TEGE | Exempt Organizations Council

Comments in Response to REG–142338–07

Taxes on Taxable Distributions From Donor Advised Funds Under Section 4966

February 15, 2024

This document responds to the request for comments in REG–142338–07, Taxes on Taxable Distributions From Donor Advised Funds Under Section 4966 (the "Proposed Regulations"), and reflects feedback from individuals participating in the TEGE Exempt Organizations Council (the "Council" or "TEGE Council").

The TEGE Council was formed to (i) open and maintain lines of communication between the Tax Exempt & Government Entities Division (the "Division") of the IRS and the practitioner community, (ii) provide the Division with the thinking of the practitioner community on procedural and systemic matters, (iii) provide practitioners a forum to share their concerns with the IRS regarding both policies and specific tax issues and procedures, and (iv) educate the practitioner community and the exempt organizations community.

The Council's members and participants include attorneys, certified public accountants, and other practitioners and professionals in the exempt organizations community (including in-house practitioners and professionals). The comments below do not necessarily represent the views of the Internal Revenue Service (the "Service" or "IRS"), Treasury Department ("Treasury"), the TEGE Council, or any particular Council member. The preparers of these comments were not engaged by any client for the purpose of submitting these comments or otherwise to influence the development or outcome of regulatory guidance.

Although the Council's members and participants may have clients who might be affected by the federal tax principles addressed by these Comments, no member who has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of one or more specific issues addressed by, these Comments has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Council's diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

This comment letter provides comments on several specific issues raised by the Proposed Regulations and comments on the general direction and approach that the IRS and Treasury appear to be pursuing with respect to regulating donor advised funds ("DAFs").

I. General Comments

As a general matter, we believe that the Proposed Regulations reflect an overly restrictive and punitive approach to regulating DAFs, without statutory authority, and that they should be withdrawn and reproposed rather than remaining in proposed form as the official position of the IRS. The negative effects of these rules on the larger tax-exempt sector are exacerbated by various definitions within these Proposed Regulations that attempt to treat many more types of

organizations as DAFs. Specifically, the Proposed Regulations improperly and unfairly unleash three powerful statutory provisions that Congress intended to apply solely to DAFs on the nonprofit sector at large—namely, prohibited benefits (Section 4967), taxable distributions (Section 4966), and excess benefit transactions (Section 4958). This regulatory overreach is unwarranted and should be walked back as soon as possible to avoid dramatic, wholly avoidable, and unintended consequences not limited to DAFs but to the entire nonprofit sector.

As practitioners, we support efforts by the IRS and Treasury to resolve long-standing questions of how to interpret many aspects of Section 4966 and other provisions enacted as part of the Pension Protection Act of 2006. However, these Proposed Regulations reflect a marked departure from the statutory rules that tax-exempt organizations have been complying with and relying on for nearly 20 years. The statute provides workable definitions that have been understood within the tax-exempt sector without issue, including the definition of "donor advised fund."

We are not aware of any widespread confusion regarding the definitions or donor advisor and DAF that would necessitate these rulemaking efforts. As such, we believe that these Proposed Regulations unreasonably expand the scope of these rules to organizations that Congress never intended to be treated as DAF sponsoring organizations and funds or accounts that were never intended to be DAFs. Instead of providing greater certainty in this area, the Proposed Regulations introduce confusion and complexity to the entire nonprofit sector, a sector of taxpayers that is widely regarded as highly compliant and risk adverse.

For these reasons, the Proposed Regulations should be withdrawn and reproposed to narrowly address topics that are in fact ambiguous within the original statute, if any. As you know, proposed regulations represent the official position of the IRS and effectively establish a safe harbor for taxpayers seeking to reduce tax risk because IRS Exam will not seek to enforce a position that is contrary to proposed regulations. Given that it has taken nearly two decades for the IRS and Treasury to issue the Proposed Regulations, it is not unreasonable to assume that it will take many years to issue the next round of guidance on DAFs. If these Proposed Regulations are allowed to remain outstanding, they will exert an inexorable distortionary force on the entire nonprofit sector which is widely regarded as highly compliant and risk averse. As we and many other commentators have indicated, many of the legal positions and statutory interpretations set forth in the Proposed Regulations are incorrect and overbroad. Withdrawal and re-proposal, therefore, is appropriate here.

If this recommendation is not adopted, we are providing the following specific comments to encourage the next round of regulations to align more closely with the statutory text and other rules regarding exempt organizations generally and DAFs in particular.

II. <u>Separate identification by reference to contributors of a donor or donors</u>

Regulations must give effect to Section 4966(d)(2)(A)(ii).

Section 53.4966-3(b) of the Proposed Regulations addresses when a fund or account will be "separately identified by reference to contributions of a donor or donors," the first prong of the

three-part test. However, the proposed definition relies heavily on factors unrelated to the language of section 4966(d)(2)(A)(ii), factors that pertain either to the existence of a fund or account or to the existence of advisory privileges with respect to the fund or account. Whether a fund or account exists, and whether there are advisory privileges, are separate and independent statutory requirements under Section 4966(d)(2)(A). Such factors are not relevant to determining whether the "separately identified by reference to contributions from a donor or donors" prong of the statutory DAF definition is met.

A basic principle of statutory construction is that "[a] statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant...." *Hibbs v. Winn,* 542 U.S. 88, 101 (2004) (Citing 2A N. Singer, Statutes and Statutory Construction §46.05, pp. 181-186 (rev. 6th ed. 2000) (footnotes omitted)).

The "facts and circumstances" test in §53.4966-3(b)(2) of the Proposed Regulations contravenes this canon of statutory construction. By including factors that indicate the existence of a fund or account (e.g., subsection (b)(2)(i) of the proposed "facts and circumstances" test) or that indicate the existence of advisory privileges (e.g., subsections (b)(2)(v) and (vi) of the test), this "facts and circumstances" test would authorize a finding that a fund or an account is DAF based solely on the existence of a fund or account in which a donor had advisory privileges — which gives no effect whatsoever to the "separately identified by reference to contributions of a donor or donors" prong of the definition. In effect, Proposed §53.4966-3(b)(2) would use facts showing that *other* elements of the DAF definition had been satisfied to bootstrap a finding that the section 4966(d)(2)(A)(ii) test was also satisfied, contrary to the plain language of the statute which establishes the "separately identified" test as an additional and separate requirement.

The definition under §53.4966-3(b)(1) of the Proposed Regulations is similarly flawed, because it takes the position that the "separately identified" requirement is met whenever a sponsoring organization keeps a record of the donors who contributed to a particular fund, even if fund is identified by reference to charitable purpose of the contributions rather than by reference to a particular donor or donors. Charities that receive donor-restricted contributions commonly use fund accounting to track gifts restricted for endowment purposes, capital purposes, or program purposes, and keeping records of the contributions or other revenue credited to each fund is part of sound accounting practice.

If merely keeping a record of the donations to a fund causes it to be "separately identified with respect to contributions of a donor or donors," then any charity that tracks restricted gifts through fund accounting will find that all of its restricted funds (including endowment funds and funds to support particular program areas) will meet the test. This is contrary to legislative intent because Section 4966(d)(2)(A)(ii) by its terms requires something more than the existence of a fund or account. Under the structure of the statute, a fund or account must exist before the three-prong test even applies; and to satisfy the first prong, the fund or account must meet the additional requirement of being "separately identified by reference to contributions of a donor or donors," which must mean something more than the fact that a fund or account exists.

Section 53.4966-3(b) of the Proposed Regulations should be revised to elucidate the "separately identified by reference to contributions of a donor or donors" prong of the three-part test in a manner that is consistent with and gives effect to the statutory language of Section 4966(d)(2)(A)(ii). The rule should not rely on other elements of the statutory definition of a DAF—such as the existence of a fund account within the meaning of Section 4966(d)(2)(A), or the existence of advisory privileges described in Section 4966(d)(2)(A)(iii)—to bootstrap a finding that the requirements of this prong of test are satisfied.

Regulations should be consistent with the legislative history of Section 4966.

The meaning of Section 4966(d)(2)(A)(ii) is discussed in the technical explanation of the legislation prepared by the Joint Committee on Taxation at the time Section 4966 was enacted. *See* Joint Committee on Taxation, *Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006* (JCX-38-06), August 3, 2006 [hereinafter, "Technical Explanation of H.R. 4"]. In this explanation of the legislation, the provisions of Section 4966(d)(2)(A)(ii) are explained as follows:

> The first prong of the definition requires that a donor advised fund be separately identified by reference to contributions of a donor or donors. **A distinct fund or account of a sponsoring organization does not meet this prong of the definition unless the fund or account refers to contributions of a donor or donors, such as by naming the fund after a donor, or by treating a fund on the books of the sponsoring organization as attributable to funds contributed by a specific donor or donors.** … [A] fund or account may be treated as identified by reference to contributions of a donor or donors if the reference is to persons related to a donor. For example, if a husband made contributions to a fund or account that in turn is named after the husband's wife, the fund is treated as being separately identified by reference to contributions of a donor.

Technical Explanation of H.R. 4, pages 342-43 (emphasis added). According to this legislative history, the "separately identified" requirement is met if the fund or account is named after a donor or related party, or if the funds are contributed by a specific donor or donors.

Proposed §53.4966-3(b) is not consistent with the Joint Committee on Taxation's explanation of the enacting legislation. Section 1.E of the Preamble to the Proposed Regulations state, "[t]he Treasury Department and the IRS anticipate that, in most circumstances, a multiple donor-fund or account would be separately identified by reference to contributions of a specific donor or donors." This statement demonstrates that the regulations are inconsistent with the Technical Explanation of H.R. 4, which explained:

> **[A] fund or account of a sponsoring organization that is distinct from the organization's general fund and that pools contributions of multiple donors generally will not meet the first prong of the definition unless the contributions of specific donors are in some manner tracked and accounted for within the fund.** Accordingly, if a sponsoring organization establishes a fund dedicated to the

> relief of poverty within a specific community, or a scholarship fund, and the fund attracts contributions from several donors but does not separately identify or refer to contributions of a donor or donors, the fund is not a donor advised fund even if a donor has advisory privileges with respect to the fund.

Technical Explanation of H.R. 4, pages 342-43 (emphasis added). The Proposed Regulations have turned this outcome on its head, and reached a result that is directly opposite to the Joint Committee on Taxation's explanation of Section 4966(d)(2)(A)(ii). We urge the Treasury Department and IRS to construe Section 4966(d)(2)(A)(ii) in a manner consistent with the understanding of section 4966 at the time it was enacted in 2006, as reflected in the Technical Explanation of H.R. 4.

Proposed language for §53.4966-3(b)

Consistent with the Technical Explanation of H.R. 4, we propose the following definition:

> *A fund or account is separately identified by reference to contributions of a donor or donors if the sponsoring organization credits or adds contributions to the fund or account based on the identity of the donor or donors or based on the designation by the donor or donors, and either*
>
> *(i) the fund or account is named after a donor or person related to the donor or*
>
> *(ii) substantially all donations to the fund are contributed by a single donor or by a donor and persons related to that donor. For this purpose, "substantially all donations" means 85% of the fair market value of the aggregate of donations to the fund.*

The proposed definition above gives effect to Section 4966(d)(2)(A)(ii) as it was understood at the time that Congress enacted the legislation, and it is consistent with the Technical Explanation of H.R. 4.

If the above recommendations are adopted, we do not anticipate that the "facts and circumstances" test of §53.4966-3(b)(2) would be necessary. If retained, however, the factors that compose the test should not include factors drawn from other parts of the statutory definition of a DAF, such as whether there are advisory privileges or whether a separate fund or account exists. Rather, the factors should address solely the question of whether the fund or account is separately identified by reference to contributions from a donor or donors.

Factors indicating this prong of the DAF test has been met would include:

- The fund or account is named after one or more donors or related persons.
- Substantially all contributions to the fund are from a donor and a group of persons related to that donor.

- The fund is not restricted to a particular charitable purpose but can be used by the sponsoring organization for any of the sponsoring organization's section 170(c)(2)(B) purposes.
- If the fund is restricted to a particular charitable purpose, the fund is separate from other funds or accounts of the sponsoring organization that are held for the same charitable purpose.
- The sponsoring organization does not solicit contributions for the fund from the general public but only solicits contributions from persons who are donors with advisory powers, donor-advisors, or related parties.

Factors that would indicate a fund or account is not separately identified by reference to contributions from a donor or donors would include:

- There are several unrelated donors to the fund and the contributions of various donors are not separately accounted for or tracked within the fund.
- Significant contributions to the fund have been made by donors who are not related to any donor or donor-advisor with advisory privileges.
- The fund is restricted to a particular charitable purpose of the sponsoring organization and such purpose is distinct from any other restricted fund of the sponsoring organization.
- The sponsoring organization solicits contributions to the fund from the general public or from the sponsoring organization's members, donors, or supporters generally.
- The fund receives significant exempt function revenue as well as contributions.

III. Exception for funds or accounts that make distributions only to a single identified organization

Definition of "single identified organization"

Section 4966(d)(2)(B)(i) provides that the term "donor advised funds" shall not include any fund or account "which makes distributions only to a single identified organization or governmental entity." However, the Proposed Regulations limit this definition to certain public charities and Section 170(c)(1) governmental entities with no statutory support for doing so. Congress clearly did not intend this rule to be limited in this way because this language differs from other parts of the statute, such as Section 4966(c)(1)(B)(ii), that specifically refer to "any organization described in Section 170(b)(1)(A) (other than a disqualified supporting organization)." Congress could have used the same wording when it mandated an exception for funds that distribute to a single organization, but Congress chose not to include that limitation. For the IRS and Treasury to impose such limits through regulations goes beyond interpreting the wording of legislation to imposing requirements not found in, and directly contradictory to, the legislation.

Consistent with the statute, the exception provided in §53.4966-4(a) should apply to funds that make distributions to a single identified organization or governmental entity. To the extent that the IRS and Treasury are concerned about the organization exercising appropriate discretion and

control over distributions to a single identified organization, regulations could incorporate the safeguards of Revenue Ruling 69-79, which concerns US-based "friends of" organizations that support a foreign organization. In Rev. Rul. 69-79, the governing Board of the US charity pre-approved grants to the foreign organization for specific charitable projects, and then the US charity raised money for the purpose of funding the pre-approved grants. A pre-approved grant arrangement such as the one described in this revenue ruling should fall within the exception for funds that make distributions to a single organization. The structure of the pre-approved grant was later termed a "Model C" or regranting fiscal sponsorship. *See* National Network of Fiscal Sponsors, *Guidelines for Pre-Approved Grant Relationship Fiscal Sponsorship*, http://www.fiscalsponsors.org/pages/best-practices-fiscal-sponsorship (last visited Feb. 15, 2024).

Substitution for specified organization

The Proposed Regulations provide that a sponsoring organization may substitute a single identified organization for another only in limited circumstances. Specifically, substitution can only occur if "the substitution is conditioned upon the occurrence of a loss of exemption, substantial failure or abandonment of operations, or a dissolution or reorganization that results in the named single identified organization ceasing to exist, and the event is beyond the direct or indirect control of donor(s), donor-advisor(s), or related persons."

The Proposed Regulations restrict the sponsoring organization's power of substitution in a manner that conflicts with the community trust rules under Treas. Reg. §1.170A-9(f)(11)(ii), which addresses when separate funds will be treated as component parts of a charity. These community trust rules require that the governing body of the sponsoring organization have the power "[T]o modify any restriction or condition on the distribution of any funds for any specified charitable purposes or to specified organizations if in the sole judgment of the governing body…such restriction or condition become, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served." Many community foundations and federations include a version of this provision in their standard agreement to establish a nonprofit endowment fund for a specific charitable organization. For example, this type of variance power is among the 26 "National Standards" required for accreditation under the Community Foundation National Standards Accreditation Program, a compliance program in which hundreds of U.S.-community foundations have participated in. Community Foundation National Standards, *https://www.cfstandards.org/getting-accredited/national-standards* (last visited February 15, 2024).Consistent with these rules, a fund should not be disqualified from the exception if the sponsoring organization's board retains variance power to redirect the fund to a different organization in the event that the original organization becomes ineffective or changes its purpose.

The sponsoring organization should have this power whether or not a donor or donor-advisor in some way influenced the circumstances that cause substitution to be appropriate. For example, if a donor's withdrawal of direct funding to a recipient organization causes that organization to abandon operations, the sponsoring organization holding a fund for that recipient should still be able to select a different recipient that is able to use the funds for their charitable purpose.

Distributions to a single identified organization

Proposed §53.4966-4(a)(3) provides that the fund must make distributions to the single recipient organization for its activities "other than the activities of administering donor advised funds or grant-making." The limitation is inconsistent with the statutory language. Given that a fund that makes distributions to a single identified organization is not a DAF, any distributions from the fund should be governed by the existing rules applicable to a public charity's distribution of funds to another organization. These additional restrictions affect the ability to provide general support grants, which would be even more restrictive than the rules applicable to private foundations.

IV. Definition of "advisory privileges"

Gift Restrictions that are not "advisory privileges"

A restricted gift is generally documented in a written agreement between the public charity and the donor. The gift typically includes conditions such as a restriction on the use of the gift to a specific exempt purpose or project, periodic reporting back to the donor that the gift is being used for the purpose intended, and recovery of funds if the funds are not being used for the intended purpose or project. Gift Agreements also frequently provide the donor with ongoing visibility into and the ability to provide input on the project or program funded under their restricted grant. For example, a gift agreement regarding the construction of laboratory facilities may provide the donor with the ability to review and comment on architectural plans and proposed equipment upgrades.

We recommend that the final regulations provide a presumption that contemporaneous gift restrictions do not give rise, by themselves, to advisory privileges. Unless a gift restriction is a recommendation as to an ultimate distributee or with regard to the investment of the assets (or reservation of a right to do either), it should not create a DAF. Typical donor restrictions as to time and purpose are not the type of restrictions that are intended to be captured and would pull in a much broader group of organizations than intended under the statute.

Donor, donor-advisor, or related person appointed to an advisory committee

Proposed §53.4966-3(c)(iii) provides a default rule that any donor, donor-advisor, or related person appointed by a sponsoring organization to be on a committee of persons that advises as to distributions or investments of amounts in the fund or account will be deemed to result in advisory privileges by reason of the donor's status as a donor. The Proposed Regulations provide an exception to the default treatment as a donor advisor if three conditions are met: (i) 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; (ii) The committee consists of three or more individuals, not more than one third of whom are related persons with respect to any member of the committee; and (iii) 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 exception as to whether someone has advisory privileges by reason of their appointment to a committee that advises on distributions or investments should not require all three factors be present. Instead, any one of the factors should, on its own, be sufficient to provide that the donor, donor-advisor, or related person does not hold advisory privileges because, unless provided otherwise, a single member of a committee does not have independent rights to exercise advisory privileges and can only do so through action of the committee authorized by a majority of the members.

In the alternative, the third factor should be required (regarding whether they are a significant contributor) and either factor one (their appointment was based on objective criteria) or two (the committee is three or more individuals and no more than 1/3rd are related to each other) must be present. While it should be sufficient that the appointee is not a significant contributor because their influence as a donor at that level is minimal, simultaneously requiring that they also be appointed because of objective criteria and requirements about the size of the committee and relatedness of its members is overly burdensome. If someone doesn't meet the standard for a substantial contributor, then that means that even if there were other related individuals on the committee, those individuals are also not substantial contributors (because their donations would be aggregated together for purposes of determining whether they are a substantial contributor).

V. Safe Harbor for Funds Satisfying a Public Support Test

We further propose that the definition of a DAF specifically exclude funds that satisfy a public support test. Specifically, a donor should not be deemed to have advisory privileges (even if they exercise them) if the fund they donate to could on its own pass a public support test to qualify as a non-private foundation under Section 509(a). For example, it is common to have a situation where a sponsoring organization is serving as a fiscal sponsor to a fund that is housed within the sponsor. It is likely in that scenario that there will be individuals who are donors and also serve on an advisory committee or otherwise provide ongoing advice related to the operation of the project that is being fiscally sponsored. This would not lead to abuse because it follows the same rationale as it would if the fund were an independent entity rather than a fund of a sponsoring organization. If there are sufficient donors to pass a public support test, then the fund is attracting broad public support and sufficient oversight by those donors. Such a rule promotes efficient administration because it will decrease the likelihood that the individuals donating to the fund will want to create an independent entity that will then need to apply for tax exemption and file ongoing Forms 990 which have their own IRS administrative burdens.

This principle could also be characterized as a safe harbor under §53.4966-3(b) because a fund with a sufficiently broad base of donors to satisfy a public support test would not satisfy the "identified by reference to a donor or donors" test as such test was explained in the Technical Explanation of H.R. 4.

VI. Taxable Distributions

Customary vendor and service provider fees as reasonable investment or grant-related fees

Section 4966(a)(1) subjects a sponsoring organization to a 20% excise tax on any "taxable distribution." Section 4966(c)(1) defines a "taxable distribution" as "any distribution from a donor-advised fund (A) to any natural person or (B) to any other person if (i) such distribution is for any purpose other than one specified in Section 170(c)(2)(B), or (ii) the sponsoring organization does not exercise expenditure responsibility with respect to such distribution in accordance with Section 4945(h)." Section 4966(c)(2) lists three "exceptions" to the definition of taxable distribution, excluding from the definition of taxable distribution any amounts paid (a) to any organization described in Section 170(b)(1)(A) (other than a disqualified supporting organization), (b) to the sponsoring organization of the donor-advised fund in question, or (c) to another donor-advised fund. The Proposed Regulations include language substantially similar to Sections 4966(c)(1) and (2), with a limited exception for investments and reasonable investment or grant-related fees. Notwithstanding those limited exceptions, the Proposed Regulations provide that "a distribution includes any use of donor advised fund assets that results in a more than incidental benefit (within the meaning of section 4967) to a donor, donor-advisor, or related person. In addition, a distribution includes an expense charged solely to a particular donor advised fund that is paid, directly or indirectly, to a donor, donor-advisor, or related person with respect to the donor advised fund."

The final regulations should provide additional clarity on reasonable investment and grant-related fees and other expenses that do not constitute "distributions." There are an array of common non-abusive scenarios in which sponsoring organizations make payments and customarily reduce the fund balance of a donor-advised fund in connection with such payments, which should not be prohibited under Section 4966, and yet those payments do not cleanly fall within the exceptions of Section 4966(c)(2) nor do they lend themselves to the performance of expenditure responsibility as contemplated by Section 4966(c)(1) (for example, it is unclear how a vendor would be required to submit reports on its use of funds paid for services via donor advised fund).

To illustrate this point, we need look no further than Section 4966(c)(1) itself. In directing a sponsoring organization to exercise expenditure responsibility in connection with certain distributions from a donor-advised fund, the Code contemplates that certain administrative expenses must necessarily be reasonably incurred in connection with the maintenance and operation of DAFs. For example, in connection with performing expenditure responsibility as permitted by Section 4966(c)(1), a sponsoring organization may need to engage legal counsel to conduct a limited pre-grant inquiry of the proposed distributee, to draft a written grant agreement between the sponsoring organization and the proposed distributee, to advise regarding local law (in the case of distributees in foreign countries), or for numerous other reasons that help advance the charitable purpose of the distribution. To that end, it is foreseeable that a sponsoring organization will incur legal expenses in connection with its adherence not only to the expenditure responsibility rules but to all aspects of a sponsoring organization's obligations to ensure that its DAFs comply with the Code. It is a pervasive, if not universal, practice among

sponsoring organizations to pay legal expenses (for example) with amounts held in the donor-advised fund whose activity gave rise to the need to incur such expenses. Yet under the Proposed Regulations, it is unclear whether this type of expense would be a "grant-related" fee (and thus excluded from the definition of a distribution) or would require expenditure responsibility to be excluded from the definition of a taxable distribution.

Furthermore, there are other scenarios in which sponsoring organizations incur reasonable and necessary administrative expenses in connection with their maintenance and operation of donor-advised funds and should be permitted to pay such amounts with the moneys held in such donor-advised funds. For example, a sponsoring organization may incur expenses for philanthropic advisory services, paying such expenses with amounts held in the donor-advised fund that utilized the services. Philanthropic advisors may help to inform and develop the giving strategy for a particular fund and help provide oversight over the use of the grant funds, for example by reviewing grant reports and attending meetings with grantees. These advisors help the sponsoring organization to ensure that its funds are used appropriately and in furtherance of its charitable mission.

The foregoing examples, and others similar to them, should not constitute "taxable distributions." Public charities and private foundations alike are permitted to pay reasonable and necessary administrative expenses incurred in connection with their conduct of charitable activities—even to substantial contributors and family members—without any need to exercise expenditure responsibility over those payments. Indeed, private foundations are even permitted to treat such amounts as qualifying distributions within the meaning of Section 4942(g) and the Treasury Regulations thereunder.

The language of Section 4966 does not require the regulations to treat these types of expenses as "distributions," and it would be inconsistent with Congressional intent to adopt rules for DAFs that are more restrictive than the requirements applicable to private foundations. From a policy standpoint, there is no reason to hold donor-advised funds to a more restrictive standard than those that apply to private foundations. We do not believe that this recommendation would lead to any abusive transactions because they may still be treated as a "deemed distribution" under Proposed §53.4966-1(e)(2) and would still be subject to the Section 4958 prohibition on excess benefit transactions, as reiterated in §53.4966-1(3)(2) of the Proposed Regulations.

To that end, we recommend that final regulations provide a clear mechanism via which sponsoring organizations may utilize amounts held in donor-advised funds to cover expenses reasonably incurred in connection with activities validly undertaken by such sponsoring organizations in furtherance of their maintenance and operation of those donor-advised funds. We have identified multiple ways of doing so.

One approach is to provide clearer guidance establishing that amounts expended from a donor-advised fund by a sponsoring organization, in satisfaction of expenses validly incurred by such sponsoring organization, shall be permitted under the exception of Section 4966(c)(2)(B) and the Proposed Regulations thereunder. That section states that the term "taxable distribution" shall not include any distribution "to the sponsoring organization of such donor advised fund." If a

sponsoring organization incurs reasonable administrative expenses in connection with its maintenance and operation of a particular donor-advised fund and then uses the assets of the same donor-advised fund to satisfy those payment obligations, such an arrangement is tantamount to a distribution from the donor-advised fund to the sponsoring organization, followed by the sponsoring organization paying the relevant vendor or service provider with respect to which the sponsoring organization incurred the payment obligation.

A second approach would be to provide additional guidance around the term "distribution" itself. Section 4966(c) and the Proposed Regulations thereunder define the term "taxable distribution" as consisting of various types of "distributions," but no further definition of "distribution" is offered. If the term "distribution" were to be defined as a transfer of funds to a recipient that does not provide goods or services of commensurate value, then all scenarios in which the assets of donor-advised funds are used to satisfy payment obligations incurred in connection with the provision of reasonable and necessary administrative services would not constitute "distributions." By extension, if such payments are not "distributions," then they per se would not constitute "taxable distributions." As further support to this concept of excluding transfers for equal value from the definition of "distributions," we note that Section 4958(c)(2), in the context of "automatic excess benefit transactions" involving donor-advised funds, does not use the term "distribution." Rather, it expressly refers to grants, loans, compensation, and other similar payments. If the term "distribution" included compensatory payments, Section 4958(c)(2) could have simply referred to any "distribution" made to a person described in Section 4958(f)(7) as an "automatic excess benefit transaction." It does not do so.

A third approach would be to introduce a specific exclusion from the definition of "taxable distribution" for reasonable and necessary business expenses incurred in connection with the maintenance and operation of donor-advised funds. By way of analogy, Section 4941(d)(2)(E) excludes from the definition of self-dealing any "payment of compensation (and the payment or reimbursement of expenses) by a private foundation to a disqualified person for personal services which are reasonable and necessary to carrying out the exempt purpose of the private foundation" so long as the compensation paid is "not excessive." A similar type of "personal services" exception for donor-advised funds would permit sponsoring organizations to utilize funds held in donor-advised funds to satisfy those expenses that the sponsoring organizations incur in connection with the maintenance of such donor-advised funds. Again, as noted above, in some instances those expenses will themselves arise from the sponsoring organization ensuring compliance with the Code sections and regulations thereunder that impose obligations on donor-advised funds.

Program-related investments

Donor-advised funds currently engage in a broad range of impact investing strategies, including through program-related investments. As provided in Section 4944, a program-related investment is an investment, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property." Program-related investment may include zero-interest loans, along with other types of investments, including those that earn a nominal amount of

interest. The Section 4944 regulations provide several such examples, beyond merely zero-interest loans. Given the range of investments that may be considered program-related investments, the final regulations should clarify that all program-related investments (as defined by Section 4944 and the regulations thereunder) should fall within the scope of the term "distributions." We recommend that Treasury and the IRS incorporate the existing program-related investment rules under Section 4944 for purposes of Section 4966, rather than adopt standards that would be specific to DAFs.