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August 7, 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, DC 20515

Re: Public Comment in Response to Subcommittee Advisory OV-4

Dear Chairman Lewis:

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 CEO 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 59 ½, 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

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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 dialogue 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.

Respectfully submitted,



Patricia Read
Senior Vice President, Public Policy and Government Relations
Independent Sector