ADLER & COLVIN
A Law Corporation

newventurefund

February 15, 2024

Submitted Electronically
IRS and REG-142338-07

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

RE: Comments of the New Venture Fund and Adler & Colvin in response to Notice 2023-24982 Proposed Regulations Under Code Section 4966

Ladies and Gentlemen:

We are attorneys with Adler & Colvin, a nationally-recognized law firm based in San Francisco, California, which specializes in the law of nonprofit organizations. We are writing on behalf of ourselves and our client, the New Venture Fund, in response to Notice 2023-24982. In that Notice, the Department of the Treasury (the "Treasury") and the Internal Revenue Service (the "IRS") proposed regulations under Section 4966 of the Internal Revenue Code (the "Code"). We appreciate the time and effort that has gone into drafting the notice and the opportunity to provide feedback. These comments focus on the detrimental effect that the proposed regulations would have on fiscal sponsorship, an area of philanthropy separate and distinct from donor advised funds ("DAF"). The first part of this letter provides an overview of Adler & Colvin and New Venture Fund. The second provides an overview of fiscal sponsorship. The third part addresses specific comments on the proposed regulations in the NPRM. Finally, this letter concludes with specific suggestions to address the concerns raised herein.

Overview of Commentators

New Venture Fund ("NVF" or the "Fund") is a public charity founded in 2006 that has established itself as a leader in the efficient deployment of philanthropic capital in the United States and around the world, through fiscally sponsoring charitable projects. As a fiscal sponsor, NVF enables impact by relieving change makers of administrative and operational burdens so they can focus on their mission. In 2022, NVF had revenue of close to $800 million, and the Fund is now home to more than 130 individual projects and more than 700 full-time employees. In that year, NVF distributed over $500 million in grants to over 1,350 domestic and international organizations and deployed another $300 million to support from its fiscally sponsored projects. NVF's work spans a wide array of issues, including climate change and conservation, early education, civic participation, global health, criminal justice, and creating a

more equitable world. Over the past 17 years, NVF has helped launch nearly 500 philanthropic projects, many of which have left to become standalone public charities. Such nonprofit incubation is one of the ways fiscal sponsorship serves the philanthropic sector and society at large. Because NVF and other fiscal sponsors lower the barriers to entry, philanthropic efforts can get off the ground quickly, grow, thrive, and ultimately stand on their own.

Adler & Colvin (the "Firm") is a group of 23 seasoned attorneys based in San Francisco. We are deeply committed to serving the legal needs of the nonprofit sector and advancing the practice of exempt organization law. For over 40 years, the Firm has brought an unrivaled depth of expertise and passion to its representation of tax-exempt organizations and individual philanthropists. We serve grantmakers, nonprofit service providers, individual and corporate donors, nonprofit advocacy groups, and others. As advocates for the nonprofit sector, we participate in committees of local, state, and national bar associations and help draft recommendations for improvements in laws and regulations. Members of our Firm have testified before Congressional committees on issues of nonprofit law and have served on government advisory committees that focus on the nonprofit sector.

Among our areas of practice, the lawyers in our Firm include the leading legal experts on fiscal sponsorship. Lawyers from the Firm have authored "Fiscal Sponsorship: 6 Ways to Do It Right" published by the San Francisco Study Center, now in its third edition and widely considered to be an indispensable resource on fiscal sponsorship.

Fiscal Sponsorship

These comments focus on the implications of the proposed regulations for fiscal sponsorship. To understand the structures that have been developed over the past few decades, and which are now firmly rooted in the charitable sector, a brief primer on the history of fiscal sponsorship is required. The advantages of fiscal sponsorship to the sector, society, and to the IRS are significant and should be taken into account to ensure that the legislative mandate to further clarify the regulation of DAFs does not have the unintended consequence of undermining this effective tool.

Overview of Fiscal Sponsorship

Many private foundations ("PF"), government agencies, and other donors require grant recipients to be tax-exempt under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code"). Not all individuals, associations, or organizations, however, have the resources to develop charitable projects into fully-fledged nonprofits recognized as tax-exempt by the IRS.[1] In order to cultivate the charitable works of such groups, the charitable sector has responded by developing fiscal sponsorship arrangements addressing a range of such situations, which have in turn greatly benefited the sector, and society, as a whole.

[1] For purposes of this Comment, the term "nonprofits" is used to describe organizations that are charitable under the law of the state in which they have been incorporated, and federally tax-exempt under Section 501(c)(3) of the Code.

The term fiscal sponsorship is not defined in any Code section or regulation, but describes an arrangement between an existing nonprofit, which serves as the "fiscal sponsor" to a discrete charitable project that has not itself applied for or been recognized as a 501(c)(3) organization in its own right. The project may exist within the sponsor with no separate legal existence, as a separate legal entity, or within a third entity, as discussed further below. The sponsor provides the project with financial, administrative, and/or certain tax advantages as well as legal and fiduciary oversight of the project. Typically, the sponsored project is looking for support from donors that require charitable contribution deductions, or are otherwise restricted by federal tax law in making grants to a nonexempt entity (e.g., private foundations). By law or preference, the donor will make contributions to the fiscal sponsor, which will receive the funds and use them to support the purposes of the project. This arrangement is decidedly *not* a conduit arrangement as the sponsor is maintains "complete discretion and control" over the funds, and makes payments to or for the project only in furtherance of the sponsor's charitable and tax-exempt purposes.[2]

Through practice, various types of fiscal sponsorship have developed over the years, but the most common types of fiscal sponsorship arrangements are the direct project model and the grant model. The direct project model refers to an arrangement in which the fiscally sponsored project is housed directly in the fiscal sponsor such that the project has no separate legal identity from its sponsor. The fiscal sponsor receives contributions for the project's purposes, and the receipt and use of these funds is reported on the sponsor's tax filings. Project personnel are employees or volunteers of the fiscal sponsor, and the sponsor is legally liable for the actions of the project. In this type of relationship, the fiscal sponsor must exercise significant control so as to protect its tax-exempt status and itself from legal liability.

In the grant model, the project is not part of the fiscal sponsor, but rather exists in a separate legal entity (often another public charity, but possibly a taxable business) that has a grantor-grantee relationship with the fiscal sponsor. The grantee provides the fiscal sponsor with a proposal, detailing the project and its activities, and if the project furthers the fiscal sponsor's charitable purposes, the fiscal sponsor may receive funds for the project's purposes. The sponsor typically grants the funds from time to time under the terms of a grant agreement with the grantee to carry out the project. Unlike the direct project model, the fiscal sponsor in the grant model is not legally liable for the activities of the project, but still exercises sufficient oversight over the funds to ensure that they are used charitably and in accordance with the grant agreement, redirecting the funds if necessary. The grantee under the grant model is responsible for any tax reporting required by its legal status, its receipt of grant funds, and the project activities.

Fiscal sponsorship has many key characteristics that distinguish them from DAFs. Fiscally sponsored projects are established to house a discrete program, address a specific problem, or further a specific charitable purposes. DAFs are not. Unlike DAFs, where contributions are unrestricted, contributions to support fiscally sponsored projects are held in restricted accounts subject to donor restrictions. Fiscally sponsored projects rarely hold funds for longer than a year or two, typically spending funds as they come in to support the mission. Exceptions arise generally only when a fiscally sponsored project purchases assets that are then used to carry out

[2] IRS Private Letter Ruling 9247030

charitable work or if an investment similar to a PRI is held to achieve a charitable purpose. As a result, there is no expectation that projects will exist in perpetuity, and they must continue to raise funds to support ongoing work. Finally, projects are named based on the work they do, not the donor.

Benefits of Fiscal Sponsorship to the Sector, Society, and the IRS

Fiscally sponsored **projects** benefit from fiscal sponsorship in several ways. The arrangement enables them to receive tax-deductible donations to carry out charitable work. Many fiscally sponsored projects are seeking support during a critical stage of growth; without the financial support that fiscal sponsorship can provide, they may not have the resources to survive, or would deplete their resources on administration at the expense of the charitable activities. The fiscal sponsor is also typically a more experienced nonprofit with expertise in management, operations, finance, accounting, legal requirements, and compliance. The project benefits from this expertise immediately and can focus on its charitable activities until project leadership and staff learn how to handle these functions correctly under the experienced guidance of the fiscal sponsor.

Fiscal sponsorship also provides economies of scale, with fiscal sponsors furnishing administrative support to many projects, such as salary and benefits administration, technical assistance, office space, access to software, insurance, and the use of established processes and templates, much more cost-effectively than each project could obtain on its own. These services can be invaluable to a project that is just starting out. Without a fiscal sponsor's support, fledgling charitable enterprises must often allocate limited resources to operational infrastructure rather than to programming and activities. Fiscal sponsorship can minimize or eliminate those hard choices. As a result of these economies of scale and turnkey infrastructure for new charitable projects, it is ultimately **society** that benefits from the increase in new charitable programs and assistance that fiscal sponsorship makes possible.

The economies of scale also benefit the **IRS and other regulators**. Without fiscal sponsorship, the IRS would receive more applications for exemption and would be processing a much higher number Forms 990 each year. Data from a recent survey by Social Impact Commons and the National Network of Fiscal Sponsors reports that the 100 self-identified fiscal sponsors responding to the survey house over 12,000 projects, steward over $2.6 billion in philanthropic funds, manage $575 million in government funding, and employ or contract with over 18,000 people.[3] Over half of the fiscal sponsors responding to the survey were established after 2010. Without fiscal sponsorship, many, if not most, of these sponsors' projects would have had to create a new entity and pursue recognition of exemption as its own entity. This would have further burdened already strained IRS resources as well as the capacity of state regulatory agencies.

Undermining the practice of fiscal sponsorship would lead to unwanted consequences for both the charitable sector and the IRS. Without fiscal sponsorship, new charitable projects would either not come to fruition, or funds would be expended (often unnecessarily) to set up a new

[3] https://www.socialimpactcommons.org/s/2023-Fiscal-Sponsor-Field-Scan-Report_FIN.pdf

tax-exempt entity. This would lead to an influx of exemption applications for the IRS, which already suffers from an overwhelming number of applications and a shortage of staff.

As Professor Philip Hackney noted in recent testimony before the House Ways and Means Committee, IRS resources dedicated to oversight and enforcement of the tax-exempt sector have decreased while the sector continues to grow. [4] According to Hackney's research, the IRS budget fell by 20% in real (inflation adjusted) dollars from 2017 to 2022; between 2010 and 2019 IRS staff decreased 22% from 94,000 to 73,554 full time equivalent ("FTEs") employees; and the IRS workforce responsible for exempt organization matters shrank from 889 FTEs to 550 FTE's.[5] At roughly the same time, between 2010 and 2017, the number of charitable organizations filing Form 990 increased from 186,000 to over 217,000. Between 2017 and 2022, applications for exemption from new organizations increased from 65,000 to 136,000.[6]

Donors gain comfort knowing that the project is part of a larger, established, and professionally managed institution. The evaluation process that each project must go through before being accepted by the fiscal sponsor provides assurance to donors that the initiative they are funding meets or exceeds charitable requirements and has been vetted by a third-party. Fiscal sponsors provide ongoing technical expertise, giving donors further confidence that the initiative will have the capacity to comply with legal and regulatory requirements as well as other restrictions and obligations imposed by the donor.

Donor Involvement in the Context of Fiscal Sponsorship

While fiscal sponsors provide operational expertise and administrative support, and some offer their projects substantive expertise, many do not have subject matter expertise for every one of the projects they host. While staff and consultants specific to projects are issue experts, in order to better fulfill their legal and fiduciary obligations to oversee each project, the boards of fiscal sponsors often delegate oversight responsibility to, and rely on, a project advisory board or committee to help provide strategy and oversight for each project. Those committees consist of individuals appointed by the sponsor who can provide technical expertise, help raise funds to support the project, engage with project staff, and help provide oversight and guidance for budgets and grant dockets. Advisory committees often include a donor or representatives of a donor, many of whom are subject-matter experts and community leaders. Donors may also recommend others to serve on committees, such as experts in relevant fields, other potential donors, or contractors with whom the donor has worked who have skills and experience that will benefit the project. Finally, advisory committee members may become donors, by choosing to support the important work with their own gifts. Each advisory board member is vetted and appointed by the fiscal sponsor and serves at the pleasure of the fiscal sponsor.

[4] Written Testimony of Philip Hackney, Professor of Law University of Pittsburgh School of Law U.S. House Ways & Means Subcommittee on Oversight Hearing on Growth of the Tax-Exempt Sector and the Impact on the American Political Landscape. December 13, 2023. https://gop-waysandmeans.house.gov/wp-content/uploads/2023/12/Hackney-Testimony.pdf

[5] IRS, TEGE, FISCAL YEAR 2019 ACCOMPLISHMENTS, Pub. 5329 (2020).

[6] IRS, DATA BOOK, 56, Table 24 (2010). IRS, DATA BOOK, 28, Table 12 (2022).

Apart from formal advisory boards, the relationships at the core of fiscal sponsorship sometimes result in ongoing back and forth communication among donors, the project, and the fiscal sponsor. Frequently, interactions between donors and project staff relate to the strategic direction of the project, evolving understandings of the problem the project is attempting to resolve, or adjustments to priorities and activities necessary for the project to succeed. At other times, such interactions may relate to specific operational questions, such as the appropriateness of using grant funds for a particular activity, conducting due diligence on a prospective grantee of the project, requesting budget variances, or extending the deadline for expending grant funds. Each of these interactions are opportunities for the donor to offer advice. Both the donor and the sponsor not only expect to offer and receive that advice, but rely on such advice to maximize the effectiveness of the project.

There is nothing inappropriate or abusive about donors having ongoing interactions with fiscal sponsors regarding the activities and programs funded by the donor. To the contrary, donor engagement promotes transparency and accountability and is essential to promoting a healthy and vibrant charitable sector. To the extent that donor involvement with grantees can cross lines, rules under section 170 of the Code (denying deductions where a donor retains excessive control over contributed funds) and under section 4942 (excluding payments from counting as qualifying distributions if the foundation retains excessive control) provide the IRS with authority to police and penalize violations.

Fund Accounting and Reporting in the Context of Fiscal Sponsorship

Fiscal sponsors hold assets contributed to support projects in restricted accounts specifically established for each project's purpose. The fiscal sponsor tracks contributions, investment income, program expenditures, administrative expenses, and any other financial information relevant to the project. Often, this type of accounting and reporting on a project basis is also required by private and government donors. Doing so ensures that the fiscal sponsor complies with donor restrictions and state charitable trust law, often expressly required by the terms of grant agreements. Such detailed recordkeeping and reporting is also required to comport with generally accepted accounting practices and is essential to fully discharging the fiscal sponsor's fiduciary obligations. The proposed regulations impose additional burdens if a charity engages in best practices in fund accounting, disincentivizing those practices.

Fiscal sponsors usually provide financial and accounting reports to donors. In addition to financial information for the project as a whole, such reports often include specifics of the particular grant or contribution made by that donor. For example, private foundations typically require that grant reports provide sufficient detail about the use of grant funds to ensure that the fiscal sponsor has complied with the terms of the grant. Because different donors may impose different restrictions and obligations on the use of their funds, reports often describe how the project used each donor's funds. For example, a sponsor that has received funds that may not be used for lobbying is required to confirm to that donors that neither the funds, nor any income derived from the funds, have been used in violation of that restriction. There is nothing inappropriate about fiscal sponsors and other charities providing regular reporting to donors on a project or grant-specific basis. To the contrary, such reporting promotes accountability and provides donors with essential information needed to evaluate the effectiveness of projects and

make decisions about subsequent funding. By imposing additional compliance burdens on fiscal sponsors because they provide reports to donors, the proposed regulations discourage accountability to donors.

Implications of the Proposed Regulations for Fiscal Sponsorship

The proposed regulations greatly expand the definition of DAF relative to the common understanding of that definition that existed long before the term was ever addressed in federal tax law, and has sharpened since enactment of the Pension Protection Act nearly twenty years ago. That expanded definition would sweep in many, if not most, fiscally sponsored projects and many other charitable initiatives housed at public charities that segregate funds by initiative, provide regular reporting to one or more donors, and interact with donors over the course of the initiative. Applying the restrictions imposed on DAFs under section 4966 of the Code would effectively destroy fiscal sponsorship and many other discrete charitable programs. Fiscally sponsored projects often conduct direct charitable activity, such as building and running schools, conducting scientific research, running advocacy campaigns, and building housing for the homeless. They hire staff, engage contractors, purchase supplies and equipment, and engage in many other transactions with individuals, companies, and non-charities. All of these are effectively impossible if the expenditure responsibility rules apply to such transactions. Fiscally sponsored projects also engage in charitable work in other ways that would be impossible or severely limited under the proposed DAF rules, including making grants for charitable purposes to international organizations, individuals, other non-profits, and even for-profit companies. Even if these activities are technically permissible, the regulatory compliance regime imposed by virtue of including fiscal sponsorship within the definition of DAF would effectively cripple the cost and operational efficiency of the fiscal sponsorship model and wreak havoc on the important work of the projects.

Multi-Donor Funds

Proposed §53.4966-3(b)(3) would include within the definition of DAF any fund where even a single donor of any amount has advisory privileges with respect to that fund or account as a whole. Section 53.4966-3(c)(1)(ii) states that if at least one donor or donor-advisor has, or reasonably expects to have, advisory privileges with respect to a fund or account, that fund or account qualifies as a donor-advised fund. This is true even if there are numerous donors to the fund or account whose funds are commingled and the donor advises on the whole fund, not just the donor's contributions. As the examples make clear, this is also true even if the donor's advisory privileges arise solely by virtue of their service on an advisory committee that the donor does not control.[7] Example 8 demonstrates the reach of this proposed definition, indicating that a fund is a DAF even though it was established by fifteen unrelated donors who commingle their funds and advise on investments and distributions for the fund as members of a committee (emphasis added). Example 9 goes further and clarifies that a fund would still be considered a DAF even if that committee was comprised of a fraction of the donors.

[7] §53.4966-3(c)(1)(iii). Exceptions apply if the appointment is based on objective criteria, the committee consists of at least 3 individuals (who are not related to the appointee), and the appointee is not a significant contributor.

Conceptually, the concern that led to the DAF provisions of the Pension Protection Act was the belief that where a sponsoring organization follows the donor's advice substantially all of the time, such advice was tantamount to control. Thus, a single donor or group of related donors holding advisory privileges, it was thought, gave them sufficient influence over the fund or account to justify the additional rules imposed under section 4966. Where the advice offered by donors is diluted, however, this inference of control is unjustified and the additional DAF restrictions are unnecessary. For example, section 4966(d)(2)(b)(ii) specifically excludes from the definition of DAF accounts that award grants to individuals for travel, study, or other similar purposes if the donor's advisory privileges arise from that person's capacity as a member of a committee not controlled by the donor or related persons. Section 4966(d)(2)(C) reinforces this by giving the Secretary authority to exempt funds from treatment as DAFs if the fund or account is *advised by a committee not directly or indirectly controlled by the donor*, donor advisor, or related parties (emphasis added). Indeed, that authority was properly used to exclude disaster relief funds from the definition of DAFs in Notice 2006–109. The proposed regulations appear to recognize this, but then go too far in attributing control to a relatively minor and limited donor role in the context of an advisory committee.

The Joint Committee on Taxation's Technical Explanation of the Pension Protection Act noted that "a fund or account of a sponsoring organization that is distinct from the organization's general fund and that pools contributions of multiple donors generally will not meet the first prong of the definition for a DAF [separately identified by reference to contributions of a donor] *unless the contributions of specific donors are in some manner tracked* and accounted for within the fund."[8] (Emphasis added) Accordingly, for the past 17 years, it has been widely understood that a pooled fund where no donor has the ability to advise on his or her specific contribution and does not control the advisory committee is not a DAF. Expanding that definition as proposed would ensnare many pooled funds, including many fiscally sponsored projects, in the definition of DAF, contrary to apparent Congressional intent. While the proposed regulations include some exceptions that allow charities to establish project advisory committees with some limited donor involvement, the exceptions are too narrow and would deprive fiscal sponsors of access to advice and guidance.

Separately Identified by Reference to Contributions of a Donor

In defining what constitutes a DAF, Code section 4966(d)(2)(A) includes three prongs, all three of which must be satisfied for a fund to meet the definition of DAF. The first of those prongs requires that the fund or account be "separately identified by reference to contributions of a donor or donors". The proposed regulations vastly expand the concept of what it means for a fund or account to be separately identified by reference to contributions of a donor or donors, compared to long-established understanding in the sector of what a DAF is. Under the proposed rules, the sponsoring organization need only "maintain a formal record of contributions to the fund or account" to be considered a DAF. Even if no formal record of such contributions exist, under proposed regulations section 53.4966-3(b)(2), a fund or account is separately identified if other facts and circumstances are met. A few of the factors discussed in the proposed regulations

[8] Joint Committee on Taxation's Technical Explanation of H.R. 4, The "Pension Protection Act of 2006," As Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006, JCX-38-06, pp. 342-343.

relate to whether the fund is referred to as a DAF or whether there is an agreement or understanding that the fund is a DAF. However, other factors suggest that merely maintaining accurate accounting records or providing reports to donors is sufficient for a fund or account to be "separately identified" by reference to a donor. For charities that are required to issue receipts to their donors and track and appropriately aggregate gifts for public support purposes, this interpretation of "separately identified by reference to a contribution" effectively makes any fund meet the first prong of the test.

Such an expansive definition, if adopted, would sweep into the definition of DAF huge numbers of funds not previously considered DAFs, including fiscal sponsorship funds. The type of financial accounting referenced in the proposed regulations is standard across far more types of funds than just DAFs. As noted above, detailed financial accounting and reporting is common, and arguably required, for fiscal sponsors. Outside of fiscal sponsorship, countless charities segregate funds for specific projects or initiatives, and they all have to provide receipts and track donations for public support purposes. As with fiscal sponsorship, it is routine and consistent with transparency, accountability, and compliance obligations to provide regular and detailed reports about the activities and expenditures for each of those funds to donors.

Advisory Privileges.

The third prong of the statutory definition for DAFs requires that the donor, or donor advisor, has or reasonably expects to have advisory privileges arising from the individual's status as a donor and with respect to their contribution. As noted above, many fiscally sponsored projects have advisory committees that include donors or individuals identified or recommended by donors. Further, if a member of the advisory board makes a contribution to the project, regardless of how small, they become a donor. Even where no formal advisory committee structure exists, donors sometimes consult with their grantees about the work they are funding, evaluate progress, and receive formal and informal reports on project income and expenses. Donors sometimes offer, and grantees routinely seek, advice and guidance with respect to the best strategies and tactics for furthering the charitable work. These conversations often include discussion related to investments and expenditures. Accordingly, many fiscally sponsored projects will meet the third prong of the DAF. While we believe a minority of fiscally sponsored projects could fall within the definition of DAF as it was previously understood, sponsors often sought to avoid such classification by relying on the pooled fund approach, on advisory committees, or both. Eliminating or significantly restricting the ability for fiscally sponsored projects to benefit from advice and guidance offered by donors or individuals identified by or otherwise connected to donors will limit the effectiveness and efficiency of thousands of charitable projects.

Distributions in the Context of Fiscal Sponsorship

Fiscal sponsorship involves a wide array of activities, including but not limited to grantmaking. If the proposed regulations are enacted as proposed, sweeping in many fiscal sponsorship funds, all distributions from such fiscal sponsorship funds would be subject to the expenditure responsibility requirements described in the statute and proposed regulations. This would present unique challenges beyond anything most traditional DAFs would face. While a few DAFs

engage in direct charitable activities, fiscally sponsored projects often conduct charitable activity and have direct expenses.

Proposed §53.4966-1(e)(1) provides that "[t]he term distribution means any grant, payment, disbursement, or transfer, whether in cash or in kind, from a donor advised fund." Unlike Code section 4945(d)(4) that requires expenditure responsibility for grants[9], the proposed regulations are not so limited. Accordingly, all distributions other than grants to excepted public charities, including payments made in furtherance of the charitable purposes of the project, would result in taxable expenditures unless the fiscal sponsor exercises expenditure responsibility with respect to the payment. Expenditure responsibility was designed to apply to grants and some of its requirements are inoperable when applied to payments for goods or service contracts. If proposed regulations are enacted as drafted, fiscal sponsorship projects would be unable to hire staff or contractors; could not buy supplies or equipment; could not retain lawyers, accountants, fundraisers, or other consultants; and would not be able to pay for travel, hotels, conferences or other expenses in furtherance of the charitable project's purposes. They could no longer conduct charitable activity. Such restrictions would make fiscal sponsorship impossible.

Summary of Recommendations

To address these concerns and ensure that enhanced regulation of DAFs does not eliminate or significantly restrict the effectiveness and availability of fiscal sponsorship as a tool for the charitable sector, we suggest several changes to the proposed regulations. Some suggestions are offered to exclude fiscal sponsorship from the definition of a DAF. Even if those suggestions are adopted, the remaining recommendations will help ensure that other programs and initiatives housed at public charities are not inadvertently included in the definition of a DAF. If the recommendations eliminating all or most fiscal sponsorship funds from the DAF definition are not adopted, the recommendation to harmonize the expenditure responsibility rules must be adopted or the practice of fiscal sponsorship and all its benefits will be severely crippled as a practice, if not destroyed. The suggested changes are:

- Exclude fiscal sponsorship from the definition of DAF.
- Exempt funds advised by a committee not controlled by a donor.
- Exclude multi-donor funds from the definition of a DAF.
- Exclude private foundations from the definition of donor.
- Harmonize the expenditure responsibility rules applicable to DAFs and PFs.
- Remove the prohibition on lobbying from the ER rules as they apply to DAFs.
- Delay the effective date.

[9] Under section 4945(d)(4) the term "taxable expenditure" includes any amount paid or incurred by a private foundation as a grant to an organization (other than an organization described in section 509(a)(1), (a)(2), or (a)(3) (other than an organization described in section 4942(g)(4)(A)(i) or (ii)) or in section 4940(d)(2)), unless the private foundation exercises expenditure responsibility with respect to such grant.

Exclude Fiscal Sponsorship From the Definition of a DAF

In articulating when a fund will be considered separately identified with respect to a donor, the proposed regulations include facts and circumstances to be considered. Proposed § 53.4966-3(b)(2) includes, among other considerations, whether the fund is named after one or more donors, whether the sponsoring organization refers to the fund as a DAF, and whether there is an agreement that the fund is a DAF. How a fund is marketed should also be considered. To recognize the distinction between DAFs and fiscally sponsored projects, the regulations should include a list of factors that indicate that a fund is not a DAF. Those factors could include a) that the fund is named for a specific program or initiative of the sponsor; b) the sponsoring organization refers to the fund as a fiscally sponsored project or other initiative; c) the sponsoring organization has a written agreement the donors that the fund or account is a fiscally sponsored project or other initiative; and d) the sponsoring organization markets or otherwise promotes the services it provides as fiscal sponsorship. Other factors could include that contributions are held in a restricted account, contributed funds are generally not held for a period longer than three years, and the fund regularly seeks addition support to fund ongoing work. The Commissioner's authority to look at the substance of an arrangement, not merely its form, is sufficient to address potential abuse.

Exempt Funds Advised by a Committee Not Controlled by a Donor

Code Section 4966(d)(2)(B)(ii) requires that the advisory committee of a scholarship fund seeking exception from DAF characterization not be controlled directly or indirectly by a donor, donor advisor, or persons related to a donor or donor advisor. However, the donor or an individual selected by the donor may still sit on the committee. Similarly, Code Section 4966(d)(2)(C)(i) grants the Secretary authority to exempt other funds from the definition, and that was used to exempt certain disaster relief funds. That section states that a donor may serve on an advisory committee so long as the donor does not control the committee directly or indirectly. This application should exclude all funds from classification as a DAF if the donor's advisory privileges arise from their service on a committee that they do not control. That is the appropriate standard in other instances and there is no reasonable justification for additional limitation. The proposed regulations go too far in limiting donor participation on committees or even in identifying and recommending other participants.

Exclude Multi-donor Funds From the Definition of a DAF

Funds and accounts that are able to attract support from multiple unrelated donors, none of whom control the fund, represent a much lower risk of abuse and should be exempted from the definition of a DAF. The concept that a broad base of support is meaningful from a legal compliance and anti-abuse perspective should apply to projects in the same manner that it applies to publicly supported public charities as a whole. Further, because multi-donor funds are, by definition, housed at a pubic charity, that provides an additional layer of stakeholder engagement to identify and prevent abuse. This is consistent with the explanation in the Joint Committee on Taxation's Technical Explanation and should be preserved.

Exclude Private Foundations from the Definition of Donor

The notice states that the regulations do not explicitly exclude private foundations from the definition of donor because they could use a DAF to circumvent the payout and other requirements that are applicable to private foundations. Yet the proposed regulations do not include any provisions that specifically identify or seek to address such uses. Other prohibitions that do apply by virtue of a fund being classified as a DAF do not make sense when applied to a donor who is a private foundation. For example, a grant from a DAF that results in a more than insubstantial benefit to a private foundation doesn't present legal challenges because any such benefits necessarily have to be used to further charitable purposes.

Thus, a DAF distribution that results in tickets to an event is not abusive if the private foundation uses those tickets to further its mission. Indeed, the private foundation could make such contributions directly and would not violation any restrictions. To the extent that a DAF distribution might be used to confer an impermissible benefit on a disqualified person of the private foundation, ample authority already exists to penalize such abuses under Section 4941 and its accompanying regulations on self-dealing. Rules that prevent a foundation from doing indirectly what it can do directly, and where no other abuses or tax principals are violated, make little sense.

Concerns about private foundations using DAFs to circumvent other rules, such as to buttress a grantee's public support calculation, are better addressed where those private foundation rules are articulated. Further, would-be private foundation abusers can easily avoid DAF classification either by establishing single-entity funds or by deliberately avoiding the factors (financial accounting, reporting, calling the fund a DAF, or naming it after the donor) that are needed for an account to qualify as a DAF. Alternatively, funds can be routed through multiple accounts at different organizations before ultimately ending up in accounts or organizations where the abuses can still be perpetrated. While the Secretary has, and should have, authority to disregard a series of transactions to prevent abuse, such authority is only useful once the abuses are detected. The likelihood of detecting these abuses is low. Accordingly, the rules, if adopted, are more likely to curtail effective and legitimate charitable activity than to dissuade or penalize intentional circumvention.

Expenditure Responsibility Requirements for DAFs and PFs Should be the Same

If some project funds at public charities continue to fall within the definition of a DAF once the regulations are formalized, those funds may still be able to conduct some of their activities if the rules that apply to them are substantially the same as the rules that apply to private foundations. Private foundations have been subject to and following the expenditure responsibility rules under section 4945 for over 50 years. Many public charities that are not required to follow expenditure responsibility do so anyway as a best practice for some grants. Non-charities, including other exempt organizations that do important charitable work consistent with their exempt status, are familiar with the requirements and have the process and systems in place to manage such grants and comply with the restrictions imposed on them by donors. There is considerable guidance giving all organizations affected by those rules great comfort in knowing how to follow them.

The possible extension of the expenditure responsibility rules from grants and PRI's to all distributions from DAFs to non-charities has for seventeen years introduced unnecessary confusion, inconsistency, and administrative burdens. Because the expenditure responsibility rules were written to apply only to grants, they are effectively impossible to apply outside of the grant context. For example, a sponsor using funds from a DAF to purchase supplies for an after school program would have to require the store selling the supplies to keep the funds in a separate account, commit to using them solely to further charitable purposes, and provide reports back to the charity until the funds are fully expended. This is impossible in a commercial context.

Other rules can better address concerns about this kind of abuse without destroying the ability of DAFs to carry out good charitable work. To the extent distributions from a DAF are being made in a manner that suggests the donor has retained control, the IRS could penalize the donor by disallowing their deduction for each donation to the fund, and treating each donation as an incomplete gift. If a payment to a non-charity for goods or services furthers exempt purposes, is fair and reasonable to the charity, does not result in an impermissible benefit, and does not otherwise demonstrate effective control over the funds by the donor, it is not clear why such distributions should be prohibited from DAFs. Private foundations can and regularly make such payments in carrying out their charitable purposes, and they are able to do so without expenditure responsibility and count them as qualifying distributions under section 4942. The rules that apply to DAFs should be no more stringent than the rules that apply to private foundations.

Remove the Prohibition on Lobbying From the ER Rules as They Apply to DAFs

Private foundations are prohibited from funding lobbying. Thus, the rules that allow private foundations to fund non-charities require that the written agreement expressly prohibit lobbying. Public charities are not prohibited from funding lobbying. Donors may fund lobbying through public charities, and DAF sponsors, as public charities, are still required to comply with lobbying limits that apply to the sponsor at the entity level. Therefore, there is no policy rationale or anti-abuse justification for extending the private foundation prohibition on lobbying to funds granted out of a DAF. To the extent that the IRS is concerned that a private foundation may fund a DAF and then recommend grants from the DAF that support lobbying, the IRS should address that concern by updating the rules under section 4945.

Delay the Effective Date

The notice indicates that the new rules would apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulations. Organizations that have funds that they have not previously understood to fall within the definition of a DAF will need time to make changes to the funds to ensure they continue to fall outside of the definition, or to prepare for them to comply with the regulations. In the case of fiscal sponsorship, the sponsor may need to renegotiate thousands of fiscal sponsorship agreements and revise policies to impose new restrictions on the fund, such as prohibiting grants to individuals or exercising expenditure responsibility for all distributions to non-charities. Projects that cannot comply, such as those that conduct direct charitable activities, may have to shut down their activities and

properly dispose of funds and assets, transfer the project, or make other plans such as helping its served population find assistance elsewhere.

If the regulations go into effect before the end of the year, the effective date could be retroactive to January 1, depriving a sponsor of the opportunity to make such changes and subjecting it to penalties for activity that has already taken place. During this period of uncertainty, sponsoring organizations are faced with the impossible choice of shutting down funds that do important work and that they believe should not be characterized as DAFs or risk incurring penalties if the regulations ultimately apply to them. Accordingly, the regulations should not go into effect in 2024 and the effective date should be delayed such that organizations be given a minimum of six months between when they are published as final regulations and the start of the first tax year to which they will apply**.** To the extent that retroactive application is necessary to prevent significant abuse that the IRS believes it does not have the current authority to penalize, the retroactive applicability of these rules should be narrowly tailored to apply only to such abusive activities.

These comments were prepared by Andrew Schulz, Rosemary Fei, Shirley McLaughlin, and Stephanie Petit of Adler & Colvin. If you have any questions or would like to discuss these comments, please contact Adler & Colvin at (415) 421-7555 or aschulz@adlercolvin.com.

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