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Treasury Releases Proposed Donor Advised Fund Regulations Addressing Taxable Distributions and Key Definitions

Following more than 15 years of anticipation, Treasury and the IRS have issued proposed regulations interpreting certain Internal Revenue Code (Code) provisions applicable to donor advised funds (DAFs). A popular charitable giving technique that has grown exponentially in recent years, a DAF is an account maintained by a charitable organization (a "sponsoring organization") to which donors may make deductible contributions and thereafter make recommendations regarding charitable grants from and the investment of the assets in the account.

The proposed regulations provide guidance on only the taxable distribution provisions applicable to DAFs under Code Section 4966, which impose excise taxes on certain prohibited distributions by DAFs. As a result, taxpayers must continue to await further guidance addressing other long-standing questions. Such questions include the impact of DAF distributions on a public charity grantee's tax-exempt status, the tax treatment of grants by private foundations to DAFs, and confirmation of the rules applicable to DAF distributions used to satisfy binding pledges. The taxable distribution provisions contain the fundamental definitions applicable to DAFs, however. The proposed regulations thus provide some insights into the operation of certain other DAF rules. In addition, they provide technical guidance implementing the prohibition on taxable distributions, and sponsoring organizations and donors will need to understand this guidance to ensure they do not inadvertently violate the rules.

Key take-aways include the following:

- **The proposed regulations provide expansive definitions of the terms "donor advised fund," "donor-advisor," and "taxable distribution."** Overall, the proposed regulations reflect concern that taxpayers could structure funds to sidestep the DAF rules when it would be advantageous. They include provisions designed to ensure that funds that are, in substance, DAFs are captured by the rules. Certain funds that have not historically been considered DAFs might, therefore, be treated as DAFs under the rules and subject to the special restrictions that apply to DAFs. Charitable organizations that maintain endowment or other funds will need to consider whether the rules could reach them unexpectedly.
- Charitable organizations, particularly including community foundations, often provide donors with an opportunity to impact the ongoing administration of a fund by participating on an advisory committee that makes recommendations regarding the fund's distributions or investments. A donor, donor-advisor, or related person (as defined in the proposed regulations) who serves on such an advisory committee, as well as any committee member who was recommended to serve on such a committee by a donor or donor-advisor, will be treated as having advisory privileges with respect to the fund unless strict requirements are satisfied. **As a result, individual grantmaking, field of interest, and other funds with advisory committees will be particularly more likely to be captured as DAFs. Organizations that permit donors to establish funds with advisory committees will therefore need to take care when structuring the funds, especially if a fund's classification as a DAF would inhibit its purpose.**
- Many DAF programs permit investment advisors to help manage the assets in their clients' DAFs, and the advisors may therefore provide investment advice with respect to both the assets maintained in a donor's DAF and the donor's personal assets. The regulations propose to treat an investment advisor serving such dual roles as a donor-advisor of a donor's DAF, regardless of whether the advisor is formally appointed to such position, unless the advisor is properly viewed as providing services to the sponsoring

organization as a whole (rather than the particular DAF). **If finalized in their current form, the proposed regulations will therefore largely restrict DAFs from compensating donors' personal investment advisors. This rule will have a significant impact on DAF programs whose business models involve such fee arrangements.** The preamble to the proposed regulations explains that Treasury and the IRS are concerned that these arrangements may create conflicts of interest and may result in a donor's personal investment advisor receiving prohibited benefits.

- The Code imposes a 20% excise tax on a sponsoring organization that makes a taxable distribution from a DAF and a 5% excise tax on any fund manager who knowingly agrees to the distribution. **Treasury and the IRS rejected requests to construe the term "distribution" narrowly as including only gratuitous transfers. Rather, any payment from a DAF – other than most investments and reasonable investment and grant-related fees – will potentially be subject to, and will therefore need to comply with, the taxable distribution rules.**

For additional details regarding key provisions in the proposed regulations, please continue reading.

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