Re: Recommendations for 2012-2013 Guidance Priority List Pursuant to Notice 2012-25

Dear Sirs and Mesdames:

On behalf of the Charitable Planning and Organizations Group of the American Bar Association’s Section on Real Property, Trust and Estate Law (the “Section”), we are pleased to provide the following recommendations for inclusion on the 2012-2013 Guidance Priority List (the “Guidance Priority List”) issued by the Department of Treasury (“Treasury”) and Internal Revenue Service (“IRS”). We have prepared these recommendations in response to the request for recommendations in IRS Notice 2012-25 and as discussed in a meeting among representatives from the Section and representatives from Treasury on April 18, 2012. These recommendations have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association. These recommendations do not represent the views or positions of the law firms, financial institutions, or universities of which the principal authors are shareholders, partners or employees.

These recommendations were prepared by members of the Charitable Planning and Organizations Group (the “Group”) of the Section. Carol G. Kroch, Supervisory Council Member of the Group, supervised the preparation of these recommendations and participated in their preparation. The principal drafting responsibility was exercised by Elaine Waterhouse Wilson with substantive contributions from Ramsay Slugg, Stephanie (Stevie) Casteel, and Sharon J. Bell. A schedule of contact information for the principal authors is attached to this letter. Additional review and commentary were provided by Christopher Hoyt (donor advised funds), Carlyn S. McCaffrey (charitable lead trusts), and Grace Allison (qualified appraisal regulations). Finally, the recommendations were reviewed.

May 1, 2012

Internal Revenue Service
Room 5203
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Washington D.C. 20044

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Although members of the Section who participated in preparing these recommendations have clients who are affected by the federal tax principles addressed, or have advised clients on the application of such principles, except as described below, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a governmental submission with respect to, or otherwise influence the development or outcome of, the specific subject matter of these recommendations. Sharon J. Bell has been engaged by a client to make a submission solely with respect to a suggested three-year rolling average in computing the required annual distribution of non-functionally integrated Type II supporting organizations. Ms. Bell did not participate in the drafting of this letter with regard to this subject matter.

**Summary of Recommended Guidance**

**Exempt Organizations**

- **Supporting Organizations.** Carry forward the projects in the 2011-2012 Guidance Priority List to issue final regulations under Sections 509 and 4943 regarding the new requirements for supporting organizations, as added by Section 1241 of the Pension Protection Act of 2006 (“PPA”) and to issue additional guidance under Section 509(a) as needed. We recommend that the final regulations provide guidance as follows:
  - Prior to finalization, review Section 1.509(a)-4(i)(5)(ii) of the Proposed Regulations regarding the amount and manner of calculation of the mandatory payout for the non-functionally integrated Type III supported organizations. **Priority: Very High**
  - Provide additional guidance in Section 1.509(a)-4(i)(3)(iv) of the Proposed Regulations regarding the types of activities that would meet the responsiveness test for charitable trusts. **Priority: High**
  - Provide transition guidance in Section 1.509(a)-4(i)(3)(v) of the Proposed Regulations for charitable trusts created between November 20, 1970 and the effective date of the PPA that will be unable to meet the revised responsiveness test. **Priority: High**

- **Donor Advised Funds.** Carry forward the project in the 2011-2012 Guidance Priority List to issue proposed regulations regarding the new excise taxes on donor advised funds and fund management under Section 4966 as added by Section 1231 of the PPA. We recommend that proposed regulations be issued under Section 4967 as well as Section 4966. We recommend that the proposed regulations under these Sections provide guidance as follows:
• Whether the fulfillment of a charitable pledge of a fund advisor by a donor advised fund is a “more than incidental benefit” under Section 4967(a)(1). **Priority: High**

• Whether the payment of the charitable portion of a bifurcated gift by a donor advised fund is a “more than incidental benefit” under Section 4967(a)(1). **Priority: High**

• Provide guidance regarding the application of the advisory committee requirements for scholarship funds in Section 4966(d)(2)(B)(i)(II) when the donor to the scholarship fund is a non-charitable tax-exempt membership organization. **Priority: Medium**

• Provide guidance regarding under what circumstances payments may be made “for the benefit of” a single named charitable beneficiary consistent with Section 4966(d)(2)(B)(i). **Priority: Medium**

**Gifts and Estates and Trusts**

• *Charitable Lead Trusts.* We recommend two pieces of guidance regarding existing projects and two pieces of new guidance.

  • In light of the issuance of final regulations under Section 642(c), provide additional guidance as follows:
    - Application of the effective date provisions in the final regulations. **Priority: High**
    - Provide additional guidance regarding certain income ordering and characterization issues in the context of charitable lead trusts. **Priority: High**

  • We recommend two new guidance projects with regard to charitable lead trusts:
    - Review Treas. Reg. Section 1.170A-6(c), Rev. Proc. 2007-45, and Rev. Proc. 2008-45 to clarify the manner in which the recapture of the charitable income tax deduction under Section 170(f)(2) is calculated when a charitable lead trust ceases to be treated as a grantor trust. **Priority: Medium**
    - Revise Treas. Reg. Section 20.2055-2(e)(2)(vi)(a) and Treas. Reg. Section 25.2522(c)-3(c)(2)(vi)(a) to provide further guidance regarding the types of fluctuating annuities that a charitable lead trust may provide. **Priority: Medium**
General Tax Issues

- **Qualified Appraisal Proposed Regulations.** Carry forward the project in the 2011-2012 Guidance Priority List to issue final regulations under Section 170 regarding qualified appraisals. We recommend that the final regulations provide guidance in the following areas:
  
  - Further guidance regarding the definition of “generally accepted appraisal standards” under Section 1.170A-17(b)(2)(ii) of the Proposed Regulations. **Priority: High**
  - Further guidance regarding the definition of a “recognized professional appraiser organization” under Section 1.170A-17(b)(2)(iii) of the Proposed Regulations. **Priority: High**

- **Charitable Contribution Deduction.** Guidance regarding whether a taxpayer is allowed an income tax deduction for a charitable contribution made directly to a disregarded entity (such as a single member limited liability company) of which an organization described Section 170(c) is the owner. **Priority: Medium**

Specific Comments on the Guidance Priority List Recommendations

1. **Supporting Organizations.** The Exempt Organizations section of the 2011-2012 Guidance Priority List includes two projects with regard to supporting organizations: the issuance of final regulations and additional guidance not covered by the Proposed Regulations. To the extent not complete by the end of the 2011-2012 guidance year these items should be carried forward. On January 3, 2008, the Section provided commentary regarding various supporting organization issues, as requested by the IRS. On December 23, 2009, the Section submitted to the IRS extensive comments on the Proposed Regulations that were published on September 24, 2009,(with the Section’s January 3, 2009 comments, collectively, the “SO Comments”). We believe the following three critical areas should be addressed in the final regulations:

   a. **Mandatory Payout for Non-Functionally Integrated Type III Supporting Organizations.** The final regulations regarding the amount and manner of calculation of the mandatory payout for non-functionally integrated Type III supporting organizations will have significant operational impact on such organizations and their charitable beneficiaries. We respectfully refer you to our SO Comments, in which we extensively discuss our recommendations regarding the appropriate payout rate and the methodology used to calculate the mandatory distributions.

   **Evaluation Criteria.** We believe this issue to be of paramount importance to all non-functionally integrated Type III organizations and the charities they support.
Affected supporting organizations and their charitable beneficiaries will need to review their operations in order to comply with the final regulations. Regardless of what the mandatory final payout may be, affected organizations may need to adjust the investment of their funds, and the short-term and long-term operating budgets of their supported charities may need to be reviewed and possibly amended. Because of the significant impact these final regulations will have on both supporting organizations and their supported charities, we believe this project has a Very High priority.

b. Meeting the Responsiveness Test. Section 1.509(a)-4(i)(3)(iv) of the Proposed Regulations contains two examples that address the manner in which a charitable trust may comply with the alternate responsiveness test. These two examples leave a number of open issues, specifically including but not limited to the frequency and manner in which meetings with beneficiaries may be conducted and whether contact with multiple beneficiaries may vary depending on the nature of their respective interests.

Evaluation Criteria. In the absence of additional examples, conservative trustees will use Example 1 (requiring quarterly in person meetings with the charitable beneficiary) as a “safe harbor,” which will likely prove to be excessively burdensome without providing additional meaningful responsiveness under the applicable test. Further guidance would hopefully forestall future controversies between the IRS and trustees regarding compliance with the fact-intensive responsiveness test. The uncertainty caused by the lack of additional examples and the potential for the erosion of charitable assets due to high administrative compliance costs is significant. We believe this project has High priority.

c. Transition Relief. The Proposed Regulations provide that a supporting organization that cannot otherwise meet the responsiveness test and that was supporting or benefiting a supported organization before November 20, 1970, may take into account additional facts and circumstances, such as a historic and continuing relationship between the organizations. There is no similar transition relief for organizations created between November 20, 1970 and the effective date of the PPA.

Evaluation Criteria. For affected supported organizations and their trustees, this guidance will be crucial in evaluating the manner in which such organizations remain in compliance with the tax laws in a cost effective manner. Providing transition relief for organizations formed prior to the effective date is consistent with the transition rules adopted for existing entities when the private foundation requirements were first enacted in the Tax Reform Act of 1969. We believe this project has a High priority.
2. **Donor Advised Funds.** The Exempt Organizations section of the 2011-2012 Guidance Priority List includes issuing proposed regulations regarding the new excise taxes on donor advised funds and fund management under Section 4966 as added by Section 1231 of the PPA. In addition, we believe that proposed regulations under Section 4967, regarding taxable distributions from donor advised funds, should be issued as well. To the extent not complete by the end of the 2011-2012 guidance year this item should be carried forward. On April 9, 2007, individual members of the Group submitted comments on certain donor advised fund issues in response to a request for comments in IRS Notice 2007-21 (the “DAF Comments”). We believe the following four critical areas should be addressed in proposed and final regulations, as follows:

   a. **Payment of Charitable Pledges.** Section 4967 imposes an excise tax when a donor receives, directly or indirectly, a “more than incidental benefit” from a distribution from a donor advised fund. It is unclear whether payment of a donor’s legally binding charitable pledge would be a “more than incidental benefit” under Section 4967(a)(1).

      **Evaluation Criteria.** The uncertainty in this area imposes a significant burden on all donor advised funds, their charitable beneficiaries, and their donors, as well as the IRS. Given the difficulty in administration and the potential for uneven results in the absence of further guidance as well as the widespread nature of the issue, we give this project **High priority**.

   b. **Bifurcated Gifts.** Similarly, it is unclear whether payment by a donor advised fund of the charitable portion of a bifurcated gift would give rise to a “more than incidental benefit” under Section 4967(a)(1).

      **Evaluation Criteria.** In the absence of further guidance, different donor advised funds are taking different approaches to these types of distributions. Guidance would promote uniformity among taxpayers. Given the widespread nature of the issue and the uneven manner in which it is currently addressed by donor advised funds, we give this project **High priority**.

   c. **Scholarship Funds.** The scholarship fund exception from the definition of a “donor advised fund” requires, among other things, that “no combination of [donors or people appointed or designated by donors](or persons related to such persons) control, directly or indirectly, such committee.” Section 4966(d)(2)(B)(ii)(II). The wording of this requirement is difficult to apply when the donor is a non-charitable exempt membership organization (such as a fraternal society, business league, or veterans’ post) that sponsors a scholarship fund.

      **Evaluation Criteria.** We believe that additional clarifying guidance may encourage private charitable giving by such membership organizations. The lack
of guidance is burdensome on organizations that may wish to set up such funds, as the conservative course in the absence of additional guidance is to locate individuals otherwise unrelated to the organization to serve on scholarship advisory committees. We believe this project has a Medium priority.

d. **Payments for the Benefit of Single Charitable Beneficiaries.** The definition of a “donor advised fund” excludes “any fund or account which makes distributions only to a single identified organization or governmental entity.” Section 4966(d)(2)(B)(i) (emphasis added.) We request guidance with regard to whether payments may be made “for the benefit of” a single named beneficiary consistent with the statutory language of Section 4966(d)(2)(B)(i).

**Evaluation Criteria.** This recommended guidance would reduce the burdens on donor advised funds and the organizations they support. In the absence of additional guidance, the conservative course is to use a two-step process for distributions, which costs charitable organizations time and money. Because this recommendation could simplify the administration of charitable organizations, we give this project a Medium priority.

3. **Charitable Lead Trusts.** The Gift and Estate and Trust section of the 2011-2012 Guidance Priority List includes the issuance of final regulations under Section 642(c) concerning the ordering rules for charitable payments made by a charitable lead trust. Proposed regulations were published on June 18, 2008. Final regulations under Section 642(c) were issued on Friday, April 13, effective on Monday, April 16, 2012.

a. **Open Issues with Regard to the Final Regulations under Section 642(c).** In light of the final regulations, we recommend that Treasury and the IRS develop further guidance regarding two issues, as follows:

i. **Effective Date Issues.** The proposed regulations state that “the regulations, as proposed, apply to trusts and estates for taxable years beginning after the date final regulations are published in the Federal Register.” However, the effective date provision was changed in the final regulations to Monday, April 16, 2012. Given the fairly substantial change in the effective date provisions between the proposed and final regulations, we believe it would be helpful for the IRS and Treasury to issue guidance on the applicability of the final regulations to 2011 tax returns filed after the effective date, as well as transition relief for 2012.

**Evaluation Criteria.** We believe that ambiguity regarding the effective date of the final regulations under Section 642(c) will result in significant confusion, creating a high potential for taxpayer error and an equivalent burden on the IRS to review possibly erroneous returns. Accordingly, we give this issue High priority.
ii. **Specific Income Ordering Issues for CLTs.** Although a non-grantor CLT is treated simply as a complex trust under Subchapter J, it is a unique vehicle that gives rise to specialized income tax issues. In light of the final regulations under Section 642(c), it would be helpful to have administrative guidance giving examples of how the pro rata income ordering rules should work specifically in the context of CLTs, including such issues as distributions from a prior year’s undistributed gross income and the amount and timing of income received from pass-through entities.

**Evaluation Criteria.** Subchapter J is an extremely complex area of federal tax law. We believe that additional guidance will make this area easier for trustees and their tax advisors to understand and will lead to uniformity in the manner in which CLT income is reported. This should reduce the oversight burden on the IRS and promote tax compliance. Although there are a relatively small number of CLTs in existence, the complexity of the issues and the potential for confusion are significant; therefore, we give this project Medium priority.

b. In addition, we believe two new projects regarding CLTs should be included in the Guidance Priority Plan.

i. **Grantor CLT Recapture Issues.** If a CLT structured as a grantor trust loses its grantor trust status, then the charitable income tax deduction under Section 170 that was allowed to the donor upon creation of the CLT is subject to recapture. There is some question, however, as to how recapture should be calculated. Compare Section 170(f)(2), Treas. Reg. Section 1.170A-6(c), Rev. Proc. 2007-45, section 8.01(5) and Rev. Proc. 2008-45, section 8.01(5). We recommend that Treasury and the IRS issue guidance clarifying the manner in which recapture is calculated, given the apparent discrepancies among the Code, the Regulations, and the Revenue Procedures.

**Evaluation Criteria.** Due to the discrepancies among the statutory language, the Regulations, and the Revenue Procedures, substantial uncertainty exists among taxpayers regarding the appropriate application of the recapture rules. Such uncertainty leads to taxpayers taking different, but supportable, tax positions, resulting in a lack of uniformity among similarly situated taxpayers. While the number of affected CLTs and taxpayers may be fairly small, the confusion on this issue is significant. Therefore, we give this project a Medium priority.
ii. *Fluctuating Annuity Amounts in CLATs.* The charitable interest in a charitable lead annuity trust (“CLAT”) must be a “guaranteed annuity interest” in order to qualify for an estate or gift tax deduction. Sections 2055(e)(2)(B) and 2522(c)(2)(B). In general, a guaranteed annuity interest is the right to receive annual payments, the amounts of which are determinable at the inception of the trust for a fixed period of years. Treas. Reg. Section 20.2055-2(e)(2)(vi)(a) and Treas. Reg. Section 25.2522(c)-3(c)(2)(vi)(a); see also Rev. Proc. 2007-45, section 5.02. We recommend that Treasury and the IRS issue guidance regarding the limits, if any, on the structure of the variable annuity payments in CLATs.

*Evaluation Criteria.* The current guidance on the permitted structure of a CLAT’s variable annuity payments is ambiguous, leading to significant uncertainty among taxpayers and their advisors. Although the number of taxpayers that would create a CLAT with a variable annuity payment may be fairly small, CLATs can provide important support to charitable organizations. Clarifying the extent to which variable payment CLATs are permitted will encourage donors who may presently be concerned about making such gifts. While we think it is very important to bring certainty to this issue, we give it a Medium priority because of the limited number of taxpayers it may affect.

4. **Qualified Appraisal Proposed Regulations.** The General Tax Issues section of the 2011-2012 Guidance Priority List includes a project to issue final regulations under Section 170 regarding charitable contributions. Proposed regulations were published on August 7, 2008. To the extent not complete by the end of the 2011-2012 guidance year this item should be carried forward. We recommend that two definitional issues be addressed in the final regulations, as follows:

a. “*Generally accepted appraisal standards.*” The Treasury Regulations under Section 170 require a taxpayer to submit a “qualified appraisal” to support the charitable income tax deduction for certain types of charitable gifts. In order for an appraisal to be a “qualified appraisal,” current law requires that the appraisal comply with “generally accepted appraisal standards.” We recommend that Treasury and the IRS clarify further the definition of “generally accepted appraisal standards.”

*Evaluation Criteria.* This guidance would be of great assistance to all taxpayers that make charitable gifts that require the submission of a qualified appraisal. We believe that the definition contained in the Proposed Regulations is sufficiently vague as to be impossible to apply, unless one simply chooses to use the USPAP standards. The USPAP may not be appropriate or cost-effective in all circumstances. Because of the large number of taxpayers impacted and the
mandatory nature of the qualified appraisal requirement, we give this project **High priority**.

b. “**Recognized professional appraiser organization.**” Similarly, a qualified appraisal must be performed by a “qualified appraiser.” One of the criteria for a “qualified appraiser” is that he or she must have a “recognized appraisal designation,” which is defined as “a designation awarded by a recognized professional appraiser organization on the basis of demonstrated competency.” Prop. Treas. Reg. Section 1.170A-17(b)(2)(iii). The Proposed Regulations give four examples of recognized appraisal designations: MAI, SRA, SREA, and SRPA. While these examples are helpful, all four designations relate to real estate and are awarded by a single entity, the Appraisal Institute. We recommend that the final regulations include additional guidance regarding the term “recognized professional appraiser organization.”

**Evaluation Criteria.** As with the discussion above regarding the definitions of “generally accepted appraisal standards”, this recommended guidance applies to all taxpayers making charitable gifts subject to the qualified appraisal requirement. The Proposed Regulations simply do not provide sufficient guidance to taxpayers attempting to comply with the requirements necessary to support a charitable income tax deduction for affected property. Given the burden placed on these taxpayers and the mandatory nature of the qualified appraisal requirement, we give this project **High priority**.

5. **Contributions to Disregarded Entities.** The General Tax Issues section of the 2011-2012 Guidance Priority List does not contain a project regarding the allowance of deductions under Section 170 for charitable contributions made directly to a disregarded entity (such as a single member limited liability company) that is wholly owned by an organization described in Section 170(c). We recommend that guidance be issued as to the deductibility under Section 170 for contributions to disregarded entities that are wholly owned by a charitable organization.

**Evaluation Criteria.** There is substantial uncertainty regarding whether a charitable contribution deduction would be allowed if the contribution is made directly to a disregarded entity. This may have a chilling effect on charitable giving and lead to unnecessary administrative burdens on charities. We give this project **Medium priority**.
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Thank you for the opportunity to provide our thoughts regarding the Guidance Priority List. Should you have any further questions, please do not hesitate to contact any of the principal authors.

Sincerely,

/s/ Andrew F. Palmieri

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