

Treasury and the IRS Issue Proposed Regulations on Donor-Advised Funds

Tax Alert
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On November 13, 2023, the U.S. Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) issued long-awaited [Proposed Regulations](#) on donor-advised funds (DAFs), REG-142338-07. DAFs have been the subject of much discussion in recent years – as they have grown in number and importance to the charitable sector, some have called for Congress and Treasury to impose greater restrictions.

Since the enactment of the Pension Protection Act of 2006, Pub. L. 109-290 (Aug. 17, 2007), section 4966(d)(2)(A) has defined a DAF as a fund or account (i) that is separately identified by reference to the contributions of a Donor Advisor, (ii) that is owned and controlled by a sponsoring section 501(c)(3) entity (a sponsoring organization), which must be a public charity, and (iii) with respect to which a person (the donor advisor) has or reasonably expects to have advisory privileges with regard to the distribution or investment of the funds. Section 4966 also imposes excise taxes on sponsoring organizations of DAFs and DAF managers on the payment by DAFs of certain "taxable distributions." DAFs are subject to restrictions in sections 4967 and 4958 as well, which impose additional excise taxes on distributions from DAFs that result in a more than incidental benefit to donors and related persons and on distributions that constitute excess benefit transactions, respectively. The Proposed Regulations are limited to interpreting and implementing the excise tax and key definitions in section 4966; they do not address the excise taxes imposed by sections 4967 and 4958.

The Proposed Regulations elaborate on several key statutory definitions, most notable of which is the definition of DAF.

- The Proposed Regulations provide that a fund or account is separately identified by reference to contributions of a donor or donors if the sponsoring organization maintains a formal record of contributions to the fund from each donor or donors, or, in the absence of a formal record, if all facts and circumstances tend to show that the fund or account is separately identified.¹ The Proposed Regulations provide several factors that are relevant in determining whether the facts and circumstances tend to show that an account is separately identified.²
- Whether a donor or donor-advisor has advisory privileges (or the reasonable expectation of advisory privileges) as a result of the donor's status as a donor is based on all facts and circumstances, taking into account factors such as a donor's appointment to an advisory committee, the make-up of such committee, and the capacity in which a person provides advice.³ A donor or donor-advisor will be treated as having advisory privileges if any of the following are present:
 - The sponsoring organization takes nonbinding recommendations from the donor or donor-advisor on the distribution or investment of assets
 - A written agreement provides for advisory privileges
 - Advisory privileges are advertised in written documents or marketing materials provided to the donor or donor-advisor by the sponsoring organization
 - The sponsoring organization solicits advice from the donor or donor-advisor regarding the distribution or investment of assets⁴
- While the Proposed Regulations do not contain an explicit rule excepting multiple-donor funds from the definition of DAF, proposed rules on the existence of advisory privileges and the proposed definition of "donor," discussed below, would appear to constitute an exception for multiple-donor funds as a practical matter.

The Proposed Regulations also elaborate on the definitions of "donor" and "donor-advisor."

- "Donor" is broadly defined to include any person, other than a public charity or governmental entity, that makes a contribution to a fund or account of a sponsoring organization.⁵ Because public charities and governmental units are excluded from the Proposed Regulations' definition of "donor," funds separately identified by reference to contributions from those entities are not DAFs.
- "Donor-advisor" is broadly defined to include a person appointed by a donor (or donor-advisor) to have advisory privileges regarding the distribution or investment of fund assets.⁶ The person who establishes a fund or account is always a donor-advisor. A personal investment advisor will be considered a donor-advisor to the extent the advisor provides investment advice with respect to fund assets, provided the advisor is not determined to advise the DAF as part of services that they provide the sponsoring organization as a whole. The Proposed Regulations contemplate a facts and circumstances analysis as to who an investment advisor should be treated as advising.⁷

Finally, the Proposed Regulations adopt the statutory definition of a "taxable distribution" as any distribution from a DAF to any person other than a public charity, the DAF's sponsoring organization, and another DAF. The Proposed Regulations also include an anti-abuse rule that treat a series of distributions as a single "taxable distribution" if it is meant to avoid the application of the section 4966 excise tax.⁸

The Proposed Regulations state that regulations under section 4966 will apply to the tax year in which they are published as final regulations in the Federal Register. Interested parties can submit comments and requests for a public hearing through January 16, 2024.

Treasury and the IRS acknowledge that previous guidance, namely Notice 2017-73, contemplated proposed regulations that would provide, among other things:

- Certain distributions from a DAF that pay for the purchase of tickets to attend or participate in a charity sponsored event result in a more than incidental benefit to a donor or related person under section 4967
- Certain distributions from a DAF that the distributee charity treats as fulfilling a pledge made by a donor, donor-advisor, or related person, do not result in a more than incidental benefit under section 4967 if certain requirements are met.

Treasury and the IRS imply that the Proposed Regulations do not address Notice 2017-73's proposals under sections 4967 and 4958 because the majority of comments submitted in response to previous administrative guidance addressed definitions in section 4966. The Proposed Regulations do not indicate that Treasury and the IRS have reversed their positions in Notice 2017-73.

It is also notable, although not surprising, that the Proposed Regulations contain none of the changes suggested in S.1981, the [Accelerating Charitable Efforts \(ACE\) Act](#) (introduced in the U.S. Senate on June 9, 2021). That proposal would have overhauled the DAF system, provided that most DAFs would have to make distributions within a certain timeframe, and imposed other restrictions, most of which are beyond the scope of authority of Treasury and IRS.

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¹Prop. Treas. Reg. § 53.4966-3(b).

²*Id.* at (b)(3).

³*Id.* at (c).

⁴*Id.* at (c)(2).

⁵Prop. Treas. Reg. § 53.4966-1(f).

⁶*Id.* at (h)(1).

⁷See 88 Fed. Reg. 77926. ("For example, if an investment advisor contracts with a sponsoring organization to provide services to all of its 1,000 DAFs, and the sponsoring organization reasonably charges the investment advisor's fees uniformly to all of those DAFs, the investment advisor would properly be viewed as providing services to the sponsoring organization as a whole.")

⁸Prop. Treas. Reg. § 53.4966-5(a)(3).

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