Re: Notice 2017-73

In Notice 2017-73 (the “Notice”), the Internal Revenue Service (IRS) requests comments on proposed application of excise taxes with respect to donor advised funds (“DAFs”) in certain situations. The Notice states that, among other proposals, “the Treasury Department and the IRS are considering developing proposed regulations that would change the public support computation for organizations described in §§ 170(b)(1)(A)(vi) and 509(a)(1) and in § 509(a)(2) to prevent the use of DAFs to circumvent the excise tax rules applicable to private foundations under Chapter 42 of the Code.” NGOsource, a project of TechSoup Global (“TechSoup”) and Council on Foundations, respectfully submits these comments in response to the proposed regulation that would change the public support computation for organizations receiving contributions from sponsoring organizations of DAFs.

While we acknowledge the intent of the proposed public support rule is to prevent abuse, we request that the IRS and Treasury consider carving out an exception for non-US organizations seeking public charity equivalency recognition. Application of the rule in this context would be unduly burdensome on non-US charities, where the corresponding potential for abuse is negligible.

Background

NGOsource is a project of two 501(c)(3) public charities – TechSoup and Council on Foundations – that streamlines international giving through the creation of a repository of non-US organizations that qualify as equivalent to 501(c)(3) public charities. NGOsource’s equivalency determination service launched as a program of TechSoup on March 18, 2013. NGOsource has to date completed over 4,000 equivalency determinations in over 125 countries. Its value to the nonprofit sector globally is evidenced by the number of non-US charities able to efficiently complete the equivalency process, as well as by the time and money saved by private foundations and sponsoring organizations of DAFs in their grantmaking processes. NGOsource estimates that it has facilitated over one billion dollars in cross-border philanthropy.

On a daily basis, NGOsource reviews information from, and collaborates with, charities operating under dozens of different languages, legal regimes, customs, and cultural norms. NGOsource’s global reach and expertise in international giving and due diligence provide it with an unparalleled perspective on the way that non-US charities are affected by, and comply with,
US regulations imposed on funds from US private foundations and DAF sponsoring organizations.

Proposed Public Support Rule

"In light of the potential for abuse, the Treasury Department and the IRS are considering treating, solely for purposes of determining whether the distributee charity qualifies as publicly supported, a distribution from a DAF as an indirect contribution from the donor (or donors) that funded the DAF rather than as a contribution from the sponsoring organization. Such treatment would better reflect the degree to which the distributee charity receives broad support from a representative number of persons."

IRS Notice 2017-73.

The Proposed Public Support Rule Would Unfairly Affect Non-US Organizations Seeking Public Charity Equivalency

1. Public charity equivalency: a unique process

Currently, a non-US organization may be deemed equivalent to a US public charity if it meets the requisite organizational and operational tests under Internal Revenue Code ("Code") section 501(c)(3), and if it either meets a public support test under Code sections 509(a)(1) and 170(b)(1)(A)(vi) or section 509(a)(2), or it qualifies under another Code section of 170(b)(1)(A) by the nature of its activities (such as a church, hospital, or school). See Treas. Reg. §53.4945-5(a)(5)(i); see also Rev. Proc. 2017-53. If an organization is deemed equivalent to a public charity by a qualified tax practitioner, the private foundation or DAF sponsoring organization that received or drafted the determination need not exercise expenditure responsibility with respect to grants made to that entity. See id.

Typically, the equivalency process is initiated by the funder, not by the recipient, and is unique to the funder who obtained the written advice. The vast majority of non-US organizations undergoing the equivalency process have no familiarity with the rules applicable to US public charities. In particular, to our knowledge, there is no foreign equivalent to the public support test. NGOsource has yet to encounter a similar rule in any of the more than 125 countries whose charity laws it has reviewed in the process of discerning whether certain foreign laws might apply similar restrictions on local charities’ activities and finances. Obtaining the necessary information from non-US organizations to document and calculate public support is routinely the most difficult aspect of the equivalency process given the uniqueness and complexity of the rules, combined with varying bookkeeping and reporting requirements specific to individual countries.

2. Non-US organizations have little incentive or opportunity for abuse

Given that nearly all non-US organizations that undergo the equivalency process have never heard of a public support requirement, it is highly unlikely that these organizations would proactively avoid public support limitations by soliciting and receiving support from a US DAF.
Most non-US organizations have few ties to US donors and entities, and are not subject to local requirements that would encourage them to seek diverse forms of income. Consequently, non-US charities are exceedingly unlikely to use US DAFs as a means to obtain public support. US DAFs are correspondingly unlikely to be used as a mechanism to falsely create public support for non-US charities, since non-US charities have no incentive to maintain public support outside the unanticipated possibility that they may be requested to undergo the equivalency process.

3. Non-US organizations have limited access to donor information and limited familiarity with US reporting obligations

Requirements to obtain and disclose the name of the original donor or donor-advisor to the DAF would be especially difficult for non-US grantees. Such grantees legitimately treat DAF grants as coming from the sponsoring organizations that own and control the funds. Non-US organizations have no reason to track down the origin of the DAF given differences in accounting systems and legal or reporting regimes. Because such organizations would have no reason to obtain this information in the first place, it is highly possible that, over time (within a span of five years), the information would no longer be accessible without undue hardship, and compliance would be impractical by the time the organization would be required to submit five years of financial data for the purposes of an equivalency determination. Requiring non-US charities to "look through" the sponsoring organization and report the individual donor on its financial schedules required for the purpose of equivalency would be especially burdensome.

4. The equivalency process ensures a level of compliance and scrutiny on donations to non-US entities

US tax law treats gifts from DAFs as gifts from the sponsoring organization because the sponsoring organization maintains discretion and control over the ultimate recipient of any donor-advised gifts. See IRC §4966(d); see also DONOR-ADVISOR FUNDS GUIDE SHEET EXPLANATION July 31, 2008. While individual donors may claim a charitable contribution tax deduction on gifts made to a sponsoring organization, and may retain advisory privileges over the funds in the account, the donors nonetheless relinquish authority over the use of the funds. This trade-off is a notable distinction between donating through a DAF versus through a donor-controlled private foundation, or by giving directly. In reality, the typical DAF advisor is an individual without the means to create a private foundation. The individual donor gives through a DAF often because it allows him or her to support charitable work in a variety of contexts with the added security that the sponsoring organization will responsibly, efficiently (and anonymously, if requested) manage the giving process.

Currently, an individual donor could choose to send funds directly to a charity in another country with little oversight on the use of the funds. The donor would have limited mechanisms to confirm that the recipient organization is in fact charitable and has appropriate binding restrictions on its funds. By giving through a DAF, however, the sponsoring organization necessarily must either exercise expenditure responsibility or obtain an equivalency determination. These processes provide a high level of assurance that funds will only be used for charitable purposes. Added measures are often taken to protect the sponsoring organization and ensure that funds are properly utilized. These include verification that the grantee has not been
designated or individually identified as a terrorist organization by the United States Government, for example, or measures taken to comply with economic sanctions.

Many sponsoring organizations to DAFs refuse to exercise expenditure responsibility and as a result solely make grants to non-US organizations that are deemed equivalent. If non-US charities are less likely to be deemed equivalent as a result of one or more significant DAF donations, the sponsoring organization may be unwilling to follow a donor’s recommendation to give to that particular charity. Dis-incentivizing a donor from making a donation to a non-US entity through a DAF – with its added transparency and protections – thus necessarily reduces the amount of funds being transferred abroad under a process that ensures compliance with US law and also ensures proper utilization of charitable funds.

The Proposed Public Support Rule would Negatively Impact International Philanthropy

It is our position that non-US charities do not use US DAFs to circumvent the private foundation rules and excise taxes imposed by the Code. Non-US charities face an uphill battle when it comes to understanding and complying with the rules around expenditure responsibility and foreign public charity equivalency. These rules are in place for a good reason. They help ensure that charitable funds are not misused while permitting US grantmakers a mechanism to support essential charitable services around the globe. Further complicating these rules with an added restriction that has no direct bearing on non-US charities would have several likely outcomes: (1) it would impede a small number of non-US charities from meeting the public support test and therefore would require expenditure responsibility, which many grantmakers are unwilling to undertake. (2) It would discourage DAFs from recommending grants to non-US charities if doing so would risk tipping the charity out of public charity status. (3) It would further complicate the equivalency process for non-US grantees, both delaying and preventing the flow of charitable funds to legitimate non-US charities.

While we recognize the intent of the proposed regulation is to avoid abuse and place DAFs on equal footing with private foundations, we believe that it will likely result in negative, unintended consequences with respect to under-funded small non-US charities around the world who are in much need of funds and who are otherwise in full compliance with their own local laws in addition to US tax-exempt laws. Should the IRS and Treasury finalize this particular proposed regulation, we respectfully request that it consider carving out an exception for non-US organizations seeking public charity equivalency recognition.

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*Please note that these comments represent the opinions of NGOsource, and not necessarily of any of its individual grantmaker members, or of COF or any other affiliated organization.