January 29, 2024

Ms. Rachel Leiser Levy
Associate Chief Counsel
Office of Chief Counsel (EEE)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Ms. Lynne Camillo
Deputy Associate Chief Counsel
Office of Chief Counsel (EEE)
Internal Revenue Service
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Re: Notice of Proposed Rulemaking Regarding Taxes on Taxable Distributions from Donor Advised Funds Under Section 4966

Dear Ms. Levy and Ms. Camillo:

The American Institute of CPAs (AICPA) is providing feedback and recommendations to the Department of Treasury (Treasury) and the Internal Revenue Service (IRS) on the proposed regulations regarding taxable distributions from donor advised funds (DAFs) under section[1] 4966 (REG-142338-07) (the "proposed regulations").

BACKGROUND

The AICPA appreciates the efforts of Treasury and the IRS to address the need for guidance related to section 4966. This letter is in response to the request by Treasury and the IRS for comments on these proposed regulations.

Section 4966 was enacted under the Pension Protection Act of 2006[2] which was signed into law on August 17, 2006. Section 4966 imposes excise taxes on taxable distributions made by sponsoring organizations from a DAF,[3] and on the agreement of certain fund managers to the making of such distributions.[4] The AICPA has previously requested guidance in this area in the form of proposed regulations.[5]

Per section 4966(d)(2), a DAF is a fund or account owned and controlled by a sponsoring organization, which is separately identified by reference to contributions of a donor or donors, and with respect to which the donor, or any person appointed or designated by such donor (donor-advisor), has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of the funds. A deduction under section 170 is generally allowed for a contribution to

[1] All references to "section" or "§" are to the Internal Revenue Code of 1986, as amended, and all references to "Treas. Reg. §" and "regulations" are to U.S. Treasury regulations promulgated thereunder.
[2] P.L. 109-280.
[3] Section 4966(a)(1).
[4] Section 4966(a)(2).
[5] See AICPA comments, "Recommendations for the 2023-2024 Guidance Priority List (Notice 2023-36)," May 9, 2023.

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a DAF even though a final decision with regard to how the funds will eventually be used is not made at the time of the donation. The donor retains advisory privileges with respect to the future distribution and/or investment of amounts held in the fund or account.

Section 4966(d)(2)(B) provides for two types of funds which are excluded from the definition of a DAF. Section 4966(d)(2)(B)(i) provides an exception for any fund or account "which distributes only to a single identified organization or governmental entity," and section 4966(d)(2)(B)(ii) provides an exception for a fund which makes grants to individuals for travel, study, or other similar purposes, provided other criteria are met.

The proposed regulations provide guidance regarding taxable distributions from DAFs and would generally apply to organizations that maintain one or more DAFs, and to other persons involved with DAFs, including donors, donor-advisors, related persons, and certain fund managers.

Our recommendations, detailed below, address the following areas:

I. Effective Date of Final Regulations Should be Postponed

II. Certain Advisory Rights Connected with a Restricted Gift Should Not Create a DAF

III. A Fund Established at a Single Charity (for the Sole Benefit of that Organization) Over Which a Donor Has Advisory Privileges with Respect to Use and/or Investment of Funds Should Not be Considered a DAF

IV. Investment Advisors (Including Personal Investment Advisors) Should Be Explicitly Excluded from the Definition of Donor-Advisor

V. Definition of Significant Contributor Should Follow Section 507(d)(2)(A) and Section 507(d)(2)(C)

VI. Extend Exception from the Definition of a DAF Provided for Scholarship Funds of Section 501(c)(4) Organizations to Section 501(c)(5) and Section 501(c)(6) Organizations

VII. Modify Expenditure Responsibility Rules and Provide Additional Guidance

I. Effective Date of Final Regulations Should be Postponed

Overview

As written, the proposed regulations would be applicable to tax years ending after the date of publication of the final regulations. Taxpayers would have the option to rely on the proposed regulations for tax years ending before the date the final regulations are published.

Recommendation

The AICPA recommends that Treasury and the IRS change the effective date of the final regulations to tax years beginning on or after the date of publication of the final regulations.

Analysis

The proposed regulations contain many complex provisions that will require additional time for taxpayers to implement in order to adjust their current operations to comply with the new rules. The IRS has previously allowed final regulations to be effective for tax years beginning on or after the date final regulations are published in the Federal Register. For example, the proposed regulations (REG-106864-18) which provided guidance on how an exempt organization determines it has more than one unrelated trade or business under section 512(a)(6) allowed for an effective date of tax years beginning on or after final regulations were published. It would promote effective tax administration to allow more time before the final regulations become mandatory. By allowing taxpayers a full tax year to understand and apply the final regulations strengthens compliance efforts are strengthened and taxpayers' burden lessened, including costs and time spent, to successfully implement changes to conform their operations to the new rules.

II. Certain Advisory Rights Connected with a Restricted Gift Should Not Create a DAF

Overview

The preamble of the proposed regulations states that commenters have asked Treasury and the IRS to clarify that advisory privileges do not include certain legally enforceable rights of the donor with respect to a contribution. Earmarking a donation (at the time the gift is made) for a particular fund or program of the recipient charity does not create an advisory privilege. Treasury and the IRS have requested comments on the circumstances in which a gift agreement or advisory rights retained by a donor could create a DAF.

Recommendation

The AICPA recommends that the final regulations allow donors to make infrequent changes (not more than once every five years) to restricted gifts related to annual distribution amounts or allocations of distributions to recipient charities without causing the account to become a DAF.

Analysis

A donor can impose restrictions on a gift related to fulfilling one or more particular purposes for a duration of time or in perpetuity. Gift restrictions are governed through each state's version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). UPMIFA allows an organization to ask the donor for a release or revision from the donor-imposed restrictions, or the organization can petition a court for such relief.

A recipient charity's mission often changes over time, and in some cases, a charity no longer pursues one or more causes for which it has funds that have been restricted by donors. Also, some charitable organizations allow a donor to contribute to a Designated (or similarly-named) Fund in which the donor specifies one or more charitable organizations to receive an annual distribution (or portion thereof), often set at no more than 5% of the fund's value. Each state's version of UPMIFA sets this percentage by law.

Designated Funds generally do not meet the definition of a DAF because the donor does not retain advisory privileges after the fund has been created and the recipients and distribution allocations have been determined. However, just as a single organization may change its purposes and causes, a Designated Fund can encounter situations in which a recipient charity no longer exists or the allocations of annual distributions to recipients are no longer in concert with the donor's original wishes.

Since UPMIFA allows for changes to restricted funds with the approval of donors, infrequent changes requested by the donor related to the recipient(s) and/or the allocation of annual distributions should be permitted without changing a restricted fund into a DAF. It seems reasonable that such changes should not occur more often than once every five years.

III. A Fund Established at a Single Charity (for the Sole Benefit of that Organization) Over Which a Donor Has Advisory Privileges with Respect to Use and/or Investment of Funds Should Not be Considered a DAF

Overview

It is increasingly common for donors to make a gift to a public charity which is restricted to support specific programs of the charity, but which allows the donor to provide advice on the investment of such funds until they are used and/or provide advice on which specific program(s) are to be supported with the funds at a later date. For organizations that do not normally consider themselves to be a sponsoring organization of DAFs, it would be helpful to provide guidance as to when such a restricted gift would be considered a DAF so they can comply with the laws governing such funds.

Recommendation

The AICPA recommends that funds meeting the criteria below not be considered DAFs:

- Funds established at a public charity;
- The written agreement establishing the fund or account provides that the contributed amounts can only be used to support programs within that public charity;
- The donor retains advisory privileges with respect to the public charity's use or investment of some or all of the funds; and

- The donor is not permitted to make recommendations as to specific third-party recipients of the funds (e.g., vendors or secondary grantees).

Analysis

Section 4966(d)(2)(B)(i) excludes from the definition of a DAF any fund or account which makes distributions only to a single identified organization or governmental entity. In the circumstance where a fund is set up at a public charity to support its programs, distributions from the fund would go to third parties to pay for operating expenses of the program rather than to the charity itself. If this type of fund were considered to be a DAF, to the extent that the donor provides advice with respect to payments made from the fund, such payments must be analyzed to determine whether they could be considered to be taxable distributions within the meaning of section 4966(c). If the donor is only permitted to provide advice as to the purpose of distributions from the fund (e.g. capital campaign feasibility study, scholarships, building renovations, etc.) but not the recipient (i.e. particular vendor or scholarship recipient), then the fund should not be considered a DAF.

IV. Investment Advisors (Including Personal Investment Advisors) Should Be Explicitly Excluded from the Definition of Donor-Advisor

Overview

Section 4966(d)(2)(A)(iii) defines "donor-advisor" as "a donor (or any person appointed or designated by such donor) [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 proposed regulations further clarify this definition by stating "the term donor-advisor means 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 the sponsoring organization. If a donor-advisor delegates any of the donor-advisor's privileges to another person, or appoints or designates another donor-advisor, that person is also a donor-advisor. No particular form of appointment or designation is necessary."

The proposed regulations also include in the definition of donor-advisor an investment advisor who provides investment management and/or investment advice with respect to assets maintained in a DAF and the personal assets of a donor to that DAF (personal investment advisor), regardless of whether the investment advisor was recommended by a donor or donor-advisor. However, the proposed regulations provide an exception to including a personal investment advisor in the definition of donor-advisor if the investment advisor is properly viewed as providing services to the sponsoring organization as a whole, rather than providing services to the DAF and request comments on what criteria should be evaluated to arrive at that conclusion.

Recommendation

The AICPA recommends that Treasury and the IRS explicitly exclude investment advisors (including personal investment advisors) from the definition of donor-advisor. In the alternative,

if Treasury and the IRS decide to retain that definition, then the AICPA recommends that the final regulations include multiple criteria for determining that an investment advisor is properly viewed as providing services to the sponsoring organization rather than to the DAF under a facts and circumstances approach.

Analysis

If an investment advisor selected by a donor to a DAF is a donor-advisor, then any compensation paid to the investment advisor is considered an automatic excess benefit transaction under section 4958(c)(2)(A). This result would effectively limit the ability of donors to have advisory privileges with respect to the investment of amounts held in their DAFs because they would be unable to recommend the use of third-party investment management companies that would reasonably expect to be compensated for their services.

Since a third-party investment management company can be replaced at any time by the donor, the use of their services should not be considered a true delegation of advisory privileges with respect to the investment of amounts in the fund. Additionally, investment advisors do not typically make recommendations about distributions from the fund. Therefore, we recommend that the final regulations clarify that the term donor-advisor does not include third-party investment management companies recommended by a donor or donor-advisor to the fund. It is noted that a third-party investment management company may still be a disqualified person for purposes of section 4958 if such company is more than 35% controlled by donors, donor-advisors, and related persons. Therefore, only investment advisors that are not donors, donor-advisors, or related persons would be eligible to receive compensation from the fund.

The proposed regulations also include in the definition of "donor-advisor" an investment advisor who provides investment management and/or investment advice with respect to assets maintained in a DAF and the personal assets of a donor to the DAF. The first concern discussed in the proposed regulations is that "the Treasury Department and the IRS view the close relationship between a donor and his or her personal investment advisor as giving the donor influence over investment decisions with respect to assets held in the DAF comparable to that of a donor-advisor."[6] Presumably, this statement means that Treasury and the IRS consider a personal investment advisor to be merely a proxy for the donor with respect to the investment decisions. However, this argument implies that the personal investment advisor would merely follow the wishes of the donor, which supports the position that the personal investment advisor is not a donor-advisor since they would not be making unilateral decisions with respect to the fund's assets under their management.

The second concern discussed in the proposed regulations relates to inherent conflicts of interest with respect to the use of personal investment advisors to manage fund assets.[7] Since the compensation of such advisors is frequently determined as a percentage of assets under

[6] REG-142338-07, Preamble, Explanation of Provisions, Part 1.C.
[7] Ibid.

management, they would presumably have an incentive to encourage their clients to contribute to their DAFs (rather than other public charities) and to reduce distributions out of their DAFs to public charities. Although it is questionable whether personal investment advisors truly have significant influence over whether a donor contributes to their DAF and/or recommends distributions be made from their DAF, the law does not prohibit a donor from choosing to contribute to their DAF rather than a separate public charity or require that a DAF distribute a certain amount annually. Therefore, it would be inappropriate to penalize a donor, investment advisor, or DAF for engaging in an activity that might impact those matters.

The final concern regarding potential conflicts of interest cited in the proposed regulations is the possibility of a more than incidental benefit accruing to the donor if the investment advisor charged a reduced fee for managing the donor's personal assets because the advisor also managed the fund's assets.[8] The tax on a donor, donor-advisor, or related person which advises a DAF to make a distribution which results in such person(s) receiving a more than incidental benefit as a result[9] would be a better mechanism to address this potential conflict of interest. An investment advisor who merely provides investment management services and advice regarding investment strategy should not be considered to be a donor-advisor because they do not provide recommendations for distributions to be made out of the fund and have not been delegated the power to make investment decisions for the fund. The fact that they also provide similar advice to the donor with respect to the donor's personal assets does not impact that determination.

The proposed regulations provide an exception to including a personal investment advisor in the definition of donor-advisor if the investment advisor is properly viewed as providing services to the sponsoring organization as a whole, rather than providing services to the DAF. An example in the proposed regulations states that "if an investment advisor contracts with a sponsoring organization to provide services to all of its 1,000 DAFs, and the sponsoring organization reasonably charges the investment advisor's fees uniformly to all of those DAFs, the investment advisor would properly be viewed as providing services to the sponsoring organization as a whole."[10] Following this example, an investment advisor could only be compensated by a DAF if the advisor provided investment advice to substantially all of the sponsoring organization's DAFs. Major financial institutions that have formed charitable organizations to be DAF sponsoring organizations would likely qualify for this exception since such organizations typically require that their DAFs use the named financial institution as the investment advisor. Community, religious, and other similar charitable organizations that sponsor DAFs would be at a disadvantage compared to financial institution sponsored DAFs since they provide more flexibility as to the selection of the investment advisor.

If Treasury and the IRS decide to retain that definition of donor-advisor, the final regulations should include multiple criteria for determining that an investment advisor is properly viewed as

[8] Ibid.
[9] Section 4967(a)(1).
[10] REG-142338-07, Preamble, Explanation of Provisions, Part 1.C.

providing services to the sponsoring organization rather than to the DAF under a facts and circumstances approach including factors such as:

- The investment advisor is approved by the Board of the sponsoring organization.
- The investment advisor is included in a list of advisors who have been vetted and pre-approved by the sponsoring organization and offered as potential investment options for DAFs held by such organization.
- The investment advisor is required to follow the Board-approved investment policies of the sponsoring organization. Such policies could include a prohibition on the making of certain types of investments, caps on the percentage of the portfolio that can be invested in certain types of investments, and caps on the percentage of assets that can be charged as a management fee.
- The investment advisor provides services to more than one DAF held by the sponsoring organization.

V. Definition of Significant Contributor Should Follow Section 507(d)(2)(A) and Section 507(d)(2)(C)

Overview

When a donor, donor-advisor, or related person is appointed to an advisory committee of a fund or account by the sponsoring organization, that individual would generally be considered to have advisory privileges for the purpose of determining whether the fund is a DAF. The proposed regulations provide that a sponsoring organization's appointment of such a person would not be deemed to result in advisory privileges by reason of the donor's status as a donor if:

- The appointment is based on objective criteria related to the expertise of the appointee in the particular field of interest or purpose of the fund or account;
- The committee consists of three or more individuals, not more than one-third of whom are related persons with respect to any of the others; and
- The appointee is not a **significant contributor** to the fund or account, taking into account contributions by related persons with respect to the appointee, at the time of appointment.

The proposed regulations request comments on how "significant contributor" should be defined for purposes of this exception.

Recommendations

The AICPA recommends that the final regulations reference the definition of "substantial contributor" found in section 507(d)(2)(A) for purposes of this exception. This definition includes any person who contributed or bequeathed an aggregate amount of more than $5,000, if such amount is more than 2% of the total contributions received before the close of the tax year in which the contribution or bequest is received.

The AICPA also recommends that the guidance provided in section 507(d)(2)(C) related to when a person shall cease to be considered a substantial contributor be incorporated into the final regulations and modified for purposes of the exception. We suggest that the modified language read as follows:

"A person shall cease to be treated as a substantial contributor with respect to any fund or account as of the close of any tax year if:

- During the 10-year period ending at the close of such tax year, such person (and all related persons) has not made any contributions to the fund or account, and
- The aggregate contributions made by such person (and related persons) are determined by the Secretary of the Treasury to be insignificant when compared to the aggregate amount of contributions to the fund or account by other unrelated persons."

Analysis

The term "substantial contributor" is defined in section 507(d)(2)(A) and Treas. Reg. § 1.507-6 for various purposes affecting section 501(c)(3) organizations such as the public support test under section 509(a)(2) and identifying disqualified persons for purposes of section 4958. Following existing guidance to define a "significant contributor" for purposes of the regulations under section 4966 would provide clarity and consistency in the application of these rules.

VI. Extend Exception from the Definition of a DAF Provided for Scholarship Funds of Section 501(c)(4) Organizations to Section 501(c)(5) and Section 501(c)(6) Organizations

Overview

The proposed regulations provide an exception to the definition of a DAF for a fund or account established by a broad-based membership organization described in section 501(c)(4) if six conditions are met. The proposed regulations request comments on whether and under what circumstances other organizations use similar types of committee-advised scholarship funds and whether the exception should be extended to those organizations.

Recommendation

The AICPA recommends that Treasury and IRS extend the exception to the definition of a DAF in reference to scholarship funds of section 501(c)(4) organizations to section 501(c)(5) and section 501(c)(6) organizations.

Analysis

Section 501(c)(5) organizations include labor unions which represent an association of workers in a particular trade, industry, or company. Section 501(c)(6) organizations include business leagues

formed to further the interests of a particular industry and chambers of commerce formed to further the business interests of a particular community. In both cases, the organizations typically have a broad-based membership and a focus on either a particular industry or business in general. It is common for these organizations to raise funds to support the education of individuals in their particular industry concentration. Therefore, it would be reasonable to allow such organizations to form scholarship funds held by a sponsoring organization subject to the same criteria provided in the proposed regulations for section 501(c)(4) organizations. Should Treasury and the IRS consider whether it should limit such funds to support scholarships only in the particular industry which the section 501(c)(5) or section 501(c)(6) organization is formed to promote, the AICPA recommends that no such limit be imposed as education in a general sense furthers section 501(c)(3) purposes.

VII. Modify Expenditure Responsibility Rules and Provide Additional Guidance

Overview

The proposed regulations generally reference the private foundation expenditure responsibility requirements of section 4945(h) and related regulations but make minor modifications to stand in the place of Treas. Reg. § 53.4945-5(b)(3)(iv)(c) and Treas. Reg. § 53.4945-5(b)(4)(iv)(c) (pertaining to the recipient's permitted use of the funds). The modifications change the required terms of the expenditure responsibility agreement, with respect to a DAF grant, to require that the grantee not use the funds in a manner that would otherwise be prohibited by the grantor DAF. The Explanation of Provisions section preceding the proposed regulations provide clarification that: "For purposes of these rules pertaining to the secondary use of distributions, the definition of 'grant' set forth in §53.4945-4(a)(2) would apply, rather than the broader definition of 'distribution' found in proposed §53.4966-1(e). If the definition of 'distribution' found in proposed § 53.4966- 1(e) applied, distributees would be required to exercise expenditure responsibility in the purchase of goods and services, which is not intended under the proposed rule."

Recommendations

The AICPA recommends that Treasury and the IRS provide the following guidance:

- Add, to Prop. Reg. § 53.4966-1 or Prop. Reg. § 53.4966-5(d), that the definition of "grant" per Treas. Reg. § 53.4945-4(a)(2) applies to the secondary use of distributions, consistent with the information presented in the Explanation of Provisions section preceding the proposed regulations.
- Provide additional guidance on how organizations can satisfy the requirement to report the expenditure responsibility grants to the IRS, per Treas. Reg. § 53.4945-5(d), on Form 990, *Return of Organization Exempt from Income Tax*.

Analysis

The AICPA agrees with the proposed modifications aligning DAF expenditure responsibility reporting with the private foundation requirement under section 4945(h) and related regulations.

However, we have concerns that if the proposed regulations do not define the term "distribution" to mean "grant" per Treas. Reg. § 53.4945-4(a)(2), regarding the secondary use of the expenditure responsibility grant funds, readers might misunderstand the intended meaning of the proposed rule. The Explanation of Provisions section clarifies this intent. Therefore, the AICPA recommends that this definition be added to the definitions under Prop. Reg. § 53.4966-1 or to the expenditure responsibility modifications in Prop. Reg. § 53.4966-5(d).

Further, the AICPA is concerned that Form 990 filers with an expenditure responsibility reporting requirement, under Treas. Reg. § 53.4945-5(d), do not have guidance on how to report the required information. Private foundations filing Form 990-PF, *Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*, must answer a question as to whether or not they maintained expenditure responsibility if they made a grant to an organization described in section 4945(d)(4)(A). Also, tax software providers of the electronically filed Form 990-PF have formatted statements in which private foundations can input their required expenditure responsibility details since the instructions to Form 990-PF cite the regulations describing the information that must be reported on the annual filing.

Sponsoring organizations of a DAF filing Form 990 must answer "yes" or "no" as to whether they made any taxable distributions under section 4966. However, Form 990 has no prescribed part, section, or instructions on how to disclose expenditure responsibility grants. Schedule O of Form 990 is available for general disclosures however, it is unclear how to report the required elements, resulting in inconsistent reporting that may not satisfy the requirements under the proposed regulations. Form 990, Schedule D, *Supplemental Financial Statements*, Part I concerns organizations maintaining DAFs. A question regarding taxable distributions and/or expenditure responsibility grants could be added to this section with a formatted statement added to Part XIII of Schedule D to disclose the details of each expenditure responsibility grant.

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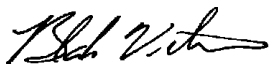
We welcome the opportunity to discuss these comments or to answer any questions that you may have. If you have any questions, please contact; Peter Mills, AICPA Senior Manager, Tax Policy & Advocacy at (202) 434-9272, or Peter.Mills@aicpa-cima.com; Christopher Anderson, Chair, AICPA Exempt Organizations Tax Technical Resource Panel at (216) 363-0100 or CAnderson@maloneynovotny.com; or me at (830) 372-9692 or Bvickers@alamo-group.com.

Sincerely,



Blake Vickers, CPA, CGMA
Chair, AICPA Tax Executive Committee

cc: Ms. Amber MacKenzie, Attorney Advisor, Office of Tax Policy, Department of Treasury