

Senate Bill Proposes Dramatic Changes for Donor Advised Funds and Private Foundations

On June 9, 2021, United States Senators Angus King (Ind.-ME) and Charles Grassley (R-IA) introduced the "[Accelerating Charitable Efforts Act](#)" or the "ACE Act" (the "Act") which, if adopted, would implement significant changes with respect to the rules surrounding donor advised funds ("DAFs") and private foundations. The proposed changes, already being hotly debated in the philanthropic community, would mandate, among other things, operational changes for DAF sponsoring organizations and offer financial incentives (in the form of both excise taxes and tax benefits) to motivate donors, sponsoring organizations, and private foundations to distribute funds to public charities at a rapid pace.

Following is a high-level summary of certain key provisions of the Act:

Donor Advised Funds

DAFs were first defined in 2006 under Section 4966 of the Internal Revenue Code of 1986, as amended (the "Code"). A DAF is a fund or account owned and controlled by a 501(c)(3) public charity "sponsoring organization" which (i) is separately identified by reference to contributions from a donor or donors and (ii) with respect to which the donor, or any person appointed or designated by the donor has, or reasonably expects to have, advisory privileges over the distribution or investment of the amounts in the fund or account. Under current law, a donor can generally claim a charitable contribution deduction in the tax year in which they make a contribution to a DAF and, over time, can recommend charitable distributions, generally to other public charities, from the DAF.

New Categories of DAFs

The Act establishes three new categories of DAFs with different rules for each with respect to deductibility of contributions and requirements relating to the timing of charitable distributions from DAFs—(1) Qualified DAFs, (2) Qualified Community Foundation DAFs, and (3) Nonqualified DAFs. The proposed changes would take effect for contributions to DAFs taking place after the enactment of the Act.

1. Qualified DAFs

Definition: Under the Act, a Qualified DAF is a DAF established through an agreement with a sponsoring organization under which, for the duration of the DAF's existence, any advisory privileges of a donor (or their designee) with respect to any contribution (including any earnings therefrom) would end before the last day of the 14th taxable year beginning after the taxable year in which the contribution is made.

Contributions Generally: In addition to the existing requirements for deductibility of contributions to DAFs, contributions to a Qualified DAF would be deductible only if the donor identifies a preferred organization to receive distributions of amounts contributed (and the earnings attributed to each specific contribution) that have not been distributed before the end of the last day of the 14th taxable year beginning after the taxable year in which the contribution was made.

Contributions of Non-Publicly Traded Assets and the Charitable Deduction: For donations of non-publicly traded assets to a Qualified DAF, no charitable deduction would be allowed until the sponsoring organization sells the contributed assets. The amount of such deduction would be limited to the amount of the gross proceeds received from such sale and credited to the donor's DAF.

Tax on Contributions not Distributed Within Specified Time: Any portion of a contribution to a Qualified DAF (and the attributable earnings) which is not distributed by the last day of the six months following the last day of the 14th taxable year beginning with the year after the contribution is made is subject to a 50% tax (effectively creating a 15-year distribution rule).

Contemporaneous Written Acknowledgments: The Act modifies the requirements applicable to contemporaneous written acknowledgments ("CWAs") issued to donors (used by the donor to substantiate their charitable deduction). In addition to other items, CWAs would require the DAF sponsoring organization to provide certification of the sale of a non-publicly traded asset, the amount of the gross proceeds received from the sale and credited to the DAF, and a statement that the deductible amount of the contribution may not exceed the amount of such gross proceeds. The acknowledgement would have to be provided within 30 days of the date that the gross proceeds from the sale are credited to the DAF. The sponsoring organization would be required to report on the information in the acknowledgment in a manner to be determined.

2. Qualified Community Foundation DAFs

Definition: A Qualified Community Foundation DAF is a DAF held at a "qualified community foundation" for which either (i) each individual with advisory privileges with respect to the DAF does not have advisory privileges over other DAFs at the qualified community foundation with an aggregate value at any time in excess of \$1,000,000 (as adjusted for inflation) or (ii) the DAF is established under an agreement that requires qualifying distributions from the DAF to equal at least 5% of the DAF's value (calculated as of the last day of the preceding calendar year).

A "qualified community foundation" is an organization (i) described in Code Section 501(c)(3); (ii) which is organized and operated for the purpose of understanding and serving the needs of a particular geographic community that is no larger than 4 states by engaging donors and pooling donations to create charitable funds in direct furtherance of those needs; and (iii) which holds substantial assets (but in no case less than 25% of the organization's total assets) outside of its DAFs.

Contributions of Non-Publicly Traded Assets and the Charitable Deduction: For donations of non-publicly traded assets to a Qualified Community Foundation DAF, no charitable deduction would be allowed until the sponsoring organization sells the contributed assets. The amount of such deduction would be limited to the amount of the gross proceeds received from such sale and credited to the donor's DAF. No other changes would apply with respect to the deductibility of contributions to a Qualified Community Foundation DAF.

Contemporaneous Written Acknowledgments: The Act modifies the requirements applicable to CWAs issued to donors and, in addition to other items, would require certification of the sale of a non-publicly traded asset, the amount of the gross proceeds received from the sale and credited to the DAF, and a statement that the deductible amount of the contribution may not exceed the amount of such gross proceeds. The acknowledgement would have to be provided within 30 days of the date that the gross proceeds from the sale are credited to the DAF. The community foundation would be required to report on the information in the acknowledgment in a manner to be determined.

3. Nonqualified DAF

Definition: A Nonqualified DAF is a DAF that is neither a Qualified DAF nor a Qualified Community Foundation DAF.

Charitable Deductions for Contributions to Nonqualified DAFs: For Donors to Nonqualified DAFs, no charitable deduction would be allowed until the sponsoring organization makes a qualifying distribution from the applicable contribution, and the amount of the deduction would be limited to the amount of such qualifying distribution. For donations of property other than cash to a Nonqualified DAF, no charitable deduction would be allowed until the sponsoring organization sells the property for cash and a qualifying distribution of such cash has been made. For purposes of determining the availability of the deduction, distributions would be treated as being made from contributions (or earnings therefrom) on a first-in, first-out accounting basis.

Tax on Contributions not Distributed Within a Specified Time: Any portion of a contribution to a Nonqualified DAF (and the attributable earnings) which is not distributed by the last day of the six months following the last day of the 49th taxable year beginning with the year after the contribution is made is subject to a 50% tax (effectively creating a 50-year distribution rule).

Contemporaneous Written Acknowledgments: The Act modifies the requirements applicable to CWAs to require certification of the sale of non-cash property and the amount of cash received in the sale, that a qualifying distribution has been made from such contribution, the amount of the qualifying distribution, and a statement that the deductible amount of the contribution may not exceed the amount of the qualifying distribution. The acknowledgement would have to be provided within 30 days of the qualifying distribution. The sponsoring organization would be required to report on the information in the acknowledgment in a manner to be determined.

DAFs and the Public Support Test

In determining whether a public charity is publicly supported, an organization generally includes contributions from a donor in its public support calculation only to the extent that such person's total contributions to the organization during the taxable period do not exceed 2% of the organization's total support during such period (the "2% limitation"). Grants from a publicly supported organization described in Code Section 170(b)(1)(A)(vi) (and certain governmental units) are not subject to the 2% limitation, and 100% of the grant can be included in the public support calculation.

Under the Act, despite the public charity status of sponsoring organizations, the treatment of their support by public charity grantees in their public support calculations would be treated differently.

All amounts from a sponsoring organization would be treated as made by "one person" and subject to the 2% limitation. If the support is "identified with a donor or a donor advised fund" and the donor is identified by the sponsoring organization (such as "This grant was made at the recommendation of the Patterson Belknap Fund") the support would be treated as made by the donor. This would mean that for purposes of the 2% limitation, the DAF contribution is aggregated with any other contributions from that donor. Only support from a sponsoring organization that specifies that (i) the amount is not from a DAF and (ii) no donor (or any designee of the donor) had advisory privileges with respect to the support provided would be considered public support and not subject to the 2% limitation. For example, distributions from "field of interest" funds of the type managed by some sponsoring organizations, which support particular causes without the advice of donors, could be considered donations from the sponsoring organization itself.

This change would take effect for contributions made in taxable years beginning after the date of the enactment of the Act.

Private Foundations

1. Investment Tax

Under Code Section 4940, private foundations are currently subject to a 1.39% tax on investment income (generally, interest, dividends, rents, royalties, and capital gain net income) (the "4940 Tax"). In order to encourage qualifying distributions by private foundations above the 5% currently mandated under Code Section 4942, the Act exempts a private foundation from the 4940 Tax if one of the following applies:

The 7% Exception. A private foundation would not have to pay the 4940 Tax in any year in which it distributes at least 7% of the aggregate fair market value of the excess of (i) all assets of the foundation (other than those which are used (or held for use) directly in carrying out the foundation's exempt purpose) determined as of the first date of the taxable year over (ii) the acquisition indebtedness with respect to such assets (as determined under Code Section 514(c)(1)).

The Limited Duration Provision. The 4940 Tax would not apply to a private foundation which, at the time of its establishment and at all times thereafter, provides in its governing documents that it would not exist for more than 25 years and it makes no distributions to "disqualified private foundations" (defined as another private foundation with a common disqualified person).

The Act would enable the IRS to "recapture" the investment tax for the first year in which the foundation fails the relevant requirements for limited duration or makes distributions to a disqualified private foundation.

This change would take effect for taxable years beginning after the date of the enactment of the Act.

2. Distributions by Private Foundations to DAFs

The Act would treat contributions from a private foundation to a DAF as qualifying distributions under Code Section 4942 only if qualifying distributions equal to the contribution are made "out of corpus" by the end of the DAF sponsoring organization's taxable year after the year in which the contribution is received. The requirement would not apply to grants from private foundations to sponsoring organizations where no specific DAFs are designated. This requirement mirrors the requirement currently applicable to contributions from a private foundation to another private foundation.

Reporting: The private foundation would be required to report on its annual Form 990-PF grants to DAFs and the sponsoring organization (as it does now), and the recommendations made regarding DAF distributions.

The distribution requirement would apply to distributions made after December 31, 2021. The reporting requirement would apply to returns required to be filed after December 31, 2021.

3. Administrative Expenses Involving Foundation Disqualified Persons

Code Section 4942 currently provides that a private foundation's qualifying distributions generally include "any amount (including that portion of reasonable and necessary administrative expenses)" paid to accomplish the charitable purposes of the foundation, subject to certain exclusions. The Act would disallow "administrative expenses" paid to a disqualified person as defined in the Code, other than foundation managers (directors, trustees officers and others having similar responsibilities) who are not family members of substantial contributors or persons who own more than 20% of an entity that is a substantial contributor. We note that the proposed rule would not prohibit such payments (subject to applicable self-dealing rules), but would only disallow them as qualifying distributions.

This change would apply to taxable years beginning after December 31, 2021.

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These changes, if adopted by Congress, would constitute substantial changes to the operations of DAFs, their sponsoring organizations, and private foundations, and it would also affect public support calculations of many public charities. We will continue to update you as the Act moves through the legislative process.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

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