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May 11, 2007

Susan Brown
Deputy Tax Legislative Counsel – Regulatory Affairs
Department of the Treasury
1500 Pennsylvania Ave., NW – 3049 MT
Washington, DC 20220

Dear Ms. Brown:

Alliance for Justice (AFJ) writes to request clarity from the Department of the Treasury regarding expenditure responsibility requirements for Donor Advised Funds (“DAFs”) under the recently enacted Pension Protection Act of 2006 (“PPA”) (PL 109-280).

Specifically, we seek assurance that complying with the expenditure responsibility requirement of new Internal Revenue Code (“IRC”) section 4966(c)(1)(B)(ii) does not require a DAF that is a public charity to impose on its grantees the restrictions on use of private foundation funds described at IRC section 4945(d). AFJ has long encouraged public charities, including DAFs, to exercise their rights under the IRC to engage in legally permissible lobbying and nonpartisan voter engagement work. These activities would be restricted if section 4945(d) were believed to apply, and we see no reason why they should be read into the expenditure responsibility rules of section 4945(h).

About Alliance for Justice

AFJ is a national association of environmental, civil rights, mental health, women’s, children’s and consumer advocacy organizations. These organizations and their members support legislative and regulatory measures that promote political participation, judicial independence, and greater access to the justice system.

AFJ’s Nonprofit Advocacy Project and Foundation Advocacy Initiative work to increase nonprofit (including foundation) involvement in the policymaking process. AFJ supports nonprofit advocacy through plain-language guides to the laws governing nonprofit advocacy, workshops for nonprofit organizations, and individualized technical assistance. It also monitors

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Public Service Program
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legislative activity related to nonprofit advocacy, provides information to the charitable community and lobbies to ensure nonprofits' continued presence in the policy-making arena.

The Value of Donor Advised Funds

As Congress has recognized in its recent passage of the PPA, DAFs have become a valuable tool for donors and the charitable community. DAFs are a means to devote the greatest possible portion of charitable resources to the best possible charitable purposes. DAFs provide a way to contribute more freely to charity, and they prevent unnecessary waste of the resources once donated. According to the Council on Foundations, DAFs made more than \$1.05 billion in grants in 2005 (COF comments submitted to the IRS on April 9, 2007 in response to IRS Notice 2007-21). Many of these grants went to small organizations and programs that otherwise would not have been funded. We cannot imagine Congress wanted to curtail the ability of DAFs to make grants to those charitable organizations in need.

While it was appropriate for Congress to establish legitimate safeguards to prevent abuse of DAFs – or any other type – of tax-exempt organization, it is also important to protect the important role that DAFs play in ensuring the most efficient use of charitable resources.

Expenditure Responsibility and DAFs

AFJ seeks clarification that the requirements of “expenditure responsibility” on certain distributions from DAFs imposed by the PPA are different from the restrictions that apply only to private foundations.

Section 4966 of the IRC, added by section 1231 of the PPA, imposes a 20% tax on certain distributions of DAFs. All distributions to individuals fall within the scope of such “taxable distributions,” and most other distributions¹ from DAFs will likewise be taxed unless the DAF restricts the use of the funds to charitable purposes and exercises “expenditure responsibility” in accordance with IRC section 4945(h).

Section 4945(h) states that:

- ...expenditure responsibility... means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures –
- (1) to see that the grant is spent solely for the purposes for which made,
 - (2) to obtain full and complete reports from the grantee on how the funds are spent, and
 - (3) to make full and detailed reports with respect to such expenditures to the Secretary.

¹ There are exceptions allowing tax-free distributions to the DAF’s sponsoring organization, to other DAFs, or to charities other than certain types of supporting organizations or charities controlled by the donor or the donor’s advisor.

Prior to the PPA, only private foundations were required to make grants under the expenditure responsibility requirements of section 4945(h). Due to concern over the more limited control of private foundations, private foundations are subject to greater restrictions than are public charities, including how their funds can be spent. Federal tax law imposes a tax on certain private foundation expenditures, including those for lobbying and carrying on, directly or indirectly, voter registration drives. However, no such restrictions on grantmaking apply to public charities. In contrast to private foundations, *public charities may earmark funds for lobbying*. See, for example, IRC section 501(h) (permitting limited lobbying expenditures by charities). Likewise, charities *may* conduct voter registration activities. See, for example, IRC section 4945(f) (permitting grants to certain charities to conduct voter registration activities).

The restrictions on private foundation expenditures were written into the expenditure responsibility regulations to prevent the use of foundation funds for prohibited purposes. Treasury Regulation § 53.4945-5(b)(3) describes four criteria for private foundations to exercise expenditure responsibility:

- (i) To repay any portion of the amount granted which is not used for the purposes of the grant,
- (ii) To submit full and complete annual reports on the matter in which the funds are spent and the progress made in accomplishing the purposes of the grant . . . ,
- (iii) To maintain records of receipts and expenditures and to make its books and records available to the grantor at reasonable times, and
- (iv) Not to use any of the funds—
 - a. To carry on propaganda, or otherwise to attempt, to influence legislation (within the meaning of section 4945(d)(1)),
 - b. To influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive

The first three prongs correspond with the statutory definition, and the fourth prong prohibits the use of funds for certain purposes, such as lobbying and voter registration activity. When the Joint Committee on Taxation described expenditure responsibility, it referred to the first three prongs only (see pages 348-349 of the 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, Aug. 3, 2006 (“JCT Report”). These prohibitions included in the fourth prong should not be applied to DAFs, as they exceed the fundamental purpose of expenditure responsibility. The expenditure responsibility requirements of section 4945(h) can be met without adding on the prohibitions in the fourth prong of the regulatory requirements.

Appropriate Expenditure Responsibility Requirements for DAFs

The Treasury should provide clarification that while DAFs must exercise expenditure responsibility, their grants need not prohibit use of the funds for legitimate lobbying or voter registration activities. Based on the limited legislative history provided in the JCT report,

expenditure responsibility was imposed on DAFs to make sure grants from DAFs were spent as intended, not to prohibit or restrict how the funds can be spent.

In adding an expenditure responsibility requirement for certain DAF distributions, the PPA only referenced IRC section 4945(h)—the requirement that grant funds must be spent solely for purposes for which the grant was made. The PPA does not reference the restrictions of 4945(d) nor the Treasury regulations for expenditure responsibility by private foundations that incorporated those restrictions.

Our fear is DAFs and their advisors who are familiar with (or who discover) the requirements of expenditure responsibility in the private foundation context will simply apply the private foundation version of the regulations without further guidance. If so, DAFs would feel obliged to make grants that are subject to the terms required by Treas. Reg. section 53.4945-5(b)(3)(iv), prohibiting use of the funds for lobbying or voter registration activities. This would needlessly restrict the use of funds for legitimate charitable purposes.

Already, there has been uncertainty on this point. At the January 2007 meeting of the American Bar Association Tax Section’s Committee on Exempt Organizations, a panel including IRS EO Division Senior Tax Law Specialist Robert Fontenrose and IRS Assistant Chief Counsel Catherine Livingston was asked “whether expenditure responsibility for donor-advised funds will look any different than it does for private foundations?” with the questioner noting “that the reg[ulations]s for private foundations include a lot of prohibitions that may or may not apply in the donor-advised fund context.” (from transcript in EXEMPT ORGANIZATION TAX JOURNAL, vol. 12, no. 1, January/February 2007, at 35). According to the transcript, Ms. Livingston invited the questioner to seek clarification on this issue, explaining the justification for such clarification. While we did not pose the question, we gladly accept the invitation.

Similarly, an explanation of the PPA produced by the Council on Foundations offers the following response to the question of what “expenditure responsibility” in the context of the PPA:

While the Council will be seeking guidance as to what expenditure responsibility means for public charities, the regulations for private foundations provide some guidance. Charities that make grants from donor-advised funds to non-charities or affected supporting organizations for lobbying, nonpartisan voter registration activity or for regranting should consult with counsel as to how expenditure responsibility should be handled in those situations.

Council on Foundations, “Taxable Distributions from Donor-Advised Funds,” available at www.cof.org.

Congress is considering whether further regulation of DAFs is necessary, including options for imposing requirements on DAFs that already apply to private foundations. See, for example, PPA section 1226, requiring the Secretary to conduct a study of DAFs that specifically includes

whether DAFs should be subject to a payout requirement similar to that imposed on private foundations. Unless and until Congress takes such explicit steps, however, it is not appropriate for the regulations to impose them unilaterally.

For these reasons, we urge the Department of the Treasury to clarify that the PPA-mandated expenditure responsibility as applied to DAFs does not require DAFs to impose the IRC 4945(d) restrictions on grantees.

Thank you for your consideration of this request. We would be happy to provide any additional information or respond to any questions you may have about this issue.

Sincerely,

A handwritten signature in black ink, appearing to read "Nan Aron". The signature is fluid and cursive, with the first name "Nan" and the last name "Aron" clearly distinguishable.

Nan Aron
President
Alliance for Justice

cc: Catherine Livingston, IRS Assistant Chief Counsel
Robert Fontenrose, IRS EO Division Senior Tax Law Specialist