NEW YORK STATE BAR ASSOCIATION
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January 12, 2012

The Honorable Emily S. McMahon
Acting Assistant Secretary
(Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

**Re: Report on Tax Deductibility of Contributions to Disregarded Entities Owned by Charities**

Dear Ms. McMahon, Mr. Wilkins and Mr. Shulman:

We are pleased to submit New York State Bar Association Tax Section Report No. 1254. The report addresses the tax deductibility under Section 170 and related sections of the Internal Revenue Code (the "Code") of contributions made to a disregarded entity ("DRE") subsidiary of a tax-exempt organization eligible to receive tax deductible contributions ( a

"charity"). In Announcement 99-102, 1999-43 I.R.B. 545, the Internal Revenue Service announced that, in light of the entity classification regulations' treatment of DREs, if a tax-exempt organization owns a DRE, the DRE's operations are treated as a branch or division of its owner and its owner "must include, as its own, information pertaining to the finance and operations of a disregarded entity in its annual information return." In 2001, the IRS indicated it intended to publish guidance on charitable contributions to disregarded entities. However, to date, the IRS has not taken a public position on the question of whether a donor is entitled to claim a charitable contribution deduction under Section 170(a) if the donor makes a contribution to a DRE whose sole member is a charitable organization described in Section 170(c)(2) and recognized as exempt from tax under Section 501(c)(3). There is no case law directly addressing the deductibility of charitable contributions to a disregarded entity owned by a charity.

Reg. § 301.7701-1(a)(1) provides that the entity classification regulations apply "for federal tax purposes." The Section 7701 entity classification regulations (also referred to as the "check-the-box regulations") provide that an eligible entity may either default to be, or elect to be, a DRE.

In our view, the IRS should not limit the deductibility of gifts to DREs. As discussed in the report, but for the check-the-box regulations' treatment of DREs, contributions to a charity's subsidiary generally would not be deductible unless the subsidiary itself is qualified as a charity or the subsidiary is the agent of the parent charity. Only contributions "to or for the use of" a domestic charity are deductible under Section 170(a). Treatment of eligible entities as disregarded is purely a regulatory concept and is not expressly required by the Code or case law. We acknowledge that, as for employment taxes and several other specific purposes, the IRS has the power to change the check-the-box regulations prospectively to provide that, for purposes of deductibility under Section 170(a), otherwise disregarded entities are regarded.

That said, we have found no compelling reason why the IRS must or should regard otherwise disregarded entities for purposes of Section 170. Well over a decade of experience with the check-the-box regulations as applied to DREs owned by charities has not brought to light any real abuses or problems of tax administration. The IRS can and does receive information about such DREs on Form 990. If the IRS desires or needs more information, it can revise Form 990 to require such information. Further, the IRS has the power to revoke the exempt status of any charity that is not operated exclusively for charitable purposes. If a DRE (which is treated as part of the charity) engages in activities that are incompatible with being tax-exempt, the IRS can revoke the parent's exempt status.

Thus, we believe that under current law, a contribution to a DRE owned and controlled by a charity is treated as a gift to the charity and is deductible under Section 170(a), to the same extent and subject to the same conditions and limitations, as a gift to a branch of the parent charity. We think the same conclusion applies in determining whether a deduction is allowed for estate and gift tax purposes for gifts to DREs owned and controlled by charities.

As discussed in the report, arriving at these conclusions involves a two-step analysis. Is there anything about the way the DRE is organized or operated that is inconsistent with the parent's tax-exempt status? If no, would the gift have been deductible if made to a branch of the charity (rather than to a DRE), assuming the gift is subject to the same express or implied restrictions imposed on the gift to the DRE? If the DRE is organized and operated consistently with the parent's tax-exempt status and a gift to a DRE would have been deductible if it had been made to a branch of the charity, our view is that such a gift should be deductible when made to a charity's DRE. We do not think the DRE should have to independently be able to qualify as a charity for gifts to the DRE to be deductible. For example, a gift to a DRE that has solely investment purposes should be deductible even though investment purposes standing alone are not charitable.

We request that the IRS issue a ruling or other guidance confirming these conclusions. Deductibility should be premised on the DRE being controlled by the charity and on the DRE's governing documents not providing that the DRE be operated for purposes that are contrary to the tax-exempt purposes of the charity owner. Finally, deductibility could require the acknowledgment required under Section 170(f)(8) to give the parent charity's name and address and to contain a statement confirming the DRE status of the recipient of the gift. Such guidance should provide at least one example involving a foreign DRE owned by a domestic charity. Here, the IRS should confirm that the check-the-box regulations do apply and a contribution to such a foreign entity is deductible to the same extent as a contribution to a charity's domestic DRE.

In sum, we recommend that the IRS treat otherwise disregarded entities as disregarded for purposes of Section 170 and related estate and gift tax provisions of the Code and treat contributions to a DRE owned and controlled by a charity as contributions to the parent charity.

We appreciate your consideration of the report and our recommendations.

Sincerely,

Jodi J. Schwartz

cc: Erik Corwin
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