UNITED PHILANTHROPY FORUM
A network for the common good

February 15, 2024

VIA ELECTRONIC SUBMISSION

The Honorable Lily Batchelder
Assistant Secretary (Tax Policy)
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, D.C. 20220

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

Mr. William Paul
Acting Chief Counsel and Deputy Chief Counsel (Technical)
Internal Revenue Service
1111 Constitution Avenue NW
Washington, D.C. 20224

Re: Comments to Notice of Proposed Rulemaking, REG–142338–07

Dear Assistant Secretary Batchelder, Commissioner Werfel, and Chief Counsel Paul,

United Philanthropy Forum (the "Forum") and the undersigned philanthropy-serving organizations respectfully submit comments to the U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") with respect to the proposed regulations promulgated under the Notice of Proposed Rulemaking, REG–142338–07, Taxes on Taxable Distributions From Donor Advised Funds Under Section 4966, as published in the Federal Register at 88 Fed. Reg. 77922 on November 14, 2023 (the "Proposed Regulations"). We appreciate your consideration of our comment letter on behalf of the philanthropic community.

As the largest and most diverse network in American philanthropy, United Philanthropy Forum holds a unique position in the social sector to help increase philanthropy's impact in communities across the country. We are a membership network of nearly 100 regional and national philanthropy-serving organizations ("PSOs"), representing more than 7,000 funders, who work to make philanthropy better.

The Forum uses "PSO" as something of a catch-all term to describe a diverse and dynamic group of philanthropy associations and networks that bring funders together with a focus on a geographic region, funding issue, identity/population group, or philanthropic practice. Through our members and their networks, we reach almost every state and district, working to promote a strong philanthropic sector and advocate for vibrant, healthy, and equitable communities across the country.

This sustained approach allows the Forum to lead and advocate on behalf of the sector while addressing systemic inequities and identifying practical solutions that catalyze a just and equitable society where all can participate and prosper.

The Pension Protection Act of 2006, Pub. L. 109-280, 120 Stat. 780 (Aug. 17, 2006) (the "PPA") introduced into the Internal Revenue Code (the "Code") provisions that define and regulate donor-

advised funds ("DAFs"). In particular, the PPA added section 4966, which imposes an excise tax on taxable distributions, and 4967, which addresses distributions resulting in a more than incidental benefit to a donor or donor advisor or a related person, to the Code and added certain DAF-specific provisions to section 4958, which addresses excess benefit transactions.[1]

The Proposed Regulations provide guidance on several key provisions in section 4966, including the definitions of DAF, donor, and donor-advisor, among others. While they are issued under section 4966, the definitions on which the Proposed Regulations elaborate and provide guidance are significant to the application of the statutory scheme of the PPA as a whole.

As discussed in further detail below, we respectfully make recommendations with regards to several of the elements of the Proposed Regulations. In particular, we recommend that Treasury and the IRS eliminate or significantly narrow the proposed rule that would include a donor's personal investment advisor within the definition of "donor advisor." We also recommend that final regulations clearly state that certain collaborative or other funding arrangements, such as fiscal sponsorships and designated funds, are not DAFs under section 4966. In addition, we recommend clarifications on the statutory exception to the definition of a DAF for certain scholarship funds and the regulatory exception for certain disaster relief funds. We recommend streamlining and clarifying the rules addressing the effects of serving on an advisory committee. We also recommend clarifying that certain payments, such as those which are used for lobbying activities, are not taxable distributions under section 4966. Finally, we recommend changes to the effective date of the Proposed Regulations.

I. Recommendations on the Definition of Donor-Advisor

In general, the Proposed Regulations define "donor-advisor" for purposes of section 4966 as "a person appointed or designated by a donor [or a donor-advisor] to have advisory privileges regarding the distribution or investment of assets held in a fund or account of a sponsoring organization."[2] The Proposed Regulations also provide that a "personal investment advisor" will also be treated as a "donor-advisor," without regard to "whether the donor appointed, designated or recommended the personal investment advisor."[3] A "personal investment advisor" means "[a]n investment advisor defined in section 4958(f)(8)(B) of the Code who manages the investment of, or provides investment advice with respect to, both the assets maintained in a donor advised fund and the personal assets of a donor to that donor advised fund."[4] To the extent "the personal investment advisor is properly viewed as providing services to the sponsoring organization as a whole, rather than providing services to the donor advised fund," it will not be treated as a "donor-advisor."[5]

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[1] All section references are to the Internal Revenue Code of 1986, as amended, unless otherwise stated.

[2] Prop. Treas. Reg. § 53.4966-1(h)(1).

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

[4] *Id.*

[5] Prop. Treas. Reg. § 53.4966-1(h)(3)(ii).

We believe that the Proposed Regulations' treatment of personal investment advisors as donor-advisors is inappropriate as a matter of statutory application, is not necessary as a practical matter, and will cause significant tumult in the charitable sector. Treating personal investment advisors as donor-advisors will subject them to the DAF-specific enhanced excess benefit rule in section 4958(c)(2). Under this rule, *any payment* will be treated as an excess benefit transaction, subject to a penalty, regardless of whether it is at arm's-length or not. Generally, section 4958 only penalizes so-called *excess* benefit transactions, that is, the portion of the payment that exceeds what is arm's length. Congress provided in the PPA that donors, donor-advisors, and investment advisors are all disqualified persons for purposes of the *general* excess benefit rule, the enhanced excess benefit rule does not apply to all disqualified persons. [6] The language of section 4958 is clear that the enhanced excess benefit rule applies only to payments from a DAF to a donor or donor-advisor, but not from a DAF to an investment advisor.[7]

This is significant. Under the approach taken by the Proposed Regulations, if an investment advisor of a donor-advisor gains advisory privileges over the DAF (perhaps because the sponsoring organization of the DAF permits or even encourages such arrangements, as is common), it will be treated as a donor-advisor itself, which means that it cannot be paid *anything* by the DAF absent a penalty. But there is nothing in the statute that evinces a Congressional intent to treat certain investment advisors as *per se* donor-advisors, subjecting them to the enhanced excess benefit rule. In fact, if Congress so intended, it stands to reason that it would have been explicit about this, as section 4958 already addresses investment advisors.

The Proposed Regulations' approach is also wrong from a policy perspective. To the extent the engagement of a personal investment advisor to manage the assets in a DAF might result in a benefit to a donor—perhaps by allowing the sponsoring organization to pay for some of the donor-advisor's investment fees with respect to non-DAF assets—the Code already provides guardrails against such a result. Sections 4967 and 4958 already apply punitive sanctions to distributions and transactions, respectively, that result in inappropriate benefits to donors. Moreover, there are existing federal and state rules the prohibit conflicts of interest and self-dealing in tax-exempt organizations. The Proposed Regulations' punitive treatment of personal investment advisors is duplicative of rules, in the Internal Revenue Code and elsewhere, that address the same policy concerns.

Further, treating personal investment advisors as donor-advisors, and subjecting them to the automatic excess benefit rule, will harm the charitable sector and their beneficiaries. The broad restriction on the involvement of personal investment advisors could push donors to abandon DAFs altogether and establish private foundations. This move will come at the expense of the Forum's members, which include local and regional organizations that benefit grantees in their local communities. Moreover, this proposed rule will interfere with existing commercial agreements, entered into at arm's length, between sponsoring organizations and investment advisors that currently manage DAF assets. Neither the charitable sector nor beneficiaries are well-served by forcing organizations to expend additional funds to renegotiate contracts or to breach them altogether to avoid the punitive tax under section 4958.

Therefore, we respectfully recommend that Treasury and the IRS eliminate Prop. Treas. Reg. § 53.4966-1(h)(3) from final regulations. If final regulations retain Prop. Treas. Reg. § 53.4966-1(h)(3), we

[6] *See* section 4958(f)(7), (8).

[7] *Id.* at (c)(2)(A).

respectfully recommend that Treasury and the IRS clarify and expand the exception such that it does not interfere with existing management contracts between sponsoring organizations and investment advisors from which fiduciary duties to the sponsoring organization arise, or preclude sponsoring organizations from entering into such contracts in the future. We would also request that Treasury and the IRS more narrowly tailor the rule to the perceived abuses about which they are concerned.

II. Recommendation on the Definition of Donor Advised Fund

Under section 4966(d)(2), a DAF is a fund or account (1) separately identified by reference to contributions of a donor or donors, (2) owned and controlled by a sponsoring organization, and (3) with respect to which a donor (or donor-advisor) 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 Proposed Regulations elaborate on each of these three elements. [8]

Generally, the Proposed Regulations provide that whether a donor or another person has, or reasonably expects to have, advisory privileges is based on a facts and circumstances analysis.[9] The analysis is focused on the conduct of the donor or other person and the sponsoring organization, in addition to any relevant agreements or understandings they may have.[10] A donor or other person's service on an advisory committee can constitute advisory privileges sufficient to satisfy the statutory elements of a DAF under the Proposed Regulations.[11] We are concerned that the Proposed Regulations would find that "advisory privileges" exist in an overly broad range of circumstances, which could inappropriately subject non-DAF funds to the restrictions in sections 4966, 4967, and 4958.

Many community foundations and public charities host collaborative giving arrangements through which donors can increase the effect of their gifts to projects in their community. While there are different types of collaborative arrangements, such as field of interest funds, giving circles, and collaborative funds, each with a unique focus and structure, there are certain elements that are common to all of them and could result in their treatment as DAFs under the Proposed Regulations. Often in these arrangements, donors pool their contributions in a fund owned by the host organization and an advisory committee provides guidance to the host organization on grants. Donors in these arrangements may serve on advisory committees but do not have exclusive advisory privileges over grantmaking from the fund. Nevertheless, where a donor to a collaborative funding arrangement serves on an advisory committee, the arrangement could be treated as a DAF under the Proposed Regulations.

We are also concerned that advisory privileges would exist with respect to many fiscal sponsorship arrangements would be treated as DAFs under the Proposed Regulations. In a fiscal sponsorship, a tax-exempt organization effectively lends its tax-exempt status to a project aligned with the organization's charitable mission, so the project can raise funding before it obtains its own exempt status. Often, the fiscal sponsor establishes and owns a fund, which is separately identified by reference to the contributions of one or more donors, and makes grants to the sponsored project. Fiscal

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[8] *See* Prop. Treas. Reg. § 53.4966-3.

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

[10] *Id.*

[11] *Id.* at (c)(iii).

sponsorships are often governed by a written agreement under which certain individuals are authorized to request that the sponsor make grants to fund the project's operations. These arrangements are often established by community foundations to fund small, local projects. Under the Proposed Regulations, the agreements that authorize certain individuals to request that the sponsor make grants from the fund could constitute advisory privileges and, in turn, could make the fund established for the project a DAF.

In addition, we are concerned that the Proposed Regulations' broad definition of DAF would apply to designated funds. A designated fund is a fund established by a Sponsoring Organization (typically, a community foundation) to make grants to one or more grantee organization of the donor's choosing. While the donor designates the grantees, they have no further involvement in the investment or distribution of the funds. Rather, grants are issued by the community foundation board. Designated funds should not be treated as DAFs because a donor's identification of one or more grantee organizations to benefit from a designated fund, without more, does not give the donor "advisory privileges with respect to the distribution or investment of amounts held in [the] fund" under section 4966(d)(2)(A)(iii). However, the Proposed Regulations' broad definition of "advisory privileges" could result in the treatment of designated funds as DAFs, particularly where the board establishes an advisory committee to administer the fund and where the funds makes grants to more than one grantee (and therefore would not be within the single identified organization exception in section 4966(d)(2)(B)(i)).

Classification of these arrangements as DAFs is wrong and could not have been Treasury's or the IRS's intention. Subjecting community projects, including those in their initial stages, to the punitive excise taxes in sections 4966, 4967, and 4958 would inhibit giving to impactful local projects and may prevent projects from getting off the ground at all. The ability of donors to make recommendations, to the extent they have such ability, is limited by the terms of each arrangement; they do not broadly have the power to recommend grants to any qualifying charity, as is typically the case for donor-advisors with respect to a DAF.

Therefore, we recommend that Treasury and the IRS explicitly clarify that neither collaborative funding arrangements nor fiscal sponsorship arrangements in which a donor or other person has the power to make recommendations about how funds should be allocated, whether on an advisory committee or in the context of a specific, charitable project (including, potentially, the direction of funds to operating charities involved in that project), does not result in such persons being donor-advisors, or in the creation of a DAF. We also recommend that Treasury and the IRS clarify that designated funds in which the donor's involvement is limited to the identification of one or more grantee organizations does not result in the creation of a DAF. This could be accomplished either via a clarification of the definition of "advisory privileges" or by an expansion of the exception for funds established to benefit a single identified organization (*i.e.*, providing that a qualifying arrangement is a fund to support a single identified organization and therefore not a DAF).

III. Recommendation on the Statutory Exception for Scholarship Funds

The Proposed Regulations provide guidance on the statutory exception from the definition of DAF for funds that grant scholarships to individuals for travel, study, or other similar purposes. We support additional clarity on the statutory exception in the Proposed Regulations. We respectfully request that Treasury and the IRS clarify further in final regulations that the exception in section 4966(d)(2)(B)(ii) applies to funds that make grants of post-graduation assistance for loan repayment. The ultimate use of this money is the same as if the grant had been used to pay for tuition up-front: to pay for a course of "study." It should not matter whether or not that payment comes before the course of study has begun, or after it is completed and the student has borrowed money to pay for the expenses.

Indeed, section 4966(d)(3)(B)(ii) allows for this possibility, because it permits "grants for travel, study, *or other similar purposes*[.]" (emphasis added). Therefore, we suggest that Treasury and the IRS make explicit in regulations that funds that make grants to pay off recipients' student loans fall in the scope of the exception in section 4966(d)(2)(B)(ii).

IV. Recommendation on the Regulatory Exception for Disaster Relief Funds

The Proposed Regulations contain an exception from the definition of DAF for certain disaster relief funds. A disaster relief fund is within the exception if, in relevant part, its "single identified charitable purpose is to provide relief from one or more qualified disasters within the meaning of section 139(c)(1), (2) or (3)."[12] These disasters include those that result from a terroristic or military action, federally-declared disasters, and certain catastrophic common carrier accidents.[13] We respectfully request that Treasury and the IRS clarify that this exception also apply to funds established solely to respond to localized events that are not identified in section 139(c). Notwithstanding that they are not designated as such, these events are disasters and have a substantial impact on local communities. Limiting the exception, and potentially subjecting these funds to the excise taxes in sections 4966, 4967, and 4958, would make it more difficult for aid to get to the people who need it the most.

V. Recommendations on Rules Regarding Advisory Committees

The Proposed Regulations include two separate rules that address individuals who participate on advisory committees. The first, in the definition of "donor-advisor," provides that a person recommended by a donor or donor-advisor to serve on an advisory committee will be considered a donor-advisor unless three criteria are met.[14] The other, in the "advisory privileges" prong of the definition of DAF, provides that a donor's service on an advisory committee will constitute advisory privileges unless three criteria are met.[15] While the policy aims of each advisory committee rule are substantially similar—to provide circumstances in which a person is not a donor-advisor—the three criteria in each rule are different. We are concerned that these similar but slightly different rules could cause confusion and result in foot faults by organizations operating in good faith.

We believe that our members, and the charitable sector at large, would be well-served by creating a single rule providing an exception from the existence of a donor-advisor that would apply in both sections of the regulation. Furthermore, we respectfully recommend that Treasury and the IRS incorporate the rule governing scholarship committees under section 4966(d)(2)(B)(ii). A scholarship committee is within the statutory exception to the definition of a DAF if (1) all of its members, including any donor or donor-advisor, are appointed by the sponsoring organization based on objective criteria, and (2) the donor or donor-advisor does not directly or indirectly control the committee. Using the same framework for all three rules would promote sound tax administration and provide clear guidelines to the organizations subject to the rules.

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[12] Prop. Treas. Reg. § 1.4966-4(d)(1).

[13] Section 139(c).

[14] Prop. Treas. Reg. § 53.4966-1(h)(4).

[15] Prop. Treas. Reg. § 53.4966-3(c)(1)(iii).

VI. Recommendations on the Definition of Taxable Distribution

A taxable distribution under section 4966 is a distribution from a DAF to a natural person or to a person (other than a natural person) that is for any purpose other than one specified in section 170(c)(2)(B), other than a distribution to an organization described in section 170(b)(1)(A) (other than a disqualified organization), to the sponsoring organization, or to any other DAF.

In interpreting this rule, the Proposed Regulations provide that if a purpose that either is prohibited under section 501(c)(3) or would, if it represented a substantial part of an organization's activities, result in the loss of the organization's tax exemption, then that purpose is other than one specified in section 170(c)(2)(B), and will result in a taxable distribution.[16] In particular, the Proposed Regulations provide that distributions of DAF assets used for political campaigning or lobbying are for a purpose not specified in section 170(c)(2)(B) and, as a result, are taxable distributions.[17]

Here, the Proposed Regulations miss the mark. Section 501(c)(3) organizations are allowed to engage in legally permitted lobbying, including lobbying to influence legislation, so long as those activities do not rise to the level of being a substantial part of its activities.[18] Thus, many organizations that receive distributions from DAFs are permitted to engage in lobbying. The Proposed Regulations' approach would impose additional administrative burdens, including potentially complex tracing exercises, on sponsoring organizations and the recipient organizations. Moreover, the proposed rule would make it more difficult for those nonprofit organizations to engage with policymakers on behalf of the communities they serve and the charitable sector. We respectfully recommend that Treasury and the IRS eliminate this proposed rule from final regulations, or clarify that it only applies to lobbying expenses incurred directly by DAFs, rather than to funds distributed from the DAF to an organization described in section 1709(b)(1)(A), which are then used for lobbying expenses that are permitted to be undertaken by such organization (*e.g.*, under section 501(c)(3)).

VII. Recommendations on the Effective Date of the Proposed Regulations

The Proposed Regulations provide that final regulations would be effective as to "taxable years ending on or after [the date of publication of the Treasury decision adopting these rules as final regulations in the *Federal Register*]."[19] Should final regulations retain this effective date, these rules will apply with retroactive effect to many sponsoring organizations, in particular those that operate on a calendar year basis. That would impose a significant burden on our members and sponsoring organizations across the country. Organizations would be required to expend significant resources on professional services in order to comply with the regulations in the year in which Treasury and the IRS issue final regulations. Moreover, because some of the rules in the Proposed Regulations represent substantial changes to the prevailing practice in the industry, some organizations might be forced to breach contracts in order to become compliant.

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[16] Prop. Treas. Reg. § 53.4966-5(b)(1).

[17] *Id.*

[18] *See* section 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(c)(3).

[19] Prop. Treas. Reg. § 53.4966-6.

Considering the sea change that these rules represent to our members and the entire sector, we respectfully recommend a transition period of at least one year before the final regulations come into effect to allow sponsoring organizations to become compliant. In the absence of a transition period, we respectfully request that final regulations be effective as to taxable years *beginning* on or after the date on which the Treasury decision adopting the final rules is published in the Federal Register.

VIII. Conclusion

Thank you for your consideration of this comment letter. We appreciate the opportunity to submit this comment letter and would welcome the opportunity to meet with Treasury and the IRS to discuss it in greater detail or to answer any questions that you may have.

Sincerely,

Matthew L. Evans
Senior Director of Public Policy
Interim Leadership Team Member
United Philanthropy Forum

<u>Undersigned Philanthropy-Serving Organizations</u>

- Connecticut Council for Philanthropy
- Florida Philanthropic Network
- Forefront (Illinois)
- Grantmakers of Western Pennsylvania
- Indiana Philanthropy Alliance
- Iowa Council of Foundations
- League of California Community Foundations
- Maryland Philanthropy Network
- Minnesota Council on Foundations
- NY Funders Alliance
- Philanthropy California
- Philanthropy Colorado
- Philanthropy Ohio
- Philanthropy Southwest
- Virginia Funders Network