



national committee for  
responsive philanthropy

April 9, 2007

Mr. Mark W. Everson  
Commissioner  
Internal Revenue Service  
P.O. Box 7604  
Ben Franklin Station  
Washington, DC 20044

Dear Commissioner Everson,

On behalf of the Board of Directors, members and staff of the National Committee for Responsive Philanthropy, I am pleased to submit our comments for the study of donor-advised funds and supporting organizations being conducted by the IRS and the Department of the Treasury.

NCRP is suggesting that the IRS and the Department of the Treasury recommend that Congress:

- Require full and timely disclosure and reporting of distributions and investments for all donor-advised funds and supporting organizations;
- Subject donor-advised funds and supporting organizations to the excise tax, which could help support oversight and enforcement of accountability regulations by the IRS and state regulators;
- Require a 6 percent all-grants minimum annual spending requirement for all donor-advised funds and supporting organizations; and,
- Simplify the supporting organization structure by eliminating the Type III classification, through which most abuses occur.

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 workplace giving programs.

If you have any questions or need additional information, you can reach me at 202.387.9177 or at [adorfman@ncrp.org](mailto:adorfman@ncrp.org).

Sincerely,

Aaron Dorfman  
Executive Director



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## Protecting the Public Interest: Recommendations on Donor-Advised Funds and Supporting Organizations

### *Comments from the National Committee for Responsive Philanthropy, April 9, 2007*

The National Committee for Responsive Philanthropy (NCRP) is pleased to have the opportunity to provide comments to the Department of the Treasury and the Internal Revenue Service in response to Notice 2007-21, the study of donor-advised funds and supporting organizations as required by Section 1226 of the Pension Protection Act of 2006 (PPA).

As the nation's premier philanthropic watchdog with a 30-year track record of research and action on nonprofit and philanthropic accountability, NCRP is not a newcomer to the questions being addressed by the study. In June of 2004, NCRP included donor-advised funds in its statement on "Standards for Foundation and Corporate Grantmaking"<sup>1</sup> at a time when other national nonprofit organizations were giving scant or no attention to the problems involving these funds. NCRP presented testimony at hearings on charitable accountability later in the summer of 2004 and again called attention to troubling practices involving both donor-advised funds and supporting organizations.<sup>2</sup> We also investigated and reported on specific instances of especially egregious misuse of tax exempt funds by managers of donor-advised funds.<sup>3</sup>

In addition, NCRP addressed the problems of supporting organizations in its statement submitted to the Senate Finance Committee's July 2004 Charity Oversight and Reform roundtable.<sup>4</sup> More recently, NCRP commented widely on the problems of the Dixie and Anne Leavitt Foundation,<sup>5</sup> which, together with other press articles, contributed to some of

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<sup>1</sup> National Committee for Responsive Philanthropy, June 2004, <http://www.ncrp.org/downloads/NCRPAccountabilityStatement061804.pdf>.

<sup>2</sup> NCRP, "Recommendations for Reform of the United States Philanthropic Sector" (Statement presented to the Senate Finance Committee, June 22, 2004), <http://www.senate.gov/~finance/hearings/testimony/2004test/062204rctest.pdf>.

<sup>3</sup> Jeff Kreheley, "National Heritage Foundation: Pushing Tax Laws to the Limit," *Responsive Philanthropy* (Summer 2005): 5-7.

<sup>4</sup> NCRP, "On the Path to Philanthropic Reform: Concrete Steps toward Public and Private Accountability and Oversight" (Statement presented at the Senate Finance Committee Charity Oversight and Reform Roundtable, July 2004).

<sup>5</sup> "Groups seeks audit of Leavitt foundation," *Deseret Morning News*, August 9, 2006; Erin Stewart, "Watchdogs await audit of Leavitt Foundation," *Deseret Morning News*, August 9, 2006; Suzanne Struglinski, "New law would impact Leavitts," *Deseret Morning News*, August 5, 2006; "Our Turn: Time to take a hammer to piggy banks for rich," *San Antonio Express-News*, July 29, 2006; Robert Gehrke, "Another look at Leavitt charities," *The Salt Lake Tribune*, July 29, 2006; Howard Berkes, "Leavitt Charity's \$500,000 Returns, in the Form of Rent," *All Things Considered/National Public Radio*, July 28, 2006; Robert Gehrke and Thomas Burr, "Leavitt's 'Teflon' image is under fire," *The Salt Lake Tribune*, July 27, 2006; Kevin

the beneficial provisions on supporting organizations in the PPA. Our commentary here returns to the themes that NCRP has raised in its previous public statements.

## DONOR-ADVISED FUNDS

Donor-advised funds offer charitable donors much of the benefits of private foundations, but with some important distinctions. Unlike a private foundation, the donor establishing a donor-advised fund at a public charity can provide ostensibly only nonbinding recommendations regarding the use of the given amount. In return, the donor is alleviated of some portion of the administrative expenses normally associated with private foundations. However, public charities and others managing donor-advised funds generally charge a fee for administering the contribution.

The growth in donor-advised funds has been significant, although total assets of this type of fund trails behind private foundations. The *Chronicle of Philanthropy's* most recent survey of 88 commercial gift funds and community foundations that administer donor-advised funds counted 92,806 funds in operation, an increase of 10 percent over the previous year's survey, as well as an increase in asset value of over 22 percent to \$15.5 billion from 2004 to 2005.<sup>6</sup> The sample used by the *Chronicle* reveals only a small slice of the world of donor-advised funds. Because these funds were not even defined with much specificity before the PPA and public charities are not required to report on the assets and distributions of their donor-advised funds, the exact total of funds is actually unknown.<sup>7</sup> The *Chronicle's* survey includes only 50 of the more than 600 community foundations in the United States. Additionally, donor-advised funds have been solicited and managed by entities as diverse as universities, hospitals, and the United Way.

This constitutes a world of hidden philanthropy that merits significantly upgraded disclosure—by donor-advised funds—of assets and how these assets are invested and distributed. While donors are not supposed to exercise binding control over the managing charities' distributions from their funds, it is widely known in the field that "donor-advised" is, in many instances, a euphemism for "donor-controlled" or "-mandated".

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Freking, "Senators voice concerns about the type of tax shelter used by cabinet official's family," *Associated Press*, July 21, 2006; Jonathan Weisman, "HHS Secretary's Fund Gave Little to Charity," *The Washington Post*, July 21, 2006; Ari Shapiro, "HHS's Leavitt Benefited from Charity Tax Breaks," *All Things Considered/National Public Radio*, July 21, 2006; Kevin Freking, "HHS Secretary Defends Family Charity," *Associated Press Online*, July 21, 2006; Kevin Freking, "Report: Bush Cabinet official benefits from foundation that pays little in charity," *The Associated Press State & Local Wire*, July 21, 2006.

<sup>6</sup> Chronicle of Philanthropy, "How the Chronicle Compiled the Donor-Advised Funds Survey," May 4, 2006, <http://www.philanthropy.com/premium/articles/v18/i14/14002901.htm>; Chronicle of Philanthropy, "A Soaring Year," May 4, 2006, <http://www.philanthropy.com/premium/articles/v18/i14/14002701.htm>.

<sup>7</sup> Even the Government Accountability Office's report on donor-advised funds relies on the Chronicle of Philanthropy survey in the absence of any other more reliable data source on donor-advised funds, and consequently called for significant improvements on reporting for donor-advised funds, See: U.S. GAO, *Tax Exempt Organizations: Collecting More Data on Donor-Advised Funds and Supporting Organizations Could Help Address Compliance Challenges*, July 2006.

Until there is reporting and disclosure for each donor-advised fund, there will be no adequate way for the IRS to determine with any certainty that the donors' advice and direction is truly non-binding, that the managers of these funds are performing adequate due diligence, and that charitable purposes are being pursued through the distributions.

In passing the PPA, lawmakers removed an expected provision calling for a minimum annual required level of distributions for donor-advised funds and replaced it with the mandate for Treasury and the IRS to conduct a study to determine an appropriate "payout" requirement, if any. The defensive response of much of the community of public charities and commercial fund managers has been that their donor-advised funds pay out on average more than the 5 percent of net assets mandated for private foundations, obviating the need to legislate a minimum payout requirement.

NCRP has long challenged the 5 percent spending payout for private foundations as insufficient and unjustifiably low. Based on research and analysis by NCRP and others,<sup>8</sup> we have long contended that foundations could easily make a 6 percent payout in which the composition of qualified distributions excluded administrative grants. In other words, private foundations should be able to make a minimum payout of 6 percent all in grants.

With less overhead, less "process" to their grantmaking and a comparatively low administrative "load" charged by their fund managers, donor-advised funds should easily be able to make a 6 percent payout for each individual fund as well as cumulatively. When commercial gift funds and some commercial foundations contend that they consistently reach a foundation-like 5 percent payout, they know that their cumulative payout rates are bolstered by the fact that some of the funds in their portfolios distribute much more than 5 percent of their assets, sometimes on a quick trajectory toward a spending down, which counterbalance those donor-advised funds spending little or nothing.

## **SUPPORTING ORGANIZATIONS**

Although the dimensions of the donor-advised fund sub-sector are barely known, we do know somewhat more about supporting organizations. The General Accountability Office reported more than 80,000 private foundations and, surprisingly, over 21,000 supporting organizations that filed tax returns in 2003.<sup>9</sup> Until the Senate Finance Committee hearings in 2004, we suspect that few people even within the nonprofit sector knew what it meant to be a "supporting organization." In the wake of these hearings, NCRP heard of at least one regional association of grantmakers that initiated a survey to find out exactly how many supporting organizations existed in its state.

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<sup>8</sup> NCRP, *Helping Charities, Sustaining Foundations*, June 2, 2003; NCRP, *A Billion Here, A Billion There: The Empirical Data Add Up*, July 8, 2003; NCRP, *Closing the Loophole Removing Foundation Overhead Costs from Payout*, September 3, 2003; National Network of Grantmakers, *Spending Policies for Foundations: The Case for Increased Grants Payout*, 1999.

<sup>9</sup> GAO, *op, cit.*, p. 19.

Even now, despite definitional improvements within the PPA, the complexity of defining, identifying and classifying Type I,<sup>10</sup> Type II<sup>11</sup> and Type III<sup>12</sup> supporting organizations, much less “functionally integrated”<sup>13</sup> Type III supporting organizations, is daunting even to the experts. The complexities of the definitional tests (i.e., responsiveness, integral part, and control) have been reviewed in the literature to reveal just how impenetrable the supporting organization is to most observers.<sup>14</sup> When the mechanisms for charity and philanthropy are as technical and arcane as to defy general understanding, what can be understood is that there are great opportunities for misuse and abuse.

In fact, while there are compelling efficacy and efficiency arguments for the establishment of donor-advised funds, particularly those administered by community foundations and other institutions that have governance mechanisms and sectoral oversight that help ensure a reasonably high quality of charitable due diligence, the arguments for supporting organizations appear much less compelling. For entities that promote the creation of supporting organizations, their compelling argument seems to be that these types of organizations give donors virtually all of the benefits of private foundation control with public charity tax advantages. These advantages include maximum tax benefits such as full fair market donation of appreciated gifts and other provisions not available to private foundations, and exemption from payment of excise taxes.

At NCRP, we see many benefits from restricting the availability of the supporting organization option for donors, particularly the Type III’s in which the control by the supported organization or organizations is usually the flimsiest and the likelihood for abuse is the greatest. In Type I and Type II supporting organizations, there are at least more opportunities for the supported organizations to exercise some element of control. NCRP’s research into the Dixie and Anne Leavitt Foundation exposed the multiple opportunities for abuse and self-dealing, as well as the limited powers of the supported organization to compel better outcomes. In all candor, it was a clue in the Form 990 of one of the Leavitt Foundation’s supported organizations that led to the revelations in the press. It was an instance of whistle-blowing by a staff person at the recipient organization who was uncomfortable with following the Leavitt Foundation’s self-interested directives.<sup>15</sup>

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<sup>10</sup> As defined by the PPA, a Type I supporting organization is “operated, supervised or controlled by one or more section 509(a)(1) or 509(a)(2) organizations (Notice 2006-109).”

<sup>11</sup> In this instance, supporting organizations are supervised or controlled in connection with one or more 509(a)(1) or 509(a)(2) organizations, *Ibid*.

<sup>12</sup> Supporting organizations are operated in connection with a 509(a)(1) or 509(a)(2) organization, *Ibid*.

<sup>13</sup> “One which is not required to 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,” *Ibid*.

<sup>14</sup> The definitional tests are well described in Alyssa A. DiRusso, “Supporting the Supporting Organization: The Potential and Exploitation of 509(a)(3) Charities,” 2005, <http://law.bepress.com/expreso/eps/694>.

<sup>15</sup> NCRP pointed out the anomaly of a supported organization’s Form 990 showing a grant back to the supporting organization, which launched press inquiries revealing the supporting organization grants that eventually went to rent payments for housing owned by the Leavitt family. Berkes, *op. cit*.

Given the limitations in state and federal funding, the capacity to monitor and oversee well over 1 million tax exempt charities and the complexity of the supporting organization structure, it is difficult to see how maintaining Type III organizations makes any practical sense for public policy concerning charities. The charitable purposes of Type III supporting organizations can be accomplished by the Type I and Type II categories or by donor-advised funds, private foundations, and through direct charitable contributions. We fail to see how creating and maintaining a loophole charitable instrument furthers the purposes of charity and philanthropy.

Whether or not Treasury, the IRS, and Congress will ultimately decide to simplify the supporting organizations structure by eliminating the Type III category, a number of arguments we have been raising for donor-advised funds are equally applicable to supporting organizations. First, these organizations should face a minimum spending or distribution requirement. The minimum should be a 6 percent all-grants payout, as it should be for donor-advised funds and private foundations. Using supporting organizations to warehouse charitable funds does not further the interests of the nonprofit sector or the public at large.

Similarly, there should be full and as close to “real-time” disclosure of the grants and expenditures of supporting organizations consistent with the strictures enacted in the PPA. As one of the first organizations to argue for the creation of Form 990s and 990PFs and for their public disclosure and accessibility, NCRP believes that detailed unrestricted disclosure is the first threshold for achieving accountability among donor-advised funds and supporting organizations. If donors know, even in the absence of detailed scrutiny by the IRS and state government charity officials, that their grantmaking, spending, and investments will be available to the public and posted on easily-accessible and free websites, the fear of “getting caught” will likely induce some of them to do the right thing.

Finally, donor-advised funds and supporting organizations in many ways operate as the equivalent of foundations; they accumulate billions of dollars of tax exempt funds that the government must monitor. Consequently, we see no reason for exempting them from excise tax payments. If donors to these foundation-like structures are entitled under the law to get public charity tax benefits, one logical tradeoff, given the history of abuses by donor-advised funds and supporting organizations, is to require an excise tax payment for both. This exaction should be dedicated to IRS and potentially state charity office oversight and enforcement of accountability laws and regulations. Otherwise, this will be a hollow exercise of rule-making by the Treasury and the IRS.

## **CONCLUSION**

We at NCRP see an underlying problem with the issue of donor-advised funds and supporting organization regulation that we hope that Treasury and the IRS will address. The language included in the PPA concerning these charitable instruments hardly

measures up to the problems that have vaulted them into regular annual slots in the IRS' list of "dirty dozen" tax scams, with no evidence that the attention of the Senate Finance Committee hearings in 2004 had prompted a muscular surge of self-policing by the charitable sector to weed out the bad players.<sup>16</sup> Even the issue of a reasonable payout standard for donor-advised funds and supporting organizations had been a part of earlier drafts of the legislation until pulled late in the legislative process. Many in the philanthropic community have unleashed lobbying campaigns to undermine the moderate and entirely logical reforms in the 2004 language of the PPA. Their campaigns emphasize the exceptions, the "good" Type III supporting organizations, amidst more numerous examples of self-dealing that are completely offensive to the public if not illegal in the law.

The motivations of those attacking the Pension Protection Act, calling for the new standards on donor-advised funds and supporting organizations to be weakened, appear focused on maximizing the latitudes and minimizing constraints on donors that choose either instrument of giving rather than other more mainstream or direct charitable options. NCRP's approach is different. We call on Treasury and the IRS to ensure that the rules for donor-advised funds and supporting organizations are written with donees, rather than simply donors, in mind. The laws on charity and philanthropy will continue to be misused and abused, undermined and circumvented so long as the legislative regulatory focus gives only lip service to some of the most important stakeholders and shareholders in charity and philanthropy—the communities and nonprofits who desperately need access to these scarce tax exempt funds.

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<sup>16</sup> See item no. 10 on the IRS's 2007 list of tax scams for the latest inclusion of donor-advised funds and supporting organizations, (<http://www.irs.gov/newsroom/article/0,,id=167983,00.html>).