Department of the Treasury Issues Report on Supporting Organizations and Donor Advised Funds

December 9, 2011

I. INTRODUCTION

On December 5, 2011, the Department of the Treasury ("Treasury") issued a "Report to Congress on Supporting Organizations and Donor Advised Funds" (the "Report"). The Report was mandated by the Pension Protection Act of 2006 (the "PPA"). Specifically, Treasury was directed to study particular aspects of the operation of supporting organizations and donor advised funds ("DAFs"), including:

(1) whether deductions in respect of contributions to sponsoring organizations of DAFs or to supporting organizations are appropriate in consideration of their use of contributed assets (including timing of use);

(2) whether DAFs should be required to distribute a specified amount based on income or assets;

(3) whether the retention by donors of advisory rights or privileges is consistent with treatment of such transfers as completed gifts eligible for current deduction; and

(4) whether the issues raised above are also issues with respect to other forms of charities or charitable donations.

II. TREASURY'S INSIGHTS FROM THE STUDY

Treasury reported that their study yielded the following insights:

(1) Charities are increasingly large and complex in terms of their operations, assets, and activities.

(2) Supporting organizations and DAFs play an important role in the charitable sector, accounting for $94.1 billion and $59.5 billion, respectively, in total revenue in 2006, with total expenditures in the same year of $72.5 billion and $37.7 billion, respectively.

(3) More data will become available in the future due to the more-detailed reporting now required on Internal Revenue Service ("IRS") Form 990, the annual information return filed by supporting organizations and sponsoring organizations of DAFs.

(4) IRS data indicates that in the tax year 2006, 2,398 sponsoring organizations reported owning 160,000 DAF accounts.

(5) The average annual payout rate across sponsoring organizations of DAFs was 9.3%, with community foundations averaging 9.3%, commercially-sponsored national DAFs averaging 14.2% and other national DAFs averaging 28.7%.

(6) Sponsoring organization approval of grant recommendations is not automatic and no inference can be drawn from the fact that sponsoring organizations have high approval rates for donor recommendations, especially where they work to educate their donors about what kinds of recommendations will and will not be acceptable to the sponsoring organizations.

III. TREASURY'S ANSWERS TO CONGRESS'S QUESTIONS

Treasury stated that the above insights informed Treasury's answers to the questions Congress posed. In summary, Treasury's answers are:

(1) The PPA appears to have provided a legal structure to address abusive practices and to accommodate innovations in the charitable sector without creating undue additional burdens or new opportunities for abuse.

(2) Contributions to supporting organizations and to sponsoring organizations of DAFs are gifts to public charities, which are eligible for the most favorable deduction rules. This treatment is appropriate in that, like contributions to other public charities, the contributions are to organizations that the donor does not control.

(3) The matter of the lag between the time that a contribution is contributed and its final uses is no different at sponsoring organizations of DAFs and supporting organizations than it is at other public charities that may operate charitable funds or maintain endowment funds. Thus, it is appropriate that the contribution deduction rules applicable to these contributions are the same as those applicable to contributions to other public charities.

(4) Several provisions of the Internal Revenue Code would penalize operation of supporting organizations or sponsoring organizations if they benefit private interests.

(5) Compared to the 5% annual payout required of private foundations by law, the mean payout rates for sponsoring organizations of DAFs in tax year 2006 were high. Given those high rates, it would be premature to recommend a distribution requirement for DAFs at this point.

(6) Current law disallows a charitable-contribution deduction for a contribution to any charity if that contribution does not meet the standard of a completed gift. Since supporting organizations and sponsoring organizations of DAFs have no legal obligation to follow the preferences of their donors, there is nothing unique about them in this regard that would warrant treating contributions to them in a manner different from that required under current law applicable to completed gifts.

IV. OBSERVATIONS

The 117-page Report provides a fascinating survey of the size and scope of the supporting organization and sponsoring organization components of the charitable sector. The Report appropriately concludes that each of these charitable structures has a valued place in promoting particular kinds of charitable giving. Supporting organizations are valuable to, for example, hospitals and public universities to separate contributed assets from operating funds. DAFs are important because their low barrier to entry has promoted the "democratization of philanthropy"—as first posited by Urban Institute economist C. Eugene Steuerle—by allowing donors to pace giving in the same manner available to private foundation donors but with lower costs and much reduced effort, meaning that more assets can be transferred more easily to more charity recipients.

The Report notes that the most common criticism elicited by a request for comments on the impact of the PPA on operations was the lack of clarity in the PPA provisions. Respondents called for regulations to resolve this lack of clarity in order to promote tax compliance by supporting organizations and sponsoring organizations. Our observations are that the most pressing concerns are (1) the definition of a more-than-incidental return benefit and (2) whether satisfaction by a DAF of a donor's legally binding pledge or a bifurcated ticket purchase (e.g., to attend a benefit dinner) is a more-than-incidental return benefit subjecting the donor, and potentially the sponsoring organization's managers, to penalty excise taxes. While the Report notes those particular concerns, it remains for Treasury to issue regulations bringing clarity responsive to those concerns.

V. CONCLUSION

The Report is available online at:
http://www.treasury.gov/resource-center/tax-policy/Documents/Supporting-Organizations-and-Donor-Advised-Funds-12-5-11.pdf.

* * *

If you have any questions about the Report, supporting organizations or sponsoring organizations of donor advised funds, please contact Exempt Organizations Group Head Victoria Bjorklund (vbjorklund@stblaw.com; 212-455-2875), Senior Counsel David Shevlin (dshevlin@stblaw.com; 212-455- 3682), Counsel Jennifer Reynoso (jreynoso@stblaw.com; 212-455-2287), Counsel Jennifer Franklin (jfranklin@stblaw.com; 212-455-3597) or any other member of the Firm's Exempt Organizations Group.

This memorandum is for general informational purposes and should not be regarded as legal advice. Furthermore, the information contained in this memorandum does not represent, and should not be regarded as, the view of any particular client of Simpson Thacher & Bartlett LLP. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as additional memoranda, can be obtained from our website, www.simpsonthacher.com.

The contents of this publication are for informational purposes only. Neither this publication nor the lawyers who authored it are rendering legal or other professional advice or opinions on specific facts or matters, nor does the distribution of this publication to any person constitute the establishment of an attorney-client relationship. Simpson Thacher & Bartlett LLP assumes no liability in connection with the use of this publication.

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017-3954
+1-212-455-2000

Houston
2 Houston Center – Suite 1475
Houston, TX 77010
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2550 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3919 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Tokyo
Ark Mori Building
12-32, Akasaka 1-Chome
Minato-Ku, Tokyo 107-6037
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino Kubitschek, 1455
12th Floor, Suite 121
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000