foreign organization, or non-charitable organization.

[47] §509(a)(3)(B)(i); §509(a)(3)(B)(ii); and §509(a)(3)(B)(iii) (Supporting organizations are defined by the relationship with one or more publicly supported organizations: Type I ([o]perated, supervised, or controlled by"); Type II ("[s]upervised or controlled in connection with"); and Type III ("[o]perated in connection with").

Section 501(c)(4)" and six other conditions are met. An organization described in Section 501(c)(4) of the Code, known as a "social welfare organization," is a civic league or organization that is not operated for profit and that is organized exclusively for the social welfare.[48] Prominent examples include Rotary International, AARP, and Sierra Club. The concept of a social welfare organization that is also a "broad-based membership organization" is not one that is defined anywhere in existing regulations or guidance. According to the preamble, the Treasury Department and the IRS believe that a requirement of a "broad-based membership" is needed in order to prevent "a small group of persons [from setting] up a Section 501(c)(4) organization and use a fund or account at a sponsoring organization" to grant scholarships to their selected recipients, while circumventing the DAF rules.

In order to define the concept of "broad-based membership," we suggest that Treasury and the IRS adopt or incorporate a safe harbor that is similar to the rule set forth in Treas. Reg. § 1.170A-9(f)(2). This rule, known as the "one-third support test," provides a mathematical test for determining whether a charitable organization can avoid private foundation status in virtue of having a broad base of support. Notably, to satisfy the test, government grants or contributions from the general public must exceed a certain fraction (*i.e.*, one-third) of the organization's total support. Further, under a rule known as the "2% limitation," grants from one person are disregarded in the numerator (but not the denominator) to the extent that they exceed 2% of an organization's total support. For purposes of the 2% limitation, contributions made by a donor and certain related persons are aggregated. Thus, as a rule of thumb, an organization will not satisfy the one-third test unless it has at least 17 donors (and only if those 17 donors contribute equal amounts).[49]

A similar test could be applied in order to determine whether a social welfare organization has a broad-based membership. Specifically, in order to satisfy a safe harbor, membership fees, gifts, grants, and contributions could be required to exceed a certain fraction of a social welfare organization's total support. At the same time, membership fees, gifts, grants, and contributions

[48] Social welfare organizations also include local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes. §501(c)(4)(A).

[49] In that case each donor's contributions are included in the numerator to the extent of 2% of total support. With 17 donors, 34% of the donors' aggregate contributions count as public support, thus satisfying the one-third support test.

from one source could be disregarded to the extent that they exceed a certain percentage of total support. Treasury and the IRS can decide what parameters are appropriate in order to define "broad-based membership" for purposes of the safe harbor. As an example, if the safe harbor required that membership fees, gifts, grants, and contributions from the general public exceed 50% of the organization's total support, but disregarded membership fees, gifts, grants, and contributions from one source in the numerator to the extent that they exceed 0.5% of total support, then the safe harbor would effectively require a social welfare organization to have more than 100 members.

iii. Scholarship Funds Established by Other Organizations with Broad-Based Membership

As noted, Prop. Reg. §53.4966-4(c) protects certain scholarship funds from being treated as DAFs. The Preamble to the Proposed Regulations explains this regulatory exception from DAF status was crafted in response to comments regarding funds commonly established by membership organizations classified as social welfare organizations. We note that other broad-based tax-exempt membership organizations, even if not classified as social welfare organizations, might wish, and deserve, similar relief when they organize scholarship funds. For example, a business league described in Section 501(c)(6) of the Code might choose to establish a scholarship fund with a charitable organization. An example of such a league might be a bar organization or doctors' organization that wishes to establish a scholarship fund for disadvantaged law students or medical students. If the business league membership is sufficiently broad-based, then it appears appropriate to grant the business league the same exception as the one set forth in Prop. Reg. §53.4966-4(c) for social welfare organizations. We recommend that Treasury consider whether the exception for broad-based membership organizations should be available not only for social welfare organizations but other forms of tax-exempt membership organizations.

F. Taxable Distributions

1. Overview

Under the anti-abuse rule of Prop. Reg. §53.4966-5(a)(3), a series of distributions can be treated as a taxable distribution. In practice, an annual administrative charge is typically withdrawn from the DAF and transferred to a sponsoring organization's general account. Thereafter, ordinary sponsoring organization expenses paid from the sponsoring organization's general account presumably should not be at risk of being treated as taxable distributions, even though the funds to pay expenses derive in part from DAF distributions.

2. Recommendations

i. Anti-Abuse Rule

We recommend adding a presumption that reasonable expenses incurred in the ordinary course of the sponsoring organization's operations do not achieve a result inconsistent with the purposes of Section 4966, even though the expenses are funded in part with annual charges withdrawn from DAFs. On the other hand, payments for any of these expenses at more than arm's-length prices could be considered taxable distributions; for example, payments to investment advisors with a mark-up retained by the sponsoring organization.

ii. Program Related Investments

The Proposed Regulations draw a distinction between investments, which are not subject to excise tax under Section 4966 of the Code, and distributions, which may be taxable if not made to a public charity, the sponsoring organization, or another DAF. However, we note that many charitable organizations adopt the philosophy that even their investments should further their charitable mission. For these organizations, the distinction between charitable grants or expenditures and investments can be viewed as artificial, as they believe that their investments should be made in order to have a charitable impact.

In the case of private foundations, the Code permits investments to be made even if they are not made in order to produce income or appreciation. Specifically, if an investment meets the requirements of a "program-related investment," then the making of the investment is not subject to excise tax on Section 4944 of the Code, which generally prohibits a private foundation from making imprudent investments that jeopardize the carrying out of a foundation's exempt purposes. To qualify as a program-related investment, an investment's primary purpose must be to accomplish one or more charitable purposes, no significant purpose may be the production of income or the appreciation of property, and no purpose of the investment may be to accomplish certain political activities. The exception for program-related investments does not fully license all mission-related investments, such as those with a significant purpose of producing income. Nevertheless, it does give private foundations some ability to make investments in a manner that furthers their charitable mission.

Given the parallels between private foundations and DAFs, we recommend that Treasury consider whether program-related investments should be permitted for DAFs (and not considered as distributions) as they are for private foundations. For example, the preamble to the Proposed Regulations states that a zero-interest loan would be considered a distribution rather than an investment and potentially taxable. If a zero-interest loan qualifies as a program-related investment, however, such as may be the case if it is made to small business in a deteriorated urban area and owned by an economically disadvantage group, then at least arguably it should be permitted, even if the sponsoring organization does not exercise expenditure responsibility. We recommend that Treasury consider reserving space for rules that would allow DAFs to make program-related investments and seek comments on how the concept of a program-related investment would apply in the DAF context. In particular, comments could be sought on what procedures should be applied by the sponsoring organization before implementing a program-related investment and how program-related investments would be reported.