

Client Alert: IRS Releases Consequential Proposed Regulations on Donor Advised Funds

On November 13, 2023, the U.S. Department of the Treasury and IRS released a proposed set of long-awaited regulations related to Donor Advised Funds (DAFs) under Section 4966 of the Internal Revenue Code, which was part of the Pension Protection Act of 2006. These [proposed regulations](#) are the first of several long-planned regulatory projects related to DAFs. This alert provides background, highlights significant provisions of the proposed regulations, and suggests how those interested may wish to respond. There have also been recent legislative efforts to amend certain statutes regulating DAFs, particularly on payout requirements, the public support test, and uses by private foundations. The proposed regulations do not address these issues.

Many stakeholders in the charitable space have expressed significant concern about the negative impact of the proposed regulations and their impact on a broad array of charitable organizations and donors, in addition to DAF sponsors. We encourage you to review the proposed regulations and consider their potential impact on you or your organization, even if your organization does not maintain DAFs. ***It is important to note that the regulations are not yet in force and subject to public comment.*** Treasury and the IRS have requested comments by February 15, 2024 and many of the proposed provisions will likely receive considerable feedback. Those interested may comment through the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-142338-07).

Until now, charitable organizations overseeing DAF programs have relied on the Internal Revenue Code, legislative history, and limited administrative guidance to structure and operate DAFs. The proposed regulations attempt to establish some fundamental definitions and concepts; however, many critical questions for donors and DAF sponsors remain unaddressed. Additionally, the proposed regulations take an extremely broad approach in a way that will impact DAF donors, sponsoring organizations, and many other charitable organizations. Some specific provisions expected to attract a substantial amount of comments include:

- **The very broad definition of certain key terms (e.g., Donor Advised Fund, Donor, Donor Advisor, Advisory Privileges, Distribution).** The definitions of certain terms in the proposed regulations would significantly change how sponsoring organizations administer, structure, and operate their DAF programs. In addition, the proposed regulations could classify other types of restricted funds as DAFs, including certain designated funds, scholarships, field of interest funds, fiscal sponsorships, funds aided by advisory committees, and other restricted funds. This revised treatment could negatively impact these funds, making them burdensome and confusing to administer, as well as creating potential tax penalties to organizations and their managers if left unaddressed.
- **The adverse treatment of a DAF manager who is also the donor's personal investment manager.** An investment manager of DAF assets who is also the personal investment manager of the DAF's donor is automatically treated as a "donor-advisor," even if the manager has no advisory privileges. As a result, these outside managers would be prevented from charging or receiving investment management fees on assets in a DAF. This change would upend a widely accepted and decades-long investment management practice among DAF sponsors, including national sponsors and community foundations,

and investment advisors/firms. This rule would also create confusion because it is inconsistent with historic treatment of similar arrangements between a private foundation related to a family and that family's investment manager or family office.

- **Adverse treatment of financial support from board members.** The regulations erroneously state that board members have advisory privileges over contributions they make to organizations on which boards they serve. As a result, under the proposed regulations, a fund dedicated to supporting a single organization would be reclassified as a DAF if a board member of the supported organization contributes to the fund. Under this reasoning, gifts by members of an organization's board to various funds maintained directly by the organization could also cause such funds to be classified as DAFs. Under either scenario, this treatment seems incorrect and would create a significant and unwarranted administrative burden on charitable organizations. More importantly, it would chill giving from board members and potentially curtail support from their private foundations altogether.
- **Confusion and limitations regarding program-related investments (PRIs).** Federal tax law provides clear regulation and guidance on program-related investments made by private foundations. The proposed regulations fail to provide such clarity for DAFs and, in fact, appear to confuse certain basic elements. For instance, the proposed regulations limit PRIs from DAFs to loans and prohibit equity investments, which we doubt is the intent of Treasury and the IRS.

If you would like to discuss these proposed regulations and their potential impact on you or your organization, or the nonprofit sector in general, please contact our Tax-Exempt Organizations and Philanthropy Practice Group.

Contacts:

Ed Chaney
919.869.3080
echaney@schellbray.com

Micah Malouf
919.869.3086
mmalouf@schellbray.com

Peter Mattocks
919.869.3073
pmattocks@schellbray.com