



May 16, 2016

Via Electronic Delivery

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2016-26)
1111 Constitution Avenue N.W.
Washington, D.C. 20224

RE: Recommendations for 2016-2017 Priority Guidance Plan Notice 2016-26

Dear Ladies and Gentlemen:

On behalf of the Council on Foundations, I write to urge the Treasury Department and the Internal Revenue Service to include four items in the 2016-2017 Priority Guidance Plan that impact our foundation members. These are listed below in order of urgency, though the Council emphasizes that our foundation members would benefit significantly from further clarity on each of these regulatory issues.

First, we request for the Secretary to exercise their authority given in Section 4966(d)(2)(C) to define funds that include advisory privilege but fall outside of the definition of donor advised funds and the scholarship exception in Internal Revenue Code Section 4966 and 4967.

Second, guidance on economic development as a charitable activity as applied to foundation-sponsored student loan forgiveness programs in addition to or in replacement of scholarship programs.

Third, updated guidance regarding economic development as a charitable activity generally, including a more definitive test and/or examples of acceptable charitable activities that reflect the current needs and economic climate in many communities. To assist Treasury in developing guidance, we have provided examples of situations encountered by the Council's foundation members that could be repurposed towards guidance for the sector.

Fourth, guidance on political activity for section 501(c)(3) organizations.

Request for the Secretary to Exercise Authority Given in Section 4966(d)(2)(C)

The Council understands that the Treasury and Internal Revenue Service are currently reviewing regulations related to donor advised funds, including 4966(d)(2)(B) which we are discussing with Elinor Ramey in person.

The Council on Foundations appreciates the inclusion of Section 4966(d)(2)(C) that provides Secretarial authority to exempt a fund or account not described in subparagraph (B) from treatment as a donor advised fund, (i) if such fund or account is advised by a committee not directly or indirectly controlled by the donor or any person appointed or designated by the donor for the purpose of advising with respect to distribution from such fund (and any related parties), or (ii) if such fund benefits a single identified charitable purpose.

The Council requests that the Secretary consider defining funds that provide for some advisory privilege but are not defined as donor advised funds or scholarship funds within the Internal Revenue Code. While the Council maintains its concerns about lack of clarity in numerous parts of Section 4966, we understand from Elinor Ramey's comments on April 28, 2016 at the 33rd Annual Representing and Managing Tax-Exempt Organizations conference that the Treasury is well aware of these issues and asked for us to supply new information beyond asks for clarity. We have still attached those clarifications as an addendum, however we are now providing a rationale and proposal for a newly defined fund as permissible in 4966(d)(2)(C).

The Pension Protection Act of 2006 codified the definition of "donor advised fund." Section 4966 of the Internal Revenue Code provides that donor advised funds must have three distinct characteristics:

- Separately identified by reference to contributions of a donor or donors
- Owned and controlled by a sponsoring organization
- A donor, or any person appointed or designated by the donor, has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor's status as a donor

Pursuant to Sections 4966 and 4967, a fund that meets this definition must be managed subject to certain restrictions including prohibitions on 1) grants to individuals; 2) grants that provide a more than incidental benefit to the donor, advisor or related persons; and 3) grants to non-charities and certain other organizations unless expenditure responsibility is exercised.

Currently, we have no Treasury Regulations to expand upon or further define the provisions in Sections 4966 and 4967.

Section 4966 also gives us two important exceptions to the definition of donor advised fund; specifically:

- A fund that makes distributions only to a single identified organization or government entity
- A fund with *limited donor advisory privileges* the purpose of which is to provide grants to individuals for travel, study or similar purposes (the “scholarship exception”)

To qualify for the scholarship exception, several rules related to donor participation must be followed including:

- The donor (or person appointed or designated by the donor) exercises his/her advisory privileges exclusively as a member of a committee, all of the members of which are appointed by the sponsoring organization
- No combination of donors, persons appointed or designated by the donor, or persons related to either, may control, directly or indirectly, the committee
- All grants from the fund must be awarded according to objective and nondiscriminatory criteria approved in advance by the board of the sponsoring organization and procedures meeting certain requirements of IRC Section 4945(g)

Many community foundations maintain donor advised funds that meet the definition provided in Section 4966 whereby the donor, or persons appointed or designated by the donor, expects, and is given sole advisory privileges regarding the distributions or investment of the fund. *In a definitional donor advised fund, the sponsoring organization does not select, appoint or approve the fund advisors - this is a privilege reserved for the donor.*

Many community foundations also maintain funds that comply with the “scholarship exception” rules and allow donor participation, but only as part of a committee appointed by the sponsoring organization.

Finally, many community foundations maintain various other types of funds, including field of interest funds, designated funds and geographic affiliate funds, and allow varying degrees of participation by one or multiple donors in decisions related to distributions from these funds. Often referred to as “advisory committees,” these groups, made up of donors and other community members, provide valuable recommendations and input to the sponsoring organization. *However, unlike donor advised funds, the fund donors do not appoint or select the advisory committee members, rather the sponsoring organization has control and the ability to appoint or remove members of the committee.* Accordingly, these funds do not meet the third prong of the donor advised fund definition. Additionally, they often do not meet the first prong of the donor advised fund definition because they may not be separately identified by reference to contributions of a donor or donors.

These “non-donor advised funds” that operate with donor and community involvement have been in practice at community foundations for many years, even prior to the Pension Protection

Act. While they do not violate any provisions of the Code or the Treasury Regulations, specific rules regarding how and when a donor or other members of the community can advise or be involved with these funds have never been specifically defined or addressed by the Internal Revenue Service or Treasury.

These “non-donor advised funds” also serve an important function for the community foundation by providing a vehicle for community engagement. As explained by CFLeads, community foundations act as a community partner, leader and convener and actively bring other community institutions, resources and individuals together to address a community’s greatest opportunities and critical challenges.

The Council’s *National Standards for Community Foundations* accreditation program also requires a community foundation to demonstrate community leadership and non-donor advised funds that operate with donor and community involvement in the form of advisory committees is one way to satisfy this requirement.

The Council now proposes that these “Community Informed Funds” be recognized as a fund type with unique characteristics, but clearly distinguished from donor advised funds. The Council also proposes that guidelines be adopted to define a consistent approach to donor and community involvement with these funds and provide assurance to community foundations that an option exists, outside the donor advised fund model, for donors and community members to be engaged with particular funds and grant making decisions without the restrictions placed on donor advised funds.

Talent Retention Programs: Foundations Providing Student Loan Forgiveness

With many U.S. communities struggling to retain local college graduates as part of their economic growth strategies, community foundations are exploring offering student loan forgiveness programs in addition to or in replacement of scholarship programs. Treasury has a history of providing Revenue Rulings, Private Letter Rulings, and additional examples regarding economic development as a charitable purpose; and the Council is requesting specific guidance related to economic development and student loan forgiveness programs.

The student loan forgiveness program would resemble the structure of the National Health Service Corps Loan Repayment Program for medical professionals or the Teacher Loan Forgiveness program for teachers committing to serve a specific period of time in a high-need area. The program dollars are primarily intended to help pay off student debt. While the program could run through either the government or foundations, foundations would work with donors to provide funding for the program. Award recipients are expected to live and work in their communities in order to be eligible for the program.

This program is a response to foundations investing in students via scholarships only to see them use that investment to leave the community that provided the scholarship. Donors are excited by the idea of supporting the community by offering students an opportunity to return and to receive assistance with the burdensome student debt that is regularly in the headlines. Our foundation members have an opportunity to bring young people back to high-need communities, slow or reverse the “brain drain”, bring skilled, educated and trained professional into high-need communities, increase entrepreneurship, fill skilled and educated job openings, and give farmers and small shop owners hope that a family member or community member will take over their business.

The Council recognizes that this program may need legislation as well as Treasury’s guidance to take effect. However, additional guidance from Treasury on economic development as a charitable purpose would be a critical step facilitating an important new tool for our communities to build resiliency and talent.

Clarification of Economic Development as Charitable Activity

The Council seeks further clarification regarding when economic development will be considered a charitable activity and requests reliable guidance for foundations wishing to support such activity with charitable dollars.

The Council often fields questions from its foundation members regarding economic development. Community foundations in particular are interested in creating funds and using charitable dollars to support activities such as redevelopment of city centers, small business incubation, job training programs, home purchase assistance, and promotion of local communities for new business relocation and tourism. Currently, these foundations can look to several rulings related to economic development, including Revenue Rulings 74-587, 76-419, 77-111, and 2006-27, and can draw from these some guidance regarding the factors that will support a finding by the IRS that an activity is considered charitable. However, all of these rulings were issued prior to the recent economic downturn, and there is a general consensus in the field that this type of guidance needs to be updated to reflect current economic realities and the work that foundations wish to do. Foundations are also often asked to partner with local government entities and organizations that are qualified as tax-exempt but are not Section 501(c)(3) organizations, and guidance specifically addressing these types of partnerships is needed as well.

The Council urges the Treasury to consider updating previous guidance regarding economic development as a charitable activity by providing a more definitive test and/or examples of acceptable charitable activities that reflect the current needs and economic climate in many communities. For reference, here are examples involving fact patterns encountered by the Council’s foundation members that Treasury could utilize in illustrative guidance:

- The Chamber of Commerce is sponsoring an initiative to encourage new small businesses to locate in a deteriorating section of downtown. They approach a community foundation about establishing a charitable fund to solicit and collect charitable contributions from individuals and businesses. The community foundation will then make grants to assist individuals with expenses associated with establishing new small businesses provided they agree to locate in this particular area. The grants will be awarded based on an objective and nondiscriminatory application process. No grants will be awarded to the Chamber of Commerce, but members of the Chamber may volunteer as part of the application review committee.
- A rural airport needs to build a new control tower. The airport is owned by a governmental entity (the airport authority) and is used by the public. The authority would like to accept charitable contributions for this purpose, or work with a community foundation to establish a temporary fund that would accept contributions and make grants to the authority to be used for the building expenses.
- A rural municipality desires to expand internet services to its citizens and wants to collect charitable donations to build infrastructure.
- A city government wants to promote the city as a location for filming television and movies and wants to establish a charitable fund to collect donations to be used to pay expenses of a promotional campaign.

The Council was encouraged to see the recent publication of Rule 81 FR 24014 and IRS Notice 2015-62, updating and clarifying the regulation of Program-Related Investments and Investments Made for Charitable Purposes, respectively. Given the continued level of interest in these topics, we would encourage the Treasury Department to continue consulting with foundations on what further changes could be made to facilitate investments made for charitable purposes. Specifically, we note that the public comments to 81 FR 24014 sought greater clarity on the treatment of PRIs in the form of investments in partnership interests. The comments also highlighted a desire from some to design a more expeditious system for ruling on what constitutes a permissible PRI within existing regulations. We hope for a continued dialogue on both points.

Section 501(c)(3) Organizations Are Uniquely Vulnerable Among Tax-Exempt Organizations

Section 501(c)(3) organizations are in particular need of guidance regarding political activity because of they face consequences for crossing the vague line into impermissible political activity.¹

¹ Under Internal Revenue Code § 501(c)(3), an organization does not satisfy the organizational or operational test for 501(c)(3) status if it “participate[s] in, or intervene[s] in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.” Thus, an exempt 501(c)(3)

They are the most numerous among tax-exempt organizations; they have the most assets; and they, alone, risk revocation of their tax-exempt status as a result of any political activity, however minor.²

Furthermore, many section 501(c)(3) organizations seek to engage in the democratic process, especially in an election year, in ways that have long been accepted and even encouraged. In fact, both Congress and the Department have long recognized that section 501(c)(3) organizations play an invaluable role in preserving a healthy democratic system and an engaged citizenry.³ Yet, a lack of clear guidance in the political space has made many 501(c)(3) organizations overly risk-averse, causing these organizations to shy away from even the most benign nonpartisan efforts altogether.⁴ This creates a tremendous chilling effect on the speech of law-abiding 501(c)(3) organizations and deters long-standing civic engagement and voter education efforts. Perversely, the current system can also empower more brazen 501(c)(3) organizations to engage in overt efforts to influence election outcomes with little fear of enforcement action.

Clear rules would empower risk-averse 501(c)(3)s to engage in allowable ways and deter bold actors from intervening in elections where they do not belong.

Clarifying Political Activity for 501(c)(3)s Will Facilitate Guidance for 501(c)(4)s

Acting now to issue guidance for section 501(c)(3)s will ease the transition to new guidance for section 501(c)(4)s when the congressional bar on this rulemaking is lifted because these organizations are often related and advised by the same individuals. Furthermore, aligning the guidance on political activity for 501(c)(3)s and 501(c)(4)s would greatly boost compliance among tax-exempt organizations and simplify Department enforcement efforts.

organization engaging in any campaign activity could swiftly have its exempt status revoked. Furthermore, § 4955 also imposes monetary penalties upon both organizations and managers for political expenditures.

² See, e.g., National Center for Charitable Statistics (NCCS), “Quick Facts About Nonprofits,” <http://nccs.urban.org/statistics/quickfacts.cfm>. According to NCCS data dating back to 1995, of nearly 1.6 million tax-exempt organizations registered with the IRS, nearly 70 percent are public charities exempt under §501(c)(3).

³ See generally Rev. Ruling 2007-41, 2007-25 I.R.B. (June 18, 2007) (offering guidance on political intervention and an analysis of political intervention in 21 factual situations). In the ruling, the Service acknowledges that “Section 501(c)(3) organizations are permitted to conduct certain voter education activities (including the presentation of public forums and the publication of voter education guides) if they are carried out in a non-partisan manner. In addition, section 501(c)(3) organizations may encourage people to participate in the electoral process through voter registration and get-out-the-vote drives, conducted in a non-partisan manner Section 501(c)(3) organizations may [also] take positions on public policy issues, including issues that divide candidates in an election for public office.”

⁴ See generally Rick Cohen, *Should Nonprofits Aim To Overturn The Prohibition On Charities Promoting Candidates?* NONPROFIT QUARTERLY, October 11, 2012, <https://nonprofitquarterly.org/2012/10/11/should-nonprofits-aim-to-overturn-the-prohibition-on-charities-promoting-candidates/> (“When lobbying and electioneering—two distinct activities in the political world—get conflated in people’s minds, it may be that when nonprofits hear about the politicking prohibition, it makes them stop not only their electoral activities, which they are not supposed to do, but also their lobbying, which they legally can and really should be doing.”).

Section 501(c)(3) and 501(c)(4) organizations need analogous guidance on political activity to facilitate their day-to-day activities and operations. A significant number of social welfare organizations are affiliated with 501(c)(3) organizations, and these “tandem” organizations often share staff and have overlapping leadership. Employees who split their time must understand which activities may permissibly be conducted by each organization, and they must also track the time they spend working for each organization in a manner that enables the 501(c)(3) and the 501(c)(4) to comply with the requirements associated with their tax-exempt status, disclose their activities as required on Form 990 information returns, and comply with any applicable campaign finance or lobbying disclosure laws. For these tandem organizations, training employees and tracking their time would become significantly more burdensome if the 501(c)(4) organizations and their 501(c)(3) sibling organizations did not share a definition for political activity.

Tax-exempt organizations and those who counsel them urgently seek guidance for section 501(c)(3)s. Yet guidance for section 501(c)(3)s, particularly if analogous for section 501(c)(4)s, would have the two-fold effect of greatly helping section 501(c)(3)s navigate election-year activity while ultimately ensuring a smoother transition and better overall compliance for section 501(c)(4)s when the Department issues a revised rulemaking.

Conclusion

Thank you for the opportunity to comment on priorities for inclusion in the 2016-2017 Priority Guidance Plan. We would welcome the opportunity to discuss any of these matters with the IRS or with the Department of Treasury if it would be helpful. Please feel free to contact me for additional information or analysis on any of these topics.

Sincerely,

A handwritten signature in cursive script that reads "Sue Santa".

Sue Santa

Senior Vice President of Public Policy and Legal Affairs

CC:

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Addendum

Guidance on Pension Protection Act Donor Advised Fund Provisions

Clarification of Section 4966(d)(2)(A) Definition of “Donor Advised Fund”

While a statutory definition is helpful, significant confusion remains within the philanthropic community over whether the statutory definition of “donor advised fund” includes the following types of funds:

- Funds that have multiple unrelated donors;
- Funds established by civic organizations and other membership associations;
- Funds established by public charities and governmental entities;
- Funds established by private foundations; and
- Memorial funds.

Clarification of Section 4966(d)(2)(B) Exemptions

Tax-exempt organizations would benefit significantly from additional precision around the application of the exemption for distributions to a single organization or governmental entity, and the exemption for funds that make grants for travel, study, or similar purposes, in the following circumstances:

- Whether the exemption for single organization funds applies to funds established by organizations not described in Section 501(c)(3);
- Whether the exemption for single organization funds applies to funds established for the benefit of a single foreign organization;
- Whether the exemption for funds that make grants for travel, study, or similar purposes applies to exempt funds that make awards to individuals for past achievements; and
- Whether identifying members of a committee for a scholarship fund by position or title would constitute appointment by the donor, which could make the fund ineligible for the exemption if the donor was deemed to have “control” of the committee.

Additional Exemptions under Section 4966(d)(2)(C)

In addition to guidance on the statutory exemptions, the Council asks the Secretary to exercise his discretion under Section 4966(d)(2)(C) to create two other exemptions from the definition of a donor advised fund:

- Employer-sponsored funds for emergency hardships; and
- Non-employer funds that provide hardship assistance to individuals under certain circumstances.

Section 4966 Definition of “Distribution”

The Council believes that “distribution” as defined in Section 4966 should be interpreted consistent with the meaning of this term in Section 4967 and the definition of the term “grant” in Section 4945, which would include all gratuitous transfers that foundations make but exclude expenditure payments to vendors for goods and services.

Application of Section 4967 Penalties

The Council requests guidance clarifying the application of Section 4967 penalties for “more than incidental benefit” to two common situations encountered by our foundation members:

- Whether grants from donor advised funds may be used to satisfy a legally-enforceable pledge made by the fund’s donor or a related person;
- Whether a payment that would require a reduction in the donor’s charitable deduction can be split—or bifurcated—with the advised fund paying only the portion that would be deductible, and the donor paying the remainder; and
- Whether grants can satisfy a fund donor’s charitable pledge without incurring Section 4967 penalties.

Many of the Council’s members rely on donor advised funds as valuable charitable giving vehicles in support of their grantmaking work. A lack of clear guidance from Treasury on the tax treatment of certain types of funds and distributions creates tremendous uncertainty for both organizations and individual donors, hindering planned giving efforts. We encourage Treasury to issue this guidance as expeditiously as possible.