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February 5, 2024

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

To Whom It May Concern:

San Diego Foundation is writing to provide comments to the Department of the Treasury (Treasury) and the Internal Revenue Service's (IRS) notice of proposed rulemaking regarding "Taxes on Taxable Distributions From Donor Advised Funds Under Section 4966" (REG-142338-07). We appreciate Treasury and the IRS' work to publish this proposed rule.

This letter outlines our concerns regarding several provisions in the proposed regulations including the overly broad definition of a donor advised fund (DAF), the overly narrow exceptions for certain types of non-DAFs, the immediate effective date of final regulations, and the classification of a personal investment advisor as a donor advisor.

Background

Community foundations like San Diego Foundation are among the original sponsoring organizations of donor advised funds in the United States and have used them alongside other tools of community philanthropy for many decades to support local nonprofits and build more thriving communities for all. Donor advised funds give donors who partner with community foundations the flexibility they need to be responsive to the evolving needs of their communities.

San Diego Foundation is a regional, place-based foundation serving 3.3 million people throughout San Diego County, the second largest county in California. San Diego Foundation granted more than \$130 million to nonprofits in FY2023 the majority of which came from donor-advised funds - and awarded more than \$4 million in scholarships to local students, the largest number of scholarships provided in the county outside university systems. San Diego Foundation stewards \$1.5 billion in local community assets including through DAFs, field of interest funds, giving circles, designated funds, agency funds, fiscally-sponsored projects, and more.

The Pension Protection Act of 2006 has been the guiding regulatory framework for community foundation stewardship of donor advised funds for the past 17 years, with sophisticated systems and strategies enacted across the sector over that time frame to maximize the positive local charitable impact of DAFs. In California, DAFs play an especially important role in supporting disaster resilience initiatives, and in smoothing turbulent revenue flows to nonprofits during emergencies, crises, and economic downturns.

Key Concerns

As written, we believe several components of the proposed regulations would significantly disrupt the ability of most California community foundations to mobilize place-based, community-driven philanthropic investment. We respectfully request that Treasury and the IRS take these concerns into consideration in drafting the final regulations.

Definition of Donor Advised Fund

We are concerned that the definition of a donor advised fund set forth in the proposed regulations is too broad and could cause several common and widespread types of non-DAF accounts at community foundations to become treated as DAFs, potentially including:

- **Field of interest funds, giving circles, and other collaborative or pooled giving accounts:** Nearly all community foundations in California host field of interest funds, giving circles, and/or other collaborative grantmaking initiatives through which donors with a shared giving focus pool individual contributions into a single account and work collectively with the community foundation to identify the giving strategy and distributions. These accounts are clearly not DAFs and there is no single donor (whether an individual, family, or organization) who has exclusive advisory privileges over a given account, but this could now be considered a DAF under the proposed regulations.
- **Fiscally-sponsored projects:** Many California community foundations serve as fiscal sponsors for charitable projects in their local communities that do not have independent tax-exempt status. A typical fund agreement between a community foundation and a fiscally-sponsored project identifies authorized individuals affiliated with the sponsored group or project to submit requests for distributions from the fund as needed to cover expenses incurred in carrying out the project. These requests are subject to oversight and final approval by the community foundation to ensure all distributions are used for exclusively charitable purposes consistent with those stated in the fund agreement. These funds are clearly not DAFs, but the fact that community foundations separately identify the accounts by reference to one or more donors, maintain ownership over the accounts, and allow authorized individuals to request distributions from the accounts, could mean the account is now considered a DAF under the proposed regulations.

We encourage Treasury and IRS to consider providing additional exceptions to funds considered DAFs that include funds such as those outlined above, to ensure that community foundations may continue to provide local donors with a variety of flexible giving vehicles to support charitable causes.

Exceptions to the Definition of a Donor Advised Fund

We appreciate the clarification in the proposed regulations that certain scholarship and disaster relief funds at community foundations are not considered DAFs. The majority of scholarships from California community foundations to local students are awarded based in part on the guidance of selection committees that are often comprised of both donors to the scholarship fund and non-donor community members. We appreciate the clarification in the proposed regulations that donors can sit on selection committees for these scholarship funds, and that scholarship funds set up by broad-based membership organizations such as Rotary clubs are not considered DAFs. Likewise we appreciate the exception for certain disaster relief funds set up in response to a federally-declared disaster event. Community foundations in California are frequently on the front lines of the local philanthropic response to disasters and emergencies, often setting up relief funds within hours or days of a disaster event to mobilize critical resources that help the most vulnerable disaster victims in their time of greatest need.

We are concerned that the exemption for federally-declared disasters is overly narrow. In January 2024, unexpectedly heavy rainfall in a short period of time caused devastating flooding and mudslides in low-income communities in San Diego County. Within a few days, San Diego Foundation launched emergency relief funds and mobilized hundreds of thousands of dollars from many donors to help the most impacted, underserved and displaced storm survivors. Because this event did not receive a federal disaster declaration, these relief funds, which are clearly not DAFs, could fall under the DAF definition in the proposed regulations.

We encourage Treasury and the IRS to expand the exemption for disaster relief funds to include those funds set up in response to disaster events that receive a disaster or emergency declaration from a state or local government, in addition to those that receive a federal declaration.

Personal Investment Advisors

San Diego Foundation is concerned with treating personal investment advisors as donor-advisors and not just as an investment advisor defined in section 4958(f)(8).

The proposed regulations are overly broad and could negatively impact the many community foundations that allow DAF assets to be managed by a donor's personal investment advisor. Long-term trust-based relationships with personal investment advisors can help donors become more engaged with the local philanthropic initiatives of a community foundation and can lead the donors to ultimately give more to important charitable causes in the community. The proposed regulations assume that a direct conflict of interest occurs when an investment advisor manages the assets in both a DAF and in a donor's personal investment account(s). However, the potential for a conflict of interest in these scenarios is already addressed and mitigated by existing rules under section 4967 which penalize donors who receive more than an incidental benefit resulting from a DAF distribution. State and federal laws also already address conflicts of interest.

Classifying investment advisors as donor-advisors would represent a major disruption that is likely to reduce charitable giving from these DAFs at community foundations. In many cases a donor advised fund at a community foundation is one of the most efficient and effective ways to achieve a donor's charitable goals. When compared to private foundations, DAFs at community foundations typically demonstrate higher rates of outgoing grants to nonprofits with lower administrative costs. The proposed regulations could create an uneven playing field by discouraging donors from using DAFs at community foundations in favor of setting up new private foundations in order to maintain their preferred investment advisor relationship vis-a-vis their philanthropic assets. Setting out reasonable guidelines for personal investment advisors to safeguard against any preferential compensation or discount to the donor or the investment advisor would be a better alternative to disrupting the proven model of these common, popular, and effective charitable giving programs at many community foundations.

Advisory Committees

San Diego Foundation encourages Treasury and IRS to consolidate the slightly different rules on advisory committee service outlined in the proposed regulations in order to provide clarity to the vast majority of community foundations that frequently use advisory committees to guide distributions from and lend community voice to many types of funds including scholarship funds, field of interest funds, disaster relief funds, and more.

We encourage Treasury and IRS to consider the framework that already exists for scholarship selection committees. In this framework a community foundation appoints individuals to a selection committee that may include donors or related persons. The donors or related persons may not have a controlling voice or deciding vote on the committee. A donor's service on an advisory committee to which they are appointed by a community foundation would not result in advisory privileges over that fund as long as (1) the appointment is based on objective criteria; and (2) no individual donor, including relatives of the donor, make up a majority of the committee.

San Diego Foundation is also concerned about the term “recommend” in the second rule for advisory committees which states that a committee must include a majority of members not recommended by the donor or donor-advisor. Further definition is needed to clarify what constitutes a recommendation and whether it needs to be in writing or can be mentioned informally. We suggest using established rules around direct and indirect control to determine recommendations and ensure that the donor or donor-advisor does not maintain control of the advisory committee.

Effective Date

San Diego Foundation is concerned about the final rule’s immediate effective date and we strongly recommend the addition of a reasonable transition period. Sudden changes to DAF administration in the middle of a community foundation’s fiscal or tax year will impose significant disruption, high administrative costs, and potentially serious legal implications - including for those with active contracts with professional advisors when the final rules go into effect. San Diego Foundation recommends that the final rules take effect no sooner than two tax years after publication in the Federal Register, providing time for a smooth transition for donors, donor-advisors, community foundations, and nonprofit partners.

Definition of a Significant Contributor

Treasury and IRS have requested specific feedback on what constitutes a “significant contributor” for purposes of the advisory committee exception to the definition of a donor or donor-advisor exercising advisory privileges over a fund. We recommend a minimum of 51% of total dollars contributed to a fund as a reasonable threshold by which a donor would be considered a “significant contributor” to a fund for which they serve on an advisory committee.

We thank Treasury and the IRS for this opportunity to submit comments on “Taxes on Taxable Distributions From Donor Advised Funds Under Section 4966” (REG-142338-07).

As Treasury and the IRS finalize this rule and consider additional regulations, we encourage you to continue engaging with community foundations to protect the most positive impacts of DAFs on community philanthropy and to minimize unintended negative consequences on local giving.

San Diego Foundation is eager to work with Treasury and the IRS to ensure any rules impacting DAFs encourage charitable giving and reduce administrative burden so that flexible and responsive charitable dollars continue to flow from community foundation DAFs to nonprofit organizations.

Sincerely,



Mark A. Stuart, CFRE
President & CEO
San Diego Foundation