

Memorandum

Proposed Regulations Regarding Taxes on Taxable Distributions From Donor-Advised Funds

November 21, 2023

On November 14, 2023, the Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “IRS”) issued proposed regulations under section 4966 of the Internal Revenue Code of 1986, as amended (the “Code”), regarding excise taxes on taxable distributions made by a sponsoring organization from a donor-advised fund (a “DAF”), and on the agreement of certain fund managers to the making of such distributions (the “Proposed Regulations”).¹ The Proposed Regulations propose a portion of the long-awaited guidance concerning amendments to the Code related to DAFs, which were enacted in the Pension Protection Act of 2006 (the “PPA”).² The preamble to the Proposed Regulations also requests comments responding to questions raised by Treasury and the IRS.

The Proposed Regulations can be found [here](#).

I. Background and Key Takeaways

Certain charitable organizations establish funds—commonly referred to as donor-advised funds—to which a donor may contribute and may thereafter (directly or through designees) exercise the privilege of making nonbinding recommendations about grants from the fund and investment of the fund’s assets. DAFs are extremely popular vehicles for charitable giving. According to National Philanthropic Trust, contributions to DAFs in 2022 totaled \$85.53 billion.³

Although donor-advised funds have existed for nearly a century, the term “donor-advised fund” was not defined in the Code until the enactment of the PPA and the addition of Code section 4966.⁴ The Proposed Regulations are the first proposed regulations issued regarding the DAF provisions included in the PPA, though Treasury and the IRS have previously issued notices providing interim guidance and requesting comments.⁵

¹ Prop. Treas. Reg. § 53.4966, 88 Fed. Reg. 77922 (Nov. 14, 2023).

² Pension Protection Act of 2006, Pub. Law No. 109-280, 120 Stat. 780, 1094-1102 (2006).

³ See *The 2023 DAF Report*, NAT’L PHILANTHROPIC TRUST, [here](#). (last visited Nov. 20, 2023).

⁴ Pension Protection Act § 1226.

⁵ In December 2006, Treasury and the IRS issued Notice 2006-109, 2006-2 C.B. 1121, providing interim guidance regarding the application of certain requirements enacted by the PPA, including those related to DAFs, and requesting comments and suggestions for future guidance. In February 2007, Treasury and the IRS issued Notice 2007-21, 2007-1 C.B. 611, inviting public comments in connection with a study on the

Code section 4966 defines a DAF generally as a fund or account (i) which is separately identified by reference to contributions of a donor or donors, (ii) which is owned and controlled by a sponsoring organization and (iii) with respect to which a donor (or any person appointed or designated by such donor) 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.⁶ Code section 4966 imposes on each taxable distribution an excise tax equal to 20% of the amount of the taxable distribution, payable by the sponsoring organization with respect to the DAF.⁷ It further imposes, on the agreement of any fund manager to the making of a distribution, knowing that it is a taxable distribution, an excise tax equal to 5% of the amount of the taxable distribution, payable by the fund managers who agreed to the making of the distribution.⁸ Code section 4966 defines a taxable distribution as a distribution from a DAF to any natural person or, unless the sponsoring organization of the DAF exercises expenditure responsibility, to any non-charitable entity or disqualified supporting organization.⁹

The Proposed Regulations propose definitions and interpretative guidance regarding DAFs, which, if promulgated in final regulations, may require operational changes for sponsoring organizations, donors and donor-advisors in order to avoid excise taxes.¹⁰

For example:

- Due to an expansive definition of the term “donor-advisor,” sponsoring organizations would be prohibited from compensating investment managers who also provide personal investment advice to donors in certain circumstances.
- Due to an expansive definition of advisory privileges, donors seeking to avoid establishing a DAF would need to review any forms of advisory input, including advisory input provided as a member of a committee.
- Due to a narrow interpretation of whether a fund or account makes distributions only to a single identified organization, it is unclear whether such a fund or account that makes distributions to an organization that itself only makes grants could be excluded from the definition of a DAF.
- Due to an expansive definition of the term “distribution” and potentially expansive lists of donors, donor-advisors and related persons, the charging of expenses solely to particular DAFs would need to be closely monitored.

organization and operation of DAFs. Most recently, in December 2017, Treasury and the IRS issued Notice 2017-73, 2017-51 I.R.B. 562, describing approaches under consideration to address certain issues regarding DAFs and requesting comments on those approaches.

⁶ See Code section 4966(d)(2)(A).

⁷ See Code section 4966(a)(1).

⁸ See Code section 4966(a)(2).

⁹ See Code section 4966(c).

¹⁰ Although the Proposed Regulations are specific to excise taxes under Code section 4966, terms used in Code section 4966 are also relevant to the excise taxes under Code sections 4958 and 4967, and it is likely that they would be defined and interpreted similarly by Treasury and the IRS in forthcoming guidance under those Code sections.

II. Summary of Selected Items of Interest in Proposed Regulations

The following is an overview of selected terms of interest and is not intended as a complete summary of the Proposed Regulations.

WHAT IS A DAF?

The Proposed Regulations propose to define the term “donor-advised fund” consistently with Code section 4966(d)(2)(A).¹¹

However, the Proposed Regulations propose definitions and other interpretive guidance related to terms used within the definition of a DAF, which impact the definition of a DAF itself.

DEFINITION OF “DONOR”

For example, the Proposed Regulations propose an arguably narrow definition of the term “donor.” The Proposed Regulations propose to define “donor” as any person described in Code section 7701(a)(1) that makes a contribution to a fund or account of a sponsoring organization, other than a contributor that is a governmental unit described in Code section 170(c)(1) or an organization described in Code section 509(a)(1), (2) or (3) that is not a disqualified supporting organization.¹² Accordingly, a fund or account at a sponsoring organization that is funded exclusively by contributions from a governmental entity and/or a public charity is not a DAF because neither the governmental entity nor the public charity is a donor, and thus the fund is not separately identified by reference to contributions of a donor or donors.¹³ Likewise, a fund or account at a sponsoring organization that is funded by multiple unrelated donors, but with respect to which only a governmental entity and/or a public charity have advisory privileges, is not a DAF, because no donor or donor-advisor has advisory privileges.¹⁴ In the preamble to the Proposed Regulations, Treasury and the IRS indicate that private foundations and disqualified supporting organizations are intentionally not proposed to be excluded from the definition of donor, on the basis that they could use a DAF to circumvent the payout and other requirements that are applicable to those organizations. Notably, the Code as currently in effect permits private foundations to make grants to sponsoring organizations in satisfaction of their payout requirements without distinction or limitation, even if they retain advisory privileges with respect to the grant funds.

DEFINITION OF “DONOR-ADVISOR”

The “Dual Advisor” Problem. By contrast, the Proposed Regulations propose an arguably expansive definition for the term “donor-advisor.” The Proposed Regulations propose to define “donor-advisor” as a person appointed or designated by a donor to have advisory privileges regarding the distribution or investment of assets held in a fund

¹¹ See Prop. Treas. Reg. § 53.4966-3(a).

¹² See Prop. Treas. Reg. § 53.4966-1(f).

¹³ See Prop. Treas. Reg. § 53.4966-3(e)(3) (Example 3).

¹⁴ See Prop. Treas. Reg. § 53.4966-3(e)(4) (Example 4).

or account of a sponsoring organization.¹⁵ To this end, the Proposed Regulations propose that an investment advisor defined in Code section 4958(f)(8)(B) who manages the investment of, or provides investment advice with respect to, both the assets maintained in a DAF and the personal assets of a donor to that DAF (a “personal investment advisor”) would be treated as a donor-advisor with respect to the DAF while serving in that dual capacity, regardless of whether the donor appointed, designated or recommended the personal investment advisor, unless the personal investment advisor is “properly viewed” as providing services to the sponsoring organization as a whole (as opposed to the DAF).¹⁶ The implications of this proposed definition could be significant. For example, a DAF that is established as a memorial fund may have multiple donors that have no advisory privileges. Nonetheless, a personal investment advisor to such a non-advisory donor would be considered a donor-advisor while managing the investment of the assets in the DAF if it provides investment advice to fewer than all of the sponsoring organization’s DAFs. In the preamble to the Proposed Regulations, Treasury and the IRS indicate that a personal investment advisor that is considered a donor-advisor would be subject to the excess benefit transaction rules of Code section 4958(c)(2) if it receives a grant, loan, compensation or similar payment from the DAF. Accordingly, sponsoring organizations would be prohibited from compensating personal investment advisors, except where they provide services to the sponsoring organization “as a whole.” It is not clear whether “as a whole” would require the advisor to provide services to (or make their services available to) each of the sponsoring organizations’ DAFs or, for example, to a subset.

Advisory Privileges. Similarly, the Proposed Regulations propose an arguably expansive definition for the term “advisory privileges,” the existence of which will depend on the facts and circumstances and will be based on substance over form.¹⁷ Generally, “advisory privileges” would include those arising from service on an advisory committee.¹⁸ Under the Proposed Regulations, a sponsoring organization’s appointment of a donor, donor-advisor or related person to be on a committee of persons that advises as to distributions or investments of amounts in the fund or account would be deemed to result in advisory privileges by reason of the donor’s status as a donor unless: (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.¹⁹ Likewise, the Proposed Regulations propose that a person recommended by a donor or donor-advisor and appointed by the sponsoring organization to serve as a member of a committee of the sponsoring organization that advises as to distributions or investments of amounts in a fund or account would be treated as a donor-advisor unless: (i) the recommendation is based on objective criteria related

¹⁵ See Prop. Treas. Reg. § 53.4966-1(h)(1).

¹⁶ See Prop. Treas. Reg. § 53.4966-1(h)(3).

¹⁷ See Prop. Treas. Reg. § 53.4966-3(c)-(d).

¹⁸ See Prop. Treas. Reg. § 53.4966-3(c)(1)(i).

¹⁹ See Prop. Treas. Reg. § 53.4966-3(c)(1)(iii).

to the expertise of the member in the particular field of interest or purpose of the fund or account; (ii) the committee consists of three or more individuals, and a majority of the committee is not recommended by the donor or donor-advisor; and (iii) the recommended person is not a related person with respect to the recommending donor or donor-advisor.²⁰ Based upon the proposed definition of “related persons,”²¹ it is unclear how the proposals related to advisory privileges and donor-advisor status would be applied to representatives of non-individual donors (e.g., authorized persons of a corporate donor).

WHAT IS NOT A DAF?

Funds Making Grants Only to a Single Identified Organization. Consistent with Code section 4966(d)(2)(B)(i), the Proposed Regulations propose to exclude from the definition of the term “donor-advised fund” any fund or account that is established by written agreement to make (and that actually does make) distributions only to a single identified organization.²² However, the Proposed Regulations arguably construe narrowly whether a fund or account meets this requirement. The Proposed Regulations propose that the sponsoring organization must make distributions from the fund or account only to the single identified organization for use in the single identified organization’s activities (other than the activities of administering donor-advised funds or grant-making), and that a fund or account will not be treated as making distributions only to a single identified organization if (i) a donor, donor-advisor or related person has or reasonably expects to have the ability to advise regarding some or all of the distributions from the single identified organization to other individuals or entities; or (ii) a distribution from the fund or account provides, directly or indirectly, a more than incidental benefit (within the meaning of Code section 4967), to a donor, donor-advisor or related person with respect to the fund.²³ It is unclear whether a fund that makes distributions only to a single identified organization that exclusively makes scholarship grants would be considered making grants “for use in the single identified organization’s activities,” and excluded from the definition of a DAF. The Proposed Regulations propose an expansive view of whether a person has the ability to advise regarding distributions, which would include non-controlling membership on the governing board of the single identified organization, and which in turn could raise practical challenges in the context of funds with multiple donors.²⁴

Funds Making Grants to Individuals for Travel, Study or Similar Purposes. Consistent with Code section 4966(d)(2)(B), the Proposed Regulations propose to exclude from the definition of the term “donor-advised fund” any fund or account with respect to which a donor or donor-advisor advises as to which individuals receive grants for travel, study or other similar purposes, if (i) the exclusive purpose of the fund or account is to make grants to individuals for travel, study or other similar purposes; (ii) the donor or donor-advisor provides advice exclusively

²⁰ See Prop. Treas. Reg. § 53.4966-1(h)(4).

²¹ See Prop. Treas. Reg. § 53.4966-1(j).

²² See Prop. Treas. Reg. § 53.4966-4(a)(1).

²³ See Prop. Treas. Reg. § 53.4966-4(a)(3)-(4).

²⁴ See Prop. Treas. Reg. § 53.4966-4(a)(6)(iii) (Example 3).

in the person's capacity as a member of the selection committee selecting the individuals who receive grants; (iii) all the members of the selection committee are appointed by the sponsoring organization; (iv) no combination of donor(s), donor-advisor(s) or related persons controls, directly or indirectly, the selection committee; (v) all grants from the fund or account are awarded on an objective and nondiscriminatory basis pursuant to a written procedure approved in advance by the board of directors of the sponsoring organization, and the procedure is designed to ensure that all the grants adhere to the principles set forth by Code section 4945(g)(1), (2) or (3) and the regulations under Code section 4945 (other than the requirement to get advance approval by the IRS); and (vi) the fund or account maintains adequate records as described in Treas. Reg. § 53.4945-4(c)(6) that demonstrate the recipients were selected on an objective and nondiscriminatory basis.²⁵ In determining whether a selection committee is controlled, directly or indirectly by a donor or donor-advisor, the Proposed Regulations would look to the substance over the form of the arrangement.²⁶

Proposed Additional Exclusions. Under Code section 4966(d)(2)(C), the Secretary of the Treasury has discretionary authority to exempt certain other funds or accounts from the definition of DAF. The Proposed Regulations propose to exercise such authority in respect of (i) certain additional scholarship funds and (ii) certain disaster relief funds.²⁷

- *Funds Established by Code Section 501(c)(4) Organizations to Make Scholarship Grants.* The Proposed Regulations propose to exclude from the definition of the term “donor-advised fund” any fund or account established by a broad-based membership organization described in Code section 501(c)(4) that establishes a committee to advise as to which individuals receive grants, if (i) the fund or account's single identified charitable purpose is to make grants to individuals for scholarships described in Code section 4945(g)(1); (ii) the selection of recipients of scholarships is made by a selection committee nominated by the Code section 501(c)(4) organization and approved in writing by the sponsoring organization; (iii) the fund or account serves a charitable class; (iv) recipients of grants from the fund or account are selected on an objective and nondiscriminatory basis pursuant to a procedure, approved in advance by the sponsoring organization's board of directors, that is designed to ensure that all the grants meet the requirements of Code section 4945(g)(1) and the regulations under Code section 4945 (other than the requirement to obtain advance approval by the IRS); (v) no distribution is made from the fund or account to, or for the benefit of: (a) any director, officer or trustee of the sponsoring organization of the fund or account, (b) any member of the fund or account's selection committee, (c) any member, honorary member or employee of the Code section 501(c)(4) organization or (d) any related person with respect to anyone described in clauses (a), (b) or (c); and (vi) the fund or account maintains adequate records as described in Treas. Reg. § 53.4945-

²⁵ See Prop. Treas. Reg. § 53.4966-4(b)(1).

²⁶ See Prop. Treas. Reg. § 53.4966-4(b)(2)(i).

²⁷ See Prop. Treas. Reg. § 53.4966-4(c)-(d).

4(c)(6) that demonstrate the recipients were selected on an objective and nondiscriminatory basis.²⁸ Unlike statutorily excluded scholarship funds discussed above, this additional category of scholarship funds would only be permitted to make scholarship grants within the meaning of Code section 4945(g)(1), to be used for study at an educational organization described in Code section 170(b)(1)(A)(ii).

- *Disaster Relief Funds.* The Proposed Regulations propose to exclude from the definition of the term “donor-advised fund” any fund or account if: (i) the fund or account’s single identified charitable purpose is to provide relief from one or more qualified disasters within the meaning of Code section 139(c)(1), (2) or (3); (ii) the fund or account serves a charitable class; (iii) the selection of recipients of grants from the fund or account is made using a selection committee (a) that is not directly or indirectly controlled by donor(s), donor-advisor(s) or related persons and to which all the members are appointed by the sponsoring organization or (b) the majority of which, if the fund or account gives preference or priority to employees (or their family members) of an employer to receive grants, consists of persons who are not in a position to exercise substantial influence over the affairs of the employer (or adequate substitute procedures exist to ensure that any benefit to the employer is incidental and tenuous); (iv) the selection committee selects recipients of grants from the fund or account (and determines the amounts of such grants) based on objective and nondiscriminatory determinations of need pursuant to a procedure approved in advance by the board of directors of the sponsoring organization; (v) no distribution is made from the fund or account that would result in more than incidental benefit (within the meaning of Code section 4967) to (a) any director, officer or trustee of the sponsoring organization of the fund or account, (b) any member of the fund’s selection committee or (c) any related person with respect to a director, officer or trustee of the sponsoring organization or to a member of the selection committee; and (vi) records are maintained that demonstrate the need of the recipients for the disaster relief assistance provided and that satisfy Code section 6033(b)(14).²⁹ The Proposed Regulations would expand upon the exclusion provided in Notice 2006-109 to extend beyond employer-sponsored funds, but would continue to limit the exclusion to funds providing relief only in the context of qualified disasters (and not, for example, personal hardships).

WHAT IS A DISTRIBUTION?

Code section 4966 does not include a definition of “distribution.” Treasury and the IRS acknowledge in the preamble to the Proposed Resolutions that the proposed definition would construe the term broadly. Under the Proposed Regulations, the term “distribution” would mean any grant, payment, disbursement or transfer, whether in cash or in kind, from a DAF.³⁰ The term would also be deemed to include (i) any use of DAF assets that results in a more than incidental benefit (within the meaning of section 4967) to a donor, donor-advisor or related person and (ii) an expense charged solely to a particular DAF that is paid, directly or indirectly, to a donor, donor-advisor

²⁸ See Prop. Treas. Reg. § 53.4966-4(c).

²⁹ See Prop. Treas. Reg. § 53.4966-4(d).

³⁰ See Prop. Treas. Reg. § 53.4966-1(e)(1).

or related person with respect to the DAF.³¹ Unless included as a deemed distribution, investments³² and reasonable investment or grant-related fees would not be considered distributions. In the preamble to the Proposed Regulations, Treasury and the IRS expressly indicate that the Proposed Regulations would provide that an expense charged solely to a particular DAF that is paid, directly or indirectly, to a donor, donor-advisor or related person with respect to the DAF, is a deemed distribution subject to Code sections 4966, 4958 and/or 4967.

WHAT IS A TAXABLE DISTRIBUTION?

Consistent with Code section 4966(c), the Proposed Regulations propose to define the term “taxable distribution” generally as any distribution from a DAF: (i) to any natural person; or (ii) to any other person if (a) the distribution is for any purpose other than one specified in Code section 170(c)(2)(B) or (b) the sponsoring organization does not exercise expenditure responsibility with respect to the distribution.³³ Also consistent with Code section 4966(c), the term “taxable distribution” would not include any distribution from a donor-advised fund to: (i) any organization described in Code section 170(b)(1)(A) (other than a disqualified supporting organization); (ii) the sponsoring organization of the donor-advised fund; or (iii) any other donor-advised fund.³⁴ The Proposed Regulations would incorporate an anti-abuse rule treating as a single distribution any series of distributions undertaken to circumvent the restrictions of Code section 4966.³⁵ The Proposed Regulations would provide that a distribution to be used for an activity that is prohibited under Code section 501(c)(3) or for an activity that, if it were a substantial part of a Code section 501(c)(3) organization’s total activities, would cause loss of tax exemption, is not for a purpose specified in Code section 170(c)(2)(B).³⁶ Additionally, grants to non-charitable organizations will not be considered to be made for a Code section 170(c)(2)(B) purpose unless the grantee agrees either to separately account for the grant funds on its books or to segregate the grant funds.³⁷ Consistent with rules applicable to private foundation grantmaking, the Proposed Regulations would provide that various categories of organizations would be treated as described in Code section 170(b)(1)(A), including in order to allow for grants made to foreign organizations with equivalency determinations to be treated as grants to Code section 170(b)(1)(A) organizations.³⁸ Likewise, a sponsoring organization will be treated as exercising expenditure

³¹ See Prop. Treas. Reg. § 53.4966-1(e)(2).

³² In the preamble to the Proposed Regulations, Treasury and the IRS indicate that they would consider investments as including both debt and equity instruments held for the purpose of obtaining income or funds, including investments made partly for charitable purposes, but not, for example, a zero-interest loan, which has no purpose of, or provision for, obtaining income or funds.

³³ See Prop. Treas. Reg. § 53.4966-5(a)(1).

³⁴ See Prop. Treas. Reg. § 53.4966-5(a)(2).

³⁵ See Prop. Treas. Reg. § 53.4966-5(a)(3).

³⁶ See Prop. Treas. Reg. § 53.4966-5(b)(1).

³⁷ See Prop. Treas. Reg. § 53.4966-5(b)(2).

³⁸ See Prop. Treas. Reg. § 53.4966-5(c).

responsibility if it follows a modified process substantively similar to that applicable to private foundation grantmaking under Code section 4945(h) and Treas. Reg. § 53.4945-5(b) through (e).³⁹

III. Applicability Date

These Proposed Regulations are proposed to be applicable to taxable years ending after the date of publication of the Treasury decision adopting the Proposed Regulations as final regulations in the Federal Register, but taxpayers may rely upon the Proposed Regulations for taxable years ending before that date. Additionally, because the Proposed Regulations provide guidance regarding disaster relief funds that modifies the guidance provided in Section 5.01 of Notice 2006-109, for taxable years ending before the date the Treasury decision adopting the Proposed Regulations as final regulations is published in the Federal Register, taxpayers may rely upon either the guidance provided in section 5.01 of Notice 2006-109 or the Proposed Regulations, including for periods prior to November 14, 2023.

IV. Comments

We encourage donors, donor-advisors and sponsoring organizations and others that may be impacted by the DAF guidance set forth in the Proposed Regulations to share their views with Treasury and the IRS. Comments regarding the Proposed Regulations must be received by January 16, 2024.

For more information, please contact any member of our [Exempt Organizations Group](#):

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³⁹ See Prop. Treas. Reg. § 53.4966-5(d).