SCHELLBRAY

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Attorneys and Counselors at Law

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Via Federal eRulemaking Portal

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

Re: Comments regarding REG–142338–07, Notice of Proposed Rulemaking on Taxes on Taxable Distributions From Donor Advised Funds Under Section 4966

Ladies and Gentlemen:

Schell Bray, PLLC appreciates the work of the Department of the Treasury (the "Treasury") and the Internal Revenue Service (the "IRS") in developing the proposed regulations contained in REG– 142338–07, Notice of Proposed Rulemaking on Taxes on Taxable Distributions From Donor Advised Funds Under Section 4966 (the "Proposed Regulations").

Schell Bray, PLLC has deep experience advising philanthropic organizations of many types and sizes across the country, including private foundations, community foundations, and national donor advised fund sponsors. In particular, the undersigned attorneys have combined 22 years of experience counseling donor advised fund sponsoring organizations both as outside and in-house counsel. Our comments to the Proposed Regulations are not offered on behalf of any current or past client of Schell Bray but reflect our many years of practical experience working in the philanthropic sector.

The Proposed Regulations offer some helpful clarity on Section 4966, but they also include some inconsistent and problematic provisions, some of which are more troubling in nature than others. For the sake of simplicity, our comments below track the enumeration of the Proposed Regulations and are not offered in order of importance or priority.

I. Applicability date should be modified to provide for a reasonable transition

Proposed §53.4966–6 states any final regulations will apply to taxable years ending on or after the date of publication in the Federal Register. The Proposed Regulations include many complex provisions and new concepts which will require significant time, resources, and careful implementation by the charitable sector as a whole. An application date retroactive to the beginning of a tax year will result in significant confusion and financial costs to the entire charitable sector, as well as potential legal liability for unprepared donors and sponsoring organizations.

Further, as discussed below, certain aspects of these regulations implicate the First Amendment rights of sponsoring organizations and donors. The threat of a potential retroactive application date will chill the exercise of these rights and effectively constitutes a prior restraint on protected speech.

Accordingly, the possibility of retroactive application must be eliminated as quickly as possible. Moreover, we recommend a transition period of at least two years as well as the issuance of related transition rules which provide for an orderly conversion under the new rules for donors, DAF sponsoring organizations, and other 501(c)(3) organizations.

II. Comments to §53.4966–1 Definitions.

A. The definition of "distribution" is too broad

Proposed §53.4966-1(e)(1) defines "distribution" as any grant, payment, disbursement, or transfer, whether in cash or in kind, from a donor advised fund. While certain exceptions would apply, the inclusion of any "payment" or "disbursement" in the definition of "distribution" would generally restrict the ability of DAFs to secure vital goods and services from third-parties directly tied to furthering the charitable purposes of both the DAF and sponsoring organization.

We recommend that the regulations clarify that payments or distributions for goods or services provided to a DAF or to a sponsoring organization and made from a DAF are not "distributions" for purposes of section 4966 so long as expenses are reasonable and constitute a direct charitable expense.[1] In such event, these payments should not be considered a prohibited benefit under section 4967 or an excess benefit under section 4958.

B. The definition of "deemed distribution" circumvents the clear intent of other applicable statutory provisions

Proposed §53.4966-1(e)(2) introduces the concept of a "deemed distribution," which includes any use of donor advised fund assets that result 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 any 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. This new concept is confusing on a number of levels. First, it addresses matters that Congress already dealt with under Sections 4967 and 4958.[2] Any regulatory amplification of such matters belongs in the regulations to those sections, not Section 4966. Second, it would increase uncertainty as to when a distribution is in fact a taxable distribution when read alongside the anti-abuse rules referenced elsewhere. Third, the Proposed Regulations' Preamble suggests that such deemed distributions could be subject to excise taxes under Section 4966 and 4967. But since Congress did not contemplate this dual penalty when drafting Section 4966, it is unclear how these taxes will be calculated and applied. We recommend that this definition be struck.

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[1] See Private Operating Foundation regulations regarding distributions made directly for the active conduct of activities constituting an exempt purpose under Reg. §53.4942(b) -1(b).

[2] Section 4967 prohibits a DAF from being used to provide a more than incidental benefit to a donor, donor-advisor, or related person of the DAF and section 4958 imposes excise taxes on certain excess benefit transactions between a charitable organization and any of its "disqualified persons."

C. *The definition of "donor-advisor" would immediately unwind decades of widely accepted DAF investment management practices, disproportionally impact community foundations compared to commercial DAF sponsors, and push more donors to create private foundations lacking more independent oversight*

Under Proposed §53.4966-1(h) and §53.4966-3, an investment manager of DAF assets who is also the donor's personal investment manager is automatically treated as a "donor-advisor," even if the manager has no advisory privileges. If an investment advisor is treated as a donor-advisor, then any fee paid to the advisor is deemed to be an automatic excess benefit transaction under section 4958 (regardless of whether the compensation is at or less than fair market value) and subject to excise tax. As a result, these outside managers would be prevented from charging or receiving investment management fees on assets in a DAF. This unexpected change would upend a widely accepted and decades-long investment management practice among DAF sponsors, including both commercial DAF sponsors and community foundations, and will generally increase ongoing compliance costs resulting in less charitable dollars available for DAF grantmaking.

The introduction of this concept and related justifications in the Preamble raise a number of issues:

1. <u>The Preamble and Proposed Regulations seem presumptive and overly concerned about the presence of systemic conflicts of interest and inappropriate incentives anytime an investment advisor manages the assets of both a DAF and the same donor's personal investment portfolio.</u>

We are privileged to have served as legal counsel to a number of DAF sponsoring organizations across the country. These organizations include both national DAF sponsors and local community foundations. In our professional experience, we have not observed in any meaningful way such conflicts of interest. In sum, absent concrete evidence of material abuse, this proposal seems to be a solution in search of a problem and should be more narrowly tailored to address any concerns.

2. <u>Congress has already addressed the potential for conflicts and/or prohibited benefits flowing to donors.</u>

Congress has specifically and very clearly already addressed the appropriate use of investment advisors to manage DAF assets. Section 4958(f)(1)(f) subjects investment managers of donor advised funds to the general standards under section 4958 and not to the automatic excess benefit standards applicable to donor advisors. If Congress had intended to carve out a subset of these investment managers to also be subject to the automatic excess benefit transaction, it would have done so. It did not. We do not see how Treasury has the authority to do so on its own.

3. <u>The unauthorized expanded definition of donor-advisor would significantly harm community foundations and smaller charitable organizations in favor of larger DAF sponsors affiliated with financial institutions.</u>

DAF sponsors with a close affiliation to a financial institution are often subsidized by that commercial affiliate in various ways. In contrast, community foundations do not enjoy this same affiliation or support from their selected investment advisory relationships and must directly and fully bear all costs associated with their respective investment offerings. Likewise, these local community foundations cannot be nearly as nimble to modify their long-standing investment management relationships, including the restructuring of compensation flows and investment options. Lastly, DAF sponsors affiliated with financial institutions could likely meet the personal investment advisor exception under Proposed §53.4966-3(ii) with the financial institution itself serving as the investment advisor to the sponsoring organization "as a whole." However, community foundations and other sponsoring organizations are typically less uniform in how investment management advisors and firms are engaged.[3]

4. <u>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.</u>

This change would create a likely unintended incentive for some donors to establish new private foundations instead of DAFs to preserve their investment advisor relationships. This shift to private foundations and away from DAFs will result in less independent oversight, increased costs to taxpayers, and more cumbersome administration of charitable giving.

III. Comments to §53.4966–2 Taxes on taxable distributions.

A. For purposes of the excise tax under section 4966(a)(2) imposed on DAF fund managers, the definition of "knowledge" is problematic.

Section 4966(a)(2) imposes an excise tax on any fund manager who knowingly agrees to a taxable distribution. The Proposed Regulations define "knowledge" to mean actual knowledge ("is in fact aware that it is a taxable distribution"),[4] or that the manager has "knowledge of facts sufficient to determine that, based on those facts, the distribution would be a taxable distribution and negligently fails to make reasonable attempts to ascertain whether the distribution is a taxable distribution."[5]

Section 4945 imposes a similar excise tax on private foundation managers that agree to a distribution knowing it is a taxable expenditure. However, existing regulations under section 4945 explain that such agreement must also be "willful and…not due to reasonable cause."[6] Additionally, a private foundation manager's knowing agreement must be "voluntary, conscious, and intentional" to result in an excise tax.[7] So, under these Proposed Regulations, private foundation managers are held to a lower standard of care than that required of DAF managers. This will undoubtedly give DAF managers pause when considering their service to the organization as well as disrupt the flow of grantmaking.

Finally, this provision would result in significant undue burdens for the sponsoring organizations, which will feel obligated to police the behavior, and grantees, which will need to comply with unnecessary paperwork in order to receive funding.

Accordingly, the standards for DAF managers should be no more burdensome than the existing standards applicable to private foundation managers.

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[3] We strongly recommend that the expansion of "donor advisor" to include investment managers be struck. In the event that it is not, we suggest further clarity on whether "investment advisor" is a firm or an individual and clear criterion to determine whether such advisor is providing services "to the sponsoring organization as a whole."
[4] Prop. Reg. §53.4966-2(c)(3)(i).
[5] Prop. Reg. §53.4966-2(c)(3)(ii).
[6] Treas. Reg. §53.4945-1(a)(2)(i)(c).
[7] Treas. Reg. §53.4945-1(a)(2)(iv).

IV. Comments to §53.4966–3 Definition of donor advised fund.

A. The definition of "donor advised fund" exceeds the clear language and intent of Section 4966(d)(2)(A) and will harm the charitable sector.

Proposed §53.4966-3 recites the three-pronged definition of a DAF already codified by Congress under 4966(d)(2)(A) and then provides additional definitions as to the meaning of both "separate identification by reference to contributions of a donor or donors" and "advisory privileges." Read together, this new definition of a DAF will classify other types of restricted funds maintained by charitable organizations 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 will 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. Under the substantiation rules of section 170(f)(18), this broad definition of a DAF could also jeopardize both current and future charitable tax deductions of donors who contribute to these impacted funds. These rules require that contemporaneous written acknowledgements for gifts to DAFs must specify that the sponsoring charity has exclusive legal control over donated funds.

1. <u>"Separate identification by reference to contributions of a donor or donors"</u>

Under current law, in order to meet the definition of a DAF, the fund must be "separately identified by reference to contributions of a donor or donors."[8] Proposed §53.4966-3(b)(1) provides that a fund is "separately identified" if the sponsoring organization "maintains a formal record of contributions to the fund or account relating to a donor or donors" or, if there is no formal record, based on all the facts and circumstances. The Preamble to the Proposed Regulations states that a "formal record" exists so long as the sponsoring organization tracks contributions of a donor or donors to the account. The universal practice of a charitable organization simply collecting and maintaining basic gift information (e.g., the fact that a donor contributed to a certain fund and in what amount) would apparently satisfy the "formal record" prong of the definition of a DAF. Moreover, both internal and external auditors regularly review funds for compliance with donor intent and require certain records be kept related thereto. Thus, in practice, every fund maintained in accordance with standard accounting practices and records could be a DAF.

Similarly, in the absence of a "formal record," facts and circumstances may indicate a separately identified fund. At least half, if not the majority (in some cases), of the six factors of the facts and circumstances test Proposed §53.4966-3(b)(2) would be commonly tripped when a donor simply establishes a named restricted fund and the charity, in turn, engages in basic donor stewardship practices, including providing annual reports. Public policy dictates that charitable organizations should be encouraged to be accountable to donors and the communities they serve, but overly broad regulations risk the opposite.

Given the necessary emphasis on advisory privileges under section 4966, we recommend the definition of "formal record" be narrowed to avoid inadvertently sweeping up donor-established funds of all kinds. Specifically, we recommend removing or modifying the overly broad circumstances described in § 53.4966-3(b)(2)(i) and (v).

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[8] IRC §4966(d)(2)(a)(i).

2. <u>"Advisory privileges"</u>

In addition to the "separately identified" requirement, at least one donor or donor-advisor must have, or reasonably expect to have, advisory privileges by reason of the donor's status as a donor. The definition of "advisory privileges" under Proposed §53.4966-3(c) is so broad that it could ensnare funds maintained at charitable organizations that are also "separately identified" under the overly broad Proposed Regulations as discussed above.

It is commonplace for a donor and the supported charity to sign a gift agreement documenting, among other things, the specific purpose and use of the donated funds. Often times, the donor will retain a right to be consulted in the unlikely event that, due to unanticipated circumstances, the fund can no longer be used for the originally stated purpose. In addition, all fifty states have now adopted a version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which provides that after a gift is made, a donor can subsequently consent in writing to release or modify a restriction on the purpose, use, investment, or spending of a fund.[9] Charitable organizations also commonly reference and incorporate by reference UPMIFA in their gift agreements with donors. Any final regulations related to what constitutes "advisory privileges" should complement UPMIFA, not conflict with or unnecessarily complicate its applicability to funds never imagined to be DAFs.

B. The treatment of Advisory Committees will hamper fundraising and create confusion

Proposed §53.4966-3(c)(iii) provides for a specific exception for funds in which a donor, donor-advisor, or related person serve on a committee that advises as to distributions or investments if:

1. <u>Such appointment is based on objective criteria related to the appointee's expertise in the particular field of interest or purpose of the fund,</u>

The determination of an appointee's expertise is completely subjective and cannot be consistently applied. More importantly, this requirement inappropriately substitutes Treasury's judgement for the donor and charity's judgment. Most donors elect to donate to a specific cause not because they are subject matter experts but because they believe the cause to be worthy of financial support (not just from themselves and others). And commonly, community foundations include on field-of-interest fund committees both local leaders and philanthropists who may not necessarily be "experts" in the subject matter but add other significant value and diversity of voice to the process. These types of decisions are the province of charities, not the government, for good reason. The inverse would harm fundraising, diverse community participation in decision making, and the very agency of the sponsoring charities.

2. <u>the committee consists of at least three members with not more than one-third being a donor, donor-advisor, or related person, and</u>

Section 4966(d)(2)(c) requires an advisory committee that is not "controlled" by the donor, donor-advisor, or related party. This exception appears to wrongly equate control with only one-third of the committee. This standard is inconsistent with other areas of federal tax law related to 501(c)(3)

[9] The UPMIFA model act is available at https://www.uniformlaws.org/committees/community-home?CommunityKey=043b9067-bc2c-46b7-8436-07c9054064a3 ("<u>Model Act</u>").

organizations which generally require at least 50% or more,[10] including the standards set forth in Proposed §53.4966-4 regarding scholarships.

3. <u>the donor, donor-advisor, or related person is not a "significant contributor" to the fund at the time in which the person begins committee.</u>

Similar to other comments above, this rule is counterproductive to fundraising, the creation of new funds by donors, and community involvement generally. It is also not tailored to the concept of control in any meaningful way. Any adopted rule should be targeted at actual control by a donor, donor-advisor, or related person.

V. Comments to § 53.4966–4 Exceptions to the definition of donor advised fund.

A. Provisions of Proposed §53.4966-4(a)(5) directly conflicts with other applicable regulations or have no basis in any law

Section 4966(d)(2)(B)(i) makes an important definitional exception for funds that make distributions to a single identified organization (often referred to as "designated funds"). This exception ensures that the DAF regulations do not overly burden and potentially chill historic and beneficial philanthropic practices, such as (1) a fund created at a public charity solely to benefit its own activities, and (2) designated funds at community foundations created to make periodic distributions solely to a single identified organization. However, aspects of the Proposed Regulations would actively undermine such intent.

1. <u>Standard for Substitution of Specified Organization Is Incorrect</u>

Proposed §53.4966-4(a)(5) dictates when the public charity may change the single specified organization benefited by such a fund. This provision protects against the potential abusive situation whereby a donor is provided the ability to influence or be the cause of a periodic change to the specified beneficiary, effectively resulting in a donor advised fund. To do so, the provision adopts the standard pertaining to when a Type III supporting organization may substitute as its beneficiary a different supported organization when the supporting organization's governing documents identify its supported organizations by class or purpose and not by name.[11] Specifically, the proposed provisions states:

> A sponsoring organization may substitute another single identified organization 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.[12]

This standard is incorrect and, if adopted, would lead to confusion and inconsistency with other applicable regulations. Neither a DAF nor a designated fund is a separate organization; they are funds on the books and records of a sponsoring organization. Very frequently, these funds are

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[10] IRC §509(a)(3)(C); Treas. Reg. §1.509(a)-4(j)(1).
[11] Treas. Reg. § 1.509A-4(d)(4)(i)(A). Under this provision, such a substitution must be "conditioned upon the occurrence of an event which is beyond the control of the supporting organization, such as loss of exemption, substantial failure or abandonment of operations, or dissolution of the publicly supported organization or organizations designated in the articles."
[12] Prop. Reg. §53.4966-4(a)(5).

component funds of community foundations, which already are subject to the relevant standard. Specifically, designated funds and donor advised funds held by community foundations must be subject to variance power,[13] which bestows on the governing body of the community foundation the power to:

> modify any restriction or condition on the distribution of funds for any specified charitable purposes or to <u>specified organizations</u> if in the sole judgment of the governing body (without the necessity of the approval of any participating trustee, custodian, or agent), such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served.[14]

Confusingly, Proposed §53.4966-4(a)(5) would result in two different standards governing how community foundations can modify their own designated funds. Moreover, the standard in the Proposed Regulations is more restrictive on community foundations and would actually limit the power of the governing board in a manner contrary to fundamental tax principles applicable to community foundations.

Accordingly, Proposed §53.4966-4(a)(5) should be revised to strike the inconsistent standard applicable to supporting organizations in favor of a standard consistent with variance power as defined in Treas. Reg § 1.170A-9(f)(11)(v)(B)(1).

2. <u>Proposed §53.4966-4(a)(6) Example 3 is Incorrect as a Matter of Law and Threatens to Chill Vital Charitable Giving</u>

Example 3 of Proposed §53.4966-4(a)(6) is offered to illustrate an organization that does not make distributions to a single identified organization. In Example 1, donors establish a fund at a public charity to benefit a university but retain the right to advise as to which university projects the fund supports. Example 3 assumes the same facts, but one of the donors serves on the university board. The entirety of the example's substance states, "[because the donor] has the ability to advise some or all of the distributions from Y to other entities, Fund V does not meet the exception for a fund or account that makes distributions only to a single identified organization." In other words, this example is based on the assumption that serving on a board grants the board member advisory rights over the distributions of the charitable organization.

This is not the law. The roles, rights, duties, and responsibilities of directors are a matter of state law, typically embodied in the state's nonprofit corporation act. We know of no such state act or other law that bestows such advisory privileges on any single director.

This mistaken assumption of state law, if enacted, would have wide ranging negative impacts on charitable giving and fundraising, both of which are protected expressions under the First Amendment. It is a maxim in the charitable sector that board members must contribute to the organizations on which boards they serve. But under the Proposed Regulations, this vital source

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[13] Treas. Reg § 1.170A-9(f)(11)(v)(B)(1).

[14] *Id*. (emphasis added.) Moreover, a change in purpose of a designated fund held by a charitable organization is separately regulated at the state level under the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), as adopted in each state. Under UPMIFA, the purpose of a restricted fund may be modified with the consent of the donor, but importantly, "[a] release with donor consent <u>cannot change the charitable beneficiary of the fund</u>." *See* Model Act § 6 cmt. to Subsection (a) (emphasis added.). As a result, absent the donor's agreement to variance power in a gift document, the beneficiary of a charitable fund can only be changed by way of court approval when a fund has become "unlawful, impracticable, impossible to achieve, or wasteful." Model Act § 6(c).

of support would be chilled. First, board members would effectively be prohibited from contributing to a designated fund or even an agency endowment held at a community foundation, no matter how large the fund, small the gift, or number of donors present in the pool. Similarly, under the incorrect reasoning of the example, gifts by members of an organization's board to various restricted or unrestricted funds maintained directly by the organization could also cause such funds to be classified as DAFs. This would curtail board member giving to scholarship funds or programmatic funds that have a distributive purpose, such as a special fund at a food bank created to purchase food from third parties. In addition, it would effectively nullify the qualified charitable distributions (which cannot be made to donor advised funds) for board members[15] and could curtail support from board member's private foundations altogether (as well as discouraging private foundation disqualified persons from serving on any nonprofit board).[16]

Accordingly, it is imperative that Proposed §53.4966-4(a)(6) Example 3 be struck altogether.

VI. Comments to § 53.4966–5 Taxable distributions

A. Distribution for purpose not specified in section 170(c)(2)(B) chills protected speech

Section 4966(c)(1)(B)(i) prohibits distributions from DAFs "for any purpose other than one specified in section 170(c)(2)(B)." Proposed §53.4966-5(b)(1) amplifies this prohibition as follows:

> a distribution <u>to be used for</u> an activity that is prohibited under section 501(c)(3) of the Code or for an activity that, if it were a substantial part of a section 501(c)(3) organization's total activities, would cause loss of tax exemption, is not for a purpose specified in section 170(c)(2)(B). For example, a distribution <u>used for</u> political campaign intervention activity or for attempting to influence legislation is considered to be for a purpose not specified in section 170(c)(2)(B).[17]

We generally support this provision but believe that it should be clarified to avoid confusion and chilling effects. Specifically, the passive phrases "to be used for" and "used for" create ambiguities regarding who caused such inappropriate expenses. For example, public charities are permitted to attempt to influence legislation to a certain degree, and it would be perfectly appropriate for the organization to decide to use unrestricted contributions for that purpose. Similarly, it would be perfectly appropriate for a donor advisor to recommend a grant to a particular program that also includes some lobbying.[18] On the other hand, it would not be appropriate for the sponsoring organization or donor advisor to earmark or designate distributions from a DAF for such purposes, either when the distribution is made or after the charity receives it.

Proposed §53.4966-5(a)(3) already addresses the situation where the donor advisor or sponsoring organization arranges for a DAF distribution to be used inappropriately once received.

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[15] *See* Section 408(d)(8)(B)(i).

[16] In addition to concerns about whether such a grant would constitute qualified distributions under Section 4942, the proposed regulation effectively eliminates the well-established practice that a private foundation may, without triggering a regulatory issue, make grants to public charities on which board's a disqualified person merely serves in a standard capacity. *See, e.g.*, Treas. Reg. § 53.4941(d)-2(f)(2).

[17] Prop. Reg. §53.4966-5(b)(1) (emphasis added).

[18] See, e.g., Treas. Reg. § 53.4945-2(a)(6)(ii), which the IRS indicated in PLR 200943042 (Oct. 23, 2009) is also applicable in the public charity context.

Accordingly, we request that Proposed §53.4966-5(b)(1) be amended by using the words "earmarked" or "designated" for instead of "used for."

B. Unnecessary Confusion as to Program-Related Investments

We are not aware of any rationale for the government to limit the ability of DAFs to make program-related investments in the same manner and to the same extent as private foundations or public charities generally. In fact, Congress implicitly recognized the ability of DAFs to make program-related investments when it made DAFs subject to excess business holdings limitations with Section 4943(e). Specifically, section 4943(e)(1) states that for the purposes of 4943 generally, a DAF "shall be treated as a private foundation," and program-related investments by private foundations are not considered for the purposes of Section 4943.[19] If Congress had intended for excess business holdings to also apply to DAF PRIs, it would have explicitly said so in section 4943(e).

Proposed §53.4966-5 also implicitly recognizes the ability of DAFs to make PRIs. Proposed §53.4966-5(b)(2), relating to grants to noncharitable organizations, employs the definition of grant found in Treas. Reg. § 53.4945–4(a)(2), which explicitly includes program-related investments within that definition. Similarly, Proposed §53.4966-5(d)(1) prescribes for DAF sponsors the expenditure responsibility procedures set forth in Treas. Reg. § 53.4945–5(b) through (e), which include expenditure responsibility procedures for both traditional grants and PRIs.

However, the Preamble to the Proposed Regulations equivocates on the ability of DAFs to make PRIs. Specifically, the Preamble states:

> However, an investment would not, for example, include a zero-interest loan, as there is no purpose of, or provision for, obtaining income or funds from the zero-interest loan. The Treasury Department and the IRS <u>anticipate that a zero-interest loan would be a distribution under the proposed regulations and, unless made to a section 170(b)(1)(A)</u> organization other than a disqualified supporting organization, would require expenditure responsibility by the sponsoring organization in order not to be a taxable distribution. <u>The Treasury Department and the IRS request comments on how to further distinguish distributions from investments.</u>

Moreover, the Proposed Regulations limit the ability of DAFs to make PRIs to the same extent as private foundations. Specifically, Proposed §53.4966-5(b)(2) requires that any grant (the definition of which, as noted above, includes PRIs) to a noncharitable entity must require the grantee either "to separately account for the grant funds on its books or to segregate the grant funds." This requirement does not apply to private foundation PRIs,[20] and for good reason. Practically, it is not feasible or practicable to account for the proceeds of an equity investment in such a way. Thus, the Proposed Regulations have the effect of limiting PRIs to loans.

Limiting DAF participation in PRIs would be a harmful constraint on the important First Amendment rights of sponsoring organizations. Fundamentally, a PRI, like a grant, is an expressive act of a charitable organization in pursuit of its mission. No rationale can adequately justify the limitation of this speech in some philanthropic contexts and not others.

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[19] Treas. Reg. § 53.4943-10(b).

[20] See Treas. Reg. 53.4945-5(c)(3)(ii) and Treas. Reg. § 53.4945-5(b)(8).

Take for example, a community foundation with a substantial amount of unrestricted assets not held in donor advised funds. It identifies a need for a particular community economic development project that would require a significant amount of patient equity not readily in the capital markets. The community foundation desires to take the lead in raising program related investments from other local philanthropic institutions, but to do so successfully, it must itself invest a significant amount. Due to the large amount of unrestricted assets, it is able to make such an investment without the participation of its DAFs, and the project moves forward to benefit the community.

Compare to a community foundation the assets of which are substantially weighted in DAFs. To bring the same project to fruition, it would need the participation of multiple of its DAFs and it has donor advisors excited about the project. Under the Proposed Regulations, however, it would be unable to marshal all of its resources and, consequently, take the leadership role its community expects. As a result, the project does not move forward to the detriment of the community.

These examples illustrate both the harm from, and arbitrary nature of, a constraint placed on a sponsoring organization's ability to deploy its DAF assets in pursuit of its charitable purposes.

Accordingly, we request that the Proposed Regulations be revised to make the treatment of PRIs from DAFs parallel to the treatment of PRIs from private foundations.

VII. Conclusion

Getting these long-awaited DAF regulations right is paramount to the future of philanthropy. We greatly appreciate the opportunity to submit our comments to help ensure any final regulations are consistent with existing law, fair as to their application, and operationally workable for charitable organizations, donors, and advisors alike. We welcome any questions regarding our feedback and can be reached at 919-869-3080.

Sincerely yours,

Edward T. Chaney
Member

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