TAX-EXEMPT CHARITABLE ORGANIZATIONS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

JULY 24, 2007

Serial No. 110–55

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

38–087 WASHINGTON : 2007

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON WAYS AND MEANS

CHARLES B. RANGEL, New York, *Chairman*

FORTNEY PETE STARK, California
SANDER M. LEVIN, Michigan
JIM MCDERMOTT, Washington
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
MICHAEL R. MCNULTY, New York
JOHN S. TANNER, Tennessee
XAVIER BECERRA, California
LLOYD DOGGETT, Texas
EARL POMEROY, North Dakota
STEPHANIE TUBBS JONES, Ohio
MIKE THOMPSON, California
JOHN B. LARSON, Connecticut
RAHM EMANUEL, Illinois
EARL BLUMENAUER, Oregon
RON KIND, Wisconsin
BILL PASCRELL JR., New Jersey
SHELLEY BERKLEY, Nevada
JOSEPH CROWLEY, New York
CHRIS VAN HOLLEN, Maryland
KENDRICK MEEK, Florida
ALLYSON Y. SCHWARTZ, Pennsylvania
ARTUR DAVIS, Alabama

JIM MCCRERY, Louisiana
WALLY HERGER, California
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
SAM JOHNSON, Texas
PHIL ENGLISH, Pennsylvania
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri
RON LEWIS, Kentucky
KEVIN BRADY, Texas
THOMAS M. REYNOLDS, New York
PAUL RYAN, Wisconsin
ERIC CANTOR, Virginia
JOHN LINDER, Georgia
DEVIN NUNES, California
PAT TIBERI, Ohio
JON PORTER, Nevada

Janice Mays, *Chief Counsel and Staff Director*
Brett Loper, *Minority Staff Director*

SUBCOMMITTEE ON OVERSIGHT

JOHN LEWIS, Georgia, *Chairman*

JOHN S. TANNER, Tennessee
RICHARD E. NEAL, Massachusetts
XAVIER BECERRA, California
STEPHANIE TUBBS JONES, Ohio
RON KIND, Wisconsin
BILL PASCRELL JR., New Jersey
JOSEPH CROWLEY, New York

JIM RAMSTAD, Minnesota
ERIC CANTOR, Virginia
JOHN LINDER, Georgia
DEVIN NUNES, California
PAT TIBERI, Ohio

CONTENTS

TAX-EXEMPT CHARITABLE ORGANIZATIONS

TUESDAY, JULY 24, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:05 a.m., in room 1100, Longworth House Office Building, Hon. John Lewis (Chairman of the Subcommittee) presiding.

[The advisory of June 12, 2007 requesting written comments follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
June 12, 2007
OV–4

CONTACT: (202) 225–5522

Lewis Announces Request for Written Comments on Provisions Relating to Tax-Exempt Organizations in the Pension Protection Act of 2006

House Ways and Means Oversight Subcommittee Chairman John Lewis (D–GA) announced today that the Subcommittee is requesting written comments for the record on the provisions relating to tax-exempt organizations contained in the Pension Protection Act of 2006 (P.L. 109–280).

BACKGROUND:

On August 17, 2006, the Pension Protection Act of 2006 (Act) was enacted into law. The Act contains over thirty provisions relating to tax-exempt organizations, including charitable giving incentives and exempt organization reforms. Certain provisions were intended to improve accountability among donor advised funds and supporting organizations. Most of the provisions were never discussed on a bipartisan basis, nor the subject of Committee hearings, during the 109th Congress.

The Subcommittee is interested in the tax-exempt community's views on the impact of these recently-enacted provisions on charities and foundations. The Subcommittee is particularly interested in how these new rules affect, or will affect, charitable efforts and the difficulties that have arisen in implementing these provisions. Further, the Subcommittee requests comments on the provisions scheduled to expire on December 31, 2007. **The deadline to submit written comments is Tuesday, July 31, 2007.**

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*110th Congress*" from the menu entitled, "*Committee Hearings*" (*http://waysandmeans.house.gov/Hearings.asp?congress=18*). Select the request for written comments for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You MUST REPLY to the email and ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Tuesday, July 31, 2007**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Submitters are advised that the Committee relies on electronic submissions for printing the official record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the submission is made.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

[The advisory of July 9, 2007 announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
July 09, 2007
OV–5

CONTACT: (202) 225–5522

Lewis Announces Overview Hearing on Tax-Exempt Charitable Organizations

House Ways and Means Oversight Subcommittee Chairman John Lewis (D–GA) announced today that the Subcommittee will hold an overview hearing on tax-exempt organizations, which will focus on charities and foundations described in Internal Revenue Code section 501(c)(3). **The hearing will take place on Tuesday, July 24, 2007, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Invited witnesses will represent the Internal Revenue Service, the U.S. Government Accounting Office, the Independent Sector, and the Council on Foundations. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Subcommittee and for inclusion in the record of the hearing.

BACKGROUND:

There are approximately 1.6 million tax-exempt organizations described in the twenty-eight categories listed in Internal Revenue Code section 501(c). Two-thirds, or more than one million, of these organizations are described in Internal Revenue Code section 501(c)(3). Currently, the assets of section 501(c)(3) organizations exceed $2.5 trillion. They have annual revenues of nearly $1.2 trillion and spend approximately $900 billion on program services. Section 501(c)(3) organizations continue to grow each year with more than 350,000 organizations granted tax-exempt status since 1997.

Internal Revenue Code section 501(c)(3) describes organizations that are organized and operated exclusively for religious, charitable, scientific, educational, and certain other specified exempt purposes. These organizations include, among others, public charities and private foundations. They are eligible to receive tax-deductible contributions and are subject to operating restrictions, including a prohibition on engaging in political activities.

There have been a number of recent legislative and administrative developments that relate to section 501(c)(3) organizations and may affect their operations. These developments include the enactment of the Pension Protection Act of 2006 (P.L. 109–280), the release of the redesigned draft Form 990 (Return of Organization Exempt from Income Tax), and the activities of the Exempt Organizations Office of the IRS's Tax Exempt and Government Entities Division.

In announcing the hearing, Chairman Lewis stated: **"The volunteers and organizations that make up the charitable community work day after day providing services to our communities that are critical to all Americans and essential to the well-being of our Country. The Congress and the public must continue to support this community. I look forward to beginning a dialogue about the important role charities play in American life. The Subcommittee will continue its review of tax-exempt issues throughout the 110th Congress, including charities' efforts to assist diverse communities and other specific areas of concern."**

FOCUS OF THE HEARING:

The Subcommittee will undertake a broad overview of section 501(c)(3) charitable organizations. The Subcommittee will review the overall state of this sector, including activities and measures for ensuring public accountability and good governance.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: **Written statements submitted to the Subcommittee pursuant to the June 12, 2007, Subcommittee Advisory, OV–4, soliciting comments on tax-exempt provisions contained in the Pension Protection Act of 2006 will be included in the submissions for the record on this hearing and do not need to be submitted again. Accordingly, only one statement in total is necessary for any individual or organization with respect to comments on the Pension Protection Act of 2006.** Any person(s) and/or organization(s) wishing to submit for the record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*110th Congress*" from the menu entitled, "*Committee Hearings*" (*http://waysandmeans.house.gov/Hearings.asp?congress=18*). Select the request for written comments for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You MUST REPLY to the email and ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Tuesday, August 7, 2007**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman LEWIS. Good morning. The hearing is now called to order. The Subcommittee on Oversight is holding its first hearing on tax-exempt organizations. Today, we will take a broad look at charities and foundations, and review the current state of the charitable sector.

These organizations play such an important role in our country. Charities and foundations make up the very fiber of our communities. They know the deepest human needs of our friends and neighbors. They know the solutions that work. Often, at critical times, charities and foundations are the leaders that show the government the way to care for our citizens. We must listen and learn from you.

Last year, these organizations spent over $1 trillion on directly serving those in need. These services touch every corner of life in our communities—education, the arts, and medical research. They also serve those who need our help the most by feeding the hungry, caring for the sick, and lifting up those who live in poverty, those who have been left out and left behind.

The Government alone cannot address these important and unmet needs. We count on charities and foundations to fill this gap. The need for these programs creates a special tie between charities and the Government. As we move forward in this Congress, we must work together for the common good of our communities and our Nation.

The question today is whether we can do more. Can we really do more with what we have? Can we touch more lives and uplift more people? We must strengthen the nonprofit sector so that we can deliver more service to more Americans. They are counting on us. We must not fail them. We invite this sector to work with us toward this goal.

I am pleased to recognize the distinguished Ranking Member, my dear friend from Minnesota, Mr. Ramstad, for his opening statement.

Mr. RAMSTAD. I thank my friend, the distinguished Chairman, for yielding. He is both distinguished and a good friend. Thank you for yielding and for holding this important hearing, Mr. Chairman, to give our Members an overview of the tax-exempt charitable sector.

I think it is helpful to review present law as well as the crucial work that charitable organizations are doing across America. This will certainly help us evaluate proposed legislation in this Congress.

I am truly fortunate to represent a State with such an active and vibrant community of charitable organizations and foundations. Minnesota's charities and our volunteers are feeding the hungry at record numbers; sheltering the homeless, also record numbers; and providing protection, hope, and opportunity to the most vulnerable Americans.

Over the last 25 years, I have served on the boards of no fewer than 12 charitable organizations. I am proud to be a co-founder of the Greater Lake Country Food Bank, which is one of Minnesota's largest independent food banks. My family and I still volunteer regularly at Sharing and Caring Hands in Minneapolis, as well as Interfaith Outreach and Community Partners in our home community of Wayzata.

Recently, several of us helped launch a public/private partnership to end homelessness in Minnesota called Heading Home Minnesota. The governor was the leader of our group, and another example of good work being done by the charitable sector. I think Minnesota's charitable organizations are truly a model for the Nation, and I am proud to be associated with them and grateful, certainly, for all they do.

As I look out at the witness table, Mr. Chairman, and I am sure you have the same feeling, it is like old home week here in the Committee on Ways and Means room. I know you join me, and he will be introduced by our distinguished colleague Mr. Kind, but it is great to see Steve Gunderson back, who is now president and CEO of the Council on Foundations; also to see Steve Miller of the Internal Revenue Service (IRS), who has joined us on previous occasions, has always been responsive to our inquiries and helpful to the Subcommittee.

It is just a good thing that these types of cases are more the exception than the norm, but where there are cases of fraud and abuse, they should be rooted out so the reputations of 99.9 percent of the charities in this country that do good work are not tarnished, and Americans can be sure their donations are put to good use.

Finally, Mr. Chairman, it is also good to welcome Diana Aviv of the Independent Sector. Most of us on the Committee are familiar with the good work her organization does. I also want to welcome—not to exclude anybody, certainly—Stan Czerwinski of the Government Accountability Office (GAO), who is testifying, I think, for the first time in several years. Welcome back to the Subcommittee.

Mr. Chairman, just let me conclude by saying this. We know our charities do extremely important work across the country, and Congress should promote, should help facilitate, their good deeds. We need a vibrant charitable community in our country, and also, at the same time, must guard against those who would misuse their tax-exempt status and abuse the public trust. There are few things worse in the public arena then that type of abuse. So, we must protect the vast majority of charities that in good faith do work, perilous work, for our communities and help so many in need.

I again, Mr. Chairman, thank you for holding this hearing today. I know we can work together in a bipartisan way to continue protecting the hardworking, honorable charities and the public's trust in them because to do otherwise would fail the American people.

So, I thank the Chair, and I yield back.

[The prepared statement of Mr. Ramstad follows:]

Prepared Statement of The Honorable Jim Ramstad Ranking Member, Subcommittee on Oversight

I thank my friend for yielding and for holding this hearing to provide our Members with an overview of the tax exempt charitable sector.

It's helpful to review present law, as well as some of the crucial work charitable organizations do in our communities. This will help us evaluate proposed legislation this Congress.

I am truly fortunate to represent a State with an active and vibrant community of charities and foundations.

Minnesota's charities and our volunteers are feeding the hungry, sheltering the homeless and providing protection, hope and opportunity to the most vulnerable Americans.

Over the years, I have served on the boards of 12 charities. I am proud to be a co-founder of the Greater Lake Country Food Bank, Minnesota's largest independent food bank. My family and I still volunteer regularly at Sharing and Caring Hands in Minneapolis, and I recently helped launch a public-private partnership to end homelessness in my State, called Heading Home Minnesota.

Minnesota's charitable organizations are truly a model for the Nation, and I'm proud to be associated with them and grateful for all they do.

Mr. Chairman, as I look out at the witness table, it's like old home week! I know you join me in welcoming our former colleague from Wisconsin, Steve Gunderson, who is now the President and CEO of the Council on Foundations. Steve, it's great to see you again.

I also welcome back Steve Miller of the IRS, who joined us on previous occasions and has always been responsive to inquiries from us and our staff.

I also thank the Chairman for including Greg Kutz of GAO, who does great nonpartisan work for the Ways and Means Committee. Mr. Kutz will testify on an investigation GAO performed at my request on tax-exempt organizations that owe the Government nearly $1 billion in payroll and other taxes.

For example, one entity owed more than $15 million in taxes, while its top official received more than $1 million in annual compensation and benefits and made several hundred thousand dollars in cash transactions at banks and casinos. Obviously the organization did not fail to pay taxes due to a cash flow problem.

Fortunately, these types of cases are more the exception than the norm, but where there are cases of fraud and abuse, they should be rooted out so the reputations of countless charities that do good work are not tarnished and Americans can be sure their donations will be put to good use.

Mr. Chairman, I also welcome Diana Aviv of the Independent Sector. Many of us are already familiar with Ms. Aviv and the good work of her organization.

Finally, I would like to welcome Stan Czerwinski of GAO, who is testifying before the Committee for the first time in several years—welcome back, Stan.

Mr. Chairman, we know our charities do extremely important work across America, and Congress should promote a vibrant charitable community.

On the other hand, we must always guard against those who would misuse their tax-exempt status and abuse the public trust.

We must protect the vast majority of charities that in good faith work so tirelessly for our communities and help so many in need. That means we sometimes have to ask tough questions and consider legislation to ensure the public's trust in our charitable community remains unblemished.

This public trust in our charitable community has led to an estimated $295 billion of charitable giving in 2006.

The American people deserve our thanks for their generosity, and charities deserve our gratitude for the countless acts of kindness they deliver every day.

We will continue to protect those hardworking charities and the public's trust in them. To do otherwise would fail the American people.

I thank the Chair and I yield back.

Chairman LEWIS. Let me thank you, Mr. Ranking Member, for your fine opening statement.

Would any other Members like to make an opening statement or have any opening remarks? At this time, Ms. Tubbs Jones is recognized for her opening statement.

Ms. TUBBS JONES. Thank you, Mr. Chairman, Mr. Ramstad, Ranking Member. Good morning and thank you for hosting these hearings. My name is Stephanie Tubbs Jones, and I hail from the great city of Cleveland, the home of some of the oldest charitable foundations in the country, places like the Cleveland Foundation, the oldest and second-largest community-based foundation, with assets over $1.6 billion.

I also am the home of the Gunn Foundation, and the home of several other, like Jewish Community Fund and Jewish Community Federation. That is why I am so happy that you have chosen today to host the hearings in and around tax-exempt organizations. At a time last year during the 109th Congress, I was worried that some people were moving to push tax-exempt organizations over or, as the kids say, kicking them under the bus. So, I am so pleased today that we have this opportunity.

Other nonprofits in my congressional district work toward making sure that people have housing available, like the Cleveland History Network, Mount Pleasant NOW, and the list goes on.

Finally, Mr. Chairman, I want to say that I am proud to have begun or started a new caucus in the Congress. I am co-chairing the Philanthropic Caucus with my colleague, Robin Hayes. As we move through these next months and years here at the Congress, we want to be able to focus in on issues that are important to philanthropic organizations.

So, again, I would applaud you, Mr. Chairman, and you, Mr. Ranking Member, for the work you are doing in this area, and know that you have a stalwart Member ready to go to work on these issues.

Thank you, Mr. Chairman. I yield back.

Chairman LEWIS. Thank you, Ms. Tubbs Jones, for your fine statement.

Now I am pleased to recognize my friend from the great State of Wisconsin, Mr. Kind, for a statement.

Mr. KIND. Thank you, Mr. Chairman. I want to thank you for holding this important hearing. I would also like to thank our invited guests for your testimony here today on such a timely topic. I especially will be interested to get some feedback on the consequences and unintended consequences of the pension format that

I was heavily involved in just a couple years ago. I know some of you have some thoughts to share on that.

Basically, I wanted to welcome a good friend of mine, my predecessor in this congressional district, Steve Gunderson, who is the current president and CEO of the Council on Foundations. Those who knew Steve and worked with Steve had great respect and admiration for the work that you did around here. That was equally true for the people that you represented back home.

It is respect and admiration that you still garner, not only in this place here on Capitol Hill but especially back home in the Third Congressional District of western Wisconsin, and given the important work that you are doing right now at the Council on Foundations.

I am especially excited in previous conversations to hear of the efforts now on what we can do with these organizations for rural economic development opportunities. I know you are planning a conference in August, coming up shortly, one that I have a scheduling conflict now about but I will get back to you on later, which could be very helpful in introducing some new ideas and some new concepts in a very underserved and underrepresented region of our country.

So, Steve, I thank you. Welcome back to Capitol Hill. I look forward to hearing your testimony.

Thank you, Mr. Chairman.

Chairman LEWIS. Thank you very much, Mr. Kind, for your statement.

Mr. Pascrell, my friend, my wonderful and great friend from the State of New Jersey.

Mr. PASCRELL. Mr. Chairman, just very briefly, I am looking to see whether there is a balance between the private and public philanthropic organizations—easy for me to say—and what experiences the IRS is having.

Finally, Mr. Chairman, I am interested to know: Basically, the Treasury Department asserted recently that nonprofits are a significant source of financing to terrorists and terrorist organizations. I think we need to take a look at this very carefully so that we do not paint with a wide brush, which we are apt to do in the Congress. I am very interested in that area.

We have got a distinguished panel, so let's get on with it.

Chairman LEWIS. Thank you very much, Mr. Pascrell, for your statement.

We are at that point now where we hear from our witnesses. I ask that each of you limit your testimony to 5 minutes. Without objection, your entire statement will be included in the record. I will have all of the witnesses give their statements and then the Members will ask questions of the panel.

It is now my pleasure to introduce and present our first witness. Steve Miller is the Commissioner of the IRS Tax Exempt and Government Entities Division. Mr. Miller, welcome.

STATEMENT OF STEVEN T. MILLER, COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION, INTERNAL REVENUE SERVICE

Mr. MILLER. Thank you, Mr. Chairman. Good morning, and thank you for the opportunity to appear. As you mentioned, my office at the IRS is responsible for charities and other tax-exempt entities. We cover a great deal of ground. We have more than one million 501(c)(3) organizations we are aware of, and they hold assets in excess of $2.5 trillion.

I will begin with two observations. First, I believe the charitable sector deserves our respect and gratitude. It does wonderful things for society. There is no question. Second, I believe the vast majority of the charitable sector complies or attempts to comply with the tax law.

While we have seen problems, and some are serious and some involve major charitable institutions, the problems don't appear to be widespread. We are working to keep it that way. Our job at the Service is to maintain a balanced program for regulating the charitable sector.

Such a program ensures that congressional intent is met. It helps maintain public confidence in the integrity of the sector. It prevents erosion of the tax base by ensuring that those who would prey upon innocent contributors and misuse the privilege of tax-exempt status are identified and are stopped from doing so.

Our compliance program has three components. First is our determination letter program. We work individually with new organizations to ensure that they understand and comply with their responsibilities. The second component is a strong education and outreach program. In person and online, we help existing charities stay compliant and alert to their legal requirements.

Finally, we have an increasingly robust examination program to follow up on how organizations are actually operating. We have changed the way we examine organizations, adding staff and office to allow us to react flexibly. Last year we examined more than 7,000 returns, up 23 percent from 2003 and the most we have examined since the year 2000.

Our determination and examination programs allow us to identify areas of concern. I have outlined those in detail in my written testimony, but I will touch on a few here.

Our first concern is the overvaluation of charitable contributions, especially noncash donations. We pursue these cases, but decisions are difficult where the recovery is likely to be less than the significant cost to audit, appraise, and litigate.

The second area of concern is with charities established to benefit the donor rather than the public. In these cases, a donor claims a deduction but maintains control over the contributed assets, and often uses them for personal gain. Certain donor-advised fund arrangements and certain supporting organizations may fall into this category.

The third area involves the blurring of the line between the tax-exempt and the commercial sectors. The line grows fainter as the tax-exempt sector grows larger, wealthier, and structurally more complex. Concerns in this area usually involve the movement of commercial enterprise into the charitable sector, and difficulties in calculating and reporting the unrelated business income tax.

The fourth area is excessive compensation. High compensation based on fair market value is fine. Excessive compensation is not.

Finally, we have a concern over political activity. Charities cannot intervene in political campaigns, but in every election cycle we see reports of charities supporting or opposing particular candidates.

How will we address needs and other problems into the future? Well, first we need to continue to strengthen our compliance programs. We are improving front-end compliance by upgrading our determination letter process. We continue to create innovative and interactive educational opportunities on the web. We have increased our enforcement presence in the community, with more examinations and taxpayer-to-IRS compliance contacts.

Our second priority is to enhance transparency of the nonprofit sector by requiring better data and making that data more publicly available. Transparency is the linchpin of compliance, but when the structure and operations of charitable organizations are visible to all, the possibility of misuse and abuse is reduced.

Our transparency initiatives include the wholesale redesign of the Form 990 and expanded electronic filing. We are also working with the sector to raise standards of governance and accountability, and we salute the sector's leadership in the area, including that of the Council on Foundations and the Independent Sector.

We appreciate the support the Subcommittee has given to us, and we appreciate your support of the 2008 budget, which contains a nice increase for my function as well as enhanced electronic filing. Thank you, and I will be prepared to take questions at a later time.

[The prepared statement of Mr. Miller follows:]

TESTIMONY OF STEVEN T. MILLER
COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION
INTERNAL REVENUE SERVICE
BEFORE THE
OVERSIGHT SUBCOMMITTEE
HOUSE WAYS AND MEANS COMMITTEE
ON THE OVERSIGHT OF TAX-EXEMPT ORGANIZATIONS

JULY 24, 2007

Good morning Chairman Lewis, Ranking Member Ramstad, and Members of the Oversight Subcommittee. Thank you for the opportunity to appear this morning. My name is Steven Miller and I am the Commissioner of the Tax Exempt and Government Entities (TE/GE) division of the Internal Revenue Service (IRS).

TE/GE is one of four operating divisions created after the enactment of the IRS Restructuring and Reorganization Act of 1998 (RRA). Each division is dedicated to a specific group of taxpayers. TE/GE's three major business units – Exempt Organizations (EO), Employee Plans (EP), and Government Entities (GE) – oversee a wide range of activities affecting taxpayers from small volunteer community organizations to large private foundations; from villages to sovereign Indian tribes, from IRAs to large pension funds, as well as an ever-increasing variety of tax-exempt bonds.

In accordance with the wishes of the Subcommittee, my testimony this morning will offer an overview of the tax-exempt community, specifically 501(c)(3) organizations, our role in regulating that community, and some of our initiatives and challenges.

I am a tax administrator, and what I will say today may seem to overstate the presence of compliance problems within the charitable sector. There is no question that such problems do exist, but let me start with two observations. First, the charitable sector deserves to be commended for the vital work it does throughout America, and indeed throughout the world. Second, on the whole, the charitable sector is very compliant with the Tax Code. While we have seen problems, some of them serious, and some of them involving major charitable institutions, they are not widespread. We are working to keep it that way. We believe that through our efforts and those of the leadership of the charitable sector, we are ensuring that problems do not overwhelm the good that charities do. Credit for this should be shared with this Committee as well, and with the Congress as a whole. We appreciate your interest, action, and oversight.

Role of Charities in American Society

In General

Charities and other tax-exempt entities have always played an important role in the fabric of American life. Tax-exempt organizations meet critical needs in American society. They feed the hungry, shelter the homeless, and care for the elderly. They operate schools, universities, and hospitals. They are our churches. They conduct research that saves lives and provides for a better standard of living. They serve as the backbone of our cultural and artistic life. They preserve our history and our historic buildings; they operate museums, and they engage the desire of Americans to give something back to their communities by offering a vast array of opportunities for volunteer work. In times of crisis, such as the aftermath of September 11 or Hurricane Katrina, the importance of their work is visible for all to see.

Charities and volunteer organizations seem to represent something enduring about Americans. In our history books, we read the story of the creation of such iconic charities as Clara Barton's American Red Cross and Jane Addams' Hull House. Just last year, contributors gave more to charity than ever before. Across the centuries, the charitable impulse has been strong within our country.

The Congress has recognized charities' important role by enacting and preserving section 501 of the Internal Revenue Code, which creates the tax-exemption that charities and other tax-exempt organizations enjoy. The large annual tax-expenditure for tax-exempt organizations represents a strong endorsement by Congress of the work of the charitable community.

Demographics of the Tax-Exempt Community

The tax-exempt sector, which includes more than section 501(c)(3) charities, has been growing rapidly. Since 1997, the number of tax-exempt organizations on the IRS master-file increased by more than 350,000. The total number now approaches 1.6 million, a figure that does not include most churches. These organizations hold assets in excess of $3 trillion.

Internal Revenue Code section 501(c)(3) describes a subset of the entire tax-exempt sector. Section 501(c)(3) organizations include those organized and operated exclusively for religious, charitable, scientific, educational, and other specified exempt purposes. They are eligible to receive tax-deductible contributions and are subject to certain operating restrictions.

Currently, more than one million tax-exempt organizations are classified as section 501(c)(3) organizations. This includes private charities and private foundations, but not churches, which generally have no filing requirement. Section 501(c)(3) organizations hold assets in excess of $2.5 trillion (private charities hold $2 trillion; private foundations $500 billion). Public charities have annual revenues of nearly $1.16 trillion, and spend approximately $900 billion per year on program services. Private foundations have annual revenues of $68 billion.

Current External Environment for Charities

Like any vibrant sector of our economy, the charitable sector is changing. We have witnessed continued growth in this sector, both in terms of its sheer size and in terms of its complexity. Most 501(c)(3) organizations are created and run by volunteers and typically have a staff of fewer than ten employees. However, increasingly, many 501(c)(3) organizations are becoming large economic hubs (e.g., hospitals, universities, and foundations). Some are enormous, control great wealth, and operate on a global scale. With size may come complex organizational structures and the ability to participate in cutting edge economic transactions.

As the parents of the baby boom generation begin to pass away, and as the baby boomers themselves near retirement, we expect to see a significant transfer of wealth from one generation to another and the contribution of large sums to charities. With this transfer of wealth comes intensified financial and tax planning resulting in the creation of new, and sometimes troubling, gift and planning devices.

The Internet also has an effect on this environment. Its obvious influences include its revolutionary contributions to communications and the possibility of almost real-time transparency. It also raises issues concerning web-based fundraising and virtual charities. Moreover, the Internet may blur the concept and importance of state and national borders, with implications for local jurisdiction over local charities.

The Regulatory Environment for Charities

The tax-exempt sector has changed markedly over the past 40 years, but there has been much less change in the laws governing tax-exempt organizations. In recent years, however, legislative interest in this area has picked up. Congress has passed the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) and the Pension Protection Act of 2006 (PPA), two important pieces of legislation that address a host of issues in the tax-exempt sector. While it is too early to measure specific results, the legislation has given us additional tools.

In the early years of this decade, we began to be concerned with whether we were maintaining a sufficient enforcement presence in this area. It is clear that we need to be "on the beat," and to be perceived as such. Voluntary compliance is clearly influenced by the IRS' enforcement capacity and presence. As we will discuss later, under former Commissioner Everson's leadership, we improved our enforcement program.

The President's 2008 budget for the IRS will advance our efforts, and I respectfully request your support for it. This budget supports our continued emphasis on compliance in the tax-exempt area. For FY 2008, the Administration has requested a 6.3 percent increase in the IRS budget. The budget includes a larger increase for TE/GE (10.8 percent or $26.4 million), with a 12.3 percent increase for our examination program and a 12.6 percent increase for our determinations program.

Role of the Internal Revenue Service

Congress has established in the tax law certain limitations on what those granted the privilege of tax exemption may do. Tax exemption is granted only for certain defined categories of activity. Those who wish exemption from tax must act within those limitations. This is the cost of tax exemption -- the conditions that must be met to receive the tax subsidies granted by Congress.

The Internal Revenue Service has a balanced program for regulating the charitable sector. Within the IRS, TE/GE has the responsibility to administer and enforce these limits. Doing so accomplishes a number of important public purposes. First, it insures that Congressional intent is honored. Second, it helps maintain public confidence in the integrity of the charitable sector. And third, it prevents the erosion of the tax base by ensuring that those who would prey upon innocent contributors or misuse the privilege of tax exempt status are identified and stopped from doing so.

The Internal Revenue Service approaches this responsibility with a balanced program that emphasizes both service and enforcement. The program is carried out by the 860 members of TE/GE's Exempt Organizations function. TE/GE's efforts in this area may be best described as falling into three categories: determinations or rulings on prospective matters, education and outreach, and a vigilant examination program.

TE/GE's determination program for applicants for exempt status is particularly important. In this program, prospective exempt organizations submit information to the IRS about their purpose and structure. Determination specialists review the applications and, where necessary, work individually with the applicant to insure that the organization meets the requirements of the Code for tax exemption. Unless the organization is later selected for examination, the determination process is often the only time the IRS is in direct contact with the organization.

The determination process therefore represents an important opportunity for the IRS. It is the time when the IRS has the chance to ensure that the charity is organized as required, that the organization is operating properly, and that the IRS has the information it needs about the organization. The determination letter process also presents an important educational opportunity for the applicant to learn of its responsibilities and filing obligations as an exempt organization.

In recent years, we have received an increasing number of applications for tax-exempt status while we have been losing staff. In 2000, our determinations unit had 227 FTE and received 85,000 applications and other work items. In 2005, the unit had 171 FTE and received 87,000 determinations and other items. This led to the development of a backlog of determination cases awaiting review.

We have addressed this situation. I am happy to report that we have made good progress in reducing the backlog and improving timeliness. We are continuing this effort.

TE/GE augments the determination process with an active education and outreach program for the charitable sector. In FY 2006, for example, this program included presentations at the 12 IRS Nationwide Tax Forums of exempt organization seminars to 8,120 participants; 18 one day-long workshops in six cities with 2,153 participants, and three hour-long phone forums with 1,100 participants. Since 2005, EO has published an electronic newsletter, "EO Update." It has 20,360 current subscribers and we have published 54 issues. The IRS also maintains a TE/GE toll-free call site where individual questions are taken and answered.

The overarching purpose of the education and outreach process is to keep existing exempt organizations compliant by keeping them alert to the requirements of the law and by giving them the opportunity to have their questions answered. One particularly helpful tool is our extensive web site, which includes web-based information tools called "Life Cycles." Each Life Cycle provides practical information about each of five stages organizations typically go through during their existence: starting the organization; applying for tax-exempt status; filing required returns and other documents; maintaining the organization; and terminating the organization. We provide Life Cycles for public charities, private foundations, social welfare organizations, labor organizations, agricultural and horticultural organizations such as farm bureaus, and trade associations and other business leagues. Another tool we offer is StayExempt.org, a web-based version of the day-long workshop for small and mid-size exempt organizations.

The exempt organizations community has enthusiastically embraced these tools. We have recorded 324,226 visits to the public charity life cycle site since August 2004; 66,688 visits to the private foundation life cycle site since November 2005; and 78,116 visits to StayExempt.org since January 17, 2007.

While we provide an upfront evaluation of a charity's exempt status and support exempt organizations with customer education and outreach, we also must have a process to review these organizations as they operate. We therefore maintain a robust examination program. We have made major changes in the way we examine organizations in the last few years, adding staff and offices that allow us to respond flexibly to different types of non-compliance in different areas. We are constantly looking for more efficient and effective ways to conduct examinations.

The examination program is aimed at detecting and deterring non-compliant behavior. We have strengthened this program in a number of ways over the past several years, including shifting resources into it. In FY 2003, we had 394 examination FTE and performed 5,754 examinations. By FY 2006, we increased examination FTE to 507 and examined 7,079 returns, an increase of 23 percent from 2003, and the highest level since FY 2000. In addition, we have created new offices and engineered new business processes that broaden and strengthen our compliance presence. These include the Exempt Organization Compliance Unit (EOCU), the Data Analysis Unit (DAU), and the EO Financial Investigations Unit (FIU).

The EOCU contacts taxpayers by letter to conduct "compliance checks" or to obtain information for studies. We conduct a compliance check when we discover an error on a taxpayer's return or wish to obtain further information or clarification from a taxpayer. This is an efficient and effective way to maintain a compliance presence.

The DAU, a group of professional statisticians and economists, uses data mining, trend research and analysis, and other techniques to identify areas of noncompliance and to develop strategies to improve compliance through examinations, compliance checks, educational programs, and other techniques that may not involve the examination of books and records. A project may measure overall levels of compliance, or it may answer specific questions about a market segment.

The FIU is staffed with fraud specialists, forensic accountants, and agents with expertise in identifying fraud and tracking foreign grant activities. The FIU conducts examinations of organizations identified as potentially involved with fraudulent transactions. The staff also works jointly with law enforcement agencies, such as the Joint Terrorism Task Force and the Criminal Investigation Division, by providing support on criminal investigations and expert testimony at trials involving EO-related issues.

Areas of Concern within the Charitable Sector

As we have stated, when people make contributions to charities, they expect that their contributions will be used to accomplish a charitable purpose. If the charity uses the contribution for the personal benefit of executives, or misuses it in some other way, the credibility of the recipient charity and other charities is called into question, and Congressional intent in granting the tax exemption is thwarted.

That is why it is important for IRS to act as the "cop on the beat" to insure that charities behave in accordance with their charter and the privilege of tax exemption.

We now turn to a description of some areas in which we have specific concerns about compliance and possible abuse of the privilege of tax-exempt status. We have grouped these concerns into five areas.

1. Charitable Contribution Overvaluation: Charitable contributions raise a number of compliance concerns. One involves improper valuation of non-cash donations, an issue that occurs in many contexts in the tax-exempt area. Additional concerns are whether a donor receives some form of consideration in exchange for a contribution, and whether a donor transfers only a partial interest in the contributed item.

While recent legislation provided some much-needed assistance on the issue of proper valuation of non-cash donations, we anticipate that overvaluation will continue to be a significant problem in charitable contributions of property. These issues are often difficult. Overvaluations may arise from taxpayer or appraiser error, from aggressive taxpayer or appraiser positions, or from fraud or other deliberate behavior. Valuation problems are greatest with non-cash charitable contributions for which no ready market exists, and the failure to substantiate properly the value of such contributions exacerbates the issue. Although the problem manifests itself in various contexts, the underlying issue is the same. Cases are often difficult, because of the need for experts and because the costs to audit, appraise, and litigate generally are high and sometimes may exceed the recovery. Nonetheless, we continue to pursue this issue through a variety of compliance programs.

2. Charities Established to Benefit the Donor: This group of compliance issues shares a common feature: a donor claims a deduction for a charitable contribution while maintaining control over the contributed assets, and often uses them for personal benefit. The IRS is actively conducting examinations in all these areas, including areas such as charitable trusts. Congress acted recently with respect to the two areas described below. The IRS is implementing these changes, but it is too early to determine with any specificity their full impact.

- **Abusive Donor-Advised Fund Arrangements.** A donor-advised fund is a separate fund or account maintained by a public charity to receive tax-deductible contributions from a single donor or a group of donors, with the donor retaining the right to advise with respect to the use or investment of the account. In our examination program, we found that certain promoters encourage individuals to establish purported donor-advised funds used for a taxpayer's personal benefit. We also found that some of the charities that sponsor these funds may be complicit in the abuse.

Section 509(a)(3) Supporting Organizations Established to Provide Benefits to Founders. Supporting organizations are public charities that, in carrying out their exempt purposes, support one or more other exempt organizations, usually other public charities. Most problems we find with supporting organizations are in the so-called Type III organizations, where the relationship between the supporting and the supported organizations is least formalized. We also have found issues with Type I organizations, where a promoter may control the supported organization. Other problems include *quid pro quo* issues with money either never actually being donated or, if donated, being returned as loans or other forms of inurement, and problems with the promotion of these transactions.

3. A blurring of the line between the tax-exempt and commercial sectors. As the tax-exempt sector grows larger, wealthier, and structurally more complex, the line between charities and the commercial sector blurs as businesses try to act like charities in order to reap the benefits of tax exemption and as charities engage in business-like activities in order to raise funds for their activities. As charities themselves begin to engage in complex deals, they run the risk of violating the limitations that apply to them. Concerns exist in this area in a variety of contexts:

- **Commercial Operators Moving into the Charitable Sector**. The movement of commercial enterprise into the charitable sector remains an issue. Various factors encourage this movement, including the absence of bright line standards in the tax-exempt area, the promise of exemption from consumer protection and similar Federal and state regulatory statutes often enjoyed by charities, and the economic benefit the tax exemption itself conveys. The line between commercial and charitable operations may be further blurred in certain cases where market forces, industry practice, or the non-tax regulatory environment has changed over time. Specific examples follow:

    - **Credit Counseling**. Credit counseling is a clear and disturbing example of how commercial operators seized upon lawful tax-exempt activity and converted it into something entirely different and decidedly commercial. These operators never relinquished their claim to tax-exemption and took advantage of regulatory exceptions to operate without restriction in an otherwise highly regulated market. We conducted a vigorous examination program of the entire credit counseling industry and thus far have proposed revocation or revoked the tax-exempt status of 41 percent of the industry, as measured by gross receipts. Approvals of applications for determination letters for new credit counseling organizations have come virtually to a halt. The Congress also acted, and we believe that this action has significantly reduced the abuse and the movement of commercial operators into this area.

- **Down Payment Assistance Organizations**. Down payment assistance organizations can perform a valuable role in helping low-income individuals become home owners. However, promoters have set up "charities" that allegedly aid people who need help to make a down payment for a home. In the abusive cases, these organizations operate for the benefit of the seller and the mortgage lender, often at the expense of the buyer who assumes responsibility for mortgage payments beyond his or her means. Again, these organizations took advantage of favorable non-tax regulations intended to be available only to true charities, and instead provided an impermissible private benefit. We issued Revenue Ruling 2006-27 in 2006 to provide clear guidance on the subject of down payment assistance. Although we are working vigorously in this area, it remains a current compliance challenge.

- **Complexity and Administrative Difficulty of Unrelated Business Taxable Income Determinations (UBTI)**. A problem exists with UBTI in situations where drawing lines between "related" and "unrelated" activities and uncertainty about allocating expenses (including indirect expenses) and income between related and unrelated economic activity allows excess flexibility. This problem is becoming more critical as tax-exempt entities provide goods or services that are similar to, or in some cases virtually indistinguishable from those offered by the taxpaying commercial sector. This movement raises a number of concerns, including the erosion of the nation's tax base, unfair competition with the commercial sector, and potential damage to the public's support of the charitable sector.

  This is not to say that an organization that engages in activities that have commercial analogues cannot be tax-exempt, or that the income generated is necessarily UBTI. However, we cannot overlook the compliance issues that these and similar activities raise, or ignore the difficult administrative problems they create for the IRS. As commercial and investment activity proliferates, we must determine how much activity or funding exempt organizations are dedicating to charitable purposes.

Another issue involves the number of organizations reporting losses on the Form 990T. According to recent data, approximately 50 percent of Form 990T filers report zero income or a loss in the conduct of their unrelated business activities. Beginning in 2008, we will explore the treatment and allocation of income and expenses in university systems.

4. Executive Compensation and Inurement. The media has reported high salaries and generous allowances at some charities and foundations. High compensation based on the fair value of services an executive performs for the exempt organization is consistent with current law. The key question is whether the compensation is comparable to what similar organizations pay for similar work. The organizations used for comparison may include for-profit as well as nonprofit organizations. The law permits reasonable compensation, even if high. It does not, however, permit excessive compensation.

In March 2007, in a report on executive compensation, we noted that the exempt organizations we examined appeared to generally comply with the law in their compensation practices, but had significant reporting problems. Follow-up work from the project is continuing and includes the redesign of the Form 990, including executive compensation schedules, examinations of loans to executives, and other examination work.

We expect to scrutinize executive compensation in virtually every new exempt organization compliance initiative we conduct. As we continue to gain experience, we will review the use of comparability data to support the compensation amounts and assess the methods used to establish and approve the compensation. We will also be alert to increasing sophistication in the types of compensation exempt organizations use to pay their executives and other key personnel, such as revenue sharing or equity-based arrangements. The new Form 990 we have proposed will strengthen our ability to monitor this area.

5. Regulation and Reporting of Political Activities. We also have the responsibility to monitor political activity by exempt organizations. By law, charities cannot intervene in political campaigns, but every election season brings reports of charities supporting or opposing particular candidates. The number of allegations of improper activity, together with increased campaign spending, has raised concerns about whether prohibited funding and activity are growing in 501(c)(3) organizations. To address these issues, the IRS began the Political Activities Compliance Initiative in 2004.

In February 2006, we released a report on our examination of political campaign activity by tax-exempt organizations during the 2004 election campaign. The report concluded that nearly three-quarters of the 82 examinations we completed uncovered some level of prohibited political campaign activity.

We recently released Revenue Ruling 2007-41 which provides guidelines for exempt organizations on the scope of the prohibition of campaign activities by section 501(c)(3) organizations. We also have released a report on our efforts related to the 2006 campaign. In the report we drew comparisons to the 2004 cycle, but for the most part it is too early draw meaningful conclusions about the 2006 campaign.

Political Action Committees (PACs) and other political organizations must file certain reports with us concerning their status, receipts and expenditures, pursuant to Code section 527(i) and (j). Failure to meet these reporting requirements may result in taxes or penalties. We have begun an initiative to determine whether organizations that claim they are Qualified State or Local Political Organizations, as defined in Code section 527(j), are making this claim properly. Such organizations are exempt from the requirement under Code section 527(j) to report expenditures and contributions.

Future Direction of the IRS in Regulating the Charitable Community

In this part of the testimony, we outline future priorities and our work with respect to each priority: enhancing our compliance impact; enhancing transparency in the operations of charities; and leveraging efforts to improve stewardship of the sector.

Continue to Enhance our Compliance Impact

Increased efficiency of the determination letter process. We continue to emphasize and improve our determination letter process. We have revised the application and the manner in which it is processed. As discussed, this has allowed us to reverse a troubling trend in which the time required to process an application had reached unacceptable levels. We will shortly preview an electronic program to assist the taxpayer in filling out the form. The program, the so-called "cyber assistant," will both educate the applicant and eliminate many errors in the applications. We have also put in place processes by which we can isolate and investigate applications for tax-exempt status in troublesome areas.

Increased presence in enforcement. Since 2005 we have continued to shift resources into compliance and enforcement. We have increased examinations by 5.6 percent since 2005, and last year examined over 7,000 returns -- the highest number since 2000. These numbers do not include contacts which, though short of examinations, nonetheless establish direct compliance communication between the IRS and the taxpayer. In 2006, we contacted over 5,200 tax-exempt organizations this way. For example, we sent a nine-page, 81 item questionnaire to a sample of tax-exempt hospitals on the reporting of potential community benefit expenditures and executive compensation.

As discussed above, we have instituted processes that have broadened and strengthened our compliance presence. To cite two examples, we have undertaken studies of non-profit hospitals and the compensation of executives of charities. These studies would not have been possible without the design and staffing of the Exempt Organizations Compliance Unit, one of the new offices within TE/GE. And we continue to focus on key areas, including the above-described executive compensation area, hospitals, non-cash contributions, and political activity.

<u>Continued Efforts to Enhance Transparency: Getting Better Data and Making it Publicly Available</u>

Transparency is important in all aspects of tax administration, but it is the linchpin of compliance within the tax-exempt sector. When the structure and operations of charitable organizations are visible to all, the possibility of misuse or abuse of charitable assets is reduced. Equally important, public confidence in the organization and in the charitable sector as a whole is preserved. With that in mind, we have undertaken a number of initiatives that are designed to improve transparency with respect to the activities, fundraising, finances, and governance of charities.

Redesign of the Form 990. Transparency begins with adequate reporting. On June 14, 2007, we released for public comment a discussion draft of the new Form 990 and instructions. This redesign is intended to enhance transparency, promote compliance and minimize taxpayer burden. It is the first overhaul of the form since 1979. We are working with our stakeholders throughout the sector to make the redesigned Form 990 the model for transparency. Our goal is to have the new Form 990 ready for use for the 2009 filing season.

Electronic Filing of Form 990. One of our key transparency initiatives is to provide charities and others with the ability to file the Forms 990 and 990PF electronically. Electronic filing allows a clear, relatively error-free presentation of the information required on the Form 990. In addition, it allows for all the data to be readily available to the IRS, the states, and the public. We already require electronic filing for large exempt organizations. While this will markedly improve the ability of the IRS, state charity officials, and the public to access Form 990 data in real time, statutory restrictions limit our ability to require e-filing for any organization that files fewer than 250 returns. The Administration's FY 2008 Budget proposal echoes this concern, and includes a legislative proposal that would lower the current 250-return minimum for required electronic filing but maintain the minimum at a high enough level to avoid imposing undue burden on smaller exempt organizations.

Implementation of the E-Postcard for Small Exempt Organizations. When charities are not required to file any return, they become difficult for us to monitor, and we are unable to insure that they continue to act in a way consistent with tax-exemption. Congress has recently required small organizations (those with less than $25,000 in annual gross receipts) to submit a very limited amount of data with the IRS. This will assist the IRS in maintaining contact, educational and otherwise, with these small organizations. Moreover, as we revise the Form 990, we will look at the current filing thresholds for the "e-postcard" and for the Form 990-EZ in an effort to attain the right balance between getting the information we need and not overburdening filers.

Working with the Charitable Sector to Improve Governance and Accountability

Transparency means nothing without ensuring appropriate stewardship of assets held in charitable trust. Thus, governance and accountability are paramount in any meaningful stewardship efforts. The IRS is supporting this work and taking action to ensure that charities are aware of all available tools and practices to succeed in their vital mission.

While we regularly encounter lax governance practices on the part of tax-exempt entities in our examinations, we also see some positive signs that the sector is aware and concerned about such practices. I referred earlier to the impressive efforts of some within the tax-exempt community to establish and gain general acceptance of high standards for governance. We salute this effort. We remain convinced that the presence of an independent, empowered, and engaged board of directors is the key to ensuring that a tax-exempt organization does not misuse or squander the charitable resources in its trust. Such a board helps insure that a tax-exempt organization serves public purposes.

We have also acted to complement the efforts of some in the charitable sector to promote good governance. As we review applications for tax-exempt status, we are encouraging applicants to consider a number of good-governance policies. We are also programming education about good-governance principles into the "cyber-assistant" that we are developing as part of our program to implement an electronic application for tax-exempt status. In addition, the new draft Form 990 includes reporting regarding certain governance practices the charity undertakes. This important work will continue.

Conclusion

While we have found some tax compliance problems in the charitable sector, we remain quite optimistic that through our efforts and the efforts of others, these problems have not reached and will not reach the core of the charitable sector. We remain aware of the need for a balanced program in regulating this sector, a sector that does vital work for our society.

We appreciate the support the Subcommittee has given us in the past, and thank you for your consideration of the FY 2008 IRS Budget. That budget supports our continued emphasis on compliance in the tax-exempt area. It requests a 6.3 percent increase for the IRS as a whole, and a 10.8 percent increase ($26.4 million) for TE/GE. It will provide a 12.3 percent increase for our examination program and a 12.6 percent increase for our determinations program.

We look forward to continuing our work with all parts of the charitable sector and its progressive leaders. We intend to keep pace with this vibrant sector as it continues to evolve and change. We will work to ensure that the public remains confident that its contributions of time, effort and money, and the tax subsidies Congress provides to the charitable sector, are used well for the benefit of the public.

Thank you again for the opportunity to be here this morning. I will be happy to answer your questions.

Chairman LEWIS. Thank you very much, Mr. Commissioner, for your statement.

Our next witness is from the Government Accountability Office, so, I am pleased to welcome the Director of the Strategic Issues, Mr. Stan Czerwinski. Welcome.

STATEMENT OF STANLEY J. CZERWINSKI, DIRECTOR, INTERGOVERNMENTAL RELATIONS, STRATEGIC ISSUES, GOVERNMENT ACCOUNTABILITY OFFICE

Mr. CZERWINSKI. Thank you, Mr. Chairman and Members of the Subcommittee. We appreciate your holding this hearing, which as many of you noted in your opening statements, is on a very important topic.

GAO has done a lot of work looking at nonprofits over the years. Typically, our work has been specialized, focusing on specific topics, programs, events, and issues, especially tax-related issues. For example, Greg Kutz, our Managing Director for Forensic Audits and Special Investigations, will be speaking next about a review that he and his team have just completed.

Late last year our Comptroller General spoke at the independent sector conference. When he returned from that conference, he asked me and my team to do some background work to determine if the sector as a whole merited GAO's attention. We have just completed our initial background review, and our answer to the Comptroller General is a resounding yes.

We are pleased to share with you the initial results of our review today. Specifically, I would like to address three topics: one, the sector's role in the economy; two, its partnership with the Federal Government to provide key services; and three, some issues that we believe need further scrutiny.

As you know, the nonprofit sector is defined by its tax-exempt status. To qualify, organizations must not distribute the profits to the members, but instead must plow it back into the organization's charitable purposes. Also, those purposes themselves are dictated by what is governed in law.

My statement today will primarily focus on public charities known as 501(c)(3)s for the section of the code that governs them. Public charities make up about 60 percent of the 1.8 million organizations in the nonprofit sector as a whole. Also, as a whole, the nonprofit sector plays a key role in the U.S. economy. It represents about 11 to 12 percent of GDP. Nine percent of the nation's civilian workforce is employed by nonprofits. The sector is growing also. The number of organizations has tripled in the last two decades.

The data tell us a similar story about nonprofits' role in delivering Federal services. However, it is important to note that the data are quite limited. What we have today is a result of a herculean effort from a small band of dedicated researchers. Elizabeth Boris, Marian Fremont-Smith, Alan Abramson, Lester Salamon, and Gene Steurle are the most noteworthy, and all provided input to our work.

About $200 to $300 billion in Federal funds flow each year into nonprofits. That number is growing. For example, the researchers estimate that the dollars going into nonprofits has increased over 200 percent for the last two decades.

If anything, we see this trend continuing as the Federal Government is increasingly faced with fiscal constraints and looks for partners to help them shoulder that burden. Nonprofits offer key advantages in doing so. They exist for the sole purpose of providing the service they were created for and dedicated to. They are typically very expert in the needs of their clientele, the geographic region, and they offer greater flexibility than their Government counterparts.

In times of constrained Government resources, we increasingly look for ways to reform the way we do business and to look for additional partners. A good example of this is welfare reform. As you know, AFDC used to be a checkwriting service. It was an entitlement, and dollars were unlimited. AFDC underwent reform and was replaced by TANF, which is service-based and the funding levels limited. TANF provides such services as job training, job search, and child care. These services are pretty much provided by the nonprofit sector.

As we increasingly rely on nonprofits, it is important to know about them, both to know how to help them and also which ones need further scrutiny. The primary source of information in the nonprofit sector and for oversight of it comes from IRS through its tax-exempt status. However, IRS lacks the capacity to do this job the way that we would need from a full policy perspective, and to be fair, it is not IRS' central mission. As we know, their job is to collect taxes.

As I pointed out, the definition of nonprofits hinges on the tax-exempt status, but that hardly defines them. The role of the sector is far greater than that. They are important to the economy. They are key partners in the Federal Government.

It is in our interest to ensure their vitality, their capacity, and their integrity. That begins with the attention provided today, the support that they need, and oversight. What the Subcommittee is doing today is a first step in the right direction. We look forward to helping you as you continue your agenda and your approach.

That concludes my statement, Mr. Chairman. I will be glad to respond to questions you may have.

[The prepared statement of Mr. Czerwinski follows:]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

For Release on Delivery
Expected at 10:00 a.m. EDT
Tuesday, July 24, 2007

NONPROFIT SECTOR

Increasing Numbers and Key Role in Delivering Federal Services

Statement of Stanley J. Czerwinski
Director, Strategic Issues

GAO
Accountability • Integrity • Reliability

GAO-07-1084T

GAO
Accountability-Integrity-Reliability

Highlights

Highlights of GAO-07-1084T, a testimony before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

July 24, 2007

NONPROFIT SECTOR

Increasing Numbers and Key Role in Delivering Federal Services

Why GAO Did This Study

The nonprofit sector is an important means through which public services are delivered and national goals addressed. The federal government increasingly relies on networks, often involving nonprofits that address many issues—health care, education, and human services, for example. Because nonprofit organizations play a key role as partners with the federal government, there is a need to better understand the sector.

This testimony (1) provides a picture of the nonprofit sector—its size, composition, and role in the economy; (2) discusses how and why the federal government partners with the sector; and (3) identifies issues related to the sector as a federal partner that need to be better understood.

GAO's preliminary work on this topic focused on the intersection of nonprofit organizations and the federal government, including trends, the use of federal funding, and emerging issues. GAO interviewed key experts from relevant associations and academia, reviewed related research, and hosted roundtable discussions with key researchers and practitioners in the nonprofit area.

www.gao.gov/cgi-bin/getrpt?GAO-07-1084T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Stanley J. Czerwinski at (202) 512-6806 or Czerwinskis@gao.gov.

What GAO Found

U.S. nonprofit organizations have a significant role both in the economy as a whole and as providers of services. While the majority of nonprofit organizations have relatively small operating budgets, together their impact is large. For example, researchers estimate that the sector's spending in recent years was roughly 11 to 12 percent of the nation's gross domestic product and, in 2002, the sector had over 9.6 million employees, about 9 percent of the civilian workforce. Further, the sector has grown; the number of charitable organizations reporting almost tripled over the last two decades.

The federal government increasingly partners with nonprofit organizations as they bring many strengths to these partnerships, such as flexibility to respond to needs and access to those needing services. These organizations receive significant funds from government sources to provide services. Researchers have attempted to quantify these funds. For example, one estimate is that the federal government spent about $317 billion on nonprofit organizations in fiscal year 2004. However, the lack of data makes measuring federal funds to nonprofit organizations difficult. Many funds come through indirect routes, such as through state and local government, adding to the difficulty of determining funding and measuring performance. Although IRS is generally responsible for overseeing the tax-exempt status of these organizations, there is less focus at the federal level on the comprehensive role of nonprofits in providing services using federal funds.

Our preliminary look at how the federal government interacts with the nonprofit sector indicates that several policy issues have emerged; examples follow.

- **Coordination and collaboration**—the increasing importance of collaboration between all levels of the government and nonprofit organizations.
- **Internal governance issues**—the need to strengthen internal governance of nonprofit organizations.
- **Capacity**—the need to improve smaller nonprofit organizations' capacity to address weaknesses in finances, administration, and human capital.
- **Nonprofit sector data**—the need for improved data on the sector's size, financial status, and funds from federal sources.
- **Administrative and reporting requirements**—the many requirements to be accountable, which while important and necessary, require information in different formats and with increasing complexity.
- **Fiscal challenges for nonprofits**—the instability of some nonprofits' financial position.

At the request of the Congress, we are beginning work to examine these issues further.

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to participate in today's hearing to discuss our preliminary work and observations on the role the nonprofit sector plays in partnering with federal, state, and local governments to deliver programs and services.[1] Although the sector is an important means through which many key national goals are addressed, its role can be nearly invisible to federal policy-setting decision makers when designing and implementing programs. Broadly stated, the federal government increasingly relies on large and complex networks of nonfederal actors to carry out initiatives. In recent years, most oversight of the sector has focused on its tax-exempt status. However, because the nonprofit sector plays a key role in delivering services funded by the federal government, there is also a need to better understand the sector as a partner on which the federal government relies.

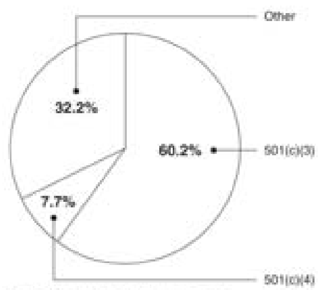
The nonprofit sector is defined primarily by its tax-exempt status, a designation that occurs at both the federal and state levels of government. In addition, nonprofit organizations share certain other characteristics. First, they work to serve public purposes or the common goals of their members. Further, they can benefit from voluntary labor and are self-governing. In addition, they are not permitted to distribute profits to their members but must instead use them to further the organization's charitable purpose. Beyond these commonalities, they have a diverse set of missions, and many of those missions are related to those of federal agencies. As a result, it is important to better understand the composition of the sector, its importance, and its strengths and challenges.

An estimated 1.8 million organizations were recognized as federal-tax-exempt organizations as of September 2006.[2] Of these, about 60 percent (see fig. 1) are public charities or foundations that benefit the broad public interest, and are referred to as 501(c)(3) organizations. Our focus today is largely on charities, as they represent the majority of the sector. (See further clarification of key terms in app. I.)

[1] The tax-exempt sector is often referred to as the nonprofit sector.

[2] GAO, *Tax Compliance: Thousands of Organizations Exempt from Federal Income Tax Owe Nearly $1 Billion in Payroll and Other Taxes*, GAO-07-563 (Washington, D.C.: June 29, 2007), p. 5.

Figure 1: Categories of Tax-Exempt Entities



Source: GAO analysis of IRS data as of September 30, 2006.

Note: The 501(c)(3) organizations are the public charities and foundations; (501)(c)(4) are social welfare organizations.

As you know, the Internal Revenue Service (IRS) serves as the agency that generally oversees the nonprofit sector at the federal level. IRS focuses on whether organizations meet tax-exempt requirements and comply with federal laws, such as those governing the use of funds intended for a charitable purpose. It approves organizations for federal tax-exempt status and is the recipient of annual reporting of financial data on Forms 990, which are required from organizations with gross receipts over $25,000.[3] In addition, a few other federal organizations, such as the Federal Trade Commission and the Department of Justice, provide oversight of nonprofit organizations in certain specialized areas. States also play an important role in the oversight of nonprofits, as they have interests and responsibilities in areas such as the legitimacy of charitable fundraising and whether a charity is meeting the charitable purpose for which it was created. In addition, the public plays a role in oversight through its ability to review key information on individual organizations, to the extent useful information is available.

[3] Churches are not required to file for tax-exempt status, nor to report annually.

My testimony today will point out some of the diversity and the range of characteristics present within the sector, along with some of the issues that arise as nonprofit organizations interact with the federal government. I would like to (1) provide a picture of the nonprofit sector—its size, composition, and role in the economy; (2) discuss how and why the federal government partners so extensively with the sector; and (3) identify issues that others have raised related to the sector as a federal partner that need to better understood.

My statement is based largely on some preliminary work we recently completed that focused broadly on the intersection of nonprofits and the federal government. We focused on trends in the use of federal funding and on identifying emerging issues in the nonprofit sector. We interviewed representatives from several large nonprofit member associations, research and advocacy organizations, academic researchers, foundation representatives, and nonprofit practitioners. We hosted two roundtable discussions with key researchers and practitioners in the nonprofit area. We also reviewed literature on the sector from academic centers, research institutes, foundations, and others to better understand sector trends and issues, and to identify additional experts for interviews. Our work included a review of our previous work related to nonprofits on a wide variety of topics, such as tax policy, human service programs, and executive compensation. Our work was performed in accordance with generally accepted government audit standards.

Role of Nonprofit Organizations in the Economy and as Providers of Services Is Significant

While the majority of nonprofits individually have relatively small operating budgets, as a whole, the nonprofit sector has a significant presence in the U.S. economy, according to researchers of the nonprofit sector. For example,

- In 2004, nonprofit organizations that submitted Forms 990 to IRS held an estimated $3 trillion in total assets and received $1.4 trillion in revenues.[1]

[1]The Urban Institute, "The Nonprofit Sector in Brief," *The Nonprofit Sector in Brief: Facts and Figures from the Nonprofit Almanac 2007* (Urban Institute, 2006), www.urban.org/UploadedPDF/311373_nonprofit_sector.pdf (downloaded Oct. 30, 2006).

- During the period 1998 through 2002, spending reported by tax-exempt entities was roughly 11 to 12 percent of the nation's gross domestic product.[5]
- The tax-exempt sector had over 9.6 million employees, about 9 percent of the civilian workforce in 2002.[6]
- Wages and salaries paid to nonprofit sector employees comprised 8.3 percent of those paid in the U.S. in 2004.[7]

In addition to representing a significant portion of the U.S. economy, the sector is growing. Data indicate that from May 2000 to May 2006, the number of registered public charities has grown over 30 percent from about 646,000 to about 851,000, although organizations that have gone out of existence may be included in those numbers.[8] Other data also suggest growth in the sector. As shown in figure 2, the number of 501(c)(3) organizations completing the Form 990 has almost tripled over the last two decades (from 1986 to 2006) from about 148,000 to about 427,000.

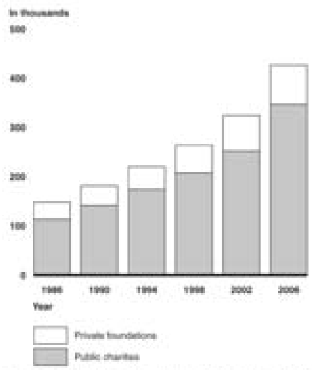
[5] GAO, *Tax-Exempt Sector: Governance, Transparency, and Oversight Are Critical for Maintaining Public Trust*, GAO-05-561T (Washington, D.C.: Apr. 20, 2005), p. 9.

[6] GAO-05-561T, p. 10.

[7] National Center for Charitable Statistics, "NCCS Quick Facts" (Urban Institute, May 2006), http://nccsdataweb.urban.org/NCCS/files/quickFacts.htm (downloaded Dec. 15, 2006).

[8] National Center for Charitable Statistics (using the IRS Business Master File, May 2006), *http://nccsdataweb.urban.org/NCCS/Public/index.php* (downloaded Dec. 18, 2006)

Figure 2: Growth in the Number of Reporting 501(c)(3) Organizations—1986 through 2006



Source: IRS, Statistics of Income Division, 1986-2002 data; National Center for Charitable Statistics (using the IRS Business Master File January 2007), 2006 data.

Note: Public charities and private foundations are both 501(c)(3) entities. Organizations that have annual gross receipts not normally in excess of $25,000, churches, and certain other exempt organizations are not required to file the annual information return.

Experts have identified several possible contributing reasons for this increase:

- a shift in recent decades away from government providing most services directly;
- the expansion of service-related industries in the U.S., of which many nonprofits are a part;
- deinstitutionalization during the 1960s and 1970s that eliminated large, public care facilities in favor of smaller, community-based organizations, often operated by nonprofit entities; and
- the trend in devolution in certain policy areas such as welfare, which contributed to a lessening role of the federal government and more localized control in the hands of state, local, and nonprofit organizations.

Nonprofit organizations are found in a wide variety of policy areas such as health care, education, and human services, and include many prominent and highly visible community institutions, such as hospitals, museums, job training centers, and churches. (See a list of categories in app. 2.) These organizations also represent a diverse range of sizes. According to the Independent Sector, 73 percent had annual budgets of less than $500,000 in 2004 and only 4 percent had budgets exceeding $10 million.[9]

Much of the data on the sector come from the IRS Form 990, but those data have limitations. For example, returned Forms 990 are sometimes incomplete or inaccurate and are not consistently followed up on, and some nonprofit organizations required to submit Forms 990 do not do so. In addition, for certain types of funding, the Form 990 does not distinguish between government and private sources of support. It also does not break out the sources of government grants by federal, state, or local level. We have pointed out in the past the importance of requiring information in a more timely and user-friendly way on IRS Forms 990.[10]

Federal Government Increasingly Partnering with Nonprofit Organizations

Nonprofit organizations bring many strengths to their partnerships with the federal government. Their breadth and diversity allow the sector to address the specific needs of communities and of individuals. Researchers commenting on the advantages of nonprofits point out the provision of benefits in the public interest, often with greater flexibility and access than can be achieved by the public sector. Nonprofits often bring an indepth understanding of a particular geographic area or special population and have access to underserved populations.

Nonprofit organizations play a large and increasing role in delivering services traditionally provided by the government, according to researchers. Their research indicates that nonprofit organizations receive significant funds from government sources and that over time these funds have increased. As we previously noted, data are limited but researchers have attempted to analyze data from various sources and identify trends in federal funding to nonprofits. Their work offers a glimpse into the

[9]The Independent Sector describes itself as a nonprofit, nonpartisan coalition of about 600 national public charities, foundations, and corporate philanthropy programs, collectively representing tens of thousands of charitable groups in every state.

[10]GAO-05-561T.

magnitude of federal funds going to nonprofits, but does not provide a comprehensive analysis of the various funding streams. For example:

- Researchers have reported that the federal government provided about $115 billion directly to nonprofits in fiscal year 2001, the majority of which hospitals received through the Medicare program. Indirect federal funds through state and local governments to nonprofits were an estimated $84 billion, totaling about $199 billion, or about 15 percent of federal payments and grants.[11]
- Data from other researchers indicate that the federal government spent an estimated $317 billion on nonprofit organizations in fiscal year 2004.[12]
- Researchers estimate that federal support to nonprofit organizations increased more than 230 percent from fiscal year 1980 to fiscal year 2004 in adjusted dollars.[13]

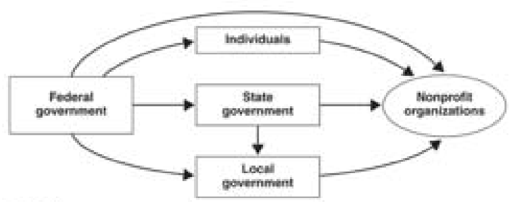
Federal funds reach nonprofit organizations through many paths (see fig. 3). Some flow directly from federal agencies to nonprofit organizations, such as research grants to universities. Some funds flow to states as grants, whose funds may flow to nonprofit organizations, or may flow to local governments that compensate nonprofit organizations for services with those funds. Also, some federal funds move to nonprofits on the basis of individuals' decisions, that is, from federal programs to nonprofits selected by the consumer, such as for health care. In addition to direct and indirect federal funds, nonprofit organizations benefit from being tax-exempt and also from other tax policies, such as donors' ability to deduct contributions on their taxes.

[11]Woods Bowman and Marion R. Fremont-Smith, "Nonprofits and State and Local Governments," *Nonprofits and Government*, 2nd Edition, eds. E. Boris and C. Steurle (Washington, D.C.: The Urban Institute Press, 2006), pp. 191-194.

[12]Alan Abramson, Lester Salamon, and C. Eugene Steurle, "Federal Spending and Tax Policies: Their Implications for the Nonprofit Sector," *Nonprofits and Government*, 2nd Edition, eds. E. Boris and C. E. Steurle (Washington, DC: The Urban Institute Press, 2006), p. 118.

[13]Alan Abramson, Lester Salamon, and C. Eugene Steurle, "Federal Spending and Tax Policies: Their Implications for the Nonprofit Sector."

Figure 3: Examples of Paths Federal Funds Take to Nonprofit Organizations

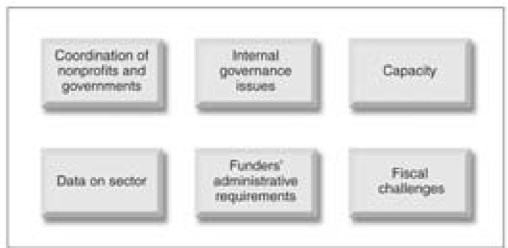


Source: GAO.

Emerging Policy Issues and Challenges Facing the Nonprofit Sector

The current federal oversight of nonprofits is focused on organizations' tax-exempt status and on specific programs. However, there is less focus on understanding the overall role of nonprofits as implementers of national and federal initiatives, and how to best ensure that nonprofits have the support they need. As we spoke with researchers and practitioners, several issues emerged as needing attention in order to ensure the strength of this important partner to the federal government. We have looked at specific issues involving nonprofit organizations over the years, but our past work was largely related to specific programs. We heard several common issues while taking this more comprehensive look at nonprofit organizations' interaction with the federal government (see fig. 4).

Figure 4: Emerging Policy Issues and Challenges Facing the Nonprofit Sector



Source: GAO.

Coordination and collaboration—One theme that surfaced in our preliminary research was the importance and value of coordination and collaboration between nonprofit organizations and government at all levels. As we pointed out in our work on 21st century challenges, the government relies increasingly on new networks and partnerships to achieve critical results and develop public policy, often including multiple federal agencies, non- or quasi-government organizations, for-profit and nonprofit contractors, and state and local governments.[14] A complex network of governmental and nongovernmental entities shape the actual outcomes achieved, whether it be through formal partnerships in grant programs or through independent actions of each addressing common problems. For example, our research on disaster relief efforts following September 11 and Hurricanes Rita and Katrina highlighted the role of nonprofits in providing assistance and the importance of communication and coordination of services with government entities. We pointed out that the scope and complexity of the September 11 attacks presented challenges to charities in their attempts to provide seamless social services for surviving family members and others in need of aid.[15] With

[14]GAO, *21st Century Challenges: Reexamining the Base of the Federal Government,* GAO-05-325SP (Washington, D.C.: February 2005).

[15]GAO, *September 11: More Effective Collaboration Could Enhance Charitable Organizations' Contributions in Disasters,* GAO-03-259 (Washington, D.C.: Dec. 19, 2002), p. 3 .

regards to the response to Hurricanes Katrina and Rita, we noted that charities could improve coordination among charities and the Federal Emergency Management Agency.[16]

We believe that many of the key practices that help enhance and sustain collaboration among federal agencies can be helpful between government and nonprofit organizations, such as when both parties collaborate to

- define and articulate a common outcome;
- establish mutually reinforcing or joint strategies;
- identify and address needs by leveraging resources;
- agree upon roles and responsibilities;
- establish compatible policies, procedures, and other means to operate across boundaries;
- develop mechanisms to monitor, evaluate, and report the results of collaborative efforts;
- reinforce accountability for collaborative efforts through plans and reports; and
- reinforce individual accountability for collaborative efforts through performance management systems.[17]

Internal governance issues—A second theme that surfaced in our preliminary research was the need to strengthen governance of nonprofit organizations, a point made by the sector itself as well as by others. At the organization level, a sound governance structure can establish the set of checks and balances that help steer an entity toward result-oriented outcomes consistent with their purposes while also guarding against abuses. Concerns about accountability and transparency of nonprofit organizations have grown in recent years. In 2004 and 2005, the Senate Finance Committee held hearings to look more closely at practices that are illegal or not in keeping with standards typical of the charitable sector, and released a discussion draft of possible solutions. In October 2004, the Independent Sector convened a panel, whose report made several

[16]GAO, *Hurricanes Katrina And Rita: Coordination between FEMA and the Red Cross Should Be Improved for the 2006 Hurricane Season*, GAO-06-712 (Washington, D.C.: June 8, 2006), p. 1.

[17]GAO, *Results-Oriented Government: Practices That Can Help Enhance and Sustain Collaboration among Federal Agencies*, GAO-06-15 (Washington, D.C.: Oct. 21, 2005).

recommendations to address concerns.[18] The panel continues to focus on self-regulation as a way to address these concerns, although there are mixed opinions on the potential success of self-regulation. In addition, several efforts are under way within the sector to raise awareness of ways to improve internal governance of nonprofits, including associations focusing on providing training or consulting, and national certification processes.[19]

Capacity—Another area to which researchers suggest attention should be paid is improving the capacity that smaller nonprofit organizations have to address weaknesses in finances, administration, and human capital. Many nonprofits struggling to accomplish their mission on limited budgets lack the resources that could allow them to better manage their finances and strengthen their infrastructure. In addition, particularly in smaller nonprofit organizations, the strengths of board members may be in addressing their organization's mission, and they may lack legal and financial knowledge or the skills necessary to oversee a nonprofit entity. One specific area identified as needing attention is the development of human capital, as these organizations need to address a complex set of issues, such as competition for service workers, leadership succession, and staff turnover. One promising change is the increase in graduate programs offering a concentration in nonprofit management from 17 in 1990 to 97 in 2001.[20] While there has not been a comprehensive effort by the federal government to improve the capacity of nonprofit organizations, several federal programs provide capacity-building grant funding and technical assistance to nonprofits. Providing assistance to improve capacity may be one area where the federal government could employ a more strategic approach.

Nonprofit sector data – As I mentioned earlier, there is a lack of sufficient knowledge on a key federal government partner and its role.

[18]Panel on the Independent Sector (Convened by Independent Sector), *Strengthening Transparency, Governance, Accountability of Charitable Organizations* (Washington, D.C., June 2005).

[19]For example, BoardSource, National Council of Nonprofit Associations, and the Alliance for Nonprofit Management all focus to some extent on strengthening internal governance of nonprofits. An example of a national certification process is one established by the Standards for Excellence Institute.

[20]Alan J. Abramson, and Rachel McCarthy. "Infrastructure Organizations," from Lester M. Salamon, *The State of Nonprofit America*, 1st ed. (Washington, D.C.: Brookings Institution Press, 2002), p. 337.

Researchers point out that without better data on the nonprofit sector as a whole, appropriate and timely policy decisions regarding nonprofits cannot be made. Some actions under way may improve information on tax-exempt organizations. Beginning in 2008, small tax-exempt organizations that previously were not required to file Form 990 returns, with some exceptions (such as churches) will be required to file a shorter notification form electronically.[21] In July 2007, IRS began mailing educational letters to over 650,000 small tax-exempt organizations that may be required to submit the notice. Further, IRS is seeking comments on a redesigned Form 990, intended to provide a realistic picture of organizations and their operations and to accurately reflect an organization's operations and use of assets.[22] In addition to the Form 990, other sources of data have also been used to better understand the sector, such as Bureau of Labor Statistics employment data, but continued access to that data has been a problem. In addition, the funds to perform the analysis generally come from the nonprofit sector, and are not consistently available.

Administrative and reporting requirements—Practitioners and researchers alike addressed the difficulty that nonprofit organizations, particularly smaller entities, have in responding to the administrative and reporting requirements of their diverse funders. While funders need accountability, the diverse requirements of different funders make reporting a time-consuming and resource-intensive task. Experts report that both government and foundations have increasing expectations that nonprofits conduct performance measurement, but meeting the expectations, given the size of grants and the evaluation capabilities of the staff, can be difficult. One researcher said that practitioners report performance evaluation as one of the biggest challenges they face, given their capacity issues.

Fiscal challenges for nonprofits—Nonprofit organizations, particularly smaller entities, often operate with limited budgets and have limited capital. As one researcher noted, the logic of the business world is "upended" with nonprofit organizations.[23] Researchers and practitioners

[21]The form is entitled "Form 990-N Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or 990-EZ."

[22]We have not evaluated the redesigned Form 990.

[23]Miller, Clara. "The Looking-Glass World of Nonprofit Money: Managing in For-Profits' Shadow Universe," *The Nonprofit Quarterly*, vol. 12, issue 1 (Spring 2005).

have pointed out that nonprofit organizations often have inadequate funds to invest in management infrastructure and that government and private foundations have not provided them adequate overhead funding to, for example, pay salaries to attract employees with needed skills or upgrade systems that would maximize efficiency. Funders—federal, state and local governments, foundations, and private donors—are willing to pay varying amounts toward overhead, resulting in nonprofit organizations needing to sometimes turn to other sources to cover their overhead costs. We believe this is an area in which more data are needed to fully understand the implications of reimbursement for overhead charges.

Concluding Observations

Virtually every American interacts with the nonprofit sector in his or her daily life through a broad range of concerns and activities such as health care, education, human services, job training, religion, and cultural pursuits. In addition, federal, state, and local governments rely on nonprofit organizations as key partners in implementing programs and providing services to the public. Given the way the sector is woven into the basic fabric of our society, it is essential we maintain and cultivate its inherent strength and vitality and have accurate and reliable data on the overall size and funding flows to the sector. Keys to a healthy nonprofit sector include strengthening governance, enhancing capacity, ensuring financial viability, and improving data quality without overly burdening the sector with unnecessary or duplicative reporting and administrative requirements. At the request of the Congress, we are beginning work to examine these issues further.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions you or other Members of the Committee may have.

Contacts and Acknowledgments

For further information on this testimony, please contact Stanley Czerwinski at (202) 512-6806. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. Individuals making key contributions to this testimony include David Bobruff, Tom James, Heddi Nieuwsma, Carol Patey, and Tom Short.

Appendix I: Key Terms Related to Nonprofit Status

- **Tax-exempt organization**: An entity determined to be exempt from federal income taxes.
- **Nonprofit status**: A state-law concept, in which approved entities may be eligible for exemption from sales, property, and state income taxes.
- **Section 501(c)(3) organization**: An organization that has an exempt purpose such as serving the poor; advancing religious, educational, and scientific endeavors; protecting human rights; and addressing various other social problems.
- **IRS Form 990**: An IRS information return that many tax-exempt entities, meeting certain requirements, must file annually.

Appendix II: Types of Programs and Services in the Nonprofit Sector

The IRS uses the National Taxonomy of Exempt Entities system to classify tax-exempt organizations by industry subsector. When an organization is initially approved as tax-exempt, it is classified into one of these 10 broad categories of tax-exempt entities:

- **Arts, culture, and humanities**
  Museums, performing arts centers, media and communications, historical societies
- **Education**
  Elementary and secondary schools, colleges and universities, libraries and educational services
- **Environment and animals**
  Botanical gardens, natural resources conservation and protection
- **Health**
  Hospitals, mental health services, medical research, home health care, substance abuse treatment
- **Human services**
  Homeless shelters, youth development, job training, crime prevention, soup kitchens, recreation and sports
- **International, foreign affairs**
  Human rights, international cultural exchange, international development, peace and security, foreign affairs
- **Public, societal benefit**
  Foundations, civil rights, credits unions, economic development, public transportation, veterans' organizations
- **Religion-related**
  Religion-related organizations, interfaith coalitions, religious media and communications
- **Mutual membership/benefit**
  Insurance providers, pension and retirement funds, fraternal societies, cemeteries
- **Unknown, unclassified**

GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "Subscribe to Updates."

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are $2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone:	Voice:	(202) 512-6000
	TDD:	(202) 512-2537
	Fax:	(202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm
E-mail: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Gloria Jarmon, Managing Director, JarmonG@gao.gov (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, D.C. 20548

Public Affairs

Paul Anderson, Managing Director, AndersonP1@gao.gov (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, D.C. 20548

PRINTED ON RECYCLED PAPER

Chairman LEWIS. Thank you very much, Mr. Director, for your statement.

Our next witness is from the Government Accountability Office. So, I am pleased to welcome Greg Kutz, Director of Forensic Audit and Special Investigations. Welcome.

STATEMENT OF GREGORY D. KUTZ, MANAGING DIRECTOR, FORENSIC AUDITS AND SPECIAL INVESTIGATIONS, GOVERNMENT ACCOUNTABILITY OFFICE

Mr. KUTZ. Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to discuss exempt organizations with tax problems.

Over the last several years, I have testified that government contractors, Medicare physicians, and Combined Federal Campaign charities were abusing the Federal tax system. At the request of Ranking Member Ramstad, we have expanded our investigation of tax abuse to exempt organizations. My testimony has two parts: first, the magnitude of unpaid taxes, and second, examples of fraud and abuse.

First, we found that 55,000 exempt organizations had $1 billion of unpaid Federal taxes. Charitable organizations accounted for 85 percent of this amount. Most of the unpaid taxes relate to 1,500 organizations that each owed over $100,000.

The amount of unpaid taxes I reported here is substantially understated because it encloses things such as nonfiling and underreporting of tax liability. We also found that more than 1,200 of those with unpaid Federal taxes received $14 billion of direct Federal grants. One thousand one hundred fifty of those were charitable organizations.

To put a face on this issue, we investigated 25 of the exempt organizations with the most significant amount of unpaid taxes, including 23 charities. For all 25 cases, we found abusive and criminal activity related to the Federal tax system. All 25 cases had unpaid payroll taxes. Willful failure to remit payroll taxes to the IRS is a felony.

The 25 case studies had $105 million of unpaid taxes, ranging from $300,000 to $30 million. The executives of these organizations have made careers out of failing to pay their Federal taxes. For example, rather than fulfill their role as trustees of payroll tax money and forward it to the IRS, these executives diverted the money for other expenses, including their own salaries.

Based on our investigation of the lifestyles of the executives of these 25 cases, we found that many were doing very well. The posterboard which is on my right shows examples of the assets we identified, including multi-million-dollar homes and luxury vehicles. As you can also see on the board, the executive director of this nursing home was paid $1 million.

These cases in our past investigations have shown that failure to pay Federal taxes isn't the only problem that these individuals have. For the most part, we found that the individuals behind these case studies are fraudsters. This point is further supported by five investigative themes, which are shown on the second posterboard on my right.

First, we found substantial Federal payments. By not paying their payroll and other Federal taxes, our case studies benefited from tens of millions of dollars of Medicare and other Federal payments.

Second, substantial other debt, including State and local taxes and individual income taxes for executives.

Third, suspicious cash transactions, including cash withdrawals and gambling by executives.

Fourth, numerous related party transactions, including millions of dollars of management fees paid by charities to entities affiliated with the executives or their relatives.

Fifth, prior convictions, including assault, attempted bribery of an IRS official, and running an illegal gambling operation.

In conclusion, the good news is that the vast majority of exempt organizations pay their Federal taxes. However, our work has shown that individuals behind thousands of these organizations have taken advantage of the opportunity to avoid paying at least $1 billion of Federal taxes. Case studies show the enrichment of a select few being bankrolled by the Federal Government and donors. Charities are supposed to be helping the poor rather than lining the pockets of these select few.

I believe that the IRS should take more aggressive criminal and collection action against those that are abusing the current system.

Mr. Chairman, this ends my statement. I look forward to your questions.

[The prepared statement of Mr. Kutz follows:]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

For Release on Delivery
Expected at 10:00 a.m. EDT
Tuesday, July 24, 2007

TAX COMPLIANCE

Thousands of Organizations Exempt from Federal Income Tax Owe Nearly $1 Billion in Payroll and Other Taxes

Statement of Gregory D. Kutz, Managing Director
Forensic Audits and Special Investigations

GAO
Accountability * Integrity * Reliability

GAO-07-1090T

GAO Highlights

Highlights of GAO-07-1090T, a testimony before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

July 24, 2007

TAX COMPLIANCE

Thousands of Organizations Exempt from Federal Income Tax Owe Nearly $1 Billion in Payroll and Other Taxes

Why GAO Did This Study

As of September 2006, nearly 1.8 million entities were recognized as tax exempt organizations by the Internal Revenue Service (IRS). As such, they do not have to pay federal income taxes. Exempt organizations are still required to remit amounts withheld from employees' wages for federal income tax, Social Security and Medicare, as well as other taxes.

Previous GAO work identified numerous government contractors, Medicare providers, and charities participating in the Combined Federal Campaign (CFC) with billions in unpaid federal taxes. Today's testimony, based on a report that we are releasing today, summarizes the results of work we performed at the request of Representative Ramstad, Ranking Member of this subcommittee, to audit exempt organizations. Specifically, this testimony covers whether and to what extent (1) exempt organizations have unpaid federal taxes, including payroll taxes; (2) selected case study organizations and their executives are involved in abusive or potentially criminal activity; and (3) exempt organizations with unpaid federal taxes received direct grants from certain federal agencies.

GAO reviewed unpaid taxes and exempt organization data from IRS and selected 25 case studies for audit and investigation. GAO also reviewed data from 3 major grant disbursement systems.

www.gao.gov/cgi-bin/getrpt?GAO-07-1090T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Gregory Kutz at (202) 512-7455 or kutzg@gao.gov.

What GAO Found

Nearly 55,000 exempt organizations had almost $1 billion in unpaid federal taxes as of September 30, 2006, with charitable organizations being responsible for more than 85 percent of the $1 billion in debt. About 1,500 of these entities each had over $100,000 in federal tax debts, with some owing multi-million dollars in federal taxes. The majority of this debt represented payroll taxes and associated penalties and interest dating as far back as the early 1980s. Willful failure to remit payroll taxes is a felony under U.S. tax law. The $1 billion figure is understated because some exempt organizations have understated tax liabilities or did not file tax returns.

GAO selected 25 exempt organizations for investigation based primarily on amount of tax debt and number of periods delinquent. In all 25 cases, we found abusive and potentially criminal activity, including repeated failure to remit payroll taxes withheld from employees. Officials diverted the money to fund their operations, including paying themselves salaries ranging from hundreds of thousands of dollars to over $1 million. Many of the officials accumulated substantial assets, such as multimillion-dollar homes and luxury vehicles. Key officials and employees at 4 entities were engaged in criminal activities, including attempted bribery of an IRS official and illegal gambling. Despite repeatedly abusing the federal tax system, these entities continued to retain their exempt status. IRS does not have the authority to revoke an organization's exempt status because of unpaid federal taxes.

Examples of Abusive and Potentially Criminal Activity by Exempt Organizations

Type of organization	Tax debt	Organization activity
Health care	Nearly $30 million	• Officials are related to several other for-profit entities, all with unpaid federal taxes. • Paid millions in management fees to a related entity. • Received millions in federal payments.
Industry association	Over $6 million	• Paid over 10 key officials salaries in excess of $100,000 instead of paying payroll taxes. • One official built a multimillion-dollar home and purchased luxury vehicles at the same time the exempt organization failed to pay payroll taxes.
Group home/ educational institution	Almost $8 million	• An official admitted to funding operations, including executive salaries, instead of paying taxes. • Operations included large compensation packages to organization officials.

Source: GAO analysis of IRS data and available public records.

Over 1,200 of these exempt organizations with unpaid federal taxes received over $14 billion in federal grants in fiscal years 2005 and 2006. Six of the 25 exempt organizations GAO investigated received grants; of those 6 entities, 5 appear to have violated the False Statement Act by not disclosing their tax debt as required. For example, one entity that received millions of dollars in grants did not disclose unpaid taxes on multiple applications. Taxpayer privacy statutes prevent granting agencies from verifying an applicant's tax status with IRS unless the taxpayer authorizes such disclosure.

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to discuss issues related to exempt organizations and their adherence to the federal tax system. This testimony builds on your concern about the $290 billion annual federal tax gap. This testimony also builds on a large body of work, conducted over the past few years,[1] in which we investigated entities that have abused the federal tax system[2] while benefiting from doing business with the federal government. Our testimony, and the accompanying report that we are releasing today,[3] address whether organizations exempt from federal income taxes were delinquent in remitting payroll and other federal taxes to the Internal Revenue Service (IRS). All employers, regardless of tax exempt status, are required to withhold from their employees' wages payroll taxes for Social Security, Medicare, and other federal taxes. Willful failure to remit payroll taxes is a felony under U.S. law.

Exempt organizations are granted exemption from federal income taxes by statutes contained in the Internal Revenue Code (I.R.C.), most notably I.R.C. § 501(c). Income tax exemption is a significant benefit unavailable to the vast majority of taxpayers. To qualify, an organization's purpose and operations must meet the criteria explicitly contained in the I.R.C. While the range of types of exempt organizations varies greatly, from large national charities to local athletic leagues and social clubs, the majority of exempt organizations are charities, churches, and educational institutions

[1]See GAO, *Tax Compliance: Thousands of Federal Contractors Abuse the Federal Tax System*, GAO-07-742T (Washington, D.C.: Apr. 19, 2007); *Medicare: Thousands of Medicare Part B Providers Abuse the Federal Tax System*, GAO-07-587T (Washington, D.C.: Mar. 20, 2007); *Tax Debt: Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes*, GAO-06-755T (Washington, D. C. : May 25, 2006); *Financial Management: Thousands of GSA Contractors Abuse the Federal Tax System*, GAO-06-492T (Washington, D.C.: Mar. 14, 2006); *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, GAO-05-637 (Washington, D.C.: June. 16, 2005); and *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, GAO-04-95 (Washington, D.C.: Feb. 12, 2004).

[2]We considered activity to be abusive when a 501(c) organization's actions (e.g., diversion of payroll tax funds) or inactions (e.g., failure to remit the annual form 990 return, which is the basis of review of whether an organization continues to meet requirements for exempt status) took advantage of the existing tax enforcement and administration system to avoid fulfilling federal tax obligations and were deficient or improper when compared with behavior that a prudent person would consider reasonable.

[3]GAO, *Tax Compliance: Thousands of Organizations Exempt from Federal Income Tax Owe Nearly $1 Billion in Payroll and Other Taxes*, GAO-07-563 (Washington, D. C.: June 29, 2007), released today, July 24, 2007.

that qualify for their exemption under I.R.C. § 501(c)3. Many exempt organizations also receive the added benefit of being able to provide a tax deduction to their contributors, meaning the donors can deduct the amount of the donation on their individual income tax returns. This statutory privilege, subsidized by the federal government, encourages donations to these organizations and aids them in raising revenue.

Our previous work on a small portion of the nation's exempt organizations, specifically those that participated in the federal government's Combined Federal Campaign,[4] indicated that some of these exempt organizations were ignoring their payroll and other federal tax obligations. Based on this previous work and at the request of Representative Ramstad, Ranking Member of this subcommittee, we expanded our audit to include all organizations considered actively exempt by IRS. We also investigated whether tax delinquent exempt organizations were receiving additional federal support in the form of grants. Today's testimony covers whether and to what extent (1) exempt organizations have unpaid federal taxes, including payroll taxes; (2) selected case study organizations and their executives are involved in abusive or potentially criminal activity; and (3) exempt organizations with unpaid federal taxes received direct grants from certain federal agencies.

To determine the extent to which exempt organizations have unpaid federal taxes, including payroll taxes, we matched IRS's unpaid tax data as of September 30, 2006 to IRS's database of exempt organizations as of September 30, 2006.[5] To identify specific instances of abusive and potentially criminal activities by selected exempt organizations and their executives, we performed investigative work on a nonrepresentative selection of 25 exempt organizations. We selected these 25 organizations using primarily the amount of tax debt and number of delinquent tax periods as selection factors. The investigative work included obtaining and analyzing tax, financial, criminal history, and other public records. We also reviewed the statutory authority provided in I.R.C. § 501 and interviewed IRS officials on their process for revoking tax exempt status.

[4]GAO-06-755T, and GAO, *Tax Debt: Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes*, GAO-06-887 (Washington, D.C.: July 28, 2006).

[5]To ensure reliability of data in IRS's Unpaid Assessments file and Exempt Organization database, we considered the results of our annual IRS financial audits, interviewed IRS officials, performed electronic testing of specific data elements, or a combination of these. For additional information on our scope and methodology and tests of data reliability, see app. I of our accompanying report, GAO-07-563.

To determine the extent to which exempt organizations with tax debt received federal grants,[6] we matched the data set of tax delinquent exempt organizations we identified from our first objective to selected agencies' grant disbursement data for fiscal years 2005 and 2006.[7] We reviewed six grant applications of selected exempt organizations with tax debts that received federal grant payments in fiscal years 2005 and 2006 to determine whether they reported federal tax debt as required. We also interviewed grant officials at selected federal agencies on whether they considered tax debts in grant award decision making. For further details on our scope and methodology, see appendix I of the accompanying report.[8]

We conducted our audit work from August 2006 through March 2007 in accordance with U.S. generally accepted government auditing standards. We performed our investigative work, conducted during the same period, in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

Summary

While the vast majority of exempt organizations pay their fair share of federal taxes, tens of thousands abused the federal tax system. Our analysis of IRS data shows that nearly 55,000 exempt organizations owed nearly $1 billion in unpaid payroll and other federal taxes as of September 30, 2006. Nearly 40,000 of the 55,000 delinquent exempt organizations were charitable, or 501(c)(3), organizations. These organizations owed almost $830 million of the nearly $1 billion in delinquent taxes. Seventy-one percent of the nearly $1 billion in unpaid taxes owed by tax exempt organizations consists of payroll taxes and

[6] For purposes of this audit, grants include formula grants, project grants, and direct payments for specified use as classified by the General Services Administration in the *Catalogue of Federal Domestic Assistance*. We excluded Medicaid from formula grants and Medicare from direct payments for specified use.

[7] Grant data we analyzed came from the Department of Education's Grant Administration and Payment System, the Department of the Treasury's Financial Management Service's Automated Standard Application Payment System, and the Department of Health and Human Services' Payment Management System. These three systems processed the majority of federal grants excluding Medicare and Medicaid during fiscal years 2005 and 2006.

[8] GAO-07-563.

related penalties and interest dating as far back as 1981.[9] Over $600 million of the nearly $1 billion is accounted for by about 1,500 exempt organizations that individually owed over $100,000. Some of these entities owed more than $10 million in unpaid federal taxes. Also, the nearly $1 billion in delinquent taxes is understated because we did not include IRS data on tax debts for current periods and disputed debts because they may be routinely resolved or not represent a fully valid tax debt. Our estimate is also understated because the IRS data used in our analysis did not include, among other items, debts owed by organizations that did not file federal tax returns or underreported their tax liability, or for which IRS had not yet assessed the amount of the tax debt.

For all 25 cases that we investigated, we found abusive and potentially criminal activity related to the federal tax system, including failure to remit to IRS payroll taxes withheld from employees. Rather than fulfill their role as "trustees" of this money, these case study entities and their executives diverted the money for other purposes. Willful failure to remit these payroll taxes, which included amounts withheld from employee wages for income taxes, Social Security, and Medicare, is a felony. The failure to properly segregate payroll taxes can be a criminal misdemeanor offense.[10]

We found multiple instances in our case studies in which the payroll taxes were diverted to fund operations or to pay hundreds of thousands of dollars in compensation to the organization's top officials. In one case, over $1 million in compensation was paid to the organization's top official at the same time that the exempt organization owed millions of dollars in delinquent taxes. Many of the top officials of selected case study entities owned significant personal assets, including multimillion-dollar homes and luxury vehicles. Other top officials of the exempt organizations in our case studies neglected to remit millions of dollars in delinquent taxes while at the same time paying millions of dollars in management fees to related entities. We also found several instances in which the same individuals

[9]Generally, there is a 10-year statutory collection period beyond which IRS is prohibited from attempting to collect tax debt. However, the 10-year time may be suspended for a variety of reasons, including for periods during which the taxpayer is involved in a collection due process appeal, litigation, or a pending offer in compromise or installment agreement.

[10]I.R.C. § 7202, 7215, and 7512 (b). Organization officials deemed by IRS to be personally liable for the withheld amounts not forwarded are assessed a civil monetary penalty known as a trust fund recovery penalty. I.R.C. § 6672.

who were top officials of the tax exempt entities in our case studies also operated other tax exempt or taxable (for-profit) entities with significant delinquent tax debts. For instance, one of our case study exempt organizations, with over $10 million in tax debt, was affiliated with several other for-profit entities, providing a variety of services from health care to management services, that were also delinquent in paying their federal taxes. The related for-profit entities owed more than $15 million in additional tax debts, primarily payroll taxes. Despite repeatedly abusing the federal tax system, all the exempt organizations in our case studies continued to retain their exempt status. We found that existing federal statutes do not authorize IRS to use tax debt as a cause for revocation of an organization's exempt status. However, IRS is allowed to revoke exempt status when it determines the organization has ceased to operate in a manner consistent with the purpose for which it was granted the tax exempt status or for other extraordinary circumstances, such as when an organization engages in more than inconsequential illegal activities.

We also found that more than 1,200 of the exempt organizations with over $72 million in tax debt received over $14 billion in direct federal grants in fiscal years 2005 and 2006. Of the more than 1,200 exempt organizations that received grants, over 1,150 were charitable organizations. These organizations owed approximately $70 million in tax debt and received over $12 billion of the $14 billion in grants. Further, the $14 billion in grant disbursements going to exempt organizations is substantially understated because our audit did not include all federal agencies that provided grants and did not cover federal grants disbursed by state or local governments, known as pass-through grants. According to our analysis of the data from the Federal Assistance Award Data System, pass-through grants accounted for about 80 percent of total federal grants. Of our 25 tax exempt case study entities, 6 received federal grants. Our limited audit of grant applications submitted by these 6 case study entities found that 5 of the 6 appeared to have violated the False Statement Act[11] by not disclosing their tax debts in their applications even though they were required to do so. The strict taxpayer privacy statute poses a significant challenge to federal granting agencies in determining the accuracy of representations made by organizations seeking grants. Specifically, federal granting agencies cannot

[11] 18 U.S.C. § 1001 provides criminal penalties for those who knowingly and willfully (1) falsify, conceal, or cover up by any trick, scheme, or device a material fact; (2) make any materially false, fictitious, or fraudulent statement or representation; or (3) make or use any false writing or document knowing that the documents contain any materially false, fictitious, or fraudulent statement or entry.

verify an applicant's tax status with IRS unless the taxpayer specifically authorizes such disclosure.[12]

Exempt Organizations Had Nearly $1 Billion in Unpaid Federal Taxes

As of September 2006, nearly 55,000 exempt organizations had nearly $1 billion in unpaid payroll and other federal taxes. Almost 40,000 of the 55,000 delinquent exempt organizations were charitable, or 501(c)(3), organizations that owed almost $830 million of the nearly $1 billion in unpaid payroll and other federal taxes. The amount of taxes owed by exempt organizations ranged from $101 to $16 million, and the number of delinquent tax periods ranged from a single period[13] to more than 80 tax periods.[14] However, the dollar amount of federal taxes owed by exempt organizations is understated because some organizations underreported their tax liability or failed to file a return altogether.

Characteristics of Unpaid Taxes by Exempt Organizations

As shown in figure 1, about 71 percent of the nearly $1 billion in unpaid federal taxes is composed of payroll taxes and related penalties and interest. About 19 percent, or over $180 million, is related to annual reporting penalties. IRS imposes reporting penalties on entities that did not file annual returns, failed to file in a timely manner, or filed inaccurate returns.[15] The remaining 10 percent of the nearly $1 billion in delinquent taxes consists of unrelated business income, excise, and other types of taxes.

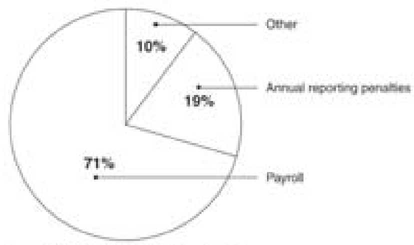
[12]Federal taxpayers can request or consent to the disclosure of their tax information. I.R.C. § 6103(c).

[13]A "tax period" varies by tax type. For example, the tax period for payroll and excise taxes is generally one quarter of a year. The taxpayer is required to file quarterly returns with IRS for these types of taxes, although payment of the taxes occurs throughout the quarter. In contrast, for income, corporate, and unemployment taxes, a tax period is 1 year.

[14]As described later in this testimony, a case study consists in some cases of multiple related entities, some or all of which have tax debts. The number of tax periods and the accumulated tax debts cited here pertain solely to the exempt organization. The number of tax periods and the accumulated tax debts cited later in this testimony pertain to the accumulated tax periods and tax debts of the exempt organization and its related entities.

[15]Generally, the tax code requires exempt organizations with $25,000 or more of revenues to file annual returns (i.e., Form 990/990EZ).

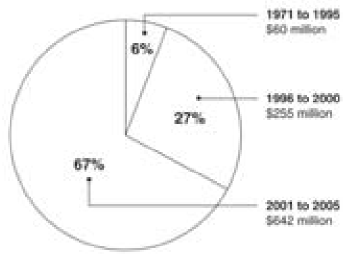
Figure 1: Unpaid Federal Tax Debt of Exempt Organizations by Tax Type



Source: GAO analysis of IRS data as of September 30, 2006.

A significant amount of the unpaid federal taxes owed by exempt organizations had been outstanding for several years. As reflected in figure 2, while the majority of the nearly $1 billion in unpaid federal taxes was from tax periods 2001 through 2005, about a third of the unpaid taxes were from tax periods prior to 2001. While there is a 10-year statutory collection period beyond which IRS is prohibited from attempting to collect tax debt. the 10-year time may be suspended for a variety of reasons, including for periods during which the taxpayer is involved in a collection due process appeal, litigation, or a pending offer in compromise or installment agreement. As a result, figure 2 includes taxes that are for tax periods from more than 10 years ago.

Figure 2: Age of Federal Tax Debt Owed by Exempt Organizations



Source: GAO analysis of IRS data as of September 30, 2006.

Our analysis of IRS data found that nearly 1,500 of the almost 55,000 delinquent exempt organizations owed in total over $600 million of the nearly $1 billion unpaid federal taxes of exempt organizations we identified. All of these nearly 1,500 exempt organizations owed over $100,000 each, with some owing more than $10 million. Another 8,400 owed from $10,000 to $100,000 each. Although the largest group—nearly 45,000—owed less than $10,000 in delinquent taxes, the majority of the debt in this group of exempt organizations related to payroll taxes withheld from employees and not remitted to the federal government and annual reporting penalties.

Although the nearly $1 billion in unpaid federal taxes we identified as owed by exempt organizations as of September 30, 2006, is a significant amount, it understates the full extent of unpaid taxes. This amount does not include amounts due IRS from exempt organizations that did not file payroll taxes (nonfilers) and that underreported their payroll tax liability (underreporters). Also, we did not include exempt organization tax debt from 2006 tax periods, tax debt for entities owing $100 or less, or tax debt for certain entities listed in IRS's database of exempt organizations.[10]

Selected Exempt Organizations Were Involved in Abusive and Potentially Criminal Activity Related to the Federal Tax System

For all 25 cases involving exempt organizations with delinquent tax debts that we audited and investigated, we found abusive activity, potentially criminal activity, or both related to the federal tax system. The amount of unpaid taxes associated with these cases ranged from over $300,000 to nearly $30 million. Table 1 highlights 5 of the 25 organizations we investigated with unpaid taxes. Appendix I provides a summary of the other 20 cases we examined. We are referring the 25 cases detailed in this testimony to IRS for further collection activity and criminal investigation, if warranted.

[10]IRS's database of exempt organizations contained over 2.5 million entities. IRS does not consider all 2.5 million as currently tax exempt. We only included in our analysis the classifications of exempt organizations that IRS identified as currently tax exempt. This resulted in about 1.8 million entities. For additional information on our scope and methodology and tests of data reliability, see app. I of our accompanying report, GAO-07-563.

Table 1: Exempt Organizations with Unpaid Federal Taxes

Case	Nature of work[a]	Unpaid federal tax amount[b]	Comments

1	Health care-related facilities	Nearly $30 million	• This case consists of an exempt organization and multiple for-profit related entities with tax debt.
			• The entities owe mostly payroll taxes dating back to the late 1990s.
			• While failing to pay its taxes:
			  • The exempt organization paid millions of dollars in management fees to a contractor that is listed in public records as an affiliate of the exempt organization.
			  • The charity received millions of dollars of its funding from federal government programs.
			• While the entities owed taxes, a top official owned an offshore entity and a residence valued at over $500,000.
			• Federal, state, and local tax liens were filed against the charity for over $10 million.

2	Industry association	Over $6 million	• Tax debts are mostly payroll taxes dating back to the late 1990s. • An officer acknowledged the tax debt and the decision to fund operations, including salaries to over 10 officers in excess of $100,000, rather than pay the tax liability. • During the time the organization incurred payroll tax debt, a top officer owned a multimillion-dollar home and purchased luxury vehicles. • IRS assessed a Trust Fund Recovery Penalty (TFRP) against one official and placed a tax lien on the organization.

3	Health care-related facilities	Over $15 million	• Tax debts are mostly payroll taxes dating back to the early 2000s.
			• At the same time the organization failed to pay its taxes, the top official
			  • received more than $1 million in annual compensation and benefits and
			  • made several hundred thousand dollars in cash transactions at banks and casinos.
			• Millions in federal tax liens have been placed against the organization and IRS is in the process of assessing a TFRP.

4	Social club	Over $1 million	• The tax debt, mostly payroll taxes, dates back to the late 1990s. • This organization and former officials pled guilty to conducting an illegal gambling business. • Despite the guilty pleas, the organization continues to operate as an exempt organization. • The organization was also involved in cash transactions not reported to IRS. • As of September 30, 2006, a TFRP had not been assessed because IRS concluded that no one could be held liable. • Federal tax liens were filed against the entity.

Case	Nature of work[a]	Unpaid federal tax amount[b]	Comments
5	Services to children	Over $500,000	• This organization's tax debt dates back to the late 1980s. • The top official of the organization was convicted of attempting to bribe an IRS employee. • This same official retained a position in the organization, which continues to operate as an exempt organization. • Organization officials allegedly requested that some payments to it be made in cash. • IRS assessed TFRPs against the organization's top officials. • Federal tax liens were filed against the entity.

Source: GAO analysis of IRS, grant agencies, public and other records.

[a]As described earlier in this testimony, a case study consists in some cases of multiple related entities, some or all of which have tax debts. The number of tax periods and the accumulated tax debts cited earlier in this testimony pertain solely to the exempt organization. The number of tax periods and the accumulated tax debts cited here pertain to the accumulated tax periods and tax debts of the exempt organization and its related entities.

[b]Rounded dollar amount of unpaid federal taxes as of September 30, 2006.

The above cases illustrate how some officials of delinquent exempt organizations abused the federal tax system for their own benefit. These officials started multiple exempt organizations and failed to remit taxes, paid large management fees to related entities, paid high salaries and accumulated significant assets, or were involved in criminal activity all the while failing to remit payroll and other taxes to the federal government.

Despite continuing to abuse the federal tax system, all of the 25 case study organizations we investigated retained their tax exempt status. Existing federal statutes do not authorize IRS to revoke exempt status based on an organization's tax delinquency. However, IRS can revoke an organization's exempt status when it determines that the organization has ceased to operate in a manner consistent with the purpose for which it was granted the tax exempt status or for other extraordinary circumstances, such as when an organization engages in more than inconsequential illegal activities or pays officials excessive compensation.

Exempt Organizations with Unpaid Federal Taxes Received Billions in Federal Grant Payments

Based on our analysis, we determined that of the nearly 55,000 exempt organizations with federal tax debt, more than 1,200 received over $14 billion in federal grants from the Department of Health and Human Services (HHS),[17] the Department of Education, the Department of Energy, the National Aeronautics and Space Administration, and other federal agencies in fiscal years 2005 and 2006. The more than 1,200 exempt organizations owed over $72 million in tax debt yet received substantial amounts in federal grants. Of the more than 1,200 exempt organizations that were delinquent in taxes yet received grants, over 1,150 were charitable organizations that owed approximately $70 million in unpaid federal taxes. These charitable organizations received over $12 billion of the $14 billion in grants disbursed to tax delinquent exempt organizations. Additionally, our estimate of the over $14 billion in federal grants disbursed to exempt organizations with federal tax debt is likely understated because our audit did not include all federal agencies that provided grants and did not cover pass-through grants.

Exempt Organizations with Tax Debt Misrepresented Their Tax Status to Granting Agencies

Organizations that apply for federal grants are required to complete a Standard Form (SF) 424, "Application for Federal Assistance," to provide granting agencies with entity information, such as name, employer identification number, address, and a descriptive title of the project for which the grant will be used. The SF424 also requires that the grant applicant provide information as to whether the applicant has any delinquent federal debts. The instructions that accompany the SF424 define federal debt to include taxes owed. The applicant is required to certify that the information provided on the SF424 is true and correct.

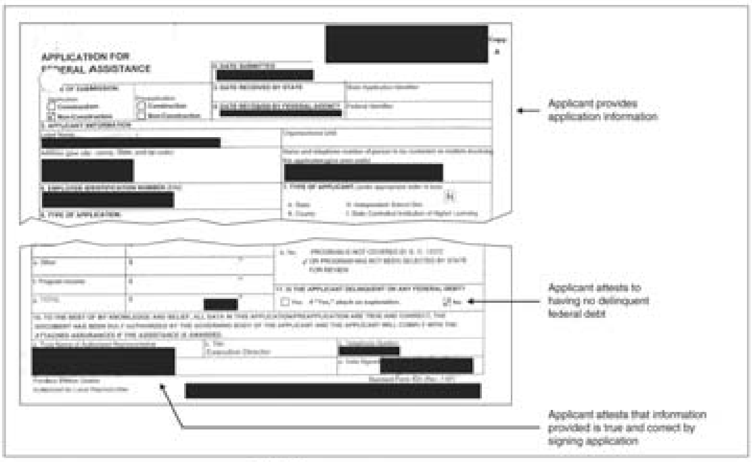
We examined information provided on the SF424 for six of our case study tax exempt organizations that received grants, all of which had substantial tax debts outstanding. We found that five of the six that received federal grants failed to disclose their federal tax debts on the SF424s filed with the granting agencies. The six entities applied for and received over $13 million in total grant payments in fiscal years 2005 and 2006. In a recent 3-year time span, one of the exempt organizations we audited applied for multiple grants to provide community services. Even though the entity had an outstanding balance of unpaid federal taxes, the entity

[17] The HHS amount excludes Medicare and Medicaid payments. For additional information on our scope and methodology and tests of data reliability, see app. I of our accompanying report, GAO-07-563.

did not disclose its tax liability on the SF424s. The organization subsequently received several million dollars in grant payments during 2 recent fiscal years. Figure 3 provides excerpts of an SF424 for this organization where the applicant appears to have violated the False Statements Act[10] by not disclosing its delinquent tax debt.

[10] 18 U.S.C. § 1001.

Figure 3: Excerpt of SF424 Showing Failure to Declare Delinquent Tax Debt



Source: HHS.

We found that while granting agencies can ask prospective grantees for consent to verify federal tax debt information with IRS, granting agencies did so only in a few cases where the grant applicant disclosed having federal debts. Agencies did not confirm with IRS the accuracy of applicant information related to federal tax debts because of strict taxpayer privacy laws. Officials at three granting agencies informed us that procedurally, if tax debt were declared on the SF424, the agencies would request further information, including consent to verify tax debt with IRS, to determine the financial responsibility of the applicant and whether any action needs to be taken, including withholding grant payments until a payment plan has been entered into with IRS. Without accurate debt information, granting agencies are limited in their ability to fully evaluate whether the grantee is a responsible party and should receive the grant, whether additional action needs to be taken, or a combination of these.[19]

Concluding Observations

The vast majority of exempt organizations pay their fair share of federal taxes. However, our work has shown that tens of thousands of exempt organizations and their officers have taken advantage of the opportunity to avoid paying their federal taxes, in part because IRS does not have the authority to revoke exempt status for failure to pay taxes. In many cases, officers of these delinquent organizations are responsible for diversion of payroll tax money—a felony offense—to pay their substantial salaries and accumulate substantial personal wealth. It is likely that many of these exempt organizations have provided significant and positive services to those in need. Nevertheless, it is also important that they comply with federal tax law in order for the federal government to collect the funds to which it is entitled to finance critical government priorities, and to help improve the overall level of compliance with the nation's tax laws.

Mr. Chairman and Members of the Subcommittee, this concludes my statement. I would be pleased to answer any questions that you or other members of the committee may have at this time.

Contacts and Acknowledgments

For further information about this testimony, please contact Gregory D. Kutz at (202) 512-7455 or kutzg@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony.

[19]Further actions granting agencies can take include placing restrictions on the funding, requiring that the prospective grantee enter into a payment agreement with IRS, or denying the grant.

Appendix I: Exempt Organizations with Unpaid Federal Taxes

Table 1, in the main portion of the testimony, provides data on 5 detailed case studies. Table 2 provides details of the remaining 20 exempt organizations we selected as case studies. As with the 5 cases discussed in the body of this testimony, we also found abuse, potential criminal activity, or both related to the federal tax system during our audit and investigations of these 20 case studies. The case studies primarily involved exempt organizations with unpaid payroll taxes, one for as many as 14 years.

Table 2: Exempt Organizations with Unpaid Federal Taxes

Case[a]	Nature of work	Unpaid federal tax amount[b]	Comments
6	Community services	Nearly $3 million	• Tax debts were mostly payroll taxes dating back to the late 1990s. • The state fined this organization for employing convicted felons in positions of public trust. • An entity employee engaged in criminal activity while employed by the entity. • Although this organization has ceased operations, a similar business has replaced it operating out of the same facility. • Federal tax liens were filed against the entity.
7	Health care-related facilities	Over $6 million	• This case consists of several related entities with tax debt and with related executives that share financial and other operational ties. • Combined, these related entities owe mostly payroll taxes dating back to the late 1990s. • Combined, the entities received over $20 million annually from government-funded programs. • Several of the exempt organizations appear to pay management fees that total in the millions to a related entity. • Federal tax liens were filed against the entities.
8	Community services	Over $1 million	• Entity officials claim they were unaware they had not paid payroll taxes for several years. • Entity officials recently chose to close the entity rather than pay the tax. • Entity received nearly $3 million in federal grants during a recent 2-year period. • A top official received compensation of nearly $100,000. • Despite owing taxes, this entity did not declare federal tax debt in its grant application. • Federal tax liens were filed against the entity.

Case[a]	Nature of work	Unpaid federal tax amount[b]	Comments
9	Group home	Nearly $8 million	• Entity owes mostly payroll tax from the early 1990s. • A key official knew of the growing tax debt, but the entity chose to fund operations rather than pay the taxes. While incurring the tax debt, key officials owned multimillion-dollar properties. • Entity filed for bankruptcy. • A Trust Fund Recovery Penalty (TFRP) has been assessed against a key official. • Federal, state, and local tax liens were filed against the entity for several million dollars.
10	Educational services	Over $3 million	• Entity owes mostly payroll taxes dating back to the early 2000s. • Despite owing taxes, this entity did not declare federal tax debt in its grant application. The entity received several million dollars in federal grants in a recent year. • IRS seized some of the organization's assets in the mid-2000s. • A large TFRP has been assessed against several officials. • Federal tax liens were filed against the entity.

11	Health care facility	Over $500,000	• Entity received local funding on the condition that it would be current in paying its payroll taxes.
			• After IRS placed levies on the organization for failing to remit mostly payroll taxes for over 3 years, the entity lost its local funding.
			• While the entity incurred the tax debt the top official of the entity
			    • was compensated by the entity close to $200,000 for management services as a sole proprietor,
			    • owed the entity nearly $200,000 for overbudget expenditures and unpaid rents,
			    • had the entity's license to operate suspended because of violations of regulations,
			    • owed individual income tax, and
			    • filed for personal bankruptcy.
			• IRS assessed a TFRP against this top official.
			• Federal and state tax liens have been filed against the entity and this official.

12	Community services	Over $300,000	• This entity received over $2 million in federal grants. • Entity pays a $75,000 annual salary to a relative of the executive director. • Despite owing taxes, this entity did not declare federal tax debt in its grant application.
13	Social services	Over $800,000	• Entity received nearly $400,000 in federal grants during a recent 2-year period while owing payroll tax dating back to the early 2000s. • Previous top official, responsible for incurring the debt, was convicted of a felony. • IRS placed a TFRP on the previous top official. • Federal tax liens were filed against the entity.

Case[a]	Nature of work	Unpaid federal tax amount[b]	Comments
14	Group homes	Over $3 million	• This case consists of multiple exempt organizations with tax debt. These entities owe mostly payroll tax dating back to the late 1990s. • Entities make and receive interest-free loans to and from other related entities and key officials. • Related key officials are annually compensated over $300,000 from multiple entities. • One key official owes individual income tax. • Federal tax liens have been filed against some of the related entities and related key officials. • IRS placed a large TFRP on one of the related key officials. • One of the entities entered into multiple installment agreements with IRS and was out of compliance on at least one agreement.
15	Health care-related facility	Nearly $2 million	• Entity has twice filed for bankruptcy, and the top official filed for personal bankruptcy. During this time the entity failed to remit mostly payroll tax dating back to the late 1990s. • IRS assessed TFRPs against key officials who are each compensated over $100,000 annually. • Federal tax liens have been filed against the entity totaling over $1 million.

16	Services to children	Over $1 million	• Entity owes mostly payroll tax dating back to the mid-1990s. The top official of this entity is also an official for another for-profit entity with tax debt.
			• This top official
			  • has a history of personal and business bankruptcies;
			  • incurs tax debt, files for bankruptcy, reincorporates as another entity, and incurs additional tax debt; and
			  • runs a separate company that provides services to the exempt organization. The associated costs are significantly greater than those of similar children's services organizations in the same region.
			• IRS assessed TFRPs against key officials.
			• Federal tax liens have been filed against the top official.

17	Social services	Over $1 million	• Entity owes mostly payroll taxes dating back to early 2000s. • IRS placed tax liens on this organization. • IRS assessed a TFRP against an organization official.
18	Rehabilitation services	Over $1 million	• Entity accumulated tax debt over several years dating back to the late 1990s. • During this time period, organization officials withdrew several hundred thousand dollars in cash from entity bank accounts. • Related key officials were annually compensated close to $200,000 in total. • IRS assessed TFRPs against key officials. Some payments have been made, but the majority of the tax remains unpaid. • Federal tax liens have been filed against the entity.

Case[a]	Nature of work	Unpaid federal tax amount[b]	Comments
19	Educational services	Over $1 million	• This entity owes mostly payroll tax dating back to the mid-1990s. • A top official owns an expensive home and has recently filed for personal bankruptcy. • IRS assessed a TFRP against organization officials. • Federal tax liens were filed against the entity.
20	Services to the elderly	Over $3 million	• Entity owes mostly payroll tax for tax periods dating back to the late 1980s. • IRS assessed a TFRP against organization officials. • Federal tax liens were filed against the entity.

21	Community services	Nearly $3 million	• Entity reported on recent financial statements cash and cash equivalents of over several million dollars. At the same time, the entity owed mostly payroll tax dating back to the mid-1990s.
			• While the entity was incurring the tax debt,
			  • the top official received compensation of over $250,000 and
			  • several other employees received compensation from $75,000 to $200,000.
			• A key official owns an expensive home in an exclusive neighborhood and has been investigated or indicted for various violations of civil laws.
			• Federal tax liens have been filed against the entity.

22	Education services	Over $2 million	• Entity owes mostly payroll tax dating back to the mid-1990s. In addition, entity owes nontax debt totaling several million dollars. • Federal and state tax liens have been filed against the entity. • IRS assessed a TFRP against key officials, one of whom also has unpaid federal tax debt dating back to the early 1990s.

23	Children's services	Over $2 million	• While failing to remit mostly payroll taxes dating back to the early 2000s,
			  • the entity received over $2 million in federal grants in recent years,
			  • a key official received compensation of over $100,000, and
			  • the entity entered into multiple payment plans with the IRS, and was out of compliance on at least one.
			• Despite owing taxes, this entity did not declare federal tax debt in its grant application.
			• IRS assessed large TFRPs against key officials.
			• Federal tax liens were filed against the entity.

24	Health care services	Over $5 million	• Entity owes mostly payroll tax dating back to the early 2000s. • Key official received compensation of over $200,000. • IRS has not assessed a TFRP against any individual. • Federal tax liens were filed against the entity.

Case[a]	Nature of work	Unpaid federal tax amount[b]	Comments
25	Educational services	Over $300,000	• Entity received over $2 million in federal grants during a recent 2-year period while owing mostly payroll tax dating back to the late 1990s. • Despite owing taxes, this entity did not declare federal tax debt in its grant application. • Entity did not file payroll tax returns for several years, although it made payments for some periods. IRS is considering a request from the entity for an offer in compromise in which the entity would pay only a portion of the unpaid tax debt.

Source: GAO analysis of IRS data, public, and other records.

[a]As described earlier in this testimony, a case study consists in some cases of multiple related entities, some or all of which have tax debts. The number of tax periods and the accumulated tax debts cited earlier in this testimony pertain solely to the exempt organization. The number of tax periods and the accumulated tax debts cited here pertain to the accumulated tax periods and tax debts of the exempt organization and its related entities.

[b]Rounded dollar amount of unpaid federal taxes as of September 30, 2006.

GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "Subscribe to Updates."

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are $2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone:	Voice:	(202) 512-6000
	TDD:	(202) 512-2537
	Fax:	(202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm
E-mail: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Gloria Jarmon, Managing Director, JarmonG@gao.gov (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, D.C. 20548

Public Affairs

Paul Anderson, Managing Director, AndersonP1@gao.gov (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, D.C. 20548

PRINTED ON RECYCLED PAPER

Chairman LEWIS. Thank you very much, Mr. Director, for your statement. I am sure there will be a lot of questions.

I am pleased to welcome the President and the Chief Executive Officer of the Independent Sector, Diana Aviv. Welcome.

STATEMENT OF DIANA AVIV, PRESIDENT AND CHIEF EXECUTIVE OFFICER, INDEPENDENT SECTOR

Ms. AVIV. Thank you, Chairman Lewis and Ranking Member Ramstad and Members of the Committee. Thank you for inviting me to testify.

Independent Sector is a national nonpartisan organization with approximately 600 members who represent tens of thousands of public charities, private foundations, and corporate giving programs. America's nonprofit community includes more than 1.5 million organizations, large and small, committed to improving lives. Its impact is a result of the talent and dedication of millions of volunteers, and a workforce of 11.7 million paid employees, 9 percent of the entire national workforce.

Twenty percent of the sector's funds are from voluntary contributions, 31 percent from government grants and contracts, and 38 percent from fees for service. Together, charitable organizations spend nearly $1 trillion annually to serve communities here and abroad.

These vital organizations face tremendous challenges. Corporate giving has declined, and Americans of modest means are finding it more difficult to give because of rising prices and difficult economic conditions in many regions. Additionally, organizations that rely on government grants and contracts, particularly those that serve the most vulnerable members of our society, have been hurt by funding cuts and changes in priorities.

To provide some relief, Congress acted last year to allow older Americans to make charitable contributions from their Individual Retirement Arrangement (IRA) funds without suffering adverse tax consequences. This new incentive has already resulted in small and large contributions totaling millions of dollars to support counseling for at-risk youth, housing for homeless families, and much more.

Many of you are cosponsoring legislation to expand and extend this provision, which is set to expire at the end of this year, and we are committed to working with you to ensure that legislation is enacted.

Nonprofits are also facing human resource challenges. Many leaders are baby boomers who will be retiring, and there is a much smaller pool to replace them. There have also been some declines in the number of Americans who are able to volunteer.

On another front, there have been a number of stories in recent years concerning troubling practices at some nonprofits. Many in our community were concerned about these stories, and we brought together leaders of charities and foundations to explore needed changes.

At the urging of key leaders in Congress, we formalized our efforts in the national Panel on the Nonprofit Sector. The result constituted the most comprehensive review of governance, regulations, and operations of the charitable community in more than three decades.

The panel offered a strong, carefully integrated package of over 130 recommendations for action that lawmakers, the IRS, and the sector itself could take to improve governance and accountability. We worked closely with congressional leaders, and are pleased that much of the panel's work was reflected in the reforms passed last year with the Pension Protection Act (PPA) (P.L. 109–280).

The panel has continued its work and this fall will release a set of 33 principles for good governance and effective practice to guide charitable organizations. The IRS has also drawn on the panel's recommendations in implementing the Pension Act reforms and developing the draft Form 990 that was released last month.

Our field is now providing feedback to improve that draft. The revised form will increase transparency and facilitate compliance, but its implementation will require significant educational efforts and adjustments in nonprofit accounting and recordkeeping practices.

We have asked Congress to increase funding to the IRS. We also believe that the best way to improve enforcement and transparency is to require mandatory electronic filing of nonprofits' information returns.

There is another way Congress can help strengthen the operations of our charitable community. Many individuals create or come to work for charitable organizations with passion and commitment, but insufficient knowledge of the legal requirements and skills necessary for success.

Like their counterparts in the small for-profit community, these leaders could benefit substantially from the planning services, financial and legal advice, and management training provided by the Small Business Administration. We stand ready to work with Congress to create a Small Nonprofit Administration to nurture and train leaders of charities in the skills necessary to ensure that we can all benefit from the vital services their organizations provide.

Thank you, and I am pleased to answer any questions.

[The prepared statement of Ms. Aviv follows:]

INDEPENDENT SECTOR
A vital voice for us all

Testimony of
Diana Aviv
President, and CEO
Independent Sector

United States House of Representatives
Ways and Means Subcommittee on Oversight
Hearing on Tax-Exempt Charitable Organizations

July 24, 2007

1200 Eighteenth Street, NW
Suite 200
Washington, DC 20036
202-467-6100
202-467-6101 fax
diana@independentsector.org
www.independentsector.org

Testimony of Diana Aviv
President, and CEO
Independent Sector

United States House of Representatives
Ways and Means Subcommittee on Oversight
Hearing on Tax-Exempt Charitable Organizations

July 24, 2007

Chairman Lewis, Ranking Member Ramstad, and Members of the Committee:

Thank you for this opportunity to appear before you today. It's an honor to help provide an overview of our nation's charitable community, and to comment upon recent legislation and pending regulatory activities that will have a significant impact on the future of the nonprofit sector.

I am Diana Aviv, president and CEO of Independent Sector, a national, nonpartisan charitable organization with approximately 600 members, including public charities, private foundations, and corporate giving programs, collectively representing tens of thousands of charitable groups in every state across the nation. Our coalition leads, strengthens, and mobilizes the charitable community to fulfill our vision of a just and inclusive society and a healthy democracy of active citizens, effective institutions, and vibrant communities. IS members represent a broad cross-section of our nation's nonprofit community, which exists to meet society's needs, frequently in partnership with government, in diverse areas such as the arts, education, human services, community development, and health care.

My remarks today will focus on four topics. I will begin by giving you an overview of the charitable community, including a discussion of its health. Next, I will examine the essential partnership between government and the charitable community in improving lives. Third, I will describe the recent challenges and inspiring response of the sector and the government in strengthening accountability and transparency. Finally, I will discuss two significant challenges facing the community and propose solutions for the Committee's consideration.

State of the Sector

More than 170 years ago, Alexis De Tocqueville marveled in *Democracy in America* at how Americans came together to solve problems through voluntary associations. He came to see these efforts as one of America's most distinctive features. Today, America's charitable community plays an even more indispensable role in improving lives across the country and around the world. It has grown to encompass more than 1.5 million organizations, large and small, that engage people in securing basic needs, creating opportunities, offering hope, fostering creative expression, and nurturing our spirits.

We are religious and secular relief organizations that serve people in need. We are therapy centers for disabled children, inner city free clinics, and after-school programs. We are large and small foundations that fund services for the most vulnerable in our society, creative arts programs, and economic development. We are also small neighborhood groups, cleaning the roadsides, protecting our children, and fighting for the causes we believe in. No matter who you are, or where you are in this country, your life is touched and enhanced by the work of nonprofit organizations.

America's charitable community produces its results because of the talent and dedication of caring people. Part of that service comes from volunteers, who collectively provide the equivalent of 9 million full-time staff members. Our organizations' results are also supported by its 11.7 million paid employees, 9 percent of the entire national workforce and a number greater than the finance, insurance, and real estate industries combined[1].

To do this important work also requires financial resources. The voluntary contributions of millions of Americans provide 20 percent of the revenues that support the programs our community offers. We rely on government funding for approximately 31 percent of our support, and fees for services – generally calibrated based on the client's ability to pay—provides 38 percent of the needed revenues. The remaining 11 percent of the support is derived from investment earnings, income from unrelated business activities, and other sources. Charitable organizations collectively spend nearly $1 trillion annually to provide programs and services that improve lives and strengthen communities throughout the United States and the world. Add to that the value of countless hours of volunteer effort each year, and it is clear that the nonprofit community is a major and essential force for good in our society.

Partnership with Government

Throughout our history, the American people have relied on voluntary organizations to address the needs of many of our most vulnerable neighbors. In the colonial period, some groups who found themselves in the minority – Scotsmen and women in Massachusetts, for example, the Jewish community in South Carolina, and African-Americans in the South – had the opportunity to create their own organizations to help their members. The number of voluntary associations expanded significantly in the 19th century, leading to thousands of new organizations such as Jane Addams' Hull House and the African Meeting House in Boston. The first part of the 20th century witnessed further expansion in the number and variety of charitable organizations, from private universities to community centers, from foundations to health care providers.

As our nation grew and the problems facing our communities became more complex, we increasingly turned to government to help meet our collective responsibilities for ensuring the quality of life we want all people to enjoy. Some programs started by nonprofits—including libraries, local schools, fire stations , and parks—have been expanded by government, enabling the broader community to enjoy their benefits. At the same time, philanthropic institutions incubated new ideas—such as rocket science and the 9-1-1 emergency response system—that are now an integral part of the services government provides. In addition, charitable organizations are the partners through which government effectively and efficiently delivers services such as early childhood education, health clinics, drug counseling, and after-school programs. Without this vital collaboration between government and the charitable community, our nation would not address such needs nearly as well.

Congress and state legislatures have long recognized the critical role of nonprofit organizations dedicated to advancing the common good by granting them exemption from income taxes. This enables those organizations to devote their funds to fulfilling their missions. To encourage the

[1] Lester M. Salamon, editor. *The State of Nonprofit America* (Washington, D.C.: Brookings Institution Press, 2002).

American people to contribute, federal and state governments also have allowed taxpayers to deduct charitable contributions when calculating their income taxes.[2]

Several government agencies are charged with monitoring and regulating charitable organizations to ensure that they meet the conditions under which they were granted this special tax status. The Internal Revenue Service's Tax Exempt and Government Entities Division bears the primary responsibility for approving applications for tax-exempt status, and monitoring and enforcing compliance with the rules for tax-exempt organizations. In most states, attorneys general bear the primary responsibility for enforcing state laws governing the creation, operation, and dissolution of charitable organizations.

Although the system of oversight has proven effective in identifying and deterring some individuals or organizations that violate these laws, a serious shortage of resources has made it difficult for government officials to identify and punish many violators.

Accountability and Transparency

Starting in 2002, news outlets that had been following corporate scandals began to examine charitable organizations more carefully. They subsequently identified a number of cases involving practices that were illegal or not in keeping with standards typical of the charitable community. Some stories described individuals who received inappropriate personal economic benefits, others focused on unethical fundraising practices, inattentive boards of directors, and individuals claiming excessive contributions. Many leaders in the charitable community were troubled by these stories and wanted to explore ways we could strengthen oversight and improve the governance and accountability of our organizations. To begin a dialogue for change, I invited two dozen leaders among charities and foundations to come together.

The leaders of the Senate Finance Committee were also taking a closer look at charities and foundations, and in 2004 convened several hearings and a roundtable discussion, to examine oversight and needed reforms. That year, the House Ways and Means Committee launched its own examination of the charitable community, efforts by the IRS to improve compliance, and the need for further congressional oversight.

Many in the nonprofit community urged caution when considering new legislative options, particularly given the diverse ways in which charitable organizations operate. They noted that while a particular remedy might solve the targeted problem, it might also have unintended adverse consequences for a great many other organizations. The leadership of the Senate Finance Committee agreed that more thorough study was needed, and with their encouragement, Independent Sector expanded our initial analysis. The national Panel on the Nonprofit Sector was born. The result constituted the most comprehensive review of the governance, regulations, and operations of the charitable community in more than three decades.

[2] The Internal Revenue Code defines more than 25 categories of organizations that are exempt from federal income taxes, including private country clubs, business associations such as Chambers of Commerce or the National Association of Manufacturers, labor unions, fraternal organizations, and many others. Because charitable organizations – those defined under section 501(c)(3) of the tax code--must benefit the broad public interest by addressing specific types of programs, Congress has provided, with very limited exceptions, that they are the only tax-exempt organizations eligible to receive tax-deductible contributions.

The Panel consists of 24 distinguished leaders from public charities and private foundations from around the country. It was supported by five Work Groups that included a total of more than 100 experienced representatives of the nonprofit sector that examined key issues in governance and accountability. Also making major contributions were two advisory groups: one made up of technical experts, the other of leaders of America's business, educational, media, political, cultural, and religious institutions, who provided a broad perspective on how these issues affected the public at large. Two additional groups were later added to examine specifically how the annual information returns filed by charitable organizations, the IRS Forms 990 and 990-PF, might be improved.

The Panel adopted an inclusive and transparent process for its work, conducting 15 field hearings around the country, including in Atlanta, Minneapolis, and New York City, hosted several national conference calls, and posted all of its draft recommendations for comment on its website. Altogether, the Panel received comments from more than 15,000 people who improved the final product and lent their support to this massive effort.

In June 2005, the Panel presented its Final Report to Congress and in April 2006, it released a Supplemental Report. Together these reports contain a strong, carefully integrated package of over 130 recommendations for action that lawmakers, the IRS, and the sector itself could take to improve the governance and accountability of charitable organizations. The Panel identified areas of misconduct that were not covered by existing law, which was not surprising given that there had been no significant change in federal laws governing the nonprofit community in more than 30 years despite significant growth in the sector during that period. The Panel also recommended methods for strengthening existing law enforcement systems to facilitate a more streamlined use of resources.

In the Panel's view, the recommendations balance the need for meaningful oversight with the need to protect the independence that has been a hallmark of the charitable community's effectiveness. They also recognize the diverse range of needs and interests of charitable organizations, understanding that while one solution might be appropriate for larger organizations it could devastate smaller or new nonprofits. The Panel paid special attention to smaller organizations by creating a work group whose goal was to ensure that they were not adversely impacted by its recommendations.

The Panel's report was formally endorsed by 460 large and small organizations throughout the nation, from the American Cancer Society to the Boys and Girls Club of Carlsbad, California, from the Boston Foundation to the Georgia Center for Nonprofits. Many organizations have adopted governance policies and practices recommended by the Panel, and the Internal Revenue Service incorporated many of the Panel's recommendations in its recently released draft of a revised Form 990.

<u>Legislative Developments</u>
In the year following the release of the two reports, Independent Sector and many other nonprofit organizations consulted with Members of Congress and with tax staff of the Senate Finance Committee and the House Ways and Means Committee, encouraging them to enact legislation following the Panel's recommendations. The result was the package of legislative reforms passed by Congress with the Pension Protection Act of 2006 and enacted into law last August. Those reforms included increased fines and penalties for violations of prohibitions on excessive private benefits, clearer rules for appraisals required to substantiate tax deductions for charitable contributions, and new rules to ensure that assets held in donor-advised funds and supporting organizations are used to

benefit the intended charitable purposes. These reforms represent the most comprehensive change to the laws governing charitable organizations since the 1969 Tax Act and have significantly strengthened the legal framework that enables our charitable community to be a vital resource for our nation.

The inclusion in the Pension Protection Act of several new incentives to encourage charitable giving is also helping to generate new resources needed to support the work of charitable organizations. These incentives include the IRA Charitable Rollover, which allows older Americans to make charitable contributions from accumulated retirement funds without additional tax burdens; an enhanced tax deduction for gifts of property for conservation purposes; and enhanced deductions for corporate contributions of food and book inventory. Unfortunately, these incentives will expire at the end of this year unless Congress takes action to extend them.

Since its enactment, the IRA Charitable Rollover provision has encouraged tens of millions of dollars of new or increased contributions to help build cancer centers, develop programs for counseling at-risk youth, provide college scholarships, support housing for homeless families, conserve wilderness areas, and provide art therapy for people with developmental disabilities. Beginning at age 70 ½, all IRA owners are required to take annual minimum distributions, even if they do not need the income. While there are some large gifts that have been received by organizations, we are seeing around the country that smaller donations of $4,000 to $5,000 are being given by persons who might not otherwise have donated in the past. This new provision allows those who have accumulated more assets than they need to use that required distribution and other funds in their IRAs to give back to society by supporting their cherished causes on a tax-free basis. This is particularly helpful for older Americans who do not itemize their tax deductions and would not otherwise receive any tax benefit for their charitable contributions.

We thank Chairman Lewis, Ranking Member Ramstad, and the other committee members who are co-sponsors of legislation introduced by Representatives Earl Pomeroy and Wally Herger to extend the IRA Charitable Rollover. This legislation would also expand the reach of this important provision by making all charitable organizations eligible to receive IRA Rollover donations, and provide IRA owners with the opportunity, starting at age 59 ½ to secure their own retirement income while giving to charity by using several planned giving options currently in the tax code. I would think this latter component would be of particular interest to all members of the Ways and Means Committee because it encourages Americans to give to charities and receive annuities in return, thus marrying the Committee's concerns for efficient giving and retirement security in the form of annuities. Extending and expanding the IRA Charitable Rollover would likely generate millions of additional charitable donations that would help improve lives and strengthen communities, and we urge that it be enacted before the current giving incentive expires at the end of the year..

Independent Sector also believes that some changes are needed to a few of the reform provisions in the Pension Protection Act. Private foundations and donor-advised funds should be permitted to make grants to supporting organizations, other than Type III supporting organizations that are not functionally integrated. Funds established by public charities and government entities should not be defined as, and subject to, many of the restrictions on donor-advised funds. We appreciate this Subcommittee's Advisory requesting comments on the Pension Protection Act and will be submitting more detailed responses.

In anticipation of a study on donor advised funds called for as a result of the legislation that will be completed and made public next month by the Treasury Department, we ask for the opportunity to work with the Committee to construct appropriate additional reforms.

One pressing issue that did not find its way into the Pension Protection Act that would go along way to enhance transparency and accurate reporting by charitable organizations, is the Panel's recommendation to require all charitable organizations to file their tax returns electronically. Accordingly, Independent Sector urges the Ways and Means Committee to extend mandatory electronic filing of Form 990 returns to virtually all charitable organizations.

Regulatory Developments

As I noted earlier, the Panel on the Nonprofit Sector also recommended changes in Treasury regulations, particularly in the annual information returns filed by charitable organizations, to improve accountability and transparency. The Treasury Department and the Internal Revenue Service consulted with Independent Sector and many other charitable organizations to develop quickly the regulations and advisory notices needed to implement and facilitate compliance with the Pension Protection Act reforms. We particularly appreciate their continuing efforts to help organizations clarify and correct their misclassification as supporting organizations and to assist grantmakers in obtaining information they need to comply with new restrictions.

Last month, the Internal Revenue Service published a draft of a significantly revised Form 990 return, the document that many nonprofit organizations must file with the Service. By separating information that applies only to a limited number of organizations into distinct schedules, standardizing the extensive number of attachments required on the current form, and clarifying the information organizations are expected to provide, the draft is a vast improvement for both filers and readers of the current form. Steve Miller and his team at the IRS are to be commended for an outstanding job in reaching out to the regulated community and for listening to our concerns. Their open and straightforward approach is another facet of the continuing partnership between the government and the nonprofit community.

Due to competing priorities within the Service, Steve and his team are operating under an extraordinarily tight deadline for implementing these changes. Independent Sector has been working with our members to provide feedback to the IRS on areas where the draft needs to be refined and corrected. For example, we believe that the "efficiency indicators"—that is, the percentage of funds and employee compensation devoted to particular activities—that the Service has included on the opening page of the Form are misleading and will not provide useful information to regulators or the public. We further have serious concerns about the dangers that new disclosures called for in the draft will create for individuals and groups working outside the United States that are part of or funded by American organizations. We are committed to ensuring that our charitable resources are not diverted to those who mean harm to our nation, but we also must ensure the safety of those who are working to improve the lives of people in parts of the world that are hazardous for workers or hostile to American organizations and interests.

We also recognize that the extent of the changes on the new form will require time to educate organizations about new definitions and requirements and to enable them to adjust their accounting and other record-keeping systems required for accurate reporting. We look forward to working with the IRS to develop an implementation schedule for the revised Form 990 that will allow rapid implementation of positive changes without imposing unrealistic compliance demands on charitable organizations.

Challenges Facing the Charitable Community

Concerns about ethics and accountability should not overshadow the other significant challenges facing our nation's charitable organizations. Despite the welcome news of substantial donations by generous individuals like Warren Buffet and Bill Gates, growth in overall charitable giving has been very modest. According to a report in the July 21, 2007, issue of the *Chronicle of Philanthropy*, corporate giving declined by 10.5% in 2006, and giving by individuals increased only 1 percent after inflation. The article reports that Americans of modest means are finding it more difficult to give in the face of rising prices for fuel and other necessities and difficult economic conditions in many regions of the country.

At the same time, organizations that rely on grants and contracts from federal, state, and local governments to provide services have been affected by cuts and changes in funding priorities. In recent years, we have witnessed a decrease in the absolute dollar amounts (not just inflation-adjusted dollars) in the federal budget for non-defense domestic discretionary programs vital to the sector. Indeed, spending on non-defense discretionary services outside of homeland security has declined both as a share of the total federal budget and of the nation's economy. There have also been changes in the dollars allocated for and funding formulas for mandatory programs that affect services for needy individuals and families, raising the demand for services provided by charitable organizations.

Like other businesses and families, charitable organizations are facing rising fuel and operating costs, making the need for increased capital even greater. Some organizations have been forced to reduce services or abandon certain programs altogether. Some have increased fees while struggling to preserve access to services, while others have turned to developing business enterprises, which often require capital investments and business expertise that may be out of reach.

Charitable organizations are also facing declines in human resources. Financial and time demands have led to a decrease in the number of Americans who are able to volunteer time to charitable programs. In addition, the current generation of leaders of charities and foundations, like the rest of the baby boom generation, are expected to retire from these leadership positions over the next decade. It is estimated that the nonprofit sector will need 640,000 new senior managers (almost 2 ½ times the number currently employed) to replace those retiring. There is no institution, mechanism, or program currently in place for identifying the next generation of nonprofit leaders and providing them the skills needed to make it thrive.

Many individuals create or come to work for charitable organizations with a wealth of passion and commitment for the causes they address, but with little knowledge or experience of the legal requirements and business skills necessary for success. While a number of consultants and management support organizations provide some training and assistance to help managers and boards of charitable organizations address these needs, the quality of these services and access to them varies greatly across the country. These outside resources are also not affordable to many smaller nonprofits. Like their counterparts in the small for-profit business community, nonprofit leaders could benefit substantially from the business planning services, financial and legal advice, and management training provided by the Small Business Administration.

We call upon this Committee and your congressional colleagues to give serious consideration to the creation of a **Small Nonprofit Administration** that would work to nurture and train leaders of charitable organizations in the administrative, governance, fundraising, and planning skills necessary to ensure that the people of our nation will continue to benefit from the vital services these organizations provide. While some federal agencies have developed programs to assist organizations they fund or contract with to provide services, it is time to pull these efforts together to ensure broad access to high-quality training and support for the thousands of organizations that work to ensure the health and vitality of people and communities throughout our nation. Independent Sector and our members stand ready to assist you in this important effort.

We appreciate the opportunity to testify before the Subcommittee and I am pleased to answer any questions you may have.

Chairman LEWIS. Madam President, I thank you for your statement. I am sure there will be some questions.

I am pleased to welcome the next witness, our friend, our former colleague. It is good to see you, the Honorable Mr. President, in your new role as head of the Council on Foundations. To Ron Kind, I am not so sure, Steve, whether Ron really introduced you when he made his opening statement, but you can get a second introduction. You haven't forgot how we act here in the Congress on this Committee when a good, a dear friend returns. It is really good to see you. You are looking good. There is life after Congress.

Mr. GUNDERSON. There is life after Congress.

Chairman LEWIS. I believe it. Thank you.

Mr. KIND. Thank you, Mr. Chairman. I did introduce and welcome Steve to the Committee before. It is a delight to have him back up here. I don't know if I ever shared this with Steve, but as a new Member in my first term, getting to meet my colleagues around here, inevitably they asked, "What district are you representing? Who are you replacing?" When I told them it was Steve Gunderson's seat, they had nothing but high praise for you. I can't tell you how good that made me feel as a new Member of Congress, to hear the type of work you were doing.

So, welcome back. Glad to have you today.

STATEMENT OF STEVE GUNDERSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, COUNCIL ON FOUNDATIONS

Mr. GUNDERSON. Well, thank you very much to you, Mr. Chairman; to my colleague, friend, and successor, Mr. Kind; to my friend on Northwest Airlines back and forth, Mr. Ramstad, way too many times; to Mr. Becerra, where we toiled on the old Education and Labor Committee; and to our distinguished co-chair of the Philanthropic Caucus. Thank you very much, Ms. Tubbs Jones, for doing that. I do feel like I am coming home, and I really appreciate the opportunity.

The Council on Foundations is a membership organization of more than 2,000 grantmaking foundations and corporate giving programs worldwide. We promote responsible and effective philanthropy. We gather today at a unique time in American history. Thanks to the combination of demographics and personal resources, we are looking at the most significant generational transfer of wealth at any time in history.

Whether we can use this moment to create new philanthropic resources committed to enhancing the public good depends on how well we—you the Congress and those of us in philanthropy—can partner to create the tools for a new generation of service.

More than 71,000 grantmaking institutions contributed over $40 billion in 2006. Collectively, these institutions hold approximately $550 billion in assets. That is a lot of money, but a word of caution: Philanthropy can never replace government's role.

However, foundations can and do play a vital role in strengthening and sustaining our communities. For example, in your home city, Atlanta, Mr. Chairman, the Arthur Blank Family Foundation holds that promise for every child ought to be the mantra of that city. The foundation awarded $23 million last year for students who attend Atlanta's new schools at Carver, the Southeast's first small high school campus, and is helping children in some of Atlanta's toughest neighborhoods get a fair start in life by funding early learning and family support programs.

As much as philanthropy does, we can and should do more. The council is partnering with our members to act as a program leader for a coalition funding workforce investment; to conduct a national study to determine how we can better respond to national disasters; to hold a conference next month, creating an agenda for philanthropy in rural America; to grow philanthropy's role in addressing the social challenges facing our neighbors in Latin America and the Caribbean region.

Our growth depends upon our ability to earn and maintain the public trust. Our growth and our service also depend upon policymakers becoming our partners in creating the environment and encouraging that growth. There are times when legislation and regulation are appropriate and necessary, but we must be partners in this effort in ways that achieve the proper balance, both in the environment we create and in the regulations we impose.

The council will continue steps toward effective, credible self-regulation. We have established standards for every sector of our membership. We have significantly enhanced our ethical review process. We take self-regulation seriously.

Last year's Pension Protection Act includes the first-ever regulation of donor-advised funds, and substantially increases regulations of supporting organizations. The council supported many of those provisions. However, in a couple of those areas, we believe the legislation might have gone too far or it might have had unintended consequences.

We were disappointed by the last-minute exclusion of donor-advised funds, supporting organizations, and private foundations as eligible recipients of charitable distribution from IRAs. We ask the Congress to extend the IRA rollover benefit, but we also ask that you allow donors to freely choose where they will direct those funds.

This morning I want to underscore that donor-advised funds democratize philanthropy, giving ordinary citizens the chance to become philanthropists. Six donors from Mr. Ramstad's area, the Minneapolis Foundation, recently recommended grants of $16,000 from their donor-advised fund to support ending homelessness.

We at the council want to fix certain provisions of the Pension Protection Act, but we also want a positive agenda, not only expanding the IRA rollover with appropriate fixes, but we want to provide program-related investments by private foundations to facilitate urban and rural economic development, to extend the PPA's incentives for gifts of qualified conservation property, and to make tribal governments qualified recipients of charitable contributions of food by businesses.

Mr. Chairman, this is all about partnerships. We seek your help to create the environment encouraging the growth of philanthropy in order that we might all better partner in serving the common good.

Thank you very much.

[The prepared statement of Mr. Gunderson follows:]

COUNCIL on FOUNDATIONS

Subcommittee on Oversight
Committee on Ways and Means
Hearing on Tax-Exempt Charitable Organizations
July 24, 2007

Statement for the Record by the Honorable Steve Gunderson
President and CEO, Council on Foundations

Thank you for the opportunity to appear this morning.

The Council on Foundations (COF) is a membership organization of more than 2,000 grantmaking foundations and giving programs worldwide. For more than 55 years, the Council has served the public good by promoting and enhancing responsible and effective philanthropy. The Council's membership includes private foundations, community foundations, company foundations, corporate giving departments and public charities that are primarily grantmakers. The world of philanthropy is growing and changing and the Council is changing with it.

We gather today at a unique time in American history, and philanthropy. Thanks to the combination of demographics and personal resources, we are looking at the most significant generational transfer of wealth at anytime in world history. Whether we can use this moment to create new philanthropic resources committed to enhancing the public good depends upon how well we – you, the Congress, and those of us in philanthropy – can partner to create the tools for a new generation of service to society. One of the most distinguished leaders in our sector, Barry Gaberman of the Ford Foundation, defines philanthropy as the "voluntary transfer of personal resources to the public good." This is our moment.

Today, the Foundation Center (one of our sector's best research organizations) estimates that the nation's more than 71,000 grantmaking institutions contributed over $40 billion in 2006 to the betterment of communities in America and around the world. Collectively, these philanthropic institutions hold approximately $550 billion in assets. Consider these commitments. In 2005, philanthropy resources were allocated as follows:

- 24% to education
- 21% to health care
- 26% to the combination of human services and public affairs/society benefit, a category which includes the promotion of civil society, civil rights, and community improvement.
- the remainder to arts and culture, environment and animals, international affairs, science and technology, social sciences, religion, and other

Half a trillion dollars in assets is a vast sum of money, but a word of caution is in order. Even with these generous resources, philanthropy can never take on government's role in providing services and resources to Americans. Just as an example, foundation assets in 2006 – that's total assets, not grants – equaled just 21 percent of a single year's federal budget. If grantmakers spent all the money

1828 L STREET, NW, SUITE 300, WASHINGTON, DC 20036-5168 • 202/466-6512 • www.cof.org

they have, they could cover one year of Social Security payments or three years of interest on the national debt. But then the money would be gone.

Although philanthropic institutions can never replace government, foundations can and do play a vital role in strengthening and sustaining communities. In doing so there are times when foundations collaborate with government to pioneer innovative solutions to pressing problems. At other times, philanthropy's role may be to challenge government to do better. Let me cite several examples.

Atlanta

The Community Foundation for Greater Atlanta recently led a successful three-year pilot program, the Metro Atlanta Youth Opportunities Initiative (MAYOI), to help young people make successful transitions from foster care to adulthood. The pilot enrolled 240 youth and made use of multiple strategies to assist youth through this transition period. One of these – a program to encourage savings by combining instruction in financial literacy with a 1:1 match of participants' deposits resulted in 82 young people saving $83,000 toward asset purchases.

- Two participants became homeowners and two others opened successful small businesses.
- 32 participants secured rental housing
- 46 participants purchased vehicles
- Two participants used the match funds toward investments
- Two participants used the match funds for educational expenses (the state offers tuition waivers for foster youth)

Based on the lessons learned from the pilot effort, the community foundation is now working with its public and private partners on a second three-year effort to institutionalize components of the pilot effort statewide and to provide reliable financing for the program, including maximizing federal and state funding, making existing funding streams more flexible, and creating public-private partnerships with local banks.

The Arthur M. Blank Family Foundation has a vision for Atlanta of a community that holds promise for every child; of a city with a sense of place and potential; of vital neighborhoods, rich with vibrant cultural opportunities for all. In support of this vision, the foundation awarded $23 million in grants last year, primarily in Atlanta.

- The foundation's Pathways to Success partnership provided over $4 million, payable over four years, to support programs for students who attend Atlanta's New Schools at Carver - the Southeast's first "small high school" campus.
- Early grants from the Blank Family Foundations Inspiring Spaces program led to the development of the plan for The Atlanta BeltLine, a proposed 22-mile loop of trails, transit, and parks, which promises not only to connect communities, spur development, mobilize residents, and increase green space, but to redefine and transform the City of Atlanta. The foundation has continued to provide support for land acquisition, trail development, park advocacy and park improvement.
- Through the Better Beginnings initiative the Blank Family Foundation is helping more children in Atlanta's toughest neighborhoods and poorest circumstances get a fair start in life, by funding early learning and family support services. For example, $450,000 in mini-grants will support nonprofit organizations and child care centers that implement

practices designed to reduce child abuse and neglect, promote child development and family well-being, and lead to improved long-term outcomes for children.

Over the last ten years, IBM, whose Corporate Citizenship and Corporate Affairs Department is headquartered in Atlanta, has been one of the largest corporate contributors of cash, equipment, and people to nonprofit organizations and educational institutions across the U.S. and around the world. The company's efforts focus on helping people use information technology to improve the quality of life for themselves and others. As one example, the IBM KidSmart Early Learning Program integrates new interactive teaching and learning activities using the latest technology into the pre-kindergarten curricula. The program is now being implemented in 60 countries internationally, serving more than 2 million children from remote geographic areas to underprivileged areas of town and cities

Kalamazoo, MI

For more than a century, the local economy of Kalamazoo County, Michigan's population of 250,000 had relied on the presence of "Big Pharma"–namely, Upjohn Corp. – for its continued robust health. When Upjohn merged with Pharmacia and then was acquired by Pfizer, Inc, the resulting loss of jobs, people and philanthropic support was potentially devastating to the area. More than 1,200 jobs were eliminated with the Pfizer purchase alone. Community leaders banded together with Southwest Michigan First (the area's private, nonprofit economic development organization) to develop a far-reaching, forward-thinking plan to help save Kalamazoo's economy. An integral component of the plan was a scientific incubator designed to encourage biotech and life scientists to stay in the area. After receiving state, city and county funding, as well as private donations, Southwest Michigan First was $2 million short of its Innovation Center construction budget. The Kalamazoo Community Foundation stepped in with a $2 million program-related investment to make up that shortfall. Today, the Southwest Michigan Innovation Center is home to a dozen thriving start-ups, launched and staffed largely by ex-Pfizer scientists, creating high-skill/high-wage jobs and contributing to the area's continued economic growth and development.

Rhode Island

HousingWorks RI is a coalition of more than 120 organizations, led and financed by The Rhode Island Foundation, to ensure every Rhode Islander a quality, affordable home. Coalition members include banks, builders, chambers of commerce, colleges, community-based agencies, faith-based groups, manufacturers, municipal officials, preservationists and unions. Through its members, activities and website: HousingWorks RI:

- Draws attention to housing issues in Rhode Island.
- Provides a one-stop, authoritative source of information about affordable housing in Rhode Island.
- Hunts down new ideas and best practices from across the nation.
- Celebrates housing progress in our communities.
- Advocates for solutions that will end the housing crisis.

The coalition achieved its most significant victory to date in November 2006, when 66 percent of Rhode Island voters approved a $50 million affordable housing bond, the largest majority given any affordable housing referendum in the United States. Since then, Rhode Island's Housing Resources

Commission (HRC) has received more than 60 applications seeking funding to construct 936 affordable homeownership and rental units.

Philanthropy's Growth in Size

As I look at global philanthropy in the 21st century, I am convinced that we will be defined by the three Ss. We'll certainly grow in size. Projections are that we'll witness no less than $41 trillion in asset transfer by the middle of this century; no less than $6 trillion of this for charitable giving. We don't know how much of that giving will be directed to foundations, but whatever the amount, it is clear that we will witness growth at rates much faster and much larger than previously anticipated.

Philanthropy's Growth in Service

We will grow in our service to the common good. In area after area, we are witnessing the growth of philanthropic leadership, which complements effective grantmaking. We are looking at new ways in which philanthropy fills the void left by government at all levels when political polarization results in policy paralysis. It is not philanthropy's role to step in where government has failed to do its proper duty. But it is clear that the vision, leadership, and innovation in addressing the challenges facing our social sector will come more and more from philanthropy. Philanthropy's very mission is to innovate, take risks, be creative, sometimes even fail – but keep moving forward to find new ways to respond to the challenges of society.

As we grow in service, we will also embrace a new generation of philanthropic leadership. Today, the Council on Foundations has just become the program leader for a coalition of philanthropic organizations seeking to create new partnerships between public, private and philanthropic resources aimed at workforce investment.

As I speak, we are engaged in a national feasibility study to determine how philanthropy can better respond to our national disasters in the future. We too learned from our response to Katrina. Today, we are proposing to our field a national task force of philanthropic experts in disaster response who would be prepared for instant relocation to a disaster to determine how philanthropy can best coordinate its resources to a most effective response. We are also asking the question of whether we should capitalize a philanthropic disaster fund to more effectively coordinate our resources.

Next month, we are convening in Missoula, Montana a national conference on Philanthropy and Rural America. We hope to use these three days of meetings with rural funders from all over the nation to craft "A 21st Century Agenda for Philanthropy and Rural America."

We are also presently engaged in an Initiative of the America's to grow philanthropy's role in addressing the social challenges facing our neighbors in the Latin American/Caribbean region. The Council has just committed $100,000 to strengthen the philanthropy infrastructure and to translate our materials into Spanish to provide better access to these materials in ways that will grow philanthropy's service.

Around the globe, philanthropy is playing critical roles to fight HIV/AIDS in Africa, and to promote civil society in the new democracies of Eastern Europe. Because of our continued interest in supporting and expanding all international philanthropy, I wanted to share with you some comments about the Treasury Department's Anti-Terrorist Financing Guidelines: Voluntary Best Practices for

U.S.-Based Charities and their potential to harm our collective work. The Guidelines based on Treasury's view that the U.S. charitable sector is a significant source of financing for terrorists.

Let me be clear, the Council on Foundations is steadfastly opposed to the use of charitable vehicles for the support of terrorist activities at any time in any place. Our work is geared towards supporting appropriate safeguards against any use of the charitable sector for this purpose.

In fact, we have seen no evidence to indicate that U.S. charities are a major source of terrorist support. Out of hundreds of thousands of U.S. charities and billions of dollars given out in grants and material aid each year, only six U.S. charities are alleged to have intentionally supported terrorists. Thus far, Treasury has not identified a single case of inadvertent diversion of funds from a legitimate U.S. charity to a terrorist organization. In other words, *bona fide* charities are doing an excellent job of following IRS rules concerning due diligence and taking reasonable precautions to ensure that charitable assets are not diverted for terrorism or any other unlawful purpose.

The principal difficulty with the Guidelines is that they call on charities to collect a prodigious amount of information about their grantees – much more than is legally required. If charities were to fully comply, they would incur substantial additional administrative costs resulting in less funding going directly to charitable activities. Given that existing due diligence has apparently been sufficient to prevent the diversion of funds, the collection of this additional information should not be necessary. An even larger issue is that, by exaggerating the extent to which U.S. charities serve as a source of terrorist funding, Treasury is fueling an environment in which wary donors may refrain from making charitable contributions.

The Council-led Treasury Guidelines Working Group of 75 foundations, charities, associations, advocacy groups and legal experts has met with Treasury, commented on various versions of the Guidelines, and developed a helpful alternative for the charitable sector titled the *Principles of International Charity*. While acknowledging that successive versions of the Treasury Guidelines have improved, the Working Group has continued to feel that, on balance, they are not useful and we have consistently urged that they be withdrawn.

Philanthropy's Growth in Scrutiny:

We will also grow in scrutiny as both policymakers and the media seek to monitor, investigate, and yes, regulate this field. And regulation of the philanthropic sector is part of why we're all here today. Hardly a month now goes by when I'm not spending time with a new reporter just assigned to the philanthropic beat of their news agency. And hardly a week goes by when we don't hear from the Washington Post, the New York Times, the Los Angeles Times, or the Wall Street Journal.

In defining our field, philanthropic organizations must be ethical, accountable, and effective. As Council board chair, Max King, CEO of the Heinz Endowments, said at our Annual Conference this year:

> For us, these matters of good governance, accountability, and strong ethics are, we know, central to our mission and our success. We must all become expert in managing these public-trust issues, and we must become highly skilled in collaboration and communication in order to ensure that the general public and its representatives fully understand our work and the requirements for success.

Our growth and our service are dependent upon our ability to earn and maintain the public trust. Our growth and our service are also dependent upon policymakers becoming our partners in creating the environment that encourages the growth of philanthropy. There are times when legislation and regulation are appropriate and necessary. But we must be partners in this effort in ways that achieve the proper balance – both in the environment we create and in the impact these regulations have on philanthropy. For our part, the Council and its members will continue the steps we have taken toward effective, credible self-regulation. We have established standards for every sector of our membership. We have significantly enhanced our ethical review process. The Council on Foundations takes self-regulation seriously and our members join us in this commitment.

You should know, Mr. Chairman, that the Council on Foundations has embarked upon a major leadership initiative to promote diversity within our sector. Last year, our Board of Directors approved an aggressive agenda recommended by our Committee on Inclusiveness. The agenda consists of six initiatives:

1. Philanthropy Corps – To attract and retain diverse talent in service to philanthropy.
2. Emerging Philanthropic Leaders Fellowships – To mentor and highlight promising talent that is new to the sector.
3. Effectiveness Requires Inclusiveness: Educational Programs for Grantmakers
4. Communicate Philanthropy's Value and Knowledge on Societal Issues
5. Research on the Value of Inclusiveness
6. Connecting US Expertise with International Outreach.

We have just completed a national search and in August the Council's new Director of Diversity and Inclusive Practices will lead our efforts to ensure that our field reflects the face of those we seek to serve in every way.

Building a Partnership

Mr. Chairman, your call for this hearing talked about the Partnership between the public and non-profit sectors in serving society. We share this commitment. And we ask our partners in the Congress to help us create the legislative and regulatory environment which enhances the growth of philanthropy – in order to grow our service to society.

The committee has also asked for comments on the Pension Protection Act of 2006. The Council will be filing detailed comments by the July 31 deadline, but let me make just a few key points, particularly with respect to the Act's regulation of donor advised funds.

The Council's membership includes 561 community foundations, all of which have assets held in donor advised funds and many of which also are supported by supporting organizations. The Council's membership also includes about 130 other public charities that are primarily grantmakers. Some of these members also offer donor advised giving as an option to their donors and some also have supporting organizations. Some public charities in this latter group focus on international grantmaking, while other support a community of interest such as the environment or women's issues.

Donor Advised Funds

Donor advised funds are a critical and increasingly important source of funding for important community programs. In a recent Council survey, 85 of the 125 largest community foundations reported making more than $1.05 billion in donor advised grants in 2005.

There are probably as many reasons for establishing advised funds as there are donors to them. However, the most important is that donors are generous and committed people with a passion for their causes and their communities. Through their donor advised funds, they provide support for charities today and, in many cases, create a legacy for the future. To take just one example, last year six donors to the Minneapolis Foundation recommended grants totaling $16,500 from their advised funds to the Sleep Out 2006 Campaign, which supports Interfaith Outreach & Community Partners' emergency housing services and long-term housing solutions. During FY2005-06, IOCP responded to 2,325 emergency housing assists, provided temporary emergency shelter for 59 homeless households, and prevented 13 families from losing their homes. IOCP also partnered with Twin Cities Habitat for Humanity and CommonBond Communities, among others, to begin construction on 54 units of long-term affordable housing in Plymouth and Wayzata.

Increasing Participation in Philanthropy: Donor advised funds offer donors several advantages over both private foundations and supporting organizations. Chief among them is that they give a broader segment of society the ability to participate in philanthropy. Many community foundations permit donors to maintain advised funds with as little as $10,000 and some even offer "acorn" funds that allow donors to create a fund with even less, bringing their funds to the minimum level over a specified period of time. This low cost structure has allowed many middle-income families to participate in philanthropy and their participation has brought major benefits to communities.

Efficiency: Donor advised funds offer efficiencies that could not normally be achieved in comparably sized private foundations or supporting organizations. Donors are attracted to advised funds because they are relatively simple and inexpensive to create and maintain.

The active oversight of a public charity that owns the funds replaces the need to create yet another nonprofit corporation or trust, seek IRS recognition of its charity status, and file annual information returns with the IRS and the states. Relying on the sponsoring charity to provide oversight, and to serve as a single point of contact with regulators, not only reduces administrative costs, but also benefits both the state and federal government by reducing the total number of exempt entities each must oversee. For the IRS alone, the reduction in the number of exemption applications and information returns that would otherwise have to be filed each year is significant.

Effectiveness: Donor advised funds at Council members offer donors the benefit of access to the members' professional expertise. By choosing to establish advised funds at community foundations and similar public charities, donors bring themselves within the organization's web of knowledge about the communities the organization serves. Donors and foundations, working together, can establish goals for the donors' philanthropy, then explore the wide range of charities working in the community to identify those that efficiently and effectively offer the services the donors want to support.

Stewardship: Donors appreciate, as well, the prudent stewardship of their charitable gifts. Council members employ professional investment managers and investment consultants to advise on the investment of the foundations' assets. These managers are overseen by volunteer boards and generally by volunteer investment committees that also possess investment expertise. Many small private foundations are unable to access similar expertise.

Focus on Mission: Yet another benefit to donors from choosing an advised fund over a private foundation or supporting organization is that they do not have to concern themselves with the administrative details of running a small organization. Instead, they can focus their efforts on supporting their charitable causes, while relying on the sponsoring organization to ensure that fund investments and distributions are fully compliant with IRS and state requirements.

Facilitating Giving: Donor advised funds are well-suited to the needs of donors who are planning to sell a substantial asset such as a business or real property. The proceeds from the sale will significantly increase the donors' income, enabling them to make a generous gift, but they may not know how their gift can be employed most efficiently and effectively. Donor advised funds allow these donors to make a substantial gift, permanently dedicated to supporting charity, yet still have the opportunity to consider how those funds can be most effectively used to promote the public good. Without such flexibility, many charitable gifts would be delayed and some ultimately might never be made.

Finally, advised funds benefit many small charities. Many smaller organizations lack the expertise to accept and process even fairly simple gifts of property such as publicly traded stock. Further, they would incur substantial fees if donors, for example, were to break up a gift of securities into odd lots. This benefit is even more pronounced when donors contribute a substantial asset, such as real property, that requires liquidation to free up assets for charitable use. Donors in these situations often want to benefit more than one charity. An advised fund allows them to do so, by making their gift to a single charitable organization and then recommending grants to other charities they wish to support.

Supporting Organizations

Supporting organizations that support Council members offer many of the benefits of advised funds. Typically, donors establish supporting organizations when they have substantial assets to contribute – many Council members require gifts of at least $1 to $5 million to justify the expense of creating a supporting organization. Most supporting organizations at Council members are Type I, although there are some Type IIs established to accept gifts of real property and a scattering of Type IIIs.

Donors who establish supporting organizations generally are also weighing the benefits of setting up a private foundation. The factors they consider often include the more favorable income tax deduction rules that apply to gifts to supporting organizations because of their public charity status compared with the control they are permitted to exercise if they establish a private foundation. Donors who choose a supporting organization over a donor advised fund generally do so because they want to play an active role in the organization's governance, even though they are not permitted to control it.

The Pension Protection Act has made the choice of philanthropic vehicle more difficult. This is particularly the case for the comparison between supporting organizations and private foundations because the rules that apply to supporting organizations are now stricter than the comparable rules for private foundations. This has led some supporting organizations to convert to private foundation status and is likely to lead to fewer supporting organizations in the future.

Like donor-advised funds, supporting organizations provide substantial and important support to communities. For example, the F.T. Stent Family Foundation, a supporting organization of the Community Foundation for Greater Atlanta made a $20,000 grant to Action Ministries, Inc. in 2005 to provide transitional housing and supportive services to 25 individuals displaced by Hurricane Katrina, most of whom will be making Georgia their home. In addition to providing direct support, the grant from the Stent Family Foundation enabled Action Ministries to claim approximately $75,000 in federal and state money for case management and program operation. In 2005, Action Ministries' transitional housing and case management services supported 144 individuals, which included 57 adults and 87 children. Of the 13 families that graduated from the program, 11 obtained permanent housing.

The Pension Protection Act

The Council supported and continues to support many of the reforms that Congress enacted last year in the Pension Protection Act of 2006. Council members not only have not abused the public trust, they have been a key source of support for their communities. However, there were some examples of the use of donor advised funds and supporting organizations for the personal gain of the donor, a promoter, or both. Changes made by the PPA, and particularly the institution of penalties for donors who misuse charitable contributions for their private benefit, effectively address these outliers.

However, the Council and its members were deeply disturbed by the last-minute decision to exclude gifts to donor advised funds, supporting organizations, and private foundations from the legislation's principal incentive to increase giving, the charitable IRA rollover provision. Our members have reported to us the extreme frustration of their donors that the law did not permit IRA rollover distributions to their donor advised funds. Our members are also reporting that many donors are choosing a second-best option by creating funds for charities designated at the time of gift. Because these designations cannot be changed once they are made, the resulting fund will lack flexibility to address emerging community needs. We urge you to extend the IRA charitable rollover before it expires at the end of this year, but we also urge you to allow donors to choose how they want to direct their gifts.

We were also disturbed by the decision to subject donor advised funds to the private foundation excess business holdings rule. We are aware of media reports in which donors have used certain Type III supporting organizations in the same way pre-1969 donors had used private foundations to secure current deductions for gifts of business interests that subsequently generated no corresponding support for operating charities. The PPA appropriately addresses this abuse by subjecting non-functionally integrated Type III supporting organizations to the section 4943 business holdings limitations. By contrast, neither the media nor Congress identified, and the Council on Foundations is not aware of, any significant cases in which donor advised funds were making decisions about how long to retain business holdings based on the private interests of the donor (as opposed to maximizing the long-term value of the assets to the fund). Further, there is no reason to believe that any such abuses would occur more frequently when the gift is made to a public charity to establish a donor advised fund than when given to a public charity for another type of fund. We believe Congress should repeal the application of the excess business holdings rule to donor advised funds.

Finally, we are concerned that Congress singled out families who choose to create Type I supporting organizations to carry on their philanthropy and treated them more harshly than families that create private foundations by refusing to permit compensation for services provided to the supporting organization or even the reimbursement of a family member's out-of-pocket expenses. We believe that Type I, II and functionally integrated III supporting organizations, should be able to provide compensation and expense reimbursement provided the payments are approved in advance by the organization's non-family board members.

The Council is also calling on Congress to make a series of adjustments to the Pension Protection Act reforms to address some situations in which the Act is hampering community philanthropy. These include:

- Clarifying the ability of sponsoring organizations to purchase goods and services on the open market using advised fund assets
- Excluding funds created by public charities and governmental entities from the definition of donor advised fund
- Permitting, with appropriate safeguards, advised funds to make grants to individuals for the relief of poverty or distress
- Clarifying that the designation in a gift instrument of scholarship committee members by title or position does not constitute an appointment by the donor of persons holding those positions
- Providing for abatement of first-tier taxes for the new penalty provisions of the PPA on the same basis as for existing penalty taxes
- Temporarily suspending the penalties for making grants to certain supporting organizations until the Internal Revenue Service can reliably identify those organizations
- Including certain publicly-supported charitable organizations within the definition of functionally-integrated Type III supporting organizations.

We will outline these areas in more detail in the statement we submit in response to the Committee's request for comments on the PPA.

Before leaving the PPA, let me underscore one other important point. That is the clear and pressing need for guidance from the Internal Revenue Service on interpreting the new requirements and for the IRS to mount and maintain an effective enforcement presence in the exempt organization area. Otherwise, we will find ourselves in a kind of death spiral in which Congress legislates ever more restrictive rules that seriously impede the ability of philanthropic organizations to accomplish their work while the abuses continue unchecked.

While the Council seeks help from Congress in fixing certain aspects of the Pension Protection Act, we are also committed to creating a positive legislative agenda to foster the growth of responsible and effective philanthropy. You will be hearing more from us about this in the future, but we are looking at such issues as:

- Changes to the rules for program related investments by private foundations to facilitate these investments, which are key to both urban and rural economic development activities. Our changes would allow entities, such as the proposed low-profit, limited liability companies or L3Cs, that want to receive these grants to pre-qualify as eligible recipients.

- Legislation to create an Office of Rural Philanthropy in the Department of Agriculture that would assist communities in creating new community foundations and other vehicles for philanthropy.

- Flattening the private foundation excise tax to 1 percent to remove the tax's perverse disincentive to increase giving and to increase the flow of grant dollars

- Extending the PPA's incentives for gifts of qualified conservation property

- Making Indian tribal governments qualified recipients of charitable contributions of certain gifts of food by businesses

As part of our commitment to a positive agenda to enhance philanthropy, I am very pleased to share with you the news about the establishment of a Congressional Philanthropy Caucus. I applaud the leadership of your colleagues, Representatives Stephanie Tubbs Jones (OH) and Robin Hayes (NC) for establishing this bipartisan caucus and serving as its House Co-chairs. The goals of the Congressional Philanthropy Caucus include informing Members of Congress and congressional staff about foundations and the important role that foundations play in our communities and around the globe, as well as identifying issues of mutual interest to the philanthropic sector and lawmakers. A Dear Colleague letter was circulated July 12th so we encourage you to join.

Turning back to the main topic of this morning's hearing, we must find a way to work together to produce healthier communities, more educated children, higher rates of employability and employment, decent housing, and compassion for those who cannot compete. Sustainability is the measure of outcomes, of change actually achieved—not only to make a difference, but also to make it again and again. Healthy children and communities are not "programs," nor are they mere ideals. They are outcomes that flow from hard and sometimes dangerous work, results that are earned by sweat and sometimes blood. Communities are not clouds that drift by or wishes that go gently to sleep; they roar with traffic and crying children, they grow with investment and a neighbor's sturdy nature; they shrink and collapse when poverty grinds them down. They burn when we are so angry we no longer have hope. They are resurrected when leaders come forward with integrity and a vision built on better knowledge, keener listening, greater diversity, and a commitment to finer outcomes. Together we must allow the creative energy of philanthropy to fulfill every donor's dream of a better world.

Chairman LEWIS. Thank you very much, Mr. Gunderson.

Mr. Miller, in your written statement, you discuss compliance in the sector. Is the charitable sector generally compliant with the tax law?

Mr. MILLER. I think that is a fair statement, Mr. Chairman.

Chairman LEWIS. Will you go further to say that it is very compliant?

Mr. MILLER. I believe that probably remains correct. As we try to quantify the level of compliance, the only comment I would make is we have not yet done a national research program to truly baseline the level of compliance here, but in our view and in our findings throughout our examination process, I would hazard that very compliant remains correct.

Chairman LEWIS. Mr. Czerwinski, your testimony indicates that the number of charities has grown 30 percent in the past 6 years. Has there been a 30-percent increase in the number of employees and volunteers?

Mr. CZERWINSKI. That is a very good question, Mr. Chairman, because we don't have precise data on these. What it points out is the limitation of the understanding that we have of this sector. Obviously, those numbers have grown, and that is one of the things at GAO that we would like to be able to do, is to try to get a more precise handle on that.

Chairman LEWIS. Why has Government been increasingly partnering with nonprofit organizations? Do you think this trend will continue in the future? If so, why?

Mr. CZERWINSKI. Oh, absolutely, Mr. Chairman.

Chairman LEWIS. This is local, county, State, and Federal; government at all levels.

Mr. CZERWINSKI. Yes, Mr. Chairman. What we see is a delivery mechanism that more and more involves all levels of Government and other players such as nonprofits. As the Federal Government is facing a fiscal condition of deficit, it looks for more partners to help with that burden, and nonprofits have proven themselves to be very effective players in that.

So, this is a trend that we have seen going on for the last number of years, and it will probably increase and accelerate.

Chairman LEWIS. Ms. Aviv, your testimony states that it would take nine million employees to replace the service performed by volunteers. Has this been increasing over the past few years? What challenges are charities facing in finding volunteers?

Ms. AVIV. Mr. Lewis, I think what I was trying to convey in my testimony is that there are the equivalent of—the number of volunteers there are the equivalent of nine million professionals. I think the charitable sector depends on both the work of full-time professionals, part-time professionals, and volunteers. It was just one way to quantify what the value was and how many volunteers we depend on.

What we have seen, though, in numbers that are of concern to us is that the number of volunteers volunteering in charitable organizations is going down. In 2004, it was 64.5 million, in 2005, 65.4, and 2006 61.2. While we see that from time to time the number of volunteers may increase in response to a crisis, the overall numbers are going down. We are a little concerned about that.

Chairman LEWIS. Mr. Gunderson, I applaud the work of foundations. I have seen the good work in places all across America, but especially in my city of Atlanta. I know the foundation you mentioned, the Arthur Blank Foundation. They help create unbelievable opportunities for children, for young people, to get an education.

How do your members determine the needs of a community?

Mr. GUNDERSON. Very carefully and very strategically. In most cases, especially at our community foundations, they would have boards. Their boards, first of all, are chosen from the community, so they seek to represent and reflect the community that they serve.

Many foundations, including our private foundations and even many of our corporate giving programs, have created their own advisory committees that will allow them to better hear from the community, especially the areas in which they choose to serve.

For example, some foundations will fund just education. Some will fund health care. Some will fund recreation or the environment. They try to specialize and bring in those kind of resources in ways that best reflects the needs of the community they seek to serve in conjunction with the mission of their foundation.

Chairman LEWIS. Mr. Kutz, let me ask you, do you have any idea what is the best way to promote self-regulation? Is this a question that they should be responding to in the private sector?

Mr. KUTZ. I wouldn't have any opinion on that, no.

Chairman LEWIS. Thank you. Let me now yield to the Ranking Member for questions.

Mr. RAMSTAD. Well, thank you, Mr. Chairman. I want to thank all the witnesses again.

Mr. Kutz, I must say I was blown away when I first learned about the 55,000 exempt organizations that are delinquent in taxes and owe nearly $1 billion. Then you say in your testimony that those numbers are understated. At the same time, you conclude, which I think speaks well for the sector, for nonprofits generally, that the vast majority of exempt organizations pay their taxes, to quote you.

First of all, how many tax-exempt organizations are there in this country?

Mr. KUTZ. I believe in the database of active ones for IRS, there was 1.8 million.

Mr. RAMSTAD. 1.8 million. So, of the 1.8 million, 55,000 exempt organizations are delinquent?

Mr. KUTZ. That's correct.

Mr. RAMSTAD. Well, you also state that more aggressive action is needed by the IRS. You alluded to the need for some criminal investigations. Do you think any changes in law, in Federal law, are also necessary?

Mr. KUTZ. No. I think the more aggressive criminal action is necessary on the payroll tax cases. We have referred several hundred of those over the last 5 years to the IRS related to government contractors, Medicare providers, et cetera. We do believe some aggressive action, making some examples of those people.

On the collections side, I also think that with these types of people, who are real fraudsters—these aren't your average American taxpayers—more aggressive seizures and levying of asset sources should be done.

Mr. RAMSTAD. So, it is not different from any other problems. A few bad apples, unfortunately. Well, I think it is important to point out the vast majority of exempt organizations pay their taxes, are contributing a great deal to this country, to the people in need in this country, as has been pointed out, as we all know.

So, I just hope that the headlines coming out of this hearing don't just concentrate on the bad apples because that would diminish the good work that is being done, but at the same time, I also think your recommendations that the IRS needs to take more aggressive action against the bad apples is well taken.

Let me ask you, Mr. Miller, do you have a mechanism in place to identify officials at exempt organizations who aren't paying their taxes? Are there some actions taken against them or for those executives otherwise abusing the Federal tax system? Why aren't you being more aggressive and taking action against these bad apples?

Mr. MILLER. Well, if I understand the question, Mr. Ramstad, we generally don't, as a part of our determination letter process up front, do tax checks on key individuals. That would be fairly burdensome on the organization and fairly burdensome on the Service, and would slow down an otherwise already pretty slow process of pushing through determination letter requests.

On the enforcement side, when these organizations do get into trouble, I think it is important to say that exempt organizations, in terms of collection, in terms of most employment tax issues, are remarkably similar to the balance of our taxpaying public. That is, there are some bad apples out there. They go into the collection queue, and they are treated like other taxpayers at that point.

So, some do sit in the queue too long, and that is a function of resources.

Mr. RAMSTAD. But whatever percent 55,000 is of 1.8 million is about proportionate to the broader——

Mr. MILLER. I don't think I can say that. I think I could look at—I have got to get back to you on that if I am correct on that, but our sense is that the exempt organizations' function, that those organizations are roughly equivalent in terms of getting into problems as other small businesses, or large business, for that matter.

Mr. RAMSTAD. Well, let me conclude before my time runs out. I want to get back to Mr. Kutz for one question.

In your written testimony, you indicated that 1,200 of the delinquent tax-exempt organizations received over $14 billion in Federal grants. I would like to see this money going to those that pay their taxes. That just doesn't make sense.

Can't the granting agencies—isn't there some way to identify applicants that have a Federal tax debt before issuing the grants?

Mr. KUTZ. It is a self-reporting process. There is a form that is filled out. It is SF–424. It has a box that says, "Do you have other Federal debt?" Five of our 25 case studies said no on the box. Even if they had said yes, I am not sure there is a mechanism for the agency, such as the Department of Health and Human Services (HHS), for example, to validate that. So, right now it is a trust but do not verify system, and so people, grantees, who have significant tax problems get Federal dollars.

Mr. RAMSTAD. Again, I thank the panel. I yield back.

Chairman LEWIS. Thank you. Now turning to Mr. Pascrell for questions.

Mr. PASCRELL. Thank you, Mr. Chairman. I would like to associate myself with your questions and the Ranking Member. I think they go to the heart of much of what we are going to be talking about today.

Mr. Gunderson, if you would, the Treasury Department asserted recently that nonprofits are a significant force of financing terrorists and their organizations. Do you agree with that assessment, and what is the COF's view of the Treasury Department's voluntary anti-terrorist financing guidelines?

Mr. GUNDERSON. Thank you for the question because this is an area of great concern for us, especially at a time in which international grantmaking is rising because of the concerns about people all over the globe.

Out of hundreds of thousands of U.S. charities and billions of dollars given in grants in material aid each year—listen to this—only six U.S. charities are alleged to have intentionally supported terrorists. Thus far, Treasury has not identified a single case of inadvertent diversion of funds from a legitimate U.S. charity to a terrorist organization.

The principle difficulty that we and our sector has with the Treasury guidelines is that they call on charities to collect a prodigious amount of information about their grantees, much more than legally is required, and there is simply no evidence that legal charities or legal foundations are in any way engaged in funding terrorist actions.

As a result of that, we have asked as a part of a coalition that Treasury withdraw those guidelines in order that we might sit down and work together to try to resolve the concerns that they may have and that we have about appropriate administration in this area.

Mr. PASCRELL. So, we painted with a wide brush about certain organizations, particularly in terms of international events. Yet there has not been a single example? Why, then, does the Treasury point to certain organizations if they are not willing to come forward with specific examples?

Mr. GUNDERSON. That might be a question we have to ask Treasury because it is one we are also trying to find out. The Council on Foundations leads this coalition trying to work with Treasury. We have had numerous meetings. They will admit we have had meetings. We continue to offer them various suggestions for remedial action. Thus far, they haven't responded to any of that.

As you may or may not know, and I will share for the record, we have recently submitted a letter to the Senate, Senator Lieberman's Committee, asking that they take some action on our behalf to try to stop what we believe has been the nonresponsiveness of Treasury on this whole area.

Mr. PASCRELL. What are the six organizations?

Mr. GUNDERSON. I would have to provide those for the record. They were six domestic Muslim charity organizations.

Mr. PASCRELL. There is no examples or proof that you know of, anyway, that any of these six are engaged in very specific activities which are contrary to the constitution and contrary to this U.S. Government?

Mr. GUNDERSON. No. If I understand, part of the issue has been that when you make international grants in certain areas, they automatically become suspect, certain regions of the country.

Mr. PASCRELL. Right.

Mr. GUNDERSON. Nobody supports the abuse if there is direct funding. We don't believe that is the case. Now, we are not saying that there hasn't been a violation. We are saying the American charitable sector is not engaged in this.

Mr. PASCRELL. What are the key indicators, Mr. Gunderson, to measure diversity in philanthropy, and how can we use these indicators to hold foundations more accountable to all communities?

Mr. GUNDERSON. You should know, Congressman, that we have made the increase in diversity a major focus of my leadership of the Council on Foundations. I think I can speak for Diana. The two of us jointly are making this a major initiative in the nonprofit sector.

Our board has just approved a major initiative that will include not only the hiring of a director of diversity and inclusive practices—the person has already been hired and will be on board as of August—we have approved an agenda which includes a philanthropy corps, emerging philanthropic leaders fellowship program, an education program, even an international area, and research in this area.

What are the indicators? I would suggest that you need to look at a series of them. You need to look at the diversity on our boards. The diversity on our staffs. You need to look at diversity in grantmaking, but of course, the metrics you use for that are not easily defined. We are certainly working with Greenlining and other organizations to try to determine what is the appropriate metrics to use in this area.

Mr. PASCRELL. Thank you. Thank you, Mr. Chairman.

Chairman LEWIS. I thank Mr. Pascrell for his questioning.

Now, Ms. Tubbs Jones is recognized for her questioning.

Ms. TUBBS JONES. Thank you. Thank you, Mr. Chairman. We only have a few minutes, so I am going to ask everybody that I ask questions to be short, like when I was in court as a prosecutor.

I am going to start with Mr. Kutz. Mr. Kutz, I am a former district attorney and a former judge. Looking at these numbers you threw at us—55,000 exempt organizations—it would have made a great TV ad for me as prosecutor until you told me that that's only 55,000 out of 1.8 million organizations. I am not a good mathematician, but it comes up to about 3 percent.

So, don't you think it would have been as good in your report and summary to tell us that there are 1.8 million exempt organizations before you threw out this 55,000 that you prosecuted? All due respect to you doing that, but don't you think that would have been a good thing for you to do for Members of Congress?

Mr. KUTZ. We have done that in the past when we have done government contractors. The problem here was that denominator of 1.8 million. A lot of those entities don't have any tax responsibility. So, we had a hard time determining whether it was 3 percent, 2 percent, or 5 percent, but I think that is a good point, and it is several percent, but it is very similar to government contractors, Medicare physicians, and other things that we have looked at.

Ms. TUBBS JONES. Right, but the point being that you are Managing Director of Forensic Audits and Special Investigations. As a forensic auditor, it is your job to be able to get the numbers running. Right?

Mr. KUTZ. Correct.

Ms. TUBBS JONES. Thank you.

Let me go to you, Mr. Miller. Can you tell me it was the IRS' recommendation that nonprofits not be able to receive tax exemption from donor-advised funds?

Mr. MILLER. I am not sure that is an IRS recommendation.

Ms. TUBBS JONES. It is the law. Maybe it wasn't an IRS recommendation, but what do you think about it?

Mr. MILLER. I think, generally, donor-advised funds are permitted to be 501(c)(3) organizations. I would agree——

Ms. TUBBS JONES. It is not that they would not be permitted to be 501(c)(3) organizations. It is the fact that the money that comes from donor-advised funds is not permitted to be given as a charitable contribution.

Mr. MILLER. Under the IRA rollover, you cannot give—they are excluded from the IRA rollover rules. Is that——

Ms. TUBBS JONES. Yes. That is what I meant.

Mr. MILLER. Yes. I got you, ma'am. I can't speak to why that is. I would say that there probably was some concern on the Hill and otherwise about what was happening in some of the areas with supporting organizations and donor-advised funds.

I would also note that, actually, that particular delineation, the difference between donor-advised funds and supporting organizations, existed pre-Pension Protection Act when we had a different rule for the Katrina and New York victims as well, I believe.

So, I can't speak—really, Congress spoke to that. It was not a Treasury-inspired rule.

Ms. TUBBS JONES. You know Congress doesn't speak to anything until we have an opinion from the Treasury or the IRS, or we have a hearing and we get all this background information, and somebody says to us this is what we ought to do.

So, what I am asking you, Mr. Miller, is as we think about rethinking that decision, are you willing to try and take a look at whatever you have oversight of and give us some good advice and counsel as to how we can get additional dollars into charitable organizations in a much smoother process than currently exists with the IRA rollovers, et cetera, et cetera?

Mr. MILLER. Absolutely.

Ms. TUBBS JONES. Thank you very much. I think I am—oh, I got time. I got time. Okay.

How would you suggest, Ms. Aviv, that we work on increasing philanthropy in the United States? The statistics say that back in the day, people had lots of money and they gave to a lot of organizations. That seems to be diminishing. I am almost out of time. Give me some suggestions of what we could do.

Ms. AVIV. Well, one very quick way that we have been talking about is to expand and extend the IRA rollover so as to enable people not only to——

Ms. TUBBS JONES. I already made that point. Come up with something else.

Ms. AVIV. One of the other issues that I raised in my testimony related to these and the Small Nonprofit Administration. One of the reasons that we see that charities don't fare well in response to the GAO study is not only because there is bad intent but also because there is ignorance or people simply don't know or are unaware of what they are supposed to do.

So, to the extent to which we can educate people to understand how to run their operations, how to fundraise, how to do all of the things to make them more effective, I think that we will be able to increase philanthropy and nonprofit organizations.

Ms. TUBBS JONES. Thank you. For the record, Mr. Chairman, I just want to be clear that I think that we ought to prosecute those who abuse the process. I don't want anybody to think that I am not supporting that. I just know that when we do that, it has an impact on the other organizations that are doing a great job.

I thank you, Mr. Chairman, for the opportunity.

Chairman LEWIS. I thank the gentlelady for her questioning.

I now turn to Mr. Becerra for questioning.

Mr. BECERRA. Thank you, Mr. Chairman. Thank you all for your testimony and getting to see many of you again.

Let me first say I think the work that many of our charitable organizations do is just phenomenal, and I hope that we do everything here in the Congress to incent the establishment of other charitable organizations that will continue to do that good work, and that we continue to have organizations that will abide by the tax rules and hopefully help make sure that they understand, and especially the smaller organizations, which may not have the sophistication to get out there and make sure that they are on top of every single change in the tax laws. I hope that you will help us make sure that the Congress is constructive in that regard.

Having said all that, I would like to now focus on just a couple of issues of concern I have with regard to the charitable work that some of these organizations do. I would like to first find out, having experienced some of this myself, and Ms. Aviv and I have gone through this a bit with the Smithsonian Institution, if you can tell me whether or not there is anything in current law that restricts what a 501(c)(3) tax-exempt charitable organization can do with regard to employee compensation.

Mr. MILLER. Perhaps I can start, sir.

Mr. BECERRA. Mr. Miller, also, as Ms. Tubbs Jones said, if you could just try to be straight to the point. Otherwise I will run out of time.

Mr. MILLER. That is difficult, but I will try.

Mr. BECERRA. I will probe. If I need more, I will probe.

Mr. MILLER. For public charities, there is Section 4958, which states very specifically that compensation, high compensation, is fine. Over fair market value compensation is not, and gives rise to an excise tax and potential revocation.

Mr. BECERRA. Fair market value is some——

Mr. MILLER. Similar compensation to other like compensations.

Mr. BECERRA. In similar organizations?

Mr. MILLER. Similar organizations, for-profit or nonprofit, however.

Ms. AVIV. Congressman, what most large nonprofits do—smaller ones, it is maybe harder for them to do—is to hire outside consultants to take a look at similar organizations, like size, region, budget, work, and so on, try and do it within the sector even though they have the right to do it outside of the sector, and then compare to see that it is reasonable.

Mr. BECERRA. Understood. What about for private foundations? Is there any restriction?

Mr. MILLER. A similar rule would apply.

Mr. BECERRA. Would apply?

Mr. MILLER. A different statutory basis, but a similar rule.

Mr. BECERRA. So, in either case, public charities or private foundations, there is this reasonableness test that is used?

Mr. MILLER. Yes.

Mr. BECERRA. Okay. Thank you. What about with regard to expenditures by the organization?

Mr. MILLER. I am not sure where you are going with that one, Congressman, so——

Mr. BECERRA. I see a great-looking BMW in that photograph down there.

Mr. MILLER. If it is being provided as compensation or it is being provided to someone and would be treated as compensation, it would go into the matrix of determining whether that was reasonable.

Mr. BECERRA. But what if it is being used by the charity to dole out food to the poor?

Mr. MILLER. That becomes a more difficult sort of test.

Mr. BECERRA. So, how do you decide if a BMW should be a vehicle that is used to dole out food to the poor?

Ms. AVIV. Congressman, we think that the responsibility of boards is immense. If boards aren't minding the store, we have a serious problem. In a case where a board is allowing for a BMW or a car of that nature or a car that is very expensive to be used when that money can be used in a different way, I don't think that that board is fulfilling fiduciary responsibility.

Mr. BECERRA. Other than the laws that require fiduciary responsibility to be assumed by the board members, is there anything else that can be done under law to try to prevent that type of activity?

Ms. AVIV. When it comes to the area of compensation, we have argued and——

Mr. BECERRA. Not compensation, but just in the utilization of tax-exempt dollars for carrying out the purpose of the charity in terms of expenditures. How can we make sure we have got a grip on that?

Mr. MILLER. If I could jump in, Congressman, two things. One, I agree 100 percent with Diana in terms of we need to ensure that the boards are managing appropriately and are accountable. Part of that is making sure that sort of expenditure, which is an obnoxious type of expenditure, shows up somewhere for the public to take a look at. So, that can be a reaction.

Mr. BECERRA. Some form of transparency.

Mr. MILLER. Correct.

Mr. BECERRA. Maybe some type of audit team. Maybe a periodic audit team might help.

Let me ask one last question. How do you decide what is charitable? Helping the poor? Helping children? Housing for disadvantaged people? Opera? Is there any way that we track what is being given charitably to different types of entities?

Ms. AVIV. Congressman, there are a lot of stats—and I will be happy to provide them to you—on the tracking of what is given to charities. In fact, we have seen a change in individual donations over the last few years in which, in the last year, the reports that we have are that the funding going to low-income organizations from individuals is much lower than the funding going to arts and culture institutions and higher education institutions.

So, when we see even the money being flat or slightly going up, that doesn't tell the full story until we look beneath the surface to see. One of the reasons why organizations serving low-income people are so concerned is partly because of individual donations not coming in their direction, and partly for concerns that other government priorities are not allowing public funds to flow to them so that the needs of their constituents or their members are rising, and there isn't the funding to support them.

Mr. BECERRA. Thank you. Mr. Chairman, I will conclude by saying I hope that as we continue to do hearings on this, we will explore what Ms. Aviv has just pointed out a little bit further. I do believe that while we want to support charitable giving, that we want to make sure that it really is serving a public purpose. I thank all of you for your testimony.

I yield back, Mr. Chairman.

Chairman LEWIS. I thank the gentleman for his questions.

I turn to Mr. Neal for questions.

Mr. NEAL. Thank you very much, Mr. Chairman.

I don't know if you are familiar with the series that the Boston Globe did a couple of years ago about what was happening with some of these old-line families and what they were doing with the money. In fact, they had given little if any of it away. Upon further examination, they were paying themselves some pretty good salaries.

What was striking about it is that frequently those are the people that preach sacrifice and hard work for the rest of us. The series, as you know, highlighted not only the fact that they were paying themselves pretty good salaries, they were paying other family members pretty good salaries. In fact, it gave new meaning to the term "the leisure class."

Mr. Miller, what is the overall compliance rate by tax-exempt entities as being made comparable to taxpayers?

Mr. MILLER. We don't have—as I mentioned in a discussion earlier with the Chairman, we don't at the current time have a baseline, a compliance baseline. Part of the 2008 budget, in fact, is to fund the beginning of exempt organizations research program to try to get that baseline. So, it is a hard thing for me to give you a precise answer to.

Mr. NEAL. So, it is hard to suggest that we should create more oversight without overburdening the majority of charities that do the right thing?

Mr. MILLER. I think we need to be careful in those areas we choose to act in.

Mr. NEAL. What type of feedback have you received on the Form 990?

Mr. MILLER. The new form has received a world of feedback, and I expect that to continue, much of it positive. All of it, so far, in my mind is constructive. Even though individuals have differing ideas as to what we should put into the hospital schedule, for example, or onto the summary first page they have been very constructive in their comments.

So, it is all positive to date, including a discussion we had late last week with the Independent Sector. I expect those discussions to continue with the Council on Foundations as well.

Mr. NEAL. How many of you read that Boston Globe series? Would you like to comment on it, Ms. Aviv?

Ms. AVIV. Sure. I think that the Boston Globe series was a wakeup call to the charitable sector of our responsibility to take a look at existing law and see whether existing law covered those kinds of practices, and whether this was an issue of inadequate oversight and enforcement or whether in fact there were gaps in the law that would allow unscrupulous individuals to come into our sector and take advantage of the charitable sector's tax-exempt status to enrich themselves.

As a result of that work, Independent Sector convened a group of 24 leaders, including the Council on Foundations, to come together to think about these issues. We worked closely with Congress to take a look at what needed to be done. The leadership on the Senate side invited us to—encouraged us to form a panel on the nonpublic sector. We came up with over 130 recommendations of how to engage in better oversight that both Congress, the IRS, and the sector itself should do to deal with this.

We took those issues very seriously, and notwithstanding the fact that it was only a small number of people, since we depend on the public trust to do our work, if in fact the public believes that this is the kind of thing that is allowed and going on, it undermines the integrity of all organizations. For that reason, we saw this as we are each other's keepers, and we were quite public about it.

Mr. NEAL. A small number of people but a lot of money.

Ms. AVIV. A lot of money and a lot of concern because if that is what the public is reading about the charitable sector and not about our good works, that won't help us raise the kinds of funds we need to serve the needs we have.

Mr. NEAL. Mr. Gunderson, you seem very anxious to answer as well.

Mr. GUNDERSON. It is probably my worst nightmare in this job. There are 71,000 foundations in America. There are probably ten that you and I can name that have been the focus of exposés in the Boston Globe, the Washington Post, the L.A. Times, et cetera. Those ten right now are defining the public trust, the credibility, and frankly, the regulation of our sector.

What we have to do, as I said in my testimony, is find that balance. The organizations that were exposed in the Boston Globe, it would be easy for me to come here and tell you they are not members of the Council of Foundations. They are not. That doesn't solve the problem.

The general public reading that says, they are a foundation. They created the problems that led to not only the panel, they led to the recommendations that you passed in the Pension Protection Act. We need to find that balance to get at the intentional abuse of the public trust while finding the balance that doesn't thwart the 70,000-plus foundations who are engaged in what is a noble effort of enhancing the common good.

How do we find that balance? It has to be a partnership on both sides of this dais.

Mr. NEAL. Thank you, but Ms. Aviv, she mentioned—she said, look. This has been unscrupulous behavior. Are you suggesting that unscrupulous behavior could go on for decades?

Mr. GUNDERSON. That it has gone on for decades?

Mr. NEAL. Yes.

Mr. GUNDERSON. It has, and unfortunately, I think it will. The reality is it is no different in the nonprofit sector than all of society. There are always people who try to get around the law.

What we have at the Council on Foundations, in order to become a member of the council, you have to sign a code of ethics statement to become a member. That gives us a carte blanche ability to go in and investigate. We have done so. We investigate any charge, anybody—the press, an anonymous complaint, a Member of Congress. Anybody can file a complaint against a member foundation.

We will investigate that charge to see whether there is cause. If there is cause, in our own internal ethics procedures, we will then turn that over to a formal ethics process and sanctions process within the council. So, we go beyond the law to deal with what we call immoral, inappropriate conduct.

For example, the Getty. The Getty didn't necessarily violate the law, but by gosh, what they did was certainly inappropriate. We put them on censure—excuse me, on probation—at the Council on Foundations until they cleaned up their act. They cleaned up the governance that Diana was talking about earlier.

So, we take this public trust very seriously.

Ms. AVIV. Congressman, can I just add one point on that? The Panel on the Nonprofit Sector is about to come up with 33 recommendations of how we can better regulate ourselves. We had an experience—Congressman Becerra knows this experience very well—with the Smithsonian, where when the issues were raised publicly about the Smithsonian, the governance committee took those 33 draft principles and looked at their own practices relative to the set of standards that we had.

At the same time, they had an independent review committee looking at some of the practices. The governance committee, looking at the 33 principles and the gaps between their own practices and those principles, then came up with a series of recommendations of how they need to change.

Those recommendations were virtually identical to what the independent review committee did, which suggests to us that if organizations move forward and embrace a broad set of principles supported by the sector as a whole, we may not need additional legal oversight, Federal oversight, of the kind—or additional laws to get there because we can get there ourselves. It is up to us, though, to step up and do that.

Mr. NEAL. I thought the Globe series was most enlightening, and I must tell you, it raised eyebrows across much of the Northeast.

Thank you, Mr. Chairman.

Chairman LEWIS. Thank you for your questioning.

It is my understanding that, Mr. Becerra, you may have a question, and Mr. Pascrell. Okay. Mr. Pascrell?

Mr. PASCRELL. Thank you, Mr. Chairman.

Mr. Kutz, I don't want you to get the opinion today from the questions that any of us are not interested in examining not necessarily lifestyles but certainly the records of chief executives who draw down a tremendous amount of dollars to themselves. You have investigated many areas, and knowing your other backgrounds and other committees, I know you have done a great job.

None of us are minimizing what you are doing, although we would all conclude, I think, that this is a very small reflection of what is going on out there in philanthropy throughout the United States. Would you agree with me?

Mr. KUTZ. Yes. I would agree with that.

Mr. PASCRELL. Mr. Gunderson, the current IRA rollover—and you explained to us what that means in and of itself—but that incentive certainly does not prohibit donors from making distributions to community foundations. They just can't make the distributions to donor-advised funds or supporting organizations.

How am I doing so far?

Mr. GUNDERSON. You are absolutely correct.

Mr. PASCRELL. What makes the donor-advised funds and supporting organizations so essential that we should remove that particular limitation?

Mr. GUNDERSON. That is really a great question because the initial question is, why wouldn't they just give to the community foundation?

Mr. PASCRELL. Right.

Mr. GUNDERSON. Every donor has an interest. They have a passion—education, children, health care, the parks, recreation, et cetera. Through a donor-advised fund, you are able to advise your funds without setting up your own private foundation and having all of the rules, regulations, legal work, and the costs of administering that foundation.

So, there is a real—it is that perfect blend. It is what I call democratizing philanthropy. It allows people with a little bit of money—most community foundations in America will take a donor-advised fund of $10,000. Some will go less than that. So, people can give to this that don't have super-wealth, but they can target the direction of it.

They can't have total control. Once it is given, they have lost that control. That is why we have the charitable incentive at that point in time, but they can say, this is the focus, rather than just saying, here is the money. Use however you wish.

Obviously, a donor has a passion. This is that vehicle to meet the passion, but to also increase philanthropy.

Mr. PASCRELL. So, you would not remove the limitation?

Mr. GUNDERSON. Oh, I absolutely would.

Mr. PASCRELL. You would?

Mr. GUNDERSON. I plead with you to remove it. Let me tell you why. We are at that unique moment in time where over the next 10 to 20 years, we are going to see a significant transfer of wealth. There is a study by the Nebraska Community Foundation.

Mr. PASCRELL. Yes. You mentioned that in your presentation. I want you to define what you mean by that transfer of wealth.

Mr. GUNDERSON. Transfer of wealth? It is literally the transfer of whatever our assets are. We now have the World War II generation and the baby boom generation both beginning to transfer their wealth. As Mr. Kind can tell you, we come from rural America. In my home county, the average transfer of wealth is only $48,000. That is what the projection is. It is not rich. It is not a lot.

That times every citizen in the 25- to 30,000 people living in that county becomes real money. If we could just get them to say 5 percent of that transfer of the value of my farm or my home when I die will go to the community foundation, imagine the resources that we could capture to use over and over again for the public good.

That is what we are talking about here. The Nebraska Community Foundation did a study in Nebraska that in 25 percent of the counties in Nebraska, the maximum transfer of wealth will occur in the next 6 years. That is because of the aging population in rural America. We will either capture some of this transfer of wealth today or we will lose it.

It is our only opportunity, that window of opportunity. That is why I get so passionate and urgent about it. It is sort of like a now or never kind of thing.

Mr. PASCRELL. I think—I am sorry.

Mr. GUNDERSON. Go ahead.

Mr. PASCRELL. I think we could have a panel and discussion and a hearing just on the transfer of wealth—its ramifications, how the tax structure over the past 30 years has changed in terms of taxing income and assets. Certainly the poor and the middle class are not in as good a position as they were 30 years ago percentagewise. A very dangerous situation, but interesting, and will have implications on charitable organizations throughout the United States of America.

Mr. GUNDERSON. I really want to work with you on this, Congressman, because the experts—and I am not one—suggest that if you are going to start a private foundation, you really ought to have at least $5 million to make it efficient and all those kinds of things. I don't know if that is right or wrong. That is what other people say.

A donor-advised fund, $10,000. Just look at the difference. If you want ordinary people to have the chance to give something to philanthropy, you have got to open up the donor-advised fund as that giving opportunity.

Mr. PASCRELL. Thank you.

Chairman LEWIS. Thank you. Mr. Becerra?

Mr. BECERRA. Thank you, Mr. Chairman.

Mr. Miller, let me ask a few questions about the efforts of the IRS to obtain compliance by the charitable organizations. I know that your budget request submitted to the Congress by the President increased your funding, not just IRS' funding the funding in particular for purposes of compliance and enforcement on the charitable organizations side, by a pretty good amount, and that a good portion of those dollars would be allocated to the examination program and determinations program.

Can you give me a sense of how the determination program when this entity is first applying for this tax-exempt status helps ensure that we actually do have a not-for-profit that will be formed that really will conduct a public purpose?

Mr. MILLER. Absolutely, Congressman. We receive about 55,000 new organizations into us annually, about 86,000 pieces of work into the determination stream but 55,000. The vast majority are 501(c)(3) organizations.

Again, for the vast majority of those organizations, it is the only time we will ever have a real one-on-one conversation with them. That is our chance to educate and get them on the right path. That——

Mr. BECERRA. But if it is a family foundation, as my friend from Massachusetts pointed out, where we have seen some problems, what are your folks looking for in assessing these family foundations and at that determination stage?

Mr. MILLER. They would be looking to see how it was operated or how it was proposed to be operated and how it was organized.

Mr. BECERRA. Do they have to state at that point what their compensation package will look like for employees?

Mr. MILLER. In some detail, not in great detail. They have to set forth their proposed budgets for 3 years, and they have to give us enough information that we can see that there is not an immediate problem.

Part of that is explaining to them what the rules are. With respect to a family foundation, there is a wide array of rules. The private foundation regime is much more restrictive in what you are permitted to do than the public charity.

Mr. BECERRA. Now, under the examinations program, your testimony says that in fiscal year 2006, you conducted 7,079 examinations of returns by tax-exempt charitable organizations. That includes the public charities and the private foundations?

Mr. MILLER. That includes both—that includes our examination program out of our Exempt Organizations function. It does not include, however, our new compliance contact program, which is about 5,000 more organizations.

Mr. BECERRA. Let's stick to this for just a second. I want to make sure. Seven thousand seventy-nine tax returns of what universe? Is that the 71,000 foundations that Mr. Gunderson mentioned, or is it the 1.8 million tax-exempt organizations which I think were identified?

Mr. MILLER. It is of the 1.8, but quite frankly, it is actually of—the Internal Revenue Service—and where you are going is coverage, I suppose.

Mr. BECERRA. Yes.

Mr. MILLER. Our coverage rate is half a percent or something like that. It is not enough.

Mr. BECERRA. So, one-half of 1 percent of all the tax-exempt charitable organizations might find themselves examined, having their tax returns examined?

Mr. MILLER. Right.

Mr. BECERRA. How does that compare to the taxpayer auditing side?

Mr. MILLER. On the for-profit side, it will depend on the particular type of return. Individuals are higher, but not by much. Large corporations much higher. It will really vary. It is on the low end. Let's put it that way.

Mr. BECERRA. Is the money you have and the resources you have sufficient to provide the deterrence that we need to make sure that more of these organizations are doing the good work that would make Ms. Aviv and Mr. Gunderson proud?

Mr. MILLER. I think we are getting there, Congressman. You mentioned at the beginning the 2008 budget. The 2008 budget gives 6.3 percent to the IRS generally. My function, Tax Exempt and Government Entities, gets a 7.3-percent increase. Actually, Exempt Organizations gets 9.7 percent.

It would be hard for us to take much more than that in a given year, but we are building up the number of people we have.

Mr. BECERRA. I hope you will continue to give us ideas on how to make this work better because we are not interested in going after or causing heartburn for those organizations that are doing tremendous work out there. Obviously, when you do this in an objective manner and in a random manner, in some cases, you catch the good folks and hopefully they are able to survive an audit without too much hurt.

I think it is necessary for us to uphold the good name of charitable giving, and for us to be able to then do the best job of weeding out the bad apples as quickly as possible.

Ms. AVIV. Congressman, that is one of the reasons why we are recommending and the panel is recommending having mandatory electronic filing. The IRS is able to do electronic filing of certain organizations, but need the legal authority to do it all.

Since we believe that with transparency and the fact that people will be much clearer about how they have to fill out those forms, in addition to reforming the 990 forms themselves, also having mandatory electronic filing will go a long way to solving the problems.

Mr. BECERRA. Mr. Miller, do you know if the IRS takes a position with regard to mandatory filing?

Mr. MILLER. We actually—another piece of the 2008 budget is to increase our ability to require additional people to file electronically.

Mr. BECERRA. So, would IRS support that recommendation?

Mr. MILLER. Absolutely.

Mr. BECERRA. Does GAO have any problems? Do they see the value in that mandatory electronic filing?

Mr. KUTZ. I think it would add to the wealth of knowledge that we need.

Mr. BECERRA. Thank you, Mr. Chairman. Thank you all for your testimony.

Chairman LEWIS. Thank you.

I will now yield to the Ranking Member, Mr. Ramstad.

Mr. RAMSTAD. Well, thank you, Mr. Chairman. I just want to make three brief observations by way of concluding here.

First of all, we simply can't overstate the monumental contributions of tax-exempt charitable organizations. As has been said repeatedly here today, the Government can't take care of all the people in need. The charitable sector is essential. I know I speak for every Member of this Subcommittee, and the full Committee as well, when we say we appreciate the incredibly important contributions that the tax-exempt charitable sector makes.

Second, I want to state categorically that I believe, as again has been testified to here today, that the vast majority of exempt organizations are upstanding, are full of integrity.

Thirdly, I want to thank publicly the Council on Foundations, certainly the Minnesota Council on Foundations as well as the Council on Nonprofits, because those organizations really set the tone for the philanthropic community and you do it exceedingly well.

So, again, I thank all the witnesses. I think this has been a very good hearing today. I yield back the balance of my time.

Chairman LEWIS. Thank you very much, Mr. Ramstad. I want to join in also thanking each and every one of you for being here, for your contribution.

Before we close, I want to ask Ms. Aviv and Mr. Gunderson whether the foundation community and the Independent Sector have they the ability to respond in a timely manner when many of your boards of your different organizations and groups meet quarterly?

When you have a crisis like Katrina or some other major crisis, how do you get together and say, we have to do something in New Orleans, we have to do something in Atlanta, or something in New York or California. What happens?

Ms. AVIV. Congressman, Mr. Chairman, in addition to the three or four board meetings that most nonprofit organizations have a year, and some have less because they don't need them because of the nature of their business, most nonprofit organizations have many, many more meetings.

In the case of Independent Sector, we have many committees that convene all the time. When there is a crisis, we have the ability—and particularly with technology—to convene a large number of people or a targeted group of people to come together to address issues.

The big change that those groups have sometimes is that they don't have enough resources. They have plenty of ideas, but they don't necessarily have the capacity to implement all of the ideas. That is where the concerns about government funding—since it is easily over 30 percent of the sector's funding—why the concerns about declining government funding or declining individual donations is of concern to the sector.

I don't believe at this point the convening capacity and the responsiveness is the problem. It is more the resources that are available.

Chairman LEWIS. Mr. Gunderson?

Mr. GUNDERSON. Mr. Chairman, we have looked very carefully at philanthropy's response to Katrina because to be honest with you, while it was well-meaning, it was probably as chaotic as the Government we all criticized. We want to figure out how we can do that better. We have held some major forums at the council on this issue. We are now doing, as I mentioned in my testimony, a feasibility study to do one or two, probably two, things.

The first thing that we have learned is that what we really need to do when a disaster like Katrina occurs, we need to be able to get some of the best experts in our sector on the ground instantly to do an assessment from philanthropy's perspective to figure out what is the Red Cross doing? What is the Salvation Army doing? What is the Office of Emergency Preparedness doing? What does philanthropy need to do that they are not doing? So, that they can report back to our sector. So we are in the process of looking at how we create that philanthropic team that comes in and does that assessment and reports to us where and how that money should go.

The second thing we are looking at is that we have normally had this mindset—and I am certainly guilty of this, being new to this field—that we said, the charitable sector will do the immediate rescue and relief. They will go in and respond instantly. Philanthropy comes in and does the long-term rebuilding.

You know what we learned in Katrina? There is a middle ground that nobody was doing. For example, if you look into the Gulf area, in many cases, in order to qualify for government funding, they need funding in order to do the planning, the planning grants, to submit the grant request to the Government.

They don't have that. Nobody funds that. The Salvation Army doesn't fund that. The Red Cross doesn't fund that. So, all of a sudden, we have learned through this that philanthropy needs to come in up front much earlier than we thought we did in this process.

The third thing we are looking at is whether or not we ought to capitalize a fund that would be a national disaster relief fund so that if there is a tornado or a hurricane or a bombing or whatever that disaster might be, there would be some money ready available where this team of our experts who went in could then immediately access some of that money rather than going back to a community foundation or a family foundation or an independent foundation and starting to raise that money. That money would already be there.

We hope by October of this year to have done our feasibility study on this so that we will be able to take recommendations to our board to come up with some new strategies for philanthropy to better respond.

Ms. AVIV. Mr. Chairman, there was one other issue in relation to Katrina. I recall testifying a couple of years ago on lessons learned immediately after Katrina in the Senate Finance Committee. There was an opportunity to look at earthquakes, California's earthquakes or similar disaster, floods, all different kinds, the tsunami and this.

What was striking about the experience is that because of what Steve was talking about, the lack of time and resources to fund lessons learned and translate them into how to prevent some of the terrible aspects of what are natural disasters from occurring again, we don't do that.

The second part was that the relationships that need to be built in advance of disasters—and we know where the disaster areas are more or less likely to strike—there need to be much stronger relationships between local government officials, national charities and local charities, and charities and these national organizations, so that in planning, by the time it is chaotic when the disaster hits, all of their thinking has already gone into the plan so that the limited resources can be more efficiently used.

Chairman LEWIS. Again, I want to thank each and every one of you for being here. Your testimony has been very helpful to Members of the Committee.

Is there any other business to come before the Committee?

[No response.]

Chairman LEWIS. There being no further business, the hearing is adjourned. Thank you very much. I want to thank each member of the staff and all who were involved.

[Whereupon, at 11:41 a.m., the hearing was adjourned.]

[Submissions for the Record follow:]

Statement of Alliance for Justice

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 policymaking 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 109th 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[1] 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 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 lob-

[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.

bying 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.

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

Statement of American Association of Museums

On behalf of the nation's museum community, American Association of Museums (AAM), representing more than 2,700 museums of every type and 16,900 individuals and organizations professionally associated with museums, would like to thank you for the charitable incentives in Pension Reform Act, particularly the IRA rollover provision, and for some of the reforms in that legislation, such as the reforms of the appraisal process.

With respect to the IRA rollover provision, we strongly encourage you to extend and make permanent this provision, as noted in Independent Sector's recent testimony before the Committee and proposed in H.R. 1419. Along with the rest of the charitable community, museums' ability to maintain and expand their services to the public has already benefited substantially from this provision due to expire in December 2007. For example, an early AAM survey of museums, covering the period from August 2006 enactment to the end of 2006, revealed that about half of survey respondents had received rollover gifts, from $1,250 to several gifts of the maximum of $100,000, and that museum staff expressed concern about the need for more time for donor education and decisions about major gifts.

We must, however, raise some significant concerns on behalf of the museum community about the fractional interest provisions in the Act. We know you have received a letter from the Association of Art Museum Directors (AAMD) noting problems in this area. AAM wants you to know that we completely share those concerns, not just on behalf of the nation's art museums but on behalf of collecting museums of all types.

In brief, here are some of our chief concerns, many of which relate to creating new disincentives to donors to give, which is a key matter since *about 80% of the collections of American museums that collect have come from donations*:

1. The discouraging effect on donors of the growing disparity between market value and their subsequent fractional deductions. As you know, the Act replaces full market value deduction for each fractional gift with the lesser of full market or the market value at the time of the original fractional gift. Since virtually all museum-quality objects appreciate in value over time, the value of subsequent deductions now decreases over time compared to market value, with each subsequent fractional gift showing a greater disparity. This clearly discourages donors, especially those for whom the value of the gift very greatly exceeds their income in a given year, who are thus not good candidates for an outright gift of 100% interest.

2. The discouraging effect on donors of requiring that the gift be completed within 10 years. Under prior law, while museums had, and usually exercised, the right to hold and exhibit the object, a donor could keep the object in his or her home for a least part of a given year until death. The new law, especially where collectors had recently acquired the object, or collection of objects, discourages donors from making a commitment in the near term to a museum, thus eliminating both the short-term access to the object(s) by the public and the likelihood of longer-term 100% possession by the museum.

3. The danger to certain kinds of objects of mandating movement without exceptions. There are valid reasons for making exceptions—for allowing the museum to waive its right to take possession in some cases until it has 100% ownership—as was already decided in a 1988 court case, *Winocour v. Commissioner*. For example, if an object is extremely large and heavy, as is the case with much modern sculpture, the costs and difficulty of transportation are very great, and where an object is extremely fragile, as is the case with some art and other objects, it is not in the public interest to move it any more than is absolutely necessary. Similarly, when new collecting museums arise, or museums are renovated, they will, of course, frequently seek to acquire or continue to acquire collection objects before the museum building is built or renovated—before they can house or display the new objects, since museum buildings frequently take quite a number of years to design and build—so that when they open or reopen, they will have objects to show.

It is also important to bear in mind that while the above concerns most broadly affect the art museum community, the new law, if not adjusted, creates problems for other types of museums as well.

For example, museums that focus on history and culture, including the history and culture of ethnically specific groups, frequently find that the key objects they need for their collections belong to private collectors. Given the limited or non-existent funding for collection acquisitions at most museums, donations are critical in many cases, and when the objects are mostly acquired by the collector, and when the museum itself is expanding or under construction, as is often the case with the new ethnically specific museums, discouraging fractional gifts can be very damaging.

And in the case of natural history museums, often the key educational as well as scientific value of objects is in fact that they are part of a collection of related objects. Where the law tends to discourage fractional gifts, modest-income donors will be discouraged from donating an intact collection and have an incentive to break it up, destroying its educational value.

Changes to the fractional interest provisions of the law as expressed in the Pension Protection Act could address areas of legitimate Congressional concern without the unintended consequence of discouraging generous donors and endangering cultural objects in the cases noted above. On behalf of the whole American museum community, we join with AAMD in urging your consideration of such changes and would be happy to meet with you and your staff to discuss them.

In closing, AAM sincerely thanks you and Ranking Member Ramstad for your leadership as principal sponsor and co-sponsor of H.R. 1524, the artist's deduction bill, which would have a very positive effect on generating new donations of works to museums, and looks forward to working with you on the fractional gift and IRA rollover issues.

Statement of American Bankers Association

The American Bankers Association appreciates having this opportunity to submit written comments for the record of the Subcommittee on Oversight's July 24, 2007, hearing on tax-exempt organizations.

The American Bankers Association, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks—makes ABA the largest banking trade association in the country.

As the Subcommittee on Oversight (the "Subcommittee") undertakes its examination of tax-exempt issues this year, the ABA would like to take this opportunity to encourage the Subcommittee to review the Internal Revenue Service's ("IRS") regulation of issues relating to tax-exempt credit unions. In particular, we urge the Subcommittee to: focus on the IRS's activities relating to the application of the unrelated business income tax ("UBIT") to credit unions, and encourage the IRS to revise its tax-exempt group return regulations to require credit unions to file individual Form 990s.

Application of UBIT to State-Chartered Credit Unions

State-chartered credit unions are subject to tax on income earned from trade or business activities that are not substantially related to the functions constituting the basis for their tax exemption. Credit unions are self-help financial cooperatives established for the purpose of promoting thrift and providing low cost credit to their members—especially to persons with low and moderate incomes—through mutual and nonprofit operations. When these organizations offer services to non-members, or undertake activities that stray beyond the exempt purposes for which they were formed, the income from such activities should be subject to taxation. In such cases, they are directly competing with other small businesses in the communities in which they operate.

Over the past year, the IRS has issued a series of technical advice memorandums ("TAMs") which essentially hold that UBIT applies to various activities undertaken by state-chartered credit unions including, among others, income from insurance sales (e.g., credit life, disability life, health, group life, and accidental death and dismemberment), sale of car warranties, and ATM fees for non-member services.[1]

The ABA is pleased that the IRS has been focusing on this important issue, because we believe that the ability of credit unions to conduct business activities unrelated to their core purpose without paying taxes on the income from such activities creates an overwhelming competitive disadvantage for the banks that operate in the same communities. However, we believe that the application of UBIT to state-chartered credit unions is not an issue that should be determined on a piecemeal basis through a series of TAMs alone. While TAMs help IRS personnel resolve complex issues, they generally are not be relied upon as guidance or cited as precedent by taxpayers other than the specific taxpayer for whom the TAM was issued.

The application of UBIT to credit unions is an issue that would be more properly addressed in generally applicable binding IRS guidance, such as regulations or a revenue ruling that provides clear notice to the credit union industry of the IRS's interpretation of the law. We urge the Subcommittee, as it continues to examine issues relating to the IRS's regulation of the tax-exempt sector, to encourage the IRS to place a high priority on the issuance of binding guidance on the application of UBIT to tax-exempt credit unions.

Equally important, under current interpretations federal credit unions have been held to be exempt from UBIT.[2] Although this exemption is based upon a broad reading of the tax exemption provided under the Federal Credit Union Act (12 U.S.C. sec. 1767),[3] there is no tax (or other) policy reason for such a significant distinction for federal credit unions. When Federal credit unions operate unrelated businesses, the same detrimental competitive effects that result from state credit union unrelated activities apply—competing taxable banks and other businesses in their communities are adversely affected by their operation of such businesses—and the Fed-

[1] See, e.g., Technical Advice Memorandum 200709072, March 2, 2007; Technical Advice Memorandum 20070903, March 2, 2007; and Technical Advice Memorandum 200717036, April 27, 2007.

[2] I.R.C. sec. 511(a)(2)(A).

[3] 12 U.S.C. sec. 1767 provides that "Federal credit unions organized hereunder, their property, their franchises, capital, reserves, surpluses, and other funds, and their income shall be exempt from all taxation, now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority. . . ."

eral revenue is diminished by applying this exemption to business activities beyond the purpose of the credit union charter. We believe it is wrong for the broad tax exemption provided to federal credit unions also to encompass all income earned from businesses that are unrelated to their exempt purpose, and we encourage the Ways and Means Committee to pursue legislation to amend Code section 511(a)(2) to subject federal credit unions to UBIT.

Form 990 Filing Requirements for Credit Unions

Tax-exempt organizations generally are required to file annual information returns (Form 990) with the IRS.[4] The annual information return must contain the organization's gross income, receipts, disbursements, compensation, and other information required by the IRS in order to review the organization's activities and operations during the previous taxable year,[5] and to review whether the organization continues to meet the statutory requirements for exemption. Only a very limited number of organizations are statutorily exempted from this annual information filing requirement. These include churches,[6] religious orders, fraternal beneficiary societies, and small organizations with annual receipts less than $5,000.

Information returns filed by tax exempt organizations on Form 990 serve important public purposes beyond simply enabling the IRS to enforce the tax laws. As the Joint Committee on Taxation has noted:[7]

> [t]he public has a legitimate interest in access to information of tax-exempt organizations. This public interest derives from the tax benefits accorded under Federal law to such organizations, as well as the nature and purposes of such organizations. The public has an interest in ensuring that tax-exempt organizations are complying with applicable laws and that the funds of such organizations (whether or not solicited from the general public) are being used for the exempt purposes of the organization.

Congress also recognized the importance of transparent financial records for all companies by passing the Sarbanes-Oxley Act of 2002. Many credit unions are profitable, retail financial service organizations whose activities are indistinguishable from taxpaying banks. Vital information, such as their sources of income, expenses, amounts of compensation paid to executives, and activities, should be subject to public disclosure, both to ensure that they are operating effectively and with integrity and for the efficient administration of the tax laws. Moreover, without adequate information, credit union members cannot understand their organization's exposures and risks and cannot exercise effective oversight and control over the board of directors and management.

Despite these recognized benefits from public disclosure requirements, a majority of state-chartered credit unions do not file individual Form 9nineties. The IRS ruled in 1960[8] that state credit unions were permitted to take advantage of the group return rules set forth in Treasury regulations.[9] These rules permit central or parent organizations to file one group return providing aggregated financial information for the parent and any local organizations subject to its general supervision or control. In the state credit union context, this means that the state regulatory authority that supervises credit unions within a state may apply for a group exemption ruling and file one group return that aggregates information from all of the state credit unions under its control or supervision.

At a November 3, 2005, hearing of the House Ways and Means Committee, Steven T. Miller, Commissioner, Tax-Exempt and government Entities Division, testified that the IRS received 1360 individual Forms 990 from state chartered credit unions in 2003, the last year for which data is available. Mr. Miller also testified that as of 2003, 34 state credit union associations filed group returns, and that 21 of the 34 group returns covered more than two thousand organizations.

Millions of members of state credit unions do not have access to information on how their organizations are being operated, because such information cannot be accessed from group returns which contain only aggregate data. IRS officials have acknowledged that this is a problem but have so far not corrected the problem. Therefore, we urge the Subcommittee to look into this matter as part of its examina-

[4] I.R.C. § 6033.
[5] I.R.C. § 6033(a)(2).
[6] I,R.C. § 6033(a)(2)(C)(vi).
[7] Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions as Required by section 3802 of the Internal Revenue Service Restructuring and Reform Act 1998, Joint Committee on Taxation, JCS–1–00, January 28, 2000, p. 6.
[8] Rev. Rul. 60–364, 1960–2 C.B. 382.
[9] Treas. Reg. § 1,6033–2(d)

tion of tax-exempt organization issues and to request that the IRS amend its group return regulations to prohibit state credit unions from filing group returns.

Again, we deeply appreciate you allowing us to comment on this issue and share the concerns of our Members. If you have further questions, please do not hesitate to contact me.

Statement of American Bar Association Section of Real Property

These comments (the "comments") are submitted on behalf of the American Bar Association section of Real Property, Probate and Trust Law. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

The comments were prepared by members of the Charitable Planning and Organizations Group (the "Group") of the Probate and Trust Division of the Real Property, Probate and Trust Law section of the American Bar Association. Principal responsibility was exercised by Carol G. Kroch of Wilmington Trust Co., Group Chair-Elect, Mary Lee Turk of McDermott Will & Emery, Group Vice Chair-Elect, Christopher R. Hoyt of University of Missouri (Kansas City) School of Law, David J. Dietrich of Dietrich & Associates, P.C., and Jarrett T. Bostwick of Handler, Thayer, & Duggan, L.L.C. Linda B. Hirschson of Greenberg Traurig LLP reviewed the comments on behalf of the section's Committee on Governmental Submissions.

Although members of the Group who participated in preparing the comments have clients who are affected by the Federal tax principles addressed, or have advised clients on the application of such principles, no such member or the firm or organization to which such member belongs has been engaged by a client to make a governmental submission with respect to, or otherwise influence the development or outcome of, the specific subject matter of the comments.

EXECUTIVE SUMMARY

These comments respond to the June 12, 2007 Advisory of the Subcommittee on Oversight of the Committee on Ways and Means of the United States House of Representatives requesting written comments on the provisions of The Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780 (2006) (the "PPA") relating to tax-exempt organizations.

These comments make the following points: (1) the PPA provisions allowing charitable IRA rollovers for individuals over age 70½ are valuable to the charitable sector and should be extended permanently and expanded to allow gifts to DAFs, SOs and private foundations; (2) the PPA provisions requiring an S corporation shareholder to reduce the basis of his or her stock only by the shareholder's pro rata share of the adjusted basis of the property donated by the S corporation appropriately treats S corporation shareholders the same as partners and should be extended permanently; and Congress should also clarify the permitted deduction when the basis of an S corporation shareholder's stock is less than the shareholder's pro rata share of the charitable contribution; (3) the PPA provisions increasing the percentage limitations for qualified conservation contributions should be made permanent and the definition of gross income for purposes of determining whether a farmer or rancher qualifies for the 100% limitation should be clarified and broadened; (4) an overly broad and unclear definition in the PPA of a donor advised fund ("DAF") should be clarified as it has caused significant administrative costs and confusion for charities administering both DAFs and other charitable funds; (5) the PPA provisions applying the excess business holdings rule to DAFs and supporting organizations ("SOs") have unnecessarily curtailed charitable gifts by owners of closely held businesses; (6) section 1218 of the PPA has not only reduced the income tax incentives to make gifts of fractional interests in tangible personal property, but has also created estate and gift tax liability for fractional contributions of appreciated property that should be eliminated; (7) the PPA provisions addressing contributions to certain SOs may have a chilling effect on a charity's access to funds; (8) the PPA may go too far in its application of the excess benefit rules to DAFs and SOs, resulting in an inconsistent application of such rules and a departure from normal commercial practices; and (9) we welcome the PPA's endorsement of minimum distribution rules for SOs and believe that minimum distribution rules similar to those currently in effect, when coupled with increased disclosure, may provide a compromise between the Treasury Department's need to monitor SOs with the charitable sector's need for sources of support; however we suggest that Congress reconsider the necessity for and effectiveness of minimum distribution rules based on a percentage of an SO's income or assets.

DISCUSSION

I. PROVISIONS SCHEDULED TO EXPIRE ON DECEMBER 31, 2007

As a preliminary comment, we note that it would provide stability and certainty to the tax law to extend permanently all three provisions discussed below.

A. Charitable IRA Rollover. Section 1201 of the PPA permitted individuals over age 70½ to make lifetime charitable gifts of up to $100,000 per year in 2006 and 2007 directly from an IRA to a public charity (other than a supporting organization or a donor advised fund).

1. Importance to Charities. This provision was an important legislative change sought by the nation's charities and should be extended permanently. Further, we suggest that Congress consider permitting donors to make gifts from their IRAs to DAFs, SOs and private foundations. If the law is made permanent, IRA administrators and charities will likely take steps to cure the technical problems they have encountered in implementing the current legislation.

2. Problem In the Year That an IRA Owner Attains Age 70½. If the law is extended to future years, the age for eligibility should be more closely coordinated with applicable retirement plan distribution rules. Currently the charitable IRA distribution rules discriminate against people born in the months of May and June. For example, a person who was born on June 27 will attain age 70½ on December 27. All distributions that are made at any time during that year can be applied toward satisfying the minimum distribution requirement to avoid the 50% penalty tax for insufficient distributions from an IRA, but only distributions made on or after December 27 qualify for the charitable IRA exclusion. The legislation should be changed for 2007 and for future years to conform the charitable exclusion with the minimum distribution requirements. Thus, if the eligible age remains 70½, then all distributions should qualify for the charitable exclusion if made "within the calendar year that the individual for whose benefit the plan is maintained has attained age 70½." This change would simplify the administration of this provision and ensure that innocent parties are not caught in a tax trap. If, however, future legislation lowers the eligible age to 59½ (as is proposed for deferred gifts in H.R. 1419 and S. 819, "The Public Good IRA Rollover Act of 2007"), then requiring qualifying IRA distributions to be made on or after the date the donor turns 59½ is appropriate as it would mirror the 10% early distribution penalty provision of I.R.C. Sec. 72(t).

B. Charitable Gifts of Appreciated Property by S Corps. Section 1203 of the PPA permitted charitable gifts of appreciated property made by S corporations to have similar tax consequences to comparable charitable gifts made by partnerships and limited liability companies ("LLCs"), but only for gifts made in 2006 and 2007. In the past, the shareholders of an S corporation had to reduce their basis in their stock by the full deduction for the appreciated value of the property, whereas the basis in the ownership interest of a partnership or an LLC was reduced by only the cost basis, consistent with partnership tax theory. Partnership tax treatment for both forms of enterprise is important. It is especially significant for an S corporation, since a shareholder's basis in his or her stock is typically lower than that of a comparable partnership or LLC ownership interest. Whereas partnership tax law permits partners and LLC members to increase their tax basis by their share of the business' debts, S corporation shareholders cannot increase their basis by their share of the corporation's liabilities.

Many shareholders with a low basis in their stock are under the impression that I.R.C. Sec. 1366(d)(1) prohibits them from claiming a charitable income tax deduction that exceeds the basis of their stock, which discourages charitable gifts from S corporations. In his letter of June 28, 2007 to Treasury Secretary Paulson, Senator Richard Lugar stated that "the intent was that the full benefit of the deduction be conferred upon those shareholders." We recommend that the PPA basis reduction rule be made permanent and that Congress clarify the amount of the deduction permitted S corporation shareholders whose basis in their stock is less than their pro rata share of the amount of the charitable contribution otherwise deductible.

C. Charitable Gifts of Conservation Easements. The PPA and I.R.S. Notice 2007–50, "Guidance Regarding Deductions by Individuals with Qualified Conservation Contributions," expand and clarify the availability of qualified conservation contributions. However, several significant questions require clarification.

1. Make the Law Permanent. We believe the expanded deduction limitations of 50% under I.R.C. Sec. 170(b)(1)(E)(i) and 100% under I.R.C. Sec. 170(b)(1)(E)(iv) for

qualified farmers and ranchers should be made permanent. The grant of a perpetual conservation easement by a farmer or rancher is likely his or her most significant financial transaction short of outright sale; yet the law "sunsets" on December 31, 2007. Many conservation easements take the form of perpetual "management plans" for agricultural land owners and can take significant amounts of time to negotiate because of their perpetual duration. Although the provision does not sunset until December 31, 2007, as a practical matter, it will be difficult for donors who have not already commenced negotiations even to donate a conservation easement in 2007.

2. The Definition of Gross Income Does Not Conform to the Calculation of Gross Income From Farming Otherwise Used in the Tax Code The definition of gross income under I.R.C. Sec. 170(b)(1)(E) remains ambiguous. I.R.C. Sec. 170(b)(1)(E)(v) provides that an individual is a qualified farmer or rancher if the individual's gross income from the trade or business of farming (within the meaning of I.R.C. Sec. 2032A(e)(5)) in the taxable year of the contribution is greater than 50% of the individual's total gross income for the taxable year of contribution. I.R.C. Sec. 2032A(e)(5), however, does not define gross income from the trade or business of farming; rather it provides a definition of "farming purposes" for purposes of alternate valuation under the estate tax. The agricultural activities listed in I.R.C. Sec. 2032A(e)(5) are significantly narrower than the broad definition of farming used throughout the Internal Revenue Code to define income and deductions in calculating gross income from farming. See I.R.C. Sec. 61 and the Farmer's Tax Guide (IRS Publication 225). We suggest that the taxpayer's "gross income from the trade or business of farming" for purposes of I.R.C. Sec. 170(b)(1)(E)(v) should be the same as gross income from farming for income tax purposes generally, as shown on Form 1040, Schedule F, line 11 or line 51, with the addition of gross income (not gain) from forestry and from sales of livestock and other farm products reported on Form 4797.

3. Other Traditional Agricultural Income Sources Should Comprise Gross Income.We recommend that rental income and income from caring for another's livestock, farm program payments, the sale of livestock, conservation reserve program payments, hunting and fishing and the sale of farm products not held primarily for sale should constitute "gross income from the trade or business of farming" under I.R.C. Sec. 170(b)(1)(E)(v). Many agricultural operations have established corporations or LLCs to hold real estate separate from the active operations conducted by a distinct corporation or LLC that owns the livestock, equipment and machinery, with a rental agreement between the two business organizations. Excluding such rental income from the definition of gross income from farming under I.R.C. Sec. 170(b)(1)(E)(v) effectively removes significant tracts of agricultural farming and ranching real estate from qualification for the expanded 100% deduction limitation even though the property is actually used for farming.

4. Reconsider Deduction Limitations for Easements Donated by Non-Publicly Traded C Corporations. Although I.R.C. Sec. 170(b)(2)(A) limits a charitable contribution deduction by a C corporation to 10% of taxable income, under new I.R.C. Sec. 170(b)(2)(B)(i) the deduction limitation for a gift of a qualified conservation easement is expanded to 100% of taxable income (reduced by other allowable charitable deductions) for certain C corporations. The higher limit is available to a nonpublicly traded corporation that is a qualified farmer or rancher, and which donates an easement restricting the property to agricultural or livestock production. We note that if the C corporation fails to meet the gross income test for a qualified farmer or rancher, it loses the expanded limitation, whereas if an individual donor fails to meet the definition of a farmer or rancher, an enhanced deduction limitation of 50% of adjusted gross income (rather than 30%) is still available. If Congress wishes to encourage contributions of conservation easements by nonpublicly traded C corporations, it could consider adopting a similar enhanced deduction limitation for gifts of conservation easements by C corporations that do not qualify as farmers or ranchers.

II. DONOR ADVISED FUNDS

A. Burdens on Charities that Administer DAFs and Also Engage in Other Charitable Activities. The PPA generated substantial administrative and compliance costs to charities that administer both DAFs and other charitable funds, especially geographic and religious community foundations. They, like virtually all nonprofit organizations, use "fund accounting." They record each restricted gift in a separate fund. Many charities have gone through the extensive and arduous task of examining each and every fund agreement to determine whether it is a DAF or not.

Their problem has been exacerbated by the absence of guidance for ambiguous situations. The definition of a DAF is so broad that it could potentially include every restricted gift where there is any continuing donor involvement. For example, one would normally not think that an endowed chair at a university foundation is a DAF. If, however, the assets are invested by an investment firm where the donor's son is employed, is the endowed chair a DAF? A DAF exists when a donor or related party advises either with respect to distributions or investments. I.R.C. Sec. 4966(d)(2)(A)(iii).

We suggest that Congress amend the PPA provisions to appropriately narrow the definition of a DAF or clarify when certain common kinds of funds, such as those with restricted charitable purposes, are excluded from the definition of a DAF. We also urge Treasury to exempt from the definition of a DAF a fund that is advised by a distribution Committee that is not directly or indirectly controlled by the donor or the donor's appointee, as is authorized by I.R.C. Sec. 4966(d)(2)(C). We further suggest that funds established by local governments and publicly supported charities at community foundations be excluded from the definition of a DAF. These entities should be able to recommend charitable grants from such funds with the same freedom as if they had directly made the disbursements themselves.

B. Repeal of Penalty if Additional Language Missing in Acknowledgment to Donor. The PPA amended I.R.C. Sec. 170 to deny a charitable income tax deduction for a contribution to a DAF unless the charity's acknowledgment to the donor specifically states that the sponsoring organization "has exclusive legal control over the assets contributed." I.R.C. Sec. 170(f)(18). Until this provision was enacted, the law governing every charity's written acknowledgment to every donor had a uniform standard. I.R.C. Sec. 170(f)(8). The new DAF provision needlessly complicates the law and the punishment is excessive. Every completed charitable gift requires a transfer of legal control, including a gift to a DAF. Furthermore, the definition of a DAF is so broad (see above) that both the donor and the charity might not realize that a simple restricted gift agreement fell within the definition of a DAF. A donor should not lose a tax deduction solely because the charity's receipt did not contain this statement. We recommend repeal of this provision, or in the alternative, the imposition of a reasonable fine on the charity (the party responsible for issuing the statement) similar to the penalty for a charity's failure to send a donor a written acknowledgment of any kind: $10 per contribution, capped at $5,000. I.R.C. Secs. 6115 and 6714.

C. The Excess Business Holdings Rules Have Curtailed Gifts of Closely Held Business Interests to Both DAFs and SOs. This subject is addressed in Par. IV C. below.

D. The Penalty for an Excess Benefit Transaction With a DAF Applies Even to the Portion of the Reasonable Value of Services Rendered. The PPA classified the entire amount of any grant, loan, compensation, or similar payment from a DAF to a donor or related party as an "excess benefit payment", whereas normally only the excess over the value of services is subject to that tax. Compare I.R.C. Sec. 4958(c)(2) and (c)(1), and I.R.C. Sec. 4941(d)(2)(E). We question why reasonable compensation is not permitted when both public charities and private foundations can make such payments to disqualified persons. If a financial institution seeks to establish a DAF, or if a donor recommends an investment firm where a family member is employed, an exemption seems appropriate if the investment firm's fees are reasonable and comparable to fees that it charges other customers. This issue is addressed in greater detail in Par. IV D. below.

III. GIFTS OF FRACTIONAL INTERESTS IN TANGIBLE PERSONAL PROPERTY

Section 1218 of the PPA made significant changes to the income, estate, and gift tax consequences of donations of fractional interests in tangible personal property to charitable institutions ("fractional contributions").

A. Overview of Changes. Under prior law, a fractional contribution was deductible for Federal income tax purposes, if the donee 1) received an undivided portion of the donor's entire interest in the property gifted, I.R.C. Sec. 170(f)(3)(B)(ii); and 2) had the right to possession, dominion, and control of the property proportionate to its ownership interest. Treas. Reg. § 1.170A–7(b)(1)(i); Winokur v. Commissioner, 90 TC 733 (1988). Like other charitable gifts of tangible personal property, a fractional contribution was valued for income, estate, and gift tax purposes at its full fair market value at the time of the gift. For estate and gift tax purposes, fractional contributions were deductible at the full fair market value, I.R.C. Secs. 2055 and 2522, and for income tax purposes they were deductible at the full fair market value of the gift, if the use of the property by the donee charity was related to its charitable purpose, I.R.C. Sec. 170(e)(1)(B), subject to the applicable percentage of contribution base limitations. I.R.C. Sec. 170(b). We are aware that in some circumstances donors took advantage of these rules, but we are concerned that the PPA has not only reduced the income tax incentives to make valid fractional contributions, but has established estate and gift tax penalties on fractional contributions of appreciated property.

The PPA established a new regime for fractional contributions, providing: (i) unique valuation rules for income, estate, and gift tax purposes; (ii) deadlines for donating the remaining fractional interest in the property, enforced by recapture and penalty provisions; (iii) a new requirement that the donee charity have substantial possession of the donated property, also enforced by recapture and penalty provisions; (iv) unrelated use recapture rules more onerous and punitive than those the PPA introduced for non-fractional contributions; and (v) narrow ownership requirements for donors to obtain deductibility.

B. New Valuation Rules. In our view, the most serious change is caused by the new valuation rules. New I.R.C. Secs. 170(o)(2), 2055(g), and 2522(e)(2) limit the charitable deduction for subsequent fractional contributions to the lesser of the fair market value of the property at the time of the initial fractional contribution or at the time of the additional contribution. Thus, the donor is denied an income, estate, or gift tax deduction for the value of any appreciation of the property since the time of the initial fractional contribution. The denial of the income tax deduction in these circumstances may be a disincentive to some taxpayers, and it is not clear why the deduction should be limited if the gift otherwise meets the requirements for fractional contributions. However, the most severe consequences arise under the estate and gift tax, as shown by the following example:

In 2007, D contributes an undivided one-half interest in a painting with a fair market value of $2 million to an art museum providing for the museum to have possession of the painting for 6 months each year. D's income tax deduction, based on fair market value, is $1 million. A similar gift tax deduction applies, so that no gift tax is due on the fractional contribution. In 2015, when the painting has appreciated in value to $4 million, D makes the final fractional contribution of the painting to the museum. Under the new PPA limitations, D's income tax deduction is only $1 million, even though the value of the subsequent fractional contribution is double that amount. More seriously, however, D has made a charitable gift of $2 million, but is entitled to a gift tax deduction of only $1 million. Under the 2007 gift tax rates of 45%, D has an actual cost (either a reduction of D's applicable exclusion amount, a gift tax liability or a combination of both) of approximately $450,000 for making a gift to charity! Similarly, if D died in 2015 and made a testamentary fractional contribution, the value of the appreciation since the initial fractional contribution would be includable in D's estate.

Denying an income tax deduction for the appreciation in value of tangible personal property since the initial fractional contribution reduces an offset against taxable income. Denying a gift or estate tax deduction for the appreciation results in a tax on a gift to a charity, which is not only punitive in nature but is an unprecedented departure from the general transfer tax approach to charitable gifts. If Congress did not intend such a draconian result, we suggest it be eliminated by the repeal of new I.R.C. Secs. 2055(g) and 2522(e)(2).

C. Deadline for Contributions of Remaining Interest. The PPA requires a donor to give the remaining fractional interest in the donated property before the earlier of 10 years after the date of the initial fractional contribution ("the 10 year period") or the date of the donor's death. If this requirement is not met, the income and gift tax deductions for the initial fractional contribution will be recaptured and subject to interest and a 10 percent penalty. I.R.C. Sec. 170(o) and 2522(e). As a technical matter, if a donor dies before the end of the 10 year period, and makes a final fractional testamentary contribution, such gift will not have been made BEFORE the donor's death. We suggest amending this provision to require the gift to be made on or before the earlier of the end of the 10 year period or the donor's death. As a substantive matter, the 10 year requirement may cause some donors not to make gifts, depriving charitable institutions and therefore the public of the opportunity to use and enjoy works of art and other property. We suggest amending the provisions to require that either a gift or a binding pledge be made within the required time period.

Under the new PPA provisions, the consequences for missing the deadline are severe. The full income and gift tax charitable deduction claimed for the initial fractional contribution is recaptured with interest and the resulting income tax is increased by a 10% penalty. We believe that the time when interest starts to run should be clarified. In our view, interest should not start to run until the event that triggers the recapture. Otherwise, the results can, at least in certain circumstances, seem unduly harsh. A gift made the day before the expiration of the 10 year period does not result in any recapture of the initial deduction, but a gift made the day after the expiration of the 10 year period results not only in recapture of the initial deduction but also a charge of 10 years of interest on the amount of the deduction—even though the charity ends up receiving 100% interest in the property. We comment on the gift tax recapture rules in general in paragraph E below.

D. Substantial Physical Possession and Related Use Requirements. I.R.C. Secs. 170(o)(3)(A)(ii) and 2522(e)(3)(A)(ii), added by the PPA, require a charity to have "substantial physical possession of the property" and to have "used the property in a use which is related to [its] purpose or function" for 10 years after the initial fractional contribution or the donor's death, if earlier. If either of these requirements is not met, the same recapture rule described above applies. It would be helpful to clarify the meaning of "substantial physical possession," particularly in light of the severe consequences of noncompliance. In addition, we suggest that there be exceptions, for example, if a painting has deteriorated and would be damaged by transporting it between the donor and the donee, or if the museum temporarily does not have exhibit space for the painting. Again, we suggest that interest should run only from the time of failure to meet the substantial use requirement, not from the time of the original gift.

We question why the new related use rules for fractional contributions are more rigid and punitive than the new related use rules, also imposed by the PPA, for gifts of a donor's entire interest in tangible personal property. The new rules in I.R.C. Sec. 170(e)(7) provide that if a donee disposes of donated tangible personal property within three years of the date of the donation, the donor must recapture the difference between the amount of the income tax deduction taken by the donor and the donor's cost basis in the property, unless the donee certifies that the use of the property by the donee was related to the donee's charitable purpose or that the intended use of the property has become impossible or infeasible. I.R.C. Sec. 170(e)(7)(D). The result of the different related use rules is that if a donor makes a fractional contribution and 2 years later the donee disposes of the property, the donor is subjected to a full recapture of the income and gift tax deduction, plus penalty and interest, while the donor of a 100% interest in the same situation must only recapture the amount of the deduction above cost basis *but only if* the donee does not certify to the related use or impossibility of use.

If Congress wishes to reconcile the related use requirements applicable to full gifts of tangible personal property and fractional contributions, the amount subject to recapture for income tax purposes under I.R.C. Sec. 170(o) could be limited to the difference between fair market value and cost basis at the time of the gift without interest or penalties. If the interest charge is retained for recapture due to change in use of fractional contributions, we recommend clarifying that interest runs only from the time of the change in use.

E. Gift Tax Recapture. We suggest that the new recapture rules for fractional contributions not be applied for gift tax purposes. We are concerned that the gift tax recapture rules inappropriately penalize a donor for making a gift to charity. Unlike the recapture of an income tax deduction which simply restores taxable income to the donor, the recapture of the gift tax results in an out of pocket cost on a transfer to charity. This harsh result is at variance with the gift tax regime, which does not otherwise impose gift tax on charitable transfers.

F. Narrow Ownership Requirements. New I.R.C. Secs. 170(o)(1)(A) and 2522(e)(1)(A) generally deny income and gift tax deductions for fractional contributions unless all interests in the property are held by the donor or the donor and the donee immediately before the contribution. This requirement may prohibit any fractional gift of community property. We recommend clarifying the application of this provision to gifts of community property. We also recommend, as allowed by new I.R.C. Secs. 170(o)(1)(B) and 2522(e)(1)(B), that the Secretary of the Treasury adopt regulations that provide an exception to the new ownership requirements where all persons who hold an interest in the property make proportional fractional contributions.

IV. SUPPORTING ORGANIZATIONS

A. General Observations. Prior law provided Treasury the means to combat the abuses intended to be addressed by the PPA with regard to SOs. The new legal regime results in severe restrictions on a charity's access to working capital and sources of funding through the imposition of penalties and sanctions on private foundations, SOs, and supported organizations. The following comments focus on four key provisions of the PPA.

B. Contributions to Supporting Organizations.

1. Prohibited Contributors. Section 1241(b) of the PPA places substantial limitations on receipt of funds by Type I and Type III SOs from "prohibited contributors" (i.e., individuals or entities who alone or with other specified persons maintain direct or indirect control over an SO's supported organization). Contributions from such contributors will result in immediate disqualification of the SO's tax-exempt status and its reclassification as a private foundation.

This limitation negatively impacts the tax-exempt community because it arbitrarily prohibits donors and charities from using SOs in traditional planning situations. For example, donors and charities use SOs for creditor protection purposes, particularly Type III SOs, the assets of which are considered separate and apart from those of its supported organization(s) for legal and creditor purposes. Maintaining the integrity of gifts separate and apart from the general assets and liabilities of charities that have higher risk profiles, such as hospitals, universities, churches, or other service-based organizations, continues to be a fundamental goal in providing for the longevity of such organizations.

Congress should consider instead addressing this issue through disclosure of the relationship between the donor and the supported organization by the SO and a demonstration on the part of the SO that it is in fact distributing its funds to or for the benefit of the specific supported organization to meet the SO's attentiveness requirements. This can be done through disclosure on the SO's Federal Form 990. Further, Treasury has a means to police this issue via the attentiveness test provisions of I.R.C. Sec. 509(a)(3) and the Treasury Regulations thereunder.

2. Private Foundations. Under section 1244 of the PPA, private foundations are penalized for certain contributions made to Type III SOs and, in certain circumstances, to Type I and Type II SOs, due to the fact that such grants no longer qualify toward a private foundation's minimum distribution requirements under I.R.C. Sec. 4942. Such grants will not qualify if made to (a) non-functionally integrated Type III SOs or (b) Type I, Type II or functionally integrated Type III SOs if (i) a disqualified person of the private foundation directly or indirectly controls the SO or a supported organization of the SO, or (ii) such grant is a distribution determined by regulation to be "inappropriate." Additionally, Section 1244(b) of the PPA imposes expenditure responsibility requirements on any private foundation that makes a grant to any of the above-referenced SOs. As a result, SOs and the charities they support will likely see funds from private foundations substantially reduced, since the "cost" of such a private foundation's grant is increased by its not counting toward the private foundation's minimum distribution requirements under I.R.C. Sec. 4942 and because such grants will be subject to expenditure responsibility. Further, private foundations may be reluctant to make grants to SOs until Treasury issues regulations clarifying what distributions are "inappropriate." Instead of penalizing private foundations, Congress should consider addressing this issue by revising the minimum distribution requirements for SOs to provide that in a year in which an SO receives a grant from a private foundation, a portion of that grant should be included as part of the base amount against which the SO's minimum distribution requirement is calculated.

C. Excess Business Holdings. Section 1243(a) of the PPA amends the excess business holdings rules under I.R.C. Sec. 4943 by adding a new subparagraph (f), which requires certain SOs which receive gifts of closely held business interests to comply with the excess business holdings rules normally applicable to private foundations, unless Treasury has provided an exemption to an SO with business holdings on the basis that such business holdings are consistent with the SO's exempt purposes. Non-functionally integrated Type III SOs and Type II SOs that receive contributions from persons or entities which maintain direct or indirect control over one or more of the SO's supported organizations are subject to this new regime; Type I SOs are not. Further, under this regime, a 2% de minimis holdings threshold is allowed as a statutory safe harbor before the excess business holdings rules would be triggered.

Under the PPA, private businessowners have lost an important way to protect the family business from a forced sale on the owner's death. Additionally, businessowners are no longer able to use their closely held business interests as a means to fund their lifetime charitable goals. Further, taxpayers cannot reasonably proceed with charitable gifts with the hope that Treasury will provide an exemption based on a determination that the SO's ownership of the business interest is consistent with the SO's tax-exempt purpose, as there is insufficient guidance as to what Treasury would consider to be "consistent" in this context to warrant an exemption being granted.

We suggest that Congress consider instead using the existing attentiveness test and control test regulations to address this problem. Under such tests, Treasury can assess whether an SO is attentive to its supported organizations or subject to the indirect control of the donor. If Treasury concludes that the SO is not attentive or is subject to too much donor control, Treasury can reclassify the SO as a private foundation. As reclassified, the SO would be subject to the excess business holdings provisions of Chapter 42. Lapham v. Commissioner, T.C. Memo 2002–293, is a clear example of Treasury using these rules effectively to combat an abusive situation. Thus, Treasury could continue to use prior law to address the problem. It could also require gifts of business interests to be more fully disclosed in the first and subsequent years, and then analyze such gifts on an ongoing basis under the "attentiveness test."

D. Excess Benefit Transactions. Section 1242 of the PPA provided for sweeping reforms to all three types of SOs with regard to any direct or indirect compensation or other arrangement which violates the excess benefit transaction rules of I.R.C. Sec. 4958. Thus, under new I.R.C. Sec. 4958(c)(3), any loan, grant, compensation, financial arrangement, or other similar payment between an SO and a "specified person" or any loan to a disqualified person will be deemed an excess benefit transaction and subject to the sanctions provided under I.R.C. Sec. 4958. A specified person includes substantial contributors (individuals who have donated more than $5,000 to the SO if the amount is more than 2% of the bequests received by the SO through the close of the taxable year), a member of such person's family, or a 35% controlled entity.

Compensatory arrangements in the non-profit sector must be "reasonable" in order to be respected under state and Federal law. Indeed, even the strict self-dealing rules applicable to private foundations exempt payment of reasonable compensation to disqualified persons. I.R.C. Sec. 4941(d)(2)(E). A strict ban on compensating individuals performing services in official capacities for SOs appears to be an unreasonable departure from normal industry compensation standards of the non-profit sector, and the breadth of the provision may cause unintended results. For example, an employee of a tax-exempt organization who is also a director of an SO that supports such tax-exempt organization would technically be considered a disqualified person to both organizations, requiring the supported organization to carry out burdensome compliance and reporting to avoid the imposition of the excess benefit transaction penalties. While combating abusive transactions in which SOs make loans, grants, or other financial arrangements with "insiders" is appropriate, prohibiting even reasonable compensation for officers, directors, or employees of SOs, regardless of their status, we believe is inappropriate.

E. Minimum Distribution Requirements. Section 1241(d) of the PPA requires Treasury to promulgate regulations modifying the distribution requirements for non-functionally integrated Type III SOs. Currently, non-functionally integrated Type III SOs are required to distribute "substantially all" of their net income each year, which typically has meant a distribution of 85% of an SO's net income. Under the regulations, Treasury is to establish a distribution regime under which SOs would be required to make a distribution of a percentage of their income or assets, so long as such distribution constitutes a "significant amount."

The current law already requires non-functionally integrated SOs to distribute substantially all of their net income each year to one or more of each such SO's supported organizations. Therefore, a minimum distribution requirement currently exists. The current methodology also ensures that the SO's distribution pattern clearly reflects the market conditions in which the SO is operating. Consequently, donors and charities can manage and maintain budgets and ensure that spending patterns are in line with the current and future support expected from the SO.

In addition, there is no guarantee that requiring a distribution standard based on a percentage of assets, like the requirement imposed on private foundations, would result in greater distributions to supported organizations and increased attentiveness. For example, an SO which holds a closely held business interest worth $1,000,000 that generates $200,000 in income would, under the current test, be required to distribute $175,000 (i.e., 85% of $200,000), versus $50,000 under the 5% of assets test. We suggest that Congress consider using prior laws (i.e., the attentiveness test) to address this issue. An increase in attentiveness test audits would provide a significant deterrent to the manipulation of income and cash flow distributions from SOs. It would also present the opportunity for Treasury to analyze the nature of the relationships between the various asset holdings of the SO in light of the Lapham decision (discussed above) to determine if the SO's public charity status should be revoked and the entity reclassified as a private foundation, triggering application of all of the excise tax provisions applicable to private foundations.

The PPA provisions impose substantial excise taxes and penalties to address perceived abuses involving SOs. However, Treasury already had the statutory means to address the problems intended to be corrected by these new laws, and in fact did so with success when the circumstances warranted action. The new legal regime results in unintended negative consequences on the non-profit community by restricting access to working capital, decreasing sources of funding, and penalizing private foundations, SOs, and supported organizations with automatic sanctions, potential reclassification of tax-exempt status, and increased compliance requirements.

CONCLUSION

We welcome the review by the Subcommittee on Oversight of the impact on charities of the significant changes made by the PPA. We appreciate your consideration of our comments.

Statement of the American Bar Association Section of Taxation

These comments ("Comments") are submitted on behalf of the American Bar Association section of Taxation ("Tax section") and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Executive Summary

The Pension Protection Act of 2006[1] (the "PPA") contained numerous provisions affecting tax-exempt organizations described in section 501(c)(3).[2] On June 12, 2007, the Subcommittee on Oversight of the Ways and Means Committee of the United States House of Representatives issued an Advisory, inviting comments on those provisions of the PPA, including on how these provisions may affect charitable efforts and the difficulties that have arisen in implementing these provisions. We welcome the Oversight Subcommittee's consideration of these issues and their impact on donor advised funds, supporting organizations, their donors and the organizations they support.

In reaction to reports of abuses by a few organizations, the PPA imposed a great many new restrictions and penalties on donor advised funds and supporting organizations. Most of those reported abuses violated pre-PPA Code provisions, which suggests that at least certain of the PPA's changes may not have been necessary. The PPA places significant new compliance burdens on donor advised funds, supporting organizations, their donors, and the organizations they support. These provisions are discouraging many well-accepted and commendable charitable activities. The PPA also places significant additional demands on the Service's limited enforcement resources. We welcome the Oversight Subcommittee's consideration of the need for balance between correcting abuses and placing additional burdens on legitimate, nonabusive charitable activities, and commend the Oversight Subcommittee to do so in a transparent manner through public hearings and open comments.

Our most significant Comments can be summarized as follows:

1. The PPA imposes new automatic excess benefit transaction rules on donor advised funds and supporting organizations that are more stringent than the self-dealing rules applicable to private foundations, add undue complexity to the tax laws, and are uncertain in their treatment of section 501(c)(3) organizations as disqualified persons.
2. The PPA makes it more difficult for charitable trusts to qualify as Type III supporting organizations and may adversely affect a significant number of nonabusive charitable trusts.
3. The PPA's new rules distinguishing functionally integrated from non-functionally integrated Type III supporting organizations are a source of significant complexity and should be reconsidered. At a minimum, the effective date of these rules should be postponed until the Treasury Department issues final regulations clarifying the scope of these rules.[3]

[1] The Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780 (2006).

[2] References to a "section" are to a section of the Internal Revenue Code of 1986, as amended (the "Code"), unless otherwise indicated, and references to regulations are to the Treasury Regulations.

[3] An Advance Notice of Proposed Rulemaking (REG 155929–06) issued on August 1, 2007 details several factors the Treasury Department and the Internal Revenue Service (the "Service") anticipate including in proposed regulations, and requests public comment by October 31, 2007.

4. The PPA's treatment of charitable contributions of undivided interests in tangible personal property is punitive and affects a great many nonabusive situations.
5. The PPA's change in the treatment of S corporation charitable deductions is consistent with longstanding tax policy favoring charitable contributions of appreciated property, promotes parity in the tax treatment of S corporations and partnerships, and should be made permanent.
6. The goal of the PPA's provision requiring the public disclosure of section 501(c)(3) organizations' Forms 990–T could be achieved more simply by expanding the disclosure of unrelated business activity on Form 990.
7. A technical correction appears necessary to ensure that the penalty abatement provisions apply to new sections 4966 and 4967; and
8. The PPA's changes to section 512(b)(13) should be made permanent in order to put tax-exempt organizations on parity with taxable entities.

Comments

In light of the breadth of the PPA's provisions affecting tax-exempt organizations, these Comments focus on those areas that present the most significant concerns. The Tax section's views on the PPA also are reflected in comments[4] to the Service dated June 4, 2007 in response to Notice 2006–109,[5] and comments[6] to the Service dated July 31, 2007 in response to Notice 2007–21.[7] As requested by the Notices, those submissions commented only on the provisions of the PPA that affect supporting organizations and donor advised funds and include recommendations for regulations and other guidance.

1. The Automatic Excess Benefit Transaction Rules Applicable to Supporting Organizations and Donor Advised Funds

Background. Private foundations defined in section 509(a) have long been subject to an excise tax under section 4941 that penalizes "self-dealing" transactions with "disqualified persons." section 4941 generally prohibits financial transactions between a private foundation and a disqualified person, but contains several exceptions, including one in section 4941(d)(2)(E) that allows a private foundation to pay reasonable compensation to a disqualified person for services provided to the private foundation.

Since September 14, 1995, transactions between public charities[8] and their disqualified persons have been subject to an excise tax found in section 4958, often called the "intermediate sanctions" excise tax. Prior to the PPA, section 4958 did not prohibit financial transactions between a public charity and a disqualified person, but instead subjected them to an arm's length reasonableness standard. section 4958 penalized only "excess benefit transactions" in which a disqualified person received an excessive economic benefit. Prior to the PPA, supporting organizations and donor advised funds, which are classified as public charities, were subject to the intermediate sanctions restrictions of section 4958 rather than the private foundation self-dealing restrictions of section 4941.

Comment on Automatic Excess Benefit Transactions. The PPA effectively establishes a third excise tax on transactions between a charity and its disqualified persons. It does so by creating a new type of *automatic* excess benefit transaction in section 4958(c)(2) and (3) that applies exclusively to supporting organizations and donor advised funds.[9] Section 4958(c)(2) applies to donor advised funds and imposes the section 4958 excise tax automatically on any "grant, loan, compensation, or other similar payments" by donor advised funds to donors, advisors, and certain related persons. The Joint Committee Report states that "other similar payments" in-

[4] Comm. on IRS Notice 2006–109, ABA Tax Sec. *Comments in response to IRS Notice 2006–109 on the application of the Pension Protection Act of 2006 to donor advised funds and supporting organizations*, (June 4, 2007).
[5] Notice 2006–109, 2006–51 I.R.B. 1121
[6] Comm. on IRS Notice 2007–21, ABA Tax Sec. *Comments in response to IRS Notice 2007–21 on Treasury Study on donor advised funds and supporting organizations,* (August 1, 2007).
[7] Notice 2007–21, 2007–9 I.R.B. 611.
[8] The term "public charity" is not defined in the Code and is used here to mean those tax-exempt organizations described in section 501(c)(3) other than private foundations. section 4958 also applies to organizations described in section 501(c)(4) and their disqualified persons.
[9] The PPA also adds new sections 4966 and 4967, which impose penalties on other donor advised fund activities.

clude expense reimbursements but not sales or leases.[10] Section 4958(c)(3)(A)(i)(I) creates comparable automatic excess benefit transaction rules for payments by supporting organizations to their substantial contributors and certain related parties. section 4958(c)(3)(A)(i)(II) creates a third, broader category of automatic excess benefit transaction for a loan by a supporting organization to any "disqualified person," not just substantial contributors and related parties.

The PPA thus establishes new rules for supporting organizations and donor advised funds that are more stringent than those that apply under either the private foundation self-dealing rules or the general section 4958 intermediate sanctions rules (both of which allow the payment of reasonable compensation and expense reimbursements to disqualified persons). It is not clear why supporting organizations and donor advised funds should be subject to a more stringent rule. Implicit in this change must be the view that payments of compensation or expense reimbursements to disqualified persons by supporting organizations or donor advised funds are more likely to result in abuse than similar payments by private foundations. However, we are not aware of any substantial evidence to that effect.

The PPA also reverses the priorities of section 4941 by prohibiting the payment of compensation but allowing sales and leases. Congress previously had determined in enacting section 4941 that sales and leases were more susceptible to abuse than compensation for services, but the PPA takes a contradictory approach. The rules under section 4941 already were subject to much criticism for their complexity, and by prohibiting the payment of all compensation by supporting organizations and donor advised funds the PPA effectively creates more traps for the unwary.

We encourage the Oversight Subcommittee to consider whether it would be more appropriate to apply either the private foundation self-dealing model or the public charity intermediate sanctions model, in lieu of these new restrictions which add further complexity to the Code. If the Oversight Subcommittee concludes that a more restrictive penalty tax regime on donor advised funds and supporting organizations is appropriate, we respectfully submit that a less complex approach would be to subject donor advised funds and supporting organizations to the self-dealing rules of section 4941, much as the PPA has subjected them to other private foundation provisions in sections 4943 and 4945.

Comment on Failure to Exclude All section 501(c)(3) Organizations. The PPA also may establish more restrictive rules for transactions between section 501(c)(3) organizations. Prior to the PPA, transactions between section 501(c)(3) organizations were excluded from the scope of both the private foundation self-dealing excise tax and the intermediate sanctions excise tax, regardless of whether they were private foundations or public charities. This exclusion was accomplished in the regulations by excepting all section 501(c)(3) organizations from the definition of "disqualified person."[11] The PPA's automatic excess benefit rule for loans by supporting organizations to disqualified persons in section 4958(c)(3)(A)(i)(II), however, creates by statute a limited exclusion that applies only to public charities described in section 509(a)(1), (2) and (4). This express statutory provision may foreclose the Treasury Department from expanding that exclusion by regulation to allow a supporting organization to make a loan to another supporting organization or to a private foundation that is a disqualified person, even though the transaction is between two section 501(c)(3) organizations. If this result is what Congress intended, it represents a material departure from the pre-PPA policy of excluding all transactions between section 501(c)(3) organizations from the application of the self-dealing and intermediate sanctions excise taxes.

The limited statutory exclusion in section 4958(c)(3)(A)(i)(II) also clouds the Treasury Department's regulatory authority with respect to the other automatic excess benefit transaction rules in section 4958(c)(2) and (c)(3)(A)(i)(I). Although neither of these latter provisions contains the same limited statutory exclusion, the language in closely related section 4958(c)(3)(A)(i)(II) may cast doubt on the Treasury Department's regulatory authority to extend the pre-PPA exclusion for all section 501(c)(3) organizations to the new automatic excess benefit transaction rules. The Treasury Department could view the limited statutory authority for loans to disqualified persons as an indication of Congressional intent toward automatic excess benefit transactions more generally.

The policy reflected in the private foundation self-dealing rules of excluding all section 501(c)(3) organizations from self-dealing penalties has withstood the test of

[10] 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, at 467 (2006) (the "Joint Committee Report").

[11] Reg. §§ 53.4946–1(a)(8) and 53.4958–3(d)(1).

time. A more restrictive approach under the automatic excess benefit transaction rules creates further complexity and more traps for the unwary. Accordingly, we respectfully suggest that the Oversight Subcommittee reconsider this aspect of the PPA.

2. The Treatment of Perpetual Charitable Trusts as Supporting Organizations

Background. Prior to the PPA, a trust described in section 501(c)(3) could qualify as a Type III supporting organization under section 509(a)(3) if it met the "responsiveness test" and the "integral part" test in Treasury Regulation section 1.509(a)-4(i)(2) and (3). Under Treasury Regulation section 1.509(a)-4(i)(2)(ii) a trust could meet the responsiveness test if it was a charitable trust under state law, named each supported organization in its governing instrument, and was subject to a state law that gave the beneficiary organization(s) the power to enforce the trust and compel an accounting. PPA section 1241(c) overruled this regulation. The Joint Committee Report states as follows:

In general, under [this] provision, a Type III supporting organization that is organized as a trust must, in addition to present law requirements, establish to the satisfaction of the Secretary, that it has a close and continuous relationship with the supported organization such that the trust is responsive to the needs or demands of the supported organization.[12]

We understand that the PPA included this provision in response to reported abuses of donors' "parking" assets in a charitable trust and retaining effective control of them due to a failure of oversight by the supported organization. Such abusive "parking" of assets is designed to avoid dedicating the assets to charitable purposes and use. However, this PPA provision is very broad in scope and affects a significant number of charitable trusts where there is no hint of abuse. For example, it is not uncommon for a donor to create a separate trust with a bank or other independent trustee to serve as an external endowment for a named charity. Donors do so for a number of reasons, including concerns that future officers of the charity will not honor the donor's intent, that the endowment should be protected from the charity's creditors, that the charity might otherwise make imprudent invasions of principal, or that the charity lacks investment expertise. Having a trust serve as an external endowment avoids these concerns and serves legitimate charitable purposes. The establishment of such trusts stands in sharp contrast to the abuses at which the provision is aimed; yet, the PPA provision applies to them as well.

Comment. We assume that Congress did not intend the PPA to have the effect of revoking the supporting organization status of the significant number of nonabusive charitable trusts described above. However, there is no assurance that the Treasury Department's regulations will adequately constrain the scope of PPA section 1241(c) to avoid the unnecessary conversion of many nonabusive charitable trusts into private foundations.[13] Accordingly, we respectfully suggest that the Oversight Subcommittee reconsider the scope of PPA section 1241(c) to ensure that it clearly reflects its intent and is not applied more broadly than intended.

3. Non-Functionally Integrated Type III Supporting Organizations

Background. The PPA imposes new restrictions directed at Type III supporting organizations that do not qualify as "functionally integrated" under section 4939(f)(5)(B), including rules that (1) deny qualified distribution treatment for grants to them by private foundations, (2) impose excess business holdings rules, (3) require private foundations that make grants to them to exercise expenditure responsibility, (4) disqualify them from administering donor advised funds eligible to receive deductible charitable contributions, and (5) impose new payout requirements to be set by the Treasury Department.[14]

Under these new provisions, non-functionally integrated Type III supporting organizations are treated more harshly than private foundations. A grant from one private foundation to another private foundation can be a qualifying distribution that

---

[12] Joint Committee Report at 362. The Advance Notice of Proposed Rulemaking (REG 155929–06) issued on August 1, 2007 addresses this charitable trust issue only preliminarily and requests further comment.

[13] The breadth of PPA section 1241(c) is discussed at pages 62–66 of the Tax Section's June 4, 2007, comments to the Service. Those comments recommend steps that the Service and the Treasury can take to ameliorate the overbreadth of PPA section 1241(c).

[14] I.R.C. §§ 4942(g)(4)(A)(i), 4943(f)(3)(A), 4945(d)(4)(A)(ii) & 170(f)(18)(A)(ii); PPA § 1241(d). The Tax section's June 4, 2007, comments to the Service, at 51–56, discuss these provisions and make recommendations regarding the definitional issues the Service and the Treasury face with respect to functionally integrated Type III supporting organizations.

counts against the grantor's minimum distribution requirement if the grantee serves as a conduit for the grant under the "out of corpus" rules of section 4942(g)(3). However, no such flexibility is allowed for grants by private foundations to non-functionally integrated Type III supporting organizations.

Comment. The PPA's rules creating the new categories of functionally integrated and non-functionally integrated Type III supporting organizations are a source of significant complexity and have resulted in significant confusion. The statutory definitions are ambiguous, and the Service has suspended issuing determination letters on whether a Type III supporting organization is functionally integrated.[15] It has been reported that many private foundations are simply refusing to make grants to any Type III supporting organization as a result of these new rules. The punitive denial of the "out of corpus" rules for grants to non-functionally integrated Type III supporting organizations has added to private foundations' concerns. The reaction of private foundations is creating problems for all Type III supporting organizations. Given the many unanswered questions, we encourage the Oversight Subcommittee to reconsider these rules. If Congress decides to retain these rules, the Oversight Subcommittee should monitor how the Treasury Department carries out its broad regulatory authority to ensure that these provisions do in fact address the reported abuses that led to their enactment. Finally, the effective date of these rules should be postponed until the Treasury Department issues final guidance clarifying the scope of these rules.[16]

4. Gifts of Partial Interests in Tangible Personal Property

Background. The PPA made several changes to the rules governing deductions for charitable contributions of tangible personal property. The changes that have caused the most concern involve new valuation and recapture rules for gifts of undivided interests in tangible personal property under sections 170(o), 2055(g) and 2522(e). Where a donor contributes an undivided interest in tangible personal property to charity, these new PPA rules: (1) limit the donor's deduction for any subsequent gift of an undivided interest in the same property for income, gift and estate tax purposes by basing the subsequent deduction on the lesser of the property's fair market value at the time of the initial gift or its fair market value at the time of the subsequent gift; (2) require the recapture of both income tax and gift tax deductions, plus interest, if either (i) the donor does not contribute all of the remaining interest in the property before[17] the earlier of the donor's death or 10 years after the initial contribution or (ii) the donee charity does not have substantial physical possession of the property and does not use the property for a tax-exempt purpose during the period it has partial ownership; and (3) impose a 10 percent addition to both income and gift tax attributable to such recapture.

Comment. Gifts of undivided interests are a valuable and legitimate way that many museums acquire works of art. We question whether the reported abuses of such gifts justify the PPA's attempts to discourage them. Moreover, the PPA's valuation and recapture rules do not simply discourage such gifts, but in fact punish them harshly. For example, assume that a donor contributes a 50 percent undivided interest in a painting worth $1 million to a museum on July 1, 2007, and gives the remaining 50 percent to the same museum 10 years later on June 30, 2017, at a time when the value of the painting has appreciated to $2 million. Under the PPA, the donor's income tax deduction for the second gift is limited to $500,000 instead of $1 million. Limiting the donor's gift tax deduction to $500,000 forces the donor to pay out of pocket $200,000 of gift tax just to make the subsequent charitable contribution within the timeframe prescribed by the PPA (assuming a 40 percent effective gift tax rate in 2017). The subsequent gift may well cost the donor more in gift tax than the donor will save in income tax.

The recapture rules pile on yet more penalties. The first recapture rule, based on a donor's failure to contribute the remaining undivided interest within the time per-

---

[15] Memorandum from Acting Director, EO Rulings and Agreements, Feb. 22, 2007.

[16] The Advance Notice of Proposed Rulemaking (REG 155929–06) issued on August 1, 2007 ("ANPRM") makes several constructive proposals regarding functionally and non-functionally integrated supporting organizations, but does not address all of the concerns with PPA's new restrictions and leaves many questions unanswered. The ANPRM requests comments by October 31, 2007, and only after that date will proposed regulations be issued. The ANPRM states that new rules will not be effective until temporary or final regulations are issued; in the interim, exempt organizations will be forced to continue to grapple with the PPA's statutory restrictions and penalties without definitive guidance.

[17] Presumably the use of the word "before" in the statute does not require a donor to foresee the date of his death, so that a bequest of the remaining interest would avoid recapture if the donor dies within 10 years.

mitted, would be triggered by a donor who forgets to amend his will and then dies before making a subsequent gift. That donor would be penalized by recapture for mere inadvertence. Recapture of the income tax, along with interest and an addition to tax, is itself a penalty. Requiring gift tax recapture as well, plus interest and addition to tax, compounds the penalty. The second recapture rule, based on a donee charity's not having substantial physical possession of the property and not putting the property to a related tax-exempt use, again is excessively punitive by requiring recapture of the gift tax as well as the income tax.[18] Because donors do not view the gift tax charitable deduction as an affirmative benefit, any gift tax recapture is particularly punitive and would discourage the making of such charitable gifts.

5. S Corporation Charitable Deductions

Background. Charitable deductions of an S corporation pass through to its shareholders under section 1366(a)(1)(A). Prior to the PPA, when an S corporation contributed appreciated long-term capital gain property to charity, the shareholders were required to reduce the basis of their stock in the S corporation by their proportionate share of the property's fair market value under section 1367(a)(2)(B). This pre-PPA rule contrasted with the partnership rule where partners are required to reduce their basis in their partnership interests only by their proportionate share of a contributed asset's basis.[19]

The partnership approach is consistent with the general policy of section 170 of encouraging charitable contributions of appreciated property by allowing taxpayers to claim a deduction for the property's full fair market value. The prior S corporation rule had the effect of depriving shareholders of the advantage of a fair market value charitable deduction afforded other kinds of assets because the larger basis reduction increased the shareholders' gain or reduced the shareholders' loss upon a later disposition of the S corporation stock. It also discouraged gifts of highly appreciated property, such as conservation easements, because shareholders often had insufficient basis to absorb the deduction. PPA section 1203(a), which expires at the end of 2007, added flush language at the end of section 1367(a)(2) that effectively establishes parity between S corporations and partnerships for this aspect of entity-level charitable contributions of appreciated property.[20] This temporary PPA change allows S corporation shareholders the same advantage for entity-level charitable contributions that individual donors have.

Comment. Because this PPA change (a) is consistent with the longstanding tax policy of allowing charitable deductions for the full fair market value of appreciated property and (b) establishes parity in the treatment of entity-level charitable contributions by S corporations and partnerships, it should be made permanent.

6. Public Disclosure of Form 990–T

Background. Prior to the PPA, no taxpayer had been required to publicly disclose Federal income tax returns. Consistent with this policy, tax-exempt organizations were not required to publicly disclose their tax returns (Form 990–T), although they were subject to public disclosure requirements with respect to their information returns (Form 990). The PPA added section 6104(d)(1)(A)(ii) to require section 501(c)(3) organizations, but not other tax-exempt organizations, to disclose their Forms 990–T in addition to their Forms 990.

Comment. The PPA's provision requiring the public disclosure of Form 990–T raises several concerns. It treats tax-exempt organizations less favorably than for-profit businesses, which are not required to disclose their tax returns. It treats section 501(c)(3) organizations less favorably than other tax-exempt organizations. It forces churches, which do not file Form 990 but do file Form 990–T, to disclose information about their operations for the first time, a mandated disclosure that implicates First Amendment concerns. It has the potential for turning away private joint venture partners and co-investors who prefer not to subject their activities to public disclosure. Its effectiveness is open to question because it often can be readily avoided by transferring an unrelated business to a taxable subsidiary corporation. Finally, because the Form 990–T is also used for purposes other than reporting unrelated business activity, such as claiming refunds of withholding and excise taxes,

[18] The second recapture rule presents separate issues, including its inconsistency with the PPA's other related-use recapture rule for tangible personal property in section 170(e)(7).

[19] *See* Rev. Rul. 1996–11, 1996–1 C.B. 140.

[20] Differences in the computation of basis for S corporation stock and partnership interests also affect the amount of the charitable contribution that an owner can deduct, but such differences are beyond the scope of these Comments to the PPA.

information with no bearing on unrelated business activity may be disclosed.[21] An alternative approach would largely avoid these concerns, while achieving the disclosure Congress seeks. Instead of subjecting the Form 990–T to disclosure, additional disclosure of unrelated business activity could be required on the Form 990. The Form 990 already requires some disclosure of unrelated business activity, and that disclosure could be expanded.

7. Extending Abatement Rules to sections 4966 and 4967

Background. Excise taxes imposed on private foundations and public charities under Chapter 42 of the Code are generally subject to the Service's authority to abate them under sections 4961–4963, except for the first-tier excise tax on self-dealing of section 4941(a) and the excise tax on tax-shelter transactions of section 4965. The PPA did not extend the Service's abatement authority to the new excise taxes imposed on donor advised funds under sections 4966 and 4967. This failure may have been an oversight because the excise taxes under 4966 and 4967 are included in the definition of "first tier taxes" in section 4963(a) but are omitted from the list of "qualified first tier taxes" eligible for abatement in section 4962(b). Moreover, the Joint Committee Report states that the excise taxes under sections 4966 and 4967 "are subject to abatement under generally applicable present law rules."[22] The excise taxes under sections 4966 and 4967 are complementary to the excise tax under section 4958, which is subject to abatement.

Comment. There appears to be no reason to exclude the excise taxes under sections 4966 and 4967 from the possibility of abatement. A technical amendment should be enacted to ensure eligibility for abatement.

8. Payments to Controlling Exempt Organizations

Background. PPA section 1205(a) amended section 512(b)(13) to provide that, for certain payments received or accrued in 2006 and 2007, tax-exempt organizations would not be subject to unrelated business income tax on interest, rents, royalties and annuities received from certain related organizations to the extent that such payments reflected an arm's-length, fair market value standard. This change conforms the treatment of tax-exempt organizations with the treatment of taxable enterprises, making both subject to an arm's-length standard under section 482. The earlier rule, which caused tax-exempt organizations to be subject to unrelated business income tax automatically on such payments, encouraged tax-exempt organizations to favor transactions with unrelated parties instead of related entities.

Comment. Consistent with prior comments of the Tax section, the substantive changes to section 512(b)(13) made by the PPA should be made permanent. Inflated pricing in related-party transactions would remain taxable (with a penalty), while arm's-length dealings could continue. This approach would place tax-exempt organizations on the same footing as taxable entities and would no longer penalize transactions between tax-exempt organizations and their related organizations.

Statement of American Institute of Philanthropy

Thank you for holding hearings on the IRS's proposal to improve the Form 990 and other ways to reform the nonprofit sector. Many of the changes, if put into effect, will greatly enhance the public's access to important information that was previously not required to be broken-out or disclosed. We appreciate that the new schedules are designed to increase the accounting and reporting burdens of only those charities with more complex financial transactions, and do not force smaller charities with simpler operations to complete additional forms.

With that said, we at the American Institute of Philanthropy (AIP) were shocked by one glaring change to the Form 990 that will significantly reduce charities' accountability to the public, and deny donors of the information they need to understand how their contributions to charity are being used. The current version of the Form 990 requires charities that divide the expenses related to joint educational/fundraising campaigns (Joint Costs) among program, management & general, and fundraising expense, to provide a breakout of what dollar amounts are being allocated to each function. The new Form 990, if adopted, would allow charities to conveniently disguise as program expense what many donors would consider fundraising activities. This would leave the public at a great disadvantage, taking away

[21] Interim guidance was provided in Notice 2007–45, 2007–22 I.R.B. 1320, which states that a Form 990–T filed solely to claim a refund of telephone excise tax does not have to be made available for public inspection, but otherwise a Form 990–T must be disclosed "in its entirety."

[22] Joint Committee Report at 349–50.

the one reporting requirement that shows donors what portion of their contributions are being used to fund more solicitations, rather than the bona-fide programs they are intending to support.

The public is being bombarded with an ever-increasing amount of phone and mail solicitations from charities. As a nationally prominent charity watchdog organization, we are flooded with questions from both the public and the media, who want to understand how charities are using donors' hard-earned dollars. Many people are outraged to learn that charities are allowed to claim large portions of solicitation costs as program service expenses. Charities may claim that such activities are educating the public. You would not know this based on the complaints we frequently receive from donors who are fed up with the constant barrage of phone calls and mail they receive from charities requesting contributions. Based on AIP's more than fifteen years of experience reviewing such mail and phone appeals, we think it would be obvious to almost anyone that the primary purpose of solicitations is to raise funds, with the educational component being largely incidental in most cases.

Under current rules, a charity that includes an "action step" in their phone or mail solicitations such as "don't drink and drive," or "buckle your seatbelt," can claim that they are "educating" the public, and can therefore report much of the expense of these appeals as a program. Such "action steps," often relayed to potential donors through professional fundraisers hired by charities to broadly solicit the public for money, are typically messages of information that is common knowledge. Professional telemarketers, on average, keep two-thirds of the money they raise before the charity receives anything. What this means is that someone donating $50 to charity through a professional fund raiser may have just paid $30 to be solicited and "learn" that they should buckle their seatbelt. This is not what most donors would consider to be a charitable program, and the public should not be excluded from knowing how much of a charity's reported program expense is part of its solicitation activities.

The reporting requirements for joint costs should be expanded not eliminated, so donors know what they are really paying for. Even when following the joint cost reporting requirements of AICPA SOP 98–2, charities are given wide latitude in how they account for and allocate these expenses. In considering changes to Form 990, the IRS should consider adding an additional requirement in which charities would disclose their five most expensive solicitation campaigns, including a breakout of each campaign's program, management & general and fundraising expenses, including the method used for allocation. The nonprofit should also provide a good description of the program being conducted in conjunction with each solicitation that cites specifically what is being accomplished and why the recipient of the solicitation has a use or need for the information.

At the very least, the current disclosure requirements for joint cost reporting on the Form 990 should remain intact. While a break-out of Joint Costs may continue to be required in a charity's audit under AICPA standards, this is not enough. There are numerous examples of charities incorrectly reporting or omitting important information from their tax forms, audits, and other reports. The Joint Cost reporting on Form 990 serves to provide information that may be cross-checked with a charity's audit, state filings, and other data, for consistency and correctness. Such reporting can prevent a charity from claiming that failing to attach a required schedule or omitting important information from their reports was simply an oversight.

In summary, AIP encourages all donors to charity to ask what percentage of their donation is being spent on programs that are not a part of a group's solicitation efforts. If the new IRS form eliminates the disclosure of Joint Cost solicitation allocations, the public will no longer be able to have this very basic question answered by referring to the Form 990. It will also open the floodgates for unscrupulous fund raisers to aggressively solicit, knowing that most of the donating public will not be able to determine that they are only funding fundraising.

I thank you for taking the time to review our concerns, and encourage you to contact me if I can be helpful in providing additional insight into how Form 990 information may improve the oversight of nonprofit organizations and better assist donors and recipients of charity services. These proposed Form 990 changes, if adopted, will have sweeping and long-lasting effects within the nonprofit sector, and it is important that they result in more accountability to the public, not less.

Sincerely,

Daniel Borochoff
President

Statement of American Society of Appraisers

The undersigned professional appraisal organizations, representing more than 30,000 professional appraisers in the U.S., greatly appreciate the Committee's invitation to comment on provisions in the Pension Protection Act (PPA or Act) relating to tax-exempt organizations. Our comments are limited to those sections of the Act which make far-reaching changes to the manner in which tax-related valuations are performed, including those involving appraisals of non-cash charitable contributions.[1]

Hundreds of provisions of the Tax Code require Individual and Business taxpayers to report the fair market value of tangible and intangible property for a variety of Income, Estate and Gift tax purposes. One of those purposes involves the valuation of noncash donations to tax-exempt organizations. Each year, eligible charities receive about $36 billion in non-cash property whose fair market value must be determined and reported to IRS to substantiate taxpayers' claims to charitable deductions.[2] The reliability and integrity of tax-related appraisals in general, and valuations of non-cash contributions in particular, have long been a source of concern to IRS, to the tax writing Committees and to the public.

Our organizations have been active participants for a number of years in the Congressional debate over how to address these concerns, culminating in the valuation reforms of the Pension Protection Act. With one important exception, we strongly support these reform provisions as appropriate, necessary and cost-effective remedies for discredited IRS valuation policies which permitted anyone to appraise the value of tangible and intangible property for tax purposes—whether or not they had any valuation education, skills or training; and which allowed the use of any approaches to determining fair market value whether or not they were generally accepted by valuation professionals.

The exception to our strong support involves the fact that the new law's most important appraisal reform provisions—requiring meaningful definitions of the terms "Qualified Appraiser" and "Qualified Appraisal"—are limited to valuations of noncash charitable contributions and do not apply to the many other Tax Code sections which require taxpayers to report the fair market value of property. These narrowly applied provisions involve (1) redefining the term "Qualified Appraiser" by requiring individuals performing tax-related valuations to have demonstrable and meaningful valuation-specific education, training and experience; and (2) redefining the term "Qualified Appraisal" by requiring adherence to generally accepted valuation standards in reaching determinations of fair market value. Although the other key features of the reforms (i.e., tightening the tolerances giving rise to findings of substantial and gross valuation misstatements and the addition of new sanctions that can be applied against appraisers) are significant and appropriately apply to all tax-related appraisals, we believe the provisions requiring appraiser competency and adherence to generally accepted valuation standards are the lynchpin of the Act's remedies and should apply, as well, to all Tax Code valuations.

Unless this imbalance is remedied, the otherwise excellent tax-related appraisal reforms established by Congress in the Pension Act will have the unintended effect of creating two separate and unequal systems for taxpayer valuations—a fully reformed system which applies only to section 170 appraisals relating to charitable contributions; and, a continuation of two of the most ineffective aspects of the old system, for all other tax purposes.

We are writing, therefore, to respectfully urge the Oversight Subcommittee to correct this major imbalance by applying the Act's appraiser competency and generally accepted appraisal standards requirements to all valuations required by the Tax Code, not just those involving noncash contributions.

We would be very pleased to work with the Subcommittee to address this issue. If you have any questions or would like to contact our organizations, please call or contact the government relations representative of the American Society of Appraisers, Peter Barash, or the Appraisal Institute's government affairs representative, Bill Garber.

[1] Title XII, Subtitle B, Part 1, sections 1213, 1214, 1216, 1218 and 1219 of H.R. 4 (P.L. 109–280).

[2] According to a recent IRS study covering tax year 2003 returns, six million individual taxpayers reported 14.3 million noncash donations valued at $36.9 billion on Form 8283. These noncash contributions included public and closely held stock; real estate; land and fade easements; intellectual property; art and collectibles; cars; household items; other investments; and so forth.

Statement of American Society of Association Executives

I am President and chief executive officer of the American Society of Association Executives ("ASAE"), a tax-exempt organization that is recognized as exempt from Federal income tax under section 501(c)(6) of the Internal Revenue Code 1986 (the "Code") and that represents roughly 22,000 members, the majority of whom are the chief executive officers or senior staff professionals of trade, professional or philanthropic organizations.

I am writing to you about a couple of relatively minor provisions in the recently enacted Pension Protection Act of 2006 (P.L. 109–280, the "Act"), that, if left unchanged, could have a major unintended impact on many associations' ability to support and be supported by their related foundations. A close review of new Code section 4958(c)(3) indicates that a technical correction may be necessary to clarify an area of ambiguity. Likewise, a change made to Code section 509(f)(2)(A) might have the same effect.

First: new Code section 4958(c)(3) provides in two separate subsections (sections 4958(c)(3)(A)(i)(II) and 4958(c)(3)(C)(ii)) an exception to the general rule imposing automatic excess benefit treatment of loans paid by supporting organizations to disqualified persons and of grants, loans, compensation, or other similar payment paid by supporting organizations to substantial contributors. The exception in each of those subsections is for "an organization described in paragraph (1), (2), or (4) of section 509(a)."

The exception language could be interpreted as not including section 501(c)(4), (5), and (6) organizations that are considered to be section 509(a)(2) organizations by virtue of the flush language of section 509(a). This clearly was not the intent of Congress and such an interpretation would present a nonsensical result in practical application. Specifically, a publicly supported section 501(c)(6) organization, for example, could qualify as a supported organization under section 509(a), and yet could be effectively prohibited from receiving a loan, grant, compensation or other similar payment from a section 501(c)(3) supporting organization even though that supporting organization is obligated by its very charter to act in support of the supported organization's charitable, educational and other qualifying purposes.

Second: IRC section 509(f)(2)(A), added by the PPA, prohibits an organization from qualifying for section 509(a)(3) "Type I" or "Type III" status if it accepts a gift from a person who directly or indirectly controls the organization being supported.

Section 509(f)(2)(B)(i), like section 4958(c)(3), provides an exception to the "controlling person" restriction for "an organization described in paragraph (1), (2), or (4) of section 509(a)." And, as with section 4958(c)(3), a credible and logical interpretation of the language would be that all organizations that are treated as section 509(a)(2) organizations by virtue of the flush language of section 509(a) are included as part of the exception provided.

But, given the lack of total clarity with regard to these changes, we believe it would be advisable to approve a technical correction to revise the language of the affected subsections slightly. A draft of such slight revisions (in "blackline" format) is set forth on the attached pages, with the proposed new language italicized and bolded. This proposed revision takes language directly from section 509(a) and gives effect to the clear intent of Congress with regard to the affected subsections.

For a more detailed review of this issue, please see the attached analysis documents.

Proposed Technical Correction #1

(b) Certain Transactions Treated as Excess Benefit Transactions.—Section 4958(c), as amended by this Act, is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) Special rules for supporting organizations.—

"(A) In General.—In the case of any organization described in section 509(a)(3)—

"(i) the term 'excess benefit transaction' includes—

"(I) any grant, loan, compensation, or other similar payment provided by such organization to a person described in subparagraph (B), and

"(II) any loan provided by such organization to a disqualified person (other than an organization described in paragraph (1), (2), or (4) of section 509(a), ***including an organization described in section 501(c)(4), (5), or (6) which***

would be described in paragraph (2) if it were an organization described in section 501(c)(3)), and

"(ii) the term 'excess benefit' includes, with respect to any transaction described in clause (i), the amount of any such grant loan, compensation, or other similar payment.

"(B) Person described.—A person is described in this subparagraph if such person is—

"(i) a substantial contributor to such organization,

"(ii) a member of the family (determined under section 4958(f)(4)) of an individual described in clause (i), or

"(iii) a 35-percent controlled entity (as defined in section 4958(f)(3) by substituting 'persons described in clause (i) or (ii) of section 4958(c)(3)(B)' for 'persons described in subparagraph (A) or (B) of paragraph (1)' in subparagraph (A)(i) thereof).

"(C) Substantial contributor.—For purposes of this paragraph—

"(i) In general.—The term 'substantial contributor' means any person who contributed or bequeathed an aggregate amount of more than $5,000 to the organization, if such amount is more than 2 percent of the total contributions and bequests received by the organization before the close of the taxable year of the organization in which the contribution or bequest is received by the organization from such person. In the case of a trust, such term also means the creator of the trust. Rules similar to the rules of subparagraphs (B) and (c) of section 507(d)(2) shall apply for purposes of this subparagraph.

"(ii) Exception.—Such term shall not include any organization described in paragraph (1), (2), or (4) of section 509(a), ***and such term shall not include any organization described in section 501(c)(4), (5), or (6) which would be described in paragraph (2) if it were an organization described in section 501(c)(3)),."***

Proposed Technical Correction #2

Internal Revenue Code

SUBTITLE A—INCOME TAXES (Sections 1 to 1564)

CHAPTER 1—Normal taxes and surtaxes (Sections 1 to 1400 . . .

SUBCHAPTER F—Exempt Organizations (Sections 501 t . . .

PART II—Private Foundations (Sections 507 t . . .

Sec. 509. Private Foundation Defined

509(f) Requirements For Suppo . . .

509(f)(2) Organizations Cont . . .

Sec. 509(f)509(f)(2) Organizations Controlled By Donors

509(f)(2)(A) In General

For purposes of subsection (a)(3)(B), an organization shall not be considered to be—

509(f)(2)(A)(i) operated, supervised, or controlled by any organization described in paragraph (1) or (2) of subsection (a), or

509(f)(2)(A)(ii) operated in connection with any organization described in paragraph (1) or (2) of subsection (a), if such organization accepts any gift or contribution from any person described in subparagraph (B).

509(f)(2)(B) Person Described

A person is described in this subparagraph if, with respect to a supported organization of an organization described in subparagraph (A), such person is—

509(f)(2)(B)(i) a person (other than an organization described in paragraph (1), (2), or (4) of section 509(a), ***including an organization described in section 501(c)(4), (5), or (6) which would be desribed in paragraph 2 if it were an organization described in section 501(c)(3),)*** who directly or indirectly controls, either alone or together with persons described in clauses (ii) and (iii), the governing body of such supported organization,

509(f)(2)(B)(ii) a member of the family (determined under section 4958(f)(4)) of an individual described in clause (i), or

509(f)(2)(B)(iii) a 35-percent controlled entity (as defined in section 4958(f)(3) by substituting "persons described in clause (i) or (ii) of section 509(f)(2)(B)" for "persons described in subparagraph (A) or (B) of paragraph (1)" in subparagraph (A)(i) thereof).

Statement of Association for Healthcare Philanthropy

The Association for Healthcare Philanthropy (AHP) is pleased to present its comments for the written record for the hearing on tax-exempt charitable organizations.

AHP is an association of professional development executives who are responsible for the management of foundations and development departments of nonprofit health care providers throughout the United States. A critical part of their mission is supporting local health care programs through philanthropic fundraising that directly benefits the institution in which they work. These nonprofit medical facilities approach and have come to rely on the generosity of grateful patients who they have served to help underwrite wellness programs, mobile health vans, mammography screenings, hearing and eye exams, hospital facility improvements, essential equipment upgrades and health care services for the uninsured.

Established in 1967, AHP is a not-for-profit organization whose 4,500+ members manage philanthropic programs of foundations and development departments in 2,200 of the nation's not-for-profit, charitable health care providers. In 2006, this philanthropic support reached $7.9 billion according to AHP's most recent giving survey report. As a practical matter, most, if not all, of health care providers routinely factor into their budgets an expected level of philanthropic support.

AHP represents highly skilled fund raisers in health care philanthropy. Many hold the Certified Fund Raising Executive (CFRE) or the Fellow Association for Healthcare Philanthropy (FAHP) designation, which recognize professionalism in the field by documenting experience and testing knowledge in health care resource development. More than 60% of AHP members have been in the field of fundraising for 11 or more years, with 39% having been in the field for 16+ years. Our members believe in transparency and accountability in their work and follow the AHP Statement of Professional Standards and Conduct and its companion Donor Bill of Rights, copies of which are included with the letter. In addition, in 2006 AHP launched the AHP Performance Benchmarking Service. One of the goals of this program is to provide consistent reporting of fundraising dollars that AHP member organizations generate.

AHP members are an integral part of their health care institutions and are a critical component in attracting needed dollars to support community benefit programs. With that in mind, AHP is a supporting organization of the Catholic Health Association's *Guide for Planning and Reporting Community Benefit*.

As the Oversight Subcommittee reviews 501(c)(3) tax-exempt health care organizations, AHP would like to share with you a number of critically important challenges facing the not-for-profit health care community and some steps AHP is taking to meet these challenges. It is important to understand the environment that health care fund raisers are currently working within to fully grasp the importance of their tax-exempt status and the need for transparency and accountability.

These challenges are fairly complex, but they fall into three main categories: long-term cultural trends, financial challenges, and regulatory concerns.

First, the long-term trend that permeates a whole range of issues confronting the health care community is the sense of entitlement that has developed over the years with regard to health care delivery. This development in our society creates many stumbling blocks for health care philanthropy—particularly for hospitals, medicals centers, long-term care facilities and hospices.

Patients believe that they have a right to the highest quality of care; that the US has the best health care in the world; that it is far too expensive; and that third parties such as insurance companies are making decisions about health care unrelated to the delivery of good care—decisions that should be made by physicians and nurses. For philanthropy, it raises the question— why donate to such a system?

In addition, few Americans are aware of the differences between for-profit and not-for-profit health care providers or the fact that only 12 to 14 percent of providers are in a for-profit delivery system. Fewer still know that only about one-third of hospitals in the United States have a positive bottom line, while another third are barely keeping their heads above water and the rest are deep in red ink and financially in trouble.

Second, the financial challenges to nonprofit health care providers are many. Some are linked to the fact that many hospitals have postponed capital spending and underinvested in their infrastructure. They need to address deteriorating facilities, but fully 85 percent of hospital chief financial officers say it is going to be more difficult for their organizations to fund capital expenditures in future years.

At the same time, technology's promise, particularly in health care delivery, has created enormous stresses on finances relative to providing quality health care and using cutting-edge technology in providing that care. Expensive technological initiatives need to be undertaken to maintain effectiveness, while operating margins that already are thin threaten to become thinner, placing more responsibility on philanthropy to fill in the gap.

Similarly, the burden of meeting the health care needs of the uninsured, including non-citizens, weighs heaviest on the nonprofit sector, even as revenues from Medicare and Medicaid decline.

Third, on the regulatory scene, the Health Insurance Portability and Accountability Act, or HIPAA, is severely impacting efforts of fundraisers. It is making philanthropic activities more costly and less efficient while increasing the cost of compliance because hospitals, nursing homes, clinics and hospices must upgrade computer systems, train staff and pay for legal advice. AHP fully supports HIPAA. Unfortunately, a lack of understanding on the role of institutionally related development offices in a health care organization has led the Federal government to enact that portion of the rule that restricts philanthropic efforts.

In fact, 4 years after HIPAA went into effect, the Federal government in a recent letter to AHP, conceded there were practically no examples of any violations "in the context of fundraising efforts." Complaints of violations of the HIPAA rule have been received by the agency's Office of Civil Rights with practically none involving fundraising.

Yet in a 2007 AHP survey, 56% of respondents who contact past patients report that HIPAA has had a negative effect in their ability to run a successful grateful patient program.

AHP has a lot of educating to do. Health care providers need more information about HIPAA compliance. government officials and legislators need a better understanding of philanthropy.

With that in mind, AHP wants to take the opportunity to educate legislators, the media and the public with regard to nonprofit health care providers and their tax-exempt status. AHP fully supports legislation that stems tax-avoidance scams and that shines more light on compensation packages of nonprofit executives. However, there is a real danger that an all too common problem will arise: unintended consequences. With the challenges facing health care delivery and the definite need for philanthropic support, it is crucial that the role of the development office and its operation is understood fully so as not to thwart fundraising efforts and erode the pubic trust of nonprofit health care providers.

As I mentioned earlier, AHP supports clearly defined terms for data reporting across the board for fundraising entities. Evidence of this is our successful launch of the AHP Performance Benchmarking Service. At its launch, 41 of our AHP members in 18 states and two Canadian provinces have become part of this new fundraising system designed to better meet corporate compliance and transparency requirements, and to ensure that dollars donated by grateful patients or their families are accounted for and spent effectively.

The AHP Performance Benchmarking Service, is a unique, integrated database of business practices and performance metrics for raising philanthropic health care fundraising to new levels of performance. Participating organizations are in Alabama, Arizona, California, Florida, Georgia, Illinois, Maryland, Michigan, Minnesota, Nebraska, New Jersey, New York, Oklahoma, Pennsylvania, Tennessee, Virginia, Washington, Wisconsin, Ontario and Saskatchewan. Philanthropic fundraising, now more than ever, is vital to sustain and grow the nonprofit health care sector's ability to deliver first class services to patients and communities. AHP's Performance Benchmarking Service advances this effort by transforming basic financial and program data into useful information that enables hospital chief executive officers and boards of directors to integrate philanthropy into their overall strategic planning for their health care organizations.

AHP members have as their missions to serve their communities. According to AHP's Report on Giving 2006, health care institutions in the U.S. raised $7.9 billion through philanthropy, a 11.5% increase over 2005. Those dollars are being used for health care construction and renovation, equipment purchases, community benefit programs, charitable care, research and training, general operation, among others. In 2005, the largest expense item for institutions was construction and renovation, accounting for 23.9%. In 2006, that expense rose to 31.8%. Each year AHP members provide data that demonstrate where their philanthropic dollars are being used by their health care organization in order to support their missions—to serve their communities.

In summary Mr. Chairman and Members of the Subcommittee, AHP members feel that every dollar donated is critical, and we are taking all necessary steps to ensure we achieve the most efficient return on the philanthropic investments of grateful donors and their families.

Enc.: AHP Statement of Professional Standards and Conduct

Donor Bill of Rights

Association for Healthcare Philanthropy

Statement of Professional Standards and Conduct

All members shall comply with the Association's Statement of Professional Standards and Conduct:

Association for Healthcare Philanthropy members represent to the public, by personal

example and conduct, both their employer and their profession. They have, therefore, a

duty to faithfully adhere to the highest standards and conduct in:

I. Their promotion of the merits of their institutions and of excellence in health care generally, providing community leadership in cooperation with health, educational,

cultural, and other organizations;

II. Their words and actions, embodying respect for truth, honesty, fairness, free inquiry, and the opinions of others, treating all withequality and dignity;

III. Their respect for all individuals without regard to race, color, sex, creed, ethnic or national identity, handicap, or age;

IV. Their commitment to strive to increase professional and personal skills for improved service to their donors and institutions, to encourage and actively participate in career development for themselves and others whose roles include support for resource development functions, and to share freely their knowledge and experience with others as appropriate;

V. Their continuing effort and energy to pursue new ideas and modifications to improve conditions for, and benefits to, donors and their institution;

VI. Their avoidance of activities that might damage the reputation of any donor, their institution, any other resource development professional or the profession as a whole, or themselves, and to give full credit for the ideas, words, or images originated by others;

VII. Their respect for the rights of privacy of others and the confidentiality of informationgained in the pursuit of their professionalduties;

VIII. Their acceptance of a compensation method freely agreed upon and based on their institution's usual and customary compensation guidelines which have been established and approved for general institutional use while always remembering that:

a. any compensation agreement should fully reflect the standards ofprofessional conduct; and,

b. antitrust laws in the United Statesprohibit limitation on compensation methods.

IX. Their respect for the law and professional ethics as a standard of personal conduct, with full adherence to the policies and procedures of their institution;

X. Their pledge to adhere to this Statement of Professional Standards and Conduct, and to encourage others to join them in observance of its guidelines.

A Donor Bill of Rights

Philanthropy is based on voluntary action for the common good. It is a tradition of giving and sharing that is primary to the quality of life. To assure that philanthropy merits the respect and trust of the general public, and that donors and prospective donors can have full confidence in the not-for-profit organizations and causes they are asked to support, we declare that all donors have these rights:

I. To be informed of the organization's mission, of the way the organization intends to use donated resources, and of its capacity to use donations effectively for their intended purposes.

II. To be informed of the identity of those serving on the organization's governing board, and to expect the board to exercise prudent judgment in its stewardship responsibilities.

III. To have access to the organization's most recent financial statements.

IV. To be assured their gifts will be used for the purposes for which they were given.

V. To receive appropriate acknowledgment and recognition.

VI. To be assured that information about their donations is handled with respect and with confidentiality to the extent provided by law.

VII. To expect that all relationships with individuals representing organizations of interest to the donor will be professional in nature.

VIII. To be informed whether those seeking donations are volunteers, employees of the organization or hired solicitors.

IX. To have the opportunity for their names to be deleted from mailing lists that an organization may intend to share.

X. To feel free to ask questions when making a donation and to receive prompt, truthful and forthright answers.

DEVELOPED BY

American Association of Fund Raising Counsel (AAFRC)

Association for Healthcare Philanthropy (AHP)

Council for Advancement and Support of Education (CASE)

National Society of Fund Raising Executives (NSFRE)

ENDORSED BY

(in formation)

Independent Sector

National Catholic Development Conference (NCDC)

National Committee on Planned Giving (NCPG)

National Council for Resource Development (NCRD)

United Way of America

Association of Art Museum Directors
New York, New York 10022
July 27, 2007

House Ways and Means Oversight Subcommittee
Congressman John Lewis, Chairman
1136 Longworth House Office Building
Washington, DC 20515

Dear Chairman Lewis:

We would like to thank you for the opportunity to comment on the charitable provisions that were contained in the Pension Protection Act of 2006 ("PPA"). The Association of Art Museum Directors, founded in 1916, represents over 170 art museums in the US. We address our comments to you on behalf of our members, most of whom receive fractional gifts and view the ability to do so as an important tool to make the best art available to the American public.

As you may be aware, many of the provisions included in the PPA have had a significant impact on charitable donations to the nation's art museums. In particular, the new restrictions imposed on fractional gifts have resulted in a pronounced reduction in donations of artwork to museums across the country. The loss of important works represented by most fractional gifts will have a lasting negative impact on the public's ability to view and appreciate invaluable works of art, most of which museums could not afford to purchase.

Section 1218 of the PPA tightened the requirements necessary for a taxpayer to receive an income tax deduction for the donation of qualified fractional gifts of tangible personal property to a museum. In most cases, these new rules also limited or reduced the available deduction for the donation of a fractional gift. These changes were made to address perceived abuses surrounding the deductions, particularly in cases where the donated artwork was not in the possession of the acquiring museums. While the changes were drafted to allow fractional gifts to continue to be made, they have effectively ended donations of fractional gifts to museums for several reasons.

First, the reduction in the available income tax deductions received during the life of a fractional gift has made the donation of appreciating artwork financially imprudent.

Second, the necessity to complete the gift in a 10-year period is a serious impediment to donors making substantial gifts. *Third*, the imposition of these changes on fractional gifts entered in to before passage of the PPA has impacted existing contracts for gifts raising questions of both fairness and the imposition of retroactive taxes. *Fourth*, the potentially unusual results created by modifying estate and gift tax rules applicable to fractional gifts has made planning for these donations practically impossible. While some of the above problems could be corrected through technical corrections, such as the estate and gift tax area, other changes will need substantive changes in law.

Already, museums are experiencing a cessation in fractional gift donations. The following are just a few examples that illustrate the problem:

- A West Coast contemporary art museum that was negotiating with a donor for his collection of 40 contemporary works has been informed by the donor that he would not be making the fractional gifts as a result of the law changes.
- An East Coast museum had a donor withdraw his offer for 13 contemporary drawings by well-known artists because of the new restrictions.
- A Santa Fe museum had a potential donor of a Tribal Folk Art collection worth approximately $2 million withdraw an offer to give the collection to the museum
- A Washington, DC museum had an offer to donate a 30% fraction on a collection of 20 prints and drawings withdrawn after the legislation was passed. A Kentucky museum had received five important works as fractional gifts from a collection of 60 pieces of 20th century American Art. Since the passage of the new law the remaining works have not been offered to the museum as had been promised before passage of the PPA.

We look forward to working with you and your Subcommittee to ensure that the overwhelming benefits that the American public derives from their museums' diverse and growing collections are enhanced by administrable and rational tax policy. While there may have been a need to correct potential abuses, we believe that the changes made in PPA went far beyond addressing these concerns and have had an unnecessary detrimental impact on our Nation's art museums.

Sincerely,

Gail Andrews
President

Statement of Association of Blind Citizens, Holbrook, Massachusetts

As you review how the Internal Revenue Code affects charitable giving, I am writing to provide the Committee with some information regarding the impact of changes made in 2004 as part of the American Jobs Creation Act to the Federal Tax Code regarding deductible vehicle donations. These changes have significantly reduced the number and value of vehicles being donated to the Association of Blind Citizens (ABC). For years before the law changed, ABC found vehicle donations to be an important and stable revenue stream. The moneys we received were used to provide critical services to the blind and visually impaired community. As unrestricted funds, these donations were utilized to support direct services and general operating expenses.

The 2004 changes have seriously impacted our work and, I am sure, the services provided by many other charities across the United States. In 2004, ABC received 3,823 vehicle donations. In 2006, ABC received 1,302 vehicle donations—a 65% decrease in volume following the change in the Tax Code. ABC's agent, Helping Hands of America, does not accept cars that are not running, which has enabled ABC to receive higher quality donations. The practice of not accepting vehicles that do not run, a practice we continue today, helps to curtail abuse of the Tax Code because a car that cannot be on the road could not represent an accurate fair market value tax deduction.

As you know, before tax year 2005, a taxpayer could deduct the fair market value (FMV) of vehicles donated to charity. Under what was then section 170 of Title 26 of the US Code, a donor could claim the FMV as determined by well-established used car pricing guides up to $5,000. I believe that donors who donated cars in working order were more likely to follow the law and claim the appropriate FMV. The donor was able to use a standard published guide such as the Kelly Blue Book to help them to compare options regarding their vehicle disposition.

Under the new section 170, deductions over $500 are limited to the actual proceeds from the sale of the vehicle, regardless of its appraised value. This means that a taxpayer with a newer-model car in good condition has no real idea what deduction will be allowed until the vehicle is sold. So donors must risk getting far less credit for the donation than it is actually worth. And they must wait days, weeks or months—sometimes into the next tax year—to learn the result. In our experience, donors with late model cars are not willing to take this risk.

Clearly, these changes that took effect in 2005 has caused a significant drop in the volume of donations. We did not make any changes in our marketing program from 2004 to 2006. In 2004, the average age of ABC's vehicle donation was 10–12 years; in 2006, the average age of vehicle donations was 12–14 years old.

I believe that potential donors are deterred from making a vehicle donation because they do not have a standard guide to obtain approximate tax deduction information. If the donor is not able to determine approximate FMV, he/she is not able to compare the tax deduction value to the options of privately selling the vehicle or trade value which is being offered by an automobile dealer. I have spoken to many donors who told me that the dealer was giving them a bad trade deal and they were happy that they could make the donation knowing proceeds were going to a good cause in addition to receiving a tax deduction.

The change in the tax law has resulted in fewer donations, especially of higher-value cars which are also the transactions least subject to abuse. This lost revenue has been difficult to replace, so we have had to reduce staff and the direct services we provide to the blind and visually impaired. It's hard to believe that's really what Congress really intended.

Please consider the issues that I have briefly discussed above as the Subcommittee reviews policy toward tax-exempt organizations. I fully respect and understand the need to curb abuse of the Tax Code. However, I believe that changes aimed at reducing abuses must be carefully balanced against the benefits to charities that Congress meant to encourage when it originally approved tax deductions for vehicle donations.

Thank you for your time and consideration of this vital matter. I look forward to working with you and am available to provide any additional information that you may need.

Statement of Association of Fundraising Professionals

On behalf of the Association of Fundraising Professionals (AFP), I am writing to provide comments regarding the provisions relating to tax-exempt organizations in the Pension Protection Act of 2006. As an organization that represents individuals responsible for generating philanthropic resources, AFP has first-hand knowledge and understanding of charitable giving. We hope that our thoughts and perspective will prove helpful to you as you review this legislation.

Background

AFP represents nearly 28,000 members in more than 190 chapters throughout the world, working to advance philanthropy through advocacy, research, education and certification programs. AFP members work for a wide variety of charities, from large multi-national institutions to small, grassroots organizations, engaged in countless missions and causes including education, healthcare, research, the environment and social services, to name a few. In 1960, four forward-thinking and prominent fund raisers met with the goal of creating an association, now AFP, that would promote good stewardship, donor trust, and ethical and effective fundraising.

AFP members are required annually to sign our *Code of Ethical Principles and Standards of Professional Practice*, which were first developed in 1964. A copy of the Code is attached. AFP instituted a credentialing process in 1981—the CFRE, or Certified Fund Raising Executive designation—to aid in identifying for the giving public fund raisers who possess the demonstrated knowledge and skills necessary to perform their duties in an effective, conscientious, ethical, and professional manner. This was followed in 1990 by the ACFRE for advanced fund raisers. We also have a strong ethics enforcement policy that can result in the revocation of credentials and expulsion of members who engage in prohibited behavior.

This background is cited to emphasize the importance that AFP and its members place on ethical fundraising. Much of our work is spent educating and training our members and the public in ethical fundraising practices while working with Federal and state regulators to improve regulation and to identify wrongdoers who don't belong in the charitable sector.

In addition, since its founding, AFP has championed donor rights. AFP was the driving force behind the creation of the *Donor Bill of Rights* and provides information to potential donors about how to select, evaluate, and give wisely to charities. AFP encourages all donors and nonprofit volunteers to investigate and become engaged with charities of their choice before making financial commitments. A copy of the *Donor Bill of Rights* is attached.

The IRA Rollover

The charitable giving provisions in the Pension Protection Act are helping our Nation's charities to thrive. In particular, the IRA Rollover provision is a powerful incentive, allowing donors to transfer funds directly and tax-free from an IRA to a charitable organization. This provision encourages potential donors to draw upon a new source of assets in support of charitable organizations that serve the public good.

Under the current provision, a donor who has reached the age of 70½ is allowed to exclude from his or her income any IRA funds up to $100,000 that are withdrawn and transferred to a charity when filing a tax return for the year of the transfer.

Tax incentives such as the IRA Rollover provision play a vital role in encouraging donors to make gifts, especially as the contribution amounts become larger. In fact, in just the past 10 months, the IRA Rollover provision has brought in over $69 million in new gifts for the charitable sector according to a recent National Committee on Planned Giving survey. It is worth noting that the survey, while instructive, is not comprehensive and does not cover the entire charitable sector. It merely represents a fraction of the positive impacts of the IRA Rollover provision.

In fact, it is estimated that there is more than $2.7 trillion in retirement funds like IRAs. The individuals and communities served by the nation's charitable sector can benefit from the IRA Rollover provision because it encourages a significant amount of new contributions from individuals who would no longer have to pay tax on a charitable gift of IRA funds. These contributions support programs for those less financially well off through important services, such as those provided by health, education, social service, and cultural organizations.

Unfortunately, the IRA Rollover provision is scheduled to sunset at the end of 2007. It is imperative that Congress make this provision permanent for the nation's charities.

Equally important, to make the provision even more effective, Congress should not only make the IRA Rollover permanent, but it should also enhance the provision by removing the $100,000 cap on gifts from IRA accounts, and by lowering the age threshold for all such gifts from 70½ to 59½.

Many in the charitable sector believe that this single provision alone will have the greatest demonstrable positive impact for all charities of any changes to Federal gift tax proposals.

Charitable Reforms

A few other charitable reforms were contained in the Pension Protection Act of 2006. Although they were mostly commonsense reforms that likely will not burden our Nation's charities, we are concerned about a potential slippery slope that might result in the enactment of unduly burdensome charitable reforms that would deter charities from fulfilling their altruistic missions.

Over the past few years, we have witnessed the introduction of proposed charitable reforms that sought to raise revenue from the charitable sector. For instance, it has been proposed that new "user fees" be imposed on the sector together with the drastic modification or complete elimination of deductions for charitable contributions of property—so called noncash contributions. Another proposal would have established a floor on deductions for both taxpayers who claim the standard deduction and those taxpayers who itemize their deductions, which essentially would impose a tax on deductions. Such proposals turn the concept of tax exemption on its head.

It also is worth noting that empirical data indicates that there is NOT widespread abuse among the charitable sector and that the new proposals are unnecessary. Reports collected by the FBI, the Federal Trade Commission, State Attorneys General and even watchdog groups like the Better Business Bureau show that reports of charity fraud are less than 1 percent of all complaints of fraud.

Moreover, the IRS already has the statutory authority, rules, regulations and enforcement mechanisms to effectively police the charitable sector. Existing laws are fully sufficient to address the abuses which may be occurring in the sector. A recent study found that of the 94 abuses cited by the Senate Finance Committee during its June 2004 hearing on charity oversight, 92 of those abuses could have been addressed by current laws, regulations and reporting requirements. However, the IRS has never been given the Congressional budget appropriations necessary to engage in the reasonable level of enforcement activity necessary to fulfill its statutory mandates.

AFP does not oppose demonstrably necessary nonprofit sector regulations. Legitimate fund raisers understand the need for regulation, and AFP has strongly supported *appropriate and defensible* initiatives on both the Federal and state levels that have increased regulation of charities and fundraising.

But in every case, the regulations that AFP has supported have been balanced with the charitable sector's need to raise funds for the critical programs it provides. AFP is concerned that some proposed reforms, like unprecedented user fees and floors for itemized deductions, will prove extremely burdensome to many charities, resulting in the loss of funds, while doing little to accomplish their stated goal of curbing abuses.

Conclusion

AFP appreciates the opportunity to provide comments to the House Ways and Means Subcommittee on Oversight.

I appreciate the opportunity to share AFP's views with you. I look forward to working with you and the Subcommittee on issues related to the tax-exempt sector.

Thank you for your time and consideration.

Statement of Atlanta Union Mission, Atlanta, Georgia

The Association of Gospel Rescue Missions (AGRM) represents 294 rescue missions in the United States that provide critical services to homeless and poor individuals who face the greatest challenges. Founded in 1913, AGRM's member missions offer emergency food and shelter, youth and family services, prison and jail outreach, medical care, rehabilitation, and specialized programs for the mentally ill, the elderly, the urban poor, and street youth.

Combined member ministries of the AGRM comprise one of the largest non-profit organizations in the United States. Last year, AGRM missions served more than 41 million meals, provided 15 million nights of lodging, distributed more than 27 million pieces of clothing and 1.1 million furniture items, and provided 142,000 individuals with the educational programs necessary to achieve productive living.

Recently, the Congress passed and the President signed the *Pension Protection Act of 2006 (PPA)*. Included in this law are a series of charitable tax reforms designed to encourage greater charitable giving. We hope that these charitable tax reforms accomplish their intended purpose of increasing the resources charities have to serve and promote the common good.

Unfortunately, one provision (Section 1216), of the PPA, if wrongly implemented, has the potential to severely hinder the charitable sector. Specifically it could cripple the ability of the member missions of AGRM from carrying out our important mission. The provision benignly states:

"Limitation of deduction for charitable contributions of clothing and household goods"

"In General—In the case of an individual, partnership, or corporation, no deduction shall be allowed under subsection (a) for any contribution of clothing or a household item unless such clothing or household item is in good used condition or better."

Our concern is addressed later in this testimony and is rooted in the original proposal set forth by the Senate.

Thrift Shops Providing Clothing & Household Goods to the Poor

One of the primary charges of rescue missions in America is to clothe the homeless and the poor. To this end, 132 rescue missions operate approximately 200 thrift stores around the United States. Each year, Americans contribute an estimated $277 million in clothing and household goods to our missions. The contributions are critical to the ability of our member missions to provide necessary clothing and other items for clients who participate in both our emergency and long-term rehabilitation programs. While these contributions provide our missions some revenue, of equal importance, the operation of thrift stores provide the poor, specifically the working poor, with the opportunity to clothe themselves and furnish their homes at an affordable cost. Moreover, the operations of thrift stores provide AGRM member missions an opportunity to integrate residential recovery programs with real experience, thereby providing vocational training for clients and customers. We do so by maintaining the dignity and pride of our customers.

We are proud of the merchandise we provide to the poor and homeless and we want the poor and homeless to be proud of the merchandise they obtain from our missions and thrift stores.

Atlanta Union Mission

For example, Mr. Chairman, the Atlanta Union Mission, located in Atlanta, Georgia, runs six thrift stores throughout the Metro Atlanta region. Proceeds from the thrift store operations are used to help fund the Mission's programs of emergency services and recovery. The ministry also makes vocational training available to men in recovery at the Mission's Northeast Georgia Campus (The Potter's House), and it employs qualified recovery program graduates. The Mission also donates a significant amount of merchandise to needy families in the community. Opened in 1938, the Mission serves as many as 1,070 individuals each day with residential recovery programs, emergency shelter, and transitional housing.

Through its thrift stores, the Mission reaches more than 200,000 customers each year. Last year, the Mission distributed free of charge, 44,600 pieces of clothing and household goods to clients or persons in need from the community. These were all items that had been donated to the Mission. Another 1.15 million items that were donated to the Mission were used to stock and replenish the thrift stores.

With the help of clients, volunteers and about 15 paid staffers, the Mission is able to process and distribute these donations. In addition, the Mission currently operates seven trucks, 5 days a week. This translates to approximately 1,820 truckloads of gifts-in-kind picked up by the Mission each year.

If section 1216 were to be interpreted or implemented in a draconian fashion as originally described and envisioned in Senate legislation, the Mission would have to quadruple the number of paid staff, clients, and volunteers working in its thrift stores in order to handle the volume of paperwork associated with itemizing and documenting each item donated. The truckdrivers would no longer be able to complete the 7–10 daily pick-ups they currently make. As the truckdrivers do not work in the thrift stores, they are not best suited to assessing the condition or value of donated items. As great or greater would be the impact upon the ability of staff at the Mission's thrift stores. For example, it is very common for large donations to be delivered to the Mission on Saturdays. In the larger stores, a dozen people or more would be required to process the volume of donations. This is not something that the Mission can afford to do. Alternatively, the Mission would be forced to close down its six thrift stores in the Atlanta region:

- **Athens Thrift Center**
- **Comerce Thrift Center**
- **Cumming Thrift Center**
- **Gainesville Thrift Center**
- **Snellville Thrift Center**
- **Winder Thrift Center**

Union Gospel Mission Twin Cities and the Marie Sandvik Center, Inc.

In Minnesota, the Union Gospel Mission Twin Cities and the Marie Sandvik Center, Inc, provide a wide variety of services to the homeless. Both missions are dedicated to providing clothing and other items necessary to meet the basic human needs of the men, women and children that reach out to the missions. While neither the Marie Sandvik Center nor the Union Gospel Mission have a thrift store, they are representative of all of our member missions who rely heavily on donated clothing and household goods to meet the needs of individuals who participate in programs at the Mission as well as for the homeless and needy who come to the Mission for help. Thousands of donations of gifts in kind are received each year by these missions. Neither the Marie Sandvik Center nor Union Gospel Mission sell these items—they give them away because they believe good, decent clothing is an important component of building self-confidence for these people who have been through great struggles.

If section 1216 were to be interpreted or implemented in a radical manner, the Union Gospel Mission, the Marie Sandvik Center, and all of our member missions who accept donations of clothing and household goods would find their ability to function effectively severely compromised. For example, the Union Gospel Mission receives donations of approximately 80,000 pounds of clothing and goods each year. The Union Gospel Mission would have to add multiple staff persons or take current full-time staff away from their direct work with clients in order to properly process the volume of clothing and goods donated to the Mission.

AGRM Supports section 1216 But Remains Concerned About Overregulation

AGRM supports the language of section 1216 because we believe that it clarifies the current practice of requiring the taxpayer to accurately and honestly report charitable donations. AGRM is concerned, however, that if the IRS interprets and implements the provision in the most draconian sense it could shift the responsibility from the donor to the donee charitable organization to evaluate and appraise the donation of clothing and household goods.

This provision, as originally proposed in S. 2020, the Tax Relief Act of 2005, would have required the Secretary of the Treasury to annually publish an itemized list of clothing and household goods and assign an amount representing the fair market value of each item in good used condition. Every conceivable item would have had to be assigned a value, from shoes, socks and pantyhose to jeans, sweaters, and suits to hats, scarves, and bandanas. And, the burden of assessing or valuing each article of clothing or household good donation would have fallen on our rescue mission clients, staff, and volunteers. Imagine the amount of time it would take a truck driver who is picking up a contribution of clothing and goods from a donor's home. In order to comply with the provision, the truckdriver would have to sort through each item, making the judgment of whether or not the item was in good used condition so that he could properly credit the donor for the contribution. If a used coffeepot were included in the donation, for example, should the truckdriver ask the contributor if he may make a pot of coffee to determine if the coffeepot works? Similarly, consider the burden that would be placed on a staff person or volunteer who receives donations at a mission. Imagine the backlog that would develop as the mission staff examine and evaluate each and every item while the donor waits for the process to be completed. The mission or any nonprofit in a similar situation would quickly be overwhelmed, potentially discouraging donors from donating items to the missions.

This proposed change presented serious concerns for AGRM, including:

1. The potential personnel hours and paperwork involved in complying with this proposal would have been extensive, and would have required itemizing, defining, and determining the condition of each donation at point and time of intake. Most of our members would not have the resources to meet this requirement and would be forced to close their thrift store operation.
2. Alternatively, a donor who disagreed with the Treasury's valuation list or our member's assessed value could have asked for a receipt for the value of the sale at a later date. It would not have been feasible for our thrift stores to provide documentation of sales amounts to the donor of donated items. Such a burden would be crippling to our organization.[1]
3. The Secretary would be required to establish values of donated items which may or may not be accurate. A vase from a dollar store has a very different value than a crystal or silver vase from Dillard's or Macy's.
4. If enacted, this provision would have placed nonprofit organizations in the unreasonable and uncomfortable position of being the evaluator between the taxpayer and the taxing entity.

[1] Because it is not possible to determine if a donated item will be sold or given away in the future by the charity, there would be no assurances that a sales record would be available to the donor at point of intake. Our member missions do not barcode the millions ofm donated items for tracking through our system.

To shift the overwhelming evaluation and appraisal process as well as the extraordinarily complicated accounting process would have tragic consequences. Not only would staff costs increase dramatically, but our missions would be forced to take staff away from hands-on work of meeting the critical needs of our clients. As a result, our ability to transform the lives of the hurting would be greatly diminished. Additionally, it would cripple our revenue streams, it would cripple our practical training programs, and it would cripple the poor and working poor who rely on thrift stores for everyday clothing and household goods.

Rightfully, rationally, and thankfully, the provision enacted into law in the Pension Protection Act leaves the responsibility to fairly and accurately report the value of a charitable donation of clothing and household goods, in good used condition or better, on the donor. AGRM is fully supportive of this provision and urges the Committee to ensure that the provision is implemented and interpreted as written.

AGRM supports Congress's efforts to encourage charitable giving. Overwhelmingly, our member missions rely on the generosity of their communities to provide them with clothing and household goods and with monetary donations to carry out vital services such as education, counseling, job training, and addiction treatment. We appreciate the need for accurate accounting practices, but we urge the Committee to ensure that the laws they pass are not arbitrary and ensure that they will not add hours of paperwork, increase accounting costs, or worse, discourage charitable giving.

Baton Rouge Area Foundation
Baton Rouge, Louisiana 70802
July 27, 2007

Committee on Ways & Means
Subcommittee on Oversight
U.S. House of Representatives
1102 Longworth House Office Building
Washington D.C. 20515

Dear Committee Members,

I am writing this letter to supplement the letter my colleagues and I drafted in response to your request for comments regarding the impact of certain provisions of the recently enacted Pension Protection Act of 2006 (PPA). In addition to recognizing that the PPA has many beneficial provisions which promote charitable giving, we outlined our concerns and advised you to discontinue the provisions which hinder legitimate philanthropic initiatives. Because we would like you to amend the PPA provisions which unfairly penalize donor advised funds, I would like to provide additional examples demonstrating the good that donor advised funds have done over the past 2 years. Donor advised funds offer a unique way for individuals to donate to charitable causes, and thus increasing philanthropy overall.

After Hurricanes Katrina and Rita, the Baton Rouge Area Foundation's activities shifted, and our main focus became aiding those who had been affected by two of the three largest natural disasters in our country's history. We were overwhelmed yet very grateful for the support we received from people across the United States. In total, we received over $45 million in donations designated for hurricane relief efforts. Various community foundations and national charities made significant donations to help us aid hurricane victims. Without the support of donor advised funds, the Foundation would not have been able to fund as many programs devoted to hurricane relief efforts. In this instance, donor advised funds helped over 99 charitable organizations which in turn provided aid to individuals affected by Hurricanes Katrina and Rita. Our local knowledge and strong relationships with Louisiana nonprofits helped ensure donors that their money would be devoted to the cause they wished to support.

It makes no difference whether donors choose to establish a donor advised fund at a national charity or at a community foundation. Both institutions provide effective means to support philanthropic endeavors. Donors benefit greatly when they can choose from various mechanisms to donate to charities because no two donors are exactly alike. Each form of organized giving has a different objective and fulfills different needs.

Donor advised funds have created an efficient way for donors to plan their giving. Donor advised funds established at national as well as those established at community foundations advance philanthropy by connecting donors with charities whose needs match the donors' philanthropic interests. Such efficiency in giving was clear when donors wanted to help South Louisiana residents who were impacted by Hurricanes Katrina and Rita. Institutions that manage donor advised funds were able to move funds efficiently and got money to those organizations serving impacted individuals quickly.

Without the use of donor advised funds, we would not have been able to provide such great support to South Louisiana's recovery efforts. In addition to the countless recipients of aid, the Foundation's administration and Board of Directors are indebted to those institutions that maintain donor advised funds. These donors directed massive amounts of funds, affection, and good will to hurricane affected areas. We remain grateful for the donors' belief in us and know that we could not have helped so many South Louisiana residents without the support from donor advised funds.

Sincerely,

John G. Davies
President

Statement of Capital Region Community Foundation

The Subcommittee has requested comments regarding the impact of the Pension Protection Act of 2006 (the Act) upon charitable foundations. The Capital Region Community Foundation, located in Lansing, Michigan, has been adversely affected by one particular portion of the Act, dealing with scholarship funds, in a manner that seems to be an unintended consequence of the Act's provisions. Other community foundations around the nation have been similarly affected, and the wording of the current statute will in the long run discourage the establishment of scholarship funds that would otherwise assist thousands of deserving students obtain a college education.

The problem lies in the way in which the Act affects scholarship funds that are established by sponsoring organizations or associations. These include service clubs (Rotary, Kiwanis, Lions, and so forth.), high school alumni groups, professional associations, and other civic organizations that are not 501(c)(3) entities. They also include 501(c)(3) organizations such as educational foundations associated with local schools, as well as school districts themselves. Tens of thousands of such organizations around the country have established scholarship funds designed to assist students from local high schools attend college. The awards are often modest, but the members and supporters of these organizations are quite proud of the financial assistance they are able to render to local students, especially since these scholarship awards are often based in large part upon financial need.

Many of these organizations have utilized their local community foundations, which are public charities, as the vehicles for holding and managing these scholarship funds. This arrangement allows individual donors to receive tax deductions for their gifts, and the funds can be professionally invested, benefiting from the safeguards associated with community foundation management. Prior to the enactment of the Act, sponsoring organizations that utilized a community foundation to hold and invest the funds could still handle the administration of their own scholarship programs, including the review of applications and the selection of award recipients. The ability of a sponsoring organization to make the award selections is understandably a source of pride for its members and supporters, and has served to encourage ongoing donations to such scholarship funds by many individuals.

Unfortunately, under the provisions of the Act such scholarship funds now fall under the definition of "donor advised funds," and donor advised funds are precluded under the Act from making grants to individuals, whether such grants are made directly to an individual, or to a college or university on the individual's behalf.[1] Although the Act provides an exception to this rule, the primary way that such scholarship funds can fall within that exception is for the sponsoring organization to give up its ability to select the scholarship recipients. Instead, the community foundation must appoint an independent advisory Committee to make those selection decisions.[2]

[1] Note that a 501(c)(3) organization (or other qualified organization) that can make scholarship grants to individual students from a fund it holds on its own is prohibited by the Act from making similar award decisions regarding a fund that it establishes with a community foundation. Treating the two situations differently makes no logical sense.

[2] The Act provides another exception for funds that make distributions to only one organization. However, this exception is unavailable in many situations, such as: (1) where the fund provides support for charitable causes other than scholarships, and distributions are therefore

This results in two adverse consequences. First, the community foundation must assume full responsibility for administering the scholarship program, including the recruitment and appointment of advisory committee members unrelated to the sponsoring organization, coordination of the committee's meetings, and the handling of all paperwork associated with the committee's work. As a result of incurring this additional burden, the foundation usually has to charge a higher administrative fee, which naturally reduces the amount available for scholarships.

Second, and more importantly, this arrangement reduces the sponsoring organization's involvement in the scholarship selection process, and diminishes its members' interest in contributing to a scholarship over which the organization has lost control. Although the Act permits the sponsoring organization to have some representation on the advisory Committee, such limited participation understandably reduces the organization's membership's sense of satisfaction and level of support for "their" scholarship fund. When one considers the large number of such scholarship funds across the nation, the cumulative negative impact of such loss of support is quite significant.

I would propose that the Act be amended to allow sponsoring organizations to make scholarship award decisions relating to funds they have established with community foundations, provided that the grants are awarded in an objective and nondiscriminatory basis, as the Act requires.[3] This would restore to these organizations the incentive to continue funding the tens of thousands of scholarships that they support each year, reduce the administrative burden on community foundations, and increase the number of scholarship dollars available to deserving students nationwide.

Statement of Chapman Trusts

The Chapman Trusts are a group of 12 trusts supporting 18 charitable, medical and educational organizations in Oklahoma, Arkansas and Texas.[1] The trusts are managed by independent fiduciaries and have provided consistent and responsive support to their charitable beneficiaries since 1949. Because each of the twelve trusts is a type III supporting organization, the following comments are confined to those provisions of the Pension Protection Act[2] (the "PPA") affecting type III supporting organizations.[3]

Introduction

Unlike type I and type II supporting organizations, whose governing boards are controlled by or overlapping with those of the supported organizations, type III supporting organizations have governing boards that are independent of those of their supported public charities.[1] In order to demonstrate that a type III nevertheless has a sufficiently close relationship with its supported organizations to justify its public charity status, existing Treasury Regulations have required such organizations to meet two tests: a "responsiveness test" and an "integral part test." The responsiveness test requires that the supporting organization be responsive to the needs and desires of its supported organizations, while the integral part test requires that the support actually provided by the supporting organization is substantial and needed by the supported organizations to conduct their charitable programs. Together, these two tests ensure that, despite having independent management, the supporting organization is operating closely with the supported public charities in much the same way as a controlled subsidiary would.

We agree with the distinguished panelists at the Subcommittee's hearing on July 24, including Steven T. Miller, Commissioner of the Tax Exempt and government Entities Division of the Internal Revenue Service, and Steve Gundersen, President and chief executive officer of the Council on Foundations, that in general the chari-

made to various charitable organizations; and (2) where the sponsoring group is informally organized, such as an alumni group for a local high school, and therefore has no bank account, financial officer, and so forth. In addition, channeling scholarship moneys through the sponsoring organization is often less secure than having the community foundation—with its substantial internal controls—handle the moneys and issue scholarship checks directly from the fund.

[3] Where the sponsoring organization is a 501(c)(3) organization (or other qualified organization), the community foundation should be permitted to assume that the decisionmaking process is carried out appropriately. In other cases, the community foundation can exercise due diligence to ensure that the selection process complies with the necessary requirements.

[1] See attached schedule of Chapman Trust beneficiaries.

[2] Pub. L. No. 109–280, 120 Stat. 780 (2006).

Each Chapman Trust is a state law charitable trust, exempt from taxation under IRC § 501(c)(3) and qualifying as public charity under I.R.C. § 509(a)(3)(iii).

table sector is very compliant with the tax laws. We also acknowledge that there are those in every sector, including our own, that will use whatever means are available to enrich themselves, and that in recent years some have used type III supporting organizations for improper personal gain. However, as was pointed out numerous times during the Subcommittee's hearing, the charitable sector is a vital part of American society, and charitable organizations—including type III supporting organizations—play an important role in healing the sick, educating our young, caring for the aged and at-risk youth, and countless other important tasks that the government alone cannot accomplish.

Several provisions of the PPA were aimed at supporting organizations generally and type III supporting organizations specifically. It is no secret that some on the Hill would solve the problem of abuse within the type III community by eliminating all type III supporting organizations,[4] and many of the PPA provisions appear to reflect this radical approach. For example, without attempting to delineate between abusive and essential supporting organizations, the PPA jeopardized the private foundation funding for all type III supporting organizations (and in some cases all supporting organizations) by placing harsh penalties on private foundations that fund certain type III supporting organizations. Similarly, without any evidence of the extent or nature of the abuse of supporting organizations save a few anecdotal media reports, the PPA included sweeping prohibitions on compensation of substantial contributors to all supporting organizations, as well as reimbursement of expenses they incur, that extend far beyond the restrictions placed even on private foundations. Other provisions appear to have been hastily inserted, without much idea as to how they would apply in practice, leading potentially to many unintended consequences. And yet other provisions delegate to Treasury vast discretion to subject all type III supporting organizations to restrictive operating and payout requirements that would inhibit the ability of good organizations to provide support tailored to the needs and desires of their supported public charities.

We submit that this is no way to strengthen and improve the charitable sector. Instead, Congress should undo the misguided PPA supporting organization provisions and direct the IRS to embark on a comprehensive program of enforcement of the current regulatory standards. This would eliminate abusive supporting organizations that are indirectly controlled by or providing private benefits to their donors as well as organizations that do not have a close relationship of responsiveness and dependence with their supported organizations. In addition to weeding out abusive entities without uprooting effective organizations, such a targeted effort would provide Congress with information about the nature and extent of actual supporting organization abuses so that, with input from compliant and constructive type Ills and their supported public charities, Congress could enact an effective package of legislative reforms that would not eliminate good organizations along with the bad.

Although piecemeal amendment of the PPA's supporting organization provisions cannot make up for the lack of information or absence of collaboration in the lead up to their passage, it would nonetheless alleviate some of the difficulties these provisions have caused or may cause for numerous supporting organizations that daily contribute to the education, health and welfare of our communities. Following are specific comments on some supporting organization provisions of the PPA offered in response to your request for information regarding how the PPA's new rules affect charitable organizations and the difficulties arising in implementing PPA provisions.

Responsiveness

Two of the new provisions in the PPA are aimed at strengthening the responsiveness test in existing Treasury Regulations in order to ensure that an appropriately close relationship exists between the supporting and supported organizations. In current Treasury regulations, there are two alternative methods to satisfy the responsiveness test. The first alternative generally requires either that at least one officer or board member of the supporting organization be appointed by or be one of the supported public charity's officers or governing board or that the officers or board members of the supporting organization maintain a "close and continuous" relationship with the officers or board members of the supported organizations. In addition, by reason of the relationship between the supporting and supported organizations' leaders, the supported organization must have a "significant voice" in the investment policies of the supporting organization, the timing and manner of making grants, the selection of grant recipients of the supporting organization, and other-

[4] See *Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities: Hearing Before the Senate Committee on Finance,* **108th Cong., Staff Discussion Draft at 2, at *http://finance.senate.gov/hearings/testimony/2004test/062204stfdis.pdf***

wise directing the use of the income or assets of the supporting organization.[5] The second alternative, sometimes known as the "trust option," allows type III supporting organizations that are state law charitable trusts to meet the responsiveness test if (i) the trust is a charitable trust under state law; (ii) each beneficiary is named specifically in its governing instrument; and (iii) each beneficiary has the power to enforce the trust and compel an accounting under state law.[6] Many type III supporting organizations have been created as state law charitable trusts in conformity with this regulation.

The first of modification of the responsiveness test was the addition of new Code section 509(0(1)(A), which requires supporting organizations to provide certain information specified by the Treasury Secretary to each supported organization, such as the supporting organization's governing documents, its annual Forms 990 and 990–T, and an annual report detailing the support provided to its supported organizations as well as a projection of support to be provided in the next year.[7] The provision of additional information about the supporting organization's finances and activities will enable the supported organizations to better monitor and supervise the supporting organization and increase the ability of supported organizations to make meaningful recommendations and requests of the supporting organization, and we fully support this new requirement. In fact, since inception the Chapman Trusts have provided the named beneficiaries annually with copies of the Trusts' Forms 990 and statements of trust activity, including all trust income and disbursements (trustee fees, consulting fees, and so forth.) and current trust asset values. Failure to provide such information would be a factor in determining whether the supporting organization meets the responsiveness test, allowing the IRS to deny type III supporting organization status to abusive organizations that do not maintain the intended close and responsive relationship with their supported organizations.

The second attempted modification of the responsiveness test fails for lack of clarity and attention to the application of the rules to type Ills organized as trusts. section 1241(c) of the PPA provides that for purposes of satisfying the requirements for type III supporting organization status a trust shall not be considered to be operated in connection with a supported organization "solely because (1) it is a charitable trust under state law, (2) the supported organization . . . is a named beneficiary of such trust, and (3) the supported organization . . . has the power to enforce the trust and compel an accounting."[8] The meaning of this provision is far from clear. Standing alone it appears to be merely an accurate statement of the existing regulations: solely meeting the trust option of the responsiveness test has never been sufficient to establish an "operated in connection with" relationship with a supported organization, because the integral part test must also be met. In its technical explanation, the Joint Committee on Taxation indicates that this provision of the PPA means that type III supporting organizations organized as trusts "must, in addition to present law requirements, establish to the satisfaction of the Secretary that it has a close and continuous relationship with the supported organization such that the trust is responsive to the needs or demands of the supported organization."[9] We certainly affirm the value of a close relationship between the trustees of a supporting organization and the leadership of its supported organizations. We have long maintained very close working relationships with the board and officers of each of our supported public charities, and we believe this to be necessary in order for us to fulfill our fiduciary duties under state trust law to these beneficiary organizations.

We have heard that in some instances a type III trust has claimed it met the responsiveness test under the trust option while failing to ever inform its supported organizations of its existence. This is clearly improper, and it is difficult to see how such an organization could meet the integral part test, which must also be satisfied before an organization can qualify as a type III supporting organization under current regulations. As noted above, we fully support the addition of new Code section 509(f)(1)(A), which gives the IRS an additional tool to use to shut down these abusive supporting organizations.

However, simply applying the other current alternative, the "close and continuous relationship" option, to all type III charitable trusts, as the IRS seems poised to

[5] Treas. Reg. § 1.509(a)–4(i)(2)(ii).

[6] Treas. Reg. § 1.509(a)–4(i)(2)(iii). State trust law varies by state. However, in Oklahoma, trustees have a duty of loyalty to invest and manage the trust assets solely in the interest of the beneficiaries, and a duty of impartiality to invest and manage the trust assets of multiple beneficiaries impartially. Okla. Stat. tit. 60, §§ 175.65,175.66. In addition, private inurement to employees, officers, directors and members of the governing board is prohibited. Okla. Stat. tit. 60, § 301.8.

[7] PPA, § 1241(b), 120 Stat. at 1102; Staff of the Joint Committee on Taxation, 109th Cong., *Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," As passed by the House*

do,[10] will not be appropriate in many type III trust situations. For example where an independent institutional trustee holds the assets of the supporting organization, it may be quite responsive to the needs and desires of the supported organization with respect to the timing and manner of distributions even without a relationship at the board level. Similarly, large institutional trustees typically neither seek nor accept advice from supported organizations regarding their investment policies and practices, but in other respects are very responsive to the needs and desires of the type III trust's supported organizations. Even the Panel on the Nonprofit Sector, a group which lacked sufficient representation of type III supporting organizations, recognized (and twice specifically noted) the need to adapt any application of the existing close and continuous relationship option to type III trusts.[11]

Section 1241(c) of the PPA, as drafted, is ambiguous and does not give type III supporting organizations or the Treasury sufficient direction. We suggest that Congress repeal section 1241(c) of the PPA and instead direct Treasury to require that the trust option of the responsiveness test in current Treasury Regulations be amended to require the supporting organization's trustees or, in the case of independent institutional trustees, appropriate trustee employees or representatives to maintain a close and continuous relationship with the officers, directors or trustees of each supported organization and that, subject to state law fiduciary duties, the trustees of the supporting organization give each supported organization the opportunity to have a significant voice in determining the recipients of, timing of, and manner of making the organization's grants.

Minimum Payout

Section 1241(d) of the PPA directs Treasury to promulgate new regulations requiring non-functionally integrated type III supporting organizations to pay out annually a percentage of assets or income for the use of the supported organization to ensure a significant amount is paid to such organization.[12] Although it may be easiest for Treasury to simply apply the highest payout rate justifiable under current law—the 5% of asset value nonoperating private foundation payout requirement—such an approach ignores the significant difference between effective supporting organizations and private foundations. Perhaps the most significant feature of a supporting organization differentiating it from a private foundation is its close affiliation with its supported charities rather than with its donors. Private foundations and donor-advised funds are donor-focused vehicles, providing flexible mechanisms for donors to meet various philanthropic goals by funding any number of charitable organizations in any given year. They are not required to designate specific beneficiary organizations, and therefore have the ability to pick and choose from a potentially unlimited pool of beneficiary organizations each year. The amount of support they provide to particular organizations can vary widely from year to year according to the shifting priorities of the foundation's management; often private foundation funding is given only for a single project or for a few years.

Supporting organizations, by contrast, are intended to be charity-focused entities, whether they are created by the supported charities themselves or by interested benefactors. A large measure of donor discretion is forfeited when the supporting organization relationship is created, binding the supporting organization to its designated supported public charities, often in perpetuity and excluding the donor from even an indirect control relationship.[13] In the case of type III supporting organizations, the supported public charities must be specifically named in their organizing documents—thus ensuring an ongoing relationship between a supporting organization and specific supported organizations.[14] Although, the type III relationship has been identified as the "loosest" of the three supporting organization relationships, it is still much closer than the typical relationship between a private foundation (or even a donor advised fund) and its grantees. Unlike the typical private foundation,

---

[10] See Advanced Notice of Proposed Rulemaking, Payout Requirements for Type III Supporting Organizations That Are Not Functionally Integrated, 72 Fed. Reg. 42,335, at 42,339 (Aug. 2, 2007).

[11] Panel on the Nonprofit Sector, *Strengthening Transparency Governance Accountability of Charitable Organizations: A Final Report to Congress and the Nonprofit Sector* 45–46 (2005).

[12] PPA, § 1241(d), 120 Stat. at 1103; JCT Technical Explanation, *supra* note 7, at 360. A non-functionally integrated type III supporting organizations is defined as a "type III supporting organization which is not required under regulations established by the Secretary to make payments to supported organizations due to the activities of the organization related to performing the functions of, or carrying out the purposes of, such supported organization." I.R.C. § 4943(f)(5)(B).

[13] Treas. Reg. § 1.509(a)–4(d).

[14] Treas. Reg. § 1.509(a)–4(d)(4).

a supporting organization acts as an integral part of its designated supported organizations, consistently providing functional or financial support over the long term.

This consistent, long-term support provided by a supporting organization is a significant advantage to its supported public charities. When beneficiaries have a reliable, sustainable source of support they are able to focus more time and energy on fulfilling their charitable mission instead of constant fundraising. In addition, a long-term relationship of support with a supporting organization, like having a permanent endowment, allows beneficiaries to conduct long-term research and initiate programs on which their service populations can rely without fear of interruption. Many public charities prefer predictable, sustainable and increasing distributions from a dedicated supporting organization rather than short-lived—even if large—distributions from private foundations and the uncertainty of hand-to-mouth fundraising.

Because type III supporting organizations are relied upon by their supported organizations as a source of long-term support for their charitable programs—much as an endowment would be—any fixed payout requirement should be set so as to preserve the supporting organization's ability to continue to provide comparable levels of support in the future. The benefits of a permanent endowment are not a novel discovery; they are age-old and well-documented. Like a permanent endowment, a supporting organization can provide beneficiaries with a reliable source of support that ensures financial stability and security even in fluctuating market conditions. Historically, inflation has averaged approximately 3 percent per annum. For a permanent endowment to maintain its inflation-adjusted value, the principal must be permitted to grow by that much each year. At least one empirical study has demonstrated that a 5 percent annual distribution rate exposes the portfolio to a high probability of failing to meet that objective.[15]

The key to preserving a supporting organization's ability to provide consistent support for its supported organizations and their charitable activities is to select a minimum percentage payout rate that is sustainable—thus assuring undiminished purchasing power of the long-term support to the supported organizations. Some have suggested that a rate of between 4 to 4.25 percent would strike an appropriate balance between Congress's stated goal of "ensuring that a significant amount is paid" out annually and the desire of many non-functionally integrated supporting organizations and their supported organizations to maintain undiminished support in perpetuity. Indeed, where there are payout requirements in the Code supporting the operation of charitable programs, they are set at rates lower than the 5 percent minimum payout rate for private foundations. For example, some medical research organizations are required to pay out 3.5 percent annually, and even this requirement applies only if less than half of their assets are used directly and continuously in their medical research activities.[16] Similarly, private operating foundations are required to pay out a maximum of 4.25 percent annually, and even less in any year in which their adjusted net income falls below 5 percent.[17] These payout rates allow the organizations to support their current operations at a level commensurate with their assets without precluding increases in principal sufficient to support future operations in the face of inflation. Payout rates for supporting organizations should similarly enable them to provide funding for the charitable programs of the supported organizations both now and in the future.

In addition, because most public charity beneficiaries of supporting organizations prefer predictable, sustainable, and increasing distributions rather than distributions that may vary widely from year to year, the regulations creating a new annual minimum distribution amount should allow for the value of the supporting organization's assets to be calculated as an average over the prior 3 or 5 years, rather than over the prior year, as is the case for private foundations. Using the average fair market value for the immediately preceding twelve or twenty quarters would smooth the effects of market volatility—thereby moderating the year-to-year variance in supporting organization required distributions.

This could be accomplished by providing two different methods for calculating the annual minimum distribution amount. The first method could simply multiply the

---

[16] Treas. Reg. § 1.170A–9(c)(2)(v)(b).

[17] The regulations require a private operating foundation to spend "substantially all" (defined as 85%) of the *lesser* of its adjusted net income or the general private foundation 5% payout requirements; 85% of 5% is 4.25%. Treas. Reg. § 53.4942(b)-1(a)(1)(ii),—1(c). A private operating foundation must also meet an endowment test, a support test, or an asset test. If it opts to qualify under the "endowment test," it must normally spend at least two-thirds of the normal private foundation 5% payout (i.e., 3⅓%) on the direct conduct of its charitable activities, regardless of its adjusted net income. Treas. Reg. § 53.4942(b)–2(b)(1). However, if it instead meets the support test or the asset test, it need never spend more than 85% of its adjusted net income for the year.

applicable percentage by the fair market value of assets at the immediately preceding fiscal year-end. The second method could multiply the applicable percentage by the average fair market value of assets over the immediately preceding twelve or twenty quarters. The first method provides a simple straightforward calculation formula that would lessen the burden of compliance and enforcement. Although a bit more difficult to calculate, the second method creates an important hedge for the supported beneficiaries against sudden downward shifts in the market. A smoothing mechanism similar to the one proposed would protect similarly situated beneficiaries, their employees, and the persons and communities they serve from large drops in annual funding due to a plunge in financial markets. For example, if there were a large drop in the value of the supporting organization's assets in 1 year, and the asset values recovered during the following year or two, the required distributions to supported organizations would remain relatively stable, decreasing only moderately, if at all, after the downturn and increasing moderately during the upswing. Using an average asset value over 3 to 5 years to calculate the minimum distribution amount thus makes it easier for the beneficiaries to project future distributions and plan accordingly—thereby increasing financial stability for the beneficiary organizations.[18]

Although some have questioned the wisdom of perpetual existence of supporting organizations, perpetual support from a supporting organization can provide a transformative base from which the supported beneficiaries can advance their charitable purposes. With the assurance of annual distributions to sustain vital programs and operations, a supported beneficiary can gradually evolve from a paycheck-to-paycheck operation with a good idea to become a regional or national leader in its philanthropic endeavors because it has the economic wherewithal to implement its vision. Often private foundations will provide seed money for an innovative philanthropic project but do not want to provide ongoing grants to carry on operations. Instead, private foundation funders will move on after a few years, funding the next organization with the next good idea. A supporting organization, however, is designed to operate hand-in-hand with the supported charities, providing sustaining support while protecting the corpus so that the charitable operations of the supported organizations can continue indefinitely.

Thank you for providing exempt organizations with an opportunity to comment on the hardships and uncertainties created by the PPA. It is unfortunate that the provisions were never discussed in a bipartisan manner nor made the subject of Committee hearings where they could be debated and commented on by those within the sector. If you should have any questions regarding the above, please feel free to contact me at (918) 582–5201.

CHAPMAN CHARITABLE TRUSTS

2005 & 2006 DISTRIBUTIONS

ARKANSAS	**2006**	**2005**
John Brown University	*$3,370,292.45*	*$2,871,868.28*
Arkansas Total	**$3,370,292.45**	**2,871,868.28**
***OKLAHOMA*—Tulsa**		
The University of Tulsa	$25,461,323.39	23,317,041.17
St. John Medical Center	9,522,975.14	6,274,307.40
Tulsa Area United Way	1,439,000.00	630,000.00
Holland Hall	2,538,289.00	2,054,362.50
Tulsa Psychiatric Center	750,470.00	684,439.04
Well Baby Clinic (PPOAEO)	235,000.00	234,521.00
Family & Children's Services	205,000.00	205,000.00
Tulsa Community Foundation (for McFarlin Pediatric Healthcare Fund)	200,000.00	300,000.00
Tula Foundation for Healthcare Services (Bedlam Clinic)	310,000.00	300,000.00
St. Simeon's Episcopal Home	*67,703.00*	61 341.92
Oklahoma—Tulsa Total	**$40,729,760.53**	**34,361,013.03**
OKLAHOMA—Oklahoma City		
Oklahoma Medical Research Foundation	$11,123,031.90	10,197,223.96
The Episcopal Diocese of Oklahoma	*748,415.00*	683 032.04
Oklahoma—Oklahoma City Total	$11,871,446.90	110,880,256.00
TEXAS		
Trinity University	$14,865,632.31	13,681,844.45
Presbyterian Children's Homes and Services	752,501.00	684,250.84
St. Mary's Hall	374,648.33	359,393.36

Southwest Foundation for Biomedical Research	187,324.16	129,696.68
Southern Methodist University (fbo McFarlin Auditorium)	208 525.00	*191,243.33*
Texas Total	**$16,388,630.00**	**15,046,428.33**
GRAND TOTAL	***$72,360,129.88***	***62,859,565.64***

Statement of Community Foundation of Western Massachusetts

These comments are submitted on behalf of the Community Foundation of Western Massachusetts, an administrator of scholarship funds for students from the western Massachusetts region it serves. They are directed at the provisions of The Pension Protection Act of 2006 (P.L. 109–280) which prohibited scholarship grants from donor advised funds unless certain procedures are followed which completely remove control of the award process from the donors.

For community foundations such as ours, with dozens of such funds, these provisions make their administration so awkward and burdensome as to reduce our incentive to accept them, and they reduce substantially the always tenuous incentive of donors and their families to create them. The big picture is that donors are not required to be generous, their generosity is good for our society, the use of an income tax deduction is a substantially leveraged investment by the government in encouraging that generosity, and the administration of that deduction should not be constructed in such a way as to be counterproductive. Crafted supposedly to prevent a few abuses, the provisions of the Act hardly qualify by this standard.

The Community Foundation of Western Massachusetts helps 1,000 students from the Pioneer Valley go to college each year with $2 million from 100 scholarship funds. Forty-one of these were classified as donor advised funds under the Act and required extensive consultations with their donors in order to make the changes required to comply with it. The donors to seventeen of them opted out, and many, unfortunately, will never be heard from again. The award process for the remaining twenty-four went from being personalized, often family centered opportunities for pioneering community engagement to impersonal, assembly line selection forced marches dictated by the tyranny of a majority selected by us. One can conceive of many relatively non-conventional students who should be given educational opportunities but would be chosen only by a persistent few who wish to champion their cause. Diversified decisionmaking is essential.

Prior to these provisions, we had in place what we thought were adequate safeguards against private inurement and self-dealing, and we know of no abuses that would have been prevented by these changes.

As these provisions are reconsidered, we make several drafting suggestions respecting the scholarship fund exception to the prohibition of grants to individuals from donor advised funds:

Oversight Subcommittee, House Ways and Means Committee, July 30, 2007, Page Two

1. The definition of "donors" who must not control the scholarship selection process should be clarified:
    - to eliminate pre-occupation with de minimus problems. A $1,000 per year minimum donation, indexed yearly, could easily allow most donors to participate without sacrificing material safeguards against abuse;
    - to exclude donors who advise only as to the amount to be distributed each year, and not as to the recipients (the law appears to include both);
    - to exclude deceased donors so that descendants are not excluded from participating as advisors;
    - to exclude the members of donor organizations, particularly non-profits (e.g. the Latino Scholarship Association).
2. In addition, the burden of preventing abuse should be shifted from administering organizations to offending donors by the use of a safe haven. If, for example, donors who participate in the scholarship selection process provide written certifications that neither they nor members of their families or others appointed by them receive any benefits, direct or indirect, from the awards made, the administering organization should be relieved of responsibility for false certifications, and such donors should be allowed to participate in the same way they did prior to the passage of the Act. Increasing the penalties for such false certifications, then, with appropriate enforcement activity, could provide the same level of safeguard against abuse without discouraging the over-

whelming number of generously well-intentioned donors from achieving their charitable goals that benefit all of us.

In short, strengthening the processes available before the passage of the Act could greatly reduce the incidence of abuse while still preserving the same incentives to be generous in ways that are highly beneficial. As the Oversight Subcommittee reviews the trail left by the Pension Protection Act of 2006, we hope these simple correctives can be considered.

Statement of DLA Piper

On behalf of various exempt organizations, I appreciate this opportunity to submit comments on issues pertaining to the impact of the exempt organization provisions in the Pension Protection Act of 2006 ("PPA"). These comments relate specifically to section 4958(c)(3) of the Internal Revenue Code as added by section 1242 of the PPA (the "excess benefit transaction" provision).

Prior to the enactment of section 1242 of the PPA, the Code provided that supporting organizations may not pay compensation to so-called "disqualified persons" that is excessive or unreasonable. Under this approach, Congress recognized that supporting organizations should be permitted to hire the best qualified service providers to support their activities, and that as long as the compensation for those services is within acceptable guidelines, it should not matter who the service provider is. This is especially true in the case of Type I supporting organizations which are controlled by the public charities which they support and are therefore protected from potential overreaching by those who create and fund them.

Under section 1242, however, arrangements between supporting organizations and disqualified persons that are within previously acceptable guidelines, including arrangements that had been subject to prior approval by the IRS, are no longer permitted.

The PPA provision simply goes too far. As the Tax section of the American Bar Association stated in a letter to the Chairs and Ranking members of the tax writing Committees dated February 3, 2006 commenting on some of the pending charitable provisions that were later incorporated in the PPA, specifically with respect to this section ". . . we believe that the bill should not address operations of Type I and II supporting organizations. We support the recommendations of the Panel on the Nonprofit Sector to prohibit payment of grants, loans, and compensation by Type III supporting organizations to or for the benefit of a donor or related party. We do not support the bill's much broader prohibition applicable to Type I and Type II organizations, which are controlled by the public charities that they support. The existing intermediate sanctions law already imposes excise taxes on improper transactions involving Type I and Type II supporting organizations. We submit that S. 2020 [the then pending Senate vehicle for charitable reforms] should not go beyond existing law with respect to such organizations."

In fact, the PPA provision actually imposes a more stringent restriction on supporting organizations than exists for private foundations, which would continue to have an exception from the disqualification rules for reasonable and necessary expenses. There is no sound basis for allowing private foundations the flexibility to hire the most qualified service providers, while denying that right to supporting organizations that are controlled by public charities.

For these reasons, I respectfully submit that Congress modify the PPA provisions by limiting its application to Type III supporting organizations as follows:

Proposed amendment to section 1242 ("Excess Benefit Transactions") of H.R. 4, the Pension Protection Act of 2006.

On page 891 of H.R. 4, the Pension Protection Act of 2006, in section 1242 (excess benefit transactions involving supporting organizations) in part (b) (which adds a new section (3) to Code section 4958(c) of the Code captioned "Special Rules for Supporting Organizations", rewrite subsection (A) of new section (3) to read as follows:

"(A) IN GENERAL.— In the case of any type III supporting organization (as defined in section 4943(f)(5)(A)) which is not a functionally integrated type III supporting organization (as defined in section 4943(f)(5)(B))—"

John Templeton Foundation
West Conshohocken, Pa 19428
August 6, 2007

Congressman John Lewis, Chairman
Subcommittee on Oversight, Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Lewis:

On behalf of the John Templeton Foundation, please accept my sincere appreciation for the opportunity to offer written comments in regard to the provisions relating to tax-exempt organizations found in the Pension Protection Act of 2006 (P.L. 109–280).

I am the Chairman of the Board of trustees of the John Templeton Foundation; a private, family foundation located outside Philadelphia, Pennsylvania. We have actively been following the charitable reform dialog of the Senate and House over the last few years and embrace the spirit of accountability and transparency behind the overall effort. However, we are concerned that many of the recently enacted provisions may have the effect of treating a perceived symptom rather than a real part of the problem, working to improve enforcement of the laws that are currently in place.

Although we believe that there are a number of areas in the Pension Protection Act of 2006 (2006 PPA) that deserve additional consideration, we would respectfully offer comment in three areas: Private Foundation Excise Taxes, Tax on Net Investment Income and Grants from Private Foundations to Supporting Organizations.

Private Foundation Excise Taxes

Currently, Code sections 4941 to 4945 impose taxes on private foundations who engage in acts of self dealing with "disqualified persons", who fail to distribute a minimum amount of their assets each year as Qualifying Distributions, who have "excess business holdings", who maintain investments that are considered to jeopardize the foundation's charitable purpose and who have expenses that are construed as "taxable expenditures". With these sections as a part of the existing Internal Revenue Code, we are concerned that the new provisions serve a purely revenue raising function rather than enhancing the enforcement of current policy.

In addition, the Internal Revenue Service does not have the ability of abating the initial tax imposed on disqualified persons as a part of a self-dealing transaction due to reasonable cause. This is not consistent with the imposition of other excise taxes. We believe that if additional excise taxes are imposed on disqualified persons with respect to self-dealing transactions that the Internal Revenue Service should have the discretion to waive these penalties for cause as with other excise taxes. We feel that if a Foundation Manager has followed the rebuttable presumption procedures found in section 4958 of the Internal Revenue Code when entering into a transaction that involves payment of compensation to a disqualified person that the manager should not be subject to penalty.

Taxation of Charitable Use Assets

Code section 4940 imposes an excise tax on the net investment income of a private foundation. At present, this definition does not include capital gain or loss from the disposition of property used to further an exempt purpose. The 2006 PPA would allow for the inclusion of the gains and losses from charitable use property in the calculation of excise tax with the only exception being the deferral of tax in a like kind exchange. This appears to be inherently contrary to the intention and purpose of charitable legislation dating back to the initial granting of tax exempt status in the late 1800's.

We have seen over the history of the charitable community the way in which it has been able to respond to the needs of the citizens of the United States in a timely and impactful manner. We have certainly seen this in the wake of Hurricanes Katrina, Rita and Wilma. The charitable community works hand in hand with the government in so many areas to provide the resources, training and education needed to impact humanity. Further taxation of charitable use assets only limits the ability of the charitable community to focus on the work identified in its mission with no corresponding result other than the generation of revenue.

We believe that the charitable community has an important role in America and do not want to see a trend like that of countries like France who do not encourage philanthropy or work it into the fiber of their legislation. In addition, in an environment where we work to reduce administrative expense and costs through cost effective fiscal management tools and policies directed by governing by-laws and charter as well as the Internal Revenue Code, it appears that many of these provisions will only add to the operational burdens and non-charitable expenditures of private foundations not make them more efficient.

The budget of the Internal Revenue Service's Exempt Organization division, which is responsible for the oversight and enforcement of the charitable community, is approximately $ 50 million dollars annually. Initially, it was the intention of Congress that the excise taxes on the books prior to the 2006 PPA fund this division of the IRS. Prior to the modification of the excise taxes in the 2006 PPA, the excise tax on private foundations brought in eight times the annual budget of the Exempt Organization division. Therefore, we do not understand the revenue component behind the taxation of charitable use assets as its funds will not be directed to the charitable community. Although we recognize that the tax moneys raised are not specifically matched with those from whom they are collected, it does appear contradictory to the intent and purpose of the Charitable sector.

Grants from Private Foundations to Supporting Organizations

Both the Senate Bill, section 345, and House Bill, section 1244, attempt to narrow a private foundation's ability to make qualifying distributions in accordance with section 4945 of the Internal Revenue Code to supporting organizations. We recognize that the House's bill further defines the restriction to Type III supporting organizations that are not functionally integrated and Type I, Type II and Type III functionally integrated organizations where a disqualified person of the private foundation directly or indirectly controls the supporting organization.

We have searched our resources and do not understand the motivation behind these changes and cannot identify any specific abuses that support a legislative change of this magnitude. Over the past 2 years, we have worked with a Type I supporting organization and have found it to be administered with an extremely high level of responsibility and fiscal management. It enables academics, scientists and researchers whose work falls within the mission of the Foundation and whom we are interested in supporting to conduct their studies and work as a collaborative network outside the direct influence of the Foundation. As an organization, we are working to bring together the scientific and religious communities to have measurable impacts on Humanity in areas like Spirituality and Health, Cosmology, Character Development, Enterprise Based Solutions to Poverty, Genius Research and Free Enterprise. It is imperative that we have the ability to encourage and support collaboration, which we believe is the backbone to modern philanthropy, by allowing these scientists and religious leaders to come together in an environment that is free from "perceived" bias. Provisions such as the restriction of grants by private foundations to supporting organizations constrain the ability of organizations to promote research that could bring about positive change and new learning. We respectfully believe that this is not the intention of Congress and strongly support reconsideration of these provisions.

Again, we thank you for the opportunity to share our thoughts with the Committee and for our voice to be heard. We are proud to be members of the charitable community and believe that it is a community whose members embody integrity and responsible stewardship as each entity recognizes the duties and honor that come with the oversight and use of charitable assets. We believe that the sensational accounts that are represented in the media with regards to the charitable community represent a very small minority of the sector and not the norm. If you require any additional information with regard to our comments, we would be pleased to be responsive and to work with you, your staff and Committee.

Sincerely,

Dr. John M. Templeton, Jr.
Chairman, Board of Trustees

Ewing Marion Kauffman Foudation
Kansas City, Missouri
August 6, 2007

Hon. John Lewis, Chairman
Subcommittee on Oversight, Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20525

Dear Chairman Lewis:

I submit this letter as the General Counsel and Secretary of the Ewing Marion Kauffman Foundation, a private foundation in Kansas City, Missouri with a philanthropic mission focused on entrepreneurship, math and science education, and the Kansas City region.

This letter is in response to the Subcommittee's request for comments regarding the Pension Protection Act of 2006, P.L. 109–280 ("PPA"). More specifically, these comments address two aspects of the PPA—those that altered how private foundations may interact with supporting organizations and that imposed a new tax on capital gains from sale of property used in charitable activity.

Private Foundations and Supporting Organizations

Until the PPA, the Internal Revenue Code ("IRC")[1] allowed private foundations to treat supporting organizations under § 509(a)(3) in the same manner as other public charities. This allowed private foundations to rely on determinations by the Internal Revenue Service for purposes of making qualifying distributions under IRC § 4942 and for presumptions that grants to supporting organizations were not taxable expenditures under IRC § 4945. The PPA changed those rules and, in doing so, imposed unnecessary risks and burdens on those private foundations still willing to make grants to supporting organizations.

We have three fundamental concerns about this provision of the PPA. First, it imposes administrative burdens on the financial and time resources of supporting organizations and foundations still willing to interact with supporting organizations, but the diversion of resources does not seem to carry a corresponding benefit. Second, it presumes that exercising expenditure responsibility is not adequate when private foundations deal with certain types of supporting organizations, which presumption is contrary to longstanding policy and practical experience.[2] Third, it potentially forces private foundations to choose between (a) making payments to fulfill existing commitments to supporting organizations and risk excise taxes or (b) not making those payments and risk breaching obligations to the supporting organizations and the loss of the corresponding programmatic opportunities.

In order to make payments to supporting organizations, even on commitments that predate the PPA, private foundations that still want to interact with supporting organizations must undertake additional due diligence not previously contemplated.[3] If the supporting organization is a type III, that due diligence can be extensive, intrusive for all involved (the foundation, supporting organization, and the supported organization), costly, and time consuming. There does not seem to be a corresponding benefit, and there is a certain irony in the reality created by the PPA that it is easier for a private foundation using expenditure responsibility to make legitimate, charitable grants to General Electric, Time Warner or the Trump Organization than it is to a supporting organization declared by the IRS to be charitable. Under the PPA, even exercising expenditure responsibility under IRC § 4945 for grants to some supporting organizations is not enough for the grant to be a qualifying distribution.

The operating presumption under this provision of the PPA appears to be that

[1] Except as otherwise noted, section references to the IRC are to the Internal Revenue Code 1986, as amended.

[2] The PPA prevents private foundations from treating as qualifying distributions payments they make to Type III supporting organizations (unless functionally integrated) or to any supporting organization in which a disqualified person with respect to private foundation grantors controls the supporting organization or its supported organization. In addition, the PPA further penalizes such payments if the grantor fails to exercise expenditure responsibility.

[3] Determination letters from the IRS prior to the PPA generally acknowledge whether an organization is a public charity under IRC § 509(a)(3), but such letters offer no guidance as to whether the supporting organization is considered a type I, II, III functionally integrated, or III nonfunctionally integrated. These distinctions are crucial under the PPA, and the burden is ultimately on private foundations to spend the time and incur the expense of making these distinctions or deciding to rely on the grantee's assessment (which itself involves time and money).

supporting organizations are rife with and inherent tools for abuse.[4] While I do not suggest that abuse has not existed, the PPA seems to have gone to extremes in assuming that all such organizations are abused and that private foundations are the primary abusers, particularly if there is overlap of disqualified persons among the foundation and the supporting organization.

Our experience with supporting organizations is quite different. We have seen first hand how universities can effectively use supporting organizations as a legitimate vehicle to expand and supplement their educational missions. However, we also have now experienced how the PPA forces these organizations to redirect money and time from their charitable and educational activities to convincing private foundation grantors that they are in compliance with the PPA. This can even involve expense associated with engaging extra legal and accounting services. This is not an effective or productive use of charitable resources, which the foundation also spends directly to undertake its own analyses to ensure compliance with the PPA or indirectly through the supporting organization's efforts to do so. Any benefit derived from these aspects of the PPA seems to be far outweighed by the burdens imposed.

This provision of the PPA also appears to apply to any payments by private foundations, including subsequent payments on grant commitments made prior to any discussions of the PPA much less its enactment. This has the potential of imposing an *ex post facto* burden on foundations of choosing between complying with the law, thereby risking breach of contract, or accepting consequences for knowingly deciding not to comply. I am not aware that any supporting organization grantee has been forced to sue a private foundation to enforce a pre-PPA commitment, but the scenario is plausible. At a minimum, the law should not apply to payments made pursuant to written agreements in effect on the effective date of the law.

If the need for reform in the relationship between private foundations and supporting organizations was so dire, requiring expenditure responsibility may have been an adequate step. If the prevailing belief is that more is necessary, expenditure responsibility coupled with pass-through requirements would have been a more measured response than that presented in the PPA. Even those steps, however, would not necessarily have reduced abuses of supporting organizations by individuals not connected with private foundations.

Taxation of Charitable Use Assets

The PPA also expanded the definition of "net investment income" under IRC § 4940 to impose a new tax on private foundations when they sell property that they used in charitable activity, unless there is a certain like-kind exchange. Taxing gains from the sale of charitable use property has arguably breached a sacrosanct policy that respected charitable activity by treating such gains differently from investment gains. Whether this is a one-time breach or a slippery slope is unclear. The fact that the breach has occurred at all is significant, particularly because the breach seems on the surface to have been motivated solely by the desire to raise revenues without a clear policy rationale. In fact, many have questioned the policy rationale for having imposed the tax before the PPA, particularly when the revenue raised has not been used for the intended purpose of funding sector-based activity; increasing the tax base is a change in the wrong direction.

Even without considering the policy implications, the new tax denies the use of these dollars for charitable purposes and imposes an additional layer of strategic complexity on those evaluating whether to sell or purchase charitable use property. The policy threat raised by taxing income from the sale of charitable assets used in charitable activities is far more dangerous.

These two components of the PPA are complex and they appear intended to address complicated issues. Unfortunately, they are also unduly burdensome in imposing monetary and time demands that seem disconnected from the problems Congress may have been seeking to address and, in the process, they imposed their own problems for the charitable and philanthropic sectors.

Mr. Chairman, we applaud the Subcommittee's willingness to hold hearings and solicit comments on the efficacy of the PPA, and we are pleased to submit these comments for the Subcommittee's consideration.

Respectfully,

John E. Tyler III
General Counsel and Secretary

[4] The paucity of hearings prior to passage of the PPA forces an unusual degree of speculation, including about the extent to which current laws and regulations are not adequate to address the problems that might exist with the use and operation of supporting organizations.

Statement of Food Donation Connection

These comments call attention to a technical correction needed to the charitable giving incentives created by recent tax legislation found in H.R. 4, the Pension Protection Act of 2006, section 1202— "Extension of Modification of Charitable Deduction for Contributions of Food Inventory". This correction would bring the provision in line with the original intent of Congress to encourage food donations by all business entities.

Food Donation Connection (FDC) coordinates the donation of wholesome prepared food from restaurants and other food service organizations to local non-profit agencies that help people in need. Federal Tax Code (IRC Section 170(e)(3)) has provided an incentive for C corporations to donate their food inventory since 1986. Since its founding in 1992, FDC has been involved in the effort to pass charitable giving incentives for food donations for all business entities and is currently working with several restaurant companies that have agreed to donate food if this issue is resolved. FDC has coordinated the donation of over 110 million pounds of prepared food for companies like Yum! Brands (Pizza Hut, KFC, Taco Bell, Long John Silver's, A&W) and Darden Restaurants (Red Lobster, Olive Garden, Smokey Bones). We currently coordinate donations from 7,000 restaurants to 3,500 non-profit agencies nationwide.

In our discussion with Yum! Brands franchisees about the charitable giving incentives contained in H.R. 4 (Pension Protection Act of 2006, which extended the provision of H.R. 3768 (KETRA) to December 31, 2007) we discovered an issue in the Tax Code that negate the tax savings for S corporations that donate food. Individual S corporation shareholders may not be able to take the deduction for the donation of food inventory, depending on their basis in the corporation. In working with S corporations we have learned the following:

- S corporation income is distributed to each shareholder based on each shareholder's ownership percentage and therefore the deductibility of the deduction depends on each shareholder having sufficient basis (i.e. 'at risk' IRS rule) in the company to permit deduction at the individual level.
- S corporations make ongoing distributions to shareholders rather than retain excess funds in the company and therefore S corporation shareholders have no basis (i.e. distributions reduce basis).
- As a result, S corporation shareholders do not believe they are entitled to a tax deduction and do not benefit from recent tax law changes and are therefore not motivated to donate.

Under this current situation, the shareholder basis rule trumps the intention of Congress to extend the special rule for certain contributions of food inventory to S corporations (H.R. 4 extension of H.R. 3768 Sec.305, which modified IRC section 170(e)(3)).

To remedy this situation, a technical correction could be made to the language of H.R. 4, the Pension Protection Act of 2006. The following wording would be added to H.R. 4 section 1202:

(c) In General—section 170(e)(3)(C) of the Internal Revenue Code 1986 (relating to special rule for certain contributions of inventory and other property) is amended by redesignating (iv) as (v) and inserting after (iii) the following new paragraph:

(iv) S corporation BASIS LIMITATION—In the case of food contributions from S corporations, limitations on individual shareholder's deductions due to shareholder basis (section 1366(d)(1)) on stock and debt do not apply. However, shareholder's basis continues to be adjusted consistent with section 1367(a).'

The immediate impact of this change would mean that over 721 restaurants in 26 states would be eligible for this deduction for donating food, and therefore willing to donate. See the list below for additional details.

It is the intent of Congress to address the needs of Americans by providing valuable resources to charitable organizations. This technical correction would fulfill the original intent of the legislation by allowing S corporations to take advantage of this charitable deduction for contributions of food inventory.

Thank you for considering these comments.

Subchapter S Corporation Shareholder Basis Example

The following example of how an S corporation treats income distributions and deductions is provided by Rage, Inc, a 100 restaurant Pizza Hut franchise.

Average annual profit per restaurant $65,000

Shareholder Basis at the beginning of the year $0

Shareholder Basis at the end of the year $65,000 (same as profit)

Dividend distribution at end of year $65,000

Taxable Income to Shareholders $65,000

Shareholder basis after Dividend Distribution returns to $0

If a restaurant donates wholesome food that results in a deduction of $1,000 they are faced with two alternatives:

1. If the dividend (profit) distribution remains $65,000 this creates an actual dividend distribution of $64,000 and would trigger a $1,000 capital gain to the shareholder.
2. The dividend distribution to the shareholder is reduced to $64,000.

Both alternatives lack the incentive to donate food that is intended by Congress for all business entities.

For S corporation shareholders to receive the intended incentive for donating food the deduction must be basis neutral and exempt from the 'at risk' IRS rules.

Yum! Brand Franchisees Willing to Donate with S Corp Basis Cost Resolution

The passage of H.R. 4 has roused the interest of many Yum! Brands franchisees to donate food. A number of franchised operators of Pizza Hut, KFC and Long John Silver's restaurants that have told Food Donation Connection they would start a Harvest food donation program if the issue with S corporation basis costs can be corrected.

The following chart lists the number of new restaurants and the pounds of food donations that can be projected from these restaurants. The poundage projections are based on averages from Yum! Brands operated restaurants. These donations include cooked prepared pizza, breadsticks, chicken, fish, mashed potatoes, vegetables, biscuits and other items that have been properly saved, packaged and chilled or frozen. The saved food would be picked up on a regular basis by local food banks and hunger relief agencies and used in the local community.

Yum! Brands has been donating surplus food from its restaurants since 1992. In 2006, over 1,800 local hunger relief agencies received about 11.5 million pounds of prepared food from 4,100 Yum! Brands restaurants. This food has been a tremendous help for these agencies, as donated food frees up their limited resources for other needs.

The list of 721 restaurants represents a broad spectrum of communities across 26 states and 140 congressional districts. These restaurants are operated by 15 different franchised groups. Since the Yum! Brands system is over 75% franchised, resolution of the S corporation tax deduction issue will result in many more opportunities to encourage donation of wholesome prepared food.

State	District	Represenative	# Resturants	Lbs per Year
AL	05	Robert E. (Bud) Cramer Jr.	2	10,350
AZ	01	Rick Renzi	6	17,197
AZ	03	John B. Shadegg	2	5,732
AZ	07	Raul M. Grijalva	11	31,529
AZ	08	Gabrielle Giffords	14	40,127
CA	24	Elton Gallegly	1	5,175
CA	26	David Dreier	2	10,350
CA	27	Brad Sherman	5	25,875
CA	28	Howard L. Berman	4	20,700
CA	29	Adam B. Schiff	2	10,350
CA	30	Henry A. Waxman	4	20,700
CA	31	Xavier Becerra	2	10,350
CA	32	Hilda L. Solis	2	16,511

State	District	Represenative	# Resturants	Lbs per Year
CA	33	Diane E. Watson	4	20,700
CA	35	Maxine Waters	1	5,175
CA	36	Jane Harman	1	5,175
CA	38	Grace F. Napolitano	4	16,861
CA	46	Dana Rohrabacher	1	1,336
CO	03	John T. Salazar	4	20,700
CO	05	Doug Lamborn	1	5,175
DC	Delegate	Eleanor Holmes Norton	1	5,175
FL	03	Corrine Brown	1	5,175
FL	05	Ginny Brown-Waite	5	14,331
FL	07	John L. Mica	3	15,525
FL	08	Ric Keller	2	10,350
FL	12	Adam H. Putnam	1	5,175
FL	13	Vern Buchanan	2	10,350
FL	15	Dave Weldon	6	31,050
FL	16	Tim Mahoney	13	15,525
FL	17	Kendrick B. Meek	5	25,875
FL	18	Ileana Ros-Lehtinen	4	20,700
FL	20	Debbie Wasserman Schultz	2	10,350
FL	21	Lincoln Diaz-Balart	2	10,350
FL	22	Ron Klein	5	25,875
FL	23	Alcee L. Hastings	2	10,350
FL	24	Tom Feeney	5	25,875
FL	25	Mario Diaz-Balart	1	5,175
GA	09	Nathan Deal	4	11,465
GA	10	Paul Broun	2	5,732
IA	05	Steve King	8	22,930
IL	12	Jerry F. Costello	1	2,866
IL	15	Timothy V. Johnson	3	8,599
IL	19	John Shimkus	4	11,465
IN	01	Peter J. Visclosky	2	5,732
IN	02	Joe Donnelly	4	11,465
IN	03	Mark E. Souder	1	2,866
IN	04	Steve Buyer	1	2,866
IN	05	Dan Burton	5	16,640
IN	08	Brad Ellsworth	2	5,732
IN	09	Baron Hill	1	2,866
KY	01	Ed Whitfield	2	5,732
KY	02	Ron Lewis	2	5,732
KY	04	Geoff Davis	3	8,599
KY	05	Harold Rogers	7	20,064
LA	01	Bobby Jindal	6	31,050
LA	02	William J. Jefferson	8	41,401
LA	03	Charlie Melancon	1	5,175
LA	06	Richard H. Baker	9	46,576
MD	01	Wayne T. Gilchrest	5	23,567
MD	02	C. A. Dutch Ruppersberger	4	20,700
MD	03	John Sabanes	3	15,525
MD	04	Albert Russell Wynn	1	5,175
MD	05	Steny H. Hoyer	7	36,226
MD	07	Elijah E. Cummings	1	5,175
MI	01	Bart Stupak	9	25,796
MI	02	Peter Hoekstra	2	5,732
MI	03	Vernon J. Ehlers	16	45,860
MI	04	Dave Camp	3	8,599
MI	05	Dale E. Kildee	1	2,866
MI	06	Fred Upton	7	20,064
MI	07	Tim Walberg	8	22,930
MI	10	Candice S. Miller	2	5,732
MS	01	Roger F. Wicker	11	56,926
MS	02	Bennie G. Thompson	10	51,751
MS	03	Charles “Chip” Pickering	10	51,751
MS	04	Gene Taylor	19	98,326

State	District	Represenative	# Resturants	Lbs per Year
NC	01	G. K. Butterfield	2	5,732
NC	02	Bob Etheridge	7	31,608
NC	04	David E. Price	25	106,846
NC	05	Virginia Foxx	14	53,980
NC	06	Howard Coble	9	46,576
NC	10	Patrick T. McHenry	5	14,331
NC	11	Heath Shuler	23	65,924
NC	12	Melvin L. Watt	5	25,875
NC	13	Brad Miller	29	122,371
NE	01	Jeff Fortenberry	11	31,529
NE	02	Lee Terry	14	40,127
NE	03	Adrian M.Smith	12	34,395
NJ	05	Scott Garrett	5	25,875
NJ	06	Frank Pallone Jr.	1	5,175
NJ	07	Mike Ferguson	3	15,525
NJ	09	Steven R. Rothman	6	31,050
NJ	10	Donald M. Payne	5	25,875
NJ	11	Rodney P. Frelinghuysen	4	20,700
NJ	12	Rush D. Holt	1	5,175
NJ	13	Albio Sires	8	41,401
NY	07	Joseph Crowley	1	5,175
NY	13	Vito Fossella	3	15,525
NY	16	José E. Serrano	8	41,401
NY	17	Eliot L. Engel	3	15,525
NY	18	Nita M. Lowey	2	10,350
NY	20	Kirsten Gillibrand	1	2,866
NY	23	John M. McHugh	16	52,786
NY	24	Michael Arcuri	7	36,226
NY	25	James T. Walsh	8	41,401
OH	02	Jean Schmidt	2	5,732
OH	08	John A. Boehner	1	2,866
OH	10	Dennis J. Kucinich	11	56,926
OH	11	Stephanie Tubbs Jones	16	82,801
OH	13	Sherrod Brown	10	51,751
OH	14	Steven C. LaTourette	7	36,226
OH	16	Ralph Regula	2	10,350
OH	17	Tim Ryan	2	10,350
PA	01	Robert A. Brady	1	5,175
PA	05	John E. Peterson	2	5,732
PA	06	Jim Gerlach	11	5,175
PA	09	Bill Shuster	1	5,175
PA	10	Christopher Carney	2	5,732
PA	13	Allyson Y. Schwartz	1	5,175
PA	16	Joseph R. Pitts	4	20,700
PA	17	Tim Holden	4	20,700
PA	19	Todd Russell Platts	8	41,401
SC	01	Henry E. Brown Jr.	12	34,395
SC	02	Joe Wilson	14	40,127
SC	03	J. Gresham Barrett	3	8,599
SC	04	Bob Inglis	6	17,197
SC	05	John M. Spratt Jr.	6	17,197
SC	06	James E. Clyburn	5	14,331
TN	04	Lincoln Davis	1	2,866
TN	07	Marsha Blackburn	4	20,700
TN	08	John S. Tanner	1	5,175
VA	01	Jo Ann Davis	3	8,599
VA	02	Thelma D. Drake	2	5,732
VA	05	Virgil H. Goode Jr.	3	10,908
VA	06	Bob Goodlatte	2	5,732
VA	07	Eric Cantor	1	2,866
VA	09	Rick Boucher	13	37,261
WI	03	Ron Kind	7	20,064
WI	07	David R. Obey	1	2,866

State	District	Represenative	# Resturants	Lbs per Year
WV	03	Nick J. Rahall II	6	17,197
		Totals	**721**	**2,930,650**

Supplemental Sheet to H.R. 4 Technical Tax Comments

Food Donation Connection (FDC) administers the *Harvest Program* to coordinate the distribution of excess food from restaurants and other food service organizations to qualified local non-profit organizations that help people in need. FDC has coordinated prepared food donation programs since 1992 involving the donation of over 110 million pounds of quality surplus food. We currently coordinate donations from 7,000 restaurants to 3,500 non-profit agencies nationwide.

Statement of Foundation For The Carolinas, Charlotte, North Carolina

Foundation For The Carolinas ("FFTC") is a community foundation located in Charlotte, North Carolina. It ranks in the top thirty of grants, gifts and assets for community foundations in the United States and has approximately 1,700 total funds, including hundreds of donor advised funds ("DAF's") and seven supporting organizations. We are writing in response to your request for comments on the charitable provisions of the Pension Protection Act ("PPA") as part of the hearings held on June 24, 2007.

1. *Definition of Donor Advised Funds:* With regard to the new statutory definition of a DAF we suggest providing specific and detailed examples in regulations of when a particular fund is or is not a DAF. Because of the sheer number of DAF's examples will help in the classification of a particular fund. For example, if a particular fund specifies four permissible donees (e.g. four universities) and the donor may specify the percentages allocated between the respective schools does this meet the donor advisory part of the test since the legislation identified a specific exclusion for one permissible donee? We also urge Congress to make certain other changes applicable to DAF's including clarifying the ability of sponsoring organizations to purchase goods and services on the open market using DAF assets and excluding funds created by public charities and governmental entities from the definition of DAF's.

2. *Excess Business Holdings and DAFs:* We urge Congress to repeal the application of the excess business holdings rules to DAF's. We believe that the other changes made by the PPA and applicable to DAF's will prevent the abuses that have occurred in the past. We do not believe that there is any reason to believe that business holdings that are given to a DAF are subject to any more abuses than if they were given to a public charity. If repeal is not a viable alternative perhaps Congress could adopt provisions that allow for the sale or payout of illiquid assets over some reasonable period of time or a phase-in of the rules to allow for an orderly transition.

3. *Payment of Grants from DAFs to Type III SOs*: With regard to the treatment of distributions from DAFs to Type III supporting organizations and certain supporting organizations as taxable distributions the new requirements put an unreasonable burden on DAF's and supporting organizations. We agree that the provision stating that a grantor, acting in good faith, may rely on a written representation signed by an officer, director or trustee of the grantee that the grantee is a Type I or Type II supporting organization provided that the representation describes how the grantee officers, directors, or trustees are selected and references any provisions and governing documents that establish a Type I or a Type II relationship between the grantee and its supporting organization. However, the grantor should not have the burden of "collecting and reviewing copies of governing documents of the grantee (and, if relevant, of the supporting organization (s)).

4. *Supporting Organizations*. Like many large community foundations FFTC currently has four Type III supporting organizations for which it is the supported organization. These Type III's are typically broadly supported community based organizations which have been formed to benefit, for example, the arts or a particular faith-based community. If a Board member of the Type III wants to make a gift from a non-operating private foundation he controls to the Type III, section 4942 (g) would deny qualifying distribution treatment to the private foundation. This is not the type of abuse the statute is designed to prevent and this type of distribution

should not be denied treatment as a qualifying distribution. In FFTC's situation, Board members are giving in response to a fundraising campaign for a particular focus area of the Type III supporting organization; they are not "controlling" members of the Board, families or sole donors. How can nonprofits conduct normal fundraising strategies under these regulations? For the same reasons if the gift was made from a DAF instead of a private foundation to the Type III the gift should not be treated as a "taxable distribution" under section 4966. Perhaps there should be some broad exception for Type III's that support community foundations because of the lack of the potential for abuse; or an exception for Type IIIs that are created to support community based causes and not controlled by one or more specific donors or families.

5. *Disaster Relief Funds*. IRS Notice 2006–109 dealt with, among other things, disaster relief funds established by employers at community foundations or other public charities to provide disaster relief grants to employees and their family members who are victims of a natural disaster (e.g., Katrina). We believe that similar regulations should be issued to apply to hardship funds established by employers for their employees. Such funds are designed to provide similar relief to employees suffering real hardship. We believe all the regulations mentioned in the Notice are reasonable and are already being followed by FFTC. However, hardship funds should be specifically mentioned as well to avoid any confusion about whether or not they meet the definition of a DAF.

6. *IRA Charitable Rollover*. We strongly support H.R. 1419 and S.819 which would allow donors to qualify for the favorable IRA charitable rollover rules when making gifts to DAF's, supporting organizations and private foundations. We also support extending these provisions beyond 2007 and to gifts over $100,000.

7. *Other Concerns*. We also urge Congress to make certain adjustments to the PPA in order to address some situations in which the PPA is hampering community philanthropy. These include:

- Clarifying that the designation in a gift instrument of scholarship Committee members by title or position does not constitute an appointment by the donor of persons holding those positions.
- Providing for abatement of first-tier taxes for the new penalty provisions of PPA on the same basis as for existing penalty taxes.
- Temporarily suspending the penalties for making grants to certain supporting organizations until the IRS can reliably identify those organizations.

Thank you for your consideration of our comments.

Grantmakers Without Borders
August 31, 2007

Hon. John Lewis, Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
343 Cannon House Office Building
Washington, DC 20515

Dear Congressman Lewis:

This statement is submitted on behalf of Grantmakers Without Borders ("Gw/oB") in response to the House Subcommittee on Oversight's request for written comments on provisions relating to tax-exempt organizations in the Pension Protection Act of 2006. In addition, Gw/oB would like to specifically respond to Congressman Pascrell's comments regarding charities and terrorism during the July 24, 2007 hearing.

Bckground

Gw/oB is a philanthropic network dedicated to international social change philanthropy in the developing world. Gw/oB's membership, currently numbering 150 grantmaking entities, includes private foundations, grantmaking public charities, individual donors with a significant commitment to international philanthropy, and philanthropic support organizations. Gw/oB's members make lifesaving grants to international grassroots organizations that target the root of economic, environmental, and social inequalities within their local communities. Grants range from support to children affected by HIV/AIDS, to reforestation projects in Brazil, to relief for victims of natural disasters.

II. Pension Protection Act

The diversity of Gw/oB's membership makes it impractical for these comments to reflect every impact felt by its membership due to the Pension Protection Act. However, two recurring matters deserve mentioning.

A. IRA Charitable Rollover

The Individual Retirement Account ("IRA") Charitable Rollover provision within the Pension Protection Act eliminates the tax that formerly discouraged transfers from IRAs to charities. Consequently, many individuals have chosen to donate their annual minimum distributions to public charities, resulting in millions in charitable donations. Unfortunately, this valuable provision expires at the end of 2007.

Gw/oB has joined Independent Sector, the National Committee on Planned Giving, and many other charities in advocating for the Public Good IRA Rollover Act of 2007. This Bill would make the IRA Charitable Rollover permanent, remove the dollar limit on donations per year, and provide IRA owners a planned giving option beginning at age 59½. Furthermore, the Public Good IRA Rollover Act includes private foundations as eligible to receive donations, thereby allowing a greater number of worthy nonprofits to enjoy the benefits of the IRA Charitable Rollover.

B. Donor Advised Funds

The Pension Protection Act makes significant changes to the operation and management of donor advised funds ("DAF"s). Recognizing the growing popularity of DAFs, Congress responded with needed regulations to offset the potential for abuse. As a result, DAFs now have a statutory definition—a fund that is owned and controlled by a sponsoring organization, separately identified with reference to the donor, and subject to the recommendations of the donor in relation to the fund's investments and distributions—limits are placed on who can receive distributions, and new requirements are in place on the management of those distributions by the sponsoring organization.

Within the legislative history of the Pension Protection Act, some lawmakers sought to limit the use of DAFs for international grantmaking. Gw/oB finds this proposal deeply disturbing. It unnecessarily and unfairly targets international philanthropy at a time when global U.S. philanthropic engagement is as crucial as ever. We hope the following comments make the case for the enormous value of DAFs to international grantmaking and giving.

Furthermore, many of Gw/oB's members are finding some regulations within the Pension Protection Act difficult to apply. Here we attempt to describe some of those challenges.

1. *Present Important Advantages to International Grantmaking and Giving*

Often, the advantages of DAFs make them an attractive choice for international grantmaking and giving. Although Gw/oB understands and respects the underlying reasons behind recent legislative changes to the operation and organization of DAFs, we urge that these advantages be preserved.

a. The Advantages of Donor Advised Funds to Grantmaking Organizations

International grantmaking, for a variety of reasons, is more complex than domestic grantmaking. Consequently, many organizations that wish to make lawful and effective international grants do not have the capacity or expertise to do so. DAFs provide a valuable mechanism whereby organizations that lack this necessary capacity and expertise may rely on a qualified sponsoring organization to provide the solutions to important international grantmaking challenges.

Federal tax law requires organizations that give international grants to practice 501(c)(3) equivalency determination[1], expenditure responsibility[2], or a degree of due diligence that guarantees the funds are used for a charitable purpose. Organizations that make few international grants, have a small a staff, or are new to international grantmaking often turn to a DAF to manage the legal obligations inherit to inter-

[1] A good-faith determination by a grantor organization that a grantee organization is the equivalent of a 501(c)(3) public charity. The grantor should collect the same information the IRS would require if it were to make its own determination of the grantee organization.

[2] Additional oversight procedures exercised by a grantor to guarantee that its funds are used for a charitable purpose. Expenditure Responsibility typically requires five steps: a pre-grant inquiry whereby the grantor determines the grantee organization to be capable of achieving the charitable purpose of the grant, a written grant agreement signed by the grantee that details the purpose of the grant and commits the grantee to only spend the funds on that purpose, one or more reports from the grantee detailing the use of the funds, a separate account maintained by the grantee that exclusively houses charitable funds, and the grantor organization, when a private foundations, must notify the IRS on Form 990–PF that an expenditure responsibility grant was made during the tax year.

national grants. In addition, the world of international grantmaking is incredibly diverse. Literally, a world of funding opportunities is possible. DAFs provide a means whereby organizations new to international grantmaking can learn more about this diverse world, thus acquiring the expertise necessary to make effective international grants.

DAFs often act as a valuable learning tool for grantmaking organizations. By contributing a DAF to a qualified sponsoring organization, the grantmaking organization is able to see what capacity and expertise is needed so that it can eventually make its own international grants.

b. The Advantages of Donor Advised Funds to Individual Donors

Critics of DAFs argue that contributions should be ineligible as charitable deductions. They reason that the retention of advisory privileges declassifies contributions as completed gifts. If accepted, this argument will undermine a core advantage to DAFs in the context of international giving.

Most charitable contributions are given for altruistic reasons, but the promise of a charitable deduction is often an underlying incentive for many individual donors. Since Federal tax law disqualifies most overseas contributions by individuals as charitable deductions, DAFs are a valuable alternative that provides the benefits and incentives of a charitable deduction while preserving the possibility that a donor's funds will support a foreign organization. Of course sponsoring organizations must protect against donors that abuse their advisory privileges. However, preventing donor abuse by making contributions ineligible as charitable deductions throws the baby out with the bath water and will, in the long run, stem the flow of U.S. charitable dollars to Haiti, Afghanistan, and elsewhere in the Third World where charitable resources are so desperately needed.

2. *The Pension Protection Act Significantly Changes The Due Diligence Required For Those Public Foundations That Give International Grants From Their DAFs.*

When a public foundation gives an international grant with its general funds, Federal tax law requires the public foundation to ensure the grant is used exclusively for its charitable purpose through sufficient "discretion and control." Public foundations are afforded a fair amount of autonomy in determining what that "discretion and control" will look like. Under the Pension Protection Act, when a public foundation makes an international grant with a DAF, the public foundation must apply due diligence methods traditionally reserved for private foundations: equivalency determination[3] or expenditure responsibility.[4] Consequently, international grants made with a DAF are not easily incorporated into a public foundation's grant portfolio. In addition, it is unclear how expenditure responsibility should be applied by a public foundation. Gw/oB is waiting for further clarification on this issue.

3. The Pension Protection Act Includes Fundraisers As Disqualified Persons With DAFs

The Pension Protection Act expands the list of disqualified persons, automatically instituting an excess benefit transaction tax on any ineligible distribution. However, one category of disqualified persons includes those that wish to be reimbursed for fundraising costs for the DAF. The fact is that not all DAFs are set up by wealthy individuals; there are those that are set up by individuals with modest financial means who raise funding from the public at large and then channel those funds overseas through a DAF. In cases such as these, it is quite reasonable to expect reimbursement for out-of-pocket expenses incurred by necessity in raising funding for the DAF. While excessive fundraising costs, as elsewhere in the non-profit sector, are to be strongly discouraged, completely forbidding reimbursement for reasonable fundraising costs associated with DAFs will jeopardize the existence of an important subset of DAFs.

III. Charities and Terrorism

During the July 24, 2007 hearing on tax-exempt organizations, Congressman Pascrell questioned the repeated accusations by the Department of the Treasury that "charities are a significant source of terrorist funding." He specifically referenced a recent Treasury Inspector General Report released on May 21, 2007[5] and noted that the Department of the Treasury seems to be "painting the sector with a wide brush." Gw/oB applauds Congressman Pascrell for his comments and hopes each Committee Member will read the June 8, 2007 letter that was sent to the Department of the Treasury by a coalition of nonprofit organizations, including

[3] See fn 1
[4] See fn 2
[5] http://www.treas.gov/tigta/auditreports/2007reports/200710082fr.pdf

Gw/oB, opposing the conclusions of the referenced Treasury Inspector General Report.[6]

Every day, Gw/oB works to counter these overbroad and unsubstantiated statements by the Department of the Treasury. Unfortunately, the Department of the Treasury's statements have inflicted real, ongoing harm on nonprofit organizations, particularly international grantmakers, and caused a loss of public confidence in the charitable sector as a whole.

Furthermore, the "tools" being released by the Department of the Treasury, such a the "Anti-Terrorist Financing Guidelines"[7] and the "Risk Matrix for the Charitable Sector,"[8] are doing little to fight terrorism and, in fact, chill important philanthropic aid that often acts as a counter balance to terrorism influences within vulnerable communities. To further frustrate things, these tools exist within a legal framework of draconian penalties that easily intimidate the highly risk adverse charitable sector.

The U.S. charitable community takes the issue of terrorism very seriously and the 1.8 million 501(c)(3) organizations, including 71,000 foundations, that exist in the U.S. work tirelessly to ensure that their charitable services or funding are used for the intended charitable purpose. As noted by Steve Gunderson, the President and CEO of Council on Foundations, within his testimony:

*[i]*in fact, we have seen no evidence to indicate that U.S. charities are a major source of terrorist support. Out of hundreds of thousands of U.S. charities and billions of dollars given out in grants and material aid each year, only six U.S. charities are alleged to have intentionally supported terrorists. Thus far, Treasury has not identified a single case of inadvertent diversion of funds from a legitimate U.S. charity to a terrorist organization. . . . An even larger issue is that, by exaggerating the extent to which U.S. charities serve as a source of terrorist funding, Treasury is fueling an environment in which wary donors may refrain from making charitable contributions.

Gw/oB's hope is that a system can be put in place that supports the charitable work of those organizations acting lawfully and provides the necessary due process to those organizations suspected of having links to terrorism.

IV. Conclusion

Gw/oB thanks you for this opportunity to submit comments regarding the Pension Protection Act and the Department of the Treasury's counter terrorism measures. In summary, Gw/oB would like:

§ the IRA Charitable Rollover to be permanent and expanded to include private foundations,

§ Congress and the IRS to resist any legal changes to the operation and management of DAFs that unnecessarily impedes their use for charitable giving to the Third World, and

§ the House Ways and Means Committee to further explore Congressman Pascrell's questioning regarding charities and terrorism (the Department of the Treasury needs to be held accountable for its counter terrorism measures that affect that charitable sector).

If you have any further questions, please feel free to contact our Advocacy Coordinator at the Washington, D.C. office, Vanessa Dick.

Sincerely,

John Harvey
Executive Director

Statement of Greenlining Institute

The Greenlining Institute is a multi-ethnic advocacy and public policy center that focuses on issues of philanthropy to underserved communities and the economic empowerment of our nation's minorities. Our members include the three largest African-American churches in California, the Hispanic Chamber of Commerce, the Black

[6] http://www.internationaldonors.org/advocacy/TIGTALetter_Paulson.pdf

[7] http://www.treas.gov/press/releases/docs/tocc.pdf—Letter released by Gw/oB opposing the "Anti-Terrorist Financing Guidelines" http://www.internationaldonors.org/news/gwob_letter_122206.pdf

[8] http://www.treas.gov/offices/enforcement/ofac/policy/charity_risk_matrix.pdf—Letter released by Gw/oB opposing the "Risk Matrix for the Charitable Sector" http://www.internationaldonors.org/advocacy/GwoB_Treasury_Letter-Risk_Matrix.pdf

Business Association, the Latino Issues Forum and the Mabuhay Alliance of San Diego.

We applaud you for announcing the Overview Hearing on Tax-Exempt Charitable Organizations.We are submitting our views as they relate to charitable giving foundations.

Greenlining recognizes that foundations have made considerable contributions to our Nation's great democracy.In the past, especially during the sixties, foundations led efforts to address civil rights through strategic grantmaking that introduced minority leaders to the public policy process in an attempt to directly benefit communities of color.Unfortunately, rather than evolving and growing, many of these efforts have subsided and foundations as a whole appear to be withdrawing from their commitment to justice and equality.

Foundations Accused of Redlining Minority Communities

"There is not a study out there that says that we are appropriately serving minority communities on a percentage basis." Steve Gunderson, President, National Council on Foundations[1]

According to the Honorable Steve Gunderson, President of the National Council on Foundations, no study exists that demonstrates foundations are adequately serving minority communities.On the contrary, there is considerable evidence to suggest that foundations are severely short-changing communities of color.Greenlining has compared this short-changing to the redlining practices of banks, insurance companies, and other corporations.

Over one third of the nation is minority and an estimated two thirds of the poor, particularly the underserved poor are minorities.Low-levels of philanthropic giving to the poor weakens the ability of the hundreds of thousands of low income organizations serving the poor to effectively serve the poor.

Below are some statistics to consider.

- *Grantmaking to Ethnic/Racial Minorities*: According to the Foundation Center, grantmaking for minorities has declined as a proportion of grants awarded by the largest foundations.Even though grant giving as a whole has increased, grants to minority communities have decreased.The numbers provided by the Foundation Center are controversial and might be understated since they only capture very large foundations, leaving out a sample of about 79,000 foundations.[2]
- *Grantmaking to the Poor*:According to Rick Cohen, former President of the National Committee for Responsible Philanthropy, grant dollars to the poor from large foundations dropped between 2004 and 2005.According to Rick Cohen, "The proportion of foundation grant dollars (from generally larger foundations) targeted to economically disadvantaged population groups was 16.7% in 2002, 20.3% in 2004, but only 15.7% in 2005."[3]
- *Empowering Minority Organizations to Better Serve Their Constituents.* Greenlining launched its efforts to hold philanthropic foundations more accountable to diverse non-profit organizations with the release of our Fairness in Philanthropy report.This report found that the top 50 foundations in the country invested only 3% of the dollars in minority-led organizations.Greenlining followed in 2006 with a second report entitled Investing in a Diverse Democracy which found that only 3.6% of dollars are invested in minority-led organizations.[4]
- *Why is Corporate America More Diverse than the Foundation Sector?* According to available data, corporate boards are slightly more diverse than foundation boards.For example,only 6.7% of foundation board members are African-American compared to 9.1% of Fortune 500 board members and 10% of Fortune 100 boards.[5]
- *Hiring Practices of Large Foundations*:Available statistics by the Council on Foundations show disproportionately few positions held by minorities at major foundations, especially among top executives.These statistics themselves are controversial since they are taken from a self selected sample of foundations.

[1] Video: Leadership in Philanthropy, Part 1.The Greenlining Institute, March 2007.Available at:http://youtube.com/watch?v=j49Wn7wgFO0

[2] Cohen, Rick. "Moral Court for Charity." *Non-Profit Quarterly* 11 May 2007

[3] Ibid.

[4] Many foundations dismissed Greenlining's reports due to flaws in the methodology.Greenlining made numerous requests to foundations requesting input and feedback on developing the methodology.

[5] Cohen, Rick. "Moral Court for Charity." *Non-Profit Quarterly* 11 May 2007

- *Foundation Endowments Might Be Causing More Harm than Good.* Recent investigative articles by the Los Angeles Times point to disturbing facts that foundation endowments might cause considerable harm on minority communities.Foundations that exclude minorities in their grantmaking and hiring practices are perhaps causing more harm than good to underserved communities by their tax-exempt existence.

Overall, the available research indicates that communities of color receive a very small portion of philanthropic dollars in our country.As you know, this debate is not new.Unfortunately foundations are still making only limited efforts to seriously address this issue.

Government Efforts to Hold Foundation's Accountable

The Chairs of the Legislative Latino, Asian and Black Caucuses in California have been national leaders on efforts to hold foundations accountable to communities of color.

- *State Hearings Hosted By California Minority Caucuses.* Joe Coto, Chair of the Latino Caucus, Alberto Torrico, Chair of the Asian/Pacific Islander Caucus, and Mervyn Dymally, Chair of the Black Caucus, held a hearing on April 24, 2006 to discuss foundation diversity practices.Unfortunately, only a very small number of foundation leaders chose to participate in this important discussion.The hearing revealed that some corporate foundations are outperforming private foundations in reaching the poor and underserved.
- *A.B. 624, Proposed Transparency Legislation.* The heads of the Latino Caucus and Black caucus introduced A.B. 624, legislation that would require foundations with greater than $250 million in assets to report key racial and ethnic data to the state's attorney general.The legislation is currently on a 2-year cycle to allow foundations to come up with a better alternative.[6]

Recommended Questions at Hearing

Given the half trillion dollars sitting in the endowments of 80,000 grantmaking institutions, we hope you will ask questions to see how that money is reaching the constituencies you represent.Specifically, we recommend the following questions:

1. What is the Council of Foundations doing to ensure that minority communities are receiving their fair share of philanthropic dollars?More importantly, how will Congress know that these efforts are leading to tangible success?
2. In exchange for their tax exemption, what diversity data should Congress require from large foundations?
3. What regulations or legislation is necessary to ensure that all communities are appropriately served by philanthropy?
4. What incentives can we give foundations to ensure that they are more responsive to community concerns?
5. What are the key indicators to measure diversity in philanthropy and how can we use these indicators to hold foundations more accountable to all communities.

Other Pertinent Issues to Explore

Two issues that have not yet been explored but are being raised informally and often quietly to avoid potential foundation retaliation are:

1. Whether foundations should count their administrative expenses as part of their grants when these expenses often equal 20 percent of grant dollars particularly when foundation staff and boards are not sufficiently diverse; and
2. Whether foundations are informally conspiring to restrict their grant giving to 5 percent of assets when their annual returns are generally in double digits.A 2-percent increase in grant giving from 5 to 7 percent of assets would increase foundation giving by approximately 15 billion a year, a sum greater than the total cash philanthropy of all corporations in America.[7]

We hope you will consider our viewpoints that are shared by hundreds of minority community leaders throughout the country.Please consider us as a resource on this topic as it moves forward.Thank you once again for your leadership and commitment to justice, equality, and civil rights on behalf of the country's 110 million minorities.

[6] A summary of A.B. 624 is attached.

[7] We raised this particularly in the context of some foundations contending that to give more to underserved minorities might displace the amount they give to American icons such as the opera, symphony, and ballet.

Statement of High Museum of Art

Thank you for the opportunity to comment on the effect of the charitable provisions in the Pension Protection Act of 2006 ("PPA"). My observations pertain to the new restrictions imposed on fractional gifts of works of art to museums. Since the passage of the PPA, no fractional gifts have been donated to the High Museum of Art. Based on informal discussions with colleagues in art museums across the country, this situation is now commonplace. Donations of fractional gifts to museums have all but disappeared.

Museums have felt the loss of fractional gifts even more keenly because many of these potential gifts are the most highly prized works in private collections and are works that museums generally cannot afford to purchase themselves. The impact of this loss is significant for museums since the American public may never have the pleasure of seeing these works.zzzzzzzzzz

Prior to the enactment of the Pension Protection Act, the High Museum of Art has been the recipient of over $1 million partial ownership interest in 37 works of art valued at over $2.2 million. Some of the gifts are entire collections, for example we have received a photography collection made up of 15 works and a ceramics collection made up of 18 pieces. One of our most beloved works, a painting by the well-known American Impressionist painter Mary Cassatt, came to the museum as a fractional gift. On the other hand, two collectors who have been contemplating the donation of entire collections—one a significant 19th and 20th century American paintings and sculpture and the other a collection of posters and prints by Toulouse-Lautrec—have declined to give as a result of the changes to the law.

The inability to take the current fair-market value deduction for each fraction given has made the donation of artworks that will appreciate in value financially imprudent. Add to that the significant negative impact on existing contracts for fractional gifts and you begin to see the devastating affect the new law has had on the ability to continue to grow museum collections.

Finally, the provision in the new law which requires donors to complete their gift within 10 years is a serious impediment to future gifts. Donors of valuable works of art may need more than 10 years to take full advantage of the tax deduction and may also wish to enjoy their art in their own homes for a longer period of time. This is particularly true of older donors who have owned works for years and for whom the works are an important part of their home, their identity and their environment. This change in the law means that people will not donate fractional gifts until much later in their life. In the museum community we have a saying: "a gift delayed is often a gift denied." Anything can happen to the work while the donor waits for the appropriate time to make the first fractional donation. We have seen this all too often.

It is also important to remember, that once a donor gives the first fraction of a work, the museum will eventually own the work and it will be available to the public; should that take an additional decade or two before a highly valuable work comes forever into the public domain does not seem to be unreasonable from a public policy standpoint, given what the American public will ultimately gain from the gift.

Thank your for your interest in this matter, and please do not hesitate to contact if you have questions.

Statement of Independent Sector

These comments are submitted by Independent Sector in response to the Oversight Subcommittee's Advisory OV–4, requesting written comments on provisions relating to tax-exempt organizations in the Pension Protection Act of 2006 (P.L. 109–280).

Independent Sector is a nonpartisan membership organization, organized as a 501(c)(3) public charity, that brings the nonprofit community together to make a greater difference in improving people's lives. Our coalition of approximately 600 charities, foundations, and corporate philanthropy programs advocates for public policies that advance the common good; strengthens the effectiveness of organizations; and connects nonprofit leaders so they can develop ideas and take action.

As you know, Diana Aviv, President and chief executive officer of Independent Sector, testified before your Oversight Subcommittee hearing on Tuesday, July 24, 2007, on tax-exempt charitable organizations. In addition to providing the Subcommittee with an overview of our Nation's charitable community, she discussed the events leading up to passage of the charitable provisions in the Pension Protection

Act of 2006 (PPA). Rather than repeating those comments here, I refer you to that testimony.

Enacted in August 2006, the Pension Protection Act contains an important package of reforms intended to strengthen the work of the charitable sector by deterring potential abuse of tax-exempt organizations and creating additional safeguards to ensure that donated funds are used for charitable purposes. The law also includes critical charitable tax giving incentives to help generate needed new resources for the sector. With the recommendations of the Panel on the Nonprofit Sector in hand, Independent Sector and many other charitable organizations worked extensively with Congress in drafting this package of charitable reforms and incentives. Accordingly, we strongly support the charitable incentives and many of those reforms. However, Independent Sector also believes that some changes are needed to a few of the reforms in the Pension Protection Act. Our comments in this submission will focus on the charitable giving incentives and the limited areas where we believe the reforms have presented problems and can be refined.

Charitable Giving Incentives

The Pension Protection Act included several important charitable giving incentives, including an enhanced tax deduction for gifts of property for conservation purposes, an enhanced deduction to corporations for contributions of food and book inventory, and a giving incentive commonly known as the IRA Charitable Rollover. All of these provisions are scheduled to expire at the end of 2007. We urge the Committee to include them in any tax packages being considered.

One of these incentives, we feel, should also be enhanced. Independent Sector has long supported the IRA Charitable Rollover incentive because we believe that it generates significant, new and badly needed resources to support the work of charities across the sector. An important first step, the limited version of the IRA Charitable Rollover included in the Pension Protection Act, permits Individual Retirement Account owners starting at age 70½ to make tax-free charitable gifts totaling up to $100,000 per year from their IRAs directly to charities (except private foundations, donor advised funds, and supporting organizations).

Even the limited version of the IRA Charitable Rollover has enabled Americans to make millions of dollars of new or increased contributions to the nonprofits—including hospitals, museums, educational institutions, and religious organizations—that benefit people every day. Thousands of older Americans have accumulated adequate funds in their IRAs to meet their retirement needs, and they are using this incentive to give something back to their communities. The incentive is particularly helpful for older Americans who do not itemize their tax deductions and would not otherwise receive any tax benefit for their charitable contributions. In addition, the pattern of giving has demonstrated that the incentive has very wide appeal. According to voluntary surveys conducted by the National Committee on Planned Giving and the higher education community, the most common IRA Rollover gift has been $5,000, with the majority of gifts between $1,000 and $10,000.

We strongly support efforts to extend and expand this valuable charitable giving incentive before it expires at the end of 2007. In the House, the "Public Good IRA Rollover Act of 2007" was introduced earlier this year on a bipartisan basis by Representatives Earl Pomeroy (D–ND) and Wally Herger (R–CA). This legislation will extend the current IRA Charitable Rollover by making it permanent and expand its reach by making all charities eligible to receive IRA Rollover donations. The measure also provides IRA owners with the opportunity, starting at age 59½, to use several planned giving annuity options currently in the Internal Revenue Code, and removes the present $100,000 limit on donations per year. This legislation has been endorsed by nearly 900 nonprofits from every state in the country.

Charitable Reforms

As discussed in Diana Aviv's testimony before the Subcommittee on July 24, Independent Sector continues to support the vast majority of reforms enacted in the Pension Protection Act. The issues we raise here for your consideration relate primarily to clarifications of the legislative language.

A. The definition of donor advised fund should be clarified to exclude funds created by a public charity or governmental entity.

Independent Sector strongly supported the inclusion of a definition of donor advised funds in the Pension Protection Act. Indeed, the Panel on the Nonprofit Sector specifically recommended that the term "donor advised fund" be statutorily defined in Federal law. The goal of this definition is to address potential abuses of these funds, now widely employed as philanthropic vehicles by a broad range of donors, without discouraging the use of such funds. The definition of "donor advised fund" incorporated in the Pension Protection Act has included a few ambiguities that have created confusion about whether certain types of funds established within public charities are subject to the new rules.

The Act's definition specifically excludes a charitable fund or account that makes distributions only to a single identified organization or governmental entity (Section 4966(d)(2)(B)(i)). However, this definition does not explicitly exempt a fund established by a public charity or governmental entity that may make distributions to other organizations. Here are two examples of how such a fund could work. A public charity establishes a disaster relief fund at a community foundation to raise and grant funds for disaster relief. All of the advisors for the fund are appointed by the public charity. The advisory Committee for the fund recommends grants to several local disaster relief organizations. In another, a state governmental entity may establish a fund at a community foundation to raise and grant funds for economic revitalization projects for economically depressed neighborhoods in the area. All of the advisors for the fund are appointed by the governmental entity. The advisory Committee for the fund recommends grants to several local organizations. The current definition of a donor advised fund could impede these kinds of efforts. Accordingly, we propose that the Act's definition of donor advised fund be clarified to exempt funds established by public charities or governmental entities to make distributions to other organizations where the public charity or governmental entity appoints all of the advisors.

B. Clarifying that sponsoring organizations of donor advised funds should be able to purchase, at or below market value, goods and services necessary to fulfill their charitable purposes with advised fund assets.

The Pension Protection Act creates penalties for sponsoring organizations and managers of donor advised funds if a sponsoring organization makes a "distribution" from fund assets to individuals and to certain organizations for a non-charitable purpose. However, the legislation does not define the term "distribution," and two questions arise. There is uncertainty about whether a donor advised fund is permitted to make payments for the purchase of goods or services, at or below fair market value, for legitimate charitable activity. Likewise, it is unclear whether the prohibition of distributions to individuals applies to otherwise legitimate purchases from individuals or businesses that operate as sole proprietorships. We propose that the statute be modified to address both of these questions by clarifying that sponsoring organizations and/or managers of donor advised funds are permitted to make such payments from fund assets to business entities and to individuals for goods or services from a business organized as a sole proprietorship.

C. Clarifying that a donor in creating a scholarship fund can designate public officials and/or leaders of the public charity where the scholarship will be used as members of the scholarship selection Committee.

As noted above, the Pension Protection Act prohibits grants to individuals, including scholarships, from donor advised funds. The Act provides an exception for grants to individuals for travel, study or other similar purposes, provided that (1) the donor's or donor advisor's advisory privileges are performed exclusively in such person's capacity as a member of a committee appointed by the sponsoring organization, (2) no combination of a donor or donor advisor or persons related to such persons control such committee, and (3) all grants from such fund are awarded on an objective and nondiscriminatory basis pursuant to a procedure designed in advance and approved by the sponsoring organization's board.

Unfortunately, the statutory definition and scholarship exception are proving problematic for donor created scholarship funds where the donor designates that the scholarship selection Committee include certain public officials and/or leaders of the public charity where the scholarships are to be used. Under section 4966 of the Pension Protection Act, such scholarship funds could fall within the definition of "donor advised fund" but would not qualify for the statutory exception permitting scholarship grants to individuals due to the donor's role in designating members of the scholarship selection Committee. Accordingly, we ask Congress to clarify the scholarship exception to section 4966 to permit a donor, in creating a scholarship fund, to designate that the members of the selection Committee include the holders of identified public offices and/or leaders of the public charity where the scholarships are to be used.

D. Providing for abatement of first-tier taxes for the new penalty provisions of the Pension Protection Act on the same basis as for existing penalty taxes.

The Act established excise taxes on taxable distributions with respect to donor advised funds but failed to extend the abatement provisions of section 4962. That section gives the Secretary authority to refrain from assessing excise taxes if it is established that a taxable event was due to reasonable cause and not willful neglect and the event was corrected within a specified period. The types of events to which this abatement provision applies include failure to distribute income of a private foundation, the making of political expenditures, and certain excess benefit transactions.

Independent Sector views the offenses prohibited in the Pension Protection Act as equivalent to those that are subject to abatement under section 4962, and recommends that the statute be amended to provide that relief. Indeed, the goal of the prohibitions is to correct behavior in this highly technical area of the law. Since the excess benefit transactions provisions in the Act, in particular, are essentially strict liability penalties, there is the likelihood that inadvertent behavior or actions could run afoul of the new, higher standards. The abatement language in section 4962 was intended to provide relief for these types of cases where inappropriate action can be corrected. We therefore recommend that the Code be amended to extend the abatement provisions of section 4962 to the new penalties enacted with the Pension Protection Act.

E. Temporarily suspending the penalties for making grants to certain supporting organizations until the Internal Revenue Service can reliably identify those organizations.

The Pension Protection Act requires private non-operating foundations and sponsoring organizations of donor advised funds to exercise expenditure responsibility with respect to grants to Type III supporting organizations that are not "functionally integrated" with their supported organizations. Unfortunately, there is currently no way for funders to know with certainty whether many proposed grantees are Type III supporting organizations, much less whether they are "functionally integrated." There is still serious doubt that the IRS EO Master File can be relied upon to provide accurate information about the status of a supporting organization. The predictable effect is that funders affected by these rules are delaying or suspending grants. Moreover, the Internal Revenue Service is only now developing regulations to provide guidance to determine whether a supporting organization is "functionally integrated." We ask Congress to modify the effective date for these provisions so that they take effect upon the issuance of IRS regulations on the definition of "functionally integrated" and to clarify what documentation will be required from a supporting organization to satisfy this classification.

Treasury Department Study on Donor Advised Funds

A final matter related to the Pension Protection Act on which we would like to comment is the study on donor advised funds by the Department of the Treasury that is due to be released in August. Section 1226 of that Act requires the Secretary to report on a series of questions related to charitable deductions, the advisability of requiring such funds to make distributions, and the retention of donor rights and privileges. Independent Sector is very interested in working with Congress to interpret the forthcoming study and to address concerns and proposals that the Secretary may raise. We therefore urge the Committee to treat the Treasury study as a continuation of the dialog on further reforms to donor advised funds and similar entities, and to convene all interested parties for a full hearing of the issues presented.

We would be pleased to discuss any of the above or related issues with the staff of the Committee at any time. Thank you for your consideration of these important matters.

Statement of Karen D. Krei, Piedmont Community Foundation, Middleburg, Virginia

Dear Committee Members,

PPA Act of 2006 has impacted the small community foundation world. The questions and comments listed below refer mostly to the IMPACT on Donor Advised Funds (DAF) and the importance of donor advised funds to the community foundation. The questions were posed by the IRS when gathering input for Congressional study.

Respectfully,

Karen Krei
Executive Directo

---

1. What are the effects or the expected effects of the PPA provisions (including the § 4958 excess benefit transaction tax amendments applicable to donor advised funds and supporting organizations) on the practices and behavior of donors, donor advised funds, sponsoring organizations, supporting organizations and supported organizations?

Many donors provide fundraising events to benefit their funds to support community causes in which they have particular interest. This gives a broad segment of society with modest means a method to make a significant charitable impact. Prior to PPA related fundraising expenses could be made from those funds; following PPA they cannot. This is an area that should be amended to allow related fundraising expenses, with oversight on self-dealing, from a DAF. PPA is causing hardship for the small donor. The current law has the chilling effect of discouraging fundraising using a DAF and will drive more donors to form their own 501(c)(3)'s. Would you rather have one responsible community foundation with a community board of directors with oversight, paid staff, and one 990 filed that encompasses many accounts; or flooded with new mini—nonprofits to oversee at the Federal and state level To what purpose is the real question!

Example: One donor lost a wife to breast cancer. He had a DAF rather than a 501(c)(3) because he doesn't want to run a board of directors or the administration of the fund, he simply wants to raise funds to prevent breast cancer using his own identifiable name on the fund. He wants to create a legacy. He is a good "salesman"; he connects to others in the community; he brings in donations for the cause. He has modest means yet now pays for all expenses out of his pocket because we cannot reimburse him or pay the legitimate costs. He does this because he believes in his cause, but how long he can do this without reimbursement is questionable. Why is the current situation OK? It is not OK. PPA should be amended so his money spent is reimbursable. He gives his time and talent. Why is his treasure not treasured as a legitimate expense?

2. What are the advantages and disadvantages of donor advised funds and supporting organizations to the charitable sector, donors, sponsoring organizations, and supported organizations, compared to private foundations and other charitable giving arrangements?

For donors: Donor advised funds (DAF) provide an invaluable conduit for the "everyday donor" to create a charitable fund, either pass through or permanent endowment legacy, without needing the vast sums of money necessary to create a private foundation., or the expense, expertise and work to create and maintain their own 501(c)(3). Because of the lower threshold to participate (as low as $5,000) the DAF is unique in the ability to rally philanthropic capital as no other tool can do. People crave the ability to have a fund "with an advisory voice" that stands in memory or honor of a loved one or their family name. It is a comfort, it gives back to the community and it encourages future family members to value participating as a steward of their community. This powerful tool lets everybody have a seat at the table of philanthropy. No other charitable tool duplicates these benefits.

For community: The DAF is the lifeblood of local level philanthropy, and therefore the community foundation. At the local level donors with a DAF have access to local knowledge of charitable need, and local collaborations can be built with other like-minded donors. Endowed DAF's provide an ongoing local funding source; always in high demand in communities across America. Charities depend on grants from these funds and as the DAF's grow so do the distributions to accomplish more charitable work in the community. Compared to a private foundation a DAF can attract like-minded donors to that fund which is not the case for a private foundation which usually works as a solitary donor. One could argue that while private foundations may have more assets on a 1 to 1 fund basis, it is the local community foundation DAF that can ignite broad support for giving back to the community in a variety of interest areas. many donors provide special community events to fund their DAF. In this respect the commercial DAF is also at a disadvantage to a local community foundation. Without the DAF at the local level, community philanthropy would be severely curtailed and many community foundations may be in jeopardy of existence. This would not serve the community.

For charitable sector: Beyond having the funding source mentioned above, the DAF's require due diligence on each nonprofit grantee. The charitable sector is well served by due diligence which vets recipients as viable tax exempt organizations with bona-fide missions, board governance and effectiveness. Due diligence is good for holding and encouraging high standards in the charitable sector. Without local DAF's at community foundations, face to face diligence would not be available to the "everyday donor" and the charitable sector standards would be viewed from afar which is heralded to lead to fraud and distrust of the sector. We do not see fraud and distrust at the community foundation. The DAF also serves the sector by suppressing the creation of more small 501(c)(3) organizations that in turn need oversight, community boards, operation incomes, and so forth. Without the DAF available the charitable sector would find more nonprofits out competing for less dollars. Not a good outcome.

3. How should the amount and availability of a charitable contribution deduction for a transfer of assets to a donor advised fund or a supporting organization, and the tax-exempt status or foundation classification of the donee, be determined if:

a. the transferred assets are paid to, or used for the benefit of, the donor or persons related to the donor (including, for example, salaries and other compensation arrangements, loans, or any other personal benefits or rights)?

No donors are allowed to personally benefit from their gift. These are the rules and we would not accept any gifts to the contrary. Not sure why you are asking this question.

b. the donor has investment control over the transferred assets?

Not sure why you are asking this question either. The value of the gift is the value of the gift at the time of ownership transfer regardless of how it came to be an asset of the Foundation. The FMV at the time of the ownership transfer is the tax deductible amount. The key words are ownership transfer. The third party investment management retained at the time of transfer has nothing to do with ownership, distribution or investment control. There is no donor investment control. That investment house the donor's gift is now our client and must meet our benchmarks, and so forth. If they do not meet our investment policy guidelines they will be fired. We own, manage and invest our assets, period.

c. there is an expectation that the donor's "advice" will be followed, or will be the sole or primary consideration, in determining distributions from, or investment of the assets in, the supporting organization or the donor advised fund?

This question seems to indicate that DAF "expectation" is a bad thing or somehow relates to a following action. These semantics seem to blur clear intention. I would say both the Foundation and the DAF should have expectation to operate as the rules apply, not via advise. Each DAF must follow the rules of the signed funding agreement which assures each party how the rules and legal control apply. Our distributions are made following the funding agreements which clearly state the Foundation has sole control of distributions. We do not "blindly" follow advice. When receiving advised requests from a DAF we do the due diligence on the potential donee, confirm that the grant falls within our foundation published funding priority guidelines and confirm it does not benefit the donor or donor-related people. If it meets our standards there is no surface reason not to fund the advised grant even though the directors are free to refuse on any grounds. Practically, why would you refuse to fund something that meets the priority funding areas for your Foundation? Again, this is the benefit of a community foundation DAF which has priority funding areas for the community; something a commercial DAF does not have.

d. the donor or the donee has option rights (e.g., puts, calls, or rights of first refusal) with respect to the transferred assets?

We hold no assets with option rights nor would we.

e. the transferred assets are appreciated real, personal, or intangible property that is not readily convertible to cash?.

It is always our action to convert transferred assets to cash as quickly as possible so that a charitable distribution will be available. Our gift policy allows us to refuse gifts that have liquidity or legal issues. If an appreciated stock takes a tumble or rises before we sell it in the 24 hour window after receipt, this is the result of our action, not the donors, and the donor is given the FMV at the time of transfer as their gift value. We take the loss/gain on our capital gains/loss statement. Our investment actions remain accountable to the public as results are published.

4. What would be appropriate payout requirements, and why, for: donor advised funds?

Why are required payouts needed for a community foundation? Our goal is to get as much money as possible to the community, not incubate it while waiting for a cause. The community expects, and should receive, maximum annual distributions that leave growth of corpus intact for endowed funds. Our distribution policy lists

5% at the discretion of the directors in order to maintain endowment commitments and distribute as much a possible to the community annually. We generally give at least 5% of assets annually, last year was 11%, and much more if looking at the impact of annual pass through funds (sometimes 100% of those funds). If a DAF does not make advised grants regularly they are in jeopardy of being absorbed into the annual unrestricted community grant making program. If they had a restriction or area of interest, then they may be restricted as a community grant. I see no benefit to add restriction on distribution amounts for individual or collective DAF's in a community foundation as they must already meet the distribution guides of the foundation which, in our case, would never fall below 5%. More regulation is not needed and would be another cost of administration if imposed to "prove" the singled out DAF class meets some kind of arbitrary payout.

- funds that are excepted from donor advised fund treatment by statute or by the authority of the Secretary, but for which the donor retains meaningful rights with respect to the investment or use of the transferred amounts?

Do not know about any such funds.

- supporting organizations?
- any other types of charities?

5. What are the advantages and disadvantages of perpetual existence of donor advised funds or supporting organizations?

DAF's at a community foundation assist in providing a reliable funding base to meet emerging need in the community. The DAF is a substantial strand in the 3 objectives of a community foundation:

- growth of an unrestricted permanent endowment as the most effective means to meet the needs of the community now and in the future
- administering a strategic grant-making program to maximize impact and effectiveness in achieving positive long-term changes in our community
- leadership of charitable activities; identify and address the important issues of the local charitable sector and harness collaborative resources to improve the quality of life in the community

Many community foundations are made up of over 90% DAF's! The community is well served by their existence and donor passion to perpetuate charitable support.

There are not perpetual DAF's at our community foundation, but the fund itself can become perpetual. There is a two generation cap on family advising. If the account is at least $25,000 in assets we maintain it as a separate fund name and grant source. If it had restricted area of interest we maintain that restriction. It becomes part of our competitive grant cycle for community grant-making program. Money will always be available and money will always be distributed to meet emerging need. Again, flexibility to serve without preset restrictions allows for effective local distribution of funds.

A word on supporting organizations: I can see no reason why there should be a problem with their perpetual existence as long as they meet the needs, rules and requirements. Many supporting organizations are integral to community foundations as they should be. They serve a defined charitable purpose that complements the supported organization. The community benefits from consolidated effort that meets the high standards of the organization. It is an efficient and effective relationship.

Statement of Kenneth H. Ryesky

I. INTRODUCTION

Per Hearing Advisory OV–4 (12 June 2007), and OV–5 (9 July 2007), House Ways and Means Oversight Subcommittee Chairman John Lewis solicited written on the provisions relating to tax-exempt organizations contained in the Pension Protection Act of 2006 (P.L. 109–280) ("PPA"). This Commentary is accordingly submitted.

II. COMMENTATOR'S BACKGROUND & CONTACT INFORMATION

Background: The Commentator, Kenneth H. Ryesky, Esq., is a member of the Bars of New York, New Jersey and Pennsylvania, and is an Adjunct Assistant Professor, Department of Accounting and Information Systems, Queens College of the City University of New York. He has also taught courses in Business Law, and in Taxation, at Sy Syms School of Business, Yeshiva University. Prior to entering into the private practice of law, Mr. Ryesky served as an Attorney with the Internal Revenue Service ("IRS"), Manhattan District. In addition to his law degree, Mr. Ryesky holds BBA and MBA degrees in Management. He has authored several scholarly articles on taxation.

Contact information: Kenneth H. Ryesky, Esq., Department of Accounting & Information Systems, 215 Powdermaker Hall, Queens College CUNY, 65–30 Kissena Boulevard, Flushing, NY 11367. Telephone 718/997–5070 (vox), 718/997–5079 (fax). E-mail: khresq@sprintmail.com.

Disclaimer: This Commentary reflects the Commentator's personal views, is not written or submitted on behalf of any other person or entity, and does not necessarily represent the official position of any person, entity, organization or institution with which the Commentator is or has been associated, employed or retained.

III. COMMENTARY ON THE ISSUES

A. Scope of Commentary

Title XII of the PPA consists of several provisions relating to tax-exempt organizations (and having little, if any, direct connection with pensions). Confident that others who have more direct and comprehensive insight and experience with other provisions of Title XII will apprise the Subcommittee of their views on such other provisions (as indeed, has already occurred at the 24 July 2007 Subcommittee Hearing), this Commentator will limit the instant Commentary to PPA § 1217, the enhanced documentation requirements for charitable deductions, codified at I.R.C. § 170(f)(17). This PPA provision, though not the most significant in dollars, does affect every individual taxpayer who itemizes deductions.

For the sake of clarity and brevity, unless specifically distinguished otherwise, the terms "charitable" and "tax exempt" will be used interchangeably in the current discussion, and the fine legal distinctions between charitable, religious, educational and governmental purposes, as reflected in the verbose provisions of I.R.C. § 501, will be largely ignored.

B. Historical Overview

It has long been the policy of the state and Federal governments to foster and encourage eleemosynary organizations, *see, e.g. Matter of Kimberly*, 27 A.D. 470, 473 (N.Y. App.Div., 4th Dept. 1898). As Chief Justice Horace Stern of the Pennsylvania Supreme Court remarked, "there is no class of institutions more favored and encouraged by our people as a whole than those devoted to religious or charitable causes," *Bond v. Pittsburgh*, 368 Pa. 404, 408, 84 A.2d 328, 330 (Pa. 1951). Indeed, those disinclined to contribute funds for charitable, religious or similar purposes were often suspected of impropriety. *See, e.g. United States v. Pape*, 253 F. 270 (S.D. Ill. 1918).

Consistent with the law's favored view of charitable and religious causes, policy dictates that tax deductions for such purposes be facilitated and encouraged, *see, e.g. Gardiner v. Hassett*, 63 F. Supp. 853, 856 (D. Mass. 1945); 11 U.S.C. § 548(a)(2).

Abuses of the tax-exempt status of charitable organizations were, for a long time, largely tolerated and condoned by the authorities and the public, given the overall benefits to society provided by the tax exempts. More recently, however, as abuses of the system have garnered public notoriety, the regulations affecting charitable organizations have multiplied. Over the years, the laws have responded to various public concerns ranging from unfair competition with legitimate taxpaying businesses, H. Rep. No. 2319, 81st Cong., 2d Sess. (1950), at 36–37, *reprinted at* 1950–2 C.B. 380, 409; S. Rep. No. 2375, 81st Cong., 2d Sess. (1950), *reprinted at* 1950 U.S.C.C.A.N. 3053, 3081, 1950–2 C.B. 483, 504–05; *C.F. Mueller Co. v. Commissioner*, 190 F.2d 120 (3d Cir. 1951), *aff'g* 14 T.C. 922 (1950), to the use of tax-exempt organizations to support subversive political activity, *see, e.g., A New Red Inquiry Approved by House: Will Study if Tax-Free Groups Use Their Wealth to Promote Subversion*, N.Y.Times, April 5, 1952, p. 5. The use of tax-exempt organizations in insurance and Medicaid fraud schemes has been a problem, *see, e.g. United States v. Hendricks*, 2003 U.S. App. LEXIS 12938 (4th Cir. 2003); *Easton v. Public Citizens, Inc.*, 1991 U.S. Dist. LEXIS 18690 (E.D.N.Y. 1991); *Congregation B'nai Jonah v. Kuriansky*, 172 A.D.2d 35, 576 N.Y.S.2d 934 (3d Dept. 1991), *app. dismissed* 79 N.Y.2d 895, 590 N.E.2d 244, 581 N.Y.S.2d 659 (1992); *Matter of Fuhrer*, 100 Misc. 2d 315, 419 N.Y.S.2d 426 (Sup. Ct. Richmond Co. 1979), *enforced*, 72 A.D.2d 813, 421 N.Y.S.2d 906 (2d Dept. 1979); *St. Francis Home, Inc., v. Ohio Dept. of Job and Family Services*, 2006 Ohio 6147 (Ohio App. 2006), *appeal denied* 864 N.E.2d 653 (Ohio 2007). The poster child for personal salary and perquisite abuse of charitable organizations was William Aramony, the CEO of the United Way of America, *see United States v. Aramony*, 88 F.3d 1369, *cert. denied* 520 U.S. 1239 (1997); *see also Vacco v. Aramony*, N.Y.L.J., 7 August 1998, p. 21 (Sup. Ct. N.Y. Co. 1998).

Suspicion of complicity by tax-exempt organizations and their principals and employees in the inflation of charitable donation dollar values is not unknown, *see, e.g.*

St. German of Alaska Eastern Orthodox Catholic Church v. United States, 840 F.2d 1087 (2d Cir. 1988). Taxpayers' abuses involving unreported quid pro quo goods or services in return for charitable contributions led to the requirement of a written receipt from the charity for contributions of $250 or more, and not just a canceled check, Omnibus Budget Reconciliation Act 1993, P.L. 103–66, § 13172(a), 107 Stat. 312, 455–456, codified at I.R.C. § 170(f)(8).

And so, while encouraging and facilitating charitable works, the law must strike a balance so that abuses of and by charitable organizations can be deterred, detected and punished.

C. The Requirements of PPA § 1217

Prior to PPA, the taxpayer could substantiate cash donations amounting to less than $250 with "reliable written records showing the name of the donee, the date of the contribution, and the amount of the contribution." Treas. Reg. § 1.170A–13(a)(1)(iii) (2006). The standard for the reliability of the written record was case-specific, Treas. Reg. § 1.170A–13(a)(2)(i) (2006). The Treasury had dispensed with some or all of the substantiation requirements by exempting the writing requirement in the case of a small cash contribution evidenced by "an emblem, button, or other token traditionally associated with a charitable organization and regularly given by the organization to persons making cash donations." Treas. Reg. § 1.170A–13(a)(2)(i)(C) (2006). Under the ambiguous and subjective standard, the taxpayer's bare unsubstantiated word, when credible, was accepted by the taxation authorities and the courts. *Cf., e.g. Bagby v. Commissioner*, 102 T.C. 596, 611 (1994); *Robinette v. Commissioner*, T.C. Summary Op. 2006–69; *Fontanilla v. Commissioner*, T.C. Memo 1999–156; *Jackson v. Commissioner*, T.C. Memo 1999–203; *Matter of Eble*, N.Y.S. Div. of Tax Appeals, Determination DTA No. 817710 (13 June 2002); *Matter of Martucci*, N.Y.S. Div. of Tax Appeals, Determination DTA No. 817748 (27 December 2001) (allowing unsubstantiated claims of cash donations to collections at houses of worship where taxpayer's word was found to be credible), *with Anthony Muhammad v. Commissioner*, T.C. Summary Op. 2006–144; *Curtis Muhammad v. Commissioner*, T.C. Summary Op. 2006–174; *Matter of Mott*, N.Y.S. Div. of Tax Appeals, Determination DTA No. 818315 (January 24, 2002) (disallowing unsubstantiated claims of cash donations to collections at houses of worship, where taxpayer had credibility issues).

Indeed, internal IRS directives permitted allowance of modest amounts credibly claimed by the taxpayer to have been given as undocumented contributions, *see, e.g. Calderazzo v. Commissioner*, T.C. Memo 1967–25, n. 3 and accompanying text.

PPA § 1217 mandates that beginning with tax year 2007, all cash donations must be substantiated with either a written acknowledgment or a bank record showing the name of donee, date and amount of contribution. Documents that are bogus, altered or otherwise of questionable provenance will presumably continue to be rejected as fulfillment of the substantiation requirement, *see, e.g. Curtis Muhammad v. Commissioner*, T.C. Summary Op. 2006–174, n. 5; *Prowse v. Commissioner*, T.C. Memo. 2007–31; *Matter of Paul Tam*, N.Y.S. Div. of Tax Appeals, Determination DTA Nos. 819366 & 819367 (27 May 2004), as will bank records such as canceled checks which do not clearly indicate the required particulars of the charitable donation. *See, e.g.* Murray v. Commissioner of Revenue, 1989 Minn. Tax LEXIS 72 at *28–*29 (Minn. Tax Ct. 1972).

D. The Specific Problems and Complications of PPA § 1217

(1) Less money placed in the donation receptacles

While it is too early to really do a comprehensive study, the anecdotal evidence to date, consistent with the Commentator's limited personal observations, seems to indicate that less cash is being placed in public donation receptacles. Certain charitable organizations, including but not limited to the Salvation Army and the Jewish National Fund, have, over the years, developed public repute and recognition through their public donation receptacles. Through calendar year 2006, those who regularly or spontaneously used donation receptacles to effect small contributions to various charitable organizations could claim the tax deduction based upon a reasonable and good faith estimate. The congregant who, at the local synagogue's morning minyan, regularly places a dollar bill in the pushke, can do the arithmetic to reach a fairly accurate estimate of his donations for the year. Starting in calendar year 2007, such estimates have not been a valid basis for a charitable deduction. Accordingly, for those taxpayers who itemize their deductions, it now makes little fiscal sense to make undocumented contributions as previously described.

(2) Reduction in spontaneous donations

A charitable deduction requires that the donor have charitable intent at the time of the donation, *United States v. American Bar Endowment*, 477 U.S. 105 (1986); *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960). For reasons previously described, small spontaneous charitable donations via public collection receptacles make no fiscal sense for those who itemize their deductions. Charitable contributions must now be planned, or at least deliberated, so that the donor can write a check and/or find a donee who is postured to give a receipt for cash, or find a donee who is prepared to accept donations via credit card. Therefore, on account of PPA § 1217, the spontaneous inspiration of the moment, which is inherent in scenarios such as the passing of a collection plate at religious services, or depositing a coin in a donation receptacle at the gravesite of a revered decedent, may well be overridden by the donor's sense of fiscal responsibility and the imperative to optimize one's financial position at tax time.

Moreover, PPA § 1217 has also enhanced the very real possibility of pressure by the donor upon the donee to tender a noncontemporaneous receipt based upon the donor's word instead of the donee's records or recollections. Such actions obviously have a corrupting effect upon the integrity of the taxation system.

(3) End of anonymous donations

It may be appropriate or desirable to tender an anonymous charitable contribution. Such a situation may arise where, for example, the donor wishes to make a small one-time donation to an organization for a particular purpose (*e.g.*, a fundraiser dinner journal ad where the guest of honor is a friend, relative or business associate of the donor), but has no intention of making subsequent donations, and does not wish to place undue burdens on the organization. If the donor's identity is known, the organization may well spend more in the ensuing years on mailings and postage, for further solicitations, than the donor contributes on this one occasion. PPA § 1217 has severely limited the tax incentive for such a would-be anonymous donor.

(4) Obsolete and invalid Treasury Regulation

Prior to PPA § 1217, contributions of "a small amount" could be substantiated by "an emblem, button, or other token traditionally associated with a charitable organization and regularly given by the organization to persons making cash donations." Treas. Reg. § 1.170A–13(a)(2)(i)(C) (2007). Thus, tokens such as the red poppy from the American Legion, the daisy from Childrens Hospital of Philadelphia, or the wrapper of a candy bar from the Lions Club's "Candy Day" fundraiser event were acceptable by the IRS as supporting evidence of small contributions to those charities. One gets the sense that the taxpayer in *Jennings v. Commissioner*, T.C. Memo 2000–366, *aff'd* 19 Fed. Appx. 351, 2001 U.S. App. LEXIS 20731, 2001–2 U.S. Tax Cas. (CCH) ¶ 50,651 (6th Cir. 2001), may have at least partially demonstrated his entitlement to a deduction to the Tax Court, if only he would have been able to produce such an "emblem, button, or other token" associated with one of his charitable donees.

PPA § 1217's blanket reference to "subsection (a)" serves to limit the utility of the poppies and daisies and candy bar wrappers so severely as to make such tokens all but irrelevant in substantiating a deduction. Absent some Congressional relaxation of the stringent provision, it would behoove the IRS to review Treas. Reg. § 1.170A–13 in general and Treas. Reg. § 1.170A–13(a)(2)(i)(C) in particular.

E. The Trade-Off of PPA § 1217's Specific Problems and Complications

Most charitable donors are motivated by higher forces and powers than the dollars and cents they contribute out of their pockets. It is obvious that in most instances, a donor can retain far more in his or her bank account by not giving anything at all to charity, taxation issues notwithstanding. Yet, people choose to give to charity.

The IRS and other taxation authorities necessarily deal with charitable contributions in strict terms of dollars and cents. But there is also an unquantifiable aspect of charitable giving, the personal involvement of the donor in the process. From this, the donor receives great moral and spiritual benefit from his or her participation. The knowledge that he or she made some sort of difference on this Earth, and the personal connection with the process, benefit the donor in ways which can never be evaluated using fiscal or accounting principles.

Congress must provide a statutory framework to foster fiscal and legal accountability of the charitable giving process, and the IRS and other law enforcement agencies must police the process and its participants. But, as Ricardo warned, taxation "frequently operates very differently from the intention of the legislature by its indirect effects," David Ricardo, The Principles of Political Economy and Taxation chapt. 16 at 157 (Everyman's Library, no. 590, J.M. Dent & Sons, London, 1969) (1817); *also printed in* 1 The Works and Correspondence of David Ricardo (Piero Sraffa, ed., Cambridge Univ. Press, 1951) at 239.

There is, of course, a need to hold the charitable and other tax-exempt organizations to a relatively high degree of scrutiny, not only to ensure that the not be used in schemes to illegally evade taxes or to confer private inurement to their principals, but also to effect general law enforcement, including the funding of terrorism and subversive activities. In seeking to impose accountability upon the tax-exempt organizations and their contributors with PPA § 1217, Congress has placed an obstacle to many acts of charitable donation which, while low in dollar value, are nonetheless significant and important in other respects.

Moreover, the numerous small-sized tax-exempt organizations that fill small specific niches and effectively handle specialized needs not well addressed by the broad brush approaches of the larger charitable organizations, are now being weighed down by the additional requirements of PPA and other recent legislation, much as the small family businesses and farms are being squeezed out by the giant retailers, manufacturers and agricultural concerns.

The inflexible documentation requirement of PPA § 1217 certainly goes far toward ensuring accountability, but this strict accountability standard has come at a price.

IV. CONCLUSION

The opening statement by Chairman Lewis at the 24 July 2007 Subcommittee Hearing emphasized the need for a strong and healthy nonprofit sector. This can only come about if donors have a positive relationship and emotional connection with the respective charitable organizations who would receive their donations.

On account of the provisions of I.R.C. § 170(f)(8), the operation of PPA § 1217 effectively operates disproportionately, if not exclusively, upon donations of less than $250.00. These donations may be small and insignificant, even in the aggregate, but there is more at stake than the small pocket change that is or is not deposited. The passionate relationship of many a large donor to his or her favorite charity has been initiated by a coin dropped, unacknowledged and undocumented, into a collection receptacle. Charitable organizations must continue to develop and nurture their donorships. PPA § 1217 has interposed some impediments to some traditional methods of donor development.

It is well to note that the aforementioned I.R.C. § 170(f)(8), which addresses the documentation of the presence or absence of a quid pro quo in charitable donations of $250.00 or more, specifically authorizes the Treasury/IRS to relax some of those requirements, I.R.C. § 170(f)(8)(E). How ironic that PPA § 1217, as codified in I.R.C. § 170(f)(17), is far more rigid for documenting smaller charitable donations!

The Treasury/IRS should similarly be authorized to relax the documentation requirements for the smaller donations under appropriate circumstances, balancing the needs of tax enforcement and law enforcement in general against the salutary effects that small, spontaneous undocumented donations may have upon the charitable sector.

According to Mr. Miller's testimony at the Hearing on 24 July 2007, America's charitable sector is generally in compliance with the tax laws; the deviations which receive attention in the news media are the exceptions, and not the general tendency. Problems relating to undocumented small pocket change donations are not among the charitable sector's significant tax problems and issues highlighted by Mr. Miller in his testimony.

Though reposing too much discretion in the tax collector does run the risk of the tax uncertainty Adam Smith admonishes us to avoid, the rigid standard of PPA § 1217 does dampen and discourage a monetarily insignificant, though highly symbolic, method of public participation in the charitable giving process. Accordingly, Congress should consider giving the Treasury and the IRS a modicum of bounded discretion to enable the good faith tax return filer to benefit from a modest charitable deduction, so as to reflect spontaneous and undocumented cash contributions not currently deductible on account of PPA § 1217.

Statement of Lester M. Salamon, Baltimore, Maryland

Executive Summary: (2 pages)

Nonprofit Governance and Accountability

Lester M. Salamon and Stephanie L. Geller

This report shows that, contrary to some accounts in the press, the nonprofit is adhering to reasonable standards of governance and accountability. The full text of the report is available at:

http://www.jhu.edu/listeningpost/news/pdf/comm04.pdf

Executive Summary: (1 page)

Investment Capital: The New Challenge for American Nonprofits

Highlights one of the significant challenges facing nonprofit organizations—their limited access to investment capital. The full text of the report is available at:

http://www.jhu.edu/listeningpost/news/pdf/comm05.pdf

Excerpts: (5 pages)

Employment in America's Charities: A Profile

This report documents the enormous scale and growing role of nonprofits in the United States. The full text of the report is available at:

http://www.jhu.edu/~ccss/research/pdf/
Employment%20in%20Americas%20Charities.pdf

Section 1: A significant employer
Section 4: A dynamic sector
Section 5: Regional variations in nonprofit employment growth
Section 6: A diverse sector
Section 7: Nonprofit prominence in particular fields

Excerpt from:

Nonprofit Governance and Accountability

Lester M. Salamon and Stephanie L. Geller, "Nonprofit Governance and Accountability" Communiqué No. 4. (Baltimore: The Johns Hopkins Center for Civil Society Studies, October 2005).

EXECUTIVE SUMMARY

Responding to concerns about nonprofit governance and accountability surfaced in a discussion draft [1] issued by the Senate Finance Committee, the Johns Hopkins Nonprofit Listening Post Project conducted a survey, or Sounding, of its nationwide sample of nonprofit organizations in five key fields (children and family services, elderly housing and services, community and economic development, theaters, and museums) to examine the governance and accountability practices of the nation's nonprofit organizations.

Key findings from this survey included the following:

(1) **Board roles.** The boards of overwhelming majorities (85–90 percent) of the nonprofit organizations surveyed are highly or significantly involved in the key strategic oversight functions that nonprofit boards are expected to perform. These include:

- Setting organizational missions (93 percent);
- Setting the chief executive's compensation (88 percent);
- Establishing and reviewing organizational budgets and finances (87 percent);
- Setting organizational objectives (87 percent);
- Reviewing auditing and accounting policies and practices (83 percent); and
- Approving significant financial transactions (81 percent).

(2) **Financial disclosure.** The overwhelming majority (97 percent) of sampled organizations have undergone an independent audit within the past 2 years and comparable proportions (95 percent) regularly distribute their financial reports to their boards.

(3) **Ethics protections.** The overwhelming majority of responding organizations also already have other policies and procedures in place to promote accountability and ethical behavior. This includes:

- Internal controls on finances and financial accounting (98 percent);

- Records retention policies (84 percent);
- Conflict of interest policies (83 percent);
- Travel expense policies (81 percent);
- Compliance programs for regulation (81 percent); and
- Codes of ethics for board and staff (73 percent).

Even among smaller organizations, a majority have such policies in place.

(4) **Best-practice standards**

- Nearly two-thirds of the organizations surveyed already take part in best-practice accreditation programs, and nearly 60 percent of these participate in more than one such program.
- Of those organizations that do not participate in formal best-practice accreditation programs, most report following an internally developed set of standards.
- Internal factors such as a desire to promote organizational excellence and improve transparency are more important in explaining adherence to best-practice accreditation standards than external pressures from funders, clients, or the press.

(5) **Organizational changes**

- Nearly one in three organizations (29 percent) reported making some material change in their structure, programs, funding, or mission over the previous two years.
- However, most of these (54 percent) reported notifying the Internal Revenue Service of this change. And those that did not report typically experienced less significant changes (e.g., changes in funding sources).

(6) Nonprofit awareness

- Most nonprofit boards (80 percent) are at least "somewhat knowledgeable" about nonprofit laws at both federal and state levels, and two-thirds reported having discussed the federal Sarbanes-Oxley law.
- Only 36 percent of the organizations reported having held at least brief board discussions of the Senate Finance Committee staff proposals for increased regulation of nonprofit governance.

The full Communiqué on Nonprofit Governance and Accountability is available for downloading at: www.jhu.edu/listeningpost.

U.S. Senate Finance Committee, Staff Discussion Draft (June 22, 2004) (http://finance.senate.gov/hearings/testimony/2004test/062204stfdis.pdf).

Excerpt from:

Investment Capital: The New Challenge for American Nonprofits

Lester M. Salamon and Stephanie L. Geller, "Investment Capital: The New Challenge for American Nonprofits" Communiqué No. 5 (Baltimore: The Johns Hopkins Center for Civil Society Studies, April, 2006).

EXECUTIVE SUMMARY

Once considered fundamentally labor-intensive institutions, nonprofit organizations are increasingly confronting expanded needs for "investment capital" to finance the facilities, technology, and innovations required to remain viable in an increasingly competitive environment. Because of their relatively small scale and their non-profit character, which makes it impossible for them to issue stock, however, nonprofits confront special difficulties in accessing investment capital. Regrettably, though, precious little is known about the special challenges nonprofit organizations face in generating such capital or the degree of success they have had in overcoming them.

To help fill this gap, the Johns Hopkins Nonprofit Listening Post Project took a preliminary "Sounding" of its nationwide sample of nonprofit organizations in five broad fields of nonprofit action (children and family services, community and economic development, elderly housing and services, museums, and theaters) to learn about the capital needs of these organizations and the ease or difficulty they face in meeting these needs.

Based on the results of this Sounding, the following major conclusions emerge:

1. Nonprofits in these core human service, community development, and arts fields have significant investment capital needs.

2. These needs extend well beyond the traditional areas of physical capital to embrace program development, staff upgrading, and strategic planning. This likely re-

flects the growing competition in many of these fields and the substantial infusion of entrepreneurial spirit into the nonprofit sector in recent years.

3. Despite these needs, nonprofits have encountered significant difficulty accessing the major pools of investment capital in our country, such as insurance companies and pension funds. Many nonprofits have limited knowledge of these capital resources, and those that do have knowledge report substantial difficulty in accessing them.

4. Although other sources, such as commercial banks, government, foundations, and individual donors, are more familiar to nonprofits, some (e.g., government) are quite difficult to access for investment capital purposes and others (e.g., commercial banks, foundations, and individual donors) are limited in their areas of interest.

5. Although some variations exist in the applicability of these findings among the different types of nonprofit organizations surveyed and between organizations affiliated with national intermediary organizations and those not so unaffiliated, what is most striking is how uniform they seem to be, at least among the types of organizations examined here.

6. While it is impossible to say for certain whether these results apply equally to other types of nonprofit organizations, they certainly suggest the need for increased attention to the investment capital needs of nonprofit organizations and possible policy actions to level the playing field for nonprofit access to capital.

Excerpts from:

Employment in America's Charities: A Profile

Lester M. Salamon and S. Wojciech Sokolowski, "Employment in America's Charities: A Profile" (Baltimore, MD: Johns Hopkins Center for Civil Society Studies, 2006).

Section I: A Significant Employer

In the first place, these data sources make clear that charitable nonprofit organizations employ far more people than is widely recognized. As of the second quarter of 2004, the latest year for which data on nonprofit organizations are available, American charities employed 9.4 million paid workers and engaged another 4.7 million full-time equivalent (FTE) volunteer workers for a total work force of more than 14 million workers (see Table 1).[4]

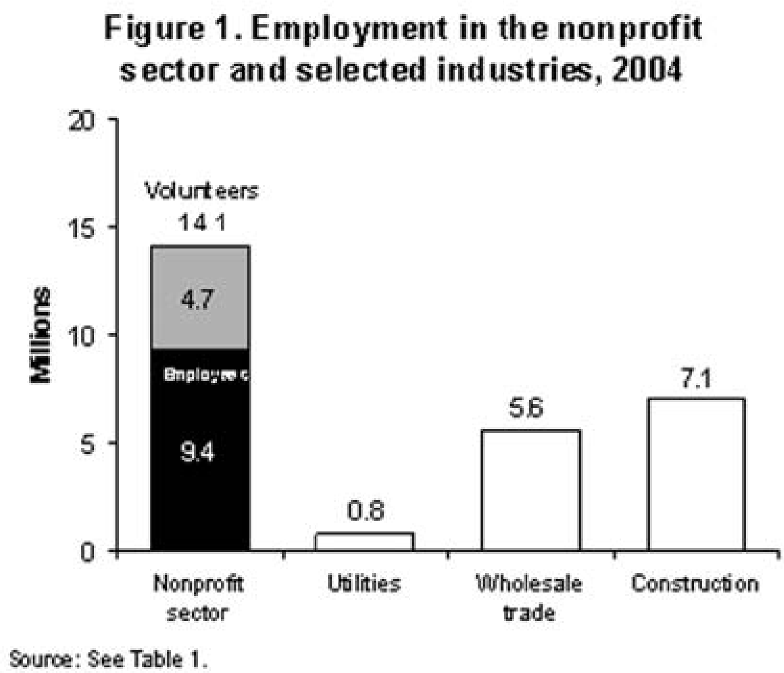
Table 1 Employment in American Charities, 2004

Item	Number	As % of US Economy
Paid workers	9.4 million	7.2%
Volunteer workers (FTEs)	4.7 million	3.9%*
Total workforce	14.1 million	10.5%*
Wages ($billions)	$321.6 billion	6.6%

Sources: Data on paid employment and wages from Quarterly Census of Employment and Wages (QCEW) accessed through the U.S. Bureau of Labor Statistics. Data on volunteer workers from U.S. Census Bureau, Current Population Survey, (http://www.census.gov/cps/). Volunteer time converted into full-time equivalent (FTE) workers by dividing the total number of hours volunteered by the number of hours in a typical work year. For further detail on data sources, see Appendix A.

*Volunteers added to total employment to compute percentage of total work force.

The workforce of the charitable nonprofit sector thus represents 10.5 percent of the country's total workforce. Put somewhat differently, the paid workers of charitable nonprofit organizations outnumber those of the utility, wholesale trade, and construction industries; and the paid and volunteer workers together outdistance the combined employment of all three of these major industries taken together (see Figure 1).



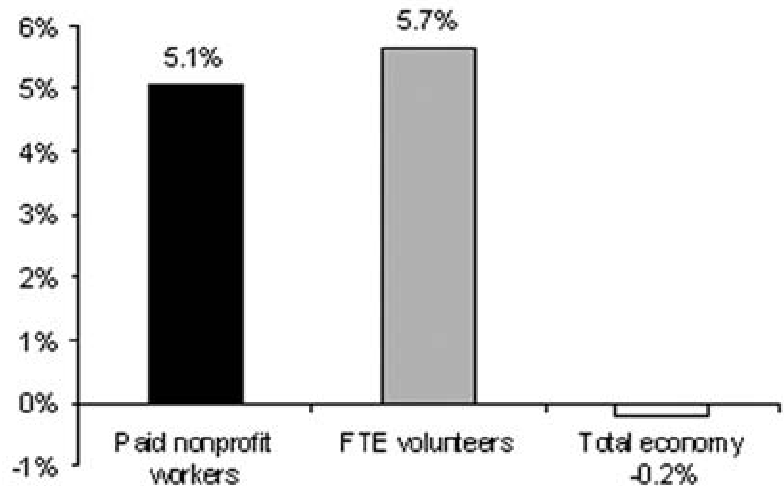
This sizable workforce naturally attracts significant wage payments. Nonprofit paid workers thus received $321.6 billion in wages in 2004, more than the wages paid by the utilities ($50.1 billion), construction ($276 billion), and wholesale trade ($283.7 billion) industries, and almost as much as the finance and insurance industry ($355.8 billion).

Section IV: A Dynamic Sector

Not only is the nonprofit sector a sizable employer, but also it has been a growing employer, adding both paid jobs and volunteer workers at a much higher rate than the rest of the economy. This has certainly been true of the past two years, for which comparable national data are now available, though it is consistent with earlier findings covering a more extended period for a limited set of states.[7] Thus, between 2002 and 2004, the nonprofit workforce, including paid and volunteer workers, grew by 5.3 percent. Both the paid and volunteer portions of the nonprofit workforce grew by over 5 percent during this period. By contrast, overall employment in the economy declined by 0.2 percent during this same period (see Figure 3).

[7] See: Lester M. Salamon and S. Wojciech Sokolowski, "Nonprofit Organizations: New Insights from QCEW Data," *Monthly Labor Review* (September 2005), p. 24.

Figure 3. Employment growth, nonprofit sector and total economy, 2002-2004



Source: See Table 1.

Table 5
Nonprofit workforce as a share of total workforce,* by state, 2004
(Ranked by Nonprofit Share of Total Workforce)

Rank	State	Nonprofit workers as % of all workers
1	District of Columbia	17.6%
2	Vermont	16.5%
3	Rhode Island	15.8%
4	New York	15.6%
5	Maine	15.3%
6	Pennsylvania	14.9%
7	North Dakota	14.8%
8	Massachusetts**	14.6%
9	Montana	14.1%
10	Wyoming**	14.0%
11	New Hampshire	13.8%
12	Connecticut	13.3%
13	South Dakota	13.2%
14	Oregon	13.0%
15	Minnesota	12.9%
16	Iowa	12.6%
17	Maryland	12.1%
18	Alaska	12.1%
19	West Virginia	12.0%
20	Hawaii	11.9%
21	Washington	11.8%
22	Nebraska	11.7%
23	Wisconsin	11.6%
24	Missouri	11.2%
25	Utah	10.9%
26	New Mexico	10.8%
27	Indiana	10.7%
28	Ohio	10.6%
29	Illinois	10.5%
30	**U.S. AVERAGE**	**10.5%**
31	Michigan	10.5%
32	Delaware	10.3%
33	North Carolina	10.2%
34	Arkansas	10.2%
35	New Jersey	10.0%
36	Kentucky	9.9%
37	Kansas	9.8%
38	Oklahoma	9.6%
39	Idaho	9.5%
40	Colorado	9.2%
41	Virginia	9.0%
42	Tennessee	8.9%
43	Arizona	8.8%
44	California	8.5%
45	Florida	8.2%
46	Georgia	7.9%
47	Texas	7.8%
48	Louisiana	7.6%
49	Mississippi	7.4%
50	Alabama	6.9%
51	South Carolina	6.0%
52	Nevada	3.7%

*Total workforce includes both paid and volunteer workers.
** Nonprofit employment estimated due to data disclosure limits.

Section V: Regional Variations in Nonprofit Employment Growth

This pattern of nonprofit workforce growth at rates in excess of the growth of total employment is evident in almost every part of the country, though the actual scale of change differs markedly from place to place as does the contribution that volunteers and paid workers make to the totals. Thus, as Table 6 shows, the nonprofit workforce grew by anywhere from nearly 10 percent in the Pacific region to under 1 percent in the West South Central region between 2002 and 2004. In every region, however, nonprofit workforce growth exceeded the growth of overall employment, though in one of these (the Mountain region) this was due largely to the substantial growth in volunteer employment. What is more, nonprofit employment grew even in regions where overall employment, affected by the economic recession then under way, actually declined. This suggests that nonprofit employment functions as a counter-cyclical mechanism, continuing to expand to meet needs even as overall employment slumps.

Table 6
Percent Change in nonprofit employment vs. total employment, 2002–2004, by region

Region	Percent Change			
	All Workers	Nonprofit Employees	Nonprofit Volunteers	Nonprofit Workforce
Pacific	0.9	10.3	8.5	9.5
West North Central	0.4	4.4	20.0	8.9
East South Central	0.9	4.4	14.7	8.1
Mountain	3.2	3.1	13.1	7.4
South Atlantic	1.9	6.0	4.5	5.4
New England	-1.1	4.3	7.1	4.9
East North Central	-0.8	5.0	3.8	4.6
Middle Atlantic	-0.2	3.9	-4.6	2.0
West South Central	0.2	1.7	-0.7	0.8
US Total	-0.2	5.1	5.7	5.3

This same pattern is also clearly apparent at the state level, though the variations here are greater. Thus, nonprofit employment grew at a faster rate, or declined at a slower rate, than overall employment in all but four states (Montana, Alabama, Missouri, and New Mexico), as shown in Table 7.

Table 7
Percent change in employment, nonprofit organizations vs. total economy, 2002-2004, by state

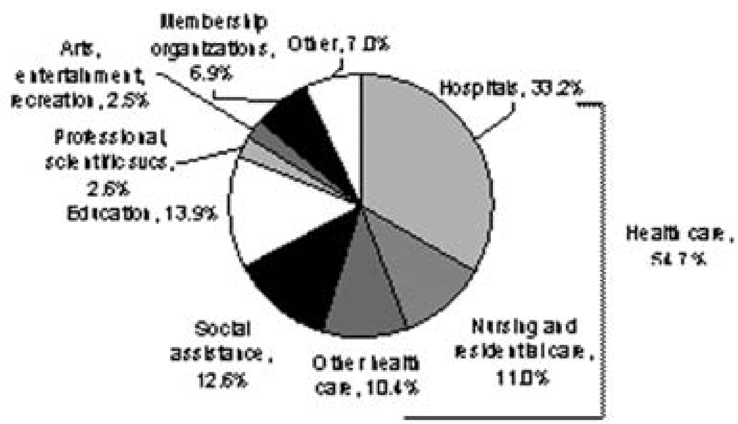
State	% Change	
	All employees	Nonprofit employees
Nevada	9.1%	30.5%
Ohio	-0.8%	14.7%
California	0.4%	13.3%
Rhode Island	1.3%	10.7%
South Carolina	1.1%	9.9%
Arizona	4.3%	9.8%
District of Columbia	1.6%	7.8%
North Carolina	0.3%	7.6%
Delaware	2.1%	7.1%
Tennessee	1.5%	7.1%
Maine	0.8%	6.9%
Utah	2.7%	6.9%
Louisiana	0.8%	6.7%
Georgia	0.3%	6.4%
Florida	4.1%	6.2%
North Dakota	3.0%	5.8%
Wisconsin	0.7%	5.2%
U.S. TOTAL	**-0.2%**	**5.1%**
South Dakota	1.9%	5.0%
Washington	2.1%	5.0%
Maryland	1.2%	5.0%
Oregon	1.5%	4.8%
Hawaii	4.6%	4.8%
Minnesota	1.0%	4.8%
Kentucky	0.4%	4.6%
Alaska	3.0%	4.2%
Pennsylvania	-0.3%	4.2%
Vermont	0.7%	4.1%
New York	-0.2%	3.9%
Idaho	3.4%	3.9%
Virginia	2.4%	3.9%
New Hampshire	1.5%	3.7%
Montana	4.3%	3.6%
New Jersey	0.2%	3.2%
Indiana	0.8%	3.1%
Iowa	0.4%	2.7%
Arkansas	0.5%	2.4%
Connecticut	-1.4%	2.3%
Mississippi	-0.1%	2.2%
Michigan	-2.1%	1.7%
West Virginia	0.2%	1.4%
Texas	0.3%	0.8%
Kansas	-0.9%	0.7%
Oklahoma	-1.7%	0.1%
Alabama	1.0%	-0.2%
Illinois	-1.3%	-0.3%
Missouri	0.0%	-0.6%
New Mexico	3.2%	-5.0%

** Comparable data unavailable on four states: Colorado, Massachusetts, Nebraska, and Wyoming.

Section VI: A Diverse Sector

Charitable nonprofit employment is scattered across a wide variety of fields, from information and scientific services to religion and civic affairs. The bulk of this employment, however, is in human services, and within that broad category, in health services. In particular, as shown in Figure 4, hospitals alone account for one-third of all nonprofit employment, and other health providers, such as clinics and nursing homes, account for another 21 percent. Two other human service fields that account for substantial shares of total nonprofit employment are education (14 percent of the total) and social assistance (13 percent).[8]

Figure 4. Nonprofit paid employment by field, 2004



Source: See Table 1

Section VII: Nonprofit Prominence in Particular Fields

While nonprofit paid workers comprise 7 percent of national employment overall, in many fields their role is far more prominent than this overall average might imply. Thus, nonprofit organizations account for more than half of all employment in hospitals, social care, and museums; and a third of all employment in nursing and residential care and colleges and universities (see Figure 5 and Appendix C). Without the nonprofit sector, therefore, crucial health, education, and social care functions would be lacking.

---

[8] For a more detailed breakdown of the distribution of nonprofit employment by NAICS code categories, see Appendix C.

Figure 5. Nonprofit* share of total employment, selected fields

Lettie Pate Evans Foundation
Atlanta, Georgia 30303
July 25, 2007

The Honorable John Lewis, Chairman
Subcommittee on Oversight
House Ways & Means Committee

Dear Chairman Lewis:

This letter is in response to the House Ways and Means Oversight Subcommittee Advisory, OV–4, requesting written comments on provisions in the Pension Protection Act of 2006 related to tax-exempt organizations. On behalf of the Lettie Pate Evans Foundation and Lettie Pate Whitehead Foundation, this letter expresses our concerns with those provisions of the Pension Protection Act that contemplate a new minimum payout requirement for certain supporting organizations.

Section 1241(d)(1) of the Pension Protection Act directs the Secretary of the Treasury to promulgate new regulations that require type III supporting organizations "to make distributions of a percentage of either income or assets to supported organizations." Existing regulations require type III supporting organizations to distribute substantially all of income annually. However, a new *asset-based* minimum payout requirement—if enacted by the Treasury Secretary—would adversely impact supporting organizations like the Lettie Pate Evans Foundation and the Lettie Pate Whitehead Foundation, which have a long history of significant and growing distributions to beneficiaries and whose donors specified in their wills that grants shall be paid from income only.

Trustees of the Lettie Pate Evans Foundation administer two separate funds—the Lettie Pate Evans Restricted Fund and the Lettie Pate Evans General Fund. Each fund is a separate type III supporting organization. The Lettie Pate Whitehead Foundation is also a type III supporting organization administered by its own distinct governing body.

Lettie Pate Evans Restricted Fund

Lettie Pate Whitehead Evans left the bulk of her estate to establish the Lettie Pate Evans Restricted Fund as trustee for the benefit of 14 specified charitable beneficiaries. In her will, Mrs. Evans dictated exactly how the income—and she specified only income—from her residuary estate should be divided among the beneficiaries. Since its inception in 1953, the Evans Restricted Fund has distributed all of its income annually (from $225,000 in 1954 to over $41 million in 2006) to the 14 beneficiaries. More than $489 million has been distributed to the beneficiaries, which is 61 times the value of the total assets contributed to the Fund. Cumulatively, the Evans Restricted Fund has become the largest donor to Georgia Tech, Berry College, the College of William and Mary, Washington and Lee University, Episcopal High School and the Protestant Episcopal Theological Seminary in Virginia.

The will establishing the Evans Restricted Fund specified that the fund's corpus "shall not be invaded" and that all payments must be made from net income. If the current minimum payout requirement is amended to require type III supporting organizations to invade corpus and distribute more than net income, trustees of the fund would be prevented from complying with the donor's instructions. The Evans Restricted Fund and its beneficiaries presumably would be forced to pursue equitable reformation proceedings in court, imposing significant hardship and considerable expenses on the fund and its beneficiaries.

Lettie Pate Whitehead Foundation

Mrs. Evans' son, Conkey Pate Whitehead, established through his will the Lettie Pate Whitehead Foundation to honor his mother. The Whitehead Foundation was established for the primary purpose of providing educational opportunity to needy women in nine specified Southern states. Funded upon Mrs. Evans' death in 1953, the Foundation immediately began making annual grants to educational institutions for need-based scholarships for women. Net annual distributions from the Lettie Pate Whitehead Foundation have grown from $100,000 in 1954 to $21,639,800 in 2006. Annual support is now provided to 201 schools and colleges and 14 facilities serving elderly women.

All 215 supported organizations receive a grant every year. More than $300 million has been distributed to beneficiaries since 1954, which is 16 times the value of the assets contributed to the Foundation. Since the Whitehead Foundation became a supporting organization, distributions to supported organizations have risen each year. Beneficiaries rely on this steadily growing income stream to fund scholarships for over 8,000 needy female college and nursing students and to fund the care of aged women.

As in the case of the Evans Restricted Fund, the Lettie Pate Whitehead Foundation was created under the terms of a will that directs trustees to make grants only from net income. If the current payout requirement is amended to an asset-based requirement, trustees of the Whitehead Foundation would be unable to comply with the will's prohibition on distributions of principal. In addition, distributions to beneficiaries would fluctuate with the market. Declining distributions in some years would jeopardize schools' ability to administer a consistent scholarship program. Schools may feel obliged to drop students from the scholarship program in years when a market decline dictates a smaller grant.

Donors to the Evans Restricted Fund and Whitehead Foundation understood that preserving principal ensures a stable and permanent income stream for supported organizations. These organizations' investment policies seek reliable and consistent income growth while preserving the real value of the corpus. Trustees of these supporting organizations are concerned that new regulations requiring organizations to pay out more than income will steadily erode value from these funds, ensuring that less total philanthropic dollars could be distributed to supported organizations over time.

Narrowly Tailor Regulations

The Evans Restricted Fund and Whitehead Foundation are not the kind of abusive organizations Congress targeted in the Pension Protection Act of 2006. We understand and share Congress's concern that some living taxpayers use supporting organizations as tax shelters while providing little or no benefit to charity. Such schemes prevent the public from realizing benefit from the donor's tax deduction. Reported abuses seem most commonly to involve donors parking non-income producing assets in supporting organizations, making no distributions to charity (because there is no income) and borrowing assets from the supporting organization for reinvestment.

We support efforts to stop these abusive practices. In particular, we applaud those provisions of the Pension Protection Act that prevent loans from supporting organizations and that strengthen restrictions and penalties for abuse by disqualified persons. These and other provisions in the Pension Protection Act should go a long way toward eliminating the reported abuse.

But no new regulations should cut so broadly as to limit legitimate philanthropy. Additional safeguards—such as a new minimum payout requirement—should be enacted only as necessary and should be crafted to target abusive taxpayers only and to avoid sweeping change that may adversely impact legitimate supporting organizations and their beneficiaries. New minimum payout requirements may be narrowly tailored to ensure that credible organizations like the Evans Restricted Fund and Whitehead Foundation can continue to distribute a steady, growing income stream to beneficiaries according to the donors' direction.

We recently suggested to the Treasury Department that new regulations limit an asset-based payout requirement only to those supporting organizations that have not yet distributed to charity the public benefit incumbent in the donor's tax deduction. The existing payout requirement set out in Treasury Regulations section 1.509(a)-4—"substantially all" of income—is appropriate and sufficient for those type III supporting organizations that have distributed to charity an amount greater than or equal to the value of the donor's cumulative gifts to the supporting organization. However, until a supporting organization distributes an amount equal to the donor's gifts, it may be necessary to require the supporting organization to distribute a minimum percentage of assets annually. With this simple overlay to the existing payout requirement, no taxpayer may create or use a type III supporting organization to shelter non-income producing assets.

We suggested that Treasury promulgate this new regulation by adding the following at the end of the first sentence of Treasury Regulations section 1.509(a)-4(i)(3)(iii)(a): provided, however, that until the first taxable year following the taxable year in which the supporting organization's cumulative distributions to one or more publicly supported organizations equal the value of the donor's contributions, the supporting organization must distribute at least X% of its assets to its publicly supported organizations for any taxable year in which such amount is greater than substantially all of its income. For purposes of applying the proviso in the prior sentence, (i) the value of a supporting organization's assets shall equal the aggregate fair market value of all non-exempt assets as described in section 4942(e), and (ii) the value of any property that is contributed shall equal the fair market value of such property at the time the contributions were made.

The following examples illustrate this provision's operation and could be incorporated into the regulations if Treasury adopts this approach.

Example 1. With a $100 million gift, a taxpayer establishes W, an organization described in section 501(c)(3), to support Y, a publicly supported organization. W meets the responsiveness test described in subparagraph (2) of this paragraph. W must pay at least X% of its asset value annually to Y until W cumulatively distributes at least $100 million to Y. In taxable years following the taxable year when W distributes a total of $100 million to Y, W must pay substantially all of its income to Y.

Example 2. The taxpayer from the above example makes a subsequent $50 million gift to W. W must pay at least X% of its assets to Y until W distributes at least $150 million to Y.

Adopting this approach will ensure that new regulations are narrowly drawn to curb abuse while also securing charitable distributions to supported organizations in perpetuity. Perhaps most importantly, this narrow approach to regulation will ensure that supporting organizations remain a vital, legitimate and attractive vehicle for taxpayers to support worthy charitable causes. Prospective donors will be less likely to create this kind of perpetual legacy if they are forced by regulation to liquidate charitable principal. Sound tax policy should encourage and facilitate the generous impulse of wealthy Americans like the donors who created the Lettie Pate Evans Restricted Fund and Lettie Pate Whitehead Foundation.

Sincerely,

P. Russell Hardin
President

Statement of Marin Community Foundation

As members of the tax-exempt community, we are responding to the Committee's Advisory of June 12, 2007 requesting written comments on provisions relating to tax-exempt organizations in the Pension Protection Act of 2006 (PPA). According to the Advisory, you are seeking public comments regarding the tax-exempt community's views on the impact of the recently enacted provisions on charities and foundations. The Subcommittee is particularly interested in how these new rules affect, or will affect, charitable efforts and the difficulties that have arisen in implementing these provisions. Further, the Subcommittee requests comments on the provisions scheduled to expire on December 31, 2007.

Overall, we believe the charitable incentives proposed are positive and most of the reforms are reasonable. However, there are a few areas of concern that we ask you to address regarding the impact on charitable foundations and their ability to meet their charitable missions.

Charitable foundations help individuals, families, corporations, nonprofits and community groups achieve their charitable goals in communities throughout the nation. There are various tools available, such as utilization of a community foundation that can help stimulate significant private investment to further the quality of life in a given community. Some reforms within the PPA, if interpreted in a particular way, could limit the ability of charitable foundations, including community foundations, to function effectively. Furthermore, some provisions may be disincentives to charitable giving.

We have outlined our concerns and suggestions in detail below. More specifically, the following sections describe challenges that the PPA poses to donor advised funds and supporting organizations, thus limiting a community's ability to increase charitable giving.

Some of the PPA Provisions Have Unnecessarily Saddled Donor Advised Funds and Supporting Organizations With New Regulations That Are Not Necessary to Correct the Abuses Identified by Congress

At a minimum, donor advised funds and supporting organizations should not be penalized in comparison to private foundations. Donor advised funds and supporting organizations are popular and effective tools for philanthropy. For the most part, these tools have enjoyed a long history of success in the United States. They allow donors to relinquish control over assets easily and commit them for charitable purposes. Yet, they also allow donors to remain involved appropriately in a manner that engages the donors and their families with philanthropy. Our foundations collectively made charitable grants of over $333 million in 2006; with more than $147 million from donor advised funds.

We are concerned that the PPA provisions may unnecessarily cast a cloud of suspicion over donor advised funds and supporting organizations. The new provisions are already causing confusion in the minds of donors who do not understand the perceived criticism. To the extent donors begin to believe that donor advised funds and supporting organizations are not legitimate charitable vehicles, or donors are hampered by unreasonably bureaucratic restrictions or procedures, current and future charitable giving will be affected negatively. The impact will be compounded by the perception that giving through donor advised funds is no longer simple. Simplicity in giving has been an attractive hallmark of these funds.

The PPA implements some additional restrictions and limitations that are not necessary. We believe that the desired reforms can be achieved in a more reasonable manner. Increased oversight can provide many of the necessary checks and balances and help detect and punish bad actors in the charitable sector. While we recognize there are some bad actors in the world of donor advised funds and supporting organizations that justify rigorous oversight including the review of an organization's exempt status, we are concerned that the result will be the casting of a wide net that will unfairly entangle reputable organizations and their honest donors.

In sum, we suggest that donor advised funds and supporting organizations should not be treated unfairly and discriminatorily in comparison to private foundations.

While Overall the Five Year Excess Business Holdings Provision is Beneficial, There Are Circumstances Under Which It Can Be Excessive and Harmful to Donor Advised Funds and Supporting Organizations

The excess business holdings provision, along with the provision allowing for an extended period under certain circumstances, may establish an appropriate policy for treating illiquid assets which are donated for charitable purposes. Five years to divest holdings of closely held stock (or other assets exceeding twenty percent of a business enterprise) is certainly a reasonable timeframe for most transactions.

However, there should be additional allowances for special circumstances that may arise while liquidating assets. There are many circumstances under which a community would benefit if the five year timeframe was extended. In fact, the five year limitation can have an unintended negative impact and unnecessarily limit utilization of donor advised funds and supporting organizations and in turn limit the philanthropic advantages to a community.

This is best understood by example. A particular fund was created with closely held stock by the founder of a private company. After the death of the founder, the company's value diminished greatly. It took slightly more than five years for the health of the company to rebound. If the stock was sold early, then the established foundation would have amounted to a few million dollars. However, allowing the company to regain its footing allowed for a stock sale price that netted over thirty times the original value of a few million dollars to support community needs. While no foundation should hold onto stock indefinitely, there is clear need to move beyond five years in specific circumstances to prohibit fire sales that shortchange a community. In another example, a donor advised fund received an ownership interest in a ranch just beyond a major urban area. The maximum value for selling that interest and creating liquidity for grantmaking was not realized until more than ten years later, when commercial development reached that area.

Moreover, the new PPA provisions will make it very difficult for donors who want to contribute significant ownership of closely held business interests to a community foundation fund without the sale of those interests in the future. While there are complex options available to accommodate donors who want a community foundation to retain long-term ownership rather than receive and sell, the new PPA provisions are unnecessarily limiting and confusing. These provisions will likely cause potential donors to avoid utilizing these vehicles which will in turn harm philanthropy.

As a further example, since the PPA provisions were passed, one of our foundations has been contacted by individuals wanting to know if they can still make donations whereby the Foundation would have long-term possession. In particular, siblings contacted the Foundation wanting to leave a portion of the bank stock in their estates to a charitable entity without the necessity of selling the stock at some point in the future. While the Foundation has been working hard to implement and explain these new provisions, it is clear that the burdensome nature of some of the provisions will cause donors to pull back. It is highly counterproductive to the purposes of philanthropy and the intent behind the PPA, to impose over-restrictive limitations on the use of donor advised funds and supporting organizations. Ultimately, a foundation has the responsibility and control with regard to investments and as such should have adequate discretion to make prudent decisions based on particular circumstances at a point in time including market conditions. Any establishment of timelines and limits in this regard is unnecessarily prohibitive.

In sum, we suggest that additional allowances be made whereby the five year limitation can be extended.

While the Excess Benefit Transaction Provisions Are Warranted, Some Technical Corrections and Definitions Are Needed

We understand and appreciate inclusion of the excess benefit transaction provision in the PPA. However, we are concerned there is the potential to interpret and apply it too broadly resulting in unforeseen restrictions. The term "excess benefit transaction" in Section 1232 (which includes any grant, loan, compensation or other payment from a fund to a donor, donor advisor, family member of the donor or donor advisor, or an entity 35 percent controlled by a donor, donor advisor or family member) should not include uniform fees and charges paid by a sponsoring organization to a service provider so long as those fees and charges are reasonable.

The routine fees for services to a sponsoring organization that are assessed by the sponsoring organization against all of the donor advised funds should not be considered a payment from a donor advised fund. For example, assume a bank provides services to a sponsoring organization and also is a donor to a donor advised fund maintained by that sponsoring organization. Assume further that the sponsoring organization assesses the bank's fees uniformly against the donor advised funds that it maintains. The pro rata portion of the fees paid to the bank from the bank's donor advised fund should not constitute an excess benefit transaction under this rule.

Additionally, compensation for professional services to disqualified individuals should be permitted in the same way these types of payments are permitted for private foundations. Compensation rules should be applied equally to all entities. Professional services include investment management of assets by disqualified individuals. However, if this were allowed, it would be important to ensure that compensation is at market rate or below, and that investment returns are commensurate with similar investment products.

Finally, the term "excess benefit transaction" should not automatically include the payment or reimbursement of reasonable expenses on behalf of a substantial contributor if the reasonable expenses are paid or reimbursed in the substantial contributor's capacity as an organization manager. Consider the following examples:

- A donor is a director of a supporting organization which is holding a meeting. The supporting organization buys lunch for all of the directors who attend the meeting and the donor eats the lunch. This should not automatically be considered an excess benefit transaction. It was not an act of self-dealing under Internal Revenue Code Section 4941 if given to or reimbursed to a foundation manager.
- A supporting organization buys D & O insurance that covers all directors, including a donor. The pro-rata portion of the premium allocable to the donor's coverage should not automatically be considered an excess benefit transaction. The pro-rata portion of the premium would not be considered an excess benefit transaction for a foundation manager.

We believe there should be no direct or indirect benefit to the donor or persons related to the donor for a donor advised fund or supporting organization. The donor receives the maximum tax deduction allowed by law and has the ability to impact the community by being allowed to recommend an investment strategy and to give advice regarding the grant making. Moreover, there should be no charitable deduction for the transfer of assets to a donor-advised fund or supporting organization when those assets are paid back to or used for the benefit of the donor or persons related to the donor. However, there should be an appropriate standard for a nominal "benefit" which does not violate this principle.

In sum, we ask that some clarifications and technical corrections be made in the excess benefit transaction provisions.

The Bookkeeping Requirements of the PPA are Illogical, Overly Burdensome and in Some Instances Impossible to Fulfill

The unreasonable nature of the PPA bookkeeping provisions is best understood with an explanation of the related laws. Under current law, any person who contributed more than $5,000 to an organization, if the amount contributed is more than 2% of the total contributions received by the organization from its inception through the close of the taxable year of the gift, is a substantial contributor. Further, a substantial contributor remains a substantial contributor until:

- He and related parties have not made contributions to the organization for 10 years,
- Neither he nor any related party was an officer, director, or trustee of the organization during those 10 years, AND
- His (and related parties') aggregate contributions are determined to be insignificant when compared to the aggregate contributions of another person.

Under the PPA, supporting organizations may not make any grant, loan, compensation, or other similar payment to substantial contributors, their family members, and 35% controlled entities of any of them. Given that substantial contributors remain as such for at least 10 years, in order to avoid unwittingly entering into disallowed transactions, supporting organizations will need to keep a running list of all of their contributors from inception, their family members, and their respective businesses, calculating the overall gifts made and each contributor's percentage thereof as of the end of each taxable year.

This recordkeeping requirement is not only burdensome, but in reality nearly impossible to fulfill. As time passes and families and business interests expand and contract, there will be much confusion with regard to the recordkeeping required herein. A substantial contributor should cease to be classified as such as soon as his or her aggregate contributions constitute less than 2% of the organization's aggregate contributions.

Further, investment advisors who are substantial contributors to the organization should be permitted to act as investment advisors to the organization, and receive compensation as such. Currently, as a substantial contributor, an investment advisor cannot receive payments of any kind from the organization. In order to curb potential abuse, investment advisors, whether substantial contributors or not, should be treated as disqualified persons for the purposes of the excess benefit tax. Thus, while transactions between an investment advisor and an organization must be fair (and perhaps could be required to comply with the Treasury Regulation § 53.4958.6 regarding safe harbor for excess benefit transactions), they will not be completely disallowed. Such an allowance would be consistent with private foundation rules and would help prevent the application of unnecessary and arguably unintentional penalties on donor advised funds and supporting organizations.

Moreover, foundations should be given flexibility with regard to reasonable expenses. At a minimum, reimbursements for services from vendors, including sole proprietors, should be permitted, particularly in situations where a donor advised fund or supporting organization has clear documentation from the vendor and support for the expenditure is directly related to a charitable program or purpose. For example, some donors want to host fundraising activities such as sporting or social events that encourage others to contribute to a donor advised fund. The fund could have one of many varied purposes including making grants that support research for a disease or making grants for memorial or educational objectives. Expenses for such events can be appropriately charged to a donor advised fund. However, for a variety of reasons including avoiding dealing with multiple vendors who helped with the event and writing many small checks, some community foundations elect to reimburse the donor for his or her expenditures. Foundations should be able to do this without concern. Foundations should be able to make payments directly to such vendors without concern that such payments will constitute taxable distributions. It is not always feasible for a foundation to exercise expenditure responsibility but there are ways to ensure that the expenses are appropriately related and legitimate.

Without appropriate flexibility, donors with donor advised funds may be forced to cease participation in many charitable fundraising events which are a vital source of funding to benefit local communities. Donors often recommend donations to charities for fundraising events that produce most of the charities' revenue. For example, a charity may sell tickets to a concert, sporting event, or dinner to raise money for its charitable mission. These events yield many donations for charities, yet some provisions of the PPA may decrease the amount of support charities receive through their fundraising events. The PPA provisions prohibit community foundations from making grants from donor advised funds which confer more than an "incidental benefit" to a donor or related party. Previously, many community foundations made grants to charitable organizations which offer donors admission to fundraising events if the foundation only paid the charitable portion from the donor advised fund and the donor paid the cost of any personal benefits, such as the value of a meal or party favors. The accuracy of this process is ensured because charities are required to state the fair market value of any goods and/or services a donor may receive through a fundraising event. The foundation can deduct the value of the goods and/or services to determine the tax-deductible portion of the donation. Because of uncertainty after the PPA was enacted, some community foundations have required that either a gift from a donor's donor advised fund not be made, or if the gift is made, the donor must promise he will not attend the fundraising event. It is very onerous for a foundation to try to monitor whether or not a donor has attended a fundraising event to which his donor advised fund has made a gift. It should be permissible for a community foundation to verify the value of any benefits associated with a fundraising event and only pay the cost of the charitable portion from the donor's donor advised fund.

In sum, we ask that the PPA bookkeeping provisions be interpreted and applied in a logical manner to which donors and charities can easily abide.

Donors Should Be "Invested!"

While a donor should not have investment control over the charitable assets in a donor-advised fund, some donors have valuable investment expertise and could provide positive contributions to the investment growth of charitable assets. We believe donors should be welcome to make recommendations about the investment of charitable assets held in donor-advised funds, subject to the actual investment control and approval of the community foundation staff members and trustees.

A distinction must be made between investment control and investment advice. If a donor best understands his charitable goals regarding grant making, a donor should be able to make suggestions regarding the investment strategy for a donor advised fund. A donor should expect to have a reasonable choice of investment options by which to grow the assets and maximize grants to the community.

In closely held stocks or alternative assets, the donor and the independent board of the foundation must work together to make sure that the maximum possible outcome is achieved so that the community benefits. To date, discussions regarding illiquid assets have not been productive. Any future legislation and regulation on these issues should avoid unnecessary negative outcomes such as "fire sales."

It is important for the donor to feel as if he is an active partner with the community foundation. It has been our practical experience that the more a donor is engaged in the fiduciary management of the fund, the more thoughtful and engaged he is in the granting of the funds. In other words, donors want to see their fund get positive returns on investments in both monetary and community benefits.

By definition, a donor's advice plays a central role in making grants from a donor-advised fund. This allows donor engagement in a way that motivates charitable giving. It also expands the community foundation's knowledge of the community and its non-profit organizations. As long as the sponsoring public charity, such as a community foundation, retains control over the investment and distribution of the assets, there is no violation of the underlying basis for allowing a charitable contribution deduction. Following donor advice does not indicate an inappropriate level of donor control. It may simply mean that the donors are recommending grants to verifiable, legitimate and effective nonprofit organizations. Community foundation staff members and trustees should augment a donor's judgment with their own professional and objective knowledge about the nonprofit grant recipient, its current nonprofit status and its legitimacy and effectiveness. The same level of a charitable contribution deduction would be available to the donor if the assets were given directly from the donor to the nonprofit. But by utilizing a donor-advised fund at a very low fee (most community foundations charge an annual one percent administrative fee), several benefits can be claimed for promoting additional charitable giving. Furthermore, the collaboration with and oversight of the community foundation are gained as added value for the promotion of good grant making.

In sum, we ask that a key distinction is made between investment control and investment advice in the application of the PPA provisions regarding donor investments.

We Support a 5% Distribution Requirement

Overall, we support the implementation of a payout requirement for donor advised funds or supporting organizations. A payout commensurate with the private foundation requirement (five percent annually) is justified. However, the payout requirement should be applied to the aggregate of those funds. The circumstances in each donor advised fund are too unique to make a uniform five percent payout requirement for each fund feasible. Any regulation that would require tracking and apply a payout requirement per fund would unnecessarily add yet another layer of administrative burden on an already over-taxed foundation staff and ultimately reduce the positive impact to the community.

Donor advised funds should be permitted to maintain their flexibility which will in turn maximize their benefit to the community. Some funds may need to accumulate over time in order to make a large grant that will have a more significant impact. Others have assets which require multiple years to liquidate appropriately. A payout in the aggregate would be a more efficient and effective way to ensure that there is a minimum aggregated annual distribution by all donor advised funds across the nation.

Donor Advised Funds and Supporting Organizations Should Be Allowed to Participate in IRA Charitable Rollover

Section 1201 provides for "charitable IRA rollovers" to virtually any charitable organization (including private foundations), but would prohibit rollovers to donor advised funds or supporting organizations. Donor advised funds and supporting organizations should be permitted recipients of charitable IRA rollovers for several reasons.

- The Securities Industry Association has requested IRS confirmation that IRA trustees/custodians are not obligated to verify charitable requirements under Sec. 1201. Thus, donor advised funds and supporting organizations can serve as a valuable resource to verify the actual charitable intent of the transaction.
- Donor advised funds and supporting organizations can serve as a valuable tool to help achieve charitable aims in a community. Donor advised funds allow for strategic deployment of charitable resources so that a donor's (whether it be a family, individual or corporation) funds can be used for the maximum benefit of the community, not simply one organization.
- Donor advised funds could help assure that IRA dollars are actually used for charitable purposes. Donor advised fund administrators possess expertise on charitable grant-making whereas IRA administrators do not. The PPA turns the IRA of every citizen into a donor directed fund that is arguably being administered by people who may not fully understand the complexities of charitable grant-making. Moreover, IRA administrators do not have the time and resources to investigate whether or not a beneficiary is a bona fide charity. Donor advised fund administrators have practices in place to ensure that charitable dollars will be distributed to qualified charities.

- With donor advised funds (or supporting organizations), the IRA rollover could easily support multiple charities. It is unlikely that the IRA administrator would allow the donor to disburse their donation to multiple charities. A community foundation for example can efficiently distribute this money into the community.
- Donor advised funds play an important role in charitable giving, and serve as a valuable tool to help donors achieve their charitable goals. As reported in the Wall Street Journal (August 1, 2006) donor advised funds are increasingly popular, distributing $3.3 billion to other charitable organizations in 2005, an increase of 20.8% over the amount granted in 2004. Donor advised funds provide efficiency and flexibility in charitable giving, and are an ideal charitable entity to use in a charitable IRA rollover.
- Given that donor advised funds are now subject to as or more stringent rules than private foundations, they should be eligible recipients for IRA rollovers. From an enforcement and/or compliance perspective, Congress and the IRS should be encouraging donors to use well-run sponsoring organizations of donor advised funds. Donor advised funds are well-qualified to identify and transmit funds to qualifying charities because they perform such transactions day-in and day-out during the regular course of their charitable activities.

In sum, we ask that donor advised funds and supporting organizations be permitted to participate in IRA charitable rollovers.

In Unique Circumstances, the PPA Can Unfairly Limit Scholarship Funds and Disaster/Emergency Relief Funds

In some instances, advisory committees to scholarship funds and employer-created emergency relief or disaster relief funds are not appointed or controlled by the community foundation. Rather, the donor and/or persons appointed by the donor serve on the advisory committee and they review applications and select scholarship recipients. Typically, the funds follow an objective and nondiscriminatory selection process similar to a private foundation and review the final selections made by the committees to ensure they followed such a process. However, under the PPA, these funds would be classified as donor advised funds and prohibited from making distributions to individuals. Thus, we ask you to consider the following technical corrections:

- If a fund can demonstrate it has proper checks and balances in place equivalent to showing that it is following a private foundation's objective and nondiscriminatory selection process approved by its board, such funds should not be considered donor advised funds under the PPA.
- In the event a scholarship fund is classified as a donor advised fund, the scholarship fund can make scholarship checks payable to a school and in so doing comply with the rule regarding prohibited grants to individuals.

Closing Comments

The PPA has provided some necessary and well-placed guidance for the charitable community as a whole. As a result, we expect to experience many benefits. However, we are concerned that particular provisions may be misinterpreted and lead to unforeseen circumstances that will make charitable giving and the continued work of charities difficult and sometimes impossible.

We appreciate the opportunity to participate in this very important process.

League of Women Voters of Arlington, Virginia
July 31, 2007

Chairman Lewis
Ways and Means Committee
House of Representatives
U.S. Congress

Dear Chairman Lewis:

I am writing to share with you the difficulties that the Pension Protection Act of 2006 has created for the League of Women Voters of Arlington, VA in operating our small scholarship program.

We created this scholarship program 15 years ago, in honor of a member who was killed in a car accident. Every year we award a scholarship in the amount of $1,000 to $1,500 to one or two graduating seniors who plan to enter college in programs related to public service. High school counselors notify students about applying and obtain the applications from them. A committee of local League members reviews the applications, interviews the applicants, and selects the winner(s). The majority of recipients are low income minority students with substantial needs for financial assistance in order to attend college. Over the years, some League members have donated between $50.00 and $100.00 per year to the scholarship fund. No relative of a League member has ever received a scholarship. The scholarship fund is administered for us by the Arlington County Community Foundation (ACCF).

According to ACCF, the Pension Protection Act requires that we change our process in the following ways:

- Change the composition of the selecting committee so that a majority of members are non-League members. This dilutes the commitment of local League members, and creates the burden of trying to find other interested individuals to serve.
- Eliminate from service on the committee any League member (or other person) who has contributed to the scholarship fund, regardless of the dollar amount given. This again reduces the number of potential volunteers, and discourages involvement of those individuals most committed to the scholarship program.
- Submit detailed documentation to ACCF about how our applicants are recruited and screened, as well as the names of members and non-members serving on the scholarship committee. We are in the process of providing this information. However, given that we are an organization of volunteers, additional paperwork requirements impose a hardship on us.

We have spent a considerable amount of volunteer time in the last year trying to understand the requirements of the Pension Protection Act in relation to our scholarship program, and we are now in the process of trying to comply. From our point of view, these requirements do not improve the management or administration of our scholarship program. Rather, the Act has made the process more labor-intensive, with no visible advantages.

Thank you for considering our concerns.

Sincerely,

Nancy E. Tate
President

Statement of National Cattlemen's Beef Association

The National Cattlemen's Beef Association (NCBA) appreciates the opportunity to comment on the charitable provisions of the 2006 Pension Protection Act (PPA). Producer-directed and consumer-focused, NCBA is the largest and oldest organization representing America's cattle industry, and it is dedicated to preserving the beef industry's heritage and future profitability through leadership in education, marketing and public policy.

Section 1206 of the PPA changed the tax incentive for voluntary conservation donations—donations by private landowners that retire development rights to protect significant wildlife, scenic, and historic resources—and NCBA strongly supports H.R. 1576 which would make these provisions permanent. By providing a more significant tax benefit for conservation donations, this provision opens the door to voluntary, landowner-led conservation on millions of acres of land across the country, and it is particularly helpful to family farmers, ranchers, and other moderate-income landowners. It is also worth noting that many of these donations are made to local, community-based charities dedicated to keeping land in agriculture, conserving important wildlife habitats, and protecting important open space and historic resources.

In the short time since the bill's passage, this provision has greatly increased the interest in and use of voluntary conservation easement donations across the country, particularly among the farmers and ranchers who own the vast majority of America's private land resources. It provides a real and effective incentive for private landowners to contribute to saving our Nation's wildlife, watersheds, working farmlands, and our scenic and historic heritage.

The donation of a perpetual conservation easement to a conservation organization is a serious and complex decision for any landowner, involving the disposition of what is usually their family's most valuable asset. It is a decision that cannot and should not be rushed by a deadline. We thank you for your cosponsorship of H.R. 1576, and urge you to do all you can to see that it is enacted into law. We look forward to working with you and your Subcommittee on this and other issues involving the protection and conservation of our Nation's natural resources.

Statement of National Christian Foundation

I serve as General Counsel to National Christian Charitable Foundation, Inc. ("NCF"), a Christian community foundation with its headquarters in Atlanta, Georgia. NCF is exempt from federal income tax under Code Section 501(c)(3), and qualifies as a public charity (rather than a private foundation) under Code Sections 509(a)(1) and 170(b)(1)(A)(vi). It maintains donor advised funds, and it is supported in its charitable service by several supporting organizations. Additionally, we are located just north of Atlanta, Georgia and are pleased that someone from Georgia is leading the effort to strengthen American charity. We are also honored to fund effective charities in your district in Atlanta. NCF appears in the 2006 Chronicle of Philanthropy report as the 4th largest charitable organization in Georgia (29th largest in the United States).

I write in response to your subcommittee's request of June 12, 2007, for comments regarding Title XII, Provisions Relating to Exempt Organizations, of the Pension Protection Act of 2006, P.L. 109–280 (the "Act"). We are very grateful for the opportunity to comment on the Act because it has introduced significant unwarranted barriers to our charitable work, as well as uncertainty regarding what it prohibits and what it allows.

Part 1 of Subtitle B of Title XII imposes heightened reporting and recordkeeping requirements and increased penalties for noncompliance with existing rules, and it eliminates deductions for contributions of property of doubtful charitable value. We applaud these enforcement provisions. Parts 2 and 3 are different. While captioned "Improved Accountability," they actually impose new rules and restrictions apparently intended to prevent private benefit that in fact the Code already prohibits. Moreover, they single out donor advised funds ("DAFs") and supporting organizations ("SOs").

We believe Parts 2 and 3 significantly impede worthwhile charitable activities, and have no foundation in any rational public policy. We identify below modifications and clarifying corrections to those parts that we believe are necessary to remove unnecessary obstacles to charity.

Misconceptions Underlying Parts 2 and 3

Parts 2 and 3 impose private-foundation rules on DAFs and SOs, treating them essentially as private foundations, and sometimes—astoundingly—treating them more harshly than private foundations. In so doing, the sponsors of these parts betray a lack of appreciation for the value of DAFs and SOs, an unwarranted and unprecedented hostility to private donor influence, and lack of thought about the obvious differences between these charitable structures and private foundations.

Donor advised funds and supporting organizations increase charitable giving, and correspondingly, charitable work, and enable donors to provide valuable, diverse input.

DAFs and SOs increase the amount of contributions to charity, thereby increasing the level of good work charities can do, improving social conditions in the United States and abroad, and decreasing the burdens of government. Donors give more when they know they will be able to participate in decisions regarding ultimate charitable distribution. Donors give more when they can make large contributions efficiently all at once, without the necessity of identifying immediately the ultimate charitable beneficiaries. Donors give more, and more frequently, when their hearts are engaged by participation in the ultimate distribution decisions.

At the same time, DAF sponsoring and supported organizations are better able than smaller charities to develop the specialized, relatively expensive expertise required to receive, hold, and liquidate complex gifts of assets other than cash and publicly-traded securities. Frequently the largest gifts, those that produce the most resources for charitable use, are such complex gifts. DAF sponsoring organizations and supported organizations efficiently spread the costs of developing such expertise and handling such assets over numerous contributions and charities.

On the other side of the ledger, donors to DAFs and SOs provide valuable assistance to sponsoring and supported organizations in identifying for distributions and expenditures worthwhile charitable endeavors and the charities that best pursue those endeavors.

This donor input makes giving through DAFs and SOs democratic giving; it spreads charitable choices over a broad spectrum of people rather than confining those choices to the leaders of a few grant-making public charities and foundations. It is efficient, free-market giving that requires charitable causes and the charities that pursue them to compete for contributions from numerous potential donors. Moreover, it is dispersed giving that allows for experimentation by innovative charities without large-scale risk of waste or harm from failed experiments. These benefits are not realized in forced contributions (taxation) or in contributions to large grant-making charities with centralized decisionmaking and relatively limited donor input.

Donor influence for charitable purposes is not and has never been considered inherently bad.

The sponsors of Parts 2 and 3 appear to have acted on a general sense that donor influence is a bad thing. This is unprecedented and unjustified.

The legislative history of the Tax Reform Act of 1969 identifies concern about *abuse* of private foundations for private benefit—not a simplistic aversion to private donor influence—as the reason for the restrictions and disincentives imposed on private foundations in that Act. See Treasury Report on Private Foundations 5–10, Staff of House Comm. on Ways and Means, 89th Cong.

In fact, the intent of the charitable-contribution deduction as identified by the Supreme Court is exactly to encourage private charitable action. See Bob Jones University v. United States, 461 U.S. 574, 590 (1983) (purpose of deduction is "to encourage the development of private institutions that serve a useful public purpose" (emphasis supplied)). Clearly neither Congress nor the Supreme Court has treated private control over choices within the bounds of 501(c)(3) as an evil in itself. To the contrary, our laws historically demonstrate a belief that numerous private actors, some large and some small, make better decisions, as a whole, than does a centralized bureaucracy. DAF and SO structures stand squarely in this tradition.

There is no reason to believe that somehow centralized decisionmakers in a few large public charities, unaided by donor input, make better charitable choices than do boards and staff of DAF sponsoring organizations aided by input from numerous donors, or leaders of SOs subject to supervision by the supported organizations.

Likewise, there is no reason to believe that public charities without donor input make better decisions about the timing of ultimate distribution or expenditure. Once given to a DAF or SO (or even a private foundation), funds may not be used for the donor's private benefit; thus, a donor gains no personal benefit by withholding funds for a need of which he or she has been convinced. In fact, donors who advise DAF sponsoring organizations to make distributions serve as a check on the motivation directors, officers, and staff of other kinds of public charities may feel to withhold distributions and expenditures inappropriately in order to assure the continuation of their livelihoods.

Treating donor advised funds and supporting organizations like private foundations (and sometimes worse) is unjustified: unlike a private foundation, a donor advised fund structure, as well as a supporting organization structure, checks a donor's use for his private benefit.

Of course the risk of private benefit outside the bounds of 501(c)(3) is a bad thing, but that risk in a DAF or SO structure logically is less than any such risk perceived to attend private foundations, and is no greater than any such risk that may attend any other kind of public charity. Accordingly, it is inappropriate to subject a DAF or SO to private foundation restrictions and disincentives.

DAF and SO structures provide for an independent check on a donor's power to use his contributed funds for private interests that is in addition to the checks present in a private foundation structure. This check is the interest of the independent directors and officers in assuring that the sponsoring organization or SO complies with the requirements for its exempt status and truly advances worthwhile charitable interests. Whatever the risk that a foundation controlled by an individual, family, or business will expend funds for inappropriate purposes, expend too little for charitable purposes, unduly delay charitable expenditures, or expend funds for a private interest (we expect such incidents are relatively infrequent), the risk that a fund or organization merely advised or influenced by such an interest is significantly smaller. This is the reason that, according to the Senate Report on the 1969 Act, SOs do not "give rise to the problems which led to the restrictions and limitations" on private foundations. S. REP. No. 91–552, at 56 (1969). The same is true for DAFs.

In summary, DAFs and SOs are useful structures resistant to abuse, and should be encouraged rather than discouraged.

Specific Problematic Provisions and Proposed Changes

The Act has produced the negative effects discussed below. We suggest that Congress make the following modifications to the Act's provisions in response.

Prohibition Against Distributions From a DAF To any Natural Person—Code Section 4966(c)(1)(A). Rescind, or at least clarify that "distribution" means only gratuitous payments.

The prohibition against a DAF making a distribution "to any natural person" blocks many gifts to needy people that will simply go unmade through any other means. It should be rescinded.

No other public charity—and not even a private foundation—is prohibited from making benevolence distributions to the poor. There is no public policy justification for such a prohibition against any charitable organization, and especially not against a DAF or SO: a donor is just as likely as a public-charity or private-foundation employee to identify worthy needy recipients. Moreover, a distribution from a DAF must be approved by independent staff members of the sponsoring organization who are concerned to maintain its tax-exempt status. Accordingly, a DAF benevolence distribution is no more likely to provide an improper private benefit than is a benevolence distribution made by a public-charity employee without any donor input, and is less likely to do so than is a private-foundation benevolence distribution.

The fear that "distribution" might be construed to include compensation payments prevents any direct charitable action with DAF funds. For example, a sponsoring organization may not use DAF funds to hire a missionary, teacher, or researcher. At the least, then, the DAF community needs a clear definition of "distribution" that confines its meaning to gratuitous payments and excludes payments of compensation.

Congress should not shut down direct good work by a DAF unless for a compelling reason, and there is no such reason when the Code already prohibits private benefit and private inurement, and when DAF payments are subject to approval by disinterested board members with input from disinterested staff members of the sponsoring organization. "Distribution" customarily refers to a payment not made in exchange for goods, services, or a promise to repay. Thus, Congress probably intended the same meaning in the Act, and this should be made clear.

Prohibition Against Distributions From a DAF To a Type III Non-Functionally-Integrated Supporting Organization—Code Sections 4966(c)(2)(A), (d)(4)(A)(i), and 4943(f)(5)(B). Suspend effectiveness until the Treasury Department issues Regulations defining "functionally integrated Type III supporting organization."

The Act recognizes the two categories of Type III SOs established in the Regulations, those that qualify as SOs on account of their integration into the operations of their supported organizations (functionally-integrated SOs), and those that do not qualify as functionally-integrated SOs and therefore must make distributions to their supported organizations (non-functionally-integrated SOs). The Act prohibits a DAF from making distributions to a non-functionally-integrated SO unless the DAF sponsoring organization exercises cumbersome expenditure responsibility over the distribution.

The problem is that the definition of a functionally-integrated SO in the Regulations is undeveloped and vague. Therefore, it is impossible to determine what qualifies as a functionally-integrated SO and what qualifies as a non-functionally-integrated SO.

In this state of uncertainty, a supported organization no longer can make distributions to a SO that it believes to be functionally integrated but cannot be sure is functionally integrated. Being able to make these distributions is beneficial because it enables the supported organization in essence to receive and liquidate complex gifts and then hold the proceeds for its Type III SOs, distributing funds to them just as needed to make grants or conduct operations. Like other supported organizations, NCF has developed technical expertise required to receive, process, hold, and liquidate non-cash contributions, and employs the experienced, trained staff necessary to manage receipting, investment, and administrative functions. Moreover, the supported organization through this practice maintains direct control over the funds the SO needs, and therefore greater control over the SO to assure that it operates exclusively to carry out the purposes of the supported organization. At the same time, the supported organization and all the funds it holds, including the funds in the particular DAF, are shielded from the SO's liabilities.

Accordingly, this provision should be suspended until the Treasury Department clarifies the meaning of "functionally integrated."

Prohibition on DAF Distributions that Produce More Than Incidental Benefit To a Donor—Code Section 4967. Clarify that distribution is permissible if it would be deductible as a contribution paid directly by the donor.

The Act does not define what a more-than-incidental benefit is. Accordingly, a DAF cannot now safely make a distribution to a public charity that then uses the funds to pay travel and other expenses of useful ministry performed by the donor, even though the donor could pay those expenses directly and receive a charitable-contribution deduction. Similarly, a DAF cannot safely make a distribution to a public charity as part of a fundraising event in which the donor pays separately for a banquet, golf tournament, or similar premium item, even though the donor could pay the charity directly and receive a partial deduction. Moreover, there is great concern among community funds and their donors that making distributions in fulfillment of a donor's pledge provides a more than incidental benefit. These possible interpretations of the Act would serve no purpose other than as traps for the unwary.

Accordingly, Section 4967 should be amended to clarify that a distribution will not be deemed to result in a more than incidental benefit if the full amount of the distribution would be deductible as a charitable contribution if paid by the donor.

Doing so would in essence make authoritative the explanation of the Joint Committee on Taxation that a more than incidental benefit is one that would reduce a donor's contribution deduction if a charity provides it in exchange for such contribution.

Prohibition On Payment By DAF or SO Of Even Reasonable Compensation To Donors (or Substantial Contributors), Related Persons, or Donor-Designated Advisors—Code Sections 4958(c)(2) and (3), (f)(1)(D), (7), 4966(d)(2)(A)(iii). Rescind the "first-dollar" definition of excess benefit transaction, or at least clarify that the prohibition of any compensation does not apply to an independent investment advisor recommended by the donor.

The Act amends Code Section 4958 to add donors to DAFs, substantial contributors to SOs, and persons related to them to the list of disqualified persons to whom an exempt organization may not provide excess benefits, on pain of the disqualified person and organization managers incurring substantial penalties. We believe these are reasonable additions.

However, the Act goes further and defines an excess benefit transaction as paying any compensation for services, even the "first dollar," to one of these new disqualified persons. This rule prevents a DAF or SO from paying reasonable compensation to qualified donors and related persons for direct charitable work (social work, evangelism, teaching, etc.), grant investigation and auditing, general administration, or investment management. A quirk in the definition of a donor-related person for DAF purposes also prevents a DAF from compensating any professional investment advisor recommended by the donor.

This first-dollar definition of excess benefit transaction should be rescinded. (If it is not, at least Section 4958(f)(7) should be amended to clarify that its list of disqualified persons does not include an investment advisor with no relation to the donor other than that the donor recommended that the DAF sponsoring organization engage him for investment advice.)

The first-dollar prohibition of compensation is inexplicable. Donors and related persons make excellent service-providers. They naturally are mission-minded, and motivated to assure that their (or their family member's) contributed dollars are used efficiently. For the same reason, they carefully select whom they recommend as service-providers. It is not rational to bar a skilled service provider—especially one who is personally motivated to achieve and protect maximum funds for his or her charitable concerns—from serving a DAF or SO merely because he or she is the donor or has been recommended by the donor.

Moreover, this first-dollar prohibition applies only to DAF and SO structures and not to any other type of exempt organization, not even a private foundation, even though DAF and SO structures better protect against unreasonable compensation. The independent directors and officers of a DAF sponsoring organization or supported organization exercise overriding legal control and supervision to prevent a donor from receiving unreasonable compensation, and they are motivated to do so in order to protect the organization's exempt status and mission. In the context of a DAF, the directors and officers feel a special motivation: they must protect the tax-advantaged status of the entire sponsoring organization, including the DAFs of all other donors.

Prohibition Against DAF Owning Excess Business Holdings—Code Section 4943. Rescind the prohibition.

Extending the excess business holding prohibition to DAFs discourages donors from contributing valuable business income streams, and thereby reduces funds for charity and constricts charitable work.

Most wealth available for gifting exists in the form of interests in businesses rather than cash. Many of these interests produce significant revenue streams even though they are not readily marketable or are transfer-restricted. Often the donor and charity correctly believe the charity will benefit more from holding these interests and continuing to receive the revenue streams for a long period of time than from liquidating them immediately. Business interests are where the wealth lies, and gifts of those interests hold tremendous promise for turning American business into an engine for charitable good here and around the world. Charities are able to tap into this source through use of the DAF structure.

For the following reasons, the DAF structure facilitates gifts of business interests, and without it most of those gifts will not be made. First, a DAF enables a donor of a business interest to give once, at the particular time the donor is able to give, while spreading the funds among several needy charities as their needs arise and as they prove their effectiveness over time. This gift-spreading reduces the risk that a donor's gift will be used ineffectively or even wasted, or that it will over-fund a charity and cause it to become complacent, unaccountable, and moribund. Moreover, sometimes a gift is simply too large for one charity's needs. Confining such large gifts to large charities stifles smaller, newer—perhaps more innovative—charities.

Second, a DAF enables a donor to give to only one charity rather than being forced to attempt to split up the business interest among numerous charities. Splitting a gift is unnecessarily expensive and time consuming, for both donor and charity. Moreover, a DAF sponsoring organization is able to develop the expertise required to receive and hold business interests. Most operating public charities do not have this expertise, and it does not make economic sense to require them to duplicate the effort and expenditure of resources necessary to develop it. Similarly, a DAF sponsoring organization develops through experience the sophistication necessary to be a reasonable shareholder while also protecting the charitable benefit of the gift. At the least, a donor knows the risk of bad shareholder behavior is less when only one charity—one the donor has investigated thoroughly—owns an interest, than when numerous charities do. In contrast, splitting a business interest among numerous charities increases the risk of at least one unsophisticated charity either unnecessarily asserting minority shareholder rights, or passively enabling the donor to exclude the charity from the full benefits to which its ownership entitles it.

Finally, a potential, eventual buyer of the donor's and the charities' interests is less likely to be interested in purchasing if it will have to deal with numerous charities rather than just one. This is also true of a donor's partners in the enterprise who must often waive restrictions to allow the donor to transfer any of their interest to charity. If the charity is unsophisticated in these type gifts or if there are multiple charities, it is understandably less likely that the charitable gift will occur.

Accordingly, the prohibition against a DAF maintaining business holdings should be rescinded.

Extending the private foundation restriction against excess business holdings to DAFs again demonstrates a failure to think about the differences between private foundations and DAFs. Congress identified the following concerns when it imposed the restriction on private foundations in 1969, none of which apply to DAFs:

- Increased use of foundations to maintain control of businesses, and a corresponding decrease in concern about producing income for charitable purposes. A donor concerned to maintain his control over his business will not contribute it to a DAF, which is controlled by independent directors and officers and over which he has only the power to advise. Likewise, the independent directors and officers of a DAF sponsoring organization can have no motivation to perpetuate a donor's control to the detriment of the organization's charitable mission.
- Uncertainty in the law about what point business involvement or noncharitable purposes become substantial non-exempt purposes for which the only penalty is the harsh one of revoking exempt status. There of course would be uncertainty about when the purpose in the head of a donor who controls both business and foundation switches from charitable advancement to personal business advancement. There is no such uncertainty about the purposes of the independent directors and officers of a DAF sponsoring organization.
- Diversion of most of the interest and attention of the foundation managers away from their charitable duties to the maintenance and improvement of the business. The donor who controls a foundation can force foundation personnel to attend to his business; the donor who merely advises a DAF has no such power over the personnel of the DAF sponsoring organization.
- Where the charitable ownership predominates, the running of a business in a way that unfairly competes with businesses whose owners must pay tax on the

> income derived from their businesses. This concern is effectively addressed by Unrelated Business Taxable Income rules, applicable to all charitable entities including DAF's and SO's. Moreover, the only reason the independent directors and officers of a DAF sponsoring organization would agree to accept, and then hold, a business interest is that the interest produces greater revenue for charitable purposes than does another holding. In other words, the DAF sponsoring organization is motivated to maximize its revenue rather than maintain a business that can compete only with lower returns. In any event, this concern is no greater when a DAF sponsoring organization holds the interest than when any other kind of public charity holds it.

See S. REP. No. 91–552 (1969), cited in Priv. Ltr. Ruling 199939046. Accordingly, there is no rational public policy interest that justifies the significant harm done to charity by extending the excess business holdings rule to DAFs.

Exclusion of DAFs, SOs, and Private Foundations As Recipients of IRA Rollovers—Code Section 408(d)(8). Extend the IRA rollover at least to DAFs and SOs, and preferably to private foundations as well.

The exclusion of DAFs, SOs, and private foundations as recipients of IRA rollovers limits overall funding for charitable work, and places these beneficial structures at a disadvantage relative to other types of public charities. The IRA rollover should be extended to each.

The exclusion is nothing more than a means of discouraging or limiting giving to DAFs, SOs, and private foundations, similar to the way the 1969 legislation limited the deductibility of contributions to private foundations. As argued previously, hostility to donor influence generally is unjustified and unprecedented. At the least, DAFs and SOs should be added as permissible recipients of IRA rollovers since they are not subject to the perceived greater risk of private benefit that drives the various private foundation disincentives.

Thank you for your consideration of these significant barriers to charitable activities thrown up by the Act, and of our requests for relief. We would be pleased to provide additional information or other assistance to the Subcommittee as you may request. Our president or I would be very pleased to testify to the Subcommittee or assist you in any way regarding the great work we are able to do with input from our donors through the DAF and SO structures.

Sincerely,

Timothy W. Townsend
General Counsel

Statement of National Committee for Responsive Philanthropy

NCRP recommends that the Committee:

- Extend the charitable provisions found in the Pension Protection Act, including the IRA Rollover, and keep them in their current form.
- Subject supporting organizations and donor-advised funds to the excise tax, similar to how private foundations already pay the tax, and dedicate the revenue to oversight of the sector.
- Simplify the supporting organization structure by eliminating the Type III classification, through which most abuses occur.
- Develop a clear set of guidelines and requirements for international organizations to be considered charitable organizations.

As the nation's premier philanthropic watchdog group, NCRP values this opportunity to substantively contribute to the discussion, which we anticipate will have an impact on efforts to promote the public's interest among foundations, corporate grantmakers, individual donors and public charities.

Comments from the National Committee for Responsive Philanthropy

July 30th, 2007

The National Committee for Responsive Philanthropy (NCRP) is pleased to have the opportunity to provide comments to the House Ways and Means Committee on the subject of provisions relating to tax-exempt organizations contained in the Pension Protection Act of 2006 (P.L. 109–280).

As the nation's premier philanthropic watchdog with a 30-year track record of research and action on non-profit and philanthropic accountability, NCRP is well acquainted with the questions being addressed by the Committee. Throughout our 30-year history, NCRP has been at the forefront of bringing about substantive change in the philanthropic sector, and with the passage of the Pension Protection Act last year, NCRP believes significant steps were taken to make philanthropy more responsive and address the needs of communities that need help the most.

The efforts of the 109th Congress in passing the Pension Protection Act of 2006 constituted, we believe, a noble starting point in the fight to significantly reform the practices of tax-exempt organizations in the United States. Notable among these revisions were the regulations put in place on donor-advised funds, supporting organizations and private foundations. Many of the regulations put in place were long overdue and received the full support of both NCRP and other organizations in the philanthropic sector. However, despite the many substantial reform measures put in place by the Pension Protection Act, NCRP believes more can be done to strengthen the charitable community by revising several of the measures introduced with the legislation last year.

In addition, the five new tax incentives that were introduced to help encourage charitable giving are set to expire at the end of 2007, and NCRP strongly believes they should be extended in their current state. Chief among these provisions is the IRA Rollover incentive, which permits taxpayers 70½ and older to make tax-free donations from Individual Retirement Accounts (IRAs) to charitable organizations.

Overall, NCRP strongly supported the passage of the Pension Protection Act and today fully endorses the vast majority of the provisions contained within it. Only a small portion of the legislation directly affects the non-profit community, with the main section being Title XII, also known as the portion of the bill pertaining to tax-exempt organizations. The giving incentives and reform measures included are a huge step forward toward increased transparency in the philanthropic sector, and the changes made have already had a substantial impact on the sector as a whole.

NCRP welcomes the efforts of the 110th Congress to address the concerns of the philanthropic sector, and we believe the arrival of new leadership in Congress this session can truly bring about substantive change in the philanthropic community. The comments we have submitted below outline NCRP's main concerns with the Pension Protection Act and highlights the sections of the bill we feel deserve reexamination by the Ways and Means Committee; in addition, we have also outlined several areas we believe deserve the attention of the Committee going forward when considering new legislation pertaining to the non-profit and philanthropic sectors.

TAX INCENTIVES FOR CHARITABLE GIVING

The passage of the Pension Protection Act last August brought with it five new tax incentives that were put in place to encourage greater contributions to charitable organizations. All five of these incentives have had a positive effect on communities all over the United States, and NCRP strongly supports extending these programs before they are due to expire at the end of the 2007 calendar year. Tax deductions allowed for food and book donations especially are programs that we believe will significantly benefit the American people; new legislation from the 110th Congress that permanently extends these programs is highly recommended and encouraged by NCRP.

The Pension Protection Act includes a tax incentive relating to IRA accounts, and the provision allows taxpayers 70½ and older to make tax-free donations to public charitable organizations. The donations have had a remarkable effect on communities all over the country, and NCRP supports legislation that would keep the IRA rollover program in its current state and permanently extend the provisions that are contained. Any changes to the requirement of which charitable organizations are eligible to receive these tax-free contributions would detract from the primary purpose of the IRA Rollover in the first place, which was to provide IRA account holders the opportunity to make charitable donations that would best serve the interests of the charitable community.

Current restrictions in the Pension Protection Act prevent IRA account holders from making tax-free contributions to donor-advised funds, supporting organizations or private foundations. Legislation introduced in Congress this year by the House and Senate (H.R. 1419 and S. 819, respectively) would repeal these restrictions and allow contributions to be made to these funds. NCRP is concerned that if these restrictions are lifted, more money will be taken away from public charities and will sit in donor-advised funds or private foundations unused. By sitting in the bank accounts of large private foundations, money that could have been donated to public charities directly will simply add to the assets of foundations. By extending the current IRA rollover tax credit in its current state, NCRP believes that money contributed from these IRA accounts will truly be put to the best use possible.

DONOR-ADVISED FUNDS

The passage of the Pension Protection Act brought forth the first substantive effort to regulate donor-advised funds. The vast majority of the provisions contained in the Pension Protection Act are changes that NCRP supports, and many are changes that were advocated by NCRP in the years leading up to the passage of the Act last August. However, there a few issues we feel should be corrected relating to donor-advised funds, and these include a payout requirement, the tax issue arising from donations to a donor-advised fund in place of a donation to a private foundation and the issue of excessive donor control.

In passing the Pension Protection Act, lawmakers removed an expected provision that would call for a minimum annual required level of distributions for donor-advised funds, a provision which NCRP fully supported. Instead of including the provision in the bill, the Pension Protection Act calls for a study commissioned by the Treasury Department and the secretary of the Treasury to answer several questions relating to donor-advised funds and supporting organizations. These questions include: whether tax deductions for contributions to supporting organizations and donor-advised funds are appropriate given how donated assets are used, and whether the donor receives any benefits from the transaction, either directly or indirectly; second, whether there should be a payout requirement on donor-advised funds; and finally, whether the retention by donors of rights associated with their contribution is consistent with the tax treatment of donations as completed gifts. The Treasury Department's study is set to be completed and turned into the Senate Finance Committee some time before the end of 2007. NCRP submitted comments in April of this year to the IRS relating to the Treasury study, and the study, when released, will hopefully be responsive to the issues we raised in our comments, which can be viewed on our website.

NCRP feels that there are a few minor inadequacies in the Pension Protection Act that should be corrected by future pieces of legislation. The first of these measures concerns donations being made to a donor-advised fund in place of a gift to a private foundation. Deduction limits already in place that prevent large, unethical gifts to private foundations are a needed check against tax abuse in the United States. Because of these laws, donors have the potential to make significant tax-exempt contributions to donor-advised funds to try and circumvent tax responsibilities. The Pension Protection Act does not address this problem. We realize that correcting all the problems relating to tax evasion with tax-exempt organizations is far from certain, but with legislation aimed at correcting these evasion techniques, the sector can become more responsive to the needs of the constituents they claim to be representing.

The second concern we have found in the Pension Protection Act relating to donor-advised funds concerns the issue of excessive donor control. One of the key requirements for a fund to be considered a "donor-advised fund" is the notion that the donor has the right to provide advice on how the fund makes investments or donations. A donor can recommend which charities receive the funds, but the foundation administering the fund is under no legal obligation to allocate the funds per the request of the donor. When a grant is made from a donor-advised fund to the donor's private foundation, we believe the transaction of funds constitutes excessive donor control. While technically allowed under the Pension Protection Act, which allows a donor-advised fund to make a donation to any organization, NCRP believes action should be taken to address the unethical nature of grants and donations being made from a donor-advised fund to a private foundation that features the same individual.

SUPPORTING ORGANIZATIONS

The structure currently set in place by the Pension Protection Act regarding supporting organizations is confusing at best. The distinctions between Type I, Type II and Type III organizations, despite the clarification brought forth in the bill, still remain unclear. The definitional tests put in place remain complex, and with no clear, transparent definitional test in place, the potential for abuse and fraud remains high. This is most true with Type III supporting organizations, where the control by the sponsored legislation is the weakest and the potential for abuse is the strongest. With Type I and Type II supporting organizations, there is at least some level of control set in place, and because of this, the abuse of funds is less likely to occur. We urge Congress to look into revising the section of the Pension Protection Act dealing with supporting organizations and scrapping the category of Type III supporting organizations all together; by eliminating this category and refining the definitions and classification of supporting organizations, the hope is that greater transparency and responsiveness will result. NCRP addressed the issue of Type III organizations in our comments to the IRS back in April 2007.

Similar to our argument for a minimum annual required level of distributions for donor-advised funds, NCRP believes the same rule should be applied to supporting organizations. To achieve a maximum level of accountability concerning supporting organizations, and donor-advised funds, all efforts should be made to ensure stronger disclosure of the distributions made by the funds. NCRP would like to see legislation introduced in Congress this session concerning an effort to require "real time" disclosure of grants made by supporting organizations that would result in detailed, unrestricted disclosure. Greater insight into who is receiving these funds in a quick and responsive way has the potential to encourage increased accountability among the supporting organizations and donors themselves, in the end resulting in more dollars going to the charities that need the money the most.

EXCISE TAXES

One of the provisions missing from the Pension Protection Act that we would like to see amended by future legislation concerns supporting organizations and donor-advised funds paying excise taxes. Given the history of abuse and fraud that is prevalent in both supporting organizations and donor-advised funds, we believe a mechanism that must be put into place is to require the funds to pay excise taxes, similar to how private foundations already do. With billions of dollars in assets, donor-advised funds and supporting organizations can easily afford to make the payments, and when coupled with a strict payout requirement, the taxes paid should not take away from the charitable contributions the funds are making. NCRP believes excise taxes on private foundations, donor-advised funds and supporting organizations should be used exclusively for oversight of the nonprofit sector. Adding a new excise tax to donor-advised funds and supporting organizations without dedicating the revenue to oversight of the sector would serve little purpose.

INTERNATIONAL ORGANIZATIONS

One aspect of the Pension Protection Act that deserves clarification is the provision dealing with international organizations. When a donor-advised fund issues a grant to an international charitable organization, the fund is required to "make a good faith determination that the organization is equivalent to a domestic charity," with no standards or rules governing how this determination is supposed to be made. With the potential for fraud and abuse by international organizations and the good-natured intent of donor advised funds being tarnished because of unclear specifications, NCRP feels that new standards should be put in place by either the Treasury Department or Congress that clarify the expectations used when making grants to international organizations. With clearer guidelines as to what constitutes a charitable international organization, donor-advised funds can have a better understanding as to whom they are contributing to; in addition, having the regulations in place can ultimately make sure charitable dollars are allocated to the people and resources that need them the most.

REPORTING REQUIREMENTS

Section 1223 of the Pension Protection Act, located under the Reforming Exempt Organizations subtitle, issues new reporting requirements on tax-exempt organizations that are not currently required to file information returns. Under the current law, these organizations have gross receipts of less than $25,000 on an annual basis. This threshold has not been raised in nearly three decades, and NCRP believes an increase in the threshold will benefit smaller organizations that cannot afford to take on the workload of the increased reporting requirements. We believe raising the annual threshold to $50,000 will have a positive impact on the sector and decrease the number of organizations that have to file the normal amount of paperwork that larger organizations are required to file. NCRP will be submitting comments to the IRS next month concerning the revisions of the 990 form, and will include comments on the threshold, and how we strongly encourage a raise in the reporting requirement.

CONCLUSION

NCRP has been on the offensive for years relating to the problems associated with donor-advised funds, supporting organizations and private foundations. The changes made in the Pension Protection Act were a noble step forward in the fight to bring about more responsiveness and transparency to the philanthropic sector. However, there is still substantial work that needs to be done, and NCRP hopes that through our comments and the comments of our colleagues there can be a dialogue to bring about change. Despite the passage of the Pension Protection Act nearly a year ago, tougher regulation standards on donor-advised funds and supporting organizations are still sorely needed, and NCRP believes this can be achieved, partly, through mandatory payout requirements and excise taxes. It is our hope that through new legislation these measures and the others laid out in our comments can be achieved.

Finally, we would like to stress our fundamental belief that the charitable provisions in the current Pension Protection Act deserve renewal. By permanently extending these provisions, Congress will be sending a clear message to the philanthropic community that they are encouraging charitable activity, especially in regard to the IRA Rollover program. NCRP strongly believes that the best way to ensure strong charitable giving through the IRA Rollover program is to leave the provision in its current state. Changing the provision in any sort of meaningful or substantial way would harm the essential spirit of philanthropy that resides in its current form. NCRP is hoping to see legislation this session that refrains from revising the IRA Rollover plan and leaves the charitable revisions contained in the Pension Protection Act intact. The other charitable revisions contained in the bill, including rewarding donations to food and book programs, deserve an extension as well.

We would like to thank the House Ways and Means Committee for allowing us to submit comments pertaining to the provisions in the Pension Protection Act that relate to tax-exempt organizations. NCRP is willing to assist the Committee in any way we can relating to issues concerning the non-profit and philanthropic sectors, and we look forward to working with the Committee to bring about substantive change to the charitable community.

Statement of National Committee on Planned Giving

National Committee on Planned Giving (NCPG) is the professional association for individuals whose work includes developing, marketing and administering charitable planned gifts. NCPG consists of more than 130 local councils representing upward of 11,000 nonprofit fundraisers as well as consultants and donor advisors working in for-profit settings. Collectively these individuals transact billions of dollars in charitable gifts each year.

The mission of NCPG is to increase the quality and quantity of charitable planned gifts by serving as the voice and professional resource for the gift planning community. As such, NCPG strongly supports federal legislation that permits older Americans to transfer money from their Individual Retirement Accounts (IRAs) directly to charities without suffering tax penalties. This legislation is commonly referred to as the IRA Charitable Rollover.

In August 2006, a limited version of the IRA Charitable Rollover was enacted into law as part of the Pension Protection Act (Public Law 109–280). This provision, scheduled to expire at the end of 2007, permits IRA owners beginning at age 70½ to make outright charitable gifts totaling up to $100,000 per year from their IRAs directly to eligible charities. The donor does not have to report the distribution as taxable income and is not entitled to claim a charitable income tax deduction for the gift.

NCPG is pleased to report that this provision has generated an enormous amount of new charitable giving. For example, NCPG has received reports of nearly 4,500 charitable gifts made pursuant to this provision, totaling over $80 million. This data is the result of a voluntary, unscientific survey conducted by NCPG, so the total number of charitable gifts from IRAs is likely much higher.

In short, the IRA Charitable Rollover has allowed older Americans, particularly those individuals who do not itemize their tax deductions and would not otherwise receive any tax benefit for their charitable contributions, to donate money to thousands of nonprofits that work every day to enrich lives and strengthen communities across the country and around the world. Unfortunately, the IRA Charitable Rollover is scheduled to expire at the end of the year. If the provision lapses, the nation's charities risk losing out on millions of dollars that could be generated by this important tax provision.

Accordingly, NCPG strongly supports enactment of the Public Good IRA Rollover Act (H.R. 1419), introduced on March 8, 2007 by Representatives Earl Pomeroy and Wally Herger, which would make permanent and expand the current IRA Charitable Rollover. Over 900 organizations from every state in the country have joined with NCPG to support this legislation.

Specifically, H.R. 1419 accomplishes four important things. First, the legislation makes the IRA Charitable Rollover permanent. Second, it removes the $100,000 cap per year on IRA gifts. Third, it permits all charities to receive IRA gifts. Fourth, the legislation permits IRA owners, beginning at age 59½, to create a life-income gift through existing planned giving options such as charitable gift annuities, charitable remainder unitrusts, charitable remainder annuity trusts and pooled income funds.

NCPG believes H.R. 1419 will build upon the great success of the current IRA Charitable Rollover. The legislation will spur millions of dollars in new charitable donations that will go to support critical programs and services. NCPG urges the Congress to act on this legislation soon.

Statement of National Council of Nonprofit Associations

Introduction

The National Council of Nonprofit Associations (NCNA) respectfully submits this testimony to the Subcommittee on Oversight of the House Committee on Ways and Means in response to the Overview Hearing on the Nonprofit Sector on July 24, 2007 and the request for comments regarding the passage of the Public Good IRA Rollover Act of 2007 (H.R. 1419, S. 819).

NCNA is the network of state and regional nonprofit associations serving over 22,000 members in 41 states and the District of Columbia. NCNA links local organizations to a national audience through state associations and helps small and midsized nonprofits:

- Manage and lead more effectively;
- Collaborate and exchange solutions;
- Save money through group buying opportunities;
- Engage in critical policy issues affecting the sector; and
- Achieve greater impact in their communities.

NCNA also serves as a unified voice for the small and midsize nonprofits who continue to positively impact their communities. Over 90% of nonprofits in America have operating budgets of less than 5 million dollars. Representing all fields within the nonprofit sector—healthcare, education, the arts, environmental groups—these small and midsize nonprofits are vital contributors to improve our nation's quality of life. It is in the interests and perspective of these organizations that we submit our comments.

The following comments express NCNA's support of two issues: (1) the Nonprofit Capacity Building Initiative, which would increase the capacity, effectiveness, and accountability of small to midsize nonprofits and, ultimately, improve the quality of life in local communities and (2) the Public Good IRA Rollover Act of 2007 (H.R. 1419, S. 819), which has already resulted in over 75 million dollars in gifts to nonprofit organizations.

The Nonprofit Capacity Building Initiative

The recently released GAO report (*Nonprofit Sector—Increasing Numbers and Key Role in Delivering Federal Services*, July 24, 2007) identified several policy issues related to how the federal government interacts with the nonprofit sector. The report noted that key to a healthy nonprofit sector include: strengthening governance, enhancing capacity, ensuring financial viability, and improving data quality without overly burdening the sector with unnecessary or duplicative reporting and administrative requirements. NCNA and its state association members have proposed a program that will address the key issues identified in the GAO report through the Nonprofit Capacity Building Initiative (NCBI). This initiative would create a federal revenue stream for training and capacity building, especially for small nonprofits through existing technical assistance and management support entities at the state and local level. Combining federal assistance with state and local level programming is necessary for best management practices to be widely understood and adopted within the nonprofit sector.

Over 90 percent of nonprofits operate with annual budgets under $5 million. These organizations play a vital role in local communities and in the quality of life of all Americans through their work in education, healthcare, the arts, social services, and other fields. While small and midsize nonprofits are best positioned to reach and serve all Americans they are least likely to have the adequate resources to meet the needs of their constituents and access to programs and information designed to help them manage and govern their operations. As aptly stated in the GAO report, "Given the way the sector is woven into the basic fabric of our society, it is essential we maintain and cultivate its inherent strength and vitality and have accurate and reliable data on the overall size and funding flows to the sector."

Specifically, topics and activities addressed by NCBI would include the following: (1) Leadership Development (Board Composition and Function, Staff Professional

Development, Volunteer Training, and Development and Succession Planning); (2) Organizational Development (Board Governance, Systems: Management, Human Resources, Financial, Planning, Policies and Procedures, Fiscal Controls); (3) Legal Compliance and Reporting (Policies and Procedures, New and Existing Federal and State laws, On-Line Reporting Systems); and (4) Technology (Training, Equipment, and Software).

The NCNA network has the national infrastructure and expertise to launch a Nonprofit Capacity Building Initiative for the nonprofit sector through state associations of nonprofits. By investing in this already existing network, the federal government can leverage the collective experience, resources, and strength of these established organizations. This investment can improve the quality and reach of services to build the capacity of nonprofits, while reducing redundancy, and avoiding the creation of new bureaucracies at the national, state, and local level.

The Public Good IRA Rollover Act of 2007

In addition, the NCNA supports the Public Good IRA Rollover Act of 2007. The response to the 2007 Act—more than 75 million dollars in giving—is a clear indicator that the IRA Rollover Act serves donors, charities, and the public at large and should be extended permanently. While NCNA has not yet gathered systematic data on the impact of the IRA Rollover on our members, initial reports are favorable. Small organizations are reporting IRA Rollover contributions that exceed past giving. For example, the Executive Director of an interfaith Pharmacy in Louisiana writes reports that one donor contributed $1,203, ten times more than the donor's previous gift. Community Foundations, including those in Montana and Louisiana, are reporting IRA Rollover contributions. This is a positive sign for the NCNA network because local and community foundations often fund our extensive network of small and midsized nonprofits.

In Closing

NCNA supports the efforts of the House Ways and Means Committee in strengthening the partnership between government and the nonprofit sector, increasing the accountability of nonprofits, and supporting the capacity and effectiveness of the charitable community across the country. We believe that the Nonprofit Capacity Building Initiative and the IRA Rollover Act are examples of policies that work to achieve our shared goals.

Thank you for the opportunity to submit these comments, please contact me if you have questions or need additional information on these or related issues.

Statement of National Multiple Sclerosis Society

The National Multiple Sclerosis Society thanks the Subcommittee for this opportunity to provide comment on the significant role and impact that the IRA charitable rollover provision enacted as part of the Pension Protection Act of 2006 is having on tax-exempt charitable organizations. In addition, these comments focus on our support for the "Public Good IRA Charitable Rollover Act of 2007" (H.R. 1419).

Multiple sclerosis (MS) stops people from moving, and the National Multiple Sclerosis Society (the Society) exists to make sure it doesn't. Through our home office and 50-state network of chapters, the Society funds MS research, provides a variety of programs and services to people with MS, offers professional education, and furthers our efforts through advocacy at the local, state and Federal levels. The Society is dedicated to ending the devastating effects of MS and moving closer to a world free of this disease.

The Society is classified as a 501(c)(3) non-profit organization under the Internal Revenue Code. To that end, we applaud the adoption of the provision in the Pension Protection Act of 2006 that allows for taxed exempt charitable rollover IRA distributions to non-profits from individual IRA plan holders. Specifically, the provision provides an exclusion from gross income for otherwise taxable IRA distribution of up to $100,000 per year from traditional and Roth IRAs for making qualified charitable distributions during the tax year 2006 and 2007 by individuals who have attended at least age 70½ at the time of disbursement to the charity of choice.

While limited in its scope, the IRA charitable rollover provision has already made a significant impact on charities across the U.S. According to the Independent Sector and the National Committee on Planned Giving, initial reports show that during the first four months this provision was in effect, more than $70 million in IRA charitable rollover contributions were made to eligible non-profits. Between September 2006 and December 2006, the Society recorded $131,000 in contributions from charitable rollover IRAs applicable to our fiscal year 2007 operating budget.

The IRA charitable rollover provision encourages a new type of planned giving that enables charities to keep improving the lives of Americans and give more back into their communities. Thus far, this type of planned giving helped organizations build new cancer centers, develop additional counseling programs for at risk youth, support housing for homeless families, and provide art therapy for elderly Americans and individuals with developmental disabilities. In addition to the community benefits, the charitable rollover IRA provision helps older Americans support their favorite causes without tax penalties when receiving required disbursements from their IRAs.

The current charitable rollover IRA provision will expire on December 31, 2007. Given the significant impact that this type of planned giving has had on the Society and the non-profit community in a very short timeframe, we urge the Subcommittee to support the Public Good IRA Charitable Rollover Act of 2007 (H.R. 1419). H.R. 1419 would extend and broaden the current charitable rollover IRA provision by making it permanent. In addition, the bill seeks to remove the current $100,000 per taxpayer per year limitation, make all charities eligible to receive these types of donations, and would allow donors to make contributions beginning at age 59½.

The Society strongly supports H.R. 1491, and we encourage this Subcommittee and Congress to take a more in-depth look at the significant benefits the charitable rollover IRA provision has had on non-profits and communities across our country. Non-profits exist to provide programs and services that help better the lives of Americans, and the charitable rollover IRA provision provides additional resources through which non-profits can improve and increase delivery of these programs and services. These additional resources go directly back into the communities non-profits serve. The Society urges the Subcommittee to mark-up and report out the Public Good IRA Charitable Rollover Act of 2007 (H.R. 1419). Thank you.

Statement of New York Community Trust

Introduction

For almost a century, community foundations have been building permanent charitable resources to meet the current needs of their communities and the unforeseen needs of the future. And for more than 80 years, The New York Community Trust (The Trust), through the generosity of donors past and present, has supported nonprofit organizations in the New York metropolitan area that work daily to ensure that our community is a vital and healthy place in which to live and work—for all residents. When we started in 1924, our sole mission was to distribute to nonprofit organizations the income from charitable trusts set up by will and held by New York City banks. The Trust's founders were men of vision who understood the power of an institution that could employ the combined charitable passions of individuals to meet a broad variety of community needs. They also understood that contemporary donors could not anticipate the compelling issues that would confront their successors—and they were committed to ensuring that adequate resources would be available for the future. In those early days, our donors set up unrestricted or broad field-of-interest funds through bequests, trusting tomorrow's leaders to spend it wisely. Today, The Trust has assets of $2 billion; $700 million of that total is held in more than 1,000 donor-advised funds, which range in size from $5,000 up to $99 million. Those funds routinely pay out more than 10 percent of their assets to charity annually. The remaining $1.3 billion rests in permanent unrestricted or field-of-interest funds.

We opened our first "donor-advised" fund in 1934, before there was even a name for it—and long before there were any specific laws or regulations. During her lifetime, this first "donor advisor" made suggestions to the staff of The Trust as to charitable distributions from the fund. When she died, the assets remaining in the advised fund became part of The Trust's discretionary grantmaking program—a program that relies on a professional staff that assesses community needs, investigates nonprofits, vets their projects and finances, and recommends grants to our distinguished volunteer board. Grants we make from the fund she created, which now has $64 million in assets, support projects to help low-income elders keep their homes and apartments, train poor, young women to become licensed day-care providers, reduce environmental health hazards in substandard housing, and much more.

A profoundly important social contract was established with that first donor-advisor that continues to this day: in consideration for the privilege of making grant recommendations, money would be left in the fund for future generations. That is still our expectation and is characteristic of our relationship with most donors to The Trust.

The philanthropic world has changed since 1934 and 21st century donors have significantly more choice than they did years ago. When the IRS gave public charity status to donor-advised funds sponsored by financial institutions, donor expectations changed. The notion of community philanthropy pioneered by community foundations morphed into individual charitable checking accounts, with little expectation of, commitment to, or mechanism for permanence.

Nonetheless, The Trust and its donors support a dazzling array of charitable activity. So it was with dismay that we greeted the tax advantages offered for Hurricane Katrina giving and the IRA charitable rollover because those incentives were not available for contributions to donor-advised funds. In addition, other provisions of the Pension Reform Act of 2006 imposed burdens that seem designed to discourage charitable giving and based on assumptions that donor-advised funds are inherently flawed and that contributions to these funds are not, in fact, completed gifts. We recognize that there have been some egregious misuses, but we believe that enforcement of existing regulations can surely find and punish those individuals who violate the law without penalizing generous people who use their funds to do good. Indeed, the 1976 Treasury regulations implementing the Tax Reform Act of 1969, and the so-called "Section 507 regs," set out in careful detail the facts and circumstances needed for a completed gift. Guided by the Section 507 regulations, The Trust, and our community foundation colleagues, instituted policies to make sure that our charitable institutions and our donor-advisors are in compliance.

In short, donor-advised funds are not a new-fangled tool to avoid taxes; they are a long-standing approach developed by community foundations and addressed in Treasury Regulations to enhance and encourage donors to invest charitably in the immediate and future needs of communities. They are one of many ways that permanent charitable institutions are able to both consolidate many grants from different funds—restricted, unrestricted, and donor-advised—to support community programs and to build their assets for the future health and well-being of their communities.

This is the prism through which we respond to the Committee's request for comments on how the Pension Protection has affected community foundations.

Definition of Donor-Advised Funds

The Trust considers the definition of donor-advised fund under Code Section 4966(d)(2) to be overly broad in that it includes donor-advised funds established by governments, public charities, and private foundations. As a result, donor-advised funds established by governmental and tax-exempt entities are prevented from indirectly supporting the types of programs that they are still permitted to operate or for which they may provide direct support. This result seems at best unintended and at worst counterproductive. Treasury Regulation Section 1.507–2(a)(8) sets out in detail the requirements for a private foundation that terminates its existence and transfers "all of its right, title, and interest in and to all of its net assets" to one or more Code Section 170(b)(l)(A) organizations. The Section 507 regulations provide clear rules, and have been looked to since their promulgation in the mid 1970s as the legal anchor not only for the proper termination of private foundations into donor-advised funds of public charities, but also for the establishment of donor-advised funds within public charities. In fact, the regulations under Section 170 governing component funds of community trusts specifically cross reference Treasury Regulation Section 1.507–2(a)(8) in defining how a transferor private foundation may transfer its assets to a fund at a community trust that would qualify as a component fund. Until the mid-1950s, The New York Community Trust existed solely in trust form, and the various funds that constituted The Trust met the requirement of being a "component fund" as prescribed in the special community foundation regulations under Code Section 170 and adopted by Treasury in 1976. Twenty years before the '69 Tax Act, The New York Community Trust created a sister not-for-profit corporation, Community Funds, Inc., to which donors could make contributions for all the same purposes and in analogous forms as contributions to The Trust. The two entities are treated as one organization for tax purposes. Most community foundations formed in recent years have taken the form of not-for-profit corporations rather than trusts, and virtually all community foundations, regardless of the structure, have looked to the Code Section 507 regulations for guidance in establishing and operating donor-advised fund programs.

The PPA also sweeps up in its definition a fund where the advisors are "appointed" by the donor—even when they are named in the instrument. As a result, a fund set up by will is deemed to be a donor-advised fund if the decedent named unrelated individuals to an advisory committee. In addition, the broad definition of what constitutes advisory privileges pulls in relationships so minor that the donor cannot be viewed as controlling the fund, for example, where the donor's advice is limited to the amount of money to be expended each year.

Applying Private Foundation Rules to Donor-Advised Funds

Donor-advised funds encourage charitable giving by individuals who want to engage regularly in thoughtful, responsible philanthropy and want to be part of a permanent charitable institution that will respond to the community's needs now and in the future. They offer a community, with all of its complexity and diversity, the opportunity to receive support from an array of donors whose passions and commitments reflect that very diversity and complexity: popular vs. unpopular causes, general support vs. project support; liberal vs. conservative; direct services vs. policy work; immediate needs vs. future needs.

As a "sponsoring organization" under the new nomenclature of the Pension Protection Act of 2006, The Trust (and other community foundations) provides its donor-advisors with professional grantmaking staff and knowledge of the community and its needs. Its board can hardly be viewed as controlled by its donors. At The Trust, staff also brings a high level of diligence to its review of potential grantees prior to approving grant recommendations. In this respect, The Trust performs an independent investigation of any charity recommended for support, including support from a donor-advised fund at The Trust. The charitable sector as a whole benefits from this kind of review because it imposes a discipline on prospective grantees, who know that both their fiscal and program operations are being scrutinized.

In addition to providing guidance on the selection of grantees, the sponsoring organization provides an extra layer of oversight and necessary administration that is otherwise difficult for individual donors or unstaffed family foundations to manage. A sponsoring organization is responsible for determining that grantees have current financial statements and or audits, operate with independent boards of directors, have timely filed their Forms 990 with the IRS, and have an organizational structure adequate to the projects being undertaken. Because The Trust, as a sponsoring organization, has legal title and control over all of its assets, including donor-advised funds, it assumes the responsibility for charitable assets and assures that these assets are used exclusively for tax-exempt charitable purposes. Being part of a major charitable institution that is equipped to manage and oversee grants to hundreds of organizations empowers donors to hold grantees accountable for the quality of their work.

The law governing charitable contribution deductions (Section 170 of the Code and the accompanying Treasury Regulations, court cases and so forth) quite clearly provides that a gift to a charity that provides impermissible private benefit to the donor or another private individual is not tax-deductible. To create special rules and regulations for contributions to donor-advised funds that are part of a functioning public charity does not add anything material to existing law. The need is for best practices and oversight by sponsoring organizations and donors and for enforcement by the IRS: new and redundant special rules will only create a maze of foot faults.

Rules restricting certain grants, described more fully below, also treat donor-advised funds like private foundations, including restrictions on grants to foreign organizations, 501(c)(4) organizations for charitable purposes, and individuals. The likely effect will be to drive more donors to private foundations, rather than to the more cost-effective donor advised funds at a professionally staffed sponsoring organization.

Prohibition on Certain Types of Grants from Donor-Advised Funds

Scholarship Funds: Complex rules about when a donor is deemed to control the advisory committee to a scholarship fund are overly broad. The PPA should have excluded from the definition those funds established for scholarships and awards, regardless of composition of committee. Congressional concern about inappropriate benefits to the donor or her family is already addressed by other rules prohibiting personal benefit. And the prohibition on grants from donor-advised funds to individuals should not have included funds with a specific charitable purpose such as scholarships and awards, regardless of the composition of the advisory committee. Many of our scholarship funds are small, but important, and function efficiently *only* because they are advised by the families or individuals who created them. We have reconstituted these committees in compliance with PPA, but we are concerned that they will not function as well as they have, and discourage future donors who want to involve their families in philanthropy.

Grants to Foreign Charities and 501(c)(4)s: Many of our donors support charities abroad. Requiring the sponsoring organization to exercise full expenditure responsibility imposes an unreasonable burden, and has compelled us to prohibit donors from suggesting these grants. Similarly, many 501(c)(4)s have charitable missions, including volunteer fire departments and rotary clubs. The burden of exercising expenditure responsibility for what are often modest grants is excessive, and we no longer permit them.

Supporting Organization: The rules precluding grants from donor-advised funds to non-functionally integrated type III supporting organizations also make the sponsoring organization responsible for determining which organizations meet the type III definition. This imposes an unreasonable burden on a sponsoring organization with hundreds of donor-advised funds. Such determinations should be the responsibility of the IRS.

Penalties on Certain Transactions

Section 4967 imposes a tax on a donor or advisor who recommends to the sponsoring organization a distribution from a donor-advised fund if the distribution results in a donor, donor-advisor, or related person receiving a more than an "incidental benefit." A tax also is imposed on the donor, donor-advisor or related person who receives the benefit and fund managers of the sponsoring organization who knowingly agree to make the distribution, with no concomitant burden on the grantee that improperly provides the benefit.

This new provision will require a sponsoring organization to devote more of its resources to the administrative task of identifying those individuals and entities that might be related to the donor or donor-advisor.

Section 4958 (Intermediate Sanctions)

The inclusion of investment advisors as disqualified persons is overly broad, picking up all investment advisors for many sponsoring organizations, whether they are independent or have a relationship with a donor to a donor-advised fund. Compensation to any vendor should be reasonable, but to create an additional category of disqualified persons solely for sponsoring organizations makes no sense. If Congress considers investment advisors and their fees suspect, then they should be suspect for all public charities.

Section 4943 (Excess Business Holdings)

The Pension Protection Act extends the application of the excess business holdings rules to donor-advised funds. In applying the rules, each donor-advised fund's holdings are aggregated with the holdings of disqualified persons with respect to the donor-advised fund, as defined by Code Section 4943(e)(2). A sponsoring organization will now be required to devote considerable staff and financial resources to compliance with these rules—no small undertaking in light of the breadth of the aggregation rules. A sponsoring organization must monitor the holdings of each donor-advised fund to determine whether it falls within the 2 percent *de minimus* rule and, if not, additionally identify the disqualified persons and their investment holdings that are in common with the donor-advised fund. This is a daunting task because of the endless string of relatedness constituting disqualified persons. There is no rational way that an institution with numerous donor-advised funds can gather and track this information in any meaningfully accurate way; the result is likely to be significant noncompliance or meaningless attempted compliance.

IRA Charitable Rollover

Because of the estate tax rates on IRA assets left to heirs other than a spouse, and because many donors can afford to forego these assets, we applauded the charitable rollover provision of the PPA. However, donor-advised funds should *not* have been excluded. Indeed, donor-advised funds at a community foundation, with the oversight and grantmaking experience explained above, are the ideal vehicles for the rollover; investment managers that hold IRA assets do not have this expertise. The Trust also believes that the rollover should be made permanent.

Form 990T

The PPA requires that Form 990T be made public. Unlike the Form 990, the information return, which is public information, the 990T is a tax return. Individuals' and corporations' tax returns are not public documents, and this provision puts public charities, and any taxable companies in which they have an interest, at a disadvantage.

As explained in the Introduction, community foundations and similar charitable institutions have twin goals: to serve living donors and meet immediate community needs; and to be permanent endowments that have the resources to respond to the needs we cannot now imagine. Encouraging donors to think in terms of contributing to a permanent fund buttresses both goals. At The Trust, all donor-advised funds, if not fully expended after two successions of advisors, become unrestricted funds of The Trust. And with our other component funds, they provide irreplaceable support for the voluntary institutions that are a vital part of American democracy.

Statement of Ohio Grantmakers Forum

Ohio Grantmakers Forum is pleased to provide the following comments on the impact of the Pension Protection Act of 2006's charitable provisions as they relate to our members, who are private and community foundations, other public charity grantmakers and corporate foundations and giving programs. We appreciate and applaud the Subcommittee's interest in exploring the impact—both intended and otherwise—of this important legislation through written comments and the scheduled public hearing.

IRA Charitable Rollover Provision

Ohio's community foundations and Jewish federated funds have received nearly $5 million in donations due to the IRA charitable rollover provisions included in last year's Pension Protection Act. During its short duration to date, the incentive has been a significant source of new dollars and some new donors, with gifts ranging from a few hundred dollars up to the $100,000 cap on contributions. These gifts result in additional funds flowing into nonprofit organizations that provide critical services to people in need, support educational achievement, make communities safer places and strengthen Ohio's economy. According to our research, many more dollars could be raised if more types of organizations—such as donor advised funds—were eligible for the charitable rollover of IRA assets. Ohio Grantmakers Forum supports H.R. 1419 and its provisions to expand and extend the rollover beyond this tax year.

Regulatory Provisions

Our community foundation members, those most affected by the new regulations included in the Pension Protection Act, have indicated to us that they are quite cumbersome and expensive to implement. This is of special concern to us since Ohio's charitable grantmakers already are regulated by federal and state law, to ensure that they fulfill their fiduciary duties and operate ethically. Additionally, the charitable sector has numerous voluntary self-regulation mechanisms in place to educate and help nonprofit entities to behave at the highest ethical levels. For instance, members of Ohio Grantmakers Forum indicate each year that they adhere to our Guiding Principles that call for greater transparency and accountability. (See below for the list of Guiding Principles.)

Furthermore, community foundations across the nation and in Ohio are rapidly adopting "National Standards." These self-regulatory standards include detailed financial, grantmaking and operational practices and policies. Adding additional federal regulations, definitions and reporting requirements is not only unnecessary, but directs the attention of foundations away from their vital work as grantmakers. The one-size-fits-all approach to the new regulations can be particularly problematic in this regard for smaller foundations with minimal or no paid staff.

We hope that the Oversight Subcommittee will review the issues outlined by Independent Sector and the Council on Foundations last fall, in a letter to the IRS, and consider how it might address and resolve these issues in this session.

Thank you for the opportunity to comment upon the Pension Protection Act's provisions impacting charitable organizations and giving.

Ohio Grantmakers Forum Guiding Principles

1. Adhere to the highest standards of ethical behavior in all philanthropic activities.
2. Operate with an active governing board that sets and regularly reviews all organizational policies, including those related to governance, conflict of interest, grantmaking, and finance (including audit).
3. Have basic information readily available regarding programs, funding priorities and application requirements.
4. Maintain constructive relationships with applicants, grantees, donors and the public based on mutual respect, candor and confidentiality.

5. Strive to include the perspectives, opinions and experiences of the broadest possible cross-section of people to inform the organization's grantmaking/contributions, governance/staff structure and business practices.
6. Support continuous learning by trustees, staff and grantees.
7. Honor donor intent through thoughtful deliberation in the context of changing social conditions.
8. Fulfill all fiduciary and legal responsibilities.

Revised by the Board of Trustees August 1, 2006

Ohio Osteopathic Foundation
Columbus, Ohio 43201–0130
July 5, 2007

The Honorable John Lewis, Chairman
Committee on Ways and Means Oversight Committee
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Lewis:

I am submitting this letter in response to the request of the Ways and Means Oversight Committee for written comments concerning the impact of the Pension Protection Act on charitable organizations.

The Ohio Osteopathic Foundation (Foundation) is a 501(c)(3) organization classified as a supporting organization within the meaning of section 509(a)(3) of the Internal Revenue Code. Immediately prior to the enactment of the Pension Protection Act (PPA) of 2006, the Foundation received the first installment of a five-year grant from a non-operating private foundation that will allow us to substantially increase the quality of our programs. As a result of the PPA restrictions on the ability of supporting organizations to accept or receive gifts from private foundations, however, the remainder of this grant is now in jeopardy. The grantor is concerned about violating these restrictions and triggering the excise tax created by the PPA. As a result, the grantor is withholding the remaining installments of the grants unless we change our public charity classification to that described in 509(a)(1) or 509(a)(2).

The Foundation has functioned as a "Type I" supporting organization for more than 20 years. It is operated, supervised and controlled by the members of the Ohio Osteopathic Association (Association) to ensure that its programs and grants benefit the entire osteopathic profession in Ohio and do not inure to the benefit of any disqualified individual or group of individuals.

As a small organization, we have been able to avoid duplicative administrative costs by donating employee time from the Association to support Foundation programs. We have also maximized investment income in the Foundation to benefit osteopathic education and research. The main beneficiary of our grants has been the Ohio University College of Osteopathic Medicine, a public institution in the state of Ohio.

While conversion of the Foundation to a 509(a)(1) or 509(a)(2) organization might have been easily accomplished in the past, we are now hindered in making a conversion because of another large grant we received immediately prior to enactment of the PPA. That grant significantly increased our annual investment income, which may exceed the one-third income limitation needed to qualify for exemptions under one of these other sections.

The Foundation believes that the restrictions imposed by the PPA on the ability of private foundations to make distributions to supporting organizations need to be refined to allow these distributions to be made when appropriate governance mechanisms are in place. We further believe that Type I supporting organizations which have appropriate governance structures and accountability mechanisms should be treated in the same manner as public charities that receive their exemption under 509(a)(1) or 509(a)(2) of the Internal Revenue Code.

Sincerely,

Jon F. Wills
President

Statement of the PGA Tour

The PGA TOUR is very grateful for this opportunity to provide comments to the Committee on the exempt organization provisions in the Pension Protection Act of 2006, and will focus its attention entirely on section 1205.

Section 1205 of the Pension Protection Act of 2006 ("PPA") was a positive first step toward resolving a problem that was created a decade ago when Congress unexpectedly altered the rules relating to transactions between tax-exempt organizations and certain taxable subsidiaries.

In general, interest, rents, royalties, and annuities (*i.e.*, payments of passive income) are received free of tax by exempt organizations. Under Code section 512(b)(13), however, these payments are subject to tax if they are received from a "controlled" organization (*e.g.*, a subsidiary). Prior to the enactment of the Taxpayer Relief Act of 1997 ("TRA 97"), an organization was considered controlled if the exempt organization had a direct ownership interest of 80 percent or more in that organization. TRA 97 changed the ownership percentage to 50 percent. According to the TRA 97 Committee Reports, the reason for automatically taxing income from a controlled organization was to prevent subsidiaries of tax-exempt organizations from "reducing otherwise taxable income by borrowing, leasing, or licensing assets from a tax-exempt parent organization at inflated levels."

Section 1205 of the PPA in structure is the product of close to a decade of discussions between members of the exempt community and Congress. As adopted, the section modifies TRA 97 to provide that interest, rents, royalties and annuities received by an exempt organization from a controlled organization will only be taxed when the payment exceeds fair market value. A 20 percent penalty is imposed on excessive payments. Tax-exempt organizations that receive interest, rent annuity or royalty payments from a controlled organization must report payments on informational tax returns. The change to Code section 1205 only applies to payments made under binding written contracts (or their renewals under substantially similar terms) in effect on the date of enactment. The fair market UBIT test is in effect for 2006 and 2007.

Congress also provided that the Treasury Department will submit no later than January 1, 2009, a year after the section expires, a study of the effectiveness of the Internal Revenue Service in administering the new section.

Section 1205 was needed to correct an anomaly in TRA 97 which resulted in exempt organizations becoming liable for UBIT on payments of passive income even when they reflect fair market amounts. For example, many exempt organizations receive rents at an arm's length amount from taxable subsidiaries that were established and operate for non-abusive purposes. Under TRA 97 these exempt organizations were subject to tax, even though their receipt of rents from unrelated organizations under the exact same terms would not be subject to tax. This treatment significantly reduced funds available for tax-exempt purposes at a time when government funding of many tax-exempt organizations is being substantially reduced and private sector organizations are being called upon to assume additional responsibilities.

Section 1205 recognizes that fair market value can be established generally by reference to amounts paid in comparable arrangements by unrelated third parties. Similarly, fair market rents or royalties can be established or referenced to existing transfer pricing principles. The Internal Revenue Service has extensive experience in determining the fair market value of transfers between related parties under Code section 482. Moreover, the Service is applying section 482 principles to transactions involving tax-exempt organizations. For example, IRS letter rulings hold that tax-exempt organizations must comply with section 482 in transfers of tax-exempt property. Thus, both the Service and taxpayers have experience with these principles.

The effort to modify the changes enacted to section 512(b)(13) in the TRA 97 resulted prior to 2006 in the adoption of provisions similar to section 1205 (but not containing the limitations discussed above) in tax bills that cleared one House of Congress but not the other, and at one point in a budget reconciliation bill that was vetoed by President Clinton on unrelated grounds. The American Bar Association Section of Taxation endorsed these efforts, which were at the time embodied in a pending Senate provision, in a letter to the Chairmen and Ranking Members of the tax writing committees dated February 3, 2006 stating that "[t]he amendment addresses concerns that many tax-exempt organizations have raised for a number of years."

While section 1205 of the PPA is a step forward, it has two notable limitations which we urge the Committee to address this year.

First, the provision only applies to binding contracts in existence on the date of enactment of the PPA, or renewals of such contracts on substantially similar terms. The Committee should remove this limitation; after all, the provision contains mechanisms against abuse both in the form of the application of a market value concept using the principles of section 482, and, in addition, applies a tough twenty percent penalty tax on the portion of any payment that exceeds fair market value. These mechanisms are the product of years of discussion between Congress and the exempt community and will be effective both with respect to existing and new arrangements between exempts and their controlled subsidiaries and there is no technical reason under the circumstances to limit the provision to existing contracts.

Second, the PPA provision as modified to cover new contracts should be extended beyond the current expiration at the end of 2007, preferably on a permanent basis. These rules were intended, absent the limitations that were added last year when the provision was made a part of the PPA, to settle the issue on a permanent basis and provide exempts with certainty regarding the tax treatment of transactions with controlled subsidiaries; they were not intended as temporary measures and were not so limited in any of the pieces of legislation in which they had previously been included.

A great many exempt organizations maintain controlled taxable subsidiaries as a permanent part of their structure. Only by extending the provision, preferably on a permanent basis, will the exempt community have the certainty it needs in this area.

Arguably the authors of the PPA version of this provision limited it with the expectation that Congress would eventually receive a Treasury study on which to base a further evaluation of the provision's effectiveness. But we submit that the approach taken will be more harmful than helpful to exempts. After all, the study might not be submitted until a year or more after the PPA provision expires creating another round of uncertainty for exempts.

Both Congress and Treasury maintain regular oversight of the tax system and will no doubt study the operation of section 512(b)(13) for some time to come. Regular oversight of an existing provision is much less disruptive, and we submit better tax policy, than enacting temporary tax provisions that can be renewed only after they have expired and only after a special study has been done of their effectiveness.

For these reasons, we urge the Committee to treat section 1205 of the PPA as a good first step, and to adopt the changes proposed in this submission in order to create certainty both for exempt organizations in this area as well as for Treasury.

Statement of Putnam Scholarship Fund

I am writing as President of the Putnam Scholarship Fund to ask for revisions to the portions of the Pension Protection Act of 2006 dealing with "donor advised funds."

The Putnam Scholarship Fund was founded in the late 1940's by Roger and Caroline Putnam of Springfield, Massachusetts with the support of many local citizens. The founders believed that securing a college education was the best way to help people of color become successful members of American society. Since then the Fund has provided help to thousands of students. Over the years recipients have gone on to careers as doctors, lawyers, politicians, clergy and other contributing members of society. Every annual donation dollar goes to scholarship aid. The Putnam Family covers all operating expenses and the Board of Trustees provides their services pro bono. In order to maximize efficiency, the Fund made arrangements with the Community Foundation of Western Massachusetts to manage its corpus and to "triage" all applications.

This last point appears to be the major problem with the new changes in the Act. Because the Scholarship Fund collected the donations and had also been making the award decisions, we were considered "donor advised" and subject to the new regulations. As I note below, this has caused us significant additional expense (affecting what we can award) and forced us to reduce the role of our volunteer board. We also worry that our donors will wonder if their wishes are being as clearly followed given the increased overhead and involvement of "outsiders."

We would like to propose the following changes in order to address these concerns and yet provide the protections the Act was aimed at:

The definition of "donor advised" in the Act is too broad. With what understanding we have of the rationale behind the Act, the need is focused on the following items:

1. Source of Funding—If the ongoing operating or initial funding comes from a limited pool (one individual or a small group of individuals), then there should be cause for concern. In the case of our scholarship fund, our corpus has been built up over years and came from a variety of unrelated people. Our annual fundraising also comes from a variety of people, some of whom are members of the Putnam family, but, again, the majority of funds raised every year, both in total dollars and in source of donations, comes from people all around the country not related to anyone in my family.

2. Relationship of Recipients to Donors—If there is a relationship between "material" donors (those whose annual contributions or income from capital contributions equals or exceeds the average annual award) and recipients, then there needs to be a clear and documented separation between those who solicit funds and those who make awards (the "independence" in the current Act). In our case, this does not exist and never has, but the current Act requires our Board to be separate from the "Selection Committee." It forced us to remove family members who have been participating for years in both fundraising and award evaluation from one or the other activity. Since this work is all done "pro bono," this has impacted us severely, but accomplished nothing since there is no relationship between donors and recipients. We have also made sure that every individual member of the Board has signed off every year indicating if they have any relationship to any recipient or would otherwise benefit from any award. While that has never happened, if that were to be the case, that member would abstain from any such award decision.

So where you have a fund that receives its money from a variety of unrelated individuals and has a Board that is unrelated and independent of the recipients, the Act should be modified to remove them from the definition of "donor advised" and the subsequent restrictions. Where the source of funding is provided by a small pool

AND there is a relationship between the recipients and the donors, then the restrictions make sense.

We propose the definition of "material" because there can be instances where someone who has routinely donated small amounts over time may be related to a recipient. Our average award is close to $2,000, but any gift of $1,000 or above is put into our (independently run) capital fund and we derive only the sustainable income for awards (about 4.5% annually).

Your feedback is appreciated as well as any information on the process so that I can understand what to expect.

Thanks,

W. Lowell Putnam
President

Statement of Robert M. Hearin Support Foundation

I commend the Subcommittee on Oversight for its appreciation of the importance of the work of the charitable community and its role in American life. I am writing on behalf of the Robert M. Hearin Support Foundation (the "*Foundation*"), a Type III supporting organization located in Jackson, Mississippi. We are pleased to have the opportunity to offer comments concerning certain tax-exempt provisions contained in the Pension Protection Act of 2006 (the "*Act*"), pursuant to the Subcommittee's June 12, 2007 advisory.

As set forth in the instrument that created the Foundation,

> The principal goal of the Foundation is to contribute to the overall economic advancement of the state of Mississippi (the "State") by making funds available to any one or more of [fifteen listed schools] (the "Schools"), to prepare students who will directly contribute to the State through capital investment, creation and expansion of higher paying jobs, and improvement in the general economy of the State. In making distributions . . . the Foundation shall concentrate its efforts on attracting promising students to any one (1) or more of the Schools, and on improving the quality of instruction in the Schools, in either case in the fields of business, science, engineering, economics, law, medicine, accounting, pharmacy, architecture and other academic disciplines which directly contribute to the overall economic advancement of the State and are viewed by trustees as furthering the goals of the Foundation (the "Areas of Emphasis"). Concentration of efforts shall be reflected in a general and long-term philosophy and goal of developing and supporting fewer larger projects at the Schools (rather than numerous small gifts to such institutions) which have the potential to accomplish the Foundation's principal goal of economic advancement of the state of Mississippi and to create recognition for excellence at one (1) or more of the Schools.

Certain provisions of the Act created significant new burdens, limitations and uncertainty for Type III supporting organizations. We would like to offer comments on several of these provisions that are of particular significance to the Foundation.

1. Minimum Payout Requirement

The Act directs the Secretary of the Treasury to promulgate new Regulations setting out a new payout requirement for Type III supporting organizations (other than those that are functionally integrated). The eventual Regulations must, according to the Act, require each such Type III organization to distribute a percentage of either its income or assets to supported organizations. Act Section 1241(d)(1). Traditionally, a Type III supporting organization has been able to fulfill its payout requirement by distributing "substantially all" (i.e., at least 85%) of its income. Treas. Reg. § 1.509(a)-4(i)(3)(iii)(a).

On August 1, 2007, the Treasury issued an "advance notice of proposed rulemaking" concerning payout requirements for Type III supporting organizations that are not functionally integrated (the "Advance Notice"). The proposed new payout requirement is anticipated to impose an annual payout obligation for Type III supporting organizations equal to five percent of the fair market value of non-exempt-purpose assets (i.e., the same distribution requirement imposed on private non-operating foundations).

A payout requirement tied to the value of a Type III supporting organization's assets would pose particular difficulties to organizations that own interests in non-publicly traded business entities and other assets that are not easily valued. A supporting organization could make payouts based on a presumed value of an investment asset notwithstanding that this value is not fully realized for any number of possible reasons, including lack of marketability and losses from unpredictable causes like hurricanes. Especially in the case of Type III supporting organizations owning interests in business entities with significant contingent liabilities, a payout requirement tied to value could effectively require the supporting organization to dispose of its ownership interest—which might necessarily occur in a manner that involves a considerable loss of value. Additionally, the Foundation (which has six trustees and no operational staff) would be required to pay outside experts to appraise its investment assets each year, thus incurring expenses that would reduce the funds ultimately available for the beneficiaries.

If, notwithstanding these considerations, Congress believes it desirable to have a payout requirement tied to the value of a Type III supporting organization's assets, it would be preferable to have a payout requirement similar to the standard applicable to private operating foundations, as proposed by the Comments in Response to IRS Notice 2007–21 on Treasury Study on Donor Advised Funds and Supporting Organizations submitted to the Internal Revenue Service by the American Bar Association Section of Taxation on August 1, 2007. As those comments explain, the proposed payout requirement for non-functionally integrated Type III supporting organizations would be the lesser of 85% of net income or 4¼% of asset value, with a minimum distribution requirement of 3⅓% of asset value.

The Advance Notice also set out the Treasury's intention to propose regulations that would "limit the number of publicly supported organizations a non-functionally integrated Type III supporting organization may support." Prospectively, the limit would be five publicly supported organizations. The Advance Notice explained that an organization already in existence when the regulations are proposed would be permitted to "support more than five supported organizations only if the organization distributes at least 85 percent of its total required payout amount to, or for the use of, publicly supported organizations to which the supporting organization is responsive pursuant to Treas. Reg. § 1.509(a)-4(i)(2)(ii)." For reasons discussed below (in part 3 of this letter) in connection with the proposed changes to the responsiveness test, this restriction on distributions would create considerable problems for the Foundation.

In light of these difficulties, it is desirable for Congress to provide more specific guidance to the Secretary of the Treasury concerning the payout requirement for non-functionally integrated Type III supporting organizations, calling for an approach that avoids the problems described above.

2. Excess Business Holdings

The excess business holdings rules under IRC Section 4943 previously applied only to private foundations. Under the Act, however, the excess business holdings rules apply to Type III supporting organizations (other than those that are functionally integrated). Act Section 1243.

Under the excess business holdings rules, an excise tax ordinarily would be imposed if a Type III supporting organization, together with its baseline and certain disqualified persons, were to hold (directly or indirectly) more than a 20% voting interest in a business enterprise. If one or more persons, other than the Type III supporting organization together with certain disqualified persons, have effective control of an enterprise, then the limit is raised to 35%, although the burden is effectively on the Type III supporting organization to establish that the control resides in other persons. A safe harbor exists under which the Type III supporting organization need not consider the holdings of disqualified persons if it (together with certain related exempt organizations) holds no more than a 2% interest in the voting stock of a given business enterprise. Transition rules apply to donated assets. Excess business holdings are subject to a 10% annual excise tax, plus a 200% excise tax if the holdings are not timely reduced to permitted levels. *See generally* IRC Section 4943.

The rules described in the preceding paragraph would be applicable to Type III supporting organizations on both a prospective ***and retroactive*** basis. However, Type III supporting organizations are granted the benefit of transition rules over an initial, two-phase period of 25 years. At the end of that period, the combined holdings of a Type III supporting organization and its disqualified persons in a business enterprise must not exceed 35% of the voting stock or 35% of the equity value of the enterprise (rather than the usual limit of 20% of the voting stock), subject to the further limitation that if disqualified persons held more than 2% of the voting stock of the business enterprise during the prior 25-year period, the holdings of the Type III supporting organization must not exceed 25% of the voting stock or 25% of the equity value. Because of the application of a very complex set of rules that may be triggered by changes in ownership of the business enterprise during the transition period, it is possible that the actual ownership limits will be lower than the maximum percentages stated above. Changes in ownership percentages that trigger these prohibitions can occur as a result of transactions in which neither the supporting organization nor any disqualified person participates (e.g., the redemption of stock held by an unrelated owner as a result of that owner's retirement or death, or any other type of change in business circumstances affecting such unrelated owner.)

The imposition of the excess business holdings rules on Type III supporting organizations could force such an organization to reduce its business holdings solely in order to effectuate compliance with a tax rule, without regard to whether the decision is necessarily in the economic best interests of the organization or, indeed, the best interests of its beneficiaries, who would bear the burden of any resulting loss of value. Reducing one's interest in a closely held business is sometimes very difficult to accomplish given the absence of a market for ownership interests in the business. The new rules also interfere with the ability of an organization to comply with a donor's wishes that a Type III supporting organization retain certain assets indefinitely. (In this regard, it is useful to bear in mind that some donors elected to create Type III supporting organizations in the first place in order to ensure that businesses with which they were involved could be preserved without regard to the rules that limit the business holdings of a private foundation. In many cases, the donor's family is no longer involved with the business in which the supporting organization has an ownership interest.)

Although the Act contains two narrow exceptions to the excess business holdings rules as applied to Type III supporting organizations, one exception is available only in those relatively limited circumstances where state officials on or before November 18, 2005 used their authority to direct an organization's investment decisions, and the other exception seems unlikely to be available unless state officials have taken some action to direct an organization's investment decisions. In other words, the exceptions are available only in extremely rare circumstances and, in effect, they impose a burden on Type III supporting organizations that is significantly higher than the burden faced by other public charities in connection with their investment activities.

It is desirable for Congress to amend the Act to create true "grandfathering" for the excess business holdings of some or all Type III supporting organizations, especially those established by donors who are no longer living. Such a rule would preserve the autonomy of boards of Type III supporting organizations to make investment decisions based purely on sound fiduciary and appropriate financial considerations.

3. Qualification of Trusts as Type III Supporting Organizations

Under current Treasury Regulations, a Type III supporting organization must meet a "responsiveness" test with respect to its supported organizations. See Treas. Reg. § 1.509(a)-4(i)(2). A Type III supporting organization structured as a charitable trust has traditionally fulfilled the responsiveness requirement simply by reason of being a trust and the fact that its supported organizations have the power to enforce the trust and compel an accounting. See Treas. Reg. § 1.509(a)-4(i)(2)(iii). However, the Act provides that this traditional means of fulfilling the responsiveness requirement will not be sufficient after the first anniversary of the Act's effective date. Act Section 1241(c). Although the Act itself does not elaborate, the Joint Committee Report states that each Type III supporting organization structured as a trust will be required to establish to the satisfaction of the U.S. Secretary of the Treasury that the organization has a "close and continuous relationship" with the supported organizations, such that the supporting organization is responsive to the needs or demands of the supported organizations.

The Advance Notice anticipates that the proposed Regulations under this provision of the Act will adopt the responsiveness test under Reg. § 1.509(a)-4(i)(2)(ii). Under those rules, one of the following elements must be present and, by reason of such element, one or more supported organizations must have a "significant voice" in the investment policies of the supporting organization, the timing of grants, the manner of making them, the selection of grant recipients, and otherwise directing the use of the income or assets of the supporting organization.

One or more officers or trustees of the supporting organization must be elected or appointed by the officers, directors, trustees or membership of the supported organizations. One or more members of the governing bodies of the supported organization must also be officers or trustees, or hold other important offices in, the supporting organization. The officers or trustees of the supporting organization must maintain a close and continuous working relationship with the officers, directors or trustees of the supported organizations. Treas. Reg. § 1.509(a)-4(i)(2)(ii).

The third of those alternatives (the "close and continuous working relationship standard") is especially appealing for a Type III supporting organization that supports multiple charities. However, the payout requirement described above for non-functionally integrated Type III supporting organizations with more than five beneficiaries has the potential to create difficulties. As noted, the Advance Notice anticipates that such organizations will be permitted to "support more than five supported organizations only if the organization distributes at least 85 percent of its total required payout amount to, or for the use of, publicly supported organizations to which the supporting organization is responsive pursuant to Treas. Reg. § 1.509(a)-4(i)(2)(ii)."

In order for a supporting organization to be responsive to a particular supported organization, the supported organization must have a "significant voice" in, among other things, the timing of grants, the manner of making them, and the selection of grant recipients by the supporting organization. If some supported organizations had such a significant voice and others did not, the appearance of favoritism or conflicts of interest could result. These problems would be particularly acute in the Foundation's case because its beneficiaries are the four-year colleges and universities in Mississippi. To a much greater extent than the multiple beneficiaries of other grant-making organizations (such as secondary schools or arts organizations), these colleges and universities compete head to head with each other for students, faculty and other resources.

Further, if every supported organization had a "significant voice" in some manner, management of the supporting organization could become unwieldy and subject to undesirable competition for grants where there are numerous beneficiaries. It would also become more difficult for the supporting organization to verify that grants were being used appropriately if its governing body consisted entirely or primarily of trustees appointed by the supported organizations. There would also be the danger of "log-rolling" by the trustees, which would frustrate the Foundation's stated preference for "developing and supporting fewer larger projects at the Schools (rather than numerous small gifts to such institutions)."

Apart from the portion of the payout requirement relating to non-functionally integrated Type III supporting organizations with more than five beneficiaries, the anticipated regulations concerning the responsiveness test for charitable trusts appears workable. But the combination of the change in the responsiveness test for charitable trusts and the payout requirement would create serious difficulties. Consequently, it is desirable for Congress to provide more specific guidance to the Secretary of the Treasury concerning the payout requirement for non-functionally integrated Type III supporting organizations that would avoid the burdensome suggested rule for Type III supporting organizations with more than five beneficiaries—especially those that support higher education.

4. Payment of Compensation and Expense Reimbursements to Certain Persons

Under the Act, the entire amount of a grant, loan, payment of compensation, or "other similar payment" by any type of supporting organization to a substantial contributor or a related person is an automatic excess benefit transaction, which triggers the various penalty provisions of IRC Section 4958 even if the payment is reasonable. IRC Section 4958(c)(3)(A)(i)(I). According to the Joint Committee report that accompanied the Act (the "Joint Committee Report"), the term "other similar payment" includes an expense reimbursement.

The IRC Section 4958 excise tax (commonly known as "intermediate sanctions" and more precisely referred to as the tax on "excess benefit transactions") is ordinarily imposed only when transactions are unreasonable and lead to excessive compensation to a disqualified person. However, for supporting organizations that pay compensation or reimbursements to a substantial contributor or related person, the tax is imposed with respect to the full amount of the compensation or reimbursement, without regard to whether the amount is reasonable or is otherwise justified.

This excise tax is imposed on the recipient of the excess benefit and may be imposed on organization managers who approve the compensation or reimbursement giving rise to the excess benefit. The tax on the recipient of the excess benefit is 25% of the excess benefit (again, in this case, the entire benefit), plus an additional 200% tax if the excess benefit (again, the entire benefit) is not timely refunded to the supporting organization.

Because of the severity of this excise tax, the new rule effectively prohibits any supporting organization, regardless of its type, from paying even reasonable compensation or expense reimbursements to its founder, his or her spouse and children, and other family members. This is true whether the compensation is for services as a director or trustee, as an executive director or program officer, or as an outside advisor. In this respect, the new rule is more stringent than the rule for a private foundation, which may, without adverse tax consequences, reimburse documented expenses and pay compensation to "disqualified persons" (provided the compensation is not excessive and provided that the services provided are reasonable and necessary to the foundation's tax-exempt purposes). See IRC Section 4941(d)(E).

Even a Type I supporting organization founded, funded and controlled by a university or other public charity could run afoul of the new rule if (for example) the supporting organization pays reasonable compensation or reimbursements to (for example) the spouse or child of a director or officer of the supporting organization. Hence, the Type I supporting organization would be effectively prohibited from entering into a compensation arrangement that the founding organization itself could enter into.

It is desirable for Congress to amend the Act in order to eliminate or modify the automatic excess benefit transaction rules that the Act imposes on supporting organizations.

Statement of Rodrigues, Horii & Choi LLP

These comments were prepared in response to Chairman John Lewis's invitation for public comments on the impact of the Pension Protection Act of 2006, Pub. L. No. 109–280 (the "PPA") on tax-exempt organizations. Specifically, this letter addresses the impact of the new rules of the PPA on donor-advised funds ("DAFs") and supporting organizations ("SOs"). The law firm of Rodriguez, Horii & Choi LLP respectfully submits the following comments in response to Chairman Lewis's request. While the firm represents a wide range of community foundations, SOs, private foundations ("PFs") and individual donors, these comments were not made on behalf of any firm clients. The comments were, however, based on the firm's experience with sponsors of DAFs, SOs, PFs and individual donors.

A. Advantages of DAFs and SOs

DAFs and SOs serve many important functions with respect to charitable giving. DAFs and SOs increase overall charitable giving and funding for charitable organizations. Private foundations ("PFs") generally view the five percent required minimum distribution as both a floor and a cap. The majority of PFs distribute only five percent of the value of their assets annually as compared to DAFs and SOs which typically, and definitely in the aggregate, distribute much greater percentages of their assets. In fact, it is not uncommon for a DAF to distribute 100 percent of its contributions within a year of contribution.

Unlike many PFs, DAFs and SOs involve management by public charities unrelated to the donors. These unrelated managers are well aware of their responsibilities and potential liabilities in managing the DAF or SO. In addition, the need to present proposed actions to unrelated managers causes self-regulation by donors who know that any proposal will have to be justified to the public charity's board of directors. Having the donors accountable to the unrelated organization also reduces potential abuse, thereby reducing the need for Internal Revenue Service oversight.

DAFs provide many unique advantages to donors. DAFs are routinely used to facilitate gifts to public charities. Many charities do not have the expertise to accept gifts of real estate, private stock and other assets with special considerations. A community foundation or other sponsor of DAFs may process the gift for one or more charities and distribute the proceeds to them. PFs are not a practical alternative because of the limitations on the tax deduction for the donor and the limitations on assets that PFs can accept.

DAFs can accept gifts on behalf of a charity that is awaiting its Internal Revenue Service determination letter. PFs in particular are reluctant to make grants to a charity that has not yet received its determination letter. Consequently, such a charity would miss out on needed start-up funding.

Organizations that sponsor DAFs and SOs provide a donor with investment advice to maximize the amount available for charitable funding. Sponsoring organizations can also make recommendations for achieving a particular donor's charitable goals and bring together other donors to achieve common goals they may not be able to achieve on their own. DAFs enable a donor new to charitable giving arrangements to test out his or her philanthropy goals before incurring the expense of creating a PF to achieve these same goals.

PFs have significant start-up and administrative costs and have a psychology of permanence. While they are an important long-term source of funding for the charitable sector, the benefit they provide will almost always be spread over a long period of time. DAFs, on the other hand, provide the most immediate benefit to charities and experience the highest payout percentages as compared to SOs and PFs. DAFs are routinely suggested as a vehicle to allow a donor to make a single gift that will be distributed to charities within a year. For a donor facing timing issues with respect to making a gift (*e.g.*, providing disaster relief or a possible sale of an asset), the simplicity of creation, low cost and flexibility of the DAF encourage charitable giving that might not otherwise occur. A donor who has timing issues with respect to a gift of $10,000 can easily create a DAF but would never consider a PF because the donation would likely be eaten up by start-up costs. Indeed, a PF for a short term would almost never be practical given the amount of resources and time that it takes to create a PF.

DAFs allow donors at more modest levels to have flexibility in giving, making philanthropy more attractive to a donor at a five, six or even low seven figure giving level. While some of these benefits can be enjoyed with direct gifts, the flexibility of the DAF may be the key difference between making or not making the gift, or at least the amount of the gift.

DAFs provide a significant administrative benefit to the Internal Revenue Service. They eliminate the need for processing separate information returns and for oversight of the individual accounts.

SOs also serve an important role in charitable giving. SOs generally involve significant participation by the supported public charities. While an SO is not subject to a minimum distribution requirement like PFs, the presence of the public charity's board of directors brings a sense of immediacy to the SO's board of directors, encouraging distributions.

SOs are routinely used by public charities that wish to create a new entity for liability purposes such as hospital fundraising foundations. An SO is also useful when a charity wants different governing boards for different aspects of its operations. For example, one board may manage the exempt purpose activities of the charity while an SO may be established to hold the endowment with a governing board focus on investment expertise. Generally, a PF would be unattractive to a public charity for these functions, and the activities might not otherwise qualify for public charity status absent the SO rules.

SOs are also used by public charities working together jointly to carry out a charitable purpose. The operations of the joint charity may be limited in a PF, and the joint activities or funding may not qualify for public charity status.

In short, DAFs and SOs serve a vital role to the charitable sector that cannot be filled by the other public charity classifications or by PFs. These structures are important to charitable giving arrangements because they increase overall giving to the charitable sector and are essential to the structuring of its operations. The direct benefits that DAFs and SOs provide justify treating them as public charities for all purposes, including charitable contribution deductions. Indeed, public charity treatment is essential to allow DAFs and SOs to serve their vital missions. However, the restrictions imposed on DAFs and SOs by the PPA makes these charitable vehicles less attractive to donors and will reduce charitable giving overall.

B. Impact of the PPA on DAFs and SOs

Donor benefits from DAFs and SOs are best regulated under the excess benefit rules under section 4958 of the Code that existed prior to the PPA with one exception. Donors to other types of public charities receive the maximum charitable contribution deduction allowed under the Code even if they engage in transactions that do not violate the excess benefit transaction rules. To ensure that excess benefit standards and scrutiny are applied to transactions that may involve the donor or a related party, it is appropriate to treat the donor to a DAF as a disqualified person with respect to transactions related to the DAF. Such treatment will ensure that the public charity analyzes any such transaction as a potential excess benefit transaction and takes the appropriate steps to ensure that no excess benefit is provided to the donor.

The automatic excess benefit rules added to section 4958 of the Code by the PPA, on the other hand, are not an appropriate mechanism to address DAFs and SOs. The automatic excess benefit rules implicitly assume that the managers of DAFs and SOs will not review transactions with related parties as carefully as managers of other public charities that are not DAFs or SOs. Experience does not support this assumption. As noted above, these managers take their obligations seriously and are aware of their potential liabilities. As with other types of public charities, there will be lapses in oversight by managers of some DAFs and SOs, but these lapses should be dealt with on an individual basis as is done with other public charities. There is no evidence that DAFs and SOs experience greater mismanagement than other public charities.

The provisions of the PPA have and will continue to adversely impact charitable giving. The complexity and ambiguity of the provisions have already forced DAF sponsors and SOs to incur significant compliance costs. The distribution limits on DAFs significantly and unduly restrict the flexibility of DAFs. There is no evidence to conclude that wide spread abuses of DAF distributions to individuals existed, and yet many legitimate DAF charitable programs that assisted individuals in need have been forced to terminate.

While there was no wide spread abuse of compensation from DAFs and SOs, the automatic excess benefit rules under section 4958 of the Code have forced the termination of many legitimate employment relationships. The onerous effective dates caused needless anxiety and expense for DAFs and SOs with such relationships. The automatic excess benefit rules are particularly problematic for SOs, which as legal entities, often require employees and impose legitimate expenses upon their officers and directors that should be reimbursed or paid by the SO as part of its administrative costs.

Furthermore, the provisions of the PPA result in traps for the unwary. For example, a donor who intended to run fundraising events out of a DAF is now prohibited from being reimbursed for any expenses by the DAF because the reimbursement would be an automatic excess benefit even if the expenses are reasonable. Such expenses may also be a taxable distribution under section 4966 of the Code as distributions to individuals are strictly prohibited from a DAF. Donors who put funds for fundraising expenses into a DAF prior to the PPA have no way of pulling those funds out of the DAF. Donors who create a DAF after the PPA must be aware of this rule and reserve some of the funding to fund fundraising events, resulting in a trap for the unsophisticated donor. The consequences of these rules result in donors being less inclined to conduct fundraisers, resulting in less funding going to the charitable sector.

Additionally, there is insufficient guidance on how to apply the PPA provisions to DAFs and SOs. It is not clear what types of payments from DAFs and SOs would be considered a payment similar to a grant, loan or compensation under the automatic excess benefit transaction rules. Would this include the payment of a donor's personal pledge that is satisfied through the donor's DAF? It is not a direct payment from the donor but it alleviates an obligation of the donor and consequently, has been held as an act of self-dealing in the PF context.

On the other hand, the satisfaction of a donor's pledge may properly be addressed under the rules of prohibited benefit transactions under section 4967 of the Code. A prohibited benefit includes a distribution on which a donor of a DAF provides advice and that results in the donor receiving, directly or indirectly, a "more than incidental benefit." The legislative history states that "[i]n general, a distribution results in a more than incidental benefit if, as a result of a distribution from a DAF, a disqualified person 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." The satisfaction of a pledge would have been tax deductible as a charitable contribution to the donor so it appears to be excluded from the definition of a prohibited benefit and, therefore, permitted under section 4967 of the Code.

The problem with this uncertainty for the donor is that correction and the excise taxes imposed on the transaction are not the same. A donor who is not sure which rules properly apply must guess. If the donor does not come to the same conclusion as the Internal Revenue Service, the donor will be subject to additional failure to report and failure to pay penalties, resulting in another trap for the unwary.

Another question on the minds of DAF donors is whether a donor can purchase tickets to a charitable fundraising event which the donor attends if the donor bifurcates the cost of the ticket by paying for the non-deductible portion of the ticket himself or herself and having the DAF pay for the portion of the ticket that would result in a charitable contribution deduction. A payment by the DAF for only the charitable portion, with the donor paying the non-deductible portion, should not result in the donor receiving a prohibited benefit, because the amount that would have reduced (or eliminated) the charitable contribution deduction is not being paid out of the DAF. However, the answer is unclear given the conflicting guidance that the Internal Revenue Service has issued in the PF context with respect to the self-dealing rules.

All of the uncertainty caused by the PPA will inevitably reduce charitable giving because donors and sponsoring organizations will not want to make distributions that may later be determined to be a prohibited distribution and subject to excise taxes by the Internal Revenue Service in the future. This uncertainty, coupled with the PPA making DAFs and SOs less flexible, will discourage some donations and encourage other donors to form PFs, thereby reducing and deferring the amount that will go to the charitable sector. For active philanthropists with diverse sources of gifts and activities, the PPA will require the formation of multiple entities in order to accomplish goals that might have previously been accomplished with a single DAF or SO. Multiple entities increase the administrative costs of the philanthropy, reducing its overall benefit. Multiple entities also add to the return processing and compliance burden of the Internal Revenue Service.

C. Conclusion

Public charities and donors make routine and wide-spread use of DAFs and SOs to carryout the important work of the non-profit sector in the United States. The existing provisions of the PPA and any further regulation should be based on a study of the operations of all DAFs and SOs, not widely reported actions of a few DAFs and SOs. There is no basis to conclude that sponsors of DAFs and SOs are less compliant with tax and fiduciary requirements than managers of other public charities. Accordingly, DAFs and SOs should be accorded the same flexibility and benefits given to other public charities.

As a final note, in contrasting PFs with DAFs and SOs, we do not intend to diminish the vital role that PFs play in the non-profit sector. PFs are the endowment of the non-profit sector and often are the first source of funds for new and innovative programs. PFs, however, have limitations that would make it impossible for them to fulfill the roles of DAFs and SOs. As important as PFs are, if DAFs or SOs are not available or are subject are further limitations, the non-profit sector will be diminished.

If you wish to contact the firm regarding these comments, please do not hesitate to contact Reynolds T. Cafferata, William C. Choi or Shannon M. Paresa.

Samaritan's Purse
Boone, North Carolina 28607
July 26, 2007

Oversight Committee
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Honorable Members of the Subcommittee:

Samaritan's Purse is grateful for dozens of gifts totaling hundreds of thousands of dollars donors have contributed from their IRAs pursuant to the Philanthropy Protection Act of 2006 (PPA). We would encourage the permanent extension of the charitable IRA rollover provisions of the PPA continued for those who have attained age 70½. We also believe that expanding the law to allow transfers into planned giving arrangements such as Charitable Remainder Trusts and Gift Annuities for those who have attained 59½ would be in the best interests of donors/taxpayers, charities and those they serve, and the government. Further expanding the provisions to include rollover gifts from other qualified retirement accounts and tax-deferred annuities would likewise create a winning combination. We believe that these provisions likely would accomplish the following:

1. Samaritan's Purse could help more victims of war, poverty, disease, natural disasters and famine.

2. Many charities would be able to help more people who otherwise would be dependent on government or would go without help.

3. Large amounts of money currently sitting out of the reach of taxes in retirement and tax-deferred annuity accounts would be moved into planned-gift arrangements that will pay out income to the donors. That income would be fully taxable during the lifetime of its recipient. The income amount paid to a taxpayer from a gift annuity or charitable trust in many cases would exceed the Required Minimum Distribution (RMD) amount for many donors over age 70½. This would increase tax revenues.

4. For donors between 59½ and 70½, there is great reluctance to withdraw funds from a tax-deferred account because of the tax on such withdrawals. If such donors were allowed to roll over such funds into a charitable trust or gift annuity, many would be highly motivated by the ability to make a greater difference through their

favorite charities with the initial tax disincentive removed. We have talked to numerous donors both under and over 70½ who would be willing to pay tax on their income from the trust or annuity if they are able to avoid taxation on moving funds from the tax-deferred account to the charitable gift plan. The result would be increased tax revenues.

5. Many donors withdraw only the RMD from their retirement accounts until they die, after which they give all or a portion of the account to charity. This means no income tax is ever collected on the remaining tax-deferred funds. Allowing tax-free rollovers into charitable trusts and annuities means that some of this tax-deferred money would be taxed as it is paid out to donors through the trust income or annuity payments.

Thank you for considering the extension and expansion of the IRA charitable rollover gift provisions in the Philanthropy Protection Act of 2006.

Sincerely,

James J. Loscheider
Vice President of Donor Ministries

Steve Nickel, J.D.
Senior Gift Planning Counsel

Schwab Charitable Fund
San Francisco, California 94104
July 30, 2007

The Honorable John Lewis, Chairman
House Ways and Means Oversight Subcommittee
1136 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you very much for the opportunity to submit written comments on the provisions relating to tax-exempt organizations contained in the Pension Protection Act of 2006 (P.L. 109–280). On behalf of the Schwab Charitable Fund, I am writing to share our views on how the Pension Protection Act of 2006 ("PPA") has affected our operations, and to suggest two areas in need of improvement.

The Schwab Charitable Fund is an independent, non-profit organization that is recognized as a tax-exempt public charity. The Charitable Fund was launched in September 1999 and had received more than $2.2 billion in contributions as of June 30, 2007. Currently, the Charitable Fund has 8,340 accounts (called "Charitable Gift Accounts"). A donor can contribute $10,000 or more to open a Charitable Gift Account. A significant majority of charitable gift accounts have assets of less than $50,000. Since inception, the Charitable Fund has made more than 155,000 individual grants totaling $673 million to more than 32,000 different charitable organizations. More than 31 percent of all donations made to the Charitable Fund have been granted to public charities throughout the country, in every state in the union. In 2006, the Charitable Fund received more than $700 million in donations, a record and a 28% increase over 2005. More than $215 million was granted to over 15,000 charities in 2006 alone.

The Pension Protection Act contains a number of provisions affecting donor-advised funds held by charitable organizations. The Charitable Fund supports many of the new provisions, particularly the Section 4967 excise tax on prohibited benefits from donor-advised fund distributions. The Charitable Fund expects that most of the PPA's donor-advised fund provisions will have little effect on it because the provisions are consistent with longstanding Charitable Fund policies. In addition, the Charitable Fund is aware that the PPA included a requirement that the Department of the Treasury conduct a comprehensive study of donor-advised funds and report back to Congress with any recommendations for further legislation. The Charitable Fund has been actively involved in this process by submitting a detailed comment letter about the Fund's operations and policies, and by meeting directly with IRS and Treasury staff to answer questions. Our comment letter to the Treasury Department provides a more comprehensive review of the Charitable Fund and its policies, and also addresses a number of specific questions posed by Treasury in their request for comment. We would be happy to provide a copy of that comment letter to the Committee if that would be helpful.

For the purposes of the Committee's request, we will limit our comments to two areas of the PPA that have already proven to be problematic: the prohibition on rolling IRA funds directly to a donor-advised fund, and the restriction in new section 4966 on making grants to "disqualified supporting organizations."

IRA Charitable Rollover

The Pension Protection Act included a provision allowing individuals age 70½ and over to make charitable donations of up to $100,000 from IRAs and Roth IRAs directly to a charity without having to count the distributions as taxable income. According to data collected by the National Committee on Planned Giving, more than $75 million was donated to charity during the first 10 months after enactment of the legislation, in gifts ranging from $25 to $100,000.[1] None of those dollars, however, were donated to a donor-advised fund, because donor-advised funds were specifically excluded from the definition of "eligible charity" in the legislation.

The Schwab Charitable Fund believes strongly that the IRA Charitable Rollover provision, which is set to expire at the end of 2007, should be made permanent and that it should be expanded so that individuals can make IRA and Roth IRA distributions to donor-advised funds. Representatives Earl Pomeroy (D–ND) and Wally Herger (R–CA) have introduced legislation, the Public Good IRA Rollover Act of 2007 (H.R. 1419), that will accomplish both goals. Their bill, a companion of which has been introduced in the Senate, has attracted a bipartisan group of more than 50 Members of Congress. There is virtually no disagreement that permitting rollovers from IRAs directly to charities has been a positive development for charitable giving, as the $75 million donated to date attests. Awareness of this option for contributing to charity is still relatively low, given the short amount of time financial institutions and financial planners have had to promote it to their clients. By making the charitable rollover permanent, charitable contributions from IRAs should continue to rise significantly. Congress should quickly make this provision permanent so as not to slow the growing momentum from their important new mechanism for philanthropy.

Given that contributions to donor-advised funds also represent irrevocable gifts to charity, it is important that donor-advised funds also be allowed to accept these IRA distributions. Donor-advised funds bring a number of advantages to the philanthropic arena, including:

- Providing liquid assets readily available to respond quickly to natural disasters;
- Maintaining a source of funds for charitable giving during downturns in the economy;
- Reducing the red tape, time pressure, and administrative burdens that often get in the way of giving;
- Enabling donors to research charitable organizations and find a matches for their interests; and
- Establishing a legacy of charitable giving that can involve the whole family and be passed on to future generations.

In summary, they simplify the process of giving for the donor, particularly if the donor wants to use his or her IRA funds to give to multiple charities. Donor-advised funds can play an important role in helping individuals make the most of the IRA charitable rollover.

The PPA and the legislative history underlying it provide no rationale for why IRA holders were not allowed to send distributions directly to a donor-advised fund, and there is no policy reason for their exclusion. Passage of the Public Good IRA Rollover Act of 2007 would ensure that donor-advised fund holders could take advantage of this important new mechanism for philanthropy. I urge the Committee to bring this legislation to a vote at the earliest opportunity.

Restrictions on Grants to "Disqualified Supporting Organizations"

The other provision of the PPA that has already begun to have a significant impact on the Charitable Fund's operations is the restriction in new Section 4966 on making grants to "disqualified supporting organizations," as defined in Section 4966(d)(4). On December 4, 2006, the Internal Revenue Service issued Notice 2006–109, which provides interim guidance on several issues, including how donor-advised funds can determine whether a potential grantee is a disqualified supporting organization. As a result of Section 4966 and Notice 2006–109, the Charitable Fund has instituted new due diligence procedures designed to determine (1) whether a public

[1] "NCPG Survey of IRA Distributions to Charity: Results as of June 4, 2007," National Committee on Planned Giving, p. 1. Available at http://www.ncpg.org/gov_relations/NCPG%20IRA%20Survey%206-4-07.pdf.

charity is a supporting organization; (2) if so, whether it is a Type I, II or III supporting organization; and (3) if it is a Type III supporting organization, whether it is functionally integrated. The Charitable Fund must also determine if the donor or donor-advisor directly or indirectly controls a supported organization of the supporting organization (as described in Section 4966(d)(4)(A)(ii)(I)). These determinations are often difficult for the grantor and time-consuming for both the grantor and the grantee.

The Charitable Fund anticipates that relatively few of its recommended grantees will be Type III supporting organizations that are not functionally integrated and even fewer will be subject to the control relationship described in Section 4966(d)(4)(A)(ii)(I). Given that the Charitable Fund makes hundreds of grants to supporting organizations each year, the Charitable Fund believes that more practical and efficient procedures are needed for determining a supporting organization's status. Several proposals have been suggested, including permitting reliance by grantors on a grantee's representation of its status as reported on its most recent Form 990 or on an affidavit. The Charitable Fund supports these proposals and any others that would simplify the process of making grants to supporting organizations.

As the Committee continues its review of the tax-exempt provisions of the PPA, please do not hesitate to contact me if I can answer questions or provide additional information.

Sincerely,

Kim Wright-Violich
President

Statement of Senator Byron Dorgan

Chairman Lewis, Ranking Member Ramstad and other distinguished Subcommittee Members, I appreciate this opportunity to visit with you today about one of the most important charitable giving tax incentives that Congress has passed in decades.

Last summer, the Congress passed and the President signed into law a major bill to reform our pension laws. This 392-page bill contained a little noticed but important new charitable giving tax incentive.

For the first time, the Tax Code permitted taxpayers who have reached age 70½ to give money directly from their individual retirement accounts (IRAs) to qualifying charities on a tax-free basis without the need to worry about complicated adjusted gross income and other restrictions that otherwise would apply to tax deductible charitable contributions. The charitable IRA rollover provision in H.R. 4 applied only for direct IRA gifts, is capped and is available for a limited time—expiring at the end of this year.

In fact, the charitable IRA rollover provision in H.R. 4 adopted the same general approach of legislation for direct IRA gifts that I have been working on called the Public Good IRA Rollover Act with Senator Snowe of Maine and several of our Senate colleagues.

Before the charitable IRA rollover was enacted into law, I was told by many charities that potential donors frequently asked about using their IRAs to make charitable donations but decided against such gifts after they were told about the potential tax consequences under then-current tax law. I am pleased to report that the charitable community is feeling a positive impact of the new charitable IRA rollover measure. According to a survey conducted by the National Committee on Planned Giving, over 4,000 IRA donations totaling more than $80 million have been made to eligible charities since the tax-free IRA rollover provision took effect last August.

I'm told that the IRA rollovers have resulted in significant gifts in North Dakota. For example, it reportedly inspired a donor to Lutheran Social Services of North Dakota to contribute $15,000, an amount higher than the donor's typical gift. This charitable gift will help the organization to continue its diverse programs in such areas as adoption services, counseling for at-risk youth, economic self-sufficiency for refugees, and services for farmers and ranchers. Lutheran Social Services believes that the IRA rollover provision encourages people to give more and to continue giving. The University of Mary has received five IRA gifts totaling some $280,000. The Theodore Roosevelt Medora Foundation has received four IRA gifts and commitments of over $300,000. Jamestown College received fourteen IRA gifts totaling $130,000. Other North Dakota charities, including Catholic Health Services for Western North Dakota, have benefited from tax-free IRA gifts as well. Hillsboro Medical Center Foundation has received nearly $20,000 in IRA rollover commitments that will help build a new nursing home, an assisted living facilities and needed hospital improvements. Most recently, the State Historical Society of North Dakota Foundation has endorsed the bill.

The positive results are undeniable: the temporary charitable IRA rollover incentive is working well and making a difference in the lives of people who are assisted by the nation's network of charities. But we can even do better. That's why the Public Good IRA Rollover Act that we have introduced in the 110th Congress would remove its current dollar cap, expand it to allow taxpayers who have attained age 59½ to make life-income gifts and by make it a permanent part of the Tax Code.

Mr. President, with the help and hard work of the Independent Sector the charitable IRA rollover approach in this legislation has been endorsed by nearly 900 charitable organizations, including: the American Cancer Society, the American Red Cross and American Heart Association, America's Second Harvest, American Association of Museums, Big Brothers Big Sisters of America, Ducks Unlimited, Easter Seals, Goodwill, Lutheran Services of America, March of Dimes, the Salvation Army, United Jewish Communities, United Way of America, Volunteers of America, YMCA of the USA, Prairie Public Broadcasting, the North Dakota Community Foundation and many others. I am very pleased that the U.S. Senate is previously on record in support of the Public Good IRA Rollover Act in its entirety. In doing so, the Senate recognized that the charitable IRA rollover is an important tool for charities to use to raise the funds they need to serve those in need, especially when government assistance is not available.

The Bush Administration supports charitable IRA rollovers. In his FY 2008 budget submission, President Bush has proposed making permanent the limited tax-free charitable IRA distributions provision passed last summer that is scheduled to expire at the end of this year. While the President's charitable IRA proposal has merit, the Public Good IRA Rollover Act is superior in one important respect: by allowing tax-free life-income gifts from an IRA whose owner has attained the age of 59½.

In addition to direct IRA gifts, many charities use life-income gifts to secure funds today to meet their future needs. Life-income gifts involve the donation of assets to a charity, where the giver retains an income stream from those assets for a defined period.

The benefit of allowing life-income gifts at an earlier age is twofold. First, the life-income gift provision would stimulate additional charitable giving. The evidence also suggests that people who make life-income gifts often become more involved with charities. They serve as volunteers, urge their friends and colleagues to make charitable gifts and frequently set up additional provisions for charity in their life-time giving plans and at death. Second, this approach comes at little or no extra cost to the government when compared to other major charitable IRA rollover proposals.

Life-income gifts are an important tool for charities to raise funds, and would receive a substantial boost if they could be made from IRAs without adverse tax consequences. But life-income gifts are not part of the administration's proposal. Again, the Public Good IRA Rollover Act permits individuals to make tax-free life-income gifts at the age of 59½.

In closing, Mr. Chairman, I hope your Subcommittee and the Full House Ways and Means Committee will act this year to permanently enact into law a tax-free IRA rollover provision that charities say is needed to encourage billions of dollars in new giving that will provide assistance to those who need it most.

Statement of Goodwill Industries International

On behalf of Goodwill Industries International, Inc., I am writing in response to the request by the House Ways and Means Subcommittee on Oversight for comments on the recently enacted Pension Protection Act of 2006 (P.L. 109–280).

Goodwill Industries International, Inc. is a network of 186 community-based, independent member organizations in the United States, Canada, and 14 other countries. Each organization serves people with disabilities, low-wage workers and other job seekers by providing education and career services, as well as job placement opportunities and post-employment support.

Through its services, the network helps people overcome barriers to employment and become independent, tax-paying members of their communities. In 2006, nearly one million people benefited from Goodwill's career services. Donations of clothing and household goods help to fund our mission.

The new law changes the tax treatment of donated clothing and household goods by allowing tax deductions only for such donated items that are in "good used condition or better.” Under the new provisions, however, a deduction is allowed regardless of the condition if the amount claimed for the item is more than $500 and the taxpayer has a qualified appraisal. The Internal Revenue Service (IRS), under the new law, can deny a deduction for the contribution of clothing or household items that have minimal monetary value, such as used socks and underwear.

The IRS has issued new guidance on these provisions in Publication 561 that references the price that buyers of used items actually pay in used clothing stores as an indication of value. We strongly support educating taxpayers about the new provisions. Many of our retail stores now include language on their donation receipts to indicate that “federal law provides that donated clothing and household items must be in good used condition or better for tax purposes.” In addition, many of our agencies offer sample valuation guides, that is, a guide with the selling price of a range of clothing and household goods to assist taxpayers in valuing their donations.

We have found, however, that much confusion still exists over this new law. Many of our donors have been told that they can no longer take any deductions for clothing and household goods. Others have been told that the charity must place a value on the item. The new law is clear that deductions still can be taken by the taxpayer as long as the new requirements are met and the onus remains with the taxpayer to value his or her items. The public needs to hear this message from the IRS.

We ask that you request the IRS to issue further guidance pointing out that, subject to these requirements, donations of clothing and household goods to charities like ours remain tax-deductible and serve a worthy public purpose.

If we can be of any assistance, please feel free to contact Lisa P. Kinard, Director of Public Policy and government Relations for Goodwill Industries International, Inc.

Statement of Stewart Mott Foundation

On behalf of the Charles Stewart Mott Foundation, these comments are submitted in response to the Advisory from the Committee on Ways and Means Subcommittee on Oversight, dated June 12, 2007, requesting comments from the public on the provisions relating to tax-exempt organizations contained in the Pension Protection Act of 2006 (PPA) (P.L. 109–280). We wish to comment on one provision of the PPA that affects the Charles Stewart Mott Foundation directly: the provision amending sections 4942(g) and 4945(d)(4)(A) of the Internal Revenue Code, restricting grants to supporting organizations by private foundations.

The Charles Stewart Mott Foundation is a private grant making foundation established in 1926 in Flint, Michigan. The Foundation’s mission is “to support efforts that promote a just, equitable and sustainable society.” The Foundation’s grant making activity is organized into four major programs: Civil Society, Environment, Flint area and Pathways Out of Poverty. Other grant making opportunities, which do not match the major programs, are investigated through the Foundation’s Exploratory and Special Projects program. In 2006, the Foundation’s grant actions totaled 545, and total grant payments were $122 million. The Foundation has assets in excess of $2.5 billion.

The PPA requires private foundations to exercise expenditure responsibility when making grants to Type III supporting organizations that are not functionally integrated. It also prohibits private foundations from counting such grants toward their annual minimum distribution requirement. Unfortunately, prior to the enactment of the PPA, the Internal Revenue Service (IRS) had never classified supporting organizations by type. The IRS also did not make determinations with respect to whether Type III supporting organizations are or are not functionally integrated. Private foundations are generally permitted to rely on IRS Publication 78 in determining when a grant requires the exercise of expenditure responsibility under section 4945 because the grantee is not a public charity. However, the IRS did not publish information about whether an organization’s public charity status was based on section 509(a)(1), section 509(a)(2), or section 509(a)(3) in Publication 78, so the Publication is not helpful to a foundation seeking to comply with this provision of the PPA.

The IRS Business Master File (BMF) is also available to download directly from the IRS Web site. Alternatively, on March 27, 2007, in the 2007–8 issue of EO Update, the IRS provided that a grantor may use a third party to obtain the BMF information. In this circumstance, the third party must provide the grantor the BMF information in a report that includes: (i) the grantee’s name, Employer Identification Number, and public charity status under section 509(a)(1), (2), or (3); (ii) a statement that the information is from the most currently available IRS monthly update to the BMF, along with the IRS BMF revision date; and (iii) the date and time of the grantor's research. The report must also be in a form which the grantor can store in hard copy or electronically. GuideStar's [1] Charity Check subscription service includes IRS Publication 78 information and has recently been enhanced to include information from the IRS BMF.

However, this information is still incomplete. The BMF includes the Code section under which an organization was classified as a public charity [that is, section 509(a)(1), (2), or (3)], but does not include the type of supporting organization or whether it is functionally integrated. As a result, a private foundation cannot rely on even this more detailed information when making a grant to a supporting organization.

In recognition of the difficulties faced by foundations when making grants to supporting organizations after passage of the PPA, the IRS issued interim guidance in Notice 2006–109, section 3.01. The guidance in the Notice, while helpful in the absence of legislation correcting the problems created by this provision of the PPA, requires a foundation to follow a cumbersome process to determine whether a grantee is a Type I, Type II, or functionally integrated Type III supporting organization. This process requires a grantor to collect and review specified documents and a written representation signed by an officer, director, or trustee of a supporting organization grantee and to make its own determination, acting in good faith, as to the status of the grantee. (As an alternative, a grantor may rely on a reasoned written opinion of counsel of either the grantor or the grantee concluding that the grantee is a Type I, Type II, or functionally integrated Type III supporting organization.)

We have found that the collection and review of the specified documents, including copies of governing documents of the grantee and, if relevant, of the supported organization(s), is a time-consuming and burdensome process for both the grantor and grantee. Even for a larger foundation like the Charles Stewart Mott Foundation, which has the resources to try to follow the guidance in the Notice, the process increases substantially the cost of making a grant to a supporting organization and the time required to process the grant. It also means that many smaller grants (including grants under matching gift programs) are cost-prohibitive and simply will not be made. And it means that many smaller foundations, without the resources to apply the guidance in the Notice, may just stop making grants to supporting organizations.

Other commenters have reached similar conclusions. On June 4, 2007, the American Bar Association Section of Taxation submitted comments to the IRS on Notice 2006–109. As the Section notes on p. 59 of its comments:

> "While the procedures of Notice 2006–109 are helpful in that they set out safe harbors, the procedures are often impractical, time-consuming and expensive. The result is that many donors will simply forego making contributions to [supporting organizations]."

In its comments, the section makes a number of recommendations to address the problems posed by this section of the PPA. In all, the section's recommendations and discussion on this provision of the PPA run to over six single-spaced pages. Key to the recommendations is the proposal that the IRS expand its existing determination letter program to further classify supporting organizations as Type I, II, or III (and whether a Type III is functionally related) and that the IRS embark on a program to so reclassify all existing supporting organizations. We wonder whether an already overburdened IRS can even consider such a proposal. Indeed, the extent and nature of the section's comments suggest to us that the problems posed by the provision cannot be fixed administratively.

We acknowledge there have been instances in which individuals have misused supporting organizations for their personal benefit. We also believe that many of the changes made by the PPA effectively address these abuses. However, we think the changes made by the provision we are discussing here go too far. They may have some corrective effect on the abuses noted by Congress (although we believe those abuses are adequately addressed elsewhere in the PPA). But they impede legitimate, routine grant making by private foundations to supporting organizations to such an extent that whatever corrective effect they have is far outweighed by the restrictions they impose on foundation philanthropy.

For that reason, we recommend that Congress repeal this provision of the PPA. If repeal is not possible, we join in the call from Steve Gunderson, President and chief executive officer of the Council on Foundations, in testimony before the Subcommittee on July 24, that Congress temporarily suspend the penalties for making

[1] GuideStar is the operating name and registered trademark of Philanthropic Research, Inc., a 501(c)(3) public charity. GuideStar is a third party database of information on all IRS-recognized 501(c)(3) nonprofit organizations eligible to receive tax-deductible contributions.

grants to certain supporting organizations until the IRS can reliably identify those organizations.

We appreciate the Committee's attention to this important issue, and we thank you for the opportunity to provide these comments.

Respectfully submitted,

Phillip H. Peters
Group Vice President-Administration and Secretary/Treasurer

Statement of Studio Museum in Harlem

Thank you for your call for comments on provisions of the Pension Protection Act of 2006 (PPA). My name is Thelma Golden, and I am the Director and Chief Curator of The Studio Museum in Harlem. I am writing with respect to section 1218 of PPA, which has restricted "fractional" gifts of art and collectibles to museums.

Section 1218's two major restrictions are:

- Donors must complete gifts in ten years. Previously, there was no time limit.
- Donors may no longer claim a tax deduction for the fair market value of the work after the initial fraction, no matter how much it may have risen in subsequent years. Previously, each fraction could be deducted at its actual fair market value.

By discouraging generosity, Section 1218 has practically destroyed one of the most effective means of transferring private wealth to the public sector. Further, it has greatly curtailed museums' ability to build their collections, because most museums rely mainly on private gifts, especially at a time of rising prices in the art market.

In the case of the Studio Museum in Harlem, we have 13 fractional gifts in progress. We have had no new fractional gifts since the PPA. These 13 gifts are a significant addition to our growing collection, and represent works made by some of the leading artists of African descent working today.

The old law worked well for museums, donors, and the public. It was both flexible and fair. Now, works of art will remain in private homes and hands, unseen by the public, and rarely used by scholars and art historians, and people will not donate fractional gifts until much later in their life. Meanwhile, the museum has no guarantee that the gift will actually be made; it could fall victim to financial problems or family disagreements. Allowing donors to give the first fraction earlier rather than later has the effect of "locking in" the gift.

Finally the fact that PPA did not "grandfather" gifts that were already in the process of being made means that many current gifts have been stopped cold. In other words, people who gave an initial fraction, relying on their future ability to give subsequent fractions and claim deductions for fair market value, now have no reason to continue giving while they are alive. The only way that they can preserve a full deduction, instead, is to bequeath the work upon their death.

Thank your for your interest in this matter. I would be happy to answer any questions that Members of the Subcommittee may have.

The Meadows Foundation
Dallas, Texas 75204
August 6, 2007

The Honorable John Lewis, Chairman
Subcommittee on Oversight, Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Lewis:

I am writing today on behalf of the Meadows Foundation, Inc. (The Meadows Foundation), of Dallas, Texas, in response to your Subcommittee's request of June 12, 2007, for comments regarding the Pension Protection Act of 2006, P.L. 109–280 ("2006 PPA"). We would first like to express our appreciation to you and Members of your Subcommittee for your willingness to consider and re-evaluate the provisions of the 2006 PPA, many of which are complex and most of which were not the subject of Committee hearings in the House of Representatives during the 109th Congress.

The Meadows Foundation, Inc. is a private foundation. Accordingly, while there are likely a number of provisions in the 2006 PPA that deserve re-examination, our comments focus on two provisions of the 2006 PPA that directly impact private foundations and that we believe to be based on unsound policy. Our comments are as follows.

Grants from Private Foundations to Supporting Organizations

Since 1969, private foundations have been significantly limited in the types of charitable grants they can make. Under section 4945, certain grants to individuals can be made only under programs pre-approved by the IRS, and grants to charitable organizations have been limited to public charities and exempt operating foundations, unless the foundation complies with the detailed requirements for exercising expenditure responsibility.[1] Grants that do not comply with these limitations are subject to prohibitive excise taxes under section 4945.

The 2006 PPA amended Section 4945(d) to further limit the types of charitable grants that can be made by private foundations. As amended, Section 4945(d)(4) now also prohibits private foundations from making grants to certain types of supporting organizations unless the foundation complies with the detailed requirements for exercising expenditure responsibility. Technically, this new limitation applies to grants to type III supporting organizations that are not "functionally integrated" and grants to any other supporting organization that is directly or indirectly controlled by, or whose supported organization is directly or indirectly controlled by, a disqualified person of the foundation that makes the grant. I.R.C. § 4945(d)(4).[2]

As a practical matter, the Section 4945 rules added by the 2006 PPA have created a situation where a private foundation cannot make a grant to *any* supporting organization without risking a Section 4945 excise tax. This is because (a) the IRS has only recently begun including in determination letters of supporting organizations a statement of which "type" they are; (b) the IRS has not included in determination letters of supporting organizations a statement of whether they are "functionally integrated"; and (c) even if those details were covered in determination letters, there could still be a risk in some situations because of the above-described control prohibition. The Meadows Foundation is concerned that a number of our current and former grantees and other nonprofits organizations fall into this category. Let me give you some examples.

The Center for Nonprofit Management Assistance Loan Fund was created as a support organization to provide cash flow loans to nonprofits dependent on contracts that were slow to pay. It is a support organization that has proven very effective in raising funds to loan out yet remains controlled by the Center for Nonprofit Management. It was created by The Meadows Foundation.

The Children's Medical Center Foundation of Central Texas is a support organization that was created to assist in the development of a new children's hospital to serve the central part of Texas. It is located in Austin and has been a good funding partner for the Foundation.

The College For All Texans: Closing The Gaps is a support organization located in Austin to serve the entire State. It raises funds to help students attend college who normally would not have considered it. It is a support organization that has worked well to raise funds and public awareness of this issue. It has also been a good partner in assisting the Foundation in its work in education.

Presbyterian Healthcare Foundation is a support organization that assists in fundraising for one Dallas' largest public hospitals. The Foundation's founder, Algur Meadows, gave the land for the original campus that is still in use. This support organization does a wonderful job and remains a longstanding partner of The Meadows Foundation.

Starr County Historical Foundation is located in Rio Grande City, along the border, and supports historical preservation and adaptive reuse strategies in border communities. It is an excellent partner of The Meadows Foundation as it works in the border region of Texas.

There are many other examples that I could have provided, but I hope these make the point.

IRS Notice 2006–109 sets forth procedures that a private foundation can use to conclude that a supporting organization is not covered by the above-described limi-

[1] Except as otherwise indicated, all references herein to Sections refer to sections of the Internal Revenue Code 1986, as amended ("I.R.C.").

[2] The 2006 PPA added a similar provision to Section 4942 so that grants to those same supporting organizations will also fail to be treated as qualifying distributions. That treatment applies even if the foundation complies with the detailed requirements for exercising expenditure responsibility. I.R.C. § 4942(g)(4)(A).

tations. Those procedures, however, require the private foundation to, at a minimum, review supporting documents and make a legal judgment unless the foundation or its grantee incurs the added expense of obtaining an opinion of counsel. Many private foundations will simply choose not to make grants to any supporting organizations rather than comply with the burdensome rules that govern which supporting organizations may receive grants. Because of the new Section 4945(d)(4) rules added by the 2006 PPA, The Meadows Foundation will no longer consider a grant to a supporting organization unless there is an extraordinary reason for the grant.

Charity functions best when organizations are able to identify and support a variety of different needs. Each new restriction on grants reduces the ability of a foundation to identify and support the needs of its community. Accordingly, restrictions should not be placed on foundation grants absent a compelling need. In the case of the 2006 PPA, there was no compelling need for the restrictions against grants from private foundations to supporting organizations.

There is also no obvious reason for the distinction created by the 2006 PPA between grants to functionally integrated and non-functionally integrated type III supporting organizations. The term "functionally integrated type III supporting organization" is defined by new Section 4943(f)(5)(B) to include any type III supporting organization that "is not required under regulations established by the Secretary to make payments to supported organizations—due to the activities of the organization related to performing the functions of, or carrying out the purposes of, such supported organizations." The definition apparently refers to the integral part test of Treas. Reg. § 1.509(a)-4(i)(3). That test requires, in part, that a type III supporting organization either (a) perform the functions of or carry out the purposes of its supported organizations; or (b) pay substantially all its income to or for the use of its supported organizations. In other words, type III supporting organizations that are not functionally integrated are already required to pay substantially all their income to their supported organizations. Given that requirement, the complexity involved in differentiating between functionally integrated and non functionally integrated type III supporting organizations does not seem justified.

In summary, the restrictions added by the 2006 PPA to grants from private foundations to supporting organizations should be repealed. The restrictions are highly complex and burdensome, and there was no compelling need for the restrictions. The restrictions serve only as additional burdens on private foundations that further restrict the ability of private foundations to identify and support the needs of their communities.

In a time of limited federal and state resources, private foundations are being asked to do more and more through their grantmaking. As we did when Katrina struck and are currently doing now in the wake of the disastrous flooding in Texas, The Meadows Foundation has voluntarily responded by providing funding and assistance to our nonprofit partners who are helping the families hurt by this natural disaster. Please allow us to remain flexible and able to respond when necessary without tying our hands in burdensome regulations.

Taxation of Charitable Use Assets

Section 4940 imposes a 2% excise tax on the "net investment income" of private foundations. The term "investment income" historically included only dividends, interest, rents, payments with respect to securities loans, royalties, and capital gains from the sale of properties used for the production of such income. The Treasury Regulations specifically excluded any capital gains from the sale of property used for charitable purposes. Treas. Reg. § 53.4940–1(f)(1) (not yet updated for the changes made by the 2006 PPA).

The 2006 PPA amended Section 4940(c) so that the section 4940 excise tax is now also imposed on capital gains from the sale of property used in a charitable activity if the property produced dividends, interest, rents, payments with respect to securities loans, royalties, or similar sources of income. The only exception to this taxation appears to be new Section 4940(c)(4)(D), which allows the tax to be deferred in the event of certain like kind exchanges.

We believe the extension of the section 4940 tax so that it now taxes the capital gains of charitable use property reflects a poor policy decision that should be reversed. There is no policy objective achieved by the tax, other than raising additional revenues for the Federal government. The decision to raise those revenues from charities was regrettable. Charitable organizations have traditionally been looked upon very favorably in this country, and have been granted tax-exempt status since 1894.[3] The imposition of a tax on the sale of charitable use property is far out of line with that traditional treatment. It also creates a disincentive for foundations to use property directly for charitable purposes. And it will increase the amount of funds that foundations must pay to the Federal government at a time of growing charitable needs in the communities supported by foundations. The likely end result will be an increased need for governmental assistance in those communities. Accordingly, we encourage the Committee to reconsider the expansion of the Section 4940 excise tax and to revise Section 4940 to reverse that expansion.

Mr. Chairman, one of the great traditions that sets our nation apart from others is our nonprofit sector and the spirit of philanthropy that generously donates billions of dollars each year to provide assistance and address real problems. We are privileged to do this work and take this responsibility very seriously. We appreciate the fact that private foundations are tax-exempt, although we do pay excise tax to the federal government each year, and are subject to oversight.

I am concerned that the burden of over regulation and unnecessary restrictions will having a chilling effect on philanthropy as we go forward. Please protect this important sector and allow it to flourish with Congressional support.

We appreciate your consideration of our comments and your willingness to reexamine some of the more complex and burdensome provisions of the 2006 PPA.

Sincerely,

Linda P. Evans
President and Chief Executive Officer

Una Chapman Cox Foundation
Corpus Christi, Texas 78470
August 7, 2007

The Honorable John Lewis, Chairman
Subcommittee on Oversight
Committee on Ways & Means
U.S. House of Representatives
343 Cannon House Office Building
Washington, D.C. 20515

The Honorable Jim Ramstad
Ranking Member
Subcommittee on Oversight
Committee on Ways & Means
U.S. House of Representatives
103 Cannon House Office Building
Washington, D.C. 20515

Dear Chairman Lewis and Congressman Ramstad:

I am writing to you to provide comments from the Una Chapman Cox Foundation ("UCC") pursuant to your request for comments from the nonprofit sector on the charitable provisions of the Pension Protection Act[1] (the "PPA"). For more than 25 years, UCC, a type III supporting organization to the United States Foreign Service, has been dedicated to enhancing the recruitment, professionalism and effectiveness of the Foreign Service; improving the well-being and retention of its best employees and their families; and increasing public knowledge and understanding of the Foreign Service and its role in supporting U.S. foreign policy and national security interests. Throughout this period UCC has had a close working relationship with the leadership of the Foreign Service, especially the State Department, and we have repeatedly received expressions of appreciation for UCC's efforts on the Foreign Service's behalf from State Department officials.

We thank the Subcommittee for this opportunity to voice our concerns regarding some of the new supporting organization provisions of the PPA and the broad discretion given to the Treasury Department to interpret these provisions in ways that may be harmful to efficient and effective supporting organizations like UCC.

Summary of Recommendations

For the reasons detailed below, we respectfully suggest that the supporting organization provisions of the PPA be revisited, as follows:

[3] *See* Revenue Act of 1894, ch. 349, § 32, 28 Stat. 509, 556 (1894).
[1] Pub. L. No. 109–280, 120 Stat. 780 (2006).

1. Congress should amend the PPA to define "functionally integrated" supporting organizations more specifically, so that organizations like UCC with a bona fide close operating relationship with their supported organization are not denied that status simply because they have an endowment or fail to meet other criteria imposed by Treasury from time to time. Specifically, type III supporting organizations like UCC that are performing activities in support of government entities should be classified as functionally integrated.

2. Congress should apply the favorable treatment of functionally integrated type III organizations to other type III organizations that satisfy the existing responsive requirement and that have no substantial contributor (nor any individual or entity that is a disqualified person by virtue of a relationship with a substantial contributor) involved in the management of their operations.

3. Congress should also direct Treasury not to impose a payout requirement on functionally integrated supporting organizations or, in the alternative, only to impose a flexible payout requirement that can be appropriately responsive to the needs of the supported organization(s).

Introduction

UCC supports both the recent revisions to the Form 990 that improve the transparency of supporting organizations as well as the IRS's increased scrutiny of supporting organizations and enforcement of the current regulatory standards. Certainly reports of individuals or families who used charities, in some cases supporting organizations, to enrich themselves are sobering and these abuses should be stopped. I am concerned, however, that in seeking to stop the abuses perpetrated by a few, the onerous restrictions imposed on type III supporting organizations by the PPA (and by new regulations the Treasury Department has been given broad discretion to develop) will also squelch the efforts of legitimate organizations, which provide vital support for countless charitable and governmental entities. Many harsh PPA provisions—such as those that have caused many private foundations to refrain from funding all type III supporting organizations (and sometimes all supporting organizations, whatever the type)—impair the good and the bad alike. And the Treasury Department has indicated in its recent Advance Notice of Proposed Rulemaking[2] that it is poised to extend by regulation the most onerous PPA provisions to an unknown number of additional organizations by denying functionally integrated status to many organizations that perform essential functions of their supported organizations, merely because they have more than 35% of their assets in an endowment or because the varying annual needs of the supported public charity (and thus the expenditures of the functionally integrated supporting organization) do not necessarily fluctuate directly with the supporting organization's annual income stream or stay above a fixed percentage of the supporting organization's assets.[3]

Background

UCC was established in 1980 by Mrs. Una Chapman Cox of Corpus Christi, Texas as a private foundation and, after her death, the bulk of her estate was added to UCC. After her death, there was no longer anyone who could control UCC who was a disqualified person (other than by virtue of being a foundation manager).[4] By letter dated July 8, 1988, the IRS recognized UCC's termination of its private foundation status, its close and continuing historic relationship with the Foreign Service, and its conversion to be a supporting organization of the Foreign Service described in Code section 509(a)(3).

UCC's focus is strengthening American diplomacy by enhancing the professionalism and effectiveness of Foreign Service officers and increasing public awareness of the Foreign Service. To do this, UCC functions as a think tank that both generates and stimulates ideas for improving the effectiveness of the Foreign Service and its personnel. UCC's Executive Director, the Honorable Clyde Taylor, a retired ambassador himself, and its policy council, comprised of distinguished current and former Foreign Service officers and respected academics, work together not only to identify opportunities for improvement of the Foreign Service, but also to evaluate a wide range of possible projects for UCC to undertake annually. The most promising projects are discussed in advance the Director General of the Foreign Service or with the appropriate officials at the supported government offices before

[2] Internal Revenue Service, Advance Notice of Proposed Rulemaking, "Payout Requirements for Type III Supporting Organizations That Are Not Functionally Integrated," 72 Fed. Reg. 42,335, 42,338 (Aug. 2, 2007) ("Advance Notice").

[3] *Id.*

[4] Mrs. Cox was married twice but had no children, and her second husband died before she did.

recommendations are made to the UCC Board. The UCC Board meets regularly with the Director General, and UCC's Executive Director and staff maintain a continuous liaison with the Director General and his or her staff to obtain guidance as necessary throughout the year.

Projects undertaken by UCC range from the annual sabbatical leave Fellowships initiated by Mrs. Cox that allow promising mid-level State Department officers to come home to the United States for a year to conduct outreach projects to several projects recently designed to support the recruiting of young officers. These include sponsoring overseas internships in the Charles Rangel Fellowship Foreign Service recruitment program at Howard University and working with the State Department to strengthen and enhance the officer intake process, which formerly has taken an average of 28 months.

Because the costs and expertise required for the various projects can vary significantly, UCC relies not only on its own resources but often works in collaboration with other organizations and with various governmental agencies. For example, for the production of "Profiles in Diplomacy," a documentary on the Foreign Service made for national television, UCC had to raise money from other organizations. For another project, the Commission on Advocacy of U.S. Interests Abroad, commonly called the Carlucci Commission, which reviewed the role of United States foreign assistance in advancing our National interests, UCC partnered with another funding organization. UCC also provides funding for some projects administered directly by the State Department (or another governmental agency), while for some other projects UCC implements them itself by engaging or funding third parties to perform the necessary activities.

UCC, like other supporting organizations for governmental entities, found the type III classification to be the most appropriate because such supporting organizations have governing boards that are independent of those of their supported entities, and it is often this independence from the government that allows organizations such as UCC to be most effective in supporting the designated governmental entity. As discussed further below, supporting organizations to governmental organizations, unlike supporting organizations to non-governmental organizations, also often cannot choose to be type I or type II supporting organizations, whose governing boards are controlled by or overlapping with those of the supported organizations, because of limitations on government employees serving on the boards of non-governmental entities.

Although not controlled by their supported organizations, type III supporting organizations such as UCC nevertheless must demonstrate that they have sufficiently close relationships with their supported organizations to justify public charity status. Under existing Treasury Regulations, a type III supporting organization does this by meeting two tests: a "responsiveness test" and an "integral part test." The responsiveness test requires that the supporting organization be responsive to the needs and desires of its supported organizations, while the integral part test requires that the support actually provided by the organization is substantial and necessary to the conduct of the supported organization's exempt activities. Together, these two tests ensure that, despite a supporting organization's independent management, it is operating closely with the supported organization in much the same way as a controlled subsidiary would.

Distinguished panelists at the Subcommittee's hearing on July 24, including Steven T. Miller, Commissioner of the Tax Exempt and Government Entities Division of the Internal Revenue Service, noted that the charitable sector is generally "very compliant" with the tax laws. Thus, although we support ridding the sector of those that enrich themselves at charities' expense, we do not understand the PPA's harsh treatment of all supporting organizations, and all type III supporting organizations in particular. UCC has for many years functioned hand in hand with the State Department (and other federal government agencies) to leverage its relatively modest resources to produce significant improvements in America's current and future diplomatic resources, and we urge you to allow us to continue to do so efficiently and effectively. For reasons described below, certain of the PPA provisions relating to type III supporting organizations, particularly as the Treasury Department is suggesting they be interpreted, will significantly impair UCC's ability to provide this assistance in the best manner possible.

Functionally Integrated and Non-Functionally Integrated Type III Supporting Organizations

When it enacted the PPA, Congress brought into the Code the longstanding regulatory distinction between type III supporting organizations that are "functionally integrated"—those that carry on activities that perform the functions of or carry out the purposes of their supported organization—and those that are not, directing the

Treasury Secretary to revise the payout requirement that has always applied to the latter.[5] As noted above, type III supporting organizations must be both responsive to and an integral part of their supported organizations in order to demonstrate the close relationship with a supported charity or governmental entity that is the defining characteristic of supporting organizations.[6] Those type IIIs that are not functionally integrated have effectively been subject to a payout requirement under the integral part test,[7] although many, including the Treasury Department in its recent Advance Notice of Proposed Rulemaking, have asserted that a payout requirement based on a percentage of the organization's assets (or on the lesser of a percentage of the organization's assets or its income) may be a more appropriate measure than the current regulatory requirement based on a percentage of income.[8]

In addition to a revised payout requirement, harsh new restrictions, including a virtual ban on private foundation funding and application of the private foundation limits on excess business holdings, were also imposed on non-functionally integrated supporting organizations.[9] This presumably reflects a view that non-functionally integrated supporting organizations are more likely to be subject to donor abuses and less likely to be effectively supervised by their supported organizations than are functionally integrated organizations. However, the recent Advance Notice of Proposed Rulemaking reveals Treasury's disposition to eliminate abusive situations regardless of the collateral damage done to legitimate supporting organizations. Treasury would vastly broaden the number of organizations subject to the new PPA restrictions by redrawing the definition of "functionally integrated" exceedingly narrowly.[10]

Where the proper relationship of accountability and responsiveness exists, however, the new provisions of the PPA that apply to non-functionally integrated type III supporting organizations are inappropriate. In such cases, the PPA's *per se* prohibitions are more likely to prevent activity that is actually in the supported entity's best interests than to stop abuse. The PPA and the pre-existing law recognized this fact with respect to type I and type II supporting organizations—entities controlled by, or under common control with, their supported organizations. With narrow exceptions, such organizations are not subject to any payout requirement nor to the PPA's restrictions on private foundation funding and business holdings. Similarly, if a type III supporting organization is functionally integrated (as such term is now defined with reference to current Treasury Regulations) and thus providing functional support to a charity or governmental entity in a manner that is consistently responsive to that entity's needs, it can be presumed that an accumulation of income in any given year is a proper means of conserving resources in order to provide the needed support at a later date. For such organizations, no payout requirement has ever been required and indeed is unnecessary, as such a payout requirement may force an organization to be *less* responsive and effective, providing more funds than the supported entity needs in one year at the expense of support in subsequent years. This puts the directors or trustees of the supporting organization in the difficult position of choosing between fulfilling their fiduciary duty to be a responsive and effective supporter and federal tax compliance.

Assuming Congress continues to distinguish between favored and disfavored type III organizations, it should recognize that there are type III supporting organizations that do not meet either of the proposed tests for functionally integrated status but which should be treated as functionally integrated because for them additional regulation is unnecessary. Already, both the American Bar Association and the Internal Revenue Service have identified parent organizations of hospital groups as organizations that should be treated as functionally integrated even if they do not technically meet the proposed tests for that status.[11] Similarly, we believe that Congress should extend similar protection to type III supporting organizations to governmental organizations, which—like hospital parent organizations—often do not have the option of becoming type I or II organizations.

Type III supporting organizations are particularly important in the governmental context for several reasons. First, federal or state government conflict of interest rules may prohibit control of a particular organization by government employees.

[5] PPA, § 1241(d), 120 Stat. at 1103; I.R.C. § 4943(f)(5).

[6] *See* Treas. Reg. § 1.509(a)-4(i)(2), -4(i)(3).

[7] *See* Treas. Reg. § 1.509(a)-4(i)(3)(iii).

[8] Advance Notice, 72 Fed. Reg. at 42,338–42,339.

[9] *See* I.R.C. §§ 4942(g)(4), 4943(f), 4945(d)(4). While private foundations are not categorically prohibited from making grants to non-functionally integrated type IIIs, they receive no credit toward their 5% payout for such grants, destroying their incentive to make them.

[10] *See* Advance Notice, 72 Fed. Reg. at 42,338.

[11] Letter from the American Bar Association Section of Taxation to Kevin Brown, Acting Commissioner of Internal Revenue at 53 (June 4, 2007); Advance Notice, 72 Fed. Reg. at 42,338.

This is true for UCC, where due to federal conflict of interest statutes it is the State Department's position that current Foreign Service employees (the people that the Foreign Service would most naturally appoint to control UCC) cannot be appointed to serve on the UCC Board. More fundamentally, putting the organization under governmental control would often defeat the purpose of providing support to a government entity in the first place. Often type III organizations are created to provide targeted support for a single purpose—in UCC's case, the strengthening of the Foreign Service—but if such organizations were controlled by the government, their funds could be redirected to other unrelated government purposes.

If this were allowed to occur, then private support for governmental programs would cease. Mrs. Cox was passionate about the value to America of a strong Foreign Service and was willing to devote her hard-earned assets to its support. She would not have made the same gift to the United States Treasury to fund any and all federal government programs. As was observed at the Subcommittee's hearing, our country's needs are too great for the government alone to meet and it is essential for private charitable organizations to partner with the government if we are to effectively meet the many challenges that we as a nation face. Imposing inflexible payout requirements can have a similar effect, as such requirements can force supporting organizations to transfer funds to a government entity that are not currently needed for additional programs and so may lead to government funds being reallocated to other government entities or priorities, undermining the very purpose of the private support, which is to provide additional support for particular government programs.

Governmental control may also make a supporting organization less effective. For example, UCC identified the need for a website to provide information about the Foreign Service to the public in order to increase the general knowledge of and support for the diplomatic corps, and more specifically to assist in recruiting talented young persons for Foreign Service careers. UCC then appropriately addressed this need by developing a website which provides a variety of information on the Foreign Service, its challenges, needs, and opportunities. One reason the website is effective is precisely because the content was produced by an independent, non-governmental entity, not by the Foreign Service itself. Similarly, in many cases it is essential that a supporting organization be strictly non-partisan. When an organization is controlled by the government, it may not be able to stay above the political fray—and even if it does, the mere fact of government control may be enough to create at least the appearance of partisanship.

Furthermore, governmental entities are unattractive supported organizations for donors who wish to use a supporting organization to provide improper benefits to themselves. While a type III supporting organization's support can be crucial in funding supplemental programs, governmental entities typically have their own large budgets and highly qualified staffs, making them immune to domination (or even undue influence) by a supporting organization's substantial contributors. They also typically have well-developed mechanisms for monitoring the appropriate use of funds, making them ideally suited to hold the supporting organization accountable for any abuses.

Recommendations with Regard to the Definition of Functional Integration

Congress should clarify the definition of "functionally integrated" by incorporating the current regulatory standard into the Code and by directing Treasury to clarify by regulation that supporting organizations performing activities that support governmental entities and which satisfy the existing responsiveness test will be considered "functionally integrated," particularly where, as is the case with UCC, there is no involvement of any substantial contributor or a related person. At the very least, such organizations should be presumed to be functionally integrated, subject to the IRS's right to challenge that presumption in particular cases.

Alternatively, in targeting the impact of the PPA toward abuses, it may be more effective to allow all supporting organizations that meet the responsiveness test and have no substantial contributors or their family members on their governing bodies to receive the same treatment as functionally integrated type III organizations. Almost all of the publicized abuses of type III organizations seem to have involved operation of those entities for the benefit of the single donor and his or her family members or other related parties. Thus, there seems to be no ground for applying the PPA's special restrictions on private foundation funding or the private foundation excess business holding rules when substantial contributors have no continued voice in the supporting organizations' affairs. For instance, since the death of Una Chapman Cox, the UCC Board of Trustees has not included any substantial contributors nor anyone else who would be a disqualified person (other than by virtue of their position as trustees). Indeed, no descendents or spouses survived Ms. Cox.

Thus, UCC should not be subject to restrictive rules designed to prevent her from improperly using UCC for the advantage of her and her family, which is simply not a realistic concern in case of organizations like UCC.

By providing more guidance to the Treasury Department regarding the definition of a functionally integrated type III supporting organization, Congress will ensure that legitimate classes of type III organizations are properly protected. One defect of the PPA is that it does not specifically delineate the class of "functionally integrated" organizations that should be exempted from the new type III anti-abuse provisions. Rather, it simply identifies them as those not subject to a payout requirement under rules promulgated by the Treasury Department.[12] Since Treasury has the discretion to impose a payout requirement on all type IIIs, as a practical matter it has the power to ignore Congress's intention not to apply the PPA's new restrictions on non-functionally integrated type III organizations to all type IIIs simply by defining functionally integrated type III organizations very narrowly. Given the Treasury Department's institutional role in combating abuse, it is likely that the definitions it crafts will err on the side of preventing abuse, taking inadequate consideration of the important functions served by many legitimate type III organizations like UCC. We therefore urge Congress to give Treasury additional statutory guidance as detailed above.

Considerations for an Appropriate Supporting Organization Payout Rule

Although a payout requirement has long been considered unnecessary for functionally integrated organizations, and can even be counter-productive for organizations like UCC that are effectively matching their support with the needs of their supported organization, rather than the ebbs and flows of their own income, the recent Advance Notice of Proposed Rulemaking, which suggests imposing a payout requirement on all type III supporting organizations, prompts us to include the following observations regarding appropriate payout requirements for supporting organizations. We agree that a percentage of assets payout may be an easy way address concerns that a non-functionally integrated organization with continuously low distributions may not really be closely connected with its supported organization and may signal an abusive situation. However, because the vast majority of the sector is compliant with the existing tax laws, any payout requirement will be applied primarily to legitimate supporting organizations. Thus, any supporting organization payout should take into account the differences between supporting organizations and private foundations in setting the appropriate payout percentage.

While private foundations are free to grant their funds to any of a potentially unlimited pool of charitable beneficiaries, type III supporting organizations are, by design, dedicated to specifically named publicly supported charities. In addition, a type III supporting organization must be responsive to the needs and demands of its supported public charities. In many private foundation funding situations this is reversed: it is the charity that must be responsive to the goals and demands of the foundation funder.

Non-functionally integrated organizations typically perform functions similar to those of an endowment, assuring that the supported organization will continue to have the funds needed to support particular programs both now and in the future. As noted above, functionally integrated supporting organizations, which perform the functions of the supported organization, not only are committed to performing their supportive activities over the long-term, but also to providing support as and when needed by the supported entity. A university press is most effective if it is free to publish the number of books ready for publication in a given year; a strict requirement that it publish 50 volumes each year would hardly be appropriate. Similarly, UCC's primary contribution to the Foreign Service is not the amount of money it spends in any given year. Its budget is never more than a drop in the bucket compared to that of the State Department. UCC's primary contribution to the Foreign Service is the function of generating, stimulating and providing a clearinghouse and a unique capability for evaluating a wide range of ideas for strengthening and enhancing American diplomacy and the effectiveness of American diplomats. UCC is most effective if it can choose to implement the most promising projects identified in a given year and to implement only those projects that are determined to be likely to produce the desired impact for the Foreign Service. It would be a waste of resources to spend the time and resources of UCC on an ineffective project simply because the Tax Code required money to be spent this year.

[12] *See* I.R.C. § 4943(f)(5).

Recommendations with Regard to a Payout Requirement

For the foregoing reasons, we recommend that Congress clarify that functionally integrated supporting organizations should not be subject to a payout requirement, including a payout requirement imposed as part of the definition of "functionally integrated," as Treasury has suggested should be the case.

Alternatively, we recommend that Congress direct Treasury to adopt a flexible payout requirement for all type III supporting organizations so that such organizations can appropriately respond to the needs of their supported organization(s). Such a flexible payout requirement should be no more than 4%, i.e., significantly less than the 5% of net assets requirements for private foundations, as private foundations may be controlled by their substantial contributors and are therefore more open to abuse than type III supporting organizations. To permit variation in payout amounts to match the needs of the supported organization(s), type III supporting organizations should also be able to meet this payout requirement by averaging this payout over a significant period (e.g., 7 years).

Thank you for providing exempt organizations with an opportunity to comment on the hardships and uncertainties created by the PPA. If you should have any questions regarding the above, please feel free to contact me at (361) 888–9261.

Very truly yours,

Harvie Branscomb, Jr.
Chairman of the Board

Statement of United Jewish Communities

United Jewish Communities is the national organization representing and serving 155 Jewish Federations (referred to also as "Federations"), their affiliated Jewish community foundations, and 400 independent Jewish communities in more than 800 cities and towns across North America. In their communities, the Jewish federations and volunteers (collectively, the "UJC System") are the umbrella Jewish fundraising organizations and the central planning and coordinating bodies for an extensive network of Jewish health, education, and social services.

Federations are the heart and soul of North American Jewry's philanthropic and humanitarian activities. They embody a 3,500-year-old tradition of caring—translating today into the pursuit of Jewish community, values, and peoplehood. Federations build and strengthen the community by reducing poverty and hunger, rescuing and resettling new immigrants, and spurring Jewish renaissance worldwide. Federations also are involved in the general community, funding and supporting local social service programs as well as helping in times of national and international disaster such as Hurricane Katrina and the 2004 Asian Tsunami.

The endowment departments of Federations and their affiliated Jewish community foundations maintain numerous charitable vehicles including donor advised funds ("DAFs"), supporting organizations ("SOs") (together referred to as "participatory funds"), funds to support one or more specified public charities or programs, and charitable income plans. Endowment gifts enable donors to support a general or specific area of interest. Participatory funds allow donors and their families to partner with Federations to fund areas most deserving of support.

UJC appreciates the House Ways & Means Subcommittee on Oversight ("the Subcommittee") examination of the impact on the tax-exempt sector of the charitable giving provisions contained in the Pension Protection Act of 2006 ("the PPA"). As the second largest philanthropic network in North America, virtually every one of the charitable giving provisions in the PPA has an impact on the UJC system. In general, UJC applauds Congress for including several important tax incentives for charitable giving in the PPA and supports many of the reforms enacted last year. However, UJC remains concerned that some of the provisions: (1) are overreaching and have caused, and will cause, significant impediments to potential donors who plan to make gifts to important and well-established charitable vehicles; and (2) will require tax-exempt organizations to refrain from making grants to worthy projects. UJC remains committed to the overriding principles of transparency and good governance in the tax-exempt sector and looks forward to working with the Subcommittee to address many of the issues contained in this submission.

Organization of our comments: UJC has a keen interest in many of the charitable giving provisions contained in the PPA. UJC has been an active participant in the debate over reforms in the non-profit sector over the last several years. UJC filed comments on the Senate Finance Committee staff White Paper on Reforms for Tax-Exempt Organizations in 2004 ("the White Paper") and the Tax Reconciliation

Act of 2005 (S. 2020) proposals relating to nonprofits, among others. Of particular interest are the reforms with respect to participatory funds. Our comments will (1) provide background on and outline the importance of participatory funds to the UJC System; (2) address charitable giving items of general interest; and (3) provide specific detailed recommendations regarding participatory funds.

1. Background and importance of participatory funds

Participatory funds are essential fundraising tools for the UJC System and have been a vital funding source for health, education, and social service programs. Many of the provisions contained in the PPA provide needed statutory definitions and operational rules for participatory funds as well as a penalty tax framework that can be applied to discourage unwarranted acts of self-dealing. However, it is in the public interest to continue to provide incentives for donors to contribute assets to vehicles in which a public charity has control, such as participatory funds, rather than to place or leave such assets in vehicles in which a public charity has no control, such as private foundations.

DAFs and SOs provide numerous benefits to the community, charities, donors, and the government. First, the Jewish community and its philanthropic and social service mission benefit because such vehicles provide a reliable pool of dollars to fund a variety of social service activities. Second, the particular Federation benefits because the relationship with the donor fosters an ongoing dialog about community priorities and challenges of securing adequate funding. Efficient administration, sound investment policies, stewardship, and donor educational programming in both general and specific philanthropy issues—all provided by the sponsoring organization—building relationships of trust with current and future donors, increasing the likelihood of enhanced giving and involvement, raising additional opportunities for donor engagement in the community, and gaining insight into individual donor priorities. Third, individual donors benefit because participatory funds provide cost-effective alternatives to private foundations and offer on-going educational benefits regarding community philanthropic activities. This includes ready access to the knowledge and experience of Federation professional and volunteer leadership regarding the needs of the community as well as a means to engage succeeding generations in the philanthropic process. Relieved from burdensome administration and recordkeeping, donors are free to concentrate on the substance of charitable giving. Finally, there is the added benefit to the public of efficient tax administration, as well-administered DAFs and SOs have policies and procedures in place to assure qualified grants are made and impermissible material benefits to donors are not present. This oversight function is an important component of the overall tax compliance system operating in concert with the goal of furthering philanthropic endeavors. Participatory funds encourage an on-going partnership between public charities and donors. These and other benefits distinguish participatory funds from private foundations and other charitable giving vehicles. It is an unfortunate, and perhaps unintended, consequence that certain PPA provisions are forcing some donors to move away from the public charity environment toward private foundations.

Federation-managed participatory programs make periodic distributions approved by an appropriate committee or the governing body itself. UJC has provided leadership in the field of DAFs by assisting Federations and donors in expressing and following good philanthropic practices, and this, in turn, has created an expanded donor base. SOs that support Federations and other public charities provide many of the same benefits as DAFs. Almost all SOs affiliated with the UJC System are organized as "Type I" SOs and were created by individual families. They meet the Type I SO requirements of Internal Revenue Code Section 509(a)(3) (hereinafter referred to as "Section") because they are "controlled" by the Federation or affiliate they support, and their distributions are made to, for the benefit of, to perform the functions of, or to carry out the purposes of the Federation or the affiliate they support.

Participatory funds represent critical fundraising tools for the UJC System. Collectively, the UJC System raises over $2 billion each year and manages over $11 billion in endowment assets. Included in total endowment assets are both restricted and unrestricted funds, donor advised funds, and funds held by supporting organizations. Assets in DAFs and SOs amount to approximately 60% of the endowment assets held by Jewish Federations, yet these participatory funds were the source of 80% or just over $1 billion of the $1.24 billion in grants made from endowment assets to support Federation programs or other charitable activities. Distributions from DAFs and SOs represented 20.5% of their combined assets at the prior year-end. This spending rate compares favorably with the spending rate of all Federation endowment vehicles, which exceeded 14.5%. It is also important to note approximately 30% of the funds from Federation DAFs and SOs were distributed to the general community while 70% were distributed within the Jewish community.

UJC does not support the development or continuation of DAFs formed to provide personal benefits to the donor and applauds the enforcement efforts of the IRS in prosecuting such abusive DAF arrangements. We note with favor the comments on "charities established to benefit the donor" including "abusive DAFs" and "SOs established to benefit the donor" in the prepared testimony of Steven T. Miller, Commissioner, Tax Exempt and Government Entities Division, before the Subcommittee on July 24, 2007. Our concerns relate to DAFs and SOs established and administered by our Federations and those established by other community foundations and recognized publicly supported and broad-based charities. We are exceptionally proud that agencies within the UJC System employ the highest ethical standards of self-regulation in the governance and operation of participatory funds. We regularly share expertise with other charities and policy makers outside the Jewish community on a variety of charitable giving issues. To meet these high standards, appropriate rules and best practices are set forth in two separate UJC publications, *Donor Advised Funds: A Guide for Jewish Federation Endowment Professionals, and Handbook on Supporting Foundations*, for use by the UJC System. These publications are now being revised to reflect the new requirements of the PPA.

2. Items of general interest

As noted above, UJC applauds Congress for including a number of important charitable giving incentives in the PPA. We recommend that the following incentives be made permanent. In addition, we believe the tax-free Individual Retirement Account (IRA) charitable rollover be expanded as discussed below.

- **Tax-free Individual Retirement Account charitable rollover.** Under the PPA, individuals age 70½ or older may make direct charitable gifts from an IRA of up to $100,000 per year to public charities other than DAFs and SOs. This provision is set to expire on December 31, 2007. The IRA charitable rollover should be made permanent **and** it should be expanded to permit direct gifts to DAFs and SOs. Participatory funds play a vital role in philanthropy in general, and in Jewish philanthropy in particular, and such funds should not be treated adversely as compared to other public charities. The numerous statutory safeguards on such funds contained in other provisions of the PPA render moot the arguments for excluding DAFs and SOs from the IRA charitable rollover. In addition, we recommend that Congress consider expanding the IRA charitable rollover provision to cover life-income gifts by individuals who have attained age 59½. Gift vehicles such as charitable annuity trusts, pooled income funds, and gift annuities are well-recognized and well-regulated under existing law. We support the enactment of H.R. 1419 and S. 819, "The Public Good IRA Rollover Act," which makes the changes noted above and removes the $100,000 annual cap on rollover gifts.
- **Increased adjusted gross income ceiling for qualified conservation easements.** Two provisions in the PPA provide increased incentives for gifts of qualified conservation easements: (1) individuals may deduct the fair market value of any qualified conservation contribution to charity described in Section 170(b)(1)(A) to the extent of the excess of 50% of adjusted gross income (AGI) over the amount of all other allowable charitable contributions and such contribution is not taken into account in determining the amount of other allowable charitable contributions; and (2) individuals may carryover any conservation contribution exceeding the 50% of AGI limit for up to 15 years. These provisions, set to expire at the end of December 31, 2007, should be made permanent.

Numerous provisions in the PPA are intended to tighten the general rules for charitable donation. In addition to the statutory changes made to participatory funds, we believe that a number of these provisions are causing donors and some charities to spend an inordinate amount of time, effort, and expense in order to meet the statutory requirements. We especially note:

- **Penalty taxes and reporting requirements for Donor Advised Funds and Supporting Organizations:** There is a fine line between preventing abuses by certain "tax-exempt organizations" and preventing or inhibiting much-needed charitable giving. Given the essential role for public charities in our society, it is regrettable that several of the provisions of the PPA applicable to participatory funds have made oversight increasingly expensive and, in some cases, virtually impossible to manage. Numerous professionals within the UJC System are expending a great deal of time and energy to make "more than a good-faith effort" to comply with the provisions of the PPA. The experience of the past eleven months demonstrates, however, that these provisions impose severe administrative burdens that translate into a great expense for the UJC system with little or no corresponding benefit to the public treasury. Additional due diligence requirements represent an "opportunity cost" that is being paid for with a drain on the resources available to fulfill our charitable mission.

In addition to imposing new oversight responsibilities on fund administrators, the provisions of the PPA have complicated a donor's choice of philanthropic vehicles. It is important to note in many cases, DAFs and SOs are now subject to more restrictive penalty provisions and excise taxes than other types of public charities, as well as private foundations, historically the most restricted of Section 501(c)(3) tax-exempt entities.

Examples include: (1) grants to individuals are, per se, taxable rather than restricted; (2) expenditure responsibility is required for certain grants to Section 509(a)(3) public charities; and (3) compensation, including expense reimbursement, paid to disqualified persons is considered, per se, an excess benefit transaction as to the entire amount of the payment. At a minimum, existing DAFs and SOs must at the least review and rewrite operating agreements and by-laws in light of the PPA provisions. Some have abandoned DAF or SO status and have sought private foundation status.

- **Cash contributions.** The PPA provides that regardless of the amount of a cash gift, a donor must maintain a record of the contribution, bank record, or a written communication from the donee showing the name of the donee and the date and amount of the contribution. Even though the PPA does not require charitable organizations to make any changes to their current policies for issuing tax receipts to donors, certain charities, including some religious organizations and others dependant upon cash donations, will likely be forced to spend additional time and expense on administrative duties to make sure they satisfy donor requests for receipts. Unless the charitable organization provides a written communication, cash donations put into a "Christmas kettle," collection plates, and pass-the-hat collections will not be deductible. We recommend Section 170(f)(17) be stricken.
- **Clothing and household items.** A charitable deduction for donated clothing or household items is not permitted unless such items are in "good used condition or better." Most donee charities will issue receipts for qualified clothing and household donations including the descriptive statement "good used condition or better." However, the statute, existing IRS regulations, and the tax form instructions do not provide any guidance as to the definition of "good used condition." Although we acknowledge some taxpayers may have claimed inflated charitable contribution deductions for gifts of clothing and household items, we believe such a vague standard should either be further defined by Congress or the Treasury Department, or eliminated from Section 170(f)(16).

3. Specific recommendations regarding donor advised funds and supporting organizations

Definition of a donor advised fund/clarification of grants for travel, study or similar purposes. A DAF, defined in Section 4966(d)(2)(A), is prohibited from making a grant to an individual. A fund will not be considered a DAF and will be permitted to make grants to individuals for travel, study, or other similar purposes if the fund meets certain requirements including that the fund is advised by a "scholarship committee" not controlled, directly or indirectly, by the donor. See Section 4966(d)(2)(b). There is some ambiguity whether the sponsoring organization can agree in advance to appoint the donor to the scholarship committee. UJC believes such an appointment should be permitted so long as the donor or persons appointed or designated by the donor do not control the committee, whether directly or indirectly. In addition, there can be situations where DAF funds are granted to another charity which in turn makes the final scholarship selection. UJC believes it should be permissible for the DAF donor to be appointed to the other charity's selection committee, again provided the control provisions of Section 4966(d)(2)(B)(ii) are not violated. Such a situation would be similar to the existing law governing private foundations. Section 4945(g) provides that taxable expenditure rules do not apply to certain individual grants awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the IRS. Treasury Regulation Section 53.4945–4(a)(4) provides a grant by a private foundation to another organization, which the grantee organization uses to make payments to an individual, is not regarded as a grant by the private foundation to the individual grantee if the foundation does not earmark the use of the grant for any individual, and there is no agreement the grantor foundation can cause the selection of the individual grantee by the grantee organization. Such grants are not considered a grant by the foundation to an individual grantee even though the foundation has reason to believe certain individuals would derive benefits from the grant so long as the grantee organization exercises control, in fact, over the selection process and actually makes the selection independent of the private foundation.

UJC understands the Council on Foundations (CoF) is also recommending proposed changes to the definition of a DAF, including an exception for funds created by public charities and government entities and a clarification regarding the designation of scholarship committee members by position or title. UJC has reviewed both of these proposed changes and agrees with the conclusions of the CoF.

Distributions and prohibited benefits from donor advised funds. New Section 4967 imposes an excise tax if a DAF makes distributions providing a "more than incidental benefit" to a donor, donor advisor, and related party. Although the statute does not define the term "more than incidental benefit," it is important to note the Joint Committee on Taxation Technical Explanation (JCX–38–6) provides on pages 349–350 that "there is more than incidental benefit if as a result of a distribution from a donor advised fund, a donor, donor advisor, or related person with respect to such fund 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." Use of this so-called "Section 170" test to determine no goods or services have been provided to the donor is the most administrable and effective means to preclude the provision of impermissible benefits to donors under Section 4967. UJC urges that guidance be provided to make it clear that a grant from a DAF (or an SO) does not provide any benefit to the donor if the amount of the grant would have been fully deductible as a charitable contribution.

Illustrative of our concern is the discussion in Revenue Ruling 77–160, 1977–1 C.B. 351. As summarized in this ruling, fees and dues or other payments to a public charity are deductible under Section 170, including membership fees where any rights and privileges obtained are incidental to making the organization function according to its charitable purposes, and the only return benefit is the satisfaction of participating in furthering a charitable cause. Examples permitted under Section 170 include rents, building fund assessments, and periodic dues paid to a church. Such payments, if made by a private foundation relating to a disqualified person, would be prohibited. What is considered by this ruling as a "direct economic benefit" for private foundation purposes would be considered only an incidental benefit for purposes of Section 170 and, we submit, should be considered incidental for purposes of Section 4967.

UJC also believes a public charity's approval of a recommendation to make a distribution to a charity would be permitted even though in some venues such a distribution might be considered as satisfaction of a legally binding pledge. The definition as to what constitutes a pledge or legally binding pledge varies significantly among various state laws and depends upon particular facts and circumstances. It is unrealistic to expect that a public charity would be in a position, while running large fundraising campaigns, to be able to determine whether a pledge or a legally enforceable pledge has been created under applicable state law in each and every case. Whether a pledge exists or whether such a charitable pledge is legally enforceable is a matter of state law. Many public charities sponsoring DAFs run annual charitable giving campaigns and conduct other fundraising events. In response to solicitations for contributions, some donors make cash contributions and others indicate their intention to contribute in the future. A donor thereafter may recommend a DAF make a distribution, which may be deemed to satisfy a charitable pledge. The DAF may be a fund sponsored by the public charity to which the pledge has been made or it may be a DAF sponsored by a different public charity. In either case, a donor's recommendation is not binding upon the board of the public charity. The board makes the decision as to whether to distribute funds which would be deemed to satisfy a pledge. It is administratively infeasible for a public charity to make such a determination on a contribution-by-contribution basis, given the conflicting state laws on what makes a pledge "legally binding."

Originally, the White Paper proposed to make clear that DAFs should be permitted to make distributions satisfying a charitable pledge of a donor, whether or not such pledge is enforceable under state law. Such a clarification would drastically reduce the administrative burden on public charities sponsoring DAFs and, in so doing, would serve the interest of charitable beneficiaries and the public at large. Any concern that a donor would realize a prohibited benefit under Section 4967 should a DAF be permitted to make a distribution which, in turn, might be deemed to satisfy a pre-existing charitable pledge, does not comport with the legal principles that should apply to this question. By definition, a public charity enjoys broad public support and is subject to significant public oversight. Unlike a private foundation, a public charity is not subject to the control of a major donor. In this respect, we refer to federal income tax authorities, which concluded satisfaction of another party's legally-binding charitable obligation is not treated for federal income tax purposes as resulting in adverse tax consequences. See Revenue Ruling 55–410, 1955–1 C.B. 297, Revenue Ruling 64–240, 1964–2 C.B. 172 and *Wekesser v. Commissioner*, T.C. Memo 1976–214. At a bare minimum, it would be erroneous to conclude the position we support would change existing tax law, although, as in the case of the White Paper recommendation, it would clarify the confusion currently surrounding this issue.

UJC understands that the CoF is also recommending proposed changes to the rules covering distributions from a DAF, including permitting distributions for which the sponsoring organization receives consideration, the value of which equals or exceeds the amount of the distribution. In addition, CoF is proposing funds be permitted to make distributions to individuals for relief of poverty or distress. UJC has reviewed both of these proposed changes and agrees with the conclusions of the CoF.

Reliance and certification by donors and grantees. In addition to the excise tax imposed on a donor, donor advisor, or related person where there is a prohibited benefit, a tax is also imposed on any fund manager of the sponsoring organization who knowingly agrees to make the distribution. See Section 4967(a)(2). This provision will require sponsoring organizations to devote additional time and resources to the administration of grants in order to identify individuals and entities related to the donor or donor advisor. New Section 4966 imposes a 20% excise tax penalty on sponsoring organizations for each "taxable distribution" from a DAF and a 5% excise tax on a fund manager who knowingly approves a taxable distribution. A taxable distribution includes distributions to a "disqualified supporting organization" (an organization directly or indirectly controlled by the donor, an advisor to the fund, or any persons related to the donor or the advisor, unless the sponsoring organization implements expenditure responsibility over such distribution meeting the requirements of Section 4945(h)). It is important to note the burdens of Section 4945(h), previously applicable only to private foundations, may prove to be costly for many sponsoring organizations and could result in such organizations adopting policies precluding any distributions from DAFs to SOs.

To prevent an unwanted chill on the philanthropic endeavors of DAFs and SOs, it is essential that charities administering such funds not be burdened with unnecessary procedures and requirements when accepting gifts, approving grants, or making distributions in their normal course of activities. This would include determining whether: (1) the objective standard of Section 170 noted above has been satisfied with respect to the donor; (2) distributions from DAFs are not made to disqualified SOs: and (3) the SO is in receipt of a gift from a donor or related party who controls directly or indirectly the governing body of the supported organization. This third compliance task is essential because newly enacted Section 509(f) could potentially recharacterize the SO as a private foundation if it were to receive contributions from persons "in control" of the SO. We recommend either Congress clarify or that the Treasury Department promulgate regulations that permit sponsoring organizations to rely on written certification from the donor that the requested grant will not be used for a prohibited purpose or result in a "more than incidental benefit." For example, the grant distribution form could include language such as the following:

> "As a person authorized to make this request, I hereby suggest that you make the grant distribution indicated below. I understand that by making this request, I am certifying that no tangible benefit, goods, or services (including any grant, loan, compensation, expense reimbursement or similar payment) are being received by the Donor or by any individuals or entities related to the Donor or the above mentioned donor advised fund."

A similar statement could also be included in the grant transmittal letter, indicating to the recipient organization that acceptance of the grant is conditioned on the understanding the donor will receive no more than an incidental benefit. Such an example could include the following:

> "By accepting this check, your organization certifies that (1) the Donor, Donor Advisor and parties related to the Donor or Donor Advisor shall not receive more than incidental benefit (specifically, no tangible benefit, goods or services), (2) no grants, loans, compensation, expense reimbursements or similar payments shall be made to the Donor, Donor Advisor or parties related to the Donor or Donor Advisor, and (3) that your organization is not a disqualified supporting organization within the meaning of Code Section 4966(d)(4) of the Internal Revenue Code 1986, as amended (the "Code"), or a private foundation not described in Section 170(b)(1)(A)(vii) of the Code."

In addition, sponsoring organizations of a DAF should be permitted to rely on a written representation from a prospective grantee SO that it is not directly or indirectly controlled by the donor, the advisor to the fund, or any persons related to the donor or the advisor as defined by Section 4966(d)(4). Providing sponsoring organizations with safe harbor rules based on the certification of others is not without precedent. Treasury Regulations contain numerous examples where taxpayers are permitted to rely on the certification of another that there has been or will be compliance with the technical provisions of the tax law or the information provided is correct. One example of third party reliance is the exemption from backup withholding based on payee certification (see Treasury Regulation Section 31.3406(h)(3)). Indeed there is an example in the PPA itself. Newly-added Section 170(e)(7)(d) provides an exception from the rules requiring a donor to recapture some tax benefits for contributions of appreciated tangible personal property not used for an exempt purpose if the donee organization certifies the use of the property was related to the organization's exempt purpose or how such use became impossible or infeasible to implement.

Excess business holdings rules. Owners of closely held businesses sometimes meet their charitable objectives through gifts of a part of their business interests. Under prior law, such objectives could be obstructed by the rules prohibiting a private foundation from having "excess business holdings," defined as holdings in any business enterprise exceeding "permitted holdings." These complex rules and excise taxes were designed to limit private foundation holdings of interests in business activities and the conduct of unrelated business activities.

UJC believes the excess business holdings rules should not apply to DAFs and recommends the repeal of new Section 4943(e). Sponsoring organizations of such funds do not predicate decisions on how long to retain certain assets based on the private interest of the donor, but in fact seek to maximize the long-term value of assets held in such funds. Tax policy and IRS regulations should not discourage donors from making gifts of property to tax-exempt organizations, especially as a substantial portion of personal wealth is in the form of "illiquid assets" such as real property and closely-held business interests.

Although reduction or elimination of tax incentives for gifts of such types of property should be resisted, it is also important that sponsoring organizations maintain gift acceptance and investment management policies fostering the prudent stewardship of all donated assets as well as achieve the goal of investment portfolio balance. Adherence to such policies, which are prevalent throughout the UJC System, should be sufficient to assure that DAFs operate in a manner which would obviate the need for application of the excess business holdings rules. We would also note the revised Form 990, released for comment by the IRS in June 2007, would create a new required schedule asking for detailed information on gifts of property with a claimed value of $5,000 or more. Disclosure by charities through instruments such as this new schedule should provide the IRS with sufficient information to target abuses in this area.

Specific recommendations regarding supporting organizations

Certain provisions should be restricted to certain supporting organizations. UJC believes several of the provisions in the PPA adversely impact long-existing SO arrangements established by public charities for sound legal and policy reasons. We further believe that the provisions that substantially restrict the operation of SOs should be limited to non-functionally integrated Type III SOs. Concerns about donor control are not applicable to Type III SOs established by public charities or third parties, such as courts of law, to carry out specific charitable objectives. Similar to many public charities, a number of Federations and their beneficiary agencies within the UJC System hold their endowment funds in separate charitable entities structured as SOs, generally Type I or Type II, but in some cases Type III. Often this is done for important legal reasons, such as to separate endowment assets from activities creating liabilities or other creditor protection reasons. Separate endowment funds are also established for programmatic reasons, such as to enable a separate community-based governing body to oversee endowment fund investments and distributions, or to keep endowment development activities separate from annual fundraising campaigns. Similarly, SOs are used as the parent organizations in health care systems and other multi-entity systems of public charities providing direct services.

Intermediate sanctions. The Internal Revenue Code imposes excise taxes on certain excess benefit transactions between disqualified persons and charitable organizations where the transaction is one in which a charity directly or indirectly provides a disqualified person an economic benefit exceeding the value of the consideration (including the performance of services) received for providing such benefit. New Section 4958(c)(3) provides **any** grant, loan, compensation or other similar payment from a SO to a substantial contributor or related party is automatically considered to be an excess benefit transaction, whether or not it exceeds in value the consideration given in exchange.

UJC believes the restrictions of Section 4958(c)(3) should not apply to Type I, Type II, and functionally integrated Type III SOs. The concern that substantial contributors or disqualified persons can control these organizations is unfounded. The element of control exercised by the supported organization in the case of a Type I and Type II SO, and the functional integration present in such a Type III SO is sufficient to provide the essential oversight of such SOs. Precluding substantial contributors and other disqualified persons from receiving appropriate compensation or reasonable expense reimbursement on the same basis permitted by a private foundation is an unnecessarily harsh result and could force some newly-formed organizations to refrain from applying for SO status and force existing organizations to convert to private foundation status.

UJC also believes Congress or the IRS should clarify whether the rules of Section 4958 apply in the case of circumstances where an officer or director of an SO attends a charitable event in a representative capacity. We believe such an individual who is not a substantial contributor or related party should be able to attend such an event and the SO should be able to treat any such cost as administrative expense without the individual being required to include such reimbursement in gross income. Similarly, where the officer/director pays the nondeductible portion of an event ticket, the "Section 170 test," as discussed above, should apply.

Reliance and certification by donors and grantees. Procedures assuring certain SOs (Type I and Type III) do not receive contributions from persons in control of a supported organization also need to be implemented reasonably. Gift acceptance forms from potential donors to Type I and Type III SOs could require a certification that neither the donor, their family members, nor their controlled entity, either directly or indirectly, control the governing body of its supported organization. This would alleviate the need for the SO to decline any contribution proffered by any person connected with the supported organization simply because it lacks the resources to engage in extensive investigation that could involve any number of persons other than the donor.

Summary. UJC supports the overall objective of the provisions of the PPA and appreciates the concern expressed by the House Ways & Means Subcommittee on Oversight in examining the impact of these provisions on the tax-exempt sector. We are concerned however that several of the PPA provisions have imposed administrative burdens or penalty taxes inhibiting charitable giving and grantmaking to deal with what arguably may have been a limited number of abusive situations. The added administrative costs and the fear of potential penalty taxes has slowed the flow of funds to certain types of organizations, resulting in a diminution in the level of social services provided to the general public. UJC urges the Members of the Subcommittee and others in Congress to carefully consider the suggested changes noted above.

Statement of Wisconsin Alumni Research Foundation

The Honorable John Lewis, Chairman
The Honorable Jim Ramstad, Ranking Member
Subcommittee on Oversight
Committee on Ways & Means
U.S. House of Representatives
343 Cannon House Office Building
Washington, D.C. 20515

Dear Chairman Lewis and Congressman Ramstad:

Thank you for your invitation to comment on the exempt organizations provisions of the Pension Protection Act of 2006 (the "PPA"). I am the Managing Director of the Wisconsin Alumni Research Foundation ("WARF"), a Type III supporting organization to the University of Wisconsin—Madison (the "University"). For over 80 years, WARF has worked closely with the University, patenting and licensing University discoveries and using the resulting income to enrich scientific research and education at the University. On March 14, 2005, WARF received the National Medal of Technology—the nation's highest honor for technological innovation—from President George Bush, recognizing WARF's support of research at the University, and WARF's "pioneering" technology transfer of university ideas to U.S. businesses "to improve the human condition, benefit the U.S. economy and fund further scientific inquiry."

My comments focus on the PPA's provisions affecting supporting organizations like WARF. Some of the PPA's new provisions were aimed at particular abuses, often involving a single donor or family funding a supporting organization that was effectively, if not formally, under their control. That organization would then operate to benefit the donors in various ways. I applaud attempts by both Congress and the Treasury Department to stop this kind of abuse. However, I am concerned that many of the new provisions are drafted so broadly that they also significantly impede the efficient functioning of legitimate organizations such as WARF.

Already the new PPA provisions have cost WARF and the University millions in current and future foregone funding, as well as needlessly complicating a variety of WARF's activities in support of the University. Given that many of the PPA's provisions were introduced without any extended discussion with the charitable sector, there is real concern that over time WARF will continue to find its ability to provide efficient and effective support to the University impaired by unforeseen consequences of the PPA. More fundamentally, I must object to the apparent premise of the PPA that *all* supporting organizations, especially Type III organizations, are somehow suspect and in need of regulation akin to the private foundation rules—regardless of how closely or successfully they have worked with their supported institutions. Having successfully supported the University for over 80 years, WARF should not be treated equivalently to a newly-formed supporting organization created as a charitable giving device to maximize some donor's tax benefits while making minimal distributions for charitable purposes.

While I propose specific fixes to some of the problems noted below, it would be better to start anew with provisions targeted much more narrowly on the abuses Congress means to stop. Indeed, it may be that the PPA's provisions requiring increased disclosure to the IRS and to a supporting organization's supported organizations [1] will allow the IRS to stop these abuses through redoubled enforcement of existing standards, notably the rule preventing direct or indirect control by substantial contributors and other disqualified persons.[2] Even if Congress does not undertake a global revision of the PPA's supporting organization provisions, at a minimum Congress should amend or clarify these provisions so that they will not further disrupt successful supporting relationships like the one between WARF and the University.

I. *WARF Fulfills an Essential Technology Transfer Role Under the Bayh-Dole Act*

WARF was organized as a Wisconsin not-for-profit, nonstock membership organization on November 14, 1925, to own and manage patents arising out of University research on behalf of the University in order to support further research at the University and to benefit the public. At that time, the University had no mechanism to administer a patent that Professor Harry Steenbock wanted to contribute to the University so that it could be licensed to generate funding for future University research. Technologies made available to the public by WARF have had an incalculable impact on the general welfare; Dr. Steenbock's discovery alone—a process for creating Vitamin D through ultraviolet light irradiation—has led to the virtual elimination of rickets in the United States. WARF's successes have also allowed it to provide supplemental funding to the University for scientific research and education, propelling the University to its current stature as one of the nation's leading scientific universities.

One of the most important ways WARF supports the University is by fulfilling the University's obligations under the Bayh-Dole Act.[3] That Act encourages utilization of inventions arising from federally-funded research, including research conducted by universities and other nonprofits, by allowing the researching institutions to take title to any resulting intellectual property provided certain conditions are met. Under the Bayh-Dole Act, such organizations must report all inventions arising from federal funding and notify the government whether they intend to take title to such inventions. If they take title, they must promptly patent the inventions, report periodically to the government on their utilization, and use the net income received from the licensing or other use of such inventions (after administrative ex-

[1] *See* I.R.C. §§ 509(f)(1)(A), 6033(l).
[2] I.R.C. § 509(a)(3)(C).
[3] The Bayh-Dole Act is officially known as the Patent and Trademark Law Amendments Act, P.L. 96–517, 94 Stat. 3015 (Dec. 12, 1980), *codified at* 35 U.S.C. §§ 200 *et seq*.

penses and payments to inventors required by the Act) to support further scientific research or education.[4]

The Bayh-Dole Act and the regulations thereunder expressly allow a research organization such as the University to delegate its right to take title to an invention (and its attendant responsibilities) to a nonprofit organization with a principal function of managing intellectual property.[5] The University has made such a delegation to WARF, allowing and requiring WARF to fulfill its responsibilities under the Bayh-Dole Act.

II. *Congress Has Not Adequately Protected Legitimate Functionally Integrated Type III Supporting Organizations Such As WARF*

Many new restrictions under the PPA apply only to certain Type III supporting organizations, namely those that are not "functionally integrated" with one or more supported organizations. Such organizations are now (1) limited in the amount of stock in a company they and their disqualified persons can hold;[6] (2) virtually prohibited from receiving grants from a private foundation grantor because any such grantor must exercise expenditure responsibility and cannot count the grants toward its payout requirement;[7] and (3) subject to an annual payout requirement that the PPA makes mandatory.[8]

Under any reasonable definition of the term, WARF is "functionally integrated" with the University. The vast majority of WARF's staff time is spent on its core technology transfer activities. Such activities are an essential part of any major scientific research university's program in the twenty-first century. Indeed, WARF's activity fulfills the University's legal responsibility to patent and license its federally funded inventions under the Bayh-Dole Act; WARF has been specifically delegated those responsibilities as expressly contemplated by the Bayh-Dole Act. Moreover, because WARF is responsible for this crucial component of University operations, it has continuous contact with University administrators, professors, and researchers. Thus, one would expect WARF to qualify as the prototypical organization that is "functionally integrated" with its supported organization.

However, Congress left Treasury great discretion in defining the term "functionally integrated"; the statute defines the term exclusively by reference to the definition in the Treasury Regulations, and the Joint Committee on Taxation's Technical Explanation ("Technical Explanation") suggests that Treasury has the authority to narrow its definition of functional integration and even to abolish the class of functionally integrated organizations altogether.[9] Treasury has recently indicated in an Advance Notice of Proposed Rulemaking (the "Treasury Proposal")[10] that it intends to use this broad authority, grafting extraneous new requirements onto the concept of functional integration in ways that could exclude WARF and numerous other organizations despite longstanding and close operational integration with their supported organizations.

Under current regulations, an organization would be considered functionally integrated if it conducts activities "to perform the functions of, or to carry out the purposes of, [its supported] organizations," and if such activities are so important to the supported charity that "but for the involvement of the supporting organization, [they] would normally be engaged in by the publicly supported organizations themselves."[11] Treasury proposes to maintain this test, but to graft in two additional requirements taken from the private operating foundation context. First, the organization would have to spend substantially all (85%) of its income, up to at most 4.25% of its net assets not in charitable use, on direct conduct of activities meeting this "but-for" test rather than on providing financial support to the supported organizations.[12] Second, at least 65% of the assets of the organization would have to be used directly in the conduct of those activities. This proposed definition is alarming for multiple reasons.

---

[4] *See* 35 U.S.C. § 202(c).

[5] 35 U.S.C. § 202(c)(7)(A); 37 C.F.R. § 401.14(k)(1).

[6] I.R.C. § 4943(f)(1), (3)(A).

[7] I.R.C. §§ 4942(g)(4)(A)(i), 4945(d)(4)(A)(ii).

[8] Treas. Reg. § 1.509(a)-4(i)(3)(iii); PPA, § 1241(d)(1), 120 Stat. at 1103.

[9] I.R.C. § 4943(f)(5)(B); Staff of the Joint Committee on Taxation, Technical Explanation of H.R. 4, the "Pension Protection 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 360 n. 571.

[10] Internal Revenue Service, Advance Notice of Proposed Rulemaking, "Payout Requirements for Type III Supporting Organizations That Are Not Functionally Integrated," 72 Fed. Reg. 42,335, 42,338 (Aug. 2, 2007).

[11] Treas. Reg. § 1.509(a)-4(i)(3)(ii).

[12] Treasury Proposal, 72 Fed. Reg. at 42,338.

The Treasury Proposal effectively applies a payout requirement to all Type III supporting organizations. While Congress did give Treasury considerable discretion in defining the term "functionally integrated," it also instructed Treasury to impose a payout requirement on the subset of "Type III supporting organizations which are not functionally integrated." [13] Despite this apparent intention to distinguish between functionally integrated and other Type IIIs, Treasury's proposal effectively subjects all Type III supporting organizations to some sort of payout requirement. This seems at odds with Congress's explicit instructions.

The Treasury Proposal unfairly penalizes broad classes of Type III organizations without regard for their relationship to their supported organizations. Treasury's proposal seems to mandate that all functionally integrated Type III organizations provide support in the same way. If an organization's principal asset is an endowment that it uses to fund functionally integrated activities, it cannot qualify as functionally integrated—no matter how responsive to and closely integrated with its supported organization it might be.

Similarly, an organization that uses only half of its income to operate its functionally integrated activity and distributes the excess to the supported organization could also fail to qualify. This rule leads to especially strange consequences in the case of Bayh-Dole patent management organizations like WARF. Paradoxically, an organization like WARF could qualify as functionally integrated if its patent licensing activity were unprofitable enough to absorb most of its investment income. But a successful patent management organization does not spend substantially all of its net income on its technology transfer activity because it has substantial amounts of income over and above those expenses—net income that is turned over to the supported university, potentially causing the organization to fail the proposed payout test. This bizarre result would unfairly penalize Bayh-Dole patent management organizations for successfully doing what they are required by federal law to do.

The Treasury Proposal will also prevent universities and other charities from using Type III supporting organizations to hold interests in for-profit subsidiaries. Such charitable holding entities would often be impermissible: they would not be functionally integrated if more than 35% of their assets would be interests in an unrelated business, and therefore they would be prohibited by new section 4943(f) from owning more than 20% of that business. These restrictions needlessly limit how a university system can structure ownership of its own for-profit subsidiaries.

More generally, the Treasury Proposal seems to subscribe to a mistaken notion that functionally integrated organizations should be limited in their ability to provide direct financial support. In my experience, WARF has been successful precisely because it provides both financial and operational support. Unquestionably, WARF's close working relationship with the University gives it a familiarity with the University and its needs that allows WARF to be far more responsive than the typical organization that simply writes a check to its supported organization each year. But it would be absurd to say that WARF would be either more responsive to or more integrated with the University if it *limited* its support to its technology transfer activities. Rather, because of WARF's close involvement with the University's science programs, WARF has been able to identify a variety of programs it can support for which other funding is generally not available. Recent examples include a competitive research grant program, faculty and graduate student fellowship programs, and the construction of major new biotechnology and interdisciplinary research facilities on the University's campus. WARF-supported programs have become a mainstay of the research program at Wisconsin, and the campus is dependent on them to keep its competitive edge, to retain faculty, and to recruit new faculty. WARF works closely with the University to tailor these programs to the University's evolving needs. Surely this kind of financial support, informed by WARF's extraordinarily close operational relationship with the University, counts in favor of treating WARF as a full-fledged public charity, not against it.

Treasury's criterion for determining which activities are functionally integrated is inadequate for supporting organizations of governmental entities. Under current law and the Treasury Proposal, a functionally integrated organization must conduct activities that the supported organization would otherwise conduct itself. Normally, this rough test serves to screen out those organizations that do not have activities essential enough to the supported organization to give it the incentive to monitor those activities. In the governmental context, however, the supporting organization's activities may be crucial to the governmental entity precisely because the governmental entity could not (or could not easily) perform those activities itself due to restrictions specific to governmental entities. In such cases, the Treasury Department's test would apparently yield the wrong result.

[13] PPA, § 1241(d), 120 Stat. at 1102 (emphasis added).

Recommendation: Congress should define "functionally integrated" supporting organizations more specifically, ensuring that organizations are not denied that status simply because they have an endowment, generate revenue through their integrated activities, provide a combination of financial and functional support, or perform essential functions that their supported organization could not perform themselves. Specifically, that definition should clarify that Bayh-Dole patent management organizations like WARF qualify as functionally integrated.

III. ***Restrictions on Non-Functionally Integrated Type IIIs Unfairly Harm Legitimate Organizations—Especially Those Supporting Governmental Entities***

The PPA deprives legitimate organizations (and the public interests they serve) of needed funding. WARF is concerned about Treasury's apparent willingness to narrow the class of functionally integrated organizations because of the serious consequences to legitimate organizations that fail to obtain that technical status. Perhaps most seriously, such organizations will be effectively foreclosed from seeking private foundation funding, since private foundations would receive no credit for such grants in meeting their own payout requirements. For instance, one private foundation has pledged to give WARF $50 million to help pay for a new state-of-the-art interdisciplinary research center that WARF is building on the University's campus. That grant is possible because WARF is functionally integrated under the current regulations; if the Treasury Proposal is not modified, WARF's endowment will prevent it from receiving such grants in the future. This will not prevent any abuses of which I can conceive; it will simply decrease the amount of funds available to advance research and build the University.

Furthermore, the restriction on private foundation funding will negatively impact WARF and other organizations even if they *are* functionally integrated, because many private foundations will not be willing to perform the necessary due diligence to determine what type of supporting organization the potential grantee is. The University has already felt the impact of this restriction; one private foundation is terminating a $1 million annual grant formerly paid to WARF and used to fund University research because the PPA has made it too complicated to give grants to Type III supporting organizations.

The PPA's new payout requirements can actually harm governmental and other supported organizations and other charities with needs that fluctuate over time. The PPA directs Treasury to impose a payout requirement on all non-functionally integrated supporting organizations; currently, Treasury is proposing to apply the same 5%-of-assets payout requirement to supporting organizations that applies to private foundations.[14] This importation of the private foundation rules overlooks the fundamental difference between private foundations and supporting organizations. Unlike the typical private foundation, a Type III supporting organization is dedicated to specifically named charities or governmental entities, so any current spending directly impacts the amount that will be available to those entities in the future. When a supported organization can be expected to have varying needs over the years, requiring a fixed payout can actually harm it, keeping it from saving its resources for when they are needed most.

These concerns are especially pressing for state universities and other governmental entities dependent on annual budget appropriations. There is a constant risk that state legislature appropriations may be frozen or cut with the next economic downturn or change in administration. Furthermore, it can be difficult for state universities to find room in tight state budgets to obtain supplemental appropriations for special projects, leaving them able to cover core operating expenses but not to undertake the kind of major capital projects necessary to ensure that university facilities remain technologically current.

A Type III supporting organization with an endowment that can be used to supplement the standard appropriations process can play a key role in filling these gaps. For instance, in addition to its normal annual support of the University's programs, WARF is currently spending $80 million to construct three new buildings on the University's campus, and is committed to construction of a major new research institute to which it will contribute an expected $100 million. It is precisely because WARF was free to accumulate its income in prior years that it now has amassed an endowment large enough to meet these special needs as they arise and to compensate for cyclical variations in Wisconsin's funding for the University.

Type III supporting organizations offer unique advantages and should not be treated as second-class citizens of the charitable sector. The PPA demonstrates unmistakable hostility to Type III supporting organizations, as if there are no valid

[14] PPA, § 1241(d)(1), 780 Stat. at 1103; Treasury Proposal, 72 Fed. Reg. at 42,338.

reasons for choosing Type III status. As Managing Director of WARF, I witness the benefits of that status every day. Some of those benefits are specific to WARF's patent management role. A major problem for modern universities is dealing with institutional conflicts of interest—roughly, the fact that universities and other research institutions may have commercial interests that could, if unmanaged, taint the objectivity of their research interests in commercializing and profiting from their research. The separation between WARF and the University helps to mitigate these concerns by making an independent organization, WARF, responsible for commercializing the University's research, leaving the University free to focus on its educational and scientific mission.

Type III status also allows WARF to avoid being treated as a Wisconsin state entity itself. If it were a state entity, it could become subject to public information laws, making potential licensees reluctant to risk disclosing their proprietary information by licensing with WARF; public procurement laws, as noted above, could limit its ability to negotiate licenses; and civil service rules would affect its ability to deal with employees. WARF's freedom from state bureaucracy has also been especially important in enabling it to put together retention packages to keep star scientific faculty at the University. Because of their financial and bureaucratic constraints, state universities have perennially had difficulty quickly assembling compensation packages that can compete with those offered by private institutions. In two recent instances, the University would have lost key faculty members without WARF's help. Given the many legitimate reasons for choosing Type III status, that status alone should not be enough to single out an organization for special regulation.

Recommendation: The PPA's new restrictions on Type III non-functionally integrated organizations (especially the payout requirement and limit on private foundation funding) are counterproductive and should be repealed. They are particularly ill-suited for Type III supporting organizations to governmental entities and patent management organizations, which should therefore be exempted from these restrictions even if they are not repealed.

IV. *Section 4958(c)'s New Restrictions on Transactions with Supporting Organizations are Stricter Even Than Those Applicable to Private Foundations*

Prior to the PPA's enactment, section 4941 prohibited most transactions between a private foundation and its "disqualified persons"—directors, officers, substantial contributors, and certain related parties. Section 4958, on the other hand, allows public charities to engage in such transactions but imposes a 25% tax against the disqualified person for any amount he or she receives in excess of fair market value.

Under new section 4958(c)(3)(A)(i)(I), the 25% excise tax automatically applies to the entire amount of "any grant, loan, compensation, or other similar payment" that a supporting organization provides to a substantial contributor or a related party, and to any loan to the organization's disqualified persons—regardless of whether the payment is reasonable in amount. It thus appears intended to impose a regime on supporting organizations similar to the one that applies to private foundations. In fact, though, it overshoots that mark, treating WARF and other supporting organizations even more harshly than they treat private foundations.

Definition of Prohibited Payments. Section 4958(c)(3)(A) does not define what payments are "other similar payments" subject to penalty. The Technical Explanation cryptically indicates that the term was meant to include expense reimbursements but not bona fide sale or lease payments—without any explanation as to why the former but not the latter are considered similar to grants, loans, and compensation.[15] The result is a regulatory regime for insider transactions that makes no sense from a policy perspective: private foundations can pay compensation and reimburse legitimate expenses, but cannot buy or sell property, whereas supporting organizations can buy or sell property but cannot pay compensation or reimburse expenses. The Technical Explanation also raises questions about which other forms of payment might be covered. Since it apparently approves fair market rental payments to a substantial contributor, it seems other payments for the use of property, such as royalties, should be permissible. But given the draconian penalties that apply to these new payments, it behooves Congress to identify the disfavored payments more precisely.

Recommendation: Section 4958(c) should be repealed, or at a minimum, amended to include an express provision stating that no rental, lease, sale, purchase, roy-

[15] Technical Explanation at 358.

alty, or interest payments shall be considered a "grant, loan, compensation, or other similar payment" under section 4958(c)(3)(A)(i)(I).

Reasonable Compensation and Expense Reimbursement. Charities, like other employers, often reimburse expenses that their employees, officers, and directors incur out-of-pocket costs in the course of their duties. To take just one example, WARF typically will pay the costs associated with bringing its Board of Trustees—prominent business and community leaders from across the nation—together for periodic board meetings. In some cases WARF pays for the travel directly; in other cases it is more convenient for the trustee to book the travel arrangements and then obtain reimbursement. Other organizations may provide their trustees with a small amount of compensation for time spent serving the organization.

The PPA complicates these routine matters for WARF. As is the case for many other charities, WARF's trustees are among those most likely to be enthusiastic enough about WARF's work to contribute to it. Such charitable contributions should be encouraged, not penalized. However, under the PPA, even a relatively minor donation to WARF could turn a donor-trustee into a substantial contributor, because the relevant test requires only that the trustee have contributed at least $5,000 and at least 2% of all contributions to the organization. Section 4958(c)(3) of the Code punishes such a donor-trustee for his or her generosity; from the time he or she becomes a substantial contributor, that trustee is relegated to second-class status, becoming ineligible to have his or her WARF-related out-of-pocket travel expenses reimbursed or to receive the same compensation paid to other trustees. Even WARF's direct purchase of plane tickets for such a donor-trustee could be considered an in-kind grant under section 4958(c)(3). This seems bizarre; the purpose of the new rules should be to prevent improper benefits to substantial contributors, not to prevent a charity from holding board meetings at its own expense. In WARF's case, the new rules will discourage trustees from making personal commitments to funding the charitable and educational endeavor of scientific research at the University.

This disincentive for board-level giving is as unprecedented as it is perverse. Even in the private foundation context, where concerns about donor control of charitable resources are at their highest, the Code allows substantial contributors to be paid reasonable compensation for personal services rendered in furtherance of the organization's exempt purposes, and to be reimbursed for out-of-pocket costs associated with providing those services. There is no reason to impose a stricter rule simply because an organization has a connection to a public charity.

Recommendation: Congress should avoid treating supporting organizations worse than private foundations by amending section 4958(c)(3) so that it does not apply to reasonable compensation for services or to reimbursement of reasonable and necessary out-of-pocket expenses, at least when made on the same terms available to other similarly situated, non-substantial contributors.

Alternative Recommendation: Even if the prohibition on compensation is retained, Congress should clarify that it does not apply to non-personal expense reimbursements. U.S. tax law generally excludes such reimbursements from an individual's income when he or she is paid under an accountable plan, which requires the reimbursed individual to substantiate the business purpose of the expense. The current section 4958 regulations take the same approach, disregarding reimbursements under an accountable plan and other similar benefits that are excluded from income. Congress should confirm that these kinds of proper reimbursement arrangements will continue to be disregarded for purposes of section 4958(c)(3). Substantial contributors should not be penalized if they are reimbursed for legitimate, properly substantiated expenses or if they use property provided by the charity in the course of performing their duties.

Transactions among charities. Section 4958(c)(3)(C)(ii) provides that public charities other than supporting organizations are not considered substantial contributors, thus implying that private foundations and supporting organizations are substantial contributors, and therefore loans, grants, or compensation paid to them are subject to penalty. This is a marked departure from prior law. Until now, sections

[16] WARF has acquired its assets primarily in return for future royalties or by investment. Thus, a donation of well under 1% of WARF's total assets could easily be over 2% of its total contributions.

[17] I.R.C. § 4941(d)(2)(E).

[18] I.R.C. § 62(c); Treas. Reg. § 1.62–2(c)(4).

[19] Treas. Reg. § 53.4958–4(a)(4).

[20] Treas. Reg. § 53.4946–1(a)(8) (for purposes of § 4941, "disqualified person" does not include 501(c)(3) organizations other than certain organizations that test for public safety); Treas. Reg. § 53.4958–3(d)(1) (501(c)(3) organizations are deemed not to have "substantial influence," and thus prevented from becoming disqualified persons except by relationship to some other person).

4941 and 4958 have applied to protect against transactions between charities and private parties that could divert charitable funds to private use, but neither section 4941 nor section 4958 covered transactions between charities.

This expansion of section 4958 prohibits many innocent transactions, particularly in the common context of a system of affiliated charitable entities. For instance, WARF is the parent of another Type III supporting organization of the University, WiCell Research Institute, Inc. ("WiCell"). Because WARF provided initial funding to WiCell, WARF is a substantial contributor to WiCell. WiCell pays WARF service fees for bookkeeping and similar administrative services as part of a cost sharing arrangement so that the two organizations do not have to duplicate their efforts in such areas. Congress should encourage, not punish, this kind of consolidation and efficient use of charitable resources. Yet under the PPA, WiCell's service fees paid to WARF, a substantial contributor, would presumably be "compensation" subject to draconian penalties. By reaching transactions between supporting organizations to the same University, the PPA creates artificial and senseless barriers to the efficient flow of funds and services among charitable affiliates.

Recommendation: The cleanest solution to this problem, and the one Congress should adopt, is to return to the previous policy of sections 4941 and 4958, excluding all charities from the definition of substantial contributor. At the very least, however, an exception should apply to transactions within a system of related charities.

V. *Conclusion*

We at WARF believe that there is something immensely valuable about the collaborative relationship that WARF and the University have enjoyed over the past 80 years. That relationship attests that Type III supporting organizations can make unique contributions to their supported organizations, particularly when they support state universities or other governmental entities. I urge you to consider amending the PPA so that it will not disrupt or penalize these kinds of longstanding support relationships.

Sincerely,

Carl E. Gulbrandsen
Managing Director

Statement of Zimmerman-Lehman, San Francisco, California

I have worked all my life in the public interest arena primarily with small and effective nonprofit organizations. Currently, I consult with a wide range of small to midsize nonprofits, many of them social change organizations that have small administrative staff.

I am concerned any time I see major regulatory changes since I know each and every time there is a change, regardless of the reason, there is a cost to learning and implementing the change which means more overhead expenses and less resources for programs. This is particularly true for the types of organizations for which I work. Both the Pension Protection Act of 2006 and now the revised draft Form 990 will and do have the unintended consequence of requiring organizations with limited capacity to divert resources to accountants, auditors and others to collect, track and process the data required to meet the suggested reporting standards. The proposed changes will reduce service delivery and increase administrative overhead. Also very few changes add value other than more transparency (the largest value added new regulatory change in the Pension Act, the IRA rollover, is limited to only two years).

Generally, when I study the background on these changes the intentions are good and fit with the types of governance procedures I promote. However, I also feel they are often addressing problems that are faced more often by large, financially comfortable organizations such as colleges, hospitals and foundations. It is the rare small nonprofit that need worry about over "compensation." More often I worry about under-compensation and assisting organizations to not only run their programs effectively and efficiently but raise all the money they can to increase their capacity for service. I work with many many honest hard working fundraisers who struggle every day to increase resources for services that used to be provided by the government. In recent years, many public schools and even cities have needed assistance in raising private funds.

I ask you to do a "cost-benefit analysis" of every proposed change before it is made—especially the cost to smaller agencies.

- Is this new regulation really needed?

- How will it benefit the public?
- Will compliance reduce services to the public?
- Will this new regulation really promote more effective as well as transparent services?
- Should the same information be required from all nonprofits regardless of size, type or focus?

Thank you for your consideration,

Ann Lehman
Partner

p.s. At the hearing on July 24, 2007 I read that nonprofit abuses ". . . included inflated valuation of non-cash donations, charities that are established primarily to benefit a single donor, abusive donor-advised-fund arrangements, the blurring of the line between tax-exempt and commercial activities, excessive compensation, and improper political activities. . . ." These abuse should not be dismissed, but rarely affect small to midsize nonprofits and do not warrant the increase in regulations and scrutiny that has been recently heaped on all nonprofits. Rather than increasing overhead expenses for all—which donors hate to fund—the IRS should do a better job ferreting out the bad players.