National Council of Nonprofits

Champions for the public good

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Internal Revenue Service
CC:PA:01:PR (REG–142338–07)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Taxes on Taxable Distributions from Donor Advised Funds under Section 4966
Proposed Rule, REG-142338-07

The National Council of Nonprofits (Council of Nonprofits or NCN) appreciates this opportunity to provide public comments on proposed regulations to guide taxpayers in understanding Internal Revenue Code Sections 4966 and 4967, added to the law by the Pension Protection Act of 2006.[1]

Many of the Council of Nonprofits' more than 30,000 organizational members interact with DAFs as grant recipients, and some serve as DAF sponsors. Based on this experience, we applaud Treasury and the IRS for providing clarifying guidance on issues such as what constitutes a donor advised fund (DAF), who is considered a donor or donor-advisor, what is a taxable distribution from a DAF, and how DAF sponsoring organizations can exercise expenditure responsibility to make grants for charitable purposes to other than section 501(c)(3) organizations.

NCN believes that the proposed regulations provide donors, donor advised fund sponsoring organizations, and operating charities that receive DAF grants with important guidance that will serve to increase the flow of needed dollars that address significant charitable missions. We are concerned, however, that some provisions discussed below may inadvertently increase the compliance burden on DAF sponsors and DAF donors, and therefore may result in unnecessary burdens on the flow of philanthropic dollars to the work of charitable organizations.

[1] Public Law 109-280, Section 1231 (2006).

Our comments below focus on both the currently proposed regulations as well as potential future proposed regulations that can further the goal of increasing the distribution of dollars controlled by DAFs to the work of charitable nonprofits.

Background

According to the most recent surveys of charitable giving, the importance of donor advised funds, and of the proposed regulations, to the charitable nonprofit community is significant. For nearly two decades, the amount of charitable assets contributed to and granted from donor advised funds, as well as the importance of DAFs as charitable vehicles operating in the nonprofit sector, have continued to increase. *Giving USA* reports that individuals contributed $86 billion to DAFs in 2022, representing 27 percent of individual charitable contributions for that year.[2] The 2023 edition of the *Donor Advised Fund Report,* issued by the National Philanthropic Trust (NPT), reported that grants from DAFs to charitable organizations amounted to more than $52 billion.[3] NPT notes that DAFs granted 22.5 percent of their assets in 2022.[4]

The National Council believes that DAFs have become indispensable charitable giving vehicles over the past 20 years. To assure the continued flow of DAF dollars to the charitable sector, it is incumbent upon Treasury and the IRS to provide a regulatory framework that promotes increased transparency of and efficient operation in DAFs and protect against potentially abusive use of such vital charitable giving vehicles. The proposed regulations are a strong step in strengthening that regulatory framework.

Comments on the Proposed Regulations

Definition of a DAF: The proposed regulations provide guidance on the threshold question of whether a fund maintained at a charitable organization should be considered a DAF. The draft rule further addresses whether there is separate identification by reference to contributions of a donor or donors. The proposed regulations explicitly exclude from the definition of donor either a public charity described in section 509(a)(1), (2), or (3) (other than

[2] Annual Report on Philanthropy, 2023 (subscription), Giving USA, June 20, 2024.

[3] The 2023 DAF Report, National Philanthropic Trust, November 2023.

[4] Grant payout is calculated as grants made in the current year divided by DAF assets held at the end of the prior year.

a disqualified supporting organization or any governmental unit described in section 170(c)(1)).

The National Council of Nonprofits agrees with the proposed regulations that private foundations should be considered donors for purposes of this definition. We note, however, the very important question of whether contributions from a private foundation to a DAF should be considered a qualified distribution under section 4942(g) (the so-called 5 percent minimum annual payout requirement). This question was specifically raised by the IRS in Notice 2017-73 to elicit comments as to how private foundations use DAFs to support their charitable purposes and whether there should be a requirement that such transfers to DAFs qualify under section 4942 if such funds are distributed by the DAF sponsoring organization within a certain timeframe. We further note that the current version of Form 990-PF, Return of Private Foundation, requires a private foundation to disclose whether it made distributions to a DAF over which it has advisory privileges and, if so, to explain how the distributions will be used to accomplish a charitable purpose. To ensure the continued flow of charitable assets from private foundations to qualified charities, NCN believes it is imperative that Treasury and the IRS provide specific guidance on this issue.

Donor-Advisor: The proposed regulations define a "donor-advisor" in general as a person appointed or designated by a donor or another donor-advisor to have advisory privileges regarding the distribution or investment of assets held in a fund, or a person to whom a donor-advisor delegates advisory privileges. The proposed regulations also provide that an investment advisor that provides investment management and advice with respect to both assets maintained in a DAF and the personal assets of a donor will be treated as a donor-advisor with respect to the DAF while serving in that dual capacity. This would be the case regardless of whether the donor appointed, designated, or recommended the personal investment advisor. The proposed regulations contain an exception to the donor-advisor classification if the investment advisor also provides advice to the sponsoring organization as a whole and charges uniform fees to all DAFs of the sponsoring organization.

The National Council of Nonprofits believes this provision in the proposed regulation represents a trap for the unwary as any compensation or similar payment made from a DAF to pay certain investment advisors could be subject to tax on automatic excess benefit transactions under Section 4958, the tax on deemed distributions under Section 4966, and the tax on prohibited benefits under Section 4967. Because many sponsoring organizations do not impose uniform fees on all DAFs under their control, we recommend that this provision either be stricken from the proposed regulations or provide more flexibility in the

application of charged fees. Failure to do so could subject the donor and the sponsoring organization to taxable distribution penalties, which ultimately reduces the amount of funds that can be distributed to charitable nonprofits to advance their missions.

Advisory Privileges: The proposed regulations attempt to clarify how to establish that a donor or donor-advisor has advisory privileges based on permission to provide or the solicitation of non-binding recommendations. The proposed rule is not as precise and helpful as needed.

As it pertains to certain gift agreements with restrictions, the preamble to the proposed regulations states:

> [I]f a restriction is placed on a gift at the time the gift is made and there is no provision for subsequent discretion regarding the restriction, then the restriction should not give rise to advisory privileges. For example, a donor's mere earmarking of a donation (at the time of donation) for a particular fund or program of the recipient charity, without more, does not create an advisory privilege. Whether the terms of a gift agreement create a DAF depends on the restrictions set forth in the agreement. The Treasury Department and the IRS request comments on the circumstances in which a gift agreement or advisory rights retained by a donor could create a DAF.

As currently drafted, the proposed regulations do not specifically address restricted gift agreements. NCN is concerned that if a gift agreement provides a donor with subsequent advisory rights, even if never exercised, such an agreement could serve to create a DAF, which would result in unnecessary burdens on both the donor and the sponsoring organization – burdens that could adversely affect the intended recipient of the gift. We urge Treasury and the IRS to specifically address this issue in subsequent regulations and, when doing so, to refrain from characterizing the gift agreement as a DAF unless and until such advisory rights are exercised.

Exceptions to the Definition of DAFs: The Pension Protection Act of 2006 excluded from the definition of a DAF any a fund that makes distributions only to a single identified organization or government entity. The statute also provides Treasury and the IRS with regulatory authority to exempt a fund or account if it is advised by a committee not directly controlled by the donor or if the fund benefits a single identified charitable purpose.

The current draft of the proposed regulations provides that the “single identified organization exception” would not apply to private foundations, disqualified supporting organizations,

foreign organizations, or non-charitable organizations. As we will explain in more detail below, we are concerned that organizations serving as fiscal sponsors and "Friends of" organizations may be deemed sponsoring organizations of DAFs under the proposed regulations, which would subject these organizations to the DAF rules and result in unnecessary recordkeeping and regulatory expense. Further, donors and donor-advisors to such organizations risk potential excise taxes as well. This inadvertent classification as sponsoring organizations of DAFs would become possible even though distributions from such putative sponsoring organization would not be considered a "taxable distribution" under other provisions contained in the proposed regulations.

Fiscal Sponsor. As drafted, the proposed regulations could contain a trap for the unwary, especially in the context of so-called "fiscal sponsorship arrangements." Fiscal sponsorship arrangements typically arise between an organization with section 501(c)(3) tax-exempt status and a party without tax-exempt status that wants to conduct a charitable project or activity ("project"). The fiscal sponsor effectively provides its legal and tax-exempt status to the project, and thus remains responsible. The sponsor can receive support through donations that it then passes on to the project. For donations for the project to be deductible, the sponsor must have discretion and control over the funds and payments to the project must be considered as made in furtherance of the sponsor's tax-exempt purpose.

Funds held under fiscal sponsorship arrangements could fall under the proposed regulations definition of a DAF because in some cases such funds are separately identified by reference to contributions from one or multiple donors, at least one of whom retains advisory privileges over the distribution or investment of such funds. See Proposed Regulation Section 53.4966-1. In the case of fiscal sponsorship arrangements, the expansion of the concept of "advisory privileges" as noted in the preamble to the proposed regulations is especially problematic. Quite often, "donors" in the context of fiscal sponsorship arrangements could provide nonbinding recommendations regarding distributions from the fund or account or provide advice regarding the distribution or investment of amounts held in a fund or account.

Certain fiscal sponsorship arrangements, those where a fiscal sponsor funds a single organization or project, should qualify under the "single identified charitable purpose" statutory exception to the definition of a DAF. See Code Section 4996(d)(2)(C). The National Council of Nonprofits strongly recommends that Treasury and the IRS consider expanding this "single identified charitable purpose" exception in other fiscal sponsorship arrangements, especially where the arrangement is temporary in nature until the project

obtains its own tax exemption or in the case where small projects need the organizational structure of the larger sponsor in order to fulfill the charitable purpose of both the project and the sponsor.

"Friends of" Organizations. We also note that it is not uncommon for foreign organizations to establish domestic affiliate charities, so-called "Friends of" organizations, to attract deductible contributions from U.S. taxpayers. In addition, domestic public charities can also serve as fiscal sponsors for foreign grantees. If the foreign organization is deemed to be equivalent to a domestic charity under the same equivalency determinations used by private foundations, distributions to such foreign organizations would not be a taxable distribution. (See Proposed Regulation Section 53.4966-5(c)(iii)(2).) The National Council of Nonprofits strongly recommends that Treasury and the IRS exempt "Friends of" organizations that meet the requirements of Proposed Regulation Section 53.4966-5(c)(iii)(2) from the definition of a DAF.

Taxable Distributions: The proposed regulations define a DAF distribution as "any grant, payment, disbursement, or transfer, whether in cash or in kind from a donor advised fund." Although there are exceptions to this definition that cover such payments as investment or grant-related fees, we note that these do not appear to cover payments made for goods and services incurred in carrying out certain other charitable purposes. For example, the exception should be broadened to cover the distributions from the DAF for payments to vendors and other service providers that provide necessary goods and services that are a component of the charitable purpose.

The National Council of Nonprofits applauds Treasury and the IRS for providing guidance on how sponsoring organizations can utilize the expenditure responsibility provisions to make charitable grants to organizations other than those described in section 170(c). We are deeply concerned, however, that the discussion in the preamble to the proposed regulations regarding distributions for non-charitable purposes in the context of so-called "political campaign intervention" misstates the law and creates unnecessary confusion. The preamble states:

> [A] distribution to be used for an activity prohibited under section 501(c)(3), or for an activity that would cause loss of tax exemption if it were a substantial part of a section 501(c)(3) organization's total activities, is not for a purpose specified in section 170(c)(2)(B). Thus, a distribution used for political campaign intervention activity or attempts to influence legislation would be

> considered to be for a purpose not specified in section 170(c)(2)(B) and, thus, if made directly or to an entity not described in section 170(b)(1)(A), or to a disqualified supporting organization, would be a taxable distribution. (footnote omitted)

We are concerned that the language in this preamble to the proposed regulations will have an undue chilling effect on potential grants from DAFs to public charities engaged in perfectly legal nonprofit advocacy as well as nonpartisan, election-related activities. For example, the preamble language threatens to penalize the parties if a charitable nonprofit used a distribution to engage in any "attempts to influence legislation," which is contrary to long-standing law established by Congress and the IRS.[5] There is a fundamental distinction between partisan political electioneering which is expressly prohibited by section 501(c)(3) and permissible nonprofit advocacy relating to ballot initiatives and referenda, as well as charitable nonprofits engaging in nonpartisan election-related activities such as promoting public engagement in their right to vote, offering balanced candidate forums, and providing other educational activities that are deemed legitimate and legal by Treasury and the IRS.[6] NCN believes Treasury and the IRS must correct and clarify the harmful language in the preamble to protect rather than stifle these vital charitable roles and activities that communities need to be healthy and strong.

NCN is also concerned that an overly broad application of the so-called "anti-abuse" rule in Proposed Regulation Section 53.4966-5 could serve to place extraordinary compliance burdens on certain DAF sponsoring organizations in the case of DAF grants to intermediary entities such as fiscal sponsors or "friends of organizations" that often make independent determinations as to how such grants will be used for charitable purposes. Application of the

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[5] See I.R.C. §501(c)(3) (permitting charitable nonprofits to engage in activities "attempting, to influence legislation" if those activities amount to less than a "substantial part" of the organization's activities or "as otherwise provided in subsection (h)); I.R.C. § 501(h) (charitable nonprofits may elect to have a more precise measurement of lobbying apply – percentage of dollar expenditures – in lieu of the undefined no "substantial part" of activities standard). See Measuring Lobbying: Substantial Part Test, IRS, updated Dec. 4, 2023, and Instructions for Schedule C (Form 990), Part II-A. Lobbying Activity, IRS, Oct. 27, 2023.

[6] "Certain activities or expenditures may not be prohibited depending on the facts and circumstances. For example, certain voter education activities (including presenting public forums and publishing voter education guides) conducted in a non-partisan manner do not constitute prohibited political campaign activity. In addition, other activities intended to encourage people to participate in the electoral process, such as voter registration and get-out-the-vote drives, would not be prohibited political campaign activity if conducted in a non-partisan manner." The Restriction of Political Campaign Intervention by Section 501(c)(3) Tax-Exempt Organizations, IRS.gov, last updated Dec. 4, 2023. See also, IRS Fact Sheet FS-2006-17 (February 2006); IRS Revenue Ruling 2007-41 (June 2007); and generally, The Restriction of Political Campaign Intervention by Section 501(c)(3) Tax-Exempt Organizations, Internal Revenue Service, last updated Dec. 4, 2023.

"anti-abuse" rule to such grants could subject DAF sponsors to potential compliance penalties if subsequent grants are made by "the initial qualified grant recipient" which are outside of their control. We ask that any final rule include clarifying language to narrow the application of the "anti-abuse rule" to target abusers and not sweep in innocent organizations.

Open Issues: The Council of Nonprofits notes that there are several additional issues pertaining to DAFs, sponsoring organizations, donors, and donor-advisors that Treasury and the IRS have listed on the latest Priority Guidance Plan but not addressed in the pending rulemaking. These items include the definition of excess benefit transactions under Section 4958 and prohibited benefits and excise taxes under Section 4967 on donors, donor-advisors, related persons, and fund managers. We urge that these regulations be issued as soon as possible.

Respectfully submitted,

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