



Definition of a Donor-Advised Fund

Revised – September 7, 2006

The Pension Protection Act of 2006 includes the first comprehensive regulation of donor-advised funds. These new requirements generally will not take effect until the beginning of the next tax year of charities that hold assets in such funds. However, a provision barring the payment from donor-advised funds of grants, compensation and similar payments to donors, advisors, and persons related to them will take effect immediately upon the President's signature which occurred on August 17, 2006. Understanding the definition of what is a donor-advised fund also is important to the implementation of the bill's charitable IRA rollover provision because rollovers are not permitted to donor-advised funds.

Q. What is a donor-advised fund?

A. A fund must possess three characteristics to be a donor-advised fund:

- It must be separately identified with reference to the contribution of a donor or donors
- It must be owned and controlled by a sponsoring organization
- The donor or a person appointed by the donor must have, or must reasonably expect to have, the privilege of providing advice with respect to the fund's investments or distributions

If any one of these characteristics is absent, the fund is not a donor-advised fund.

Q. What does it mean for a fund to be separately identified with reference to the contribution of a donor or donors?

A. Examples of separate identification include naming the fund after a donor or persons related to the donor or tracking contributions to the fund with respect to the specific donor or donors on the organization's books.

Q. Are funds for a single designated organization or a single governmental entity donor-advised?

A. No. These funds are exempted by the legislation even if a donor provides advice with respect to investments or distributions. This exemption covers both designated funds and agency endowments.

Q. Are field-of-interest funds donor-advised?

A. Funds that attract contributions from several donors are not donor-advised as long as the fund is not tracked with reference to the gift of any particular donor. This remains the case even if the fund is advised by an advisory committee that includes some donors to the fund.

Q. Is any fund with a specific charitable purpose a field-of-interest fund?

A. No. A fund that is tracked by the gift of a particular donor is a donor-advised fund if the donor reasonably expects to provide advice about the fund's investments or distributions even if the fund agreement restricts grants to a particular purpose such as supporting the arts or improving the environment.

Q. I have a donor who would like to create a restricted fund to protect the environment. Apart from specifying the fund's purpose in the gift agreement, the donor will not provide advice about the fund's investments or distributions nor will she appoint anyone else to do so. Does specifying the fund's purpose make it a donor-advised fund?

A. No. Even though the fund will be tracked by reference to the donor's gift, the legislative history clearly differentiates between advisory privileges and legal obligations. Legal restrictions, such as a designated purpose, are not advice and will not make the fund that results a donor-advised fund.

Q. A donor would like to create a fund, to be named for the donor, to benefit arts organizations. The donor would like to recommend three individuals with expertise in the arts to serve as an advisory committee to the fund. Is this a donor-advised fund?

A. No. As long as the donor only recommends the individuals, and they are persons with expertise that can be documented, the donor will not be considered to have designated or appointed them. Therefore, the fund is not donor-advised.

Q. Are funds, such as those for giving circles or Social Venture Partners, which are established by groups of unrelated donors donor-advised funds?

A. No. As in the case of field-of-interest funds, these funds pool the contributions of several unrelated donors, the funds are not tracked by reference to the gift of any individual member of the group, and grant recommendations are a group decision. These funds are not donor-advised.

Q. Memorial funds usually have many donors. Are they donor advised?

A. A memorial fund generally is a separate fund tracked by reference to the decedent. Although the decedent is not a donor, the legislative history makes clear that contributions by related persons, such as the decedent's spouse or a child, can constitute a fund that is separately identified by the contribution or a donor or donors. If the fund is

one for which family members of the decedent will provide advice, the fund should be treated as a donor-advised fund even though it has multiple contributors unless it is otherwise exempt because it is, for example, an exempt scholarship fund or a fund designated for a single charitable organization.

Q. Are scholarship funds donor-advised if a donor is a member of the selection committee?

A. A scholarship fund is not a donor-advised fund, even if a donor or fund advisor is a member of the selection committee, if it meets the following tests:

- The sponsoring organization appoints all of the members of the committee and the donor's advice is given solely as a member of the committee;
- The donor, and parties related to the donor, do not control the committee directly or indirectly; and
- All grants are awarded on an objective and nondiscriminatory bases using a procedure that has been approved in advance by the board of directors of the sponsoring organization and the procedure is designed to ensure that all such grants meet the requirements of paragraphs (1), (2), or (3) of section 4945.

Q. What are the requirements of paragraphs (1), (2), or (3) of section 4945?

A. Grants to individuals for travel, study or similar purposes must fit into one of three categories:

- Paragraph (1) allows grants that are qualified scholarships and fellowships. These are scholarships that pay for tuition, books, room and board and so forth.
- Paragraph (2) sanctions grants that are prizes or awards. The recipient must be chosen from the general public, without any action to enter a contest or proceeding, and must not be required to provide services as a consequence of receiving the award.
- Paragraph (3) permits grants to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, testing or other similar capacity, skill, or talent of the grantee. This is the broadest category and covers, for example, awards to artists to create works of art and scholarships that do not fit under paragraph (1).

The Council publication, *Grants to Individuals by Community Foundations*, offers a detailed discussion of these requirements.

Q. Can the donor recommend the other members of a scholarship selection committee?

A. Yes, as long as it is clear that the recommendation is based on objective criteria related to the expertise of the person recommended. As an example, the legislative history states that if a donor recommends the heads of the science departments at local secondary schools to be on a committee to award grants for the advancement of sciences

at those schools, the persons so recommended will not be considered to be designated or appointed by the donor.

Q. The donor's attorney is among those she has recommended for the selection committee. May the community foundation appoint the attorney?

A. Yes, the attorney can be a member of the selection committee, but the attorney must be considered to be appointed or designated by the donor in determining whether the donor and parties related to her control the committee.

Q. Are funds that provide disaster relief or emergency hardship grants to individuals donor-advised?

A. They are not donor-advised if the donor does not sit on or designate the members of the advisory committee. We plan to ask the Treasury Department for guidance on whether funds that provide assistance to employees of a particular employer, and that are advised by employee committees, are donor-advised and, if they are, we will ask the Secretary of the Treasury to exercise his authority to exempt such funds.

The information provided here is based on our continuing analysis of the bill. Every effort has been made to ensure accuracy of these documents. However, due to the complexity of the bill and the fact that many of these provisions introduce issues that are new to the Internal Revenue Code, please understand that this information is subject to change. The information is not a substitute for expert legal, tax or other professional advice and we strongly encourage grantmakers and donors to work with their counsel to determine the impact of this legislation on their particular situations. This information may not be relied upon for the purposes of avoiding any penalties that may be imposed under the Internal Revenue Code.