

IRS Proposes Significant Changes to Donor-Advised Funds

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While tax reform garnered much attention at the end of 2017, the IRS also released a proposal relating to donor-advised funds that will significantly impact donors and charities. Notice 2017-73 (the Notice) was released on December 4 and provides major changes to existing donor-advised fund (DAF) practices. Further guidance on DAFs has been anticipated since the Pension Protection Act of 2006.

Background

DAFs are an increasingly popular philanthropic tool. A DAF is a charitable vehicle established at a public charity, referred to as the sponsoring organization, that allows donors to make a charitable contribution and then make non-binding recommendations for grants from the DAF to other charities over time. Donors receive the benefit of an immediate income tax charitable deduction and assistance with fund administration and investments.

IRS Proposals

1. DAF distributions may fulfill a donor's pledge.

The Notice proposes that DAF distributions that fulfill a pledge of the DAF donor, advisor or their families are acceptable as long as the sponsoring organization transmitting the DAF distribution does not specifically reference that the distribution is in fulfillment of a pledge.

Prior to the Notice, the common practice among sponsoring organizations was to prohibit the fulfillment of a pledge with DAF distributions because under the analogous private foundation rules such action constitutes an impermissible benefit to the person who made the pledge. Often innocent miscommunications resulted in non-compliance, however. This proposal is intended to resolve such issues and is favorable to donors and charities.

2. DAF distributions may not be used to purchase tickets or the opportunity to purchase tickets.

The Notice makes clear that any DAF distributions that are used to purchase tickets, or the opportunity to purchase tickets, for the benefit of the DAF donor, advisor, or their families constitute “more-than-incidental benefit,” such that these distributions are subject to an excise tax. The Notice specifically prohibits the practice referred to as bifurcation, whereby the DAF pays the charitable portion of a payment required for a benefit, and the donor pays the non-charitable portion constituting the value of the benefit. This proposal clarifies an existing ambiguity and is consistent with the current practices of most sponsoring organizations.

3. DAF distributions may not qualify as public support under limited circumstances.

The Notice provides that DAFs may not be used to circumvent the private foundation rules. Prior to the Notice, donors could establish a DAF and use it to fund a separate public charity. Because the DAF distributions are from the sponsoring organization and not the individual donors, this could be used to gain public charity status for an organization that otherwise would be treated as a private foundation. Under the Notice, donee organizations must treat a DAF distribution as coming from the DAF donor rather than from the sponsoring organization. In addition, all anonymous contributions made during a year must be treated as being made by one person. If finalized, this proposal will require additional recordkeeping requirements of grantee organizations receiving DAF distributions.

4. Private foundations with DAFs may receive additional IRS attention.

The Notice also requests comments with respect to the relationship between private foundations and DAFs, including (1) how private foundations use DAFs in support of their purposes, and (2) whether private foundation distributions to DAFs should be required to be distributed within a certain time period. Currently, private foundations may make their required distributions to DAFs, which thereby allows private foundations to extend the time period in which such distributions are actually distributed and used by other charities.

Conclusion

The Notice requests comments on these issues prior to the issuance of final Treasury Regulations. While the Notice generally is not considered to be binding legal authority, it provides important guidance to charities and donors. DAF distributions may now fulfill a pledge under most circumstances, and the Notice specifically provides that it may be relied upon for such purposes. DAF distributions may not be used, however, in whole or in part, for the purchase of tickets or the opportunity to purchase tickets. Also, DAF distributions may be disqualified as public support in certain limited circumstances among related parties.

Vorys will continue to monitor any forthcoming IRS guidance. Contact your Vorys attorney if you have questions about your DAF.