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Estate Planning Update Summer 2024 - Key Issues in the Proposed Regulations for Donor-Advised Funds

Donor-advised funds (DAFs) have become a prominent feature in the philanthropic landscape, offering donors a flexible, tax-advantaged vehicle with which to support charitable causes. However, as DAFs have surged in popularity, many debates have arisen over their lack of regulation. As policymakers strive to encourage philanthropy while ensuring proper oversight, the IRS has issued proposed regulations to address concerns about DAF transparency and accountability as well as the efficacy of charitable contributions to DAFs.

What Are Donor-Advised Funds?

DAFs have sometimes been called "charitable investment accounts" with the sole purpose of supporting charitable organizations about which the donor cares. DAFs were originally mainly sponsored by community foundations, but now many other public charities (including universities) sponsor DAFs. While the donor to the DAF may have advisory privileges over how the funds in the DAF are distributed and invested (or may nominate another person as an advisor who would have these privileges), the sponsoring public charity administers the DAF and has control over the funds in the DAF.

Proposed Regulations – Definition of 'Donor-Advised Fund' and 'Donor-Advisor'

DAFs have become increasingly popular in recent years, and though they have been around for decades, there has been limited guidance as to their administration. Various proposals to regulate DAFs have been introduced over the years, with the most recent one in November 2023. These proposed regulations focus primarily on specific definitions but provide some additional insight on how policymakers wish to reform DAFs. Two key takeaways from these regulations are as follows:

1. The definition of a DAF is much broader than previously thought.

The regulations apply a two-prong test to define a DAF as a fund or account that (i) is separately identified with reference to the donor and (ii) gives (or expects to give) advisory privileges to the donor. The first prong is very broad. If a charity is keeping track internally of donor contributions, then it is meeting the first prong. As a result, it seems that any charity that is following best practices will meet this first prong. With respect to the second prong, the proposed regulations state that a donor or donor-advisor will be deemed to have advisory privileges, even if those privileges are not exercised, if any of the following is true: The sponsoring organization allows the donor or donor-advisor to make nonbinding recommendations regarding distributions or investments; a written agreement provides such privileges; the sponsoring organization has a written document or marketing material indicating that the donor or donor-advisor has such privileges; or the sponsoring organization solicits advice from the donor or donor-advisor regarding distributions or investments. This two-prong test raises a concern about whether charitable organizations that are not intended to be (and previously would not have been) a DAF might now unintentionally be categorized as a DAF and thereby be subject to certain laws and regulations.

2. The definition of a 'donor-advisor' might now include investment advisors.

It has been thought historically that donor-advisors were the individuals designated by the donor to have advisory privileges over the DAF and not any professional advisors related to the donor or the DAF. The proposed regulations now define a donor-advisor to include personal investment advisors who manage both the funds of the DAF and the donor's personal assets. Furthermore, if this advisor then receives compensation from the DAF for services provided, excise taxes could

apply. The regulations do include some safe harbors to this rule, but there is still concern about how this change might impact the role that an investment advisor plays in management of a DAF.

Conclusion

The proposed regulations introduce complexities that could significantly impact DAFs you have established or for which you serve as an advisor. However, it is important to remember that they are still just that: *proposed* regulations. Comments addressing the impact that such proposed regulations could have and any concerns with the provisions of the proposed regulations therefore may be directed to the IRS. Such comments could prompt the IRS to edit the proposed regulations prior to finalizing them. As these proposed regulations evolve, it is crucial to stay informed and proactive with respect to their potential impact on establishing and administering a DAF. Please contact your Day Pitney estate planning attorney for more information.