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

Re: Notice of Proposed Rulemaking [REG 142338-07] Proposed Regulations § 53.4966-4

Ladies and Gentlemen:

I am responding to your request for comments on the proposed regulations under Section 4966 of the Internal Revenue Code[1], REG-142338-07, published in the Federal Register on November 14, 2023 (88 Fed. Reg. 77922 November 14, 2023) (the "Proposed Regulations"). Thank you for this opportunity to comment.

I submit these comments on behalf of myself and not my firm or any client. I am an attorney with 44 years of experience practicing tax law and specializing in exempt organization tax law and related matters. The Proposed Regulations are a welcome addition to the rules for donor advised funds ("DAFs") first articulated in the Pension Protection Act of 2006 ("PPA"), Public Law 109-280 (August 17, 2006). My comment is limited to one specific aspect of the Proposed Regulations—the exception for funds or accounts that make distributions only to a single identified organization under § 53.4966-4(a) of the Proposed Regulations (the "Single Identified Organization Exception").

Background. The statutory basis for the Single Identified Organization Exception is in Section 4966(d)(2)(B)(i) which provides:

> The term "donor advised fund" shall not include any fund or account—
>
> (i) which makes distributions only to a single identified organization or governmental entity, . . .

Also, a Committee Report for the PPA provides:

[1] All Section references, unless otherwise noted, refer to the Internal Revenue Code of 1986 as amended.

> A donor advised fund does not include a fund or account that makes distributions only to a single identified organization or governmental entity. For example, an endowment fund owned and controlled by a sponsoring organization that is held exclusively [to][2] [sic] for the benefit of such sponsoring organization is not a donor advised fund even if the fund is named after its principal donor and such donor has advisory privileges with respect to the distribution of amounts held in the fund to such sponsoring organization. Accordingly, a donor that contributes to a university for purposes of establishing a fund named after the donor that exclusively supports the activities of the university is not a donor advised fund even if the donor has advisory privileges regarding the distribution or investment of amounts in the fund.

Joint Committee on Taxation, *Technical Explanation of H.R. 4 "The Pension Protection Act of 2006"* JCX-38-06 (August 3, 2006).

Single Identified Organizations May Not Re-Grant. This rule is picked up in § 53.4966-4(a)(1) and (2) of the Proposed Regulations, stating the general rule and defining a *single identified organization*. In addition, § 53.4966-4(a)(3) adds what appears as a mandatory requirement for single identified organizations:

> *(3) Distributions to a single identified organization.* 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 not to third parties on behalf of the single identified organization.

(Emphasis added).

The operative rule embodied in § 53.4966-4(a)(3), particularly the parenthetical "(other than the activities of administering donor advised funds or grant-making)" is entirely appropriate because if the beneficiary organization of the fund is itself acting like a DAF or otherwise engaged in a program of grant-making, then the fund should not be excepted from Section 4966 on the basis of benefiting a single identified organization. The use of the mandatory phrase "must make distributions . . . only to the single identified organization" (together with the parenthetical that prohibits the use of the distribution for grant-making by the beneficiary organization) says to me that distributions from a fund to the beneficiary organization must be restricted to internal use at the beneficiary organization and cannot be used for grant-making if the Single Identified Organization Exception is to apply.

Example 3 is Unnecessary or Overbroad. But I believe that the elaboration of this rule set forth in Example 3 of the Proposed Regulations, § 53.4966-4(a)(6)(iii) ("Example 3"), is either unnecessary based on the operative rule or is overbroad. As currently written Example 3 will have an inappropriate chilling effect on organizations that may wish to benefit from the Single Identified Organization Exception when a donor is a board member of the beneficiary organization.

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[2] The language in this Committee Report appears potentially garbled in the original. It reads "…exclusively to for the benefit of such sponsoring organization." My assumption is that the "to" is extraneous and should be stricken so that the phrase should read "exclusively for the benefit of such sponsoring organization." An alternative interpretation of what is written might be the omission of an "or" between the "to" and the "for" so that the phrase would read "to or for the benefit of . . . " This is a common phrase appearing in 24 instances in the Code, but which is usually preceded by a more active verb like "transfer", "pay", or "make expenditures" rather than the more passive verb "held."

Example 3 builds on Example 1 of the same regulatory section, except for the fact that A (the donor) is on the board of Y, the university which is otherwise the single beneficiary of Fund V established at sponsoring organization X. Example 3 concludes:

> Because A 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.

If my reading of § 53.4966-4(a)(3) is correct, implying that the distributions coming out of a fund to the single identified beneficiary organization are legally restricted to internal use at the beneficiary organization, then board membership by a donor or family member at the beneficiary organization should be irrelevant to curtail distributions outside the beneficiary organization (*i.e.*, making the beneficiary organization itself act like a DAF). If the funds are legally restricted, then the outside distributions cannot happen. Under this rubric, Example 3 is unnecessary and board membership should not be a relevant factor.

Board Membership Should Be Encouraged. But the conclusion of Example 3, which entirely turns on board membership and the theoretical ability to make outside distributions that may not happen, creates the wrong incentives. Board members of charitable organizations (whose responsibilities include raising and stewarding funds for their organizations) should be encouraged in the use of endowment funds and other ways to protect assets for the charitable purposes of their organizations. Often there are good reasons to use a DAF sponsor for administering such funds. Professional investment management, economies of scale, administrative convenience, protection from creditors, and lower costs are all valid reasons for wanting to use a fund that is hard-wired to a single identified organization.

In my experience, the vast majority of such beneficiary organizations are focused on their own projects and activities. They never make grants to other organizations and are not themselves acting like DAFs. To disqualify a fund from the Single Identified Organization Exception because of mere membership by a donor or donor family member on the board of its beneficiary organization makes no sense when the beneficiary organization has no intent for grant-making and in fact makes no such grants.

Example 3 effectively disqualifies a fund from the Single Identified Organization Exception when the governing documents of a beneficiary organization authorize (or fail to expressly restrict) grants to other organizations when a donor (donor advisor or related person) of the fund is a board member of the beneficiary organization. In other words, such a rule precludes a donor from serving on the board of a beneficiary organization. Such a consequence I believe is the wrong policy. We should not discourage board membership by involved contributors.

Inconsistency With Example 7. Moreover, I see some inconsistency between Example 3 and Example 7 of § 53.4966-3(e) ("Example 7"). Example 7 concludes that Fund P established by sponsoring organization Y is not a DAF despite the five-member committee advising Fund P potentially including donors to Fund P. This conclusion is based on § 53.4966-3(c)(1)(iii) which treats committee members as not possessing advisory privileges when certain safeguards are satisfied. The facts in Example 7 illustrate satisfaction of those safeguards because of the diluted control exercised by any individual member of the committee. Example 7 concludes:

> However, under the circumstances, no person who serves on the advisory committee of Fund P is deemed to have advisory privileges by reason of a donor's status as a donor. Fund P is not a donor advised fund.

In most circumstances reflected in Example 3, the board member is likely to be one of a large group of board members (*i.e.*, a similarly diluted control posture to the committee in Example 7). For there to be opposite conclusions between Example 3 and Example 7 is confusing and inappropriate. In my view the problem is with Example 3 and its overbroad assumption of implied donor control that is unlikely to exist in fact.

Retained Right to Recommend Internal Expenditures. It is also somewhat anomalous that Example 1 of § 53.4966-4(a)(6)(i)—on which Example 3 is based—permits the donors to reserve the right to recommend which university projects should be supported by Fund V and which investments to make with fund assets while still qualifying for the Single Identified Organization Exception. Arguably those retained rights in Example 1 embody more significant control than the mere possibility of affecting grants out of the beneficiary organization. Those grants may never occur and, even if they did, the donor/board member might only have an attenuated voice in ultimate disposition and no real control.

Such a rule strikes me as classically overbroad. Rather, the rule should be narrowed to target the actual problem being addressed—*i.e.*, a beneficiary organization acting like a DAF itself.

Suggestions. Suggestions of how to tailor the Example 3 rule more narrowly to the problem might include making it more explicit that distributions from a fund to a single identified organization must be expressly restricted to preclude "re-granting" as some private foundations do in their expenditure responsibility grant agreements to avoid running afoul of § 53.4945-5(b)(3)(iv)(c). Another approach might be to require some quantum of board representation on the beneficiary organization by the donor or her family members before the Single Identified Organization Exception is lost. Finally, Example 3 might include a "wait and see" approach. That is to say, board membership on the beneficiary organization ought not to automatically disqualify it from the Single Identified Organization Exception unless and until there are in fact distributions from such organization. Theoretical possibilities ought not disqualify an organization.

I am aware that the Service takes the position that the indirect control inherent in board membership has a similar effect in the disclaimer area. For example, if the default taker under a disclaimer is a private foundation on whose board the disclaimant sits, the disclaimer will not be qualified because of the indirect control reflected through board membership. *See* Section 2518(b)(4) and Rev. Rul. 72-552 (1972-2 CB 525). But the Service has recognized flexible solutions to this problem through the use of segregated funds or bylaw provisions that insulate the disclaimant from any control over the disclaimed funds. *See* Priv. Ltr. Rul. 9141017 (July 10, 1991); Priv. Ltr. Rul. 9235022 (May 29, 1992); Priv. Ltr. Rul. 9317039 (February 2, 1993) and Priv. Ltr. Rul. 9320008 (February 3, 1993). The Service has privately ruled that similar remedies are effective to avoid estate tax inclusion when a donor creates a charitable lead trust, and the lead beneficiary is a private foundation with which the donor has a governance role. *See* Priv. Ltr. Rul. 200138018 (September 24, 2001) and Priv. Ltr. Rul. 200108032 (February 23, 2001).

Conclusion. I would suggest that Example 3 be dropped altogether, combined with a more explicit articulation of a rule that legally restricts money coming out of a fund to internal use at the single identified organization. However, if the Service views re-granting a problem, then similar flexibility should be incorporated into the rule embodied in Example 3. I thus request that consideration be given to changing the Proposed Regulations to reflect these comments and allow more flexibility on board membership for organizations intending to benefit from the Single Identified Organization Exception.

Thank you again for the opportunity to comment on the Proposed Regulations. Please feel free to contact me if you would like to discuss these ideas in more detail or if you have any questions.

Sincerely,

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