COUNCIL *on* FOUNDATIONS

May 28, 2021

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2021-28) Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

RE: Recommendations for 2021-2022 Priority Guidance Plan Notice 2021- 28

Dear Ladies and Gentlemen:

On behalf of the Council on Foundations (the Council), we write to urge the Treasury Department and the Internal Revenue Service to include the items below in the 2021-2022 Priority Guidance Plan.

The Council is a nonprofit leadership organization of nearly 800 grantmaking foundations and corporations. As a national voice of philanthropy, the Council works to foster an environment in which philanthropy is a trusted partner in advancing the greater good. Our foundation members and the organizations that they help fund would benefit significantly from further clarity on each of the regulatory issues outlined below.

1. Donor Advised Funds: Regulations Addressing Certain Issues
2. Foundation Sponsored Student Loan Forgiveness Programs
3. Provide Guidance on Economic Development and COVID Relief as Charitable Activities
4. Update guidance relating to grants to Mexican charities under the U.S.-Mexico Income Tax Convention (the "Treaty")
5. Continued Enforcement of Johnson Amendment
6. Improve the Reporting of Government Revenue through Modifications of the Form 990

To assist Treasury in developing guidance, the Council has provided more information as well as examples of situations our members have encountered that illustrate the need for guidance in each area described above.

Donor Advised Funds: Regulations Addressing Certain Issues

We support the continuation of the work that Treasury and the IRS have done to provide guidance on donor advised funds ("DAFs"), and particularly believe that proposed regulations under sections 4966 and 4967 should be a high priority. It has been fifteen years since the Pension Protection Act of 2006 codified the definition of "DAFs in Section 4966 of the Internal Revenue Code.

Under Sections 4966 and 4967, a fund that meets the definition of a DAF must be managed subject to certain restrictions on "taxable distributions" and the provision of more than an "incidental benefit" on disqualified persons, and can result in significant taxes. These rules also generally prohibit DAFs from making grants to individuals or grants to non-charities and certain other

organizations unless the sponsoring organization exercises expenditure responsibility over the grant.

Although we have concerns regarding some of the proposals in Notice 2017-23, we appreciate the guidance on pledges and bifurcated payments. However, there are still significant areas in which DAF sponsors have had no guidance from Treasury or the IRS. This lack of guidance results in inconsistency across the sector and confusion for sponsoring organizations and donors contributing to DAFs. It also has hampered our efforts to establish standards for sponsoring organizations.

For example, there is no guidance on the key terms in the statute, including the definition of what is and is not a donor advised fund as well as what constitutes advice that confers more than an incidental benefit upon a disqualified person. Regulations can also provide certainty to sponsoring organizations, so they know the parameters and where there is room for innovation in improving philanthropy through the use of DAFs. We would be pleased to offer you our assistance and the experience of our members to help bring this rulemaking effort to fruition expeditiously.

Section 4966 Definition of "Taxable Distribution"

One common situation encountered by sponsoring organizations of donor advised funds is the request to make in-kind grants for the benefit of individuals, such as backpacks full of school supplies to schools to then be distributed to the students. While clearly charitable, this request can be difficult for sponsoring organizations to effectuate for many reasons. First, it is not clear that a sponsoring organization may purchase goods or services from vendors due to the risk that the payment to the vendor would be treated as a taxable distribution. Second, if the vendor is a disqualified person under Section 4958(f)(7), it is unclear whether a purchase at fair market value would confer "more than an incidental benefit" upon the vendor. Third, it is not clear whether distributing the school supplies to schools for the benefit of children is a taxable distribution. Regulations clarifying whether and how sponsoring organizations may use donor advised funds to make in-kind distributions would be helpful as these issues regularly occur and sponsoring organizations may have differing interpretations of what is acceptable under the statute.

Exemptions or Exclusions for Certain Funds

Section 4966(d)(2)(c) grants the Secretary of the Treasury authority to exempt a fund or account from treatment as a donor advised fund "(i) if such fund or account is advised by a committee not directly or indirectly controlled by the donor or any person appointed or designated by the donor for the purpose of advising with respect to distributions from such fund (and any related parties), or (ii) if such fund benefits a single identified charitable purpose."

There is significant confusion within the philanthropic community over whether the statutory definition of "donor advised fund" under Section 4966(d)(2)(B) includes these types of funds:

- Funds with multiple unrelated donors including giving circles
- Funds established by civic organizations and other membership associations
- Funds established by public charities and governmental entities
- Funds established by private foundations
- Memorial funds

Our members would benefit significantly from additional precision around the definition of "donor" as applied to these situations. The Council on Foundations suggests that groups of unrelated individuals, whether organized informally as a giving circle, or more formally as a civic club such as Rotary, who contribute to a fund at a sponsoring organization, and who collectively decide on grant recommendations, do not meet the definition of "donor" for purposes of a donor advised fund, and therefore, should not be subject to the restrictions set forth in Sections 4966 and 4967.

Additionally, the Council suggests that a fund established by another charitable organization, whether public charity, private foundation, church, or school, to make grants to other charitable organizations or for charitable purposes also should not be treated as a donor advised fund, even if individuals associated with the charitable funder provide advice regarding grants from the fund. As an example: a church establishes a fund at a community foundation to accept contributions to support various charitable activities of the church. The church understands the requirements of a component fund and wants to benefit from the financial management and investment of the community foundation, while keeping the fund assets separate from the general operating funds of the church. The church intends to appoint a committee of church members to advise the community foundation regarding distributions from the fund. Occasionally, the church may want to recommend a grant from the fund to itself, for an unexpected need such as building repair. If the fund were considered a donor advised fund, Section 4967 would prohibit such a grant due to the benefit flowing back to the donor. The Council believes such a prohibition does not reflect the intent of Section 4967 which is intended to prohibit benefits from donor advised funds to individual donors rather than other charitable organizations.

Other Funds with Limited Advisory Privileges

The Council requests that the Secretary except from the definition of DAF certain scholarship funds (student loan forgiveness described below) and other funds regarding which donors have limited advisory privileges.

As stated above, the Pension Protection Act of 2006 and IRC Section 4966 codified the definition of "donor advised fund." Section 4966 also provides for several important exceptions to the definition of DAF, specifically:

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

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

- The donor (or person appointed or designated by the donor) exercises his/her advisory privileges exclusively as a member of the committee, all members of which are appointed by the sponsoring organization.
- No combination of donors, persons appointed or designated by the donor, or persons related to either, may control, directly or indirectly, the committee.

- All grants from the fund must be awarded according to objective and nondiscriminatory criteria approved in advance by the board of the sponsoring organization and procedures meeting certain requirements of IRC Section 4945(g).

Many community foundations maintain donor advised funds in which the donor, or persons appointed or designated by the donor, expect, and are given sole advisory privileges regarding the distributions or investment of the fund. Many community foundations also maintain funds that comply with the "scholarship exception" rules and allow donor participation, but only as part of a committee appointed by the sponsoring organization. Finally, many community foundations maintain various other types of funds, including field of interest funds, designated funds, and geographic affiliate funds, and allow varying degrees of participation by one or multiple donors in decisions related to distributions from these funds. Often referred to as "advisory committees," these groups, made up of donors and other community members, provide valuable recommendations and input to the sponsoring organization.

Funds should be excluded from the definition of donor advised funds if the sponsoring organization (as opposed to the donor or related parties) either (a) controls the advisory committee that selects grant recipients, (b) appoints the fund advisors, or (c) the fund is not separately identified by reference to contributions of a donor or donors.

The Council also proposes that "Community Informed Funds" be recognized as non-donor advised funds. These funds operate with donor and community involvement and have been in practice at community foundations for many years, long before the Pension Protection Act of 2006. There are no specific rules regarding how and when a donor or other members of the community can advise or be involved with these funds, and it would be helpful to have these issues specifically addressed through regulations. Community Informed Funds serve an important function for the community foundation by providing a vehicle for community engagement and facilitate the foundation's role as a community partner, leader and convener that actively brings other community institutions, resources, and individuals together to address a community's greatest opportunities and critical challenges.

The Council further proposes that guidelines be adopted to define a consistent approach to donor and community involvement with these funds and provide assurance to community foundations that an option exists, outside the donor advised fund model, for donors and community members to be engaged with particular funds and grant making decisions without the restrictions placed on donor advised funds.

Foundation Sponsored Student Loan Forgiveness Programs

With many U.S. communities struggling to retain local college graduates as part of their economic growth strategies, community foundations are exploring programs for funds that would offer student loan forgives to individuals who agree to live and work in these smaller communities. This assistance would offer the added benefit of addressing the student loan crisis affecting many young adults.

We believe that foundation-sponsored student loan forgiveness programs should be treated as qualifying distributions for purposes of 4945(g)(1) and that providing student loan forgiveness to

individuals is a charitable purpose within the meaning of Section 170(c)(2)(B), similar to the qualification of scholarships.

Foundations view student loan forgiveness as one part of an overall economic development strategy. Treasury has a history of providing Revenue Ruling, Private Letter Rulings, and additional examples regarding economic development as a charitable purpose; and the Council is requesting specific guidance, such as a Revenue Ruling, related to student loan forgives programs in an economic development context.

While we are not suggesting a government sponsored program, the student loan forgiveness program in any guidance could resemble the structure of the National Health Services Corps Loan Repayment Program for medical professionals or the Teacher Loan Forgiveness program for teachers committing to serve a specific period in a high-need area. The program dollars are primarily intended to help workers pay off student debt. Foundations would work with donors to raise funding for the program and the foundations would manage the administration of the program. Award recipients are expected to live and work in their communities to be eligible, and any payments would go directly to the lenders.

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

Guidance from Treasury including foundation sponsored student loan forgiveness programs would be a critical step facilitating an important tool for our communities to build resiliency and talent.

Provide Guidance on Economic Development and COVID Relief as Charitable Activities

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

The Council often fields questions from its members regarding economic development, and the COVID crisis has added to those requests. Prior to COVID, community foundations have been interested in creating funds and using charitable dollars to support activities such as redevelopment of city centers, small business incubation, job training programs, home purchase assistance, and promotion of local communities for new business relocation and tourism. During the past year, economic development activities have expanded to help businesses and workers that were heavily impacted by the COVID crisis. Foundations and philanthropies are also expected to be on the forefront of rebuilding as the crisis abates.

Foundations have been able to look at several rulings dating to the 1970s that provide guidance regarding the factors that will support a finding by the IRS that an activity is charitable. We also have several more recent rulings, whereby the Service has determined that certain activities are not charitable. However, it can be particularly difficult to determine when and how organizations can support for-profit businesses or work with governmental entities. As the world of philanthropy has grown and developed over the past forty years, there is a consensus in the field that this type of guidance needs to be provided so there is a consistent test that can be applied by foundations and other organizations working in economic development.

The Council urges Treasury to consider updating previous guidance regarding economic development as a charitable activity in ways that can also be helpful for those organizations working in COVID relief, by providing a more definitive test and/or examples of acceptable charitable activities that reflect the current needs and economic climate in many communities. For reference, we are including examples involving fact patterns encountered by the Council's foundation members that Treasury could utilize in illustrative guidance.

- In the wake of the Covid-19 public health emergency, a community foundation is asked to establish a charitable fund to distribute grants to local small businesses to assist with short-term needs arising from mandated shutdowns (e.g., rent, utilities, or other essential expenses) or to support compliance with new public health requirements.
- The Chamber of Commerce is sponsoring an initiative to encourage new small businesses to locate in a deteriorating section of downtown. They approach a community foundation about establishing a charitable fund to solicit and collect charitable contributions from individuals and businesses. The Community foundation will then make grants to assist individuals with expenses associated with establishing new small businesses provided they agree to locate to this area. The grants will be awarded based on an objective and nondiscriminatory application process. No grants will be awarded to the Chamber of Commerce, but members of the Chamber may volunteer as part of the application review committee.
- A rural airport needs to build a new control tower. The airport is owned by a government entity (the airport authority) and is used by the public. The authority would like a accept charitable contributions for this purpose, or work with a community foundation to establish a temporary fund that would accept contributions and make grants to the authority to be used for the building expenses.
- A rural municipality desires to expand internet services to its citizens and wants to collect charitable donations to build infrastructure.
- A city government wants to promote the city as a location for filming television and movies and wants to establish a charitable fund to collect donations to be used to pay expenses of a promotional campaign.

Request for Updated Guidance under the U.S.–Mexico Income Tax Convention

Under Article 22 of the U.S.–Mexico Income Tax Convention (the "Treaty"), and Article 17 of the Protocol to that convention, the U.S. and Mexico have agreed that certain Mexican charities meeting standards "essentially equivalent" to those applicable to U.S. public charities (originally those described in Article 70–B of the Mexican Income Tax Law) would be treated as public charities for purposes of grants from U.S. public charities and private foundations. Such Mexican charities are also exempt from U.S. income taxes to the same extent as their U.S. counterparts, and charitable contributions to such Mexican charities are eligible for U.S. income tax deductions (subject to some limitations).

In Information Letter 2003-158 (Sept. 30, 2003), the IRS confirmed that U.S. grantmakers could rely on the Mexican Ministry of Finance and Public Credit's determination of Article 70–B status, set forth either in a letter from that agency providing special authorization under Article 70–B, or reflected in the current official list of Mexican charities published in the Mexican *Official Gazette* (*el diario official de la Federacion*). That guidance, however, is now out of date. Mexico has renumbered its income tax provisions a few times since ratification of the Treaty; for more than a decade, former Article 70–B has been found in Article 97. However, it was moved to Article 82 of a Mexican Income Tax Law that took effect January 1, 2014, which also contains provisions governing other types of charities. There have been some minor substantive changes made to Article 97 at various points over the years. Article 82 includes additional changes (particularly regarding activities influencing legislation), and it was further amended in legislation that took effect April 23, 2021. However, the core requirements for public charities under former Article 70-B (to be organized and operated exclusively for exempt purposes, to avoid private inurement, to have a valid dissolution clause, etc.) are still in place.

The most current version of the list of Mexican charities eligible to receive tax-deductible contributions is available online at https://www.sat.gob.mx/consultas/27717/conoce-el-directorio-de-donatarias-autorizadas. Those organizations qualifying for treaty benefits have been specially designated as type "M" organizations; the list expressly states that such organizations meet the requirements of Article 82, formerly Article 70-B.

Until 2014, private foundations and other donors could generally rely on the Mexican authorities' determination that an organization qualified under Article 97 and former Article 70–B to treat it as a public charity. However, the recent changes inhibit many grantmakers from relying on the Mexican Treaty until Treasury and the IRS provide clear guidance about how it applies following the changes made to the Mexican Income Tax Law. We would specifically request that Treasury, consulting with the Mexican government as necessary, do the following:

- Identify the class of Mexican charities that will be treated as "essentially equivalent" to Sections 509(a)(1) and 509(a)(2) public charities under the new Mexican Income Tax Law in effect as of January 1, 2014 and provide updated information as to the documentation upon which U.S. grantmakers can rely for purposes of determining status of a Mexican organization under the Treaty.
- Confirm that under Article 2(4) of the Treaty, Section 4966's excise tax is a subsequently added excise tax "identical or substantially similar" to Section 4945, and that donor

advised funds can therefore rely on the Treaty to the same extent as private foundations and other public charities.

The Council continues to hear from members about issues arising from Mexico's anti-money laundering and anti-terrorist financing rules that are causing considerable confusion among U.S. grantmakers and are having an impact on the grantmaking authorized by the Treaty. Public statements by officials from the Treasury financial crimes enforcement agency, FinCEN, indicate that there has been coordination between Mexico and FinCEN on various enforcement matters.[1] Many of the concerns of our members arise from confusion regarding the nature and extent of information that U.S. grantmakers must provide to the Unidad de Inteligencia Financiera ("UIF"), particularly personal identifying information. Given the impact of the rules on Treaty-authorized grantmaking, we ask that Treasury consider raising the need for greater clarity in the reporting obligation when it discusses the Treaty issues with Mexico noted above.

Continued Enforcement of the Johnson Amendment

We urge the IRS and Treasury to continue enforcing the prohibition again political campaign activity by Section 501(c)(3) organizations and to maintain the standard established in Revenue Ruling 2007-41 and other published guidance that limit political campaign intervention. It is critical to preserve the demarcation between political activity and charitable activity for the good of the sector. We are concerned that if Section 501(c)(3) organizations are permitted to engage in political activity, donors will use them to claim charitable contribution deductions and anonymity for political contributions. To the extent regulation in this area is desirable and allowed, Treasury may wish to consider offering a legislative proposal to deem all funds used for political activity to have been conducted by a Section 527 organization, which are designed for that purpose and include an appropriate disclosure mechanism.

Improve the Reporting of Government Revenue Through Modifications to Part VIII of the Form 990

The Form 990 is an important tool for exempt organizations to provide information about their finances both to the IRS and to the public, however the reporting for governmental funding results in a lack of clarity. Government has emerged as one of the largest funders of nonprofit activity in the United States. It is therefore vitally important for the Form 990 to show a full picture of the overall scope of government funding of the nonprofit sector. This can then be used to show how this support has varied over the years, and what types of nonprofits and areas of the country are experiencing changes in government funding.

Unfortunately, the Form 990 Part VIII Statement of Revenue continues to lack sufficient clarity with respect to the reporting of government revenue, confusing users of the form, and likely

[1] *See, e.g.* FinCEN and Mexican Counterpart Shine Spotlight on Cross-Border Cash Couriers, FinCEN Press Release, August 1, 2014, and Jennifer Shasky Calvery, Director, Financial Crimes Enforcement Network, remarks to the *Mexican Bankers Association AML/CFT Seminar,* October 3, 2014.

resulting in inaccurate reporting. In particular, two of the largest sources of government support to the nonprofit sector—voucher-type reimbursements such as Medicare and Medicaid, and government contracts—are included in the "program service revenue" line along with private payments for services. Therefore, organizations that do not have to file Schedule H do not report separately their revenue from Medicare, Medicaid and other reimbursement payments.

Similarly, despite the fact that government contracts are a major and common source of nonprofit revenue, they are not separated on the Form 990, leading to additional confusion, particularly because contracts may fall either under Part VIII, line 1(e) (government grants), if they benefit the public as whole, or within Part VIII, section 2 (program service revenue), if the contract primarily benefits a government agency. Nowhere on the form is the totality of government support reported. Nor can this be computed from elements of it that are reported since some of the most sizable elements are incorporated into larger categories. To avoid these problems, government revenue should be more clearly labeled and distinguished in the Form 990, as noted in the following proposed changes to the form:

- Create a Dedicated Line for Government Reimbursements (e.g., Medicare/Medicaid and Contracts) in Part VIII, line 2(a)
- Clarify the Distinctions Between Government Transfers (Grants) and Private Charitable Contributions, and between Government Program Service Revenue and Market Sales

Conclusion

Thank you for the opportunity to comment on priorities to include in the 2021-2022 Priority Guidance Plan. We would welcome the opportunity to discuss any of these matters with the IRS or with the Department of Treasury if it would be helpful. In particular, the Council offers its support for convening more informal discussions of the compliance issues faced by U.S. grantmakers. Please contact me for additional information or analysis on any of these topics.

Sincerely,

David Kass
Vice President, Government Affairs
Council on Foundations