

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

Comments of Schwab Charitable

March 5, 2018

Schwab Charitable is grateful for the opportunity to respond to the request for comments in Internal Revenue Bulletin Notice 2017-73 (the “Notice”) regarding the application of excise taxes with respect to donor advised funds (“DAFs”) in certain situations.

Schwab Charitable is a tax-exempt public charity that was formed to help increase giving among individuals in the United States and helps donors achieve their philanthropic goals by offering and administering DAFs. We have been administering our DAF program for almost 20 years. Last year, Schwab Charitable made grants of \$1.6 billion to more than 64,000 charities and accepted contributions of more than \$3 billion in cash, publicly traded securities and complex assets. Through stewardship and prudent investing, we have generated almost \$2 billion of additional assets for charity since the inception of Schwab Charitable. We have significant expertise in grantmaking and the administration of DAFs and are pleased to share that expertise with you for use in promulgating regulations applicable to sponsoring organizations of DAFs.

Schwab Charitable offers its donors a convenient and effective platform that encourages philanthropy because of the ease of contributing cash and non-cash assets. We assist donors in identifying assets for giving without charging any consulting or processing fees for most donated complex assets, thereby increasing the amount of assets contributed to charity that otherwise may have been retained because of high administrative costs.

In a 2017 survey of donors, 68% said they give more to charity because they have a DAF with Schwab Charitable than they would without a DAF. Because of the ease of contributing, investing and recommending grants, Schwab Charitable continues to increase its charitable giving each year, with a 29% increase in the number of grants in 2017 over 2016, and a 34% increase in grant value.

Based on our significant expertise in this area, we believe that the imposition of additional regulatory burdens on DAFs, sponsoring organizations, or donor-advisors is not necessary. The imposition of burdens is unlikely to increase compliance with applicable law because, in our experience, DAFs are already compliant. Additional administrative burdens, therefore, would only reduce the efficiency that we provide to the charitable sector—reducing assets available to charity and making less available for use in our communities, nation and world.

Should you identify any areas of noncompliance, we urge you to craft rules that are narrowly targeted to the abuse in question without disrupting the administrative oversight processes and procedures that we have developed over two decades of experience. We further request that any additional rulemaking provide ample opportunity for notice and comment.

Background

All sponsoring organizations of DAFs, including Schwab Charitable, are public charities with diverse sources of support, and should continue to be regulated accordingly. Like other public charities, Schwab Charitable is responsive to its donors, oversees its grants to ensure they are used properly, and operates exclusively in furtherance of its charitable purpose to raise funds and make grants to other charitable organizations.

Please do not lose sight of the fact that donors relinquish legal control over the funds they contribute to Schwab Charitable, and their role is confined to recommending grants to other, valid charitable organizations. This is a bedrock principle of DAFs and any new or additional regulation of necessity must take this into account.

For more than 25 years, the IRS has held that the ability to offer nonbinding grant recommendations is disregarded for tax purposes, does not constitute ownership or legal control over the contributed funds, and is not an economic benefit to the donor. Schwab Charitable makes this structure clear to its donors throughout its policies and donor-facing documents. In Schwab Charitable's Program Policies & Guidelines, Schwab Charitable notes that:

As with all donor-advised funds and per the IRS, all contributions are irrevocable. Put simply, that means donations cannot be retrieved or refunded once contributed. Donated assets are no longer counted among the account holder's personal investments and are, in fact, the property of Schwab Charitable.

Schwab Charitable not only makes our legal control of contributed assets clear to our donors, but also operates consistently with this principle. Schwab Charitable imposes restrictions on how advisors can recommend funds for use, including, without limitation, that grants cannot be recommended to: (1) provide a private benefit to any individual; (2) be used for lobbying, political contributions, or to support political campaign activities; (3) support a private non-operating foundation; (4) support a scholarship if any donor or advisor is an eligible recipient or has a role in selecting the recipient; or (5) support a specific missionary project of an individual who is related to the donor or advisor.

Schwab Charitable's enforcement of these restrictions is also consistent with the fact that Schwab Charitable has sole legal control over the assets:

If an account holder fails to comply with Schwab Charitable's policies, the account holder's privileges can be revoked and the account's assets can be either granted to IRS-approved charities consistent with the account's granting history and/or, under certain circumstances, transferred to the Philanthropy Fund. Examples of actions that can trigger this event, but are not limited to, making grant recommendations that are inconsistent with Schwab Charitable's charitable purposes or by otherwise engaging in actions that reflect adversely on the reputation and philanthropic mission of Schwab Charitable.

We want to make clear how seriously Schwab Charitable takes its sole legal control over contributed assets because the Notice suggests that Treasury and the IRS are considering regulating DAFs like private foundations rather than public charities, the primary difference

between the two being the degree of control the donor has over funds that have been contributed. We strongly oppose any such efforts because they are unnecessary to achieve compliance with the law and are inconsistent with the Pension Protection Act of 2006 (the “PPA”).

The Notice acknowledges that “the relationship between a private foundation and its disqualified persons typically is much closer than the relationship between a DAF sponsoring organization and its Donor/Advisors,” and this is consistent with the regime established for DAFs in the PPA. Unlike donors to DAFs, donors to private foundations have the ability to maintain legal control over the funds they contribute because they and their family members can manage the foundation and the use of the funds after the gift. Because of this control, private foundations and their disqualified persons are subject to a fairly burdensome excise tax regime that does not apply to public charities.

When Congress codified the definitions of DAF and sponsoring organization in the PPA, Congress could have made the entire private foundation regulatory regime applicable to sponsoring organizations, but it did not do so. Instead, Congress made only two limited rules applicable—Section 4945 expenditure responsibility with respect to certain distributions from DAFs, and Section 4943 excess business holdings rules. This indicates that Congress was aware of the private foundation regulatory regime and specifically chose not to make it applicable to DAFs except in these two limited instances. Imposing additional regulatory burdens on sponsoring organizations that do not otherwise apply to public charities would therefore be inconsistent with the PPA and exceed the regulatory authority it confers.

As discussed below, we disagree with those regulatory options proposed in the Notice that would treat DAFs like private foundations for certain purposes.

Issue 1: Bifurcation

For the reasons set forth below, Schwab Charitable urges the IRS to issue guidance clarifying that DAFs may fund the deductible portion of “bifurcated gifts” without the grant giving rise to a prohibited benefit under Section 4967.

It is not uncommon for charitable organizations soliciting gifts to offer goods or services to donors in partial exchange for the gift. For example, many charities sell tickets to an annual gala. The ticket entitles the donor to food and/or entertainment at the event, but the price of the ticket exceeds the value of the goods or services; therefore, the ticket comprises two parts: Part A is the value of the goods or services provided to donors and Part B is the amount of the payment in excess of Part A. Under general tax principles, the amount donors pay for Part B (i.e., the amount paid in excess of the value of the goods or services received) is a deductible charitable contribution within the meaning of Section 170.

The Notice asks for comments about whether a donor could recommend a grant in the amount of the deductible portion of the payment (i.e., Part B in the example above), while paying the non-deductible portion (i.e., Part A or the portion attributable to the value of goods or services received) directly to the charity, a practice known as “bifurcation.” Specifically, the Notice asks whether the payment of the deductible portion of the ticket (i.e., Part B) by a DAF should be allowed or prohibited as a more-than-incidental benefit under Section 4967.

We believe that DAFs should be permitted to contribute the deductible portion of the ticket (i.e. Part B). The term “more than incidental benefit” is not defined in Section 4967, but the Technical Explanation of the PPA does include the following definition, which has been widely used by DAF sponsoring organizations, as well as the IRS, for more than a decade:

In general, under [Section 4967], there is a more than incidental benefit if, as a result of a distribution from a donor advised fund, a [Donor/Advisor] receives a benefit that would have reduced (or eliminated) a charitable contribution deduction if the benefit was received as part of the contribution to the sponsoring organization.¹

This definition utilizes the Section 170 standard and does not make reference to the Section 4941 standard applicable to private foundations, even though Congress was aware that it could make such private foundation provisions applicable to DAFs. By definition, when a donor or advisor recommends a grant from a DAF to a charity for the deductible portion of a payment to a charity, the donor or advisor does not receive a benefit that would have reduced the charitable contribution deduction; therefore, such a transaction does not result in a more than incidental benefit as defined for purposes of Section 4967.

Issue 2: Pledges

We agree with and commend the Treasury and IRS for providing in the Notice that DAFs can make grants that satisfy a donor advisor’s legally binding pledges without the grant being treated as a more than incidental benefit; however, we ask for clarification regarding the provision stating that the sponsoring organization may not refer to the existence of a charitable pledge when making the DAF distribution.

As discussed above, the term “more than incidental benefit” is defined in the Technical Explanation of the PPA, which the IRS adopted and the field has used for more than a decade, as “a benefit that would have reduced (or eliminated) a charitable contribution deduction if the benefit was received as part of the contribution to the sponsoring organization.”² This definition utilizes the Section 170 standard and does not make reference to the Section 4941 standard applicable to private foundations, which prohibits private foundations from satisfying legally binding pledges of disqualified persons.

The fulfillment of legal obligations of disqualified persons is prohibited under Section 4941 because of concerns that disqualified persons are able to use the private foundation for their own benefit because of their continued control over the entity.

For the reasons discussed above—namely, that DAF sponsoring organizations are public charities, and donor advisors do not control the sponsoring organization or the assets contributed to DAFs—the strict rule that treats private foundation grants in satisfaction of a disqualified

¹ 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.

² Ibid.

person's legally binding pledge as a self-dealing transaction under Section 4941 is inapplicable in the context of a DAF sponsoring organization.

In the DAF context, because the donor advisor does not control the DAF, prohibited benefits are defined instead in relation to Section 170. Donors are entitled to a charitable contribution deduction only after they make a payment to a charitable entity, not when they make a pledge. Fulfilling a pledge does not reduce or eliminate the charitable contribution deduction and, therefore, should not be treated as a more than incidental benefit within the meaning of Section 4967.

While we agree with the Notice that DAFs should be permitted to fulfill the pledges of donor advisors, we disagree with the caveat that the sponsoring organization may not refer to the existence of a charitable pledge when making the DAF distribution. It is administratively difficult and impractical for sponsoring organizations to avoid making grants from a DAF if a donor advisor has made a reference to a pledge because it is difficult to determine what constitutes a reference to a "pledge" in a grant recommendation which may include a variety of references that may or may not be readily ascertainable. It is harder still to distinguish references to legally binding pledges as compared to non-legally binding pledges or other moral obligations.

As an example of language that indirectly references a pledge, a donor's grant purpose may include a five-digit number. Under Notice 2017-73, the sponsoring organization may be required to conduct diligence to determine whether such number referred to a pledge and, if so, seek a revised recommended purpose from the donor. This requirement would therefore eliminate one piece of due diligence (determining whether a pledge is binding) while leaving in place another burdensome due diligence requirement (determining when a pledge is referenced).

These types of administrative barriers can inhibit giving and negatively impact charities, donors, and sponsoring organizations, ultimately decreasing the funds available to be granted.

Issue 3: Public Support

The most troubling proposal in the Notice is the suggestion that grants from DAFs be treated less favorably than grants from other public charities for purposes of determining the grantee's foundation status by limiting the amount of DAF grants that count as public support or imposing some sort of artificial tracing or look-through rule to treat grants from DAFs as gifts directly from the donor. We disagree with this proposal because sponsoring organizations of DAFs are public charities, and our grants should be treated as public support just like any other public charity's grants.

The policy suggestion in the Notice appears to be that DAF sponsoring organizations function as mere conduits and should be looked through or disregarded for purposes of determining the tax treatment of the grant. There are, however, well established tax rules for determining when it is appropriate to look through a charitable organization to its donors—namely, when the charity fails to exercise discretion and control over the funds and behaves as a mere conduit. As discussed above, Schwab Charitable makes sure that donors understand we maintain legal control over the contributions we receive; therefore, it is inappropriate to treat sponsoring organizations as conduits for purposes of determining the tax treatment of our grants.

There are numerous instances in the tax law when donors make grants to Section 501(c)(3) organizations that exercise dominion over the funds before regranting some or all of the funds to other organizations. The tax treatment of such regrants generally depends on the role of the public charity intermediary over the regranting decision, and in particular whether the public charity intermediary has control and discretion over the use of the funds. As discussed previously, donors to sponsoring organizations do not control the sponsoring organization and do not maintain any legal control over assets contributed to a DAF at the sponsoring organization. Instead, donors retain only the right to offer non-binding recommendations regarding the use and investment of the contributed assets, within certain parameters. Schwab Charitable makes it clear to donors that the donors do not maintain control of contributed assets and Schwab Charitable is operated accordingly.

Based on IRS guidance, the public support treatment of a grant made by an intermediary is determined by the discretion and control of the intermediary over the use of funds. When that discretion and control is complete, the donation is treated as coming from the intermediary rather than the original donor.

Schwab Charitable has full control and discretion over the use of funds contributed to DAFs and, while we receive non-binding recommendations from donors and advisors regarding the use of those assets, Schwab Charitable ultimately determines whether the making of a grant furthers its exempt purposes. Further, Schwab Charitable retains the right to grant assets contributed to DAFs without a recommendation from the donor or advisor on the account. Therefore, contributions from DAFs should be treated as contributions from the sponsoring organization and, because sponsoring organizations are Section 170(b)(1)(A)(vi) organizations, not subject to the 2% limitation.

In response to the specific proposal in the Notice that all contributions from sponsoring organizations be treated as coming from the donor or donors that funded the DAF rather than from the sponsoring organization, such a proposal has two important drawbacks: (1) it undermines the privacy of donor advisors with respect to charitable giving; and (2) it creates a significant administrative burden on both sponsoring organizations and grantees.

The ability of donor advisors to maintain their privacy when recommending grants to charity is essential for many donors. Some donors want the flexibility to support charities without sharing the details of their giving publicly and inviting further solicitation or scrutiny. In addition, some donors do not wish to receive any recognition in return, for cultural or religious reasons. Others may fear retaliation in their community for giving to polarizing organizations or causes. The ability to recommend grants from a DAF with a reasonable level of privacy leads to additional giving to charity that may not occur otherwise.

To the extent that the IRS and Treasury feel compelled to issue proposed regulations in this area, rather than rely on the control and discretion of the sponsoring organization which we believe is understood by our donors, reflected in our policies, and respected in our practices, such regulations should be narrowly crafted to reach only those situations where abuse might be likely—i.e., where the donor/advisor is unable to certify that he or she does not control the ultimate grantee. Further, the public should be given ample opportunity to comment on this limited proposal.

Other Issues: Qualifying Distributions

Distributions from a private foundation to a public charity are treated as qualifying distributions unless they are distributed to a controlled public charity. As discussed at length above, neither the sponsoring organization nor the assets contributed by the donor/advisor are controlled by the donor/advisor after contribution. Distributions from a private foundation to a DAF therefore should not be subject to a flow through or payout requirement in order to be treated as a qualifying distribution of the private foundation.

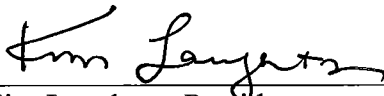
The ability of private foundations to terminate into DAFs, which is not only permitted but encouraged under Section 507(b)(1)(A) and approved by longstanding IRS practice, is the ultimate authority for the proposition that private foundations may make interim qualifying distributions to DAFs. Just as a liquidating distribution from a private foundation to a DAF is not subject to the Section 507 termination tax because a DAF is a public charity, so too should periodic distributions to DAFs be treated as grants to public charities for purposes of the Chapter 42 excise taxes applicable to private foundations, including the minimum distribution requirement.

There are numerous legitimate reasons that a private foundation may make distributions to a sponsoring organization, many of which center around the greater efficiency and lower cost of administration of DAFs as compared to private foundations. The efficiency gains and cost savings of DAFs are often the prime motivating factor inducing private foundations to contribute some or all of their funds to DAFs. Private foundations pay a high price for donor control in the form of increased regulatory burden and the duplication of resources that could otherwise be shared with other grantmaking charities. They are drawn to the cost effective expertise of DAF sponsoring organizations with respect to administrative or managerial functions related to grantmaking such as due diligence, crafting grant agreements, and reviewing grant reporting.

From our perspective, the use of DAFs by private foundations tends to increase compliance and stewardship over charitable funds—a practice that should be encouraged rather than discouraged.

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Thank you very much for your consideration of these comments. We welcome the opportunity to discuss them with you further, either by meeting or at a public hearing. If you have any questions or would like additional information about Schwab Charitable or its DAFs, please do not hesitate to reach out.



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