INSTITUTE FOR FREE SPEECH

February 13, 2020

*Via U.S. and Electronic Mail*

Charles P. Rettig, Commissioner
Internal Revenue Service
CC:PA:LPD:PR (Notice 2017-73)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044
Notice.Comments@irscounsel.treas.gov

**RE: Comment on Notice 2017-73 Concerning New Information Reporting Required to Treat Contributions from Donor Advised Funds as Public Support**

Dear Commissioner Rettig:

On behalf of the Institute for Free Speech,[1] I respectfully submit the following comments on Notice 2017-73 (the "Notice") concerning new information reporting required to treat contributions from donor advised funds as public support. As described in Section 5 of the Notice, the Department of the Treasury (the "Treasury") and the Internal Revenue Service (the "IRS" or the "Service") are considering proposing regulations to treat contributions from a donor advised fund as an indirect contribution from a donor advisor that funded the donor advised fund (rather than as a contribution from the sponsoring organization, which is currently the case) for purposes of calculating the grantee organization's public support test. For purposes of the public support calculation, any contributions to the grantee organization from any donor advised fund that the sponsoring organization fails to identify as being made from a specific donor would be treated as being made by a single individual.

This proposed change would require that a recipient organization obtain the additional donor information from the donor advised fund's sponsoring organization (and that the sponsoring organization provide such information), or the recipient organization will not be allowed to treat such contributions as public support.

The Institute's comment focuses on concerns that are grounded in procedure and the structure of the public support test under the Treasury Regulations and the Internal Revenue Code.

[1] The Institute is a nonpartisan, nonprofit Section 501(c)(3) organization that promotes and protects the First Amendment political rights of speech, press, assembly, and petition. It was founded in 2005 by Bradley A. Smith, a former chairman of the Federal Election Commission. In addition to scholarly and educational work, the Institute is actively involved in targeted litigation against unconstitutional laws at both the state and federal levels.

1. **<u>The requirement under the proposal to disclose donor information to recipient organizations is contrary to congressional intent because Code Section 6104, which requires public disclosure of certain information, does not require public disclosure of donor information by Section 501(c)(3) organizations (other than private foundations)</u>.**

The proposal, which would require disclosure of donor information to recipient organizations of donor advised funds, is inconsistent with existing congressionally-imposed statutory requirements for donor disclosure. Specifically, Code Section 6104 requires tax-exempt organizations to disclose only certain information to the general public and expressly states that donor information is not required to be disclosed to the general public. I.R.C. § 6104(d)(3)(A). Private organizations that receive donor advised fund grants are a subset of the general public, as they are not the IRS or other governmental authority authorized to receive this information. The proposal is contrary to the determination of Congress that non-private foundation Section 501(c)(3) organizations do not need to disclose donor information to the public because the proposal requires sponsoring organizations to disclose donor information to recipient organizations. The proposal is inconsistent with existing statutory provisions and therefore should be withdrawn.

Code Section 6104 governs the disclosure of return information for Section 501(c)(3) organizations. In adopting this section, Congress carefully balanced tax compliance concerns with donor privacy and the added burden of disclosure on Section 501(c)(3) organizations. Under Code Section 6104(b), there is an explicit requirement that Section 501(c)(3) organizations make their annual tax return (usually Form 990) available to the public.[2] However, under Code Section 6104(d), donor information on Schedule B is not subject to public inspection (with the exception of private foundations, which must disclose Schedule B to the public). Accordingly, a sponsoring organization of donor advised funds is not currently required to make publicly available the names and addresses of their donors. In adopting Code Section 6104, Congress established the requirements for disclosure of donor information to third parties, but expressly excluded non-private foundation Section 501(c)(3) organizations from the requirement to disclose donor information.

The donor information disclosure required under the proposal is inconsistent with the donor privacy provisions of Code Section 6104. Congress already made a determination under Code Section 6104 not to require public disclosure of donor information (balancing between the need for tax administration and supervision for charities and donor privacy), and Congress retains this prerogative. The Treasury and IRS should not and may not use regulations to upset established statutory requirements for donor disclosure.

The legislative history of Code Section 6104 shows that Congress intended to limit requirements for donor disclosure to third parties (i.e., parties that are not the IRS). As part of the Tax Reform Act of 1969, which included the public support tests, Congress added language to

[2] Congress adopted Code Section 6033 to provide a framework for information returns filed by Section 501(c)(3) organizations. Code Section 6033(b)(5) requires that Section 501(c)(3) organizations provide the names and addresses of all substantial contributors on Form 990. Organizations provide this information on Schedule B of Form 990. Under the Pension Protection Act of 2006, Congress amended Code Section 6033 to include a disclosure requirement if the Section 501(c)(3) organization holds any donor advised funds.

Code Section 6104 providing that names and addresses of contributors to tax-exempt organizations other than private foundations did not need to be disclosed to the public. Tax Reform Act of 1969, Pub. L. No. 91-172, § 101(e), 83 Stat. 487, 523.

The Senate Report for the Tax Reform Act of 1969 provided the following discussion of this donor disclosure provision:

> "A second change in present law made by the House bill required that there be shown on each information return the names and addresses of all substantial contributors, directors, trustees, and other management officials and of highly compensated employees… The committee is in accord with these changes except that it decided not to require that the names and addresses of substantial contributors be disclosed to the public in the case of exempt organizations other than private foundations (such organizations would, however, be required to disclose these names to the Internal Revenue Service). **The committee made this modification because some donors prefer to give anonymously. To require public disclosure in these cases might prevent the gifts.**" (emphasis added)
>
> S. Rep. No. 91-552 (1969).

In 1969 (and continuing to more recent reforms), Congress has weighed the need for donor privacy against information disclosure and determined that the names and addresses of substantial contributors to exempt organizations would not be required to be disclosed to the public or third parties. To require third party disclosure in this context would conflict with the intent of Congress to preserve anonymous and non-disclosed contributions. Under the proposal, the names of donors will be provided to the recipient organizations in order for the recipient organization to treat the grants as public support, thus creating a penalty for respecting a donor's privacy. The ability to make anonymous contributions (which was central in the minds of lawmakers in 1969 in adopting these public charity rules) is an important and long-accepted benefit of using a donor advised fund.

Recently, cognizant of the weighing Congress has engaged in between compliance and maintaining privacy, Treasury and the IRS have issued proposed regulations that would bring information return requirements for certain tax-exempt organizations in line with the specific statutory language in 6104 by eliminating the requirement to report the names and addresses of certain donors on Form 990, Schedule B for certain tax-exempt organizations (including 501(c)(4) and 501(c)(6) organizations).[3] In so doing, Treasury has proposed to narrow disclosure to more closely fit congressional intent; Treasury should make a similar attempt in this Notice to reject attempts to require disclosure beyond what Congress has provided for.

[3] Notice of Proposed Rulemaking, Guidance Under Section 6033 Regarding the Reporting Requirements of Exempt Organizations, 84 Fed. Reg. 47447 (September 10, 2019).

2. **Due to the invasiveness of third party information reporting and the need to carefully balance this concern with efficient tax administration, any third party information reporting requirements for tax-exempt organizations should be imposed by statute, not regulation.**

The requirement in the proposal for sponsoring organizations to provide donor information to grant recipients in order for those recipients to treat the grants as public support amounts to a new form of information reporting by the sponsoring organization. Third party information reporting is a significant and invasive obligation that should only be imposed by Congress through statute, after Congress has weighed the invasiveness, costs, and other burdens of the new information reporting obligation against the need for efficient tax administration. As such, if such a proposal is deemed necessary, it should be adopted by statute, not regulation.

Congress has established a general policy, under Code Section 6103, that tax returns and tax return information are private between the taxpayer and the IRS. Code Section 6103 imposes recordkeeping and safeguard requirements to protect the confidentiality of returns and return information. Criminal and civil sanctions apply to the unauthorized disclosure or inspection of returns and return information. *See* I.R.C. §§ 7213(a) (felony for willful violations); 7431(a) (civil damages).

Congress has created exceptions to this general policy of confidentiality by adopting specific provisions relating to third party disclosure; generally, these reporting requirements are either imposed directly by statute, or by a statute contemplating some sort of information reporting that then authorizes the Treasury Department to issue a regulation requiring reporting. *See, e.g.*, I.R.C. §§ 6041 et seq. (Form 1099); 6051–6053 (Form W-2); 3402(f) (Form W-4); 3406 (Form W-9).

Information reporting requirements similar to the proposal have been imposed by statute. Code Section 170(f)(8) provides that an individual taxpayer cannot take a charitable income tax deduction for any contribution of $250 or more unless the charitable organization provides a contemporaneous written acknowledgment to the taxpayer containing certain specified information.

Earlier, in the Tax Reform Act of 1984 (Pub. L. No. 98-369), in lieu of amending Code Section 170, Congress included a directive in Section 155 of the Act directing Treasury to issue regulations incorporating appraisal and reporting requirements for contributions of property (Treasury issued Regulations Section 1.170A-13 imposing various appraisal and information reporting requirements for contributions of property in response to this congressional directive).

In each case, Congress was responsible for imposing the information reporting obligation, or directing Treasury to adopt regulations imposing such an obligation. Information reporting is not to be taken lightly, as seen by the existence of Code Section 6103 and the penalties for disclosing confidential taxpayer information. Statutory change is the appropriate method for deviating from this general policy of taxpayer confidentiality.

3. **<u>The proposal ignores the legal reality of a donor advised fund by overlooking the existing statutory and regulatory framework governing the operation of donor advised funds and sponsoring organizations</u>.**

The proposal says that "a sponsoring organization's distribution from a DAF [must be treated] as coming from the donor (or donors) that funded the DAF rather than from the" DAF. This is not clear, but we presume it means that the contribution must be treated as if it was made by a donor advisor who contributed to the DAF and recommended the contribution.

If the DAF does not disclose to the recipient organization the identity of the donor advisor (or donor advisors) that funded the donor advised fund, all anonymous DAF contributions would be treated as being made by one person.

In either case, this treatment is inconsistent with the legal rights of a sponsoring organization of a donor advised fund under existing law. That is because the sponsoring organization has absolute legal power to make decisions with regard to the donor advised fund assets, including making grants to recipient organizations.

Specifically, Treasury Regulations Section 1.170A-9(f)(11) provides that if a sponsoring organization has the power to modify the terms of a gift, then the fund is treated as part of the sponsoring organization. This rule was not changed by the donor advised fund reform measures in the Pension Protection Act of 2006, and moreover, the IRS left in Treasury Regulations Section 1.170A-9(f)(11) following the enactment of the Pension Protection Act.

As an example of the application of this concept, after the National Heritage Foundation filed for bankruptcy in 2009, the Foundation's donor advised funds were subject to claims of the creditors of the bankruptcy estate. The donor advisors of these funds had no legal claim to the assets in the funds.

The proposal flies in the face of this legal reality by disregarding a fundamental point about donor advised funds: the assets in donor advised funds and the distributions made from these funds are made by the sponsoring organization. The proposal seeks to treat donor advised funds differently from this established reality.

The proposal also seeks to make changes without statutory authority, in an area in which Congress has already acted. Congress closely reviewed donor advised funds in 2006 and took action to treat donor advised funds as separate funds, subjecting them to private foundation-like rules for some purposes, but not for all purposes. For example, the Pension Protection Act added provisions treating donor advised funds similarly to private foundations for purposes of conflict of interest rules (the definition of "excess benefit" in Code Section 4958 and prohibited benefits for donors and advisors under Code Section 4967); excess business holdings (Code Section 4943); and expenditures not for charitable purposes (Code Section 4966). But Congress chose not to change the fundamental rules about the legal and tax nature of donor advised funds – that these funds are really only part of the sponsoring organization – yet the proposal would change these fundamental rules.

4. **The proposal will create significant administrative burdens to address the perceived issue of organizations avoiding private foundation status through support from donor advised funds, even though there is no evidence as to whether the proposal would actually prevent any violations of the private foundation rules.**

The proposal is intended to prevent abuses stemming from organizations being treated as public charities under the public support tests when they should be considered private foundations (and subject to the private foundation rules). As stated in the comment submitted by the American Bar Association Section of Taxation on April 19, 2018, "it is not clear to the Section that support from donor advised funds is, in fact, permitting charities that otherwise would be private foundations to be classified as publicly supported under Section 170(b)(1)(A)(vi)." ABA Section of Taxation Comment, Page 9.

We agree with the American Bar Association Section of Taxation on this point, but this analysis does not go far enough. Even if the IRS and Treasury were to show that recipient organizations are receiving grants from donor advised funds in a way that allows them to be classified as public charities instead of private foundations, the IRS and Treasury should also confirm that those organizations would then actually also be violating private foundation rules (Code Sections 4940–4945), such as making taxable expenditures or self-dealing. The IRS and Treasury should conduct and make public such research before such a burdensome regulation is considered.

If it conducted such research, we think Treasury would find, as is our experience, that the primary reason that organizations seek to avoid being classified as a private foundation is not for the purpose of entering into self-dealing transactions. Rather, it is simply to ensure that the organization remain a public charity for fundraising purposes. Many private foundations, as a matter of policy, do not make grants to any type of organization other than publicly-supported charities. Knowing this, most organizations will seek to avoid classification of private foundation status only to ensure that they can continue to effectively fundraise to fulfill their charitable mission. Unless there is good evidence that organizations are being misclassified for the purpose of violating the private foundation rules, the IRS and Treasury should avoid imposing this type of onerous regulation on the charitable sector.

The IRS and Treasury have not sufficiently documented any alleged harm resulting from misclassification of private foundations as public charities through the use of donor advised funds. Despite this failure, the proposal would impose new restrictions that will create several serious new problems for the charitable sector. The administrative burden of the proposal will create a compliance burden for all recipient organizations, but for small and innovative organizations that happen to be funded with contributions from one or more donor advised funds, the compliance burden will be especially heavy or impossible. These organizations often struggle with fundraising, staffing, and complying with reporting requirements, especially during early stages of operation. New, innovative organizations facing uncertainty in securing sources of contributions will be required to attempt to collect donor information from donor advised funds to ensure sources of public support, even though there is no guarantee the sponsoring organization will provide the information.

Relatedly, the current treatment of contributions from donor advised funds as public support provides certainty for donors who make a grant from a donor advised fund to these new organizations but who do not wish to "tip" the organization into private foundation status and hamper its fundraising efforts. The proposal will jeopardize this approach and could cause many new organizations to be classified as private foundations (which will likely prevent these organizations from fundraising from the public or other foundations, where this support would otherwise allow the organization to flourish).

**5. <u>There are constitutional concerns with the proposal</u>.**

For decades, the Supreme Court has consistently shielded organizational donors and supporters from compelled disclosure of their associations. The important right to private association is a necessary component of the freedom to speak. After all, "[e]ffective advocacy of both public and private points of view . . . is undeniably enhanced by group association," and there is a "vital relationship between freedom to associate and privacy in one's associations." *NAACP v. Ala. ex rel. Patterson*, 357 U.S. 449, 460, 462 (1958). Furthermore, "it is immaterial whether the beliefs sought to be advanced by association pertain to political, economic, religious or cultural matters." *Id.* at 460. Accordingly, for purposes of this proposal, civic groups possess two foundational rights: (1) the First Amendment's protection of the right to engage in debate concerning public policy, and (2) the corresponding right to "privacy of association and belief." *NAACP v. Ala. ex rel. Patterson,* 357 U.S. 449, 464 (1958).

The freedom of association must be protected "not only against heavy-handed frontal attack, but also from being stifled by more subtle governmental interference," such as registration and disclosure requirements and the attendant sanctions for failing to disclose. *Bates v. City of Little Rock*, 361 U.S. 516, 523 (1960) (collecting cases). Indeed, the Supreme Court has "repeatedly found that compelled disclosure, in itself, can seriously infringe on privacy of association and belief guaranteed by the First Amendment." *Buckley v. Valeo*, 424 U.S. 1, 64 (1976) (per curiam).

Accordingly, when the government seeks to obtain private donor information from organizations, it must pass, at a minimum, the "strict test" of exacting scrutiny. *Id.* at 66. Under exacting scrutiny, the government must justify its disclosure demand and show that its interest in the information is "sufficiently important." *Id.* But significantly, "governmental action does not automatically become reasonably related to the achievement of a legitimate and substantial governmental purpose by mere assertion." *Bates*, 361 U.S. at 525. And therefore it is not enough for the government to simply invoke a general interest. *McCutcheon v. Fed. Election Comm'n*, 572 U.S. 185, 205 (2014) (Roberts, C.J., controlling opinion) ("[T]here are compelling reasons not to define the boundaries of the First Amendment by reference to such a generalized conception of the public good.").

Even if the government has a legitimate and substantial interest, it must still tailor the law to avoid unnecessarily burdening First Amendment rights. Exacting scrutiny's tailoring analysis is "not a loose form of judicial review." *Wis. Right to Life, Inc. v. Barland*, 751 F.3d 804, 840 (7th Cir. 2014). The courts will conduct a careful review of both the asserted governmental interest *and* whether the law is tailored to that interest, because "[i]n the First Amendment context, fit matters." *McCutcheon,* 572 U.S. at 218. Exacting scrutiny requires a fact-intensive analysis of the burdens

imposed and whether those burdens *actually* advance the government's interest. *See, e.g.*, *Sampson v. Buescher*, 625 F.3d 1247, 1260 (10th Cir. 2010) (balancing the "substantial burden" of Colorado's campaign finance reporting and disclosure regime against the informational interest at stake, which the Tenth Circuit considered "minimal").

Therefore, the Service must be ready to articulate the sufficiently important governmental interests supporting this additional layer of donor disclosure in connection with donor advised funds. It cannot simply state a generalized tax compliance interest or law enforcement interest. Furthermore, even if it articulates such an interest, the proposal must be tailored so as not to unnecessarily burden First Amendment rights. Respectfully, we do not believe the Service can meet that burden.

6. **There is significant doubt that the proposal will comply with the Paperwork Reduction Act.**

The proposal may not comply with Paperwork Reduction Act (44 U.S.C. § 3501, *et. seq*.) ("PRA") requirements. The proposal will require substantial paperwork from sponsoring organizations and recipient charities. The IRS may not impose new recordkeeping requirements on private entities – specifically, those involving the "collection of information" – unless it first conducts the required review of the burden such requirements would impose. 44 U.S.C. § 3506(c). The PRA does not cover merely those instances where regulated entities are required to affirmatively collect information from other parties. Rather, the statute also covers the underlying "recordkeeping requirements imposed on ten or more persons, other than agencies, instrumentalities, or employees of the United States." 44 U.S.C. § 3502(3)(A)(i). The proposal implicates the PRA, and the Service has an obligation to consider whether it is complaint with Congress' mandate to limit paperwork burdens. It has not done so.

7. **Alternatives to the proposal are not workable and should be dismissed.**

For the reasons set forth above, Treasury should not consider alternatives to the proposal in which the sponsoring organization would report the amount of donations from separate donors or provide some sort of attestation that contributions are from separate, unrelated donors.

These alternatives impose information reporting beyond Treasury's authority. In addition, these alternatives are based on the assumption that the donations are from an individual, and not a public charity, which is inconsistent with the structure and legal status of donor advised funds. Lastly, these requirements will impose a significant burden on all organizations, but especially new organizations.

8. **Regardless of whether the IRS and Treasury withdraw the proposal, the IRS and Treasury should adopt a safe harbor for the existing 10% public support facts and circumstances test in order to provide more certainty for organizations that are attempting to obtain (or maintain) public charity status.**

If adopted, the proposal will cause more organizations to rely on the 10% facts and circumstances public support test under Regulations Section 1.170A-9(f)(3) because many organizations' amounts of public support would decrease. The IRS and Treasury should consider revising the 10% facts and circumstances test to ensure that charities can comfortably rely on this

test to meet the public support requirement with a lower public support percentage. The application of any facts and circumstances test can lead to bias and viewpoint discrimination (*see, e.g.*, *Big Mama Rag, Inc. v. U.S.*), and this test is confusing and complicated; many organizations are uncomfortable with its application. Adding a safe harbor to the 10% facts and circumstances test would provide certainty, and in many, if not most, cases, it would simplify the test. This simplification would benefit both the charitable sector and the IRS.

The safe harbor could consist of the following requirements where the organization shows:

(i) the existence of an active fundraising appeal;

(ii) three board members unrelated to any substantial donor; and

(iii) at least 10% public support.

Under this new safe harbor, organizations that meet these three requirements would qualify as public charities.

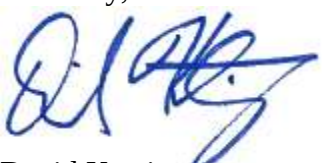
This safe harbor would address many of the perceived abuses that the existing public support test is designed to prevent. For instance, the unrelated board requirement would ensure that the organization is being governed and monitored by individuals who are not beholden to the interests of the substantial donors to the organization.

In the event the IRS and Treasury decline to withdraw the proposal, the 10% public support safe harbor described above would provide relief for organizations that would otherwise lose public charity status as a result of the new limitations and reporting burdens imposed on sponsoring organizations and donor advised funds under the proposal. Even if the IRS and Treasury were to withdraw the proposal, the IRS and Treasury should still consider adopting this safe harbor as a standalone proposal because of the benefits it would provide to the IRS and charities.

* * *

For the reasons outlined above, we respectfully request that the IRS and Treasury withdraw Section 5 of Notice 2017-73.

Sincerely,



David Keating
President