ACE Act Proposes Important Changes in DAF Rules

PG Calc Featured Article, August 2021 eRate

By Craig Wruck, PG Calc Senior Advisor

No doubt, you have heard about looming changes threatening the long-established rules governing donor advised funds (DAFs). Some commentators are sounding the alarm. The Philanthropy Roundtable says the changes "would stifle charitable giving, harming those in need." Others welcome the effort to free up charitable dollars they believe have been squirrelled away for far too long. We will leave the Wagnerian *sturm und drang* to others, but it is important to understand these proposals and what may be coming our way.

On June 9, 2021, Senator Angus King (I-ME) introduced Senate Bill 1981, the Accelerating Charitable Efforts Act (the "ACE Act") with Senator Charles Grassley (R-IA) as a co-sponsor. The bill was referred to the Committee on Finance. As of this writing, there are no additional co-sponsors and no companion legislation in the House. Although legislative prognosticators give the ACE Act only a 1% chance of becoming law in its current form, parts of it could find their way into other legislation. In addition, the ACE Act is heating up long-simmering debates about donor advised funds and private foundations.

Although the ACE Act includes some significant changes to the private foundation rules, donor advised funds are the primary focus – some will say "target" – of the bill. Following is a summary of major provisions of the ACE Act that apply to donor advised funds.

New Definitions: Qualified Versus Nonqualified Donor Advised Funds

The ACE Act would establish several new definitions and create two categories of "qualified" donor advised funds. There would be new requirements and significant limitations on the charitable deduction for many contributions to a donor advised fund.

What the Act refers to as “nonqualified” donor advised funds would be subject to even more stringent rules and limitations.

A **Qualified Donor Advised Fund** would be one with a written agreement terminating the donor’s advisory privileges within 14 years following the year of the contribution. To receive a charitable deduction, the donor would be required to identify a preferred organization for a distribution if one has not been made before the donor’s advisory privilege terminates. Failure to distribute all the gift by the end of the 14th year after the year of gift would trigger an excise tax equal to 50% of the undistributed portion, payable by the organization sponsoring the fund.

A **Qualified Community Foundation Donor Advised Fund** would be one controlled by a “qualified community foundation” that meets one of the following requirements:

> **Maximum Value of Advisory Privileges** – No individual with advisory privileges for the donor advised fund would be allowed to have advisory privileges with respect to more than $1,000,000, in the aggregate, held across all donor advised funds sponsored by the qualified community foundation
>
> **Minimum Payout** – The donor advised fund would be established under a written agreement requiring qualifying distributions of at least 5% of the value of the donor advised fund’s assets in each calendar year.

A **Qualified Community Foundation** would be required to meet the following criteria:

> **Limited Regional Focus** – The foundation would be organized and operated for the purpose of understanding and serving the needs of a particular geographic community that is no larger than four states and engaging donors to create charitable funds to further those needs.
>
> **Substantial Other Assets** – The foundation would hold substantial assets, at least 25% of which are outside of donor advised funds.

NOTE: The creation of qualified donor advised funds and qualified community foundation donor advised funds could have a significant impact on institutional donor advised funds, such as those sponsored by some universities.

Restrictions on Contributions of Non-Publicly Traded Assets

No deduction would be allowed for the contribution of a non-publicly traded asset to a qualified donor advised fund or qualified community foundation donor advised fund until

the sponsoring organization sells the asset. The deduction would be limited to the amount of the proceeds credited to the account of the donor advised fund identified with the donor.

Additional Restrictions on Nonqualified Donor Advised Funds

The ACE Act would create additional restrictions on nonqualified donor advised funds.

> **No Deduction Until Distributed** – A donor to a nonqualified donor advised fund would not be allowed to claim a charitable deduction until the sponsoring organization made a qualifying distribution of the contribution, and the deduction would be limited to the amount of the qualifying distribution. Distributions would be treated as made from contributions and earnings on a first-in, first-out basis. For non-cash contributions, a donor would not be allowed to claim a deduction until the sponsoring organization sells the contributed asset and makes a qualifying distribution.
>
> **Distributed within 50 years** – Contributions to a nonqualified donor advised fund would be required to be distributed by the end of the 49th tax year after the year of the donation. A 50% excise tax would be imposed on the sponsoring organization for failure to make the required distributions.

NOTE: These restrictions on nonqualified donor advised funds would not apply to contributions of cash or publicly traded securities to a qualified donor advised fund or a qualified community foundation donor advised fund. It seems clear the intention is to diminish the appeal of donor advised funds affiliated with financial services companies.

Private Foundation Distributions to Donor Advised Funds

Although the ACE Act stops short of an outright prohibition on private foundation distributions to DAFs, it would prevent a distribution made by a private foundation to a DAF from being treated as part of the foundation's five percent annual payout unless the DAF makes a qualifying distribution by the end of its tax year following the year the funds were transferred to the DAF.

What's Next?

Reaching for a different musical analogy, is this "the end of the world as we know it" for donor advised funds? It is important to remember that the ACE Act is merely a legislative proposal by two senators, referred to committee, with no companion legislation in the

House of Representatives. The provisions in the ACE Act are a long way from becoming law.

At this point, the best advice for donors may be to keep calm and carry on while we maintain a watch for changes.

Introduction of the ACE Act has pushed ongoing debates about donor advised funds and private foundations toward the forefront. Senator Grassley has long been on record as a vocal critic of these and other charitable gift vehicles.

The politics surrounding the ACE Act could become more interesting later in this Congress. The author of the ACE Act, Senator King, is an independent who caucuses with the Democrats in the Senate. The co-sponsor, Senator Grassley, is a senior Republican. It is not far-fetched to imagine a scenario in which some provisions of the ACE Act are added to other tax legislation to keep Senator King on board with the Democrats and gain Senator Grassley's bipartisan support.