**Leonard Mendonca**
Chair, Board of Trustees
Fidelity Charitable

February 15, 2024

*Submitted electronically through http://www.regulations.gov*

Internal Revenue Service
Attn: CC:PA:01:PR (REG-142338-007)
Room 5203, P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

**Re: Taxes on Taxable Distributions from Donor Advised Funds under Section 4966: IRS - REG-142338-07**

Dear Sir or Madam:

I am writing on behalf of the Fidelity Investments® Charitable Gift Fund ("Fidelity Charitable") in response to the Department of the Treasury's (the "Treasury") and the Internal Revenue Service's (the "IRS") recently proposed REG-142338-07, Notice of Proposed Rulemaking (the "Notice") on "Taxes on Taxable Distributions from Donor Advised Funds under Section 4966" (the "Proposed Regulations").[1]

Fidelity Charitable welcomes the guidance the Proposed Regulations offer for donor-advised funds, particularly with respect to the provisions enacted as part of the Pension Protection Act of 2006 and the definitions of the terms in Section 4966. Fidelity Charitable also welcomes additional guidance on provisions added or amended in the Pension Protection Act, including under Section 4943, Section 4958, and Section 4967, and the specific issues identified in Notice 2017-73.

Fidelity Charitable — an independent public charity, separate from Fidelity Investments, and governed by an independent Board of Trustees — was established in 1991 with the mission to further the American tradition of philanthropy by providing programs that make charitable giving accessible, simple, and effective. Fidelity Charitable continues to advance philanthropy by helping donors realize their charitable objectives with an organized approach to giving, principally through the Giving Account, Fidelity Charitable's donor-advised fund program.[2]

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[1] *See* Taxes on Taxable Distributions from Donor Advised Funds under Section 4966, Docket No. REG-142338-07, RIN 1545-BI33 (November 14, 2023), available at https://public-inspection.federalregister.gov/2023-24982.pdf.

[2] Fidelity Charitable is one of the nation's largest public charities and has the largest donor-advised fund program in the United States with approximately 185,000 Giving Accounts. In 2022, Fidelity Charitable donors actively recommended 2.2 million grants—totaling $11.2 billion (a 9% increase over 2021)—to more than 189,000 nonprofit organizations. A first-in, first-out analysis of contribution and grant dollars reveals that seventy-four percent of dollars contributed to Fidelity Charitable were granted out within five years. Fidelity Charitable is honored to assist more than 300,000 donors, including donors from every state in the United States, in achieving

Across the philanthropic sector, donor-advised funds have become a vibrant and important part of the charitable giving landscape. Donor-advised funds have grown in popularity among donors at all levels of wealth because they make it easier for donors to give in a more systematic, organized, and thoughtful way, allowing them to maximize their generosity.

While the Proposed Regulations offer much-needed clarity (including the guidance to sponsoring organizations using equivalency determination[3] or expenditure responsibility[4]), certain of the proposed definitions are overly broad, adding uncertainty and confusion to a wide range of charitable activities and charitable organizations. These proposed changes would result in negative, unintended consequences, including the reduction of American charitable giving.

## I. EXECUTIVE SUMMARY

- **The proposed definition of "donor-advisor" is overly broad.** The expansive definition of "donor-advisor" is inconsistent with the statutory framework adopted in the Pension Protection Act. In particular, the Proposed Regulations would treat an unrelated, independent investment advisor as a "donor-advisor" notwithstanding the investment advisor's contractual relationship with and fiduciary obligations to the sponsoring organization, which hired the investment advisor based on and subject to its own policies and guidelines. Under the Proposed Regulations, harsh penalties would be imposed when an investment advisor is compensated for managing a donor-advised fund on behalf of a sponsoring organization and the investment advisor also manages personal assets of a donor. The proposed penalties on compensation are not necessary given existing legal protections, including:

    - Section 4958, which governs payments to investment advisors managing donor-advised fund assets and limits such payments to no more than fair-market value; and

    - The fiduciary obligations under federal and state law that registered investment advisors owe to their clients, including the public charities that sponsor donor advised funds.

- **The broad definition of a "distribution" subject to penalties could effectively prohibit a range of legitimate expenses from being paid by an individual donor-advised fund.** The definition of a "distribution" in the Proposed Regulations could impair the ability of sponsoring organizations to carry out a range of important functions, including retaining appraisers, accountants, attorneys, and auditors in connection with an individual donor-advised fund account, and could subject the sponsoring organization to harsh and unwarranted penalties. Additionally, the proposed definition is duplicative and unnecessary, as existing rules in Sections 4958

their charitable-giving goals. Since our founding in 1991 through 2022, we are proud to have made grants of nearly $73 billion to more than 382,000 grant-recipient charitable organizations, including charitable organizations in every state in the United States, to support their charitable activities.

[3] Prop. Treas. Reg. § 53.4966-5(c).

[4] Prop. Treas. Reg. § 53.4966-5(d).

("excess benefit transactions") and Section 4967 ("prohibited benefits") are tailored to prevent abuses relating to compensation and grant payments. The Proposed Regulations would have detrimental consequences, including:

- Charities that sponsor donor-advised funds could be forced to increase fees across all of their donor-advised funds to compensate for complex contributions donated to only certain donor-advised funds which necessitate the use of third-party service providers; and

- The imposition of penalties on sponsoring organizations in connection with a "series of distributions" if a donor and grantee charity plan to use the funds for non-charitable purposes, even when the sponsoring organization has no knowledge of such a plan, unfairly imposing strict liability on sponsoring organizations.

- **The proposed effective date is arbitrary and provides insufficient time to transition.** The Proposed Regulations would "apply to taxable years ending on or after [the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register]." Accordingly, the new provisions require retroactive compliance for an organization with a fiscal year-end on or after the date of publication. The final regulations should provide a reasonable transition period for the charities that sponsor donor-advised funds to comply.

## II. THE PROPOSED DEFINITION OF "DONOR-ADVISOR" IS UNNECESSARILY EXPANSIVE

### *A. The expansive definition of "donor-advisor" mischaracterizes the relationship between the sponsoring organization and its investment advisor.*

The Proposed Regulations take an over-encompassing view of who should be included in the definition of a "donor-advisor." As a sponsoring organization, Fidelity Charitable pays close attention to ensuring that no impermissible benefits flow to a donor or person related to the donor. At the same time, it is important that Fidelity Charitable has the flexibility to fulfill its charitable mission, which frequently requires retaining third parties that provide services related to charitable functions (including the investment of property held in donor-advised funds). Under the Proposed Regulations, a number of such relationships which do not give rise to any improper benefits to donors or related persons, would be severely and unnecessarily constrained. Fidelity Charitable believes that appropriate protections against abuse already exist, with Section 4966 and Section 4967 imposing harsh penalties on improper benefits conferred on donors and related persons, and Section 4958 imposing penalties on excess benefit transactions, such that the expansive definition of "donor-advisor" is not only unnecessary but in many cases counter-productive.

Fidelity Charitable objects to the Proposed Regulations' imposition of penalty excise taxes on an investment advisor that provides services to a donor-advised fund and the personal assets of a donor invested in that fund. The overly broad interpretation in the Proposed Regulations would severely limit a sponsoring organization's ability to diversify and appropriately manage its

investments and would ultimately treat donor-advised funds far more severely than private foundations, whose investments are managed by the same investment advisor that also manages the other assets of the donor. The consequence of this overreach is that, once an investment advisor is incorporated into the definition of "donor-advisor," any payment for its investment management services—irrespective of whether there was an overpayment—would be subject to the harsh penalty tax as a "taxable distribution" under Section 4966.

Section 4966 is targeted at a very specific abuse, which is the potential for the assets of donor-advised funds to be used for the direct or indirect benefit of any donor. In this context, the mere fact that an advisor manages a donor-advised fund in which a donor is invested and also manages the personal assets of the same donor does not result in a benefit to the donor.(and thus compensation for such services should not be treated as a taxable distribution). Notably, the entire statutory framework governing donor-advised funds contemplates that a fund's assets are not treated as held for or on behalf of any donor. It would be incongruous for the donor-advised fund regime to recognize that the donor is no longer treated as the owner of assets held by the fund for tax purposes, but, nevertheless, treat arm's-length fees paid by the fund (the actual legal and tax owner of the assets) to manage those assets as providing a benefit to the donor. Services provided by an investment advisor to the fund and to the personal account of a donor should not be treated as a benefit to the donor and potentially implicate the taxable distribution rules of Section 4966.

As a sponsoring organization, Fidelity Charitable takes great care with respect to the productive use of its investment assets, including the decision to retain an investment advisor. Each investment advisor is vetted and evaluated by Fidelity Charitable. Once retained, Fidelity Charitable utilizes several processes to maintain proper oversight of the investment advisor.

Investment advisors are service providers to the sponsoring organization and are under the control and direction of the sponsoring organization. These relationships should not be characterized as an extension of the donor's own advisory privileges.

### *B. The expansive definition of "donor-advisor" is inconsistent with the Pension Protection Act, which enacted the very provisions of Section 4966 that the Proposed Regulations interprets.*

The Pension Protection Act carefully applied the penalty provisions of Section 4958 to donor-advised funds, specifically providing that investment advisors are "disqualified persons" as defined in Section 4958(f)(1), and therefore subject to the penalty provisions of Section 4958 on any "excess benefit transaction."[5] The Proposed Regulations would supplant this statutory framework in the very same legislation to address "excess benefit transactions." The legislative history to the Pension Protection Act makes it clear that Congress intended for the compensation of investment advisors to be subject to the provisions of Section 4958, and not swept into the harsh penalty provisions of Section 4966 and Section 4967:

[5] *See* Joint Committee on Taxation, Technical Explanation of H.R. 4, The "Pension Protection Act of 2006," JCX-38-06 (August 3, 2006).

> The provision provides that an investment advisor (as well as persons related to the investment advisor) is treated as a disqualified person under section 4958 with respect to the sponsoring organization. Under the provision, the term "investment advisor" means, with respect to any sponsoring organization, any person (other than an employee of the sponsoring organization) compensated by the sponsoring organization for managing the investment of, or providing investment advice with respect to, assets maintained in donor advised funds (including pools of assets all or part of which are attributed to donor advised funds) owned by the sponsoring organization.[6]

The remedial provisions of Section 4958 were appropriately imposed by Congress to ensure that a sponsoring organization could carry out its charitable mission—including investment of contributed funds—without crossing a line into providing an excess benefit. Section 4967 prohibits superseding the penalty provisions of Section 4958 by expressly stating "[n]o tax shall be imposed under [Section 4967] with respect to any distribution if a tax has been imposed with respect to such distribution under section 4958."[7] Congress enacted an appropriate remedy under Section 4958, and that provision should be applied rigorously and consistently to all investment advisors of sponsoring organizations (as well as other charitable organizations).

### *C. The expansive definition of "donor-advisor" is confusing and unnecessary in light of the fiduciary obligations of investment advisors.*

Investment professionals retained by the sponsoring organization to provide investment services are governed by federal and state laws. Under the Investment Advisers Act of 1940, for example, an investment advisor has a fiduciary duty to its client—in this instance the sponsoring organization.[8] These duties include both a duty of care and a duty of loyalty.[9] The Proposed Regulations presume, without justification, that an investment advisor for a donor-advised fund who also advises an individual donor with respect to that person's own investments is acting on behalf of the donor, notwithstanding its fiduciary obligations to the fund with respect to the fund's investments. Such a presumption is unwarranted and ignores the role of the primary federal and state regulators of investment advisors. Further, to the extent any conflict of interest arises due to the nature of the relationship with the investment advisor, such federal and state laws require the conflict to be eliminated, mitigated, or disclosed.

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6 *Id.* at 348.

7 *See* Treas. Reg. § 4967(b).

8 Investment Advisers Act Release No. 5248, 17 CFR Part 276 (June 5, 2019).

9 *Id.*

***D. The expansive definition of "donor-advisor" ignores the sponsoring organization's obligations to ensure that its property is invested prudently for the charity's own purposes, and that its activities serve exclusively charitable purposes.***

As a charitable organization exempt under Section 501(c)(3), a sponsoring organization is already obligated to be organized and operated exclusively for charitable purposes.[10] In addition, a charitable organization has an obligation under state law to ensure that its investments serve its charitable purposes.[11] Those state law obligations include the duty of care and the duty of loyalty. A sponsoring organization is already subject to obligations to invest prudently, and appropriate safeguards and remedies already exist for any failure by the sponsoring organization in meeting those obligations. Thus, the current regulatory framework enacted by Section 501(c)(3) renders the Proposed Regulations unnecessary.

***E. There is insufficient justification for imposing an expansive definition of "donor-advisor."***

The justification accompanying the Proposed Regulations does not provide sufficient reasoning why an investment advisor that provides services both to a donor-advised fund and to the donor to such fund should be subject to the Proposed Regulations. The proposing release states "the Treasury Department and the IRS view the close relationship between a donor and his or her personal investment advisor as giving the donor influence over investment decisions with respect to assets held in the donor-advised fund comparable to that of a donor-advisor."[12] However, the donor is already subject to limitations under Section 4966. The issue is whether the purposes of Section 4966 are served by treating an investment advisor retained by the sponsoring organization as a donor-advisor. The proposed justification fails to recognize the fiduciary obligations under federal and state law that registered investment advisers owe to their clients.

The Proposed Regulations further state "a counterincentive may be created for both donors and their personal investment advisors to not advise distributions out of their DAFs to operating charities."[13] An investment advisor who does not manage the donor's private funds would have the same incentives but would not be covered by the Proposed Regulations. Moreover, any donor-advisor who held grant recommendation privileges would by that reason be a donor-advisor under existing statutory rules.

Finally, the Proposed Regulations state "a more than incidental benefit may occur if the investment advisor charges the donor a reduced fee for managing the donor's personal assets because the investment advisor also manages the assets the donor contributed to the DAF."[14] The Proposed Regulations do not limit itself to such a situation in which the fees for managing the donor's personal assets are reduced. Moreover, the appropriate remedy for such a concern

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[10] Internal Revenue Code Section 501(c)(3).

[11] *See, e.g.,* Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), enacted by forty-nine states, the District of Columbia, and the U.S. Virgin Islands.

[12] Prop. Treas. Reg. § 53.4966, 88 Fed. Reg. 77922 at 77926.

[13] *Id.*

[14] *Id.*

already exists in the provisions of Section 4958, which imposes penalty taxes on "excess benefit transactions."

### *F. The expansive definition of "donor-advisor" would unfairly impose harsh penalties even where a sponsoring organization had no knowledge of facts giving rise to the penalty.*

The Proposed Regulations would unfairly subject a sponsoring organization to harsh penalties when an investment advisor also manages the personal assets of a donor. These penalties would be applied even if the sponsoring organization has no knowledge of any such relationship. Further, if the Proposed Regulations were finalized without revision, a sponsoring organization would have no means to ensure compliance. The Proposed Regulations would impose these penalties without a requirement of a finding of an abuse, nor any finding of "knowledge" on the part of the sponsoring organization (as was included in the statute with respect to "fund management").[15] A sponsoring organization would therefore be subject to penalties if a donor-advised fund's investment advisor also advised the donor with respect to its personal assets, with no protection available for the sponsoring organization. The approach taken in the Proposed Regulations would unfairly extend the statute to impose strict liability on a sponsoring organization without a finding of actual knowledge or of any abuse by the sponsoring organization and would subject a sponsoring organization to the risk of strict liability without an opportunity for the sponsoring organization to protect itself. Such a rule is unnecessary, since Section 4958, as enacted by Congress, already addresses any abuse.

## III. THE DEFINITION OF "DISTRIBUTION" IS OVERLY BROAD AND UNNECESSARY

### *A. The definition of "distribution" should not encompass reasonable expenses in support of a sponsoring organization's charitable mission, even when allocated to individual donor-advised funds.*

Sponsoring organizations should not be constrained—not to mention subject to penalties—when incurring and allocating reasonable expenses connected with charitable activities. Incurring certain reasonable expenses are in fulfillment of the sponsoring organization's charitable mission. Moreover, Congress has enacted provisions tailored to prevent any abuses, rendering the Proposed Regulations related to the definition of "distribution" unnecessary.

In Section 4966, Congress enacted a limited definition of "taxable distribution":

> The term "taxable distribution" means any distribution from a donor advised fund—
>
> (A) to any natural person, or
>
> (B) to any other person if—

[15] *See* Section 4966 (a)(2) and Section 4967(a)(2).

(i) such distribution is for any purpose other than one specified in section 170(c)(2)(B), or

(ii) the sponsoring organization does not exercise expenditure responsibility with respect to such distribution in accordance with section 4945(h).[16]

The statutory language in Section 4966, as well as the language in Section 4958, is clear and provides a full and adequate definition, and includes appropriate and targeted penalties to prevent abuses. In fact, the legislative history of the Pension Protection Act expressly states:

> A taxable distribution does not in any case include a distribution to (1) an organization described in section 170(b)(1)(A) (other than to a disqualified supporting organization); (2) the sponsoring organization of such donor advised fund; or (3) to another donor advised fund.[17]

The Proposed Regulations would inappropriately expand the definition of "distribution." This expansive definition would then be included in the definition of "taxable distribution" in Section 4966, inappropriately and unnecessarily subjecting a wide range of expenses to penalty excise taxes. In fact, the explanation accompanying the Proposed Regulations expressly states that the Proposed Regulations "would construe the term 'distribution' broadly."[18] The Proposed Regulations go so far as to stretch the definition to include a "deemed distribution," which purports to reach "any use of DAF assets that results in a more than incidental benefit to a donor, donor-advisor, or related person."[19]

The broad definition of "distribution" in the Proposed Regulations is in contrast to the current statutory framework. Section 4958 of the Pension Protection Act already addresses the potential abuses the Proposed Regulations intend to reach. The Pension Protection Act expressly amended Section 4958(c)(2)(A) to include "any grant, loan, compensation, or other similar payment" from a donor-advised fund. The regulations under Section 4958 expressly provide that an excess benefit transaction includes any economic benefit provided "directly or indirectly" to a disqualified person.[20] The expansive definition of "distribution" in the Proposed Regulations—including the extension to "deemed distributions"— is unnecessary and would only create confusion.

Any final regulation should expressly provide that a "taxable distribution" does not include an expense borne by a sponsoring organization, regardless of whether or not the expense is separately allocated to a donor-advised fund or funds, for purposes within the scope of the sponsoring organization's charitable functions. The Proposed Regulations appropriately exclude "investments and reasonable investment or grant-related fees" from the definition of

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16 *See* Section 4966(c)(1).

17 Joint Committee Report, *supra* note 14, at 349 (citations omitted).

18 Prop. Treas. Reg. § 53.4966, 88 Fed. Reg. 77922, at 77931.

19 Prop. Treas. Reg. § 53.4966-1(e)(2).

20 Treas. Reg. § 43.4958-4(a).

"distribution,"[21] but leave other expenses of the sponsoring organization at risk of being swept into the expansive definition of "distribution."

Sponsoring organizations may incur a range of expenses in connection with carrying out their charitable mission and may also reasonably determine such expenses should be separately borne by a particular donor-advised fund. Such expenses may include fees paid by the sponsoring organization to its own accountants, attorneys, and appraisers in connection with receiving contributions of certain property. Not only are such expenses in support of the sponsoring organization's charitable mission, but potential abuses derived from these expenses are already addressed under the penalty provisions of Section 4958, as described above.[22]

### *B. The definition of "taxable distribution" should not be applied to a "series of distributions" of which a sponsoring organization has no knowledge.*

The Proposed Regulations would include what it terms "an anti-abuse rule" so that a "series of distributions" through various organizations could be deemed a "taxable distribution."[23] As a result, a sponsoring organization could—without any knowledge on the part of the sponsoring organization—risk the imposition of an unwarranted penalty under Section 4966 or Section 4967, based on a subsequent "series of distributions" giving rise to the penalty. For example, a donor to a donor-advised fund might recommend a grant to a public charity and might—without any knowledge on the part of the sponsoring organization—collude with the grant recipient charity to make an improper payment to that donor. Section 4958 already applies to both the donor and public charity, subjecting each to penalties. Under the expansive definition of "distribution" in the Proposed Regulations, however, the unsuspecting sponsoring organization could—without any knowledge of the collusion—be subject to penalty. The Proposed Regulations could impose penalties on the sponsoring organization without any knowledge on the part of the sponsoring organization, amounting to strict liability.

In fact, the Proposed Regulations themselves give an example amounting to strict liability:

> For example, if a donor advises a distribution, that the sponsoring organization subsequently makes, from a donor advised fund to Charity X and the donor ***or*** the sponsoring organization arranges for Charity X to use the funds to make distributions to individuals recommended by the donor, the distribution will be a taxable distribution from the sponsoring organization to individuals.[24]

In this example, under the Proposed Regulations, an unknowing sponsoring organization could be subjected to a penalty excise tax.

Once again, the Pension Protection Act provided a range of appropriate penalties—including Section 4958 in addition to Section 4966 and Section 4967—to address abuses. The definitional

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[21] Prop. Treas. Reg. § 53.4966-1(e)(1).

[22] *See* Section 4958(a)(1).

[23] Prop. Treas. Reg. § 53.4966, 88 Fed. Reg. 77922 at 77931.

[24] Prop. Treas. Reg. § 53.4966-5(a)(3) (*emphasis added*).

provisions of Section 4966 need not and should not be stretched to overwhelm and distort the regime put in place by the Pension Protection Act.

## IV. THE EFFECTIVE DATE OF THE FINAL REGULATIONS SHOULD BE EXTENDED

The effective date provisions[25] under the Proposed Regulations leave insufficient time to adapt to new limitations and requirements, and could have retroactive application, unfairly applying unexpected new provisions. For example, if the final regulations were to be issued in May of 2024, a sponsoring organization with a fiscal year ending June 30, 2024, might be responsible under the new regulations for actions taken in good faith as far back as July 1, 2023, more than four months before the Proposed Regulations were issued. In particular, retroactive application of the Proposed Regulations could impose potential retroactive penalties on sponsoring organizations for actions previously taken in good faith. Moreover, the effective date as stated in the Proposed Regulations leave insufficient time for sponsoring organizations to review, renegotiate, revise, and re-engineer a range of operational and contractual matters that had been put in place in good faith. As proposed, the effective date could impose substantial hardship on sponsoring organizations and could impair their ability to carry out their charitable missions. Fidelity Charitable suggests that any final regulations apply no sooner than the first taxable year beginning one year or more after the date final regulations are published in the Federal Register.

## V. CONCLUSION

While Fidelity Charitable welcomes the guidance the Proposed Regulations offer regarding Section 4966, it believes that the Pension Protection Act carefully calibrated its definitions and penalty provisions to prevent specific abuses. Fidelity Charitable opposes the sweeping scope given to the definitions of "donor-advisor" and "distribution," which would extend their reach far beyond their intended purpose and would give rise to confusion among a wide range of charitable organizations. The Proposed Regulations could cause donors to restrict giving altogether or to redirect their charitable giving through private foundations due to the increased fees. The Proposed Regulations also could cause many charitable organizations to curtail their activities and fruitful engagement with their donors and other supporters. Such consequences are not necessary. Regulations detailing more narrowly tailored definitional provisions under Section 4966 would leave in place the full range of intermediate sanctions under Section 4958, which would be applicable to donor-advised funds in the very same Pension Protection Act.

Fidelity Charitable works hard to carry out its charitable mission and is keenly focused on preventing abuses and other matters that are not in furtherance of that mission. Fidelity Charitable strives to set a high standard for itself and for all sponsoring organizations maintaining donor-advised funds and shares the goals of clear guidance that benefit the entire charitable sector and, through their charitable activities, the nation as a whole.

Fidelity Charitable is grateful for the opportunity to provide these comments on the Proposed Regulations and is pleased to provide further information, participate in direct outreach efforts

[25] Prop. Treas. Reg. § 53.4966-6.

the Treasury or IRS undertakes, or respond to questions the Treasury or IRS may have about our comments.

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Sincerely yours,

Leonard Mendonca
Chair, Board of Trustees

cc:

Lily Batchelder, Assistant Secretary for Tax Policy, Department of the Treasury
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