Report No. 1390

NEW YORK BAR ASSOCIATION TAX SECTION

REPORT ON NOTICE 2017-73

February 28, 2018

Table of Contents

I. Introduction

This report ("Report")[1] responds to the request in Notice 2017-73[2] ("Notice") for comments on interim guidance and proposed regulations that are being considered by the Department of the Treasury ("Treasury") and the Internal Revenue Service ("Service") with regard to certain issues concerning donor-advised funds ("DAFs"). We generally agree and support the Treasury and the Service position in the Notice but have a number of recommendations that follow from our view that there should be a consistency between the rules for DAFs and private foundations where similar policy issues are presented. We further agree with Treasury and the Service that DAFs should not be used in conjunction with other organizations as an instrument to avoid the rules and limitations on the private foundations.

The Notice provides interim guidance on two specific issues and requests comments on several others. First, the Notice states that regulations will be issued treating a distribution from a DAF to a charity that allows a donor, donor adviser, or related person under Section 4958(f)(7)[3] (henceforth, where context requires, a "donor-advisor") to attend or participate in an event as resulting in that person receiving a more than incidental benefit under Section 4967. Second, the Notice provides rules for determining whether a contribution made by a DAF should be considered as satisfying the donor-advisor's pledge to contribute to a charity. In addition, the Notice states that Treasury and the Service are considering adopting rules that constrain the use of DAF grants to enable other charitable organizations to meet the tests for classification as publicly supported organizations. Finally, the Notice requests comments on whether, consistent

[1] The principal authors of this Report are Stuart Rosow and Bowon Koh, with substantial assistance from Joshua Gewolb, Amanda Nussbaum, Michael Schler, Karen G. Sowell and Richard Upton. Comments were received from Andrew Braiterman and Stephen Land. This report reflects solely the views of the Tax Section of the New York State Bar Association and not those of the NYSBA Executive Committee or the House of Delegates.
[2] 2017-51 IRB 562 (Dec. 4, 2017)
[3] All section references herein are to the Internal Revenue Code unless otherwise noted.

with Section 4942 and its purposes, a transfer of funds by a private foundation to a DAF should be treated as a "qualifying distribution" only if the DAF sponsoring organization agrees to distribute the funds for Section 170(c)(2)(B) purposes (or to transfer the funds to its general fund) within a certain timeframe.

Our response to the Notice's request is guided by our view that in many situations DAFs and private foundations present similar policy issues. For both types of organizations, the principal charitable activity consists of the disbursement of funds. In both situations, a contributor to the organization has the ability to control (in the case of a private foundation), or retains practical control over (in the case of a DAF), the use of the funds contributed. Indeed, in the case of a private foundation, the contributor may be able to direct the expenditure by the organization. In the case of the DAF, the contributor or designee, as donor-advisor, has the ability to recommend that the organization make a grant. Any final expenditure, however, from the DAF must be approved by the DAF's sponsoring organization and the fund's management. That requirement is in form a significant distinction between a private foundation and a DAF. Nevertheless, as a practical matter, the DAF will never decline to make the requested contribution as long as the donee is a Section 501(c)(3) organization and the donor makes the appropriate tax certifications. Thus, the ability of the donor-advisor to influence the use of the funds presents concerns that are very similar, although not identical, to those present with regard to private foundations.

In our prior report submitted in response to Notice 2007-21,[4] we expressed the view that the treatment of DAFs and private foundations should be consistent to the extent the issues raised

[4] 2007-1 C.B. 611 (Feb. 6, 2007). Prior to the Notice, Treasury and the Service had requested comments under Notice 2006-109 (2006-2 C.B. 1121 (Dec. 4, 2006)) and Notice 2007-21 with regard to DAFs and supporting organizations. Notice 2006-109 provided interim guidance on several DAF issues, including criteria for

similar concerns. This Report confirms our position that the rules governing DAFs and private foundations should be consistent when those rules serve similar public policies or where the underlying concepts or concerns are essentially the same, such as the prohibition on more than incidental benefit to a private person.

We recognize that the statutory and regulatory schemes are different for DAFs and private foundations. Private foundations are subject to a detailed set of rules that require stricter controls to ensure that funds are used for charitable purposes and do not convey substantial benefits to contributors.[5] In contrast, sponsoring organizations and their DAFs are treated as public charities for a number of purposes and are accorded treatment as such. Despite such classification, DAFs are also subject to certain special rules not applicable to other public charities. These rules generally impose penalties upon the fund, fund managers or the donor-advisor for certain improper use of the DAF assets.[6] Considering that the individual donors maintain a close relationship with the DAFs as the advisors, DAFs should also be subject to rules

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determining whether a supporting organization is a disqualified supporting organization, exclusion of certain employer-sponsored disaster relief funds from the definition of DAF, and transitional rules for educational grants. The Notice also requested comments regarding suggestions for future guidance on DAFs. Notice 2007-21 requested comments in connection with a study conducted by Treasury and the Service on the organization and operation of DAFs and supporting organizations, as required by Section 1226 of the Pension Protection Act of 2006, H.R. 4, 109th Congress, Pub. L. No. 109-280 (2006).

[5] Section 4941 imposes an excise tax on self-dealing, which includes actions that result in a benefit to a substantial contributor; Section 4942 provides for minimum distribution requirements. Section 4943 imposes an excise tax on certain excess business holdings, which is generally the amount of stock or other interest in a business enterprise that exceeds the permitted holdings. Section 4944 imposes an excise tax on the foundation and the individual foundation managers on any investments that would financially jeopardize the carrying out of the private foundation's exempt purposes. Section 4945 imposes an excise tax on a private foundation that makes any taxable expenditure.

[6] Section 4966 imposes an excise tax on each taxable distribution from a DAF. This excise tax is paid by the sponsoring organization. A separate excise tax, paid by fund managers, is imposed on the agreement of any fund manager to the making of a distribution, knowing that it is a taxable distribution. In general, under Section 4966(c), a taxable distribution is any distribution from a DAF to any natural person, or to any other person if (i) the distribution is for any purpose not specified in Section 170(c)(2)(B), or (ii) the sponsoring organization does not exercise expenditure responsibility with respect to such distribution in accordance with Section 4945(h). In addition, Section 4967 imposes an excise tax on the advice that a donor, donor-advisor, or related person provides regarding a distribution from a DAF that results in such person or any other related person receiving, directly or indirectly, a more than incidental benefit. Section 4967 also imposes excise tax on any fund manager who agreed to the making of the distribution knowing that such distribution would confer a more than incidental benefit.

that ensure the funds are used for charitable purposes and do not convey substantial benefits to donors or other persons serving as donor advisors. This requires that the charitable entities and transactions between them be subject to a certain level of scrutiny to ensure that the funds are used for charitable purposes.

II. Summary of Recommendations

This Report recommends the following:

1. We support the position set forth by Treasury and the Service that the regulations provide that the donor-advisor receives a more than incidental benefit under Section 4967 if a DAF makes a contribution to a public charity and, as a result of such contribution, the donor-advisor becomes entitled to attend an event or receives membership or similar benefits that would result in such contribution not being fully deductible if it had been made directly by the donor-advisor.

2. Treasury and the Service should confirm in regulations to be issued under Section 4967 that a distribution from a DAF to satisfy a donor-advisor's legally enforceable pledge to make a contribution to a charity would confer more than incidental benefit to the donor-advisor. In that event, the donor-advisor would be subject to penalties under Section 4967. However, to insulate the sponsoring organization from penalties under Section 4966 and Section 4958, we recommend that, in addition to the requirements specified in the Notice, a donor-advisor be required to provide a representation or certification to the DAF or the sponsoring organization that the recommended distribution is not in satisfaction of a legally enforceable pledge. If all of these requirements are met, absent actual knowledge

by the sponsoring organization or the DAF that the certification was false, the sponsoring organization and the DAF would not be subject to penalty.

3. Treasury and the Service should issue regulations providing for a "look through" rule for the treatment of grants made by a DAF to another Section 501(c)(3) exempt organization for purposes of determining whether the donee organization is considered publicly supported under Section 170(b)(1)(A)(vi) or Section 509(a)(2). Under this rule, grants made by a DAF would be treated as though the grants were made by the donor-advisor.

4. Treasury and the Service should adopt regulations to the effect that a contribution to a DAF by a private foundation would not be considered a qualifying distribution unless the DAF sponsoring organization agrees to distribute the funds for Section 170(c)(2)(B) purposes within a certain timeframe. In this regard, the regulation should follow the rules set forth in Treas. Reg. Section 53.4942-3(c).

III. Background

A. DAFs

A DAF is defined under Section 4966(d)(2) as a fund or account owned and controlled by a sponsoring organization,[7] which is separately identified by reference to contributions of a donor or donors, and with respect to which the donor, or any person appointed or designated by such donor (donor-advisor), has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of the funds. Section 4966(d)(2)(B) excepts from the definition

[7] Section 4966(d)(1) defines a sponsoring organization as an organization that: (1) is described in Section 170(c) (other than a governmental unit described in Section 170(c)(1), and without regard to the requirement under Section 170(c)(2)(A) that the organization be organized in the United States); (2) is not a private foundation (as defined in Section 509(a)); and (3) maintains one or more DAFs.

of DAF any fund or account which makes distributions only to a single identified organization or governmental entity, or certain committee-advised funds that make grants to individuals for travel, study, or other similar purposes.[8] Although the sponsoring organization of a DAF is classified as a public charity, the statute provides for penalties regulating sponsoring organizations and their sponsored DAFs in a manner different to those that are imposed on public charities generally.

Section 4967 imposes an excise tax on the advice that a person described in Section 4967(d)[9] provides regarding a distribution from a DAF that results in such person or any other person described in Section 4967(d) receiving, directly or indirectly, a more than incidental benefit. The excise tax equals 125% of the amount of the benefit and is imposed on the advisor who recommended the distribution and the recipient of the benefit, who are jointly and severally liable for the tax.[10] In addition, a 10% excise tax is imposed on such distribution on a "fund manager" of the sponsoring organization who approves the distribution knowing that it would confer a more than incidental benefit on the donor-advisor, subject to a maximum tax of $10,000 for each such distribution.[11] Section 4967(b) provides that, with respect to any distribution, no tax shall be imposed under Section 4967 if a tax has been imposed under Section 4958.

[8] A charitable deduction for a contribution to a DAF is allowed under Section 170(f)(18) only if: (A) the sponsoring organization is described in Section 170(c)(2) and is not a "type III supporting organization," as defined in Section 4943(f)(5)(A) (other than a functionally integrated type III supporting organization as defined in Section 4943(f)(5)(B)); and (B) the taxpayer obtains a contemporaneous written acknowledgment from the sponsoring organization of the DAF that the sponsoring organization has exclusive legal control over the assets contributed.

[9] Section 4967(d) refers to Section 4958(f)(7), which describes (i) a donor or donor-advisor, (ii) a family member of a donor or donor-advisor or (iii) an entity that is owned more than 35 percent by a donor, a donor-advisor, and members of their families.

[10] Sections 4967(a)(1) and (c)(1).

[11] Sections 4967(a)(2) and (c)(2).

Section 4958 imposes an excise tax on any "excess benefit transaction."[12] Section 4958(c)(2) provides that, in the case of any DAF, an excess benefit transaction also includes any grant, loan, compensation, or other similar payment from the DAF to a donor, donor-advisor, or related person. For purposes of this special rule for DAFs, the excess benefit includes the full amount of the grant, loan, compensation, or other similar payment.[13] This excise tax under Section 4958 is paid by the disqualified person with respect to the transaction. A separate excise tax, paid by organization managers, is imposed on the participation of any organization manager in the transaction, knowing that it is an excess benefit transaction, unless such participation is not willful and is due to reasonable cause.

B. Private Foundations

In the context of private foundations, Section 4941 imposes an excise tax on each act of self-dealing between a private foundation and a disqualified person.[14] Section 4941(d) defines "self-dealing" as a direct or indirect transaction between the foundation and a disqualified person. Some of the enumerated acts of self-dealing include (i) furnishing of goods, services, or facilities between a private foundation and a disqualified person (subject to certain exceptions) and (ii) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person (except for personal services reasonable and necessary to

[12] Section 4958(c)(1) defines an excess benefit transaction generally as any transaction in which an economic benefit is provided by an applicable tax exempt organization (including a Section 501(c)(3) sponsoring organization of a DAF) directly or indirectly to or for the use of a disqualified person (including in the case of any transaction that involves a DAF a donor, donor-advisor, or a person related to a donor or donor-advisor, as described in Section 4958(f)(7)), if the value of the economic benefit provided exceeds the value of the consideration received. In general, the term "excess benefit" refers to the amount by which the value of the economic benefit provided exceeds the value of the consideration received.

[13] Under the general rules of Section 4958, excise tax is imposed only on the excess benefit received by a disqualified person, which is determined based on the fair market value of the property received. Treas. Reg. Section 53.4958-4(b)(1).

[14] "Disqualified persons", as defined in Section 4946, include substantial contributors, foundation managers, owners of more than a 20 percent interest in a substantial contributor, certain family members, and corporations, partnerships, trusts and estates in which disqualified persons own more than a 35 percent interest.

carrying out the exempt purposes of the private foundation if the compensation is not excessive).[15] The excise taxes under Section 4941 for engaging in one or more of these enumerated acts of self-dealing are assessed against the self-dealer and, in appropriate cases, the foundation managers.

Section 4942(a) imposes an excise tax on a private foundation's undistributed income which has not been timely distributed.[16] Section 4942(c) defines the undistributed income of the private foundation as the excess of the distributable amount for the taxable year over the qualifying distributions made by the foundation out of that distributable amount. Section 4942(d) defines a foundation's distributable amount as its minimum investment return[17] over the private foundation taxes payable by the foundation.

"Qualifying distributions" are defined as any amount paid to accomplish one or more charitable purposes, other than (i) expenditures made to certain organizations controlled by the private foundation (or its managers) and (ii) certain expenditures to another private foundation unless that organization is an operating foundation.[18] "Qualifying distributions" also include amounts expended to acquire assets that are used directly in conducting charitable activities.

Section 4943 was adopted as part of the Tax Reform Act of 1969, which revamped the treatment of private foundations generally. As explained by the Joint Committee, Congress was

[15] Other enumerated acts of self-dealings are: (A) sale or exchange, or leasing, of property between a private foundation and a disqualified person; (B) lending of money or other extension of credit between a private foundation and a disqualified person; (C) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation; and (D) agreement by a private foundation to make any payment of money or other property to a government official (as defined in Section 4946(c)), other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating his government service within a 90-day period.

[16] Section 4942(a). If there is a further failure to meet the minimum distribution requirements, after an additional year, there a penalty tax equal to 100% of the amount of undistributed income remaining at the end of the year.

[17] Under Section 4942(e), the minimum investment return is generally equal to 5% of the average of value of the private assets.

[18] Section 4942(g)(4).

concerned with abuses of private foundations, including in particular the use of private foundations to hold non-income producing assets (such as a large stock position in a family business).[19] The changes enacted in the Tax Reform Act of 1969 also the included penalties for self-dealing among the foundation, substantial contributors and officers, limits on excess business holdings and limits on certain expenditures.

In enacting Section 4942, Congress recognized that before the Tax Reform Act of 1969,[20] there was little legal pressure on private foundations to distribute income to charity. Prior to the Tax Reform Act of 1969, a private foundation would lose its exemption if its aggregate accumulated income was unreasonable in amount or duration for carrying out its exempt purposes. This limitation on unreasonable accumulation of income proved largely ineffective and was rarely applied because reasonableness or unreasonableness is essentially a subjective determination and the only available sanction—loss of exempt status—was often viewed as unduly harsh. As a result, while the creator of a private foundation may have received immediate and substantial tax benefits from his or her contribution, charity may have received no benefit whatever or a very belated benefit. Congress responded to this situation by establishing minimum income distribution requirements for private foundations.[21]

C. Notice 2017-73

Notice 2017-73 addresses a number of issues presented by common uses of DAFs. The first issue concerns the treatment of contributions made by a DAF to another public charity that either enable the donor-advisor to attend an event or pay part of the membership fee for an organization. In both instances, the DAF funds would be used to pay only the deductible portion

[19] Joint Committee on Taxation, Summary of H.R. 13270, the Tax Reform Act of 1969.
[20] H.R. 13270, Pub. L. No. 91-172 (1969).
[21] Internal Revenue Manual 7.27.16 (Taxes on Foundation Failure to Distribute Income) (Last Revised on August 23, 2001).

of the contribution and the donor-advisor would pay the non-deductible portion. In this situation, the Notice states that Treasury and the Service intend to propose rules under Section 4967 that will treat the contribution from the DAF as conferring more than an incidental benefit upon the donor-advisor, even if the donor-advisor pays the non-deductible portion. As described below, we support the Notice's position.

The second issue concerns whether a donor-advisor may recommend contributions to a public charity that satisfy the donor-advisor's pledge to the charity. In this case, the Notice indicates support for the view that a DAF may make contributions to public charities that may satisfy the pledge of a donor-advisor and that such contributions will not result in more than an incidental benefit if certain conditions specified in the Notice are met. These include the sponsoring organization of the DAF making no reference to the existence of a charitable pledge. This view is largely premised on the difficulty, as described in the Notice, of the sponsoring organization discerning whether there is a legally binding pledge that is being satisfied as a result of making the donor-advisor's recommended contribution.

While we are sympathetic to the potential difficulty the sponsoring organization faces, we are not supportive of the "don't ask, don't tell" approach. Rather, we believe, as detailed below, that the donor-advisor is in the best position to determine whether the transfer would satisfy the donor-advisor's obligation and that the sponsoring organization should be required to receive a certification from the donor-advisor that it does not.

The third issue involves the use of DAFs to assist other charitable organizations in meeting the public support test for qualification as a publicly supported organization. The concern is a donor-advisor may exploit a DAF to avoid the limitations imposed upon an

organization with respect to contributions from a "substantial contributor". Those contributions count as public support up to a limit of 2% of the organizations total support in the case of organizations described in Section 170(b)(1)(A)(vi). That limitation does not apply to contributions from other publicly supported organizations, which includes a DAF sponsor. Thus, a grant to a DAF and then from a DAF to the other organization could avoid these rules. The Notice provides that Treasury and the Service are considering addressing this issue by providing a look-through rule that effectively treats the contribution to the ultimate recipient as if made by the donor-advisor. We support this rule.

Finally, the Notice requests comments on how private foundations may use DAFs in support of their programs. The specific concern appears to be that a contribution to a DAF by a private foundation is treated as a contribution to a public charity and thereby constitutes a qualifying distribution. This would appear to be the situation even though the private foundation (or its officers and other disqualified persons or persons the foundation designates) will as a practical matter retain influence over the use of those funds. In particular, the Notice questions whether there should be a rule requiring the DAF to distribute the funds received from the private foundation to another charity within a specific period of time. As set forth below, we support such a rule and propose that the regulations follow existing rules for grants to certain private foundations and generally adopt a look-through rule for determining whether the contribution to the DAF constitutes a qualifying distribution.

IV. Discussion

A. Certain Distributions From a DAF Providing a More Than Incidental Benefit To a Donor, Donor-Advisor, or Related Person

Recommendation: We support the position set forth by Treasury and the Service that the regulations provide that the donor-advisor receives a more than incidental benefit under Section 4967 if a DAF makes a contribution to a public charity and, as a result of such contribution, the donor-advisor becomes entitled to attend an event or receives membership or similar benefits that would result in such contribution not being fully deductible if it had been made directly by the donor-advisor.

The statutory schemes for both DAFs and private foundations impose penalties for transactions which confer more than an incidental benefit. For a private foundation, Section 4941 imposes an excise tax on a disqualified person if the person engages in an act of self-dealing with the foundation. Acts of self-dealing include any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.[22] However, the fact that a disqualified person receives an "incidental or tenuous benefit" from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing.[23] Similarly, for a DAF, Section 4967 imposes an excise tax where a distribution from a DAF results in the donor or donor-advisor (or a person "related" to either) receiving directly or indirectly a "more than incidental benefit" as a result of the distribution.

In the case of private foundations, payments by a private foundation to a charity in order to maintain a disqualified person's membership status with respect to such charity and enable such disqualified person to be eligible to purchase tickets are treated as conferring more than an

[22] Section 4941(d)(1)(E). See "Background—Private Foundations" section for more detail.

[23] Treas. Reg. Section 53.4941(d)-2(f)(2). Examples of "incidental or tenuous benefit" under the Regulations deal with situations in which the general reputation or prestige of a disqualified person is enhanced by a public acknowledgement of some specific donation by him, in which the disqualified person receives some other relatively minor benefit of an indirect nature, or in which such a person merely participates to a wholly incidental degree in the fruits of some charitable program that is of broad public interest in the general community.

incidental or tenuous benefit and constituting a prohibited economic benefit.[24] Because the policy issue is essentially the same for both private foundations and DAFs, we believe that a similar principle should be adopted for DAFs for purposes of Section 4967. Thus, we support the position set forth by Treasury and the Service that distribution from a DAF pursuant to the advice of a donor-advisor that subsidizes the donor-advisor's attendance or participation in a charity-sponsored event confers on the donor-advisor a more than incidental benefit under Section 4967. A similar rule should also be adopted with respect to membership rights or similar benefits.

We agree with the view expressed in the Notice that the contribution by the DAF has enabled the donor-advisor to receive the benefit. To the extent that the DAF has funded the entire amount of the contribution, the benefit received by the donor-advisor can generally be measured by the monetary value of the benefit assigned by the recipient charity. Even in those circumstances in which the donor-advisor pays directly the amount that is non-deductible under Section 170, we believe that the better answer is still that a more than incidental benefit has been conferred on the donor-advisor.

We note that others have advocated for a view that bifurcates the deductible and nondeductible portions of the contribution. A rationale for the bifurcation approach is that a DAF is not conferring any additional benefits to the donor-advisor where the contributed portion would be deductible under Section 170 regardless of whether such contribution was made by the DAF or the donor-advisor. The benefit of having made a charitable deduction by the donor-advisor is incidental. And, any additional value attributable to attending the event or the membership has been paid for by the donor-advisor.

[24] GCM 36784; Rev. Rul. 77-160.

We agree with the argument put forth in the Notice that without the DAF making the contribution, the contribution by the donor-advisor of the non-deductible amount would, by itself, not be sufficient for the donor-advisor to obtain the benefit. In that regard, we believe that the better view is that there is one contribution and separating it into parts is not a convincing analysis. A similar bifurcation approach has been considered in the private foundation context and was rejected by the Service in a private letter ruling involving a private foundation and a disqualified person. The Service held in such ruling that a bifurcation of payments by a disqualified person and a private foundation of the costs of attending charitable fund-raising events would constitute acts of self-dealing under Section 4941(d).[25] The rationale articulated by the Service was that the private foundation was making a payment that, if not made by the private foundation, would otherwise have to be made by the disqualified person to obtain the benefit. We believe that this analysis, which treats the entire contribution as being required to earn the benefit, is consistent with the existing authority and correct from a policy point of view.

Furthermore, there is no discernible distinction between DAFs and private foundations on this issue to warrant different standards or rules for DAFs. A similar public policy underlies the rules disallowing DAFs and private foundations from conferring more than incidental benefits, which is that private benefit is prohibited for all charitable organizations. Accordingly, we support a regulation for DAFs as set forth in the Notice.[26]

[25] PLR 9021066. A private foundation and disqualified person wished to share the cost of the tickets for future charitable fund-raising events, where the disqualified person would pay for that portion of the tickets representing the fair market value of the entertainment, and the foundation would pay for that portion allocable to the charitable contribution for the fund-raising event. The foundation represented that, in no event, would it pay for the all of the cost of the tickets to the events. The Service held that such bifurcation of costs constituted self-dealing. *See also* Rev. Rul. 77-160.

[26] We would expect that the regulation would include as person subject to the rule not only the donor-advisor but various related parties. For this purpose, we believe Treasury and the Service should look to the definition of disqualified persons under Treas. Reg. Section 53.4946-1.

We suggest that in connection with these regulations, Treasury and the Service include further guidance on when a benefit constitutes a more than incidental benefit. We believe that the scope of the incidental benefit in this context should not be any different than in the context of private foundations and should be addressed by conforming to the private foundation rules. Also, we believe that to be more than incidental, the benefit conferred needs to have a monetary value.[27] For example, it is not entirely clear whether a DAF distribution (or private foundation contribution) that permits someone to secure a slot to run in a race or marathon where there is no actual fee to participate (or where the participant does not get a reduction in the normal fee) creates more than incidental benefit to the advisor. In this example, assume the contribution permits the individual to avoid the lottery to participate in the race or permits the participant to obtain a particular starting position at an event. Because securing a slot in a race or similar benefit is without monetary value, any benefit may be considered as merely an incidental benefit. Likewise, a DAF distribution (or private foundation contribution) that provides naming rights to a building to the donor does not provide monetary value, and so naming rights should be considered an incidental benefit.[28] We believe that neither the spot in the race, nor the naming rights, would reduce the deductible amount of a cash contribution, and so our proposal is consistent with the Joint Committee explanation in the footnote.[29] Accordingly, distributions from a DAF that enable the donor-advisor to secure such slot or naming rights should be considered as not providing more than incidental benefit to the donor-advisor.

[27] While "incidental benefit" is not defined in the statute, the Joint Committee of Taxation's Technical Explanation provides that there is "a more than incidental benefit" if the benefit, under the rules governing charitable contribution deductions under Section 170, would otherwise cause the reduction or elimination of a charitable contribution deduction. Joint Committee on Taxation, Technical Explanation of H.R.4, the Pension Protection Act of 2006.

[28] *See* Rev. Rul. 73-407, 1973-2 C.B. 383.

[29] *Supra* note 26.

B. Certain Distributions from a DAF Used to Satisfy a Charitable Pledge Made by a Donor, Donor-Advisor, or Related Person

Recommendation: Treasury and the Service should confirm in regulations to be issued under Section 4967 that a distribution from a DAF to satisfy a donor-advisor's legally enforceable pledge to make a contribution to a charity would confer more than incidental benefit to the donor-advisor. In that event, the donor-advisor would be subject to penalties under Section 4967. However, to insulate the sponsoring organization from penalties under Section 4966 and Section 4958, we recommend that, in addition to the requirements specified in the Notice, a donor-advisor be required to provide a representation or certification to the DAF or the sponsoring organization that the recommended distribution is not in satisfaction of a legally enforceable pledge. If all of these requirements are met, absent actual knowledge by the sponsoring organization or the DAF that the certification was false, the sponsoring organization and the DAF would not be subject to penalty.

The Notice provides that Treasury and the Service are considering proposed regulations under Section 4967 providing that distributions from a DAF to a charity will 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. Such distribution would be permitted regardless of whether the recipient charity treats such distribution as satisfying the pledge, provided that the following conditions are satisfied:

(1) The sponsoring organization makes no reference to the existence of any individual's charitable pledge when making the DAF distribution;

(2) No donor-advisor receives, directly or indirectly, any other benefit that is more than incidental on account of the DAF distribution; and

(3) A donor-advisor does not attempt to claim a charitable contribution deduction under Section 170(a) with respect to the DAF distribution, even if the distributee charity sends the donor-advisor a written acknowledgment in accordance with Section 170(f)(8) with respect to the DAF distribution.

We do not support this view. We do, however, support providing protection to sponsoring organizations subject to conditions that make clear that the sponsoring organization lacks actual knowledge that the contribution is being used to satisfy the donor-advisor's obligation to make a gift.

First, we propose that Treasury and the Service confirm in regulations the use of a DAF to satisfy a legally enforceable pledge of the advisor would convey more than an incidental benefit upon the donor-advisor and that penalties would be imposed on the donor-advisor as provided in Section 4967.[30] It is undisputed that a distribution in satisfaction of a personal pledge would be considered as a more than incidental benefit in the context of private foundations.[31] The public policy behind such prohibition is equally applicable to DAFs – the intent behind Section 4967 was to similarly prohibit private benefit to the donor-advisors or their related parties. Thus, it would be appropriate to adopt a similar rule in the context of DAFs.

It is clear under the Code that DAFs are public charities and not equivalent to private foundations. The notable difference that sets DAFs apart from private foundations is that the sponsoring organizations, rather than the donor-advisors, have the sole and final discretion to decide whether to make a distribution as recommended by the donor-advisor or not. The statutory schemes for DAFs and private foundations recognize this difference and the autonomy

[30] We note that a legally enforceable pledge should be distinguished from mere expression of intent to contribute or a pledge that is not legally binding for this purpose. The rules discussed herein should be applicable to only legally enforceable pledges.

[31] Treas. Reg. Section 53.4941(d)-2(f)(1).

of sponsoring organizations and DAFs from the donor-advisors. In fact, some sponsoring organizations voluntarily adhere to more robust internal procedure to ensure that the recommended distribution is not to satisfy a pledge of the donor-advisor and reject the recommendation if they believe that to be the case.

Despite the different classifications of DAFs and private foundations, the statute contains in separate provisions prohibitions on the use of both types of organizations' funds for personal benefit. It is difficult to understand why the relief of a legal obligation is not more than an incidental benefit, either for a disqualified person of a private foundation or the donor-advisor of a DAF.

The Notice seems to implicitly recognize that a distribution from a DAF in satisfaction of a pledge of the advisor would convey more than an incidental benefit to such advisor, when citing the private foundation rule with approval. Instead, the position in the Notice appears motivated by practical concerns associated with the difficulty for sponsoring organizations to differentiate between a legally enforceable pledge by an individual to a third-party charity and a mere expression of charitable intent. This motive is apparent from the view expressed by Treasury and the Service in the Notice that, "in the context of DAFs, the determination of whether an individual's charitable pledge is legally binding is best left to the distributee charity, which has knowledge of the facts surrounding the pledge". We also understand that there may be no effective way for the Service to examine the DAF sponsoring organization and determine whether a particular grant by a DAF has been made in satisfaction of a pledge.

Although we are sympathetic to the practical issues associated with the difficulty that sponsoring organizations of DAFs could face in determining whether the pledge is legally binding and the administrative burden on the Service to enforce prohibition on such distributions

in the context of DAFs, we are concerned that the proposed regulations under consideration would be essentially adopting a "don't ask, don't tell" approach. Such approach could effectively permit a donor-advisor to use a DAF to satisfy a personal, legally binding, pledge as long as such fact is not shared with the sponsoring organization and other certain conditions are met. We also believe that this approach elevates form over substance and will make it difficult for taxpayers to take seriously the regulatory regime surrounding DAFs. We are not aware of any other place in the Code where a taxpayer can achieve a better tax result if, and only if, a third party (the sponsoring organization) fails to disclose a true fact (the satisfaction of a pledge) to another third party (the charity).

Considering that this is a concern of determining the facts, we believe there are other measures and rules that can be adopted in addition to the approach that the Notice contemplates to prevent an abusive use of DAFs to satisfy legally binding personal pledges. There is at least one party in the position to clearly know the facts: the donor-advisor. A certification from the donor-advisor would address those factual concerns. Even in a situation where there might some uncertainty as to whether a given pledge is legally enforceable under the applicable state law, the donor-advisor has the necessary factual details to make such determination. Indeed, it is our understanding that many sponsoring organizations already request this representation or certification.

Given the above, we believe that the requirements in the Notice should be expanded to provide that DAFs may treat the distribution as not satisfying a pledge only if the sponsoring organization receives a representation or certification from the donor-advisor that the distribution from the DAF will not be in satisfaction of the donor-advisor's (or related parties') binding

obligation to make a contribution.[32] If such representation or certification turns out to be false or incorrect, a penalty would be imposed on the donor-advisor under Section 4967. However, no penalty would be imposed on the sponsoring organization under Section 4966, Section 4967 or Section 4958 unless the sponsoring organization had knowledge that the donor-advisor's representation or certification was false or incorrect at the time the distribution was made.[33]

We do not believe that requiring the donor-advisor to give such representation or certification will create undue burden on either the donor-advisor or the sponsoring organization. Such a representation or certification could be included in the basic form in which the donor-advisor makes the recommendation to the sponsoring organization. This would result in essentially no increased burden on the sponsoring organization. As for the donor-advisors, we recognize that this may require them to pay greater attention to their undertakings with respect to charities to which they intend to fund or seek to be funded. However, it is our view that the donor-advisors should already have all the necessary facts to make such determination if they have made a pledge and it is in their personal interest to be cognizant of the extent of the legal obligation they are under to satisfy a pledge.

We also considered whether the recipient charity would also need to give a similar certification, but we believe that the cost of imposing such burden on the recipient charity would outweigh the benefit. The certification or representation by the donor-advisor should be sufficient for this purpose because a recipient charity would likely discourage the donor-advisor from advising such distribution from the DAF if it believed that doing so would result in excise

[32] We recognize that this requirement can be avoided if all the donor-advisor pledges is to recommend to the sponsoring organization that the DAF make the distribution. We believe that most charities understand the distinction between a binding pledge to contribute and a pledge to recommend a DAF distribution and will treat these pledges differently. Guidance might also confirm that a pledge either to contribute a fixed amount, or to recommend the DAF to distribute the same amount, also results in a more than incidental benefit if the DAF makes the distribution, since that distribution relieves the donor-advisor of the same obligation.

[33] Section 4967(a)(2).

tax under Section 4967.[34] In addition, we considered a de minimis exception to the certification requirement that would be measured on contribution-by-contribution basis to alleviate the burden on donor-advisors who make modest donations to various charities. However, in light of the ability to incorporate the certification or representation on a standard form, we believe a de minimis rule is unnecessary.

We also believe that it would be appropriate for Treasury and the Service to review the entire "pledge rule" as applied to pledges made to Section 501(c)(3) organizations for both DAFs and private foundations. We continue to believe that the rules should be substantially the same with respect to both types of organizations, as the statutory provisions are essentially identical. In connection with that review, we think it would be appropriate to test whether there is more than an incidental benefit by examining the benefit ultimately received by the donor-advisor (in the case of a DAF) or the disqualified person (in the case of a private foundation). Arguments can be made that if the benefit ultimately received, such as public recognition, is itself merely incidental, then the satisfaction of the pledge should also be viewed as incidental. For example, a private foundation may make a contribution to a public charity on the condition that the public charity change its name to that of a disqualified person, without there being more than an incidental benefit.[35]

C. Preventing Attempts to Use a DAF to Avoid "Public Support" Limitations

[34] It seems reasonable and conceivable for the donor-advisors to request the recipient charity to assist in making the determination as to whether the pledge would be legally binding or not, but the donor-advisors should be the one to ensure and certify that the advised distribution is not to satisfy the pledge. If they want to avoid such obligation, they could make direct contributions rather than using DAFs.

[35] Rev. Rul. 73-407, *supra* note 28. Moreover, the rule in Treas. Reg. Section 53.4941(d)-2(f)(1), which treats satisfaction of a legally binding pledge as an act of self-dealing, does not apply to grant or payment which satisfies a legally enforceable pledge made on or before April 16, 1973 to a Section 501(c)(3) organization. Given the issues with DAFs, reconsideration of this rule may be appropriate.

Recommendation: Treasury and the Service should issue regulations providing for a "look through" rule for the treatment of grants made by a DAF to another Section 501(c)(3) exempt organization for purposes of determining whether the donee organization is considered publicly supported under Section 170(b)(1)(A)(vi) or Section 509(a)(2). Under this rule, grants made by a DAF would be treated as though the grants were made by the donor-advisor.

The Notice states that Treasury and the Service are considering new provisions to the regulations defining public support to address these issues. Under the Notice, the recipient organization must treat:

(1) A sponsoring organization's distribution from a DAF as coming from the donor (or donors) that funded the DAF rather than from the sponsoring organization;

(2) All anonymous contributions received (including a DAF distribution for which the sponsoring organization fails to identify the donor that funded the DAF) as being made by one person; and

(3) Distributions from a sponsoring organization as public support without limitation only if the sponsoring organization specifies that the distribution is not from a DAF or states that no donor or donor-advisor advised.

Treasury and the Service recognize that, as a result of the proposal, a donee organization may need to obtain additional information from the sponsoring organization in order to determine its amount of public support. The Notice points out, however, that this burden will apply only if the private foundation seeks to treat the contribution from the sponsoring organization as public support.

The issue arises because a sponsoring organization is itself classified as a public supported charity, as opposed to a private foundation, and is described in Section

170(b)(1)(A)(vi). As a result of that classification, grants made to another exempt organization are treated as support from the public.[36] In particular, to be classified under section 170(b)(1)(A)(vi) an organization must normally receive a substantial part of its support from governmental units and from direct or indirect contributions from the public.[37] For these purposes, an organization may treat as support from the public contributions received from any one person during the relevant period only to the extent that such person's contributions do not exceed 2 percent of the organization's total support for the period.[38] In applying the 2-percent rule, all individuals, trusts, or corporations that are related as described in Section 4946(a)(1)(C) through Section 4946(a)(1)(G) are treated as one person.[39] The 2-percent limitation does not apply to grants made by a publicly supported organization, such as a DAF, described in Section 170(b)(1)(A)(vi), unless the grants have been earmarked by the donor to be given or used for the benefit of the donee.[40]

Similarly, organizations that seek to be treated as publicly supported under Section 509(a)(2) cannot treat contributions from a substantial contributor as public support.[41] Here again, contributions from an organization described in Section 170(b)(1)(A), including a DAF, are not subject to the substantial contributor rule and count as public support, unless the amounts have been "earmarked" by the donor to be given or used for the benefit of the ultimate recipient.[42] Thus, under the "earmarking" rules, both Section 170(b)(1)(A)(vi) and Section 509(a)(2) provide a basis to prevent an organization from inflating its support from the public

[36] Treas. Reg. Section 1.170A-9(f)(6)(v).
[37] Treas. Reg. Section 1.170A-9(f)(1).
[38] Treas. Reg. Section 1.170A-9(f)(6)(i).
[39] *Id.*
[40] Treas. Reg. Section 1.170A-9(f)(6)(v).
[41] Section 509(a)(2)(A); Treas. Reg. Section 1.509(a)-3(b).
[42] Treas. Reg. Section 1.509(a)-3(j).

through grants from other publicly supported organizations. Under the earmarking rules, a donor may not effectively designate the recipient of that donor's grant to an already public charity.[43]

We believe that the earmarking rules represent sound policy. In substance, those rules prevent a masking of the amount of public support, by preventing an organization from treating as public support amounts received from another public charity that have been given to that charity for the purpose of making a further grant. Given the nature of public charities other than DAF sponsoring organizations, the earmarking rules apply in a narrow range of cases. The initial grant must be designated as being made for the benefit of the ultimate recipient. The earmarking rules do not apply in situations in which the initial charitable recipient has unfettered control over the funds and can make an independent determination as to their use. Such unfettered control means that the determination made by the initial recipient is subject to a greater degree of examination than the DAF situation, in which the sponsoring organization is merely ensuring that the recipient is an appropriate charity. Moreover, such control permits the initial recipient generally to use the funds for other purposes.

The structure of DAFs potentially facilitates the avoidance of these earmarking rules. In the case of the DAF, the donor has a specific role in recommending a grant to be made by the sponsoring organization from the DAF and one would ordinarily expect that the donor's recommendations would be respected in almost all cases. This ability to recommend particular grants effectively gives the donor the right to earmark the funds long after they have been contributed to the DAF, rather than merely upon the initial grant. We recognize that the sponsoring organization must ultimately approve the grant and will exercise some control through that approval process. We view that control to be not substantially different than the

[43] *Id.*

situation of the initial recipient of an earmarked grant. That recipient will exercise authority in determining whether or not to accept the grant by evaluating whether it can make the ultimate earmarked contribution.

D. Treatment of Transfer of Funds by a Private Foundation to a DAF as a "Qualifying Distribution"

Recommendation: Treasury and the Service should adopt regulations to the effect that a contribution to a DAF by a private foundation would not be considered a qualifying distribution unless the DAF sponsoring organization agrees to distribute the funds for Section 170(c)(2)(B) purposes within a certain timeframe.[44] In this regard, the regulation should follow the rules set forth in Treas. Reg. Section 53.4942-3(c).

Comments were requested on whether, consistent with Section 4942 and its purposes, a transfer of funds by a private foundation to a DAF should be treated as a "qualifying distribution" only if the DAF sponsoring organization agrees to distribute the funds for Section 170(c)(2)(B) purposes (or to transfer the funds to its general fund) within a certain timeframe. We support this position and urge Treasury and the Service to adopt regulations to this effect. The agreement by the sponsoring organization of the DAF should follow the time frame in Treas. Reg. Section 53.4942(a)-(3)(c).

In the case of the minimum distributions rules, Congress was concerned that the private foundations were being used to accumulate assets without actually benefiting any charitable cause. Accordingly, the thrust of the minimum distribution requirement was to ensure that at

[44] We note that a transfer of assets by a private foundation to a DAF in connection with the dissolution and termination of the private foundation could be a qualifying distribution under Section 507(b)(1)(A) if the DAF has been in existence as an organization qualifying as Section 170(b)(1)(A)(iv) for at least 60 months immediately preceding such distribution. Regulations to be issued could also address this narrow situation.

least a portion of the assets were expended for actual charitable use. This thrust is also borne out in the provisions of the regulations setting forth the applicable rules for grants to other private foundations that would meet the qualifying distribution definition only if the donee organization distributed the grant. In particular, Treas. Reg. Section 53.4942(a)-(3)(c) specifies the conditions that the donor and donee organization must meet, including that any grant by the donee organization be made by the close of the first taxable year after the close of the donee organization's taxable year in which the contribution was received. In addition, to meet the requirements the donee organization must make information available to the granting private foundation. Finally, the grant must satisfy the other tests of qualifying distributions, treating the grant as if made directly by the first private foundation.

We believe that the agreement of the sponsoring organization to make the distribution within the time frame set forth in Treas. Reg. Section 53.4942(a)-(3)(c) will ensure that a DAF is not used merely as a parking place for funds by private foundation in contravention to Congress' intent that private foundations distribute income currently as expressed in the required minimum distribution rules.[45] In the situation that the DAF is receiving the contribution from the private foundation, it is in substance acting as an intermediary between the private foundation and the ultimate recipient. The DAF is not directly using the funds for a charitable activity; rather it is using the funds only to make the grant to another organization. In that circumstance, there is no good policy reason to distinguish between the contribution to the DAF from the contribution to another private foundation. Requiring the contribution to be used for charitable purposes, and not be merely retained and reinvested, is consistent with the underlying policy of Section 4942.

[45] We assume that the DAF sponsoring organization will respect the agreement and timely distribute the amount received from the private foundation to a charity that uses the funds in connection with its charitable activities.

In reaching this conclusion, we are relying upon the supervision of the sponsoring organization to insure that the distribution is actually made.

We note that other public charities may freely accumulate funds, including those contributed by DAFs. For example, universities and other schools may freely take contributed funds and deposit the funds in their endowment. In that case, the DAF contribution may not be used for direct charitable purposes until many years in the future.[46] However, unlike DAFs which fulfill their charitable mission only by disbursing funds, schools, hospitals and other organizations that conduct charitable activities directly are, at least arguably, determining the accumulation needed to assure their long-term viability. In those circumstances, these charities have different interests than DAFs. In brief, those organizations that directly conduct charitable activities should not be second-guessed on what accumulation is enough.

[46] Under the newly enacted Section 4968(a) (as added by Section 13701(a) of the Tax Cuts and Jobs Act, H.R. 1, 115th Congress, Pub. L. No. 115-97 (2017)), excise tax is imposed on each applicable educational institution for the tax year equal to 1.4% of the applicable educational institution's net investment income for the tax year. Congress observed that the endowment balances at many private colleges and universities have increased dramatically in recent years, but college tuition has risen at rates in excess of the rate of inflation at the same time. Given this, Congress considered it appropriate to impose a modest excise tax on the investment income derived from the endowment where the endowment of a private college or university has grown so large that it is not commensurate with the scope of the institution's activities in educating students. H. Rept. 115-409 (Nov. 13, 2017).