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Electronic Mail

Internal Revenue Service
CC:PA:LPD:PR (Notice 2017-73)
Room 5203
P.O. Box 7604
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Washington, D.C. 20044

Re: Comments Regarding Notice 2017-73

Dear Sirs and Madams:

In Notice 2017-73, issued December 7, 2017, the Service requested public comment about several issues concerning donor-advised funds ("DAFs"). One such issue is of particular concern to organizations that receive contributions recommended by DAFs to their sponsoring organizations: that of the potential use of DAFs to circumvent the excise taxes and other limitations imposed on private foundations, as discussed in Section 5 of the Notice. The Notice indicates in Section 1 that it is "considering developing proposed regulations that would change the public support computation" under Code Section 509. In Section 5 it indicates that it is "considering proposing" changes to Regulations Sections 1.170A-9(f) and 1.509(a)-3. Such a change in the public support computation would alter at least 50 years of donor-advised fund law and history in reversing the treatment of grants from sponsoring organizations to other exempt organizations, and without statutory changes to Internal Revenue Code Sections 509(a), 4966(c), and 170(b)(1)(A)(vi).

Notice 2017-73 appears to be the first ever indication by the Service of concerns about the public support ramifications of grants recommended by DAFs to

sponsoring organizations, even though DAFs began in the early 1930s and continued after the Tax Reform Act of 1969. When the Pension Protection Act of 2006 was enacted, no mention was made of any abuse that would require treating the donor to a DAF as the donor to the charity receiving a recommended grant from the DAF's sponsoring organization. The "Report to Congress on Supporting Organizations and Donor Advised Funds" produced by the Department of the Treasury in December, 2011, in response to a request in the Pension Protection Act of 2006 similarly did not raise any such issue. Statutory changes to DAFs have been enacted since 2006, without any allusion to a need for a change such as that hypothesized here.

Prior and Current Experience. I believe the suggested change to Section 509 to be unwarranted under current law and under current and historical experience, as well as logistically and operationally problematic for both the sponsoring organization and the organization receiving a grant resulting from a DAF's recommendation, as explained below. A change such as described in the Notice should be offered only on convincing evidence that contributions from sponsoring organizations actually do subvert the Chapter 49 requirements for grant recipients with any significant frequency. The Service doesn't generally seek statutory or regulatory changes unless the issue is substantial. The burdens suggested to be imposed on sponsoring organizations and their grantees certainly appear at this point to be disproportionate to any abuse.

Hypothetical Example. For purposes of this comment, consider an organization that has received a favorable determination letter declaring it to be exempt from Federal income taxes as described in Code Sections 501(c)(3) and 509(a)(1) or (a)(2). The organization's Form 1023 indicated it would be publicly supported based on the applicant's knowledge that it could hope to receive grants through DAF recommendations from donors/recommenders other than the founder. The organization has been operating and reporting as a public charity for the past six years, carrying on an active slate of programs and events in its field of interest. The organization has received the bulk of its support from a public charity that is a sponsoring organization for a particular DAF. The grants by the sponsoring organization resulted from a decision by the sponsoring organization to approve recommendations made by the donors to the DAF, which had been funded some years ago, before any grants to the organization were thought of. Neither the donors nor any related persons are in control of the organization.

Dominion and Control in Sponsoring Organization. Under current law and regulations, the contributions described in the example are treated by the organization as received from a public charity described in Code Sections 501(c)(3), 509(a)(1), and 170(b)(1)(A)(vi), and therefore as support from the general public for purposes of the one-third public support test. The donors who created the DAF retained no control rights over the DAF funds but rather had only an opportunity to recommend to the sponsoring organization the identity of the ultimate grantees. The grants were not made by the donors/recommenders, and are not considered under the Internal Revenue

Codes of both 1986 and 2017 and the Treasury Regulations promulgated thereunder to have been made by them. When the sponsoring organization received funds into the DAF, the funds were and remained for legal and tax purposes its funds. Therefore, the sponsoring organization, having **legal control** of the funds, made the grants. This has been the Service's position since at least 1969. Even before 1969, I am not aware of any other approach to DAFs having been taken by the Service.

When a recommendation is made by an advisor to a DAF, the sponsoring organization is under no legal obligation to honor the recommendation, and, in fact, as the owner of the funds, it has an obligation to make an independent decision with regard to its assets. When a sponsoring organization makes a grant, it is because the sponsoring organization has decided to do so. This is the bedrock underlying the concept of the DAF and it is why the donor receives a charitable contribution deduction for the amount of the contribution upon donating the property to a DAF, rather than when amounts are subsequently distributed as grants.

Notice Disregards Long-Standing Law. When the notice says that treating the donor to the DAF as the donor to the ultimate grantee "would better reflect the degree to which the distributee charity receives broad support from a representative number of persons," that statement totally disregards the tenets of the law that the funds in the DAF legally are owned and controlled by the sponsoring organization, as well as discounts the independence of the sponsoring organization. To say that the funds were granted by the original donor is inconsistent with that legal reality, and to say that the funds really are controlled by the donor is incorrect. The donor to a DAF would be unsuccessful in bringing a lawsuit against a sponsoring organization that did not follow the donor's recommendation. In fact, Code Section 170(f)(18)(B) was added in 2006 to require the donor to the DAF to obtain upon establishing a DAF a contemporaneous written acknowledgement from the sponsoring organization that the latter has exclusive legal control of the assets contributed, a clear recognition by Congress and the Service of legal control by the sponsoring organization.

Impact of Popularity. Further, DAFs have grown ever more popular over the past 20 years, making it likely that any publicly supported charity might receive contributions recommended by donors to DAFs. The Notice makes the point in the final paragraph of Section 5 that a recipient organization would need to collect additional information from the sponsoring organization only if it intended to treat receipts from the sponsoring organization as public support. However, this understates the significant administrative burden on all recipients of grants from sponsoring organizations. Any charity receiving grants from sponsoring organizations would necessarily have to inquire about the original donor, as contributions recommended by DAFs grow. On the other side, the sponsoring organization will need to provide the original donor's name for each grant it makes that originated from a recommendation or a statement that the donor chose anonymity.

Ramifications to Sponsoring Organizations: The Notice indicates that the changes postulated would apply only for determining whether a grantee will continue to qualify as a public charity. However, once a grantee doesn't so qualify, the sponsoring organization will face additional rules. The change could create operational uncertainty for sponsoring organizations, immediately and in the future. If grants from DAFs result in a grantee being classified as a private foundation, each granting sponsoring organization would be required to exercise expenditure responsibility under Code Section 4966(c)(1)(B)(ii). However, under the proposed changes to the Treasury Regulations, neither the recommender nor the sponsoring organization would necessarily know, at the time of the recommendation, whether the proposed grant recipient would be a public charity or a private foundation after the grant, especially if the recommended grantee were a smaller organization or the recommended grant were a large one. Therefore, the sponsoring organization might have to exercise expenditure responsibility on many grants. Even if the recipient has been listed historically as a public charity by the Service, the precise grant being made by the sponsoring organization might be the one that demotes the public charity to private foundation status. It might even be that the sponsoring organization, such as in the case of the organization in the example, has knowledge that a particular grant will cause the recipient charity to fail the one-third public support test for the year of the grant and perhaps for future years, if the grant is treated as made by the donor to the DAF rather than by the sponsoring organization. These uncertainties could severely limit the ability of sponsoring organizations to consider making a recommended grant or to satisfy a recommended grant approved by it in a timely and effective manner. To avoid this, any proposed change in the regulations would need to provide that a sponsoring organization will not run afoul of Code Section 4966(c)(1)(B)(ii) unless and until the Service issues a written notice that the recipient "public charity" no longer is described in Code Section 170(b)(1)(A). Further, the sponsoring organization would need assurance that its own knowledge that its grant could cause the recipient to fail the one-third public support test does not constitute knowledge for the purpose of penalizing the sponsoring organization, keeping in mind the warnings about such knowledge in, for example, Reg. Section 1.170A-9(f).

In addition, such a change would impose a substantial administrative burden on sponsoring organizations. The proposed changes will not enable a sponsoring organization to identify beforehand a recipient that might be trying to skirt chapter 49. Instead, the sponsoring organization would need to provide the name of the donor to the DAF with each grant made from funds held in a DAF. Given the number of DAFs in the country, estimated at 285,000 as of the end of 2016, according to National Philanthropic Trust, the total effort required by sponsoring organizations would be tremendous. The alternative would be to force the grantee organization to make an inquiry of each granting sponsoring organization, which would be an even greater total burden on the philanthropic sector. Only by knowing the name of the DAF's donor could the grantee calculate whether that donor or a related person made individual, non-DAF grants to it for purposes of aggregation under the public support test. Sponsoring organizations

might also decide to enact internal policy changes that would impact all grantees, such as stricter examination of Forms 990, or might ask to see the recommended grantee's Form 1023. Some might even shift the onus to the donor to know or warrant that the recommended grant would not cause the grantee's public charity status to be revoked. Such changes could chill the use of DAFs.

Unintended or Unavoidable Consequences. The contemplated change may require public-charities-turned-private-foundations to apply for status as operating foundations, which would require both the private foundation and the Service to devote resources to the determination of whether the grantee qualifies as an operating foundation; it can be expected that most such grantees as public charities were, and as private foundations will continue to be, carrying on active, non-grant-making activities.

Further, the change could increase the number of charities that attempt to qualify under the 10% facts and circumstances test rather than the one-third public support test. This will add work for the Service as well as the exempt entity.

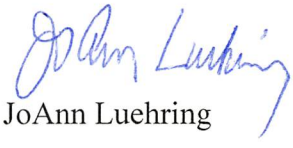
Earmarking. I have read a few comments that have made a point that the earmarking rules of Treasury Regulations Sections 1.170-9(f)(5)(v) and 1.509(a)-3(j) may already "catch" the recommendation and result in the recommended grant being deemed made on a look-through basis by the DAF's donor rather than by the sponsoring organization. However, a straight-forward reading of example 3 of Section 1.509(a)-3(j)(3) makes clear that the intermediary public charity must be "bound" by the earmark in order for the donation to be an indirect contribution from the original donor. Common sense meaning of "earmark" is that the sponsoring organization must either be bound by the earmark or refuse to make the grant. It is clear that the recommender cannot earmark the donation because the sponsoring organization has dominion and control over the funds in the DAF and thus is not bound by any recommendation. Moreover, the earmarking rules have been around for decades and have not to my knowledge been used in connection with DAFs.

Effective Date and Transitional Relief. In any event, change in the public support calculation should have effect only prospectively. Any grantee that received donations from sponsoring organizations before an announced future effective date for the changes under consideration would have received said grants at a time when the Code and Regulations unequivocally allowed such grants to be treated as from a publicly supported charity and therefore as public funds. If the character of those grants were changed after receipt, the recharacterization could unfairly undo the result of good faith reliance on the Code and Regulations. That change could be catastrophic to the grantee, especially if it is engaged in activities or received grants for which it must qualify as a public charity, such as grants from governmental agencies and some private foundations.

Any amounts received before the effective date should continue to be treated as from public sources for the five-year period examined to determine whether the donee organization continues to qualify as a public charity. Similarly, the change should not apply to future installments of multi-year grants that were put in place before the effective date of any change in the Regulations. Additionally, in the case of a DAF that was funded more than some set period of time, such as five years, before the recommendation to the would-be public charity, the tracing arguably should not apply at all, as the DAF likely was not established for the purpose of funding that recipient or avoiding the private foundation restrictions. Perhaps any DAF created before the effective date should not be subject to the change to the extent it was funded prior to the effective date, because the DAF was created in reliance on the pre-existing law and rules.

Thank you for the opportunity to submit my comments. Roberts & Holland LLP represents at least one client that would be negatively impacted by the change suggested in the Notice.

Sincerely,



JoAnn Luehring

JAL/