REPORT #855

TAX SECTION

New York State Bar Association

REPORT ON TEMPORARY AND PROPOSED REGULATIONS
REGARDING DEDUCTIBILITY, SUBSTANTIATION AND
DISCLOSURE OF CERTAIN CHARITABLE CONTRIBUTIONS

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TAX SECTION
New York State Bar Association

October 5, 1995

The Honorable Leslie B. Samuels
Assistant Secretary (Tax Policy)
Department of the Treasury
Room 3120 MT
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20200

The Honorable Margaret M. Richardson
Commissioner
Internal Revenue Service
Room 3000
1111 Constitution Avenue, NW
Washington, D.C. 20224

RE: Proposed Regulations Regarding
Deductibility, Substantiation and
Disclosure of Certain Charitable Contributions

Dear Secretary Samuels and Commissioner Richardson:

Enclosed please find a report on the Temporary and Proposed Regulations regarding deductibility, substantiation and disclosure of certain charitable contributions. The principal author of the report is Michelle P. Scott, Co-Chair of our Committee on Tax Exempt Entities.

Overall, the Committee believes that the regulations do an excellent job of reconciling the statutory rules with the practical needs of charities and donors. We commend you for this, and for your action earlier this year providing relief with respect to the substantiation required for 1994 donations.

The report provides a number of technical comments on the regulations, for the most part amplifying the regulations to provide additional guidance for various situations. In an area like this it is important to provide as much guidance as possible, and we believe the additional clarifications suggested in the report would provide useful guidance that remains consistent with the essential tenor of the regulations.

Please call if we can be of any assistance to you in finalizing the regulations.

Very truly yours,

Carolyn Joy Lee
Chair

Committee on Tax Exempt Entities
New York State Bar Association Tax Section

REPORT ON TEMPORARY AND PROPOSED REGULATIONS REGARDING DEDUCTIBILITY, SUBSTANTIATION AND DISCLOSURE OF CERTAIN CHARITABLE CONTRIBUTIONS[1]

This report comments on regulations[2] promulgated pursuant to Internal Revenue Code amendments enacted as part of the Omnibus Budget and Reconciliation Act of 1993 ("OBRA"),[3] that impose requirements relating to substantiation of charitable contributions of $250 or more and to disclosure of information about "quid pro quo" contributions in excess of $75. The Committee considers the regulations an excellent reconciliation of detailed statutory rules with practical concerns of charitable organizations and their contributors. The regulations are consistent with the general legal principles underlying Code section 170, legislators' interest in curbing abuses and the IRS

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[1] This report was prepared by the Committee on Tax Exempt Entities. The principal draftsman was Michelle P. Scott. Helpful comments were received from Harvey P. Dale, Peter L. Faber, Carolyn Joy Lee, Laura J. Parello, Jodi J. Schwartz, Jonathan A. Small, Steven C. Todrys and Ralph O. Winger.

[2] IA-44-94, Prop. Reg. sees. 1.170A-1, 1.170A-13 and 1.6115-1, issued August 3, 1995. Related regulations primarily addressing substantiation of contributions made through payroll deductions were published as final regulations on October 12, 1995. TD 8623, Treas. Reg. Sec. 1.170A-13(e) and (f).

3 Pub. L. No. 103-66.

responsibility for promoting compliance.[4] The following comments address specific provisions and requirements and recommend only minor and technical changes and clarifications.

Background

In 1993, the Congress determined that fundraisers frequently failed to inform donors that all or part of donors1 payments to tax-exempt organizations which provide the donors with goods or services, i.e., a "quid pro quo," would not be deductible. The Congress decided that when organizations solicit or receive section 170 (c) quid pro quo contributions in excess of $75, they should inform donors that only the value of their contributions in excess of the value of goods or services provided by the organization is deductible. In addition, the Congress believed that such organizations should give donors a good faith estimate of the value of the goods and services provided for payments in excess of $75. Also, to improve compliance with the rules governing charitable contributions and to assist tax administration, specific substantiation requirements for contributions of $250 or more were added to the Code.[5]

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[4] The Committee commends the Internal Revenue Service's reasonableness and flexibility in providing transitional relief for donors with respect to the substantiation requirements for 1S94, the initial effective year. Notice 95-15, 1995-15 I.R.B. 22.

5 H. Rept. No. 103-213.

Comments

1. General Requirements for Donors

The temporary and proposed regulations, consistent with prior law, place on donors the burden of establishing that contributions of $250 or more are deductible by making donors primarily responsible for meeting the new substantiation requirements.[6] In the case of quid pro quo contributions, the regulations expressly require that donors have the intent of making a payment in excess of the fair market value of goods or services received, and actually make a such a payment.[7]

Donor intent. By focusing on donee-supplied information and the donor's intent and knowledge as of the time of the contribution, the regulations balance the certainty and administrability of objective information with the subjective standards provided by case law. The imposition of a subjective standard enables the IRS to disallow deductions in abusive situations which otherwise meet the formal requirements of the regulation. For example, the IRS can disallow deductions if donors expect undisclosed benefits or privileges from the done when they make their contributions. The IRS should be allowed this flexibility to attack such arrangements. Conversely, a donor's receipt of a benefit or privilege that was neither offered nor expected when the contribution was made should not

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[6] Prop. Reg. sec. 1.170A-13(f)(1).

[7] Prop. Reg. sec. l,170A-l(h)(1)(i) and (ii). See U.S. v. American Bar Endowment, 477 U.S. 105 (1986).

affect the calculation of the donor's deduction. The Committee suggests that the regulations on deductibility state that the intent standard allows the IRS to challenge abusive situations and permits donors to disregard the receipt of unexpected benefits or privileges.

Consistency: technical comment. The Committee believes that the regulation addressing quid pro quo contributions should incorporate the same standards and definitions for payments in consideration of goods or services as are used in the regulations dealing with substantiation. To ensure consistency, the Committee recommends that the parenthetical cross-reference in the first paragraph of section 1.170A-l(h)(1) be revised to read "as provided by sec. 1.170A-13(f)(5) and (6)" (emphasis added).

2. **Contributions of $250 or More.**

For contributions of $250 or more,[8] the regulations disallow deductions unless donors obtain from donees a contemporaneous[9] written statement that includes specified information. The donee statement must provide: (1) the amount of

[8] In the case of quid pro quo contributions, the regulations apply to such contributions if the contributed amount, i.e., the amount in excess of the consideration for goods or services, is $250 or more. Prop. Reg. sec. 1.170A-13(f)(1).

[9] The statutory requirement of contemporaneous substantiation, if interpreted narrowly, is a tough standard that Congress should be urged to reconsider. Normally substantiation simply means providing adequate evidence. But the new rules for contributions of $250 or more technically permit denial of a deduction for, say, a $1 million gift that was incontrovertibly made, simply because the "contemporaneous" substantiation was not obtained.

a cash contribution or, in the case of property, a description of the property; (2) a statement about whether or not there was a quid pro quo; (3) a description and good faith estimate of any quid pro quo (except for intangible religious benefits and certain goods or services provided to the donor's employees); and (4) if the donee provides intangible religious benefits, a statement to that effect. Aggregation of contributions. The proposed regulations do not require donors to obtain donee acknowledgments if separate contributions, each for less than $250, amount to $250 or more in the aggregate. This rule reflects excellent judgment by the Service in not imposing overly burdensome record-keeping requirements on donees. If, on audit, the Service finds a pattern of multiple contributions of under $250 each, it is free to pursue an explanation as to whether the contributions were made separately to avoid the substantiation rule and whether they involved any consideration in return. The Committee also urges the Service to confirm specifically that monthly payment plans involving individual contributions which are each less than $250 do not require aggregation and substantiation from the donee. This approach would assist the administrative concerns of donees and would be consistent with the recently finalized regulations on payroll contributions.[10]

[10] See note 2, above.

3. Estimates of the Value of Goods or Services

Under the regulations, donee organizations must give donors written statements that include a good faith estimate by the donee of the fair market value of any goods or services provided in consideration of contributions in excess of $75. Acknowledgments may be provided in connection with either the solicitation or the receipt of contributions. Failure to supply the information subjects a donee to penalties.[11] In the case of quid pro quo contributions where the contributed amount is $250 or more, the substantiation requirements of Code section 170(f)(8) also apply. Donors are permitted to rely on done estimates of the value of goods or services, unless a donor has reason to know that the estimate is unreasonable.[12] The Committee recommends that the regulations also explicitly state that a donor is not required to accept the donee's estimate if the donor has knowledge that the value estimated by the donee is incorrect. If a donor uses a value that differs from the one provided by the donee, the Committee recommends that the regulations require the donor to disclose the inconsistency on his tax return.

The Committee believes that the regulations and examples, particularly the exclusions for general membership and low-cost benefits and for certain goods or services provided to

[11] The penalty is $10 for each contribution, with a maximum penalty of $5,000 for a single event or mailing. Code section 6714.

[12] Prop. Reg. sec. 1.170A-l(h)(4)(i) and (ii).

employees of donors, are sensible and proper. Usually, it is impossible for a donee to know how many people a corporate donor employs or how many employees would use the quid pro quo.[13] These provisions minimize compliance burdens for programs that are very important to many organizations but which grant benefits that are difficult to value and, if separately valued and disallowed, would result in only small reductions in charitable contribution deductions. Similarly, the regulations and examples dealing with the estimated values to be disclosed for goods or services that are not commercially available establish practical guidelines which should not be difficult to follow in most situations.

Several additional examples or clarifications, described below, might be added to the regulations to establish clearer IRS authority and to provide greater certainty for tax administrators, taxpayers and organization managers in dealing with valuation under the substantiation and disclosure regulations.

Goods or services provided to partners. directors. etc.Both the substantiation and the disclosure regulations provide exceptions from their rules for certain goods or services

[13] It should be noted that, with respect to the benefits provided employees that are disregarded under these regulations, in most cases adjusting a corporate donor's charitable contribution deduction for the quid pro quo will have no effect on the employer's or employees' tax liability: The donor will treat the amount excluded from the charitable contribution as deductible compensation, and in the case of employees the quid pro quo may also be excluded from the employees' wages as a de minimis fringe benefit.

provided to employees of donors. Insubstantial benefits and benefits to a donor's employees that are the equivalent of those provided by the donee in connection with annual memberships costing $75 a year or less need not be taken into account in determining the amount of a deduction[14] and need not be substantiated.[15] Such benefits also are excluded from the disclosure requirements imposed on donees.[16] The exception for employees of a donor should be broadened to cover other individuals who are commonly afforded benefits because of a relationship to a donor. The Committee recommends that these exceptions be extended to employees of a business that sponsors a private foundation whose grant resulted in the benefits.[17] Also, benefits to partners in a partnership, members of a limited liability company and board members of any business organization should also be excepted if those individuals receive benefits as a result of contributions by the partnership, limited liability company or business entity, respectively.

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[14] Prop. Reg. sec. 1.170A-l(h) (3).

[15] Prop. Reg. sec. 1.170A-13(f)(8) and (9).

[16] Prop. Reg. sec. 1.6115-l(b) and (c).

[17] The Committee further recommends that the Service issue guidance stating that the provision of insubstantial benefits, of the type described in the regulations, to employees of a company that sponsors the contributing private foundation is not indirect self-dealing between the company and the private foundation. The Committee believes that for the same reason these benefits are considered insubstantial for purposes of sections 170 and 6115, they also should be treated as incidental under Code section 4941(d). Accordingly, the Committee recommends that the Service provide confirmation that such arrangements do not constitute self-dealing.

Generic vs. Specific Value. The Committee further suggests that Example 1, in Proposed Regulation section 1.170A- 13(f)(8)(ii), might give additional useful guidance by having the quid pro quo be an ordinary item, e.g., ballet shoes, having a regular commercial value or sales price that is increased if used and autographed by a famous owner. The enhanced value could be determined by reference to the price charged by a business that specializes in such dance memorabilia. The example would provide that the price at which the ballet company's gift shop regularly sells ballet shoes autographed by a celebrated dancer is the fair market value for purposes of the disclosure estimate. This revision would indicate that when an ordinary item is enhanced so that it has a particular value that can be determined by reference to regular commercial transactions, the donee should provide the particular, enhanced value and not an ordinary, generic value.

Travel Donations. Travel organized by exempt organizations, such as universities and museums, also has raised tax compliance problems. An example specifically addressing the deductibility and valuation of contributions made in conjunction with payments for a trip or tour would clarify that such contributions are treated in accord with the Service's general interpretations in this area permitting a deduction for a contribution in excess of the value of the goods and services use received.[18]

[18] See Rev. Rul. 67-246, 1967-2 C.B. 104, relating to contributions in connection with charity balls, bazaars, banquets, shows and athletic events.

The example should require the donee sponsoring the trip or tour to disclose the fair market value of the travel or tour benefits and the amount of the contribution in excess of the benefits' value. In the case of group travel or tours offered as a quid pro quo, fair market value could be determined by reference to rates offered by commercial tour operators. To prevent confusion, the regulation should indicate that the example has no application to the treatment of out-of-pocket expenses incurred by a taxpayer on behalf of an exempt organization.[19]

Program Listings. The Committee also suggests that the listing of a contributor in an exempt organization's program for an event, annual report or other similar publication, should be expressly stated to be a benefit that has no substantial value.[20] Such listings should be disregarded in determining whether or not a taxpayer has received a quid pro quo. For most businesses, a payment for such a listing probably could be claimed as an advertising expense, so that treating it as nondeductible under section 170 would have little practical effect. For individuals, the benefit generally would be truly insubstantial.

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[19] See Treas. Reg. sec. 1.170A-l(g).

[20] Treating the value of the listing as insubstantial for purposes of these regulations would be consistent with the Service's position that public recognition associated with charitable contributions and foundation grants provides only incidental or tenous benefit to the donor. See, e.g., Treas. Reg. sec. 53.4941(d)-2(f)(2); Rev. Rul. 66-358, 1966-2 C.B. 218; Rev. Rul. 73-407, 1973-2 C.B. 383; Rev. Rul. 77-367, 1977-2 C.B. 193; PLR 9336041, June 15, 1993; PLR 9535044, June 5, 1995.

Availability of Benefits. The Committee also believes that Example 2 in Proposed Regulation section 1.170A-13(f)(8)(ii) requires clarification. In the Example, the Service indicates that the theater group presents two performances of each of four different plays during its season. Tickets are sold at $15 each. The theater group gives a contributor of $60 or more a membership which entitles the contributor to "free admission to any of its performances."

The first issue that should be clarified is whether this statement means that a $60 contributor can attend four or eight free performances, which would otherwise require ticket purchases of $60 or $120, respectively. Establishing the number of performances would put at least a ceiling on the amount that is nondeductible. However, even if a ceiling is established, the example could be further clarified. It is not certain in the example that it is realistically possible for a contributor to exercise his or her right to "free admission to any of [the theater's] performances." For example, the total number of seats available to all performances of a play might be less than the number of members entitled to free tickets. It would seem that a membership should be valued below $60 if the member cannot be certain of obtaining a ticket to each of the four plays. If there are sufficient seats so that each member can be accommodated, the example should state this fact. If the example is revised to provide that free admission means one ticket per play and that there are more seats per play than members, it seems appropriate to value the quid pro quo at $60. Accordingly, a contributor of $350 would be allowed to deduct $290.

In addition to amplifying the facts in Example 2, the Committee believes it would be helpful to clarify the relationship of the availability of a benefit to its valuation by adding after the words "good faith estimate of its value," the phrase, "taking into account the availability of free admissions and any done caused limitations on a member's ability to utilize the free admission benefit."

Waiver and Non—Utilization of Quid Pro Quo. The Committee recommends that the final regulations include a specific rule, consistent with the position taken in Revenue '" Ruling 67-246,[21] that the mere fact that a quid pro quo is not utilized does not entitle a donor to deduct the full value of a contribution without reduction for the value of the quid pro quo. The test for determining if a quid pro quo should be disregarded would not be whether or not the right to the quid pro quo is used, but whether or not the right is accepted or rejected by the donor. In order for a quid pro quo to be disregarded in determining the amount of a deduction, the donor should be required to provide, with the donation, a written rejection of any present or future quid pro quo which is expressly or customarily offered in connection with the contribution.[22]

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[21] 1967-2 C.B. 104, 106. Note, in particular, example 3 at page 108.

[22] Where a quid pro quo is not expressly or customarily offered in connection with a contribution but subsequently is offered to the donor, the donor should be required to formally reject the quid pro quo within a reasonably short period of time after receiving notification of the quid pro quo.

An example could be added in which Taxpayer A makes a $20,000 contribution to University X in December 1995. Every year, University X holds a two-day appreciation program on its campus in June for all contributors of $10,000 or more during the prior 12 months. All eligible contributors are guests of University X for the program and receive accommodations, meals and other benefits worth $500. The appreciation program is listed by University X in its newsletters, alumni bulletins, fundraising brochures and other publications, along with other types of donor benefits. Taxpayer A does not notify the done that he will not accept the program invitation. Under the regulations, Taxpayer A should be entitled to deduct $19,500 with respect to the contribution for 1995, whether or not he takes advantage of the program the next year. If A had provided a written waiver of the program invitation at the time of the gift, A would be entitled to deduct $20,000 in 1995.

The Committee also recommends that the regulations be amended to recognize specifically that a rejection of a quid pro quo made after the gift but sufficiently in advance of the receipt or use of the quid pro quo so as to be meaningful with respect to both the donor and donee entitles the donor to treat the return of the quid pro quo as a separate contribution. In such a case, the donor should be allowed to deduct the full amount or value of the quid pro quo that had reduced the earlier contribution. To illustrate this, the example relating to nonutilization of a quid pro quo could be expanded.

For example, assume that in April, 1996, Taxpayer A informs University X in writing that he will not attend the June program as the University's guest. University X acknowledges Taxpayer's A waiver in writing. The two-months' notice A provides to University X is sufficient to permit University X to offer attendance at the program to others, or to avoid incurring any material costs in respect of A's potential attendance. Taxpayer A would be entitled to deduct the $500 value of the 1995 quid pro quo as an additional contribution in 1996.

The Committee also recommends that the regulations expressly address the treatment of quid pro quos that, to be enjoyed by the donor, require a relatively significant additional expenditure by the donor. For example, assume that in 1995 Taxpayer B makes a $5,000 contribution to Museum G, which contribution entitles B to a $1,000 discount off the $2,500 price of a museum-sponsored tour. Assume further that the $2,500 price represents a fair market price for the tour. In computing B's 1995 deduction for the contribution to Museum G, should the $1,000 discount be deducted from the $5,000 contribution? One could conclude that the additional expenditure required by B in order to enjoy the financial benefit of the discount is so substantial that the discount does not represent a valuable quid pro quo unless and until the donor expresses an intention to, or actually does, take advantage of the discount. That approach would, however, create administrative issues, particularly where the discount (or other such quid pro quo) is utilized in a subsequent taxable year.

The Committee therefore believes that the better approach would be to treat this kind of quid pro quo like all others, and require that the $5,000 donation be reduced by the $1,000 discount unless the donor makes a contemporaneous waiver of the quid pro quo.

4. out—of—Pocket Expenses

The proposed regulations recognize that donees typically do not know the amount of out-of-pocket expenses borne by a taxpayer who contributes services to the organization. Because of this practical limitation, the general rules requiring that donees state the amount of cash paid by a taxpayer or describe donated property are relaxed with respect to the substantiation to be obtained from donees whose contributors incur out-of-pocket expenses of $250 or more in connection with services. The Committee agrees that relaxing the general rule is required in this case. It urges that the regulations be amplified and examples be provided to insure that deductions for legitimate expenses not be disallowed because of potentially narrow interpretations of the proposed language. The Committee recommends that subparagraphs (A) and (B) of proposed regulation section 1.170A-13(f)(10)(ii) be revised by adding the underscored language, below, so that these provisions read as follows: "(A) A general description of the services provided by the taxpayer; (B) The date or time period for which the services were provided;".

In addition, the Committee recommends the addition of one or more examples illustrating the out-of-pocket rules, in particular, these examples should approve statements from donees indicating, for example, that a donor participated in a fundraising drive for the organization from September through December of the specified year, during which period he or she is likely to have incurred expenses for travel, mailing, telephone and entertainment of prospective contributors. Similarly, a statement noting that, on specified dates, a donor performed services for the donee at locations distant from the donor's home should be adequate. Such a statement should meet the substantiation requirement with respect to expenses for transportation, lodging and meals, all of which are implicitly required because of the distance involved in attending the events.