

AMERICAN BAR ASSOCIATION

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August 18, 2016

Notice.Comments@irs.counsel.treas.gov
Internal Revenue Service
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Elinor Ramey, Department of Treasury, via email: Elinor.Ramey@treasury.gov
Catherine Hughes, Department of Treasury, via email:
Catherine.Hughes@treasury.gov

Re: Comments on Pending Treasury Regulations with Respect to Donor
Advised Funds

Ladies and Gentlemen:

We appreciate the opportunity to submit the enclosed comments, which represent the views of the Section of Real Property, Trust and Estate Law ("RPTE") of the American Bar Association ("ABA"). This submission has not been approved by the Board of Governors or the House of Delegates of the ABA and, accordingly, in no way represents the policy of the ABA as a whole.

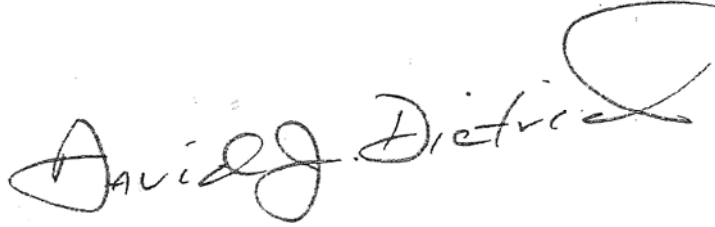
Although the attorneys who prepared this submission may have clients who would be affected by the federal tax principles addressed, or may have advised clients on the application of such principles, neither they nor their respective firms have been engaged by a client to make this submission or to otherwise influence the development or outcome of, the specific subject matter of these comments.

Thank you in advance for your consideration. Representatives of RPTE's Charitable Planning and Organizations Group are available to respond to any questions. Its designated contact persons are:

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Very truly yours,

A handwritten signature in black ink, reading "David J. Dietrich". The signature is written in a cursive style with a large, sweeping "D" at the beginning and a long, horizontal flourish extending to the right.

David J. Dietrich
Chair, Section of Real Property, Trust and Estate Law.

Enc: Comments on pending donor advised fund regulations

COMMENTS OF THE AMERICAN BAR ASSOCIATION SECTION OF REAL PROPERTY, TRUST AND ESTATE LAW, CHARITABLE PLANNING AND ORGANIZATIONS GROUP, CONCERNING PENDING TREASURY REGULATIONS UNDER I.R.C. SECTION 4966.

I. INFORMATION ON THE DRAFTING OF THIS RESPONSE

The following comments are submitted on behalf of the American Bar Association Section of Real Property, Trust and Estate Law. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

These comments were prepared by members of the Charitable Planning and Organizations Group of the Trust and Estate Division of the Section of Real Property, Trust and Estate Law (the “Section”) of the American Bar Association. Grace Allison, as Chair of the Charitable Planning and Organizations Group, supervised the preparation of these comments. Sharon Bell, Kim Heyman, Ray Prather and Judy Saxe participated in their preparation. Principal drafting responsibility was exercised by Christopher Hoyt and Grace Allison. These comments were reviewed by Jonathan G. Blattmachr on behalf of the Section’s Committee on Governmental Submissions.

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| Contact persons: | Phone Number: |
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Although the members of the Charitable Planning and Organizations Group (the “Charitable Group”) who participated in preparing these comments may have clients who would be affected by the federal tax principles addressed, or may have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a submission

with respect to, or to otherwise influence the development or outcome of, the specific subject matter of these comments.

II. BACKGROUND

The issue. At its annual meeting with Treasury representatives earlier this year, the Charitable Group requested that any regulations issued under I.R.C. Section 4966 clarify that certain funds traditionally held by the nation's nearly 800 community foundations are not "donor advised funds." In response to the Charitable Group's request, Treasury encouraged RPTE to submit examples illustrating under what circumstances specific types of community foundation funds would not be treated as "donor advised."

This is a significant issue: Foundation Center estimates that community foundations made total grants of \$6 billion in fiscal 2015.¹ These grants were made from a wide variety of community foundation funds, including designated funds, field of interest funds, scholarship funds, agency funds and fiscal sponsorship funds.²

Each of these funds may be governed by an advisory committee. The selection of committee members may, in turn, be determined under a written agreement between the donor and the community foundation (the "gift instrument").³ Where the composition of an advisory committee is governed by a gift instrument, we believe the gift instrument is the primary source to be consulted when determining whether a fund is donor-advised.⁴

¹ Foundation Center, 2015 Columbus Survey Findings, June 2016.

² An agency fund is typically established by a single tax-exempt charity at a community foundation to leverage the latter's investment expertise; all distributions from the agency fund are made to or for the benefit of the transferor charity, but at the discretion of the community foundation. See, e.g. Council on Foundations, "Accounting for Agency Endowment Funds Held At Community Foundations," www.cof.org. The gift instrument of a field of interest fund typically requires that all distributions further one or more charitable purposes, such as arts education or hunger eradication; in contrast to a designated fund, specific organizations or governmental entities are not designated as recipients. In a fiscal sponsorship relationship, funds are managed and distributed for charitable purposes by the sponsoring organization on behalf of an entity which has not yet been granted tax-exempt status.

³ UPMIFA defines "gift instrument" as "a record or records, including an institutional solicitation, under which property is granted to, transferred to, or held by an institution as an institutional fund."

⁴ If there is no donor, committee or other person "appointed or designated by the donor who 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," the fund is not a donor advised fund. I.R.C. Section 4966(d)(2)(A).

Designated funds. A designated fund typically holds contributions from one or more donors; its gift instrument typically limits distributions to one or more organizations or governmental entities. Congress specifically excepted only one subset of designated funds⁵ from the donor advised fund rules, providing that

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.⁶ *Emphasis added.*

Scholarship funds. A second statutory exception provided by I.R.S. Section 4966(d)(2)(B) applies to scholarship funds, i.e. to any fund or account

(ii) with respect to which a person described in subparagraph (A)(iii) [“a donor or any person appointed or designated by such donor who 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”] advises as to which individuals receive grants for travel, study or other similar purposes, if—

(I) such person’s advisory privileges are performed exclusively by such person in the person’s capacity as a member of a committee all of the members of which are appointed by the sponsoring organization,

(II) no combination of persons described in subparagraph (A)(iii) (or persons related to such persons) control, directly or indirectly, such committee, and

(III) All grants from such fund or account are awarded on an objective and nondiscriminatory basis pursuant to a procedure

⁵ A designated fund typically holds contributions from one or more donors; its gift instrument typically limits distributions to one or more organizations or governmental entities.

⁶ I.R.C. Section 4966(d)(2)(B)(i).

approved in advance by the board of directors of the sponsoring organization, and such procedure is designed to ensure that all such grants meet the requirements of paragraph (1), (2), or (3) of section 4945(g).

Significantly, the twin concepts of “control” and “relationship” underlie the definition of “scholarship fund.”

Regulatory authority. These two concepts are also central to an understanding of I.R.C. Section 4966(d)(2)(C)(i), which permits Treasury to exempt a fund advised by a committee if that committee is

not directly or indirectly *controlled* by the donor or any person appointed or designated by the donor for the purpose of advising with respect to distributions from such fund (and any *related parties*). *Emphasis added.*

We respectfully request that Treasury exercise its regulatory authority under I.R.C. Sections 4966(d)(2)(C)(i) and 7805(a), and, in so doing, adopt the definitions of “control” and “relationship” described below. By so doing, it will provide community foundations with guidance as to which, if any, of its “traditional funds” is “donor advised” within the meaning of I.R.C. Section 4966.

Proposed definition of “control.” Treasury has recently wrestled with the definition of “control” in the tax-exempt context. Building on established law in the tax-exempt arena, Prop. Treas. Reg. Section 1.509(a)-4(f)(5)(ii) defines “control” consistently with Treas. Reg. Section 1.509(a)-4(j):

... the governing body ... will be considered controlled by a person ... if that person, alone or by aggregating the person’s votes or positions of authority with persons described in paragraph (f)(5)(i)(B) or (C) of this section [related persons], may require the governing body of the supported organizations to perform any act that significantly affects its operations or may prevent the governing body of the supported organization from performing any such act. The governing body of a supported organization will generally be considered to be controlled directly or indirectly by one or more

persons described in paragraph (f)(5)(i)(A), (B), or (C) of this section if the voting power of such persons is 50 percent or more of the total voting power of such governing body or if one or more of such persons have [sic] the right to exercise veto power over the actions of the governing body of the . . . organization. However, all pertinent facts and circumstances will be taken into consideration in determining whether one or more persons do in fact directly or indirectly control the governing body

We recommend that Treasury adopt this “50 percent or more” control test.

Proposed definition of “related persons.” Under I.R.C. Section 4958(f)(1)(E) and (f)(7), a “disqualified person” with respect to a transaction including a donor advised fund includes family members of the donor and his designees and appointees, as well as any 35-percent controlled entities. The underlying assumption here is that family members and 35-percent controlled entities are “related to” and may be “controlled by” those persons.

“Family members” for this purpose are described in I.R.C. Section 4958(f)(4) as

. . . defined under section 4946(d), except that such members also shall include the brothers and sisters (whether by the whole or half blood) of the individual and their spouses.

“35-percent controlled entity” for this purpose is as defined in I.R.C. Section 4958(f)(3), substituting ‘persons described in I.R.C. Section 4958(f)(7) (A) or (B)’ for ‘persons described in subparagraph (A) or(B) of I.R.C. Section 4958(f)(1).’

We recommend that the pending regulations under I.R.C. Section 4966 define persons related to a donor or his appointees and designees to include “family members” and “35-percent controlled entities,” both defined as described above.

We appreciate the opportunity to provide examples to be included in regulations to be issued under I.R.C. Section 4966 (the “pending regulations”) and welcome an opportunity to discuss them further with you.

II. SUMMARY RECOMMENDATION

We respectfully request that Treasury:

A. Provide examples in the pending regulations that provide guidance as to when certain funds traditionally held by community foundations will be treated as “donor advised.”

B. For purposes of determining when an advisory committee is “directly or indirectly controlled by the donor or any person appointed or designated by the donor,”⁷ adopt a “control” test analogous to that set forth in existing Treas. Reg. Section 1.509(a)-4(f)(5)(ii), using the definitions of “family members” and “35 percent controlled entities” set forth in I.R.C. Section 4958(f)(7).

III. EXAMPLES

DONOR CONTROL

(1) Husband and wife establish a fund at a community foundation described in Treas. Reg. Section 1.170A-9(f)(11) that bears their names. They reserve the right to recommend which charities will receive grants and to recommend investments among a selection permitted by the sponsoring organization. Under the general rule of I.R.C. Section 4966(d)(2)(A), the fund is a donor advised fund.

(2) An individual establishes a fund at a community foundation. The gift instrument for the fund gives the community foundation complete discretion to make grants for any charitable purpose and to control investments. The community foundation hires the donor’s investment advisor to manage the investments of the fund. Under the investment agreement between the community foundation and the investment

⁷ I.R.C. Section 4966(d)(2)(C)(i).

manager, the investment manager is required to adhere to the investment policy of the community foundation; the community foundation can also terminate the investment manager at any time. The fund is not a donor advised fund because the donor does not 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.

(3) An individual establishes and contributes to a fund at a community foundation that will serve as a memorial to her son who died unexpectedly. Under the gift instrument, she is the only adviser to the fund; her advisory privileges include the ability to recommend grants to local theater groups. Subsequently, other donations are made to the fund by many unrelated individuals. The fund is a donor advised fund because the donor who established the fund has “advisory privileges with respect to the distribution of amounts held in such fund or account by reason of the donor's status as a donor.” I.R.C. Section 4966(d)(2)(A)(iii). Among other consequences, penalty tax may be imposed under I.R.C. Section 4966(c)(1)(A) if grants are made to individuals or if the donor is compensated for her services to the fund.⁸

(4) One individual establishes a large fund at the local community foundation as a memorial to her father. Pursuant to the gift instrument, an advisory committee supervises the grants and investments. The gift instrument further provides that no member of the advisory committee may be related to the donor or any of the donor's appointees or designees; for this purpose, “related” is as described in I.R. C. Section 4958(f)(7)(B) and (C). Despite the fact that the entire fund is attributable to the contributions of a single donor, the fund is not a donor advised fund because the donor has relinquished all advisory privileges relating to grants and investments and has no “appointees” or “designees.”

COMMUNITY FOUNDATION FUNDS THAT ARE NOT DONOR ADVISED FUNDS.

⁸ I.R.C. Section 4966(a)(1) imposes a 20 percent penalty tax on “taxable distributions,” defined in I.R.C. Section 4966(c)(1) to include any distribution from a donor advised fund “to any natural person.”

DESIGNATED FUND

(5) A married couple establishes a fund at a community foundation that requires all payments to be made from the fund to a university. The fund is a “designated fund” of the community foundation because a single charity is designated as its beneficiary. In the gift instrument, the couple reserves the right to recommend which university projects should be supported by the fund, and which investments it should make. Despite the fact that the donors control the advisory committee, the fund is not a donor advised fund because it falls within the exception of I.R.C. Section 4966(d)(2)(B)(i): all grants will be made “only to a single identified organization .”

FIELD OF INTEREST FUND

(6) A community foundation receives a \$100,000 contribution from a single donor to create a component fund (consistent with the requirements of Treasury Regulations Section 1.170A-9(f)(11)(ii)), the purpose of which is to make grants to charitable organizations in the community that support or administer arts programs. The gift instrument also provides that:

- the fund will be named for the donor and will be called the “John Smith Community Arts Fund”;
- grants from the fund will be awarded according to an annual competitive process; and
- the community foundation will appoint a volunteer advisory committee to review grant applications and make recommendations regarding potential grantees.

Assume that the community foundation receives additional contributions to the fund from multiple, unrelated donors. From time to time, it also appoints one or more fund donors to serve on the volunteer advisory committee, including the initial donor. However, pursuant to the gift instrument, with respect to each donor,

- (i) that donor,
- (ii) persons “related to” (as described in IRC Section 4958(f)(7)(B) and (C)) that donor,

(iii) appointees or designees of that donor, and

(iv) persons related to such appointees or designees,

must comprise less than fifty percent of the voting power of the advisory committee. In this situation, the advisory committee may not be controlled directly or indirectly, by any individual donor, and/or by any person appointed or designated by a donor. This field of interest fund will not constitute a donor advised fund as defined in I.R.C. Section 4966(d)(2).

(7) Five individuals establish a field of interest fund at a local community foundation to beautify the downtown area of City. The gift instrument provides that the community foundation will appoint an advisory committee of seven individuals to oversee investments and disbursements from the fund, none of whom can be related to the five original donors or to each other in the manner described in I.R.C. Section 4958(f)(7)(B) and (C). Each committee member makes a charitable contribution to the fund. Despite the fact that those with advisory privileges with respect to grants and investments are also donors, the fund is not a donor advised fund because the committee is not controlled by any one of the donors and/or their appointees or designees.

(8) Assume the same facts as in (7), **except** the individuals who establish the fund each have the right, under the gift instrument, to appoint one member of the advisory committee. Assume further that less than 50 percent of these appointees or designees are related to each other and/or a donor in the manner described in I.R.C. Section 4958(f)(7)(B) and (C). The fund is not a donor advised fund because the committee is not controlled by any one of the donors.

AGENCY FUND

(9) A social service charity recognized as tax-exempt under Section 501(c)(3) decides to use a large bequest to establish an endowment at a local community foundation. The gift instrument provides that any distributions from the fund shall be made only to the charity and only in the discretion of the community foundation. The fund is an “agency fund” of the community foundation because the community foundation

controls all distributions from the fund, which is the fund's sole beneficiary. It is not a donor advised fund because it "makes distributions only to a single identified organization or governmental entity".⁹

(10) Same facts as above but the executive director of the social service agency asks the community foundation to send a payment to a contractor who has repaired the agency's building. Despite the fact that a payment is made from the fund to a business, the fund is not a donor advised fund because the payment is made on behalf of "a single identified organization" that is the sole beneficiary of the fund.

(11) A civic organization described in I.R.C. Section 501(c)(4)¹⁰ creates a fund at a community foundation. The gift instrument provides that the sole purpose of the fund is to support the charitable activities of the civic organization. The gift instrument also permits the civic organization to appoint seven of its members to act as an advisory committee to recommend grants and investments. Assume that the civic organization encourages its members to contribute to the fund.

Despite the fact (i) that all member of the advisory committee are also members of the civic organization, and (ii) that the civic organization and each member of the oversight committee are also donors to the fund, the fund is not a donor advised fund because it makes distributions only to a single identified organization. As a result, I.R.C. Section 4966(c)(1)(A) does not apply, and the fund may make grants to individuals.

FISCAL SPONSORSHIP FUND

(12) A fledgling domestic violence shelter, which has not yet applied for 501(c)(3) status, establishes a non-endowed fund at a local community foundation. Contributions to the fund qualify for the income tax charitable deduction because the fund is a component part of the community foundation, which is recognized as a tax-exempt entity. The community foundation accounts to the shelter for all contributions and

⁹I.R.C. Section 4966(d)(2)(B)(i)

¹⁰ Such as Rotary or Kiwanis.

disbursements from the fund. Under the gift instrument, disbursements may only be made to or on behalf of the shelter, in the sole discretion of the community foundation. The fund is a “fiscal sponsorship fund.” It is not a donor advised fund because payments can be made only to or on behalf of “a single identified organization” that is the sole beneficiary of the fund.

IV. CONCLUSION

We appreciate your consideration of our recommendations and examples and welcome the opportunity to discuss them further with you.