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**VIA E-MAIL ONLY**  
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Internal Revenue Service  
Ben Franklin Station  
P.O. Box 7604  
CC:PA:LPD:PR (Notice 2017-73)  
Room 5203  
Washington D.C. 20044

Re: Notice 2017-73

To whom it may concern:

This letter is to provide comments on the guidance regarding donor advised funds proposed in Notice 2017-73 (the “Notice”). Primarily, the comments address the proposed guidance with respect to a payment from a donor advised fund being applied to a donor’s enforceable pledge. Other issues in the Notice are addressed as well.

### **Pledges**

By way of background, this firm represents a number of community foundations that sponsor donor advised funds and public charities that receive grants from donor advised funds. The comments submitted reflect our experience advising both community foundations and public charities. The comments, however, are not submitted on behalf of any firm client, and the firm has not been retained or compensated to provide these comments.

The Internal Revenue Service (“IRS”) has proposed to issue regulations that would provide that a donor does not receive more than an incidental benefit under Internal Revenue Code (the “Code”) Section 4967, when a payment from a donor advised fund is applied to the donor’s enforceable pledge to the recipient charity if: (1) the sponsor of the donor advised fund does not refer to the pledge when making the payment, (2) the donor does not receive any other benefits from the payment, and (3) the donor does not attempt to claim a deduction for the payment even if the recipient charity erroneously issues the donor a substantiation receipt. The primary basis for this proposed guidance is that it is unduly burdensome for some donor advised fund sponsors to be required to determine whether or not a donor’s written agreement with a public charity is an enforceable pledge. The IRS is correct that enforceability of a written

promise to make a gift to a charity is dependent on a number of facts and circumstances, and it often cannot be readily or easily ascertained from a review of the document.

The IRS is also correct that a donor does not receive more than an incidental benefit when a public charity applies a payment from a donor advised fund toward the satisfaction of a donor's pledge agreement. A benefit is only more than incidental if, as a result of a distribution from a donor advised fund, the donor receives a benefit that would have reduced or eliminated a charitable contribution deduction if the benefit was received as part of the transaction between the donor and the recipient charity.<sup>1</sup> Assuming there are no other goods or services provided by the public charity in connection with a payment that is applied to a pledge, the pledge payment, if it had been made directly by the donor, would have been entirely deductible by the donor, so the payment of the pledge does not provide more than an incidental benefit to the donor.

In this regard, it is important to note that the potential benefit that a donor receives when a payment from a donor advised fund is applied to the donor's pledge is that the donor is no longer subject to a suit by the charity for the amount applied to the donor's pledge. However, this release of potential liability is not a benefit that is more than an incidental benefit. As the IRS notes in the Notice, a pledge is ignored for income tax purposes. Further, as the IRS noted, it is difficult for a charity, even the charity that is a party to a pledge, to determine whether a pledge is enforceable, and thus it is difficult for a charity to sue a donor to enforce a pledge. Also, for reasons of donor relations and publicity, a charity rarely seeks to enforce a pledge agreement even when the charity believes it would prevail in court. In most instances, a donor would not be sued by a charity for any amount of a pledge that is not satisfied by the donor so a donor advised fund is not providing the donor any legal benefit by making a payment that is applied to the pledge. For all of these reasons, the release of potential liability from the payment is not a benefit that is greater than incidental.

The final guidance to be issued by the IRS, however, should be revised from the proposed guidance in two ways. First, the requirement that the sponsoring organization of the donor advised fund not refer to the donor's pledge agreement should be eliminated. Second, the language regarding the limitation of the guidance to Code Section 4967 should be revised to clarify that it is only limiting the scope of the guidance with respect to donor advised funds as distinct from private foundations and is not an indication that the satisfaction of a donor's pledge by a donor advised fund is potentially subject to excise tax under other provisions of the Code.

As explained below, the requirement that the donor advised fund sponsor not refer to the donor's pledge agreement raises several practical problems for both the donor advised fund sponsor and the recipient charity. The requirement also encourages a donor of a donor advised fund to make arrangements with the recipient charity outside of the view of the donor advised fund sponsor, and the rules regarding donor advised funds should not encourage such behavior.

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<sup>1</sup> See IRS Donor Advised Fund Guide Sheet Explanation (July 31, 2008) at p.5 (citing Staff of the Joint Committee on Taxation, Technical Explanation of H.R. 4, The "Pension Protection Act of 2006" as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006 (JCX-38-06) at 350).

Another factor to consider is that donors who make pledges to charities are focusing on committing to support a good cause. They often are unaware of the legal distinctions between pledges and letters of intent or the potential restrictions on using donor advised funds to satisfy pledges. Sometimes, the donor has not established the donor advised fund at the time of entering into the pledge. Later, when they establish the donor advised fund, they might also have transferred the assets to the public charity to satisfy the pledge with the same tax results, but they are unaware of any reason to do so. Regulations should not create traps for donors who are supporting charitable organizations.

Many charities are using enforceable pledge agreements to satisfy accounting and capital campaign counting standards and to secure financing. If a donor cannot satisfy a pledge from a donor advised fund, the charity is forced to put the donor at a disadvantage by using the enforceable pledge. If the charity instead offers a letter of intent to preserve the donor's flexibility, the charity is disadvantaged from an accounting stand-point and may not be able to obtain as favorable of financing for its mission.

Whatever benefit a donor does receive, if any, for having a pledge satisfied by a payment from a donor advised fund, the donor receives that same benefit regardless of whether or not the donor advised fund makes reference to the donor's pledge at the time of the payment. The donor benefit is the same in that the pledge is satisfied regardless of whether the donor advised fund referred to the pledge resulting in the payment being applied to the pledge or whether the recipient charity on its own or in consultation with the donor applied the donor advised fund payment applied to the pledge. Since the donor benefit is the same regardless of whether or not the donor advised fund sponsor refers to the donor's pledge, it is not clear why this is a factor in whether the payment is an incidental benefit for the donor.

Prohibiting the donor advised fund sponsor from referring to the donor's pledge also creates challenges for the recipient charity. When the charity receives the payment, it is unclear how the payment is to be applied. The charity will know the name of the donor associated with the fund, but will not have any other indication as to how the payment is to be used. If the payment matches the timing on the amount of a pledge payment due for the particular donor, then the charity may be able to infer that the payment is to be applied to that pledge. The charity, however, will not want to automatically apply donor advised fund payments to pledges as not all payments from donor advised funds will be intended to apply to donor pledges. If the charity incorrectly applies a donor advised fund payment to a pledge, the charity may miss out on the opportunity to receive both the pledge payment from the donor and the contribution from the donor advised fund. The donor may not have initially intended the payment to be applied to the pledge, but once seeing that it has, may decide not to make an additional payment.

Furthermore, the IRS' guidance will make it difficult for recipient charities to properly treat donor advised fund gifts as restricted to particular purposes or as an endowment. In order for a charity to properly treat a gift as temporarily restricted for a particular purpose or permanently restricted as an endowment, it must have an instruction from the donor to that effect under the generally applicable Uniform Prudent Management of Institutional Funds Act or

similar laws. While it will be possible for donor advised fund sponsors to enter into agreements with charities in proposing these restrictions, often the donor has entered into an agreement with the charity regarding these issues before advising a distribution from a donor advised fund. In many instances, these agreements do not involve a pledge by the donor. Normally, the donor advised fund sponsor would simply refer to the existing agreement for the fund at the public charity making the donor advised fund sponsor's gift subject to the restrictions in the existing agreement. Under the IRS' guidance, however, the donor advised fund sponsor would have to review the agreement and determine that it is not a pledge agreement before referring to the agreement, the obligation that the Notice seeks to avoid imposing donor advised fund sponsors.

If a public charity is not able to receive direction from the donor advised fund sponsor regarding the application of a payment from a donor advised fund, the public charity will be forced to seek that guidance from the donor directly. This puts the donor in the position of giving direction regarding the payment from the donor advised fund outside the view of the donor advised fund sponsor. Given that a donor is not supposed have legal control over the donor's donor advised fund, regulations governing donor advised funds should not create situations where the donor advised fund donor and the recipient charity are encouraged to have conversations and provide donor direction outside of the view of the donor advised fund sponsor.

The requirement that the sponsoring organization of the donor advised fund not refer to the donor's pledge does not change or increase the benefit that the donor receives from having a pledge paid by the donor advised fund. The donor's obligation to make that payment is relieved regardless of whether the charity applies that payment based on a direction from the donor advised fund sponsor or a direction directly from the donor. The Notice, however, limits the ability of public charities to accept designations regarding the use of or endowment of donor advised fund distributions. In order for the donors and charities to resolve these ambiguities, donors and charities will have conversations regarding donor advised fund distributions outside of the view of the donor advised fund sponsor.

For all these reasons, the IRS should eliminate the requirement that a donor advised sponsor not refer to a donor's pledge when making a distribution from a donor advised fund. It should be sufficient to avoid an incidental benefit if the donor does not receive any other benefit from the payment that is more than incidental and the donor does not claim an income tax deduction for the payment from the donor advised fund.

The Notice says that the guidance with respect to payments from donor advised funds being applied to pledges is not "intended to affect the tax treatment of any item under any provisions of the Code other than Section 4967." Donor advised fund sponsors and public charities are assuming that if the Notice's guidance is followed, that there are no adverse tax consequences of the payment from the donor advised fund being applied to a donor's enforceable pledge. If the IRS believes that there are adverse consequences to a donor advised fund payment being applied to a donor's pledge under Code sections other than Section 4967, the IRS should make clear what the consequences are and how to avoid the consequences. Specifically, the introduction to the Notice references Code Section 4958(c)(2), but this section is not specifically

addressed in the discussion of pledge payments. If the IRS believes it would have any basis to impose a tax under Code Section 4958 with respect to the satisfaction of a pledge even where the requirements of the Notice have been followed, donors and donor advised fund sponsors should be made aware of that before the IRS attempts to impose such a tax.

The Notice cites Revenue Ruling 81-110, 1981-1 C.B. 479 (January 1, 1981) in a footnote. In that ruling an individual, A, made an enforceable pledge to a charity. Later, A was unable to pay the pledge, and D made a payment to the charity directing that A's debt be satisfied. The ruling held that D made a gift to A for purposes of the gift tax. The gift tax is imposed upon transfers by individuals under Code Section 2501. It is not applicable to a charitable organization. If a corporation makes a gift, it is a distribution to the shareholders and gift by the shareholders. Treas. Reg. § 25.2511-1(h)(1). Charitable corporations do not have shareholders. It would appear that the Notice is using the fact that the donor advised fund sponsor does not refer to the pledge as a way to distinguish the application of Revenue Ruling 81-110, but this is not necessary as the transfer between the two charities is outside the scope of the Revenue Ruling. The gift tax ruling should not become a basis to impose the burdens described above on donor advised fund sponsors and recipient charities.

### **Quid Pro Quo Gifts**

The Notice provides that donor advised funds cannot pay for event tickets in a situation where the non-deductible portion of the ticket is paid for by the donor and the donor advised fund pays only the deductible portion of the ticket. The Notice concludes that attending the event provides a more than incidental benefit beyond the non-deductible economic benefit reflected by the charity. It seems that the benefit of being at the event beyond the food and other economic benefits reflected by the charity in the non-deductible portion of the ticket is the public recognition of being seen at the event by other community members. This benefit is the same benefit a disqualified person with respect to a private foundation receives when the private foundation makes a grant for which the charity names a building after the disqualified person; a benefit which is treated as an incidental and tenuous benefit. Treas. Reg. § 53.4941(d)-2(f)(2). Similarly, being present at a charity event after the economic benefit of food and drink has been addressed is incidental and tenuous, and should not be a prohibited benefit under Code Section 4967. Assuming the charity is properly valuing the non-deductible portion of its events or other quid pro quo gifts, any additional benefit should not be of greater value than a donor receives by having donor's name prominently displayed on a building.

At the February 9, 2018, Exempt Organization Committee meeting of the American Bar Association, IRS representatives raised the issue that in some circumstances a donor advised fund is being advised by someone other than the person who funded it. This, however, has been true for private foundations for a long time. It is common that a private foundation receives most of its funding when the primary donor dies. This does not change the fact the if the foundation makes a grant that results in recognition of a disqualified person who was not the substantial contributor that the benefit of the recognition still is only incidental and tenuous.

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It is welcome the IRS is attempting to provide guidance for donor advised funds and is working to base that guidance on the practical experiences of these organizations. We hope you can incorporate the above considerations into the further refinement of the guidance.

Very truly yours,

A handwritten signature in black ink, appearing to be 'R. Cafferata', written over a light gray rectangular background.

Reynolds T. Cafferata  
of RODRIGUEZ, HORII, CHOI & CAFFERATA LLP