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June 29, 2007

The Committee on Ways and Means  
Subcommittee on Oversight  
Chairman John Lewis

Dear Chairman Lewis:

Alliance for Justice (AFJ) is pleased to accept this opportunity to submit comments on the affect of the Pension Protection Act of 2006 on the tax-exempt community. We limit our comments specifically to the provisions of the Act concerning expenditure responsibility requirements for Donor Advised Funds ("DAFs").

### **About Alliance for Justice**

Alliance for Justice 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 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 Pension Protection Act, 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.

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. This is especially important since, as mentioned in the Advisory soliciting these comments, “[m]ost of the provisions [in the PPA related to tax-exempt organizations] were never discussed on a bipartisan basis, nor the subject of Committee hearings, during the 109<sup>th</sup> Congress.”

### **Expenditure Responsibility and DAFs**

AFJ believes 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. Making such a distinction does not impede Congress’ goal (as stated in the Advisory) of improving accountability among DAFs.

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 distributions<sup>1</sup> 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.

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

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<sup>1</sup> 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.

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 statute should be amended to clarify 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, we believe 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).

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](http://www.cof.org).

For these reasons, we urge Congress to amend the PPA for purposes of clarifying 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,



Nan Aron  
President, Alliance for Justice