

Comments on Notice 2017-73, Request for Comments on Application of Excise Taxes with Respect to Donor Advised Funds in Certain Situations

AMERICAN BAR ASSOCIATION SECTION OF TAXATION

April 19, 2018

*The Honorable David Kautter
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20024*

Re: Comments in response to Notice 2017-73 regarding donor advised funds

Dear Acting Commissioner Kautter:

Enclosed please find our response to Notice 2017-73 which requested comments on approaches being considered by Treasury and the Service to address certain issues regarding donor advised funds (“Comments”). These Comments are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association.

The Section of Taxation will be pleased to discuss the Comments with you or your staff.

*Sincerely,
Karen L. Hawkins
Chair, Section of Taxation*

cc:

Hon. William M. Paul, Acting Chief Counsel and Deputy Chief Counsel (Technical), Internal Revenue Service

*Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
Thomas West, Tax Legislative Counsel, Department of the Treasury*

Sunita Lough, Commissioner, Tax Exempt & Government Entities Division, Internal Revenue Service

Victoria A. Judson, Associate Chief Counsel, Tax Exempt & Government Entities Division, Internal Revenue Service

Amber L. MacKenzie, Attorney, Office of the Associate Chief Counsel, Tax Exempt Government Entities Division, Internal Revenue Service

Elinor Ramey, Attorney-Advisor, Office of Tax Policy, Department of the Treasury

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by John N. Bennett, Nathan M. Doane, Dahlia B. Doumar, Robin Krause, Richard L. Sevcik, David A. Shevlin and Justin S. Zaremby. Substantive contributions were made by Jennifer Rosen and LaVerne Woods. The Comments were reviewed by Lisa L. Johnsen, Chair of the Exempt Organizations Committee. The Comments were further reviewed by Ellen Aprill of the Section’s Committee on Government Submissions and by Melissa Wiley, Council Director for the Exempt Organizations Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: April 19, 2018

I. Executive Summary

On December 4, 2017, the Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) issued Notice 2017-73¹ (the “Notice”) which requested comments on approaches being considered by Treasury and the Service to address certain issues regarding donor advised funds.

We commend Treasury and the Service for the considered analysis set forth in Notice 2017-73, and we ask that Treasury and the Service consider the following suggestions:

1. Issue clarifying guidance confirming that a distribution from a donor advised fund will not be considered as conferring a “more than incidental benefit” where a payment to purchase tickets or a membership from a charity is bifurcated, such that the amount distributed by the donor advised fund does not exceed the portion of the ticket cost that would be deductible under section 170² if paid by the Donor/Advisor (as defined below) directly, and the Donor/Advisor pays for the non-deductible portion separately.
2. Issue regulations providing that distributions from a donor advised fund to a charity in fulfillment of a charitable pledge to the same charity would not be considered to result in a more than incidental benefit to a Donor/Advisor under section 4967.
3. Amend the regulations under section 4958 to state clearly that fulfillment of a pledge will not be treated as an excess benefit transaction to conform to Notice 2017-73 and to ensure that the Code and Treasury Regulations are consistent with respect to the fulfillment of charitable pledges by donor advised funds.
4. Take no action with respect to proposed regulations regarding the potential use of donor advised funds to circumvent the public support limitations under section 170.

In short, we suggest different or modified approaches from those in Notice 2017-73 in the first, second and fourth items above. We offer the third item as a suggested clarification to ensure consistency across regulations.

II. Discussion

A. Background

The Pension Protection Act of 2006 (the “Pension Protection Act”), enacted on August 17, 2006, added provisions relating to donor advised funds to Chapter 42 of the Code. The Pension Protection Act provided a definition

¹ 2017-51 I.R.B. 562.

² References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

for donor advised funds, imposed new reporting obligations and excise taxes on certain distributions from donor advised funds and extended to donor advised funds certain of the excise taxes formerly applicable only to private foundations. The Pension Protection Act also provided new limitations on the income tax deductibility of certain contributions to donor advised funds.

Following the passage of the Pension Protection Act, the Service issued Notice 2006-109, which provided interim guidance for several of the provisions of the Pension Protection Act concerning donor advised funds and which requested both comments regarding the Notice and suggestions for future guidance with respect to changes regarding donor advised funds. On June 4, 2007, the American Bar Association Section of Taxation (the "Section") submitted comments to Notice 2006-109 (the "2007 Comments"),³ setting forth a list of recommendations with respect to the Pension Protection Act's provisions affecting donor advised funds.⁴

On December 4, 2017, the Service issued Notice 2017-73 (the "Notice"), which described approaches that Treasury and the Service are considering to address certain identified issues regarding donor advised funds and which requested comments on those issues. Specifically, Notice 2017-73 requested comments on the following issues:

1. Whether a distribution from a donor advised fund to an organization described in section 501(c)(3) (a "charity") that enables a donor, donor advisor or related person under section 4958(f)(7) (collectively, a "Donor/Advisor") to attend or participate in an event results in the Donor/Advisor receiving a more than incidental benefit under section 4967;
2. Whether a Donor/Advisor may advise a distribution from a donor advised fund to satisfy a Donor/Advisor's pledge to make a contribution to a charity; and
3. The treatment of distributions from a donor advised fund for purposes of determining whether a charity qualifies as "publicly supported."

The Notice also requested comments as to (i) how private foundations use donor advised funds in support of their purposes; (ii) whether, consistent with section 4942 and its purposes, a transfer of funds by a private foundation to a donor advised fund should be treated as a "qualifying distribution" only if the sponsoring organization of the donor advised fund agrees to distribute the funds for charitable purposes (as defined in section 170(c)(2)(B))

³<https://www.americanbar.org/content/dam/aba/administrative/taxation/migrated/pubpolicy/2007/070604irsnotice2006109.authcheckdam.pdf>.

⁴The 2007 Comments also included recommendations regarding provisions of the Pension Protection Act affecting supporting organizations, but those recommendations are outside the scope of these comments. References herein to the 2007 Comments should be deemed to refer only to those comments that relate to provisions of the Pension Protection Act affecting donor advised funds.

(or to transfer the funds to its general fund) within a certain time frame; (iii) any additional considerations with respect to donor advised funds with multiple unrelated donors under the proposed changes described in the Notice regarding treatment of donor advised fund distributions for purposes of determining public support; and (iv) methods to streamline any required recordkeeping under the proposed changes described in the Notice regarding treatment of donor advised fund distributions for purposes of determining public support.

We commend Treasury and the Service for seeking input from practitioners on these issues and appreciate the opportunity to provide our comments.

1. Certain Distributions from a Donor Advised Fund Providing a More than Incidental Benefit to a Donor, Donor Advisor, or a Related Person

The Notice requests comments from the public as to proposed regulations addressing whether distributions from a donor advised fund that pay for the purchase of tickets enabling a Donor/Advisor to attend a charity-sponsored event result in a prohibited benefit under section 4967. Section 4967(a)(1) imposes an excise tax on a Donor/Advisor if such person receives a “more than incidental benefit” from a donor advised fund distribution advised by such person. In addition, section 4967(a)(2) imposes a separate excise tax on a donor advised fund manager who knowingly agrees to make a distribution which is taxable under section 4967(a)(1).

In examining this issue, the Notice acknowledges the ongoing uncertainty regarding whether a distribution from a donor advised fund should be considered as conferring a “more than incidental benefit” where the payment to purchase tickets from a charity is bifurcated, such that the amount distributed by the donor advised fund does not exceed the portion of the ticket cost that would be deductible under section 170 if paid by the Donor/Advisor directly, and the Donor/Advisor pays for the non-deductible portion separately. The Notice cites an example where tickets to a charity-sponsored event cost \$1,000 each, and the charity indicates that the fair market value of each ticket is \$100. Per the Notice, some commentators have argued that the Donor/Advisor paying the charity \$100 in respect of the ticket’s fair market value and a donor advised fund advised by the Donor/Advisor distributing \$900 to the charity in respect of the remaining cost of the ticket does not violate section 4967 because the tax result would be the same as if the Donor/Advisor had paid the full \$1,000 cost of the ticket and claimed a \$900 charitable deduction. In the Notice, Treasury and the Service disagree with this interpretation, instead asserting that the relief of the donor advisor’s obligation to pay the full price of the ticket confers a “more than incidental benefit” under section 4967. The Notice further maintains that a prohibited benefit also arises in the similar situation where a donor advised fund makes a distribution to a charity to pay the deductible portion of a Donor/Advisor’s membership fee charged by the charity and the Donor/Advisor separately pays the nondeductible portion of the membership fee.

According to the legislative history of section 4967, Congress intended that application of the “more than incidental benefit” standard under section 4967 turn on whether a Donor/Advisor making a direct payment to a charity would have received a benefit reducing or eliminating a charitable contribution deduction to which the Donor/Advisor otherwise would have been entitled.⁵ This legislative history supports permitting bifurcation because the portion of a bifurcated distribution from a donor advised fund would be fully deductible if paid directly by a Donor/Advisor. The Section recommends that Treasury and the Service rely on this legislative history to support the position that a bifurcated distribution would not give rise to a more than incidental benefit to the extent that the portion paid by the donor advised fund would have entitled the Donor/Advisor to a full charitable contribution deduction had the Donor/Advisor made the contribution directly. We further recommend that consistent guidance be issued regarding the tax treatment of donor advised fund distributions to pay the deductible portion of membership fees, as discussed in the Notice.

2. Certain Distributions from a Donor Advised Fund Permitted Without Regard to a Charitable Pledge Made by a Donor, Donor Advisor, or Related Person

Section 4 of the Notice states that Treasury and the Service are considering proposed regulations under section 4967 that would, if finalized, provide that distributions from a donor advised fund to a charity would not be considered to result in a more than incidental benefit to a Donor/Advisor under section 4967 merely because the Donor/Advisor has made a charitable pledge to the same charity (regardless of whether the charity treats the distribution as satisfying the pledge) if the following requirements are met (the “Pledge Distribution Requirements”): (i) the sponsoring organization makes no reference to the existence of a charitable pledge when making the donor advised fund distribution; (ii) no Donor/Advisor receives, directly or indirectly, any other benefit that is more than incidental on account of the donor advised fund distribution; and (iii) a Donor/Advisor does not attempt to claim a charitable distribution deduction under section 170(a) with respect to the donor advised fund distribution, even if the donee charity erroneously sends the Donor/Advisor a written acknowledgment in accordance with section 170(f)(8) with respect to the donor advised fund distribution.

We welcome regulations that clarify that distributions from a donor advised fund used by the donee charity to satisfy a charitable pledge do not provide a more than incidental benefit to the Donor/Advisor. Such regulations will

⁵ See Joint Committee on Taxation, Technical Explanation of H.R. 4, the “Pension Protection Act of 2006,” JCX-38-06 at p. 350 (August 3, 2006) (“In general, under [section 4967], there is a more than incidental benefit if, as a result of a distribution from a donor advised fund, a donor, donor advisor, or related person with respect to such fund receives a benefit that would have reduced (or eliminated) a charitable contribution deduction if the benefit was received as part of the contribution to the sponsoring organization.”)

eliminate the need for Donor/Advisors and sponsoring organizations to answer the difficult legal question of whether a pledge is binding, will encourage increased grantmaking by sponsoring organizations and will decrease administrative costs. We also welcome any statement by the Service or Treasury which affirms the uniqueness of charitable pledges. However, because of various ambiguities in the Notice, as well as the lack of a clear rationale for certain of the administrative requirements included in the Notice, sponsoring organizations will face challenges in developing procedures to meet the Pledge Distribution Requirements. We recommend that Treasury and the Service issue clarifying guidance, as follows.

a. *Referring to the Pledge.* Under the Pledge Distribution Requirements, for a donor advised fund distribution that fulfills a charitable pledge to be treated as providing no more than an incidental benefit, the sponsoring organization must make no reference to the existence of a charitable pledge when making the donor advised fund distribution. This formalistic requirement does not appear to address any substantive concern as to the character of the distribution. We do not understand how whether or not the sponsoring organization refers to the pledge affects whether the donor advised fund distribution constitutes an incidental benefit. Instead of implementing what we view as an unnecessary and, as discussed below, uncertain requirement, we ask that Treasury and the Service confirm that a recipient charity applying a donor advised fund distribution in satisfaction of a pledge made by a Donor/Advisor will not constitute a more than incidental benefit for the Donor/Advisor under section 4967, whether or not the sponsoring organization makes reference to the existence of a charitable pledge when making the distribution. In addition, we note the need to amend the regulations under section 4958 to clearly state that fulfillment of a pledge will not be treated as an excess benefit transaction to ensure that the Code and Treasury Regulations are consistent with respect to the fulfillment of a charitable pledge by donor advised funds.

If Treasury and the Service conclude that omitting a reference to a pledge in donor advised fund/sponsoring organization communications is required, we request additional guidance on what will constitute a “reference” to a charitable pledge. We are uncertain as to what a “reference to a pledge” would include, in particular whether the words are intended to be read literally to include only a specific reference to a pledge or whether they could include conditions that could be seen as an indirect reference to a pledge. For example, sponsoring organizations often describe the purpose of a grant in transmittal letters. Grants for special projects, or which involve the provision of naming rights for Donor/Advisors, may be subject to detailed conditions. The detailed descriptions of a distribution’s charitable purpose serve a vital role in ensuring that grant funds are used by grantees for the intended charitable purpose, but the Notice does not make clear whether such descriptions could constitute indirect references to pledges. Should the Service and Treasury decide to include in regulations the provision related to “a reference

to a pledge,” we believe that the regulations need to include an unambiguous definition of “reference,” preferably one limited to direct references.

b. *No Receipt of Any Other Benefit.* Section 4967 prohibits Donor/Advisors from receiving more than incidental benefits. Thus, we wonder why the Pledge Distribution Requirement includes a reiteration of the specific prohibition on additional benefits. If a Donor/Advisor receives an additional more than incidental benefit as a result of a donor advised fund distribution, such benefit will violate section 4967. Reiterating this prohibition in the proposed regulations seems unnecessary.

If, however, the Service and Treasury decide to retain some form of specific acknowledgment that no additional benefits are being received, we recommend requiring either (i) sponsoring organizations to obtain an acknowledgment from the Donor/Advisors or (ii) donor advised fund grantees to acknowledge this point in any appropriate material (including grant agreements, transmittal letters or donor manuals) or on their websites.

c. *Claiming a Charitable Deduction.* We agree that Donor/Advisors should not be able to claim a charitable deduction on the basis of any donor advised fund distribution. Donors are able to claim a charitable deduction at the time of contribution to the sponsoring organization itself. Following that donation, the Donor no longer has any legal claim to the donated assets and cannot claim a charitable deduction when a donor advised fund distribution is made. This concept undergirds the charitable contribution regime in section 170 and is central to understanding the relationship between the charitable deductions and contributions to any public charity (including but not limited to sponsoring organizations) or private foundation. Given the clarity of section 170 on this issue, it is unclear why the incidental benefit of fulfilling a charitable pledge would involve policing of the section 170 rules as a Pledge Distribution Requirement. Whether the Donor/Advisor seeks an inappropriate charitable deduction should not affect analysis of whether the fulfillment of a charitable pledge by a sponsoring organization is considered a more than incidental benefit.

Should the Service and Treasury believe that it is necessary to include as a Pledge Distribution Requirement that a Donor/Advisor not claim a charitable deduction, we recommend that such requirement be added to the regulations under section 170, rather than in proposed regulations relating to section 4967. If it is deemed important to include some communication on this point by a donor advised fund or sponsoring organization in connection with donor advised fund gifts, a more logical approach would be to require a sponsoring organization to include a statement for Donor/Advisors on its standard forms confirming that the Donor/Advisor cannot claim a charitable deduction for donor advised fund recommendations. Sponsoring organizations also can be asked to inform donee charities that they should not provide contemporaneous written acknowledgments within the meaning of section 170(f)(8) to Donor/Advisors in response to donor advised fund distributions. However, we do not think that the sponsoring organization

should be expected to do more to ensure compliance of third parties such as Donor/Advisors or other charities. Indeed, there is little that a sponsoring organization can do to police the actions of grantee organizations that may send acknowledgment letters to Donor/Advisors who have made charitable pledges, or Donor/Advisors who use such letters to claim charitable deductions. The consequence for claiming an impermissible charitable deduction would be loss of that deduction and any applicable penalties, but, in our view, should not involve any consequence to the donor advised fund or sponsoring organization.

3. Preventing Attempts to Use a Donor Advised Fund to Avoid “Public Support” Limitations

The Notice requests comments regarding proposed regulations to address the potential use of donor advised funds to circumvent the public support limitations and, as a result, possibly circumventing the excise tax and other rules applicable to private foundations under Chapter 42 of the Code.

For an organization described in section 501(c)(3) to be “publicly supported” and thus classified as a public charity pursuant to section 170(b)(1)(A)(vi), the organization must receive “a substantial part of its support from a governmental unit referred to in Code section 170(c)(1) or from direct and indirect contributions from the general public.”⁶ Typically, an organization that normally receives at least 33 $\frac{1}{3}$ % of its support from a governmental unit or from direct and indirect contributions from the general public will be considered “publicly supported.”⁷ However, the Treasury Regulations place limitations on the amount of contributions from any one individual, trust or corporation that may be included in both the numerator and the denominator of an organization’s public support calculation. Specifically, contributions from any one individual, trust or corporation will be considered to be support from direct or indirect contributions from the general public only to the extent that the total amount of contributions by such individual, trust or corporation during the relevant calculation period does not exceed two percent of the organization’s total support for such calculation period (the “2% Limitation”).⁸ However, the 2% Limitation does not apply to contributions from organizations that themselves receive a substantial part of their support from the general public (*i.e.*, other organizations described in section 170(b)(1)(A)(vi)).⁹ Accordingly, an organization seeking to be classified as a public charity pursuant to section 170(b)(1)(A)(vi) will be able to include, in full, contributions received from other public charities in the numerator of its public support fraction.

⁶ See Reg. § 1.170A-9(f)(1)(i)-(ii).

⁷ See Reg. § 1.170A-9(f)(4)(i).

⁸ See Reg. § 1.170A-9(f)(6)(i). Though not relevant for this discussion, the Treasury Regulations contain an exception from the two percent limitation for unusual grants. See Reg. § 1.170A-9(f)(6)(ii).

⁹ *Id.* [See Reg. § 1.170A-9(f)(6)(i).]

Sponsoring organizations of donor advised funds are, by definition, public charities.¹⁰ Therefore, under applicable law contributions from a donor advised fund to an organization seeking to be classified as a public charity pursuant to section 170(b)(1)(A)(vi) (or to an organization already classified as a public charity thereunder) will be includable in full as public support to the recipient organization. We understand from the Notice that Treasury and the Service are considering treating, solely for purposes of determining whether a donee charity qualifies as publicly supported, a distribution from a donor advised fund as an indirect contribution from the donor that funded the donor advised fund (and thus subject to the 2% Limitation) rather than as a contribution from the sponsoring organization. We understand that Treasury and the Service's concern with respect to potential circumvention of the 2% Limitation applies in particular where a donor to a donor advised fund also is in a position of control at the donee charity.

Per the Notice, Treasury and the Service are considering requiring that donee charities treat: (i) a sponsoring organization's distribution from a donor advised fund as coming from the donor (or donors) that funded the donor advised fund rather than from the sponsoring organization; (ii) all anonymous contributions received (including donor advised fund distributions for which the sponsoring organization fails to identify the donor that funded the donor advised fund) as being made by one person; and (iii) distributions from a sponsoring organization as public support without limitation only if the sponsoring organization specifies that the distribution is not from a donor advised fund or states that no donor or Donor/Advisor advised the distribution.

Although we understand Treasury and the Service's concern that a donor might attempt to circumvent the 2% Limitation with the use of a donor advised fund, the existing Treasury Regulations already provide that certain contributions from public charities are subject to the 2% Limitation. Specifically, to the extent that a donor to a public charity expressly or impliedly earmarks a contribution as being for, or for the benefit of, another organization, the contribution of earmarked funds from the public charity to the recipient organization will be subject to the 2% Limitation.¹¹ To the extent that a donor makes a contribution to a donor advised fund with the express purpose of advising that such contribution be paid, as a grant, to a charity, the Service, under the existing Treasury Regulations, could deem such grant as having been earmarked by the donor for the charity.

In addition, we note that once a donor makes a contribution to a donor advised fund, that donor has relinquished control of the contributed funds, which become the legal property of the sponsoring organization of the donor advised fund. While a Donor/Advisor may retain advisory privileges over such amounts, the sponsoring organization is under no obligation to heed

¹⁰ See I.R.C. § 4966(d)(1)(B).

¹¹ See Reg. § 1.170A-9(f)(6)(v).

the Donor/Advisor's advice with respect to a particular recommended grantee.¹² Should a sponsoring organization, in its diligence process with respect to a grant recommendation, determine that a Donor/Advisor is attempting to utilize his or her donor advised fund to circumvent the 2% Limitation, the sponsoring organization could decline the grant recommendation.

Finally, as a general matter, we do not see why, absent clear abuse, a donor advised fund's grant to an organization seeking to be classified as publicly supported would be treated differently from a grant from any other public charity. Like other public charities, sponsoring organizations have discretion over the expenditure of their assets and must use their assets to fulfill their charitable purposes. Sponsoring organizations of donor advised funds include a broad array of entities—such as universities and religious organizations in addition to more traditional sponsoring organizations like community foundations and national donor advised funds. In our view, requiring public charities to differentiate between support received from many different public charities, including support from donor advised funds and other sources at the same public charity, would be complicated and unwieldy. Further, many unrelated Donor/Advisors with donor advised funds at a single sponsoring organization may advise all of their donor advised fund grants on an anonymous basis (for reasons of personal privacy, security or otherwise). Thus, in our view requiring that all anonymous or otherwise unidentified-to-a-donor contributions from a sponsoring organization be aggregated for purposes of the 2% Limitation is overbroad and potentially significantly punitive to donee charities. We believe that compliance with proposed requirements that differentiate support received from sponsoring organizations from support received from different public charities will be extremely complex and burdensome for both donee charities and sponsoring organizations.

In short, it is not clear to the Section that support from donor advised funds is, in fact, permitting charities that otherwise would be private foundations to be classified as publicly supported under section 170(b)(1)(A)(vi). We recommend that Treasury and the Service consider delaying implementation of any proposed regulations and instead further study the issue. Furthermore, we understand that one of the underpinnings of Treasury and the Service's concerns with abuse of the 2% Limitation may be that Treasury and the Service perceive that donors to donor advised funds are entitled to a more favorable charitable contribution deduction under section 170 than donors to private foundations. If this is Treasury and the Service's concern, we note that the regulations proposed in the Notice would not address that concern in any meaningful way. Even if distributions from a donor advised fund are subject

¹² See, for example, *Styles v. Friends of Fiji*, No. 51642, 2011 Westlaw 488951 (Nev. Feb. 8, 2011) in which the Nevada Supreme Court confirmed a Nevada district court ruling that, notwithstanding that a sponsoring organization "failed to attempt in any way to satisfy [the donor's] charitable goals," the donor had no interest in or control over his contribution, once made to a donor advised fund, and therefore the sponsoring organization had the discretion to reject any recommendations for use of the contribution.

to the 2% Limitation, the donors to such donor advised fund still will be entitled to the more favorable charitable contribution deduction, as sponsoring organizations typically are classified as publicly supported under section 170(b)(1)(A)(vi). If Treasury and the Service's concern does stem from section 170 charitable contribution deductions, then instead of implementing regulations to address potential abuse of the 2% Limitation, we recommend the development of procedures to ensure that sponsoring organizations exercise appropriate discretion and control over contributions made to donor advised funds.

4. Request for Public Comments

a. *How Private Foundations Use Donor Advised Funds in Support of their Purposes.* The Notice also requests public comment on how private foundations may use donor advised funds to support their purposes. Private foundations currently do so in several ways. For example, a private foundation may use donor advised funds in its grantmaking program because sponsoring organizations, many of which make grants to a broad array of other charitable organizations, may be better positioned than individual private foundations to engage in appropriate due diligence with respect to potential grantees.¹³ Private foundations also may wish to use donor advised funds in connection with gifts to foreign charitable organizations. Like private foundations, a donor advised fund may only make a grant to an organization other than those described in section 170(b)(1)(A) (*i.e.*, public charities) if the sponsoring organization exercises expenditure responsibility (as defined in section 4945(h)) in connection with the grant.¹⁴ A large sponsoring organization often may have more experience with the expenditure responsibility requirements than a small private foundation and may be better equipped to meet those requirements accurately and efficiently. In our view, use of donor advised funds by private foundations wishing to support foreign charitable organizations can help to ensure stricter compliance with the expenditure responsibility rules than direct grants from some private foundations to foreign charitable organizations.

As a general matter, sponsoring organizations of donor advised funds also may have in place better infrastructure than small private foundations. Thus, use of sponsoring organizations by small private foundations can create cost savings and efficiency in the grantmaking process. For example, a small private foundation may elect to make one grant to a donor advised fund in each year and advise that the donor advised fund use the proceeds of that grant to make smaller grants to multiple other public charities. This practice saves the

¹³ Many sponsoring organizations maintain grantee databases against which each grant recommendation must be matched and employ grantmaking staff to conduct due diligence with respect to potential grantees.

¹⁴ See I.R.C. § 4966(c).

private foundation the administrative burden of itself issuing multiple checks and grant award letters to such charities.

A private foundation may also terminate into a donor advised fund.¹⁵ Under section 507, a private foundation may terminate without being subject to a termination tax by distributing all of its net assets to one or more organizations described in section 170(b)(1)(A), other than in clauses (vii) and (viii), each of which has been in existence and described in section 170(b)(1)(A) for a continuous period of at least 60 calendar months immediately prior to receiving the distribution from the private foundation. As discussed above, sponsoring organizations of donor advised funds are described in section 170(b)(1)(A) (specifically, in section 170(b)(1)(A)(vi)), and, accordingly, a private foundation that distributes all of its net assets to a donor advised fund at a sponsoring organization that has been in existence for a period of at least 60 calendar months may, after the distribution, terminate without incurring a termination tax.

Terminating a private foundation into a donor advised fund can offer a number of regulatory and tax policy advantages. For example, the termination of a private foundation into a donor advised fund is likely to result in lower administrative costs than maintaining a free-standing private foundation. Specifically, a private foundation must file a separate information return, is subject to recordkeeping and governance requirements, and may need to make regular state-level filings. For small private foundations, in particular, these costs can result in a more significant percentage of assets being expended on administration than in fulfillment of charitable purposes. A sponsoring organization, on the other hand, benefits from economies of scale with respect to administrative expenses generally, and files only organization-wide information returns and state filings.

In the family foundation context, changes in a family structure (*e.g.*, deaths, divorces, etc.) may require division of an existing private foundation. Forming and qualifying multiple private foundations and terminating the existing foundation into the new foundations create unnecessary inefficiencies. As an alternative, the existing private foundation could establish multiple donor advised funds at a sponsoring organization and then distribute its remaining assets among those donor advised funds, with each respective family member named as the donor advisor to one of the donor advised funds.

Terminating a private foundation into a donor advised fund is likely to decrease administrative cost, thereby allowing more money to be used for charitable purposes. Further, given the existing policy framework in place at most sponsoring organizations, money transferred from a terminated private foundation to a donor advised fund still will be subject to minimum activity requirements in place at most sponsoring organizations. Finally, given the restrictions on the use of money held in donor advised funds as compared to money held by private foundations (*i.e.*, the excise tax regime under section

¹⁵ See I.R.C. § 507(b)(1)(A).

4967 and the excess benefit transaction rules under section 4958(c)(2)), we do not view the termination of a private foundation into a donor advised fund as creating a material risk of abuses.

(b) *The Treatment of Grants by Private Foundations to Donor Advised Funds for Purposes of Section 4942.* Pursuant to section 4942, a private foundation will be subject to an excise tax in any taxable year in which it fails to make qualifying distributions equal to the private foundation's distributable amount for such taxable year.¹⁶ Qualifying distributions include distributions paid for charitable purposes (and include grants paid to public charities for charitable purposes).¹⁷ Because sponsoring organizations of donor advised funds are public charities, grants by a private foundation to a donor advised fund typically will count as qualifying distributions for purposes of such private foundation's minimum distribution requirements.

We understand that Treasury and the Service are considering whether grants to donor advised funds by private foundations should continue to constitute qualifying distributions or whether such grants should be subject to some limitations, such as a time limitation to distribute grants, as compared to grants to other public charities. In our view, subjecting private foundation grants to donor advised funds to limitations for purposes of the qualifying distribution rules is unnecessary. Imposing limitations risks harming what can be effective and useful collaborations between private foundations and donor advised funds.

As an initial matter and as we discuss above, sponsoring organizations are themselves public charities, and grants to public charities historically have been treated as qualifying distributions.¹⁸ Just as with any grant by a private foundation to a public charity, when a private foundation makes a grant to a donor advised fund, it relinquishes legal control of the grant funds. The sponsoring organization of the donor advised fund owns and controls the grant funds. The sponsoring organization must use these funds in furtherance of the sponsoring organization's charitable purposes, even though the private foundation may retain advisory privileges with respect to the use of such funds.

This type of arrangement is not significantly different from common grant structures currently used by private foundations. Consider, for example, a grant by a private foundation to fund an endowment at a museum to support

¹⁶ See I.R.C. § 4942(a). A private foundation's distributable amount is equal to 5% of the fair market value of the foundation's non-exempt use assets, minus indebtedness used to acquire such assets, and adjusted for taxes paid under Code section 4940.

¹⁷ See Reg. § 53.4942(a)-3(a)(2).

¹⁸ While we note that Reg. § 53.4942(a)-3(a)(2)(i)(b) exempts from the definition of qualifying distribution grants paid to organizations (including public charities) controlled by the grantor private foundation or one or more disqualified persons of such private foundation, that exception is not applicable here because a donor to a donor advised fund, by law, cannot control the sponsoring organization of such donor advised fund. See Reg. § 53.4942(a)-3(a)(3); Code § 4966(d).

a charitable program run by the museum. In such a case, the private foundation, pursuant to a grant agreement with the museum, could retain some level of advisory or consent rights with respect to the use of the grant (*e.g.*, such that the museum must come to the private foundation for consent if it wishes to put the grant funds to an alternate use). The grant would still constitute a qualifying distribution, even though the foundation would maintain limited rights over the use of the grant. Such is the case even if the principal amount of the grant may not be directly expended by the museum for an extended period of time. Similarly, when a private foundation has made a grant to a donor advised fund, it has relinquished control over the grant funds and has committed such amounts to the charitable purposes of the sponsoring organization (*i.e.*, eventual distribution to eligible grant recipients of the sponsoring organization). Such amounts no longer will be available to the private foundation to use for non-grantmaking purposes (*e.g.*, administrative costs, compensation, etc.) and will be available only for advised grants for charitable purposes.

As discussed above, excluding grants from private foundations to donor advised funds from the definition of qualifying distributions places unneeded restrictions on private foundations. Such an exclusion could both increase administrative costs for private foundations and, potentially, decrease regulatory compliance by private foundations that otherwise rely on donor advised funds for such purposes.

(c) *Any Additional Considerations Relating to Donor Advised Funds with Multiple Unrelated Donors under the Proposed Changes Described in Section 5 of the Notice.* As part of the 2007 Comments, the Section made recommendations regarding the first prong of the three-part definition of a donor advised fund under section 4966(d)(2)(A). There, we specifically recommended that a multiple donor fund (“MDF”) with multiple unrelated donors be excluded from the definition of a donor advised fund altogether if it met certain requirements, namely:

1. Three or more unrelated donors or groups of unrelated donors;
2. All donations aggregated together with a single consolidated account balance tracked in the fund;
3. No separate balance tracking for specific donors or groups of related donors to the fund;
4. No written or oral understanding among the donors to the MDF that any advisory privileges they have correspond to the amounts they donated to the fund; and
5. No single donor or group of related donors, since inception of the fund, has given more than thirty five percent of all donations.

We continue to recommend that that MDFs be excluded from the definition of a donor advised fund under section 4966(d)(2)(A), and we respectfully

request that any proposed regulations issued under section 4966 adopt this exclusion. Nonetheless, we acknowledge that other structures may exist where multiple unrelated donors contribute to a single fund that meets the definition of a donor advised fund under section 4966. Our recommendation regarding these structures is set forth below.

As discussed above, in our view, regulations regarding treatment of distributions from donor advised funds for purposes of the 2% Limitation are not advisable at this time. Instead, we recommend that Treasury and the Service further study the issue to determine whether any actual or meaningful abuse of the 2% Limitation exists. If, following additional study, Treasury and the Service determine that regulations are necessary, or if Treasury and the Service do not follow our recommendation and instead issue proposed regulations, we recommend that any such regulations include a clear exception for donor advised fund distributions from donor advised funds with multiple unrelated donors (“MDF*”).

We do not believe it is clear that there is meaningful abuse of the 2% Limitation as a general matter. Moreover, the theoretical potential for abuse seems less likely when a distribution is made from a MDF* as compared to the possible abuses outlined in Section 5 of the Notice. Thus, we recommend that any proposed regulations permit a donee charity to accept a distribution from a MDF* without limitation. In such a case, we suggest that Treasury and the Service expand item (3) from Section 5 of the Notice to permit a donee charity to treat as public support, without limitation, a distribution made from a donor advised fund with multiple unrelated donors so long as the sponsoring organization specifies that the donor advised fund has multiple unrelated donors. As described more fully below, to the extent that Treasury and the Service issue regulations on this issue, we recommend that Treasury and the Service devise a new form to be used by donee charities and sponsoring organizations for these purposes.

As an initial matter, we observe that the Notice is silent as to the expected “related person” test to be applied for this purpose. In the event that Treasury and the Service determine to issue proposed regulations on this issue, we recommend that the regulations define “related person” in a manner that is consistent with the existing 2% Limitation rules (*i.e.*, aggregating contributions from persons standing in a relationship to the donor that is described in section 4946(a)(1)(C) through (a)(1)(G)). For example, to the extent Husband and Wife each contribute \$500,000 to a single donor advised fund over which Wife has advisory privileges, and Wife advises a \$1,000,000 donor advised fund distribution to a donee charity, the donor advised fund would be treated as having multiple *related* donors (as Husband and Wife would be aggregated as a single contributor under the 2% Limitation rules). However, if Brother and Sister each contribute \$500,000 to a single donor advised fund over which Sister has advisory privileges, and Sister advises a \$1,000,000 donor advised fund distribution to a donee charity, the donor advised fund would

be treated as having multiple *unrelated* donors (as Brother and Sister would *not* be aggregated as a single contributor under the 2% Limitation rules).

(d) *Methods to streamline any required recordkeeping under the proposed changes described in section 5 of the Notice.* The proposed changes to the regulations would, in practical effect, require a donee charity to treat all donor advised fund distributions it receives as having been made from a single contributor subject to the 2% Limitation unless the donee public charity either:

- (i) is able to identify the donor (or donors) that funded the donor advised fund (in which case, the 2% Limitation will be applied as if the distribution came from the donor (or donors)); or
- (ii) obtains additional information from the sponsoring organization specifying either that the distribution was not from a donor advised fund or, if it was from a donor advised fund, that no donor or donor advisor advised the distribution.

In addition, if Treasury and the Service adopts [adopt] regulations that treat distributions from MDF*s as we set forth above, additional recordkeeping also will be required with respect to such distributions for the donee charity to treat such distributions as not subject to the 2% Limitation.

As we discuss above, we recommend that Treasury and the Service not issue any proposed regulations on this issue at this time. However, if Treasury and the Service, following further study, determine to issue proposed regulations, we urge Treasury and the Service to issue clear guidance setting forth simple, streamlined recordkeeping requirements for donee charities.

Treasury and the Service recognize in the Notice that a donee charity may need to obtain additional information from the sponsoring organization to determine its amount of public support. We emphasize that, given the lack of any clear evidence of abuse of the 2% Limitation by donors advising distributions from donor advised funds, implementing what will be a complex and administratively burdensome recordkeeping and reporting scheme in our view is premature. Such a regime would require donee charities to devote significant time and resources that could be better devoted to carrying out the donee charities' charitable activities.

However, should Treasury and the Service determine to issue proposed regulations, we recommend that the effective date of any such regulations be delayed until the beginning of a donee charity's tax year that begins after the year in which regulations are issued. We further recommend that Treasury and the Service seek additional comment on any such proposed regulations, particularly as to necessary revisions to Schedule A and the potential issuance of a new form for publicly supported public charities to use when requesting any required information from sponsoring organizations.

