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# Grantmaking Advice for Mega-Donors: A Second Opinion

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# GRANTMAKING ADVICE FOR MEGA-DONORS: A SECOND OPINION

*Responding to David S. Miller, Social Welfare Organizations as Grantmakers*

*Response by Stephen Schwarz\**

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## INTRODUCTION

The tax exemption for Internal Revenue Code (“Code”) § 501(c)(4) social welfare organizations dates back to the Revenue Act of 1913, but it has never attracted much serious scholarly attention. Various referred to as a “historical accident,” “hodgepodge,” “catch-all,” “dumping ground,”<sup>1</sup> and “default choice,” § 501(c)(4) is the home to at least 81,935 nonprofit organizations according to the

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\* Professor Emeritus, University of California, Hastings College of the Law. Special thanks are due to Harvey Dale and Jill Manny for organizing the 2017 annual conference hosted by the National Center on Philanthropy and the Law at New York University School of Law, and to the participants at the conference for their lively and insightful discussion. Some of this commentary goes beyond what was presented at the conference.

1. The term “dumping ground” has been attributed to various sources, including this commentator who thought it was first used (by him) as part of an introduction to social welfare organizations in an early edition of his co-authored casebook. See JAMES J. FISHMAN & STEPHEN SCHWARZ, *CASES AND MATERIALS: NONPROFIT ORGANIZATIONS* 581 (2d ed. 2000). In the most recent edition of the casebook, “dumping ground” was changed to the less colorful “default choice.” See JAMES J. FISHMAN, STEPHEN SCHWARZ & LLOYD HITOSHI MAYER, *CASES AND MATERIALS: NONPROFIT ORGANIZATIONS* 846 (5th ed. 2015). It turns out that the IRS may deserve credit for “dumping ground,” having used the term in I.R.S. Gen. Couns. Mem. 34,219 (Oct. 30, 1969), which quotes a 1966 internal study prepared by Chief Counsel and the Technical Division to help the Treasury Department better understand the meaning and scope of § 501(c)(4). Thanks go to Doug Mancino for setting the historical record straight.

latest available Internal Revenue Service (“IRS”) data.<sup>2</sup> As well detailed elsewhere in this issue,<sup>3</sup> § 501(c)(4) organizations are best known for their increasingly significant role as a destination resort for unlimited lobbying and, as long as it is not the organization’s primary purpose, political campaign activity. The conference for which the articles and commentary in this symposium have been prepared shine new light on the murky history of § 501(c)(4) and the multiplicity of other roles that social welfare organizations have played over their long history.<sup>4</sup>

David Miller’s illuminating article is a valuable contribution to this contemporary dissection of § 501(c)(4), bringing out of the shadows the emerging use of social welfare organizations as grantmakers.<sup>5</sup> Miller’s work has many of the attributes of an outstanding conference paper. For practitioners, it serves as an authoritative primer. For the entire audience, it is thought-provoking and raises important policy concerns. Most readers, even those who consider themselves experts in the field, will know more after reading the article than they did before. This is no surprise coming from Miller, whose range of expertise and perspective on the big picture is apparent from an earlier paper in which he proposed a bold and mostly sensible radical reformation of the taxation of exempt organizations and their patrons.<sup>6</sup>

The commentator’s task, however, is not just to host a testimonial dinner but also to sharpen the discussion. To that end, with elaboration to follow, I offer the following preliminary observations: (1) in discussing the use of § 501(c)(4) organizations as a grantmaking vehicle, Miller’s article understates and to some extent devalues other more traditional and widely used alternatives; (2) the donors most likely to benefit from using a *domestic* social welfare organization for grantmaking appear to be a relatively small subset of wealthy individ-

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2. INTERNAL REVENUE SERVICE (IRS) 2017 DATA BOOK 57 (2018).

3. See Roger Colivaux, *Social Welfare and Political Organizations: Ending the Plague of Inconsistency*, 21 N.Y.U. J. LEGIS. & PUB. POL’Y 481 (2018); Rosemary E. Fei & Eric K. Gorovitz, *Practitioner Perspectives on Using § 501(c)(4) Organizations for Charitable Lobbying: Realities and An Alternative*, 21 N.Y.U. J. LEGIS. & PUB. POL’Y 535 (2018).

4. See Ellen P. Aprill, *Examining the Landscape of § 501(c)(4) Social Welfare Organizations*, 21 N.Y.U. J. LEGIS. & PUB. POL’Y 345 (2018); Lloyd Hitoshi Mayer, *A (Partial) Defense of § 501(c)(4)’s “Catchall” Nature*, 21 N.Y.U. J. LEGIS. & PUB. POL’Y 439 (2018).

5. See David S. Miller, *Social Welfare Organizations as Grantmakers*, 21 N.Y.U. J. LEGIS. & PUB. POL’Y 413 (2018).

6. See David S. Miller, *Reforming the Taxation of Exempt Organizations and Their Patrons*, 67 TAX LAW. 451 (2014).

uals living in rarefied air who are indifferent to the charitable income tax deduction and have an aversion to regulation and transparency; (3) those who would opt to use a *foreign* social welfare organization reside in an even smaller gated community, requiring expensive and highly specialized counsel to navigate through an imposing maze of substantive and procedural rules; and (4) as for the policy implications, the use and potential abuse of § 501(c)(4) organizations as grantmakers may not be a big problem because so few are affected, or if this is an emerging trend, there may be a need for targeted reforms that do not go quite as far as those proposed in the article.

## I.

### COMPARING OTHER GRANTMAKING ALTERNATIVES

To set the stage, Miller's article identifies the type of donor for whom a § 501(c)(4) organization may be the ideal grantmaking choice. Jeff Bezos, Warren Buffett, and Bill Gates are mentioned as examples. Other names come to mind. These fortunate few are individuals with a huge capacity for giving and a willingness to do so. Many are indifferent to the charitable income tax deduction because it is not of great economic benefit to them. It is fairly well known, for example, that the value of Warren Buffett's annual gifts of Berkshire Hathaway stock to the Bill and Melinda Gates Foundation is well in excess of the applicable percentage limitation on his surprisingly small adjusted gross income, and, in any event, Buffett's charitable deduction is probably limited to his very low basis in the stock.<sup>7</sup>

Mega-donors such as Warren Buffett achieve a much greater benefit from their ability to avoid realizing the enormous amounts of built-in gain on the transfer of appreciated stock to a grantmaking entity they legally or effectively control. Some of these great givers have objectives that outweigh the potential tax benefits, such as flexibility in grantmaking and investing, avoiding the excessive regulation im-

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7. Warren Buffett revealed that in 2015 he made an annual donation of \$2.8 billion of Berkshire Hathaway stock but his adjusted gross income was a surprisingly low \$11.5 million. *See* Press Release, Berkshire Hathaway, Some Tax Facts for Donald Trump (Oct. 10, 2016), <https://www.businesswire.com/news/home/20161010005859/en/Tax-Facts-Donald-Trump>. The percentage limitation for gifts of capital gain property to a private foundation is 20 percent of the taxpayer's adjusted gross income. I.R.C. § 170(b)(1)(D)(i)(I) (2012). Mr. Buffett's charitable deduction also will be limited to the basis in the donated stock rather than its fair market value assuming, as seems likely, that the size of his holdings and prior gifts disqualify him from deducting the full value using the "qualified appreciated stock" exception. I.R.C. §§ 170(e)(1)(B)(ii), (e)(5).

posed by the private foundation rules,<sup>8</sup> and privacy. The incentives are well described in the introduction to Miller's article. But how many people are we talking about here? My guess: not many. And insofar as this recipe to use § 501(c)(4) organizations for grantmaking is tailored for and exploited by a very few, policy makers should consider whether and how to curtail it.

The initial thesis of this commentary is that the vast majority of donors, even those who do not benefit from the charitable deduction, can achieve most, if not all, of their goals by using other, more conventional, philanthropic vehicles. If the donors desire the flexibility to do more, such as for-profit social investing or contributing to political causes and candidates, they also have a combination of existing structures to do so. A brief survey of these alternatives reinforces the point.

The private foundation is the most traditional grantmaking vehicle. Miller accurately recites the "long list" of restrictions, limitations, and excise taxes on the private foundation in the Code and writes, "[S]o onerous are these restrictions and limitations that while the Gates Foundation welcomed Warren Buffett's gift, it discourages all other donations."<sup>9</sup> This is a bit of a non sequitur. The private foundation restrictions are probably not the major reason the Bill and Melinda Gates Foundation discourages gifts from other donors, large or small. The Gates Foundation has plenty of philanthropic capital and understandably prefers to focus on its many good projects and causes, rather than diverting its energy and staff time to the "back office" burden of accepting and acknowledging small gifts from donors who would be better served by partnering with a compatible community foundation.

The broader question is whether the private foundation rules are such an impediment to Jeff Bezos, Bill Gates and Warren Buffett that their advisers should steer them and their ilk toward § 501(c)(4) orga-

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8. For a similar illustration of a donor's willingness to forego income, gift and estate tax charitable deductions as a trade-off for avoiding the private foundation rules otherwise applicable to charitable remainder trusts under § 4947(a)(2), see I.R.S. Priv. Ltr. Rul. 2017-13-002 (Mar. 31, 2017) and I.R.S. Priv. Ltr. Rul. 2017-13-003 (Mar. 31, 2017). One can speculate that the taxpayer's agenda in these curious rulings was to defer realization of gain on the highly appreciated property contributed to the CRT and then sold, and also avoid self-dealing penalties if that sale (or any later transactions by the CRT) are with a "disqualified person," such as a related family member or entity. The rulings direct the taxpayer to "keep good records" to prove that no charitable deductions were ever taken.

9. Footnote 7 of Miller's article notes, however, that the Gates Foundation encourages individuals to give directly to its grantees. To facilitate that process, it formed a related public charity to disburse donor contributions that align with the foundation's programmatic objectives.

nizations for all their grantmaking. In most (maybe not all) cases, the answer is no. When first enacted in 1969, it was feared that the excise tax regime in §§ 4940 to 4945 of the Code threatened the future of private foundations and would contribute to their demise. Panicky lawyers advised clients to shut down their foundations and instead use donor-advised funds at community foundations for their giving. After an initial brief decline, however, private foundations flourished.<sup>10</sup> They remain the entity of choice for most grantmakers, who have learned to navigate the restrictions. Indeed, many of the private foundation rules are consistent with fiduciary standards and best practices, and they contribute to a disciplined governance process and responsible grantmaking. To be sure, there is occasional overkill, such as the bright line self-dealing rules that punish even market rate transactions. But with good counsel, private foundations can do most of what grantmakers want to do (or should want to do), albeit with slightly reduced income tax benefits, and all of this in bright sunlight and in perpetuity, if so desired. Private foundations can influence the public debate through education and robust advocacy, make grants to individuals and foreign charities, and, under recently liberalized regulations, make program-related investments in for-profit businesses and engage in other forms of impact investing. They remain under family control after the founders die and can receive large bequests that qualify for a 100% estate tax charitable deduction. What private foundations cannot do is use their considerable resources to influence political campaigns, facilitate the retention of control of a family business, pay insiders more than they are worth (although some do and are not caught), fail to make reasonable annual distributions for charitable purposes, or avoid disclosing their donors, investments, and grants.

A second traditional grantmaking alternative is the § 509(a)(3) supporting organization (“SO”). Supporting organizations avoid private foundation status as long as they have the requisite relationship with one or more supported public charities and meet certain other technical requirements. The reward is that they are treated, for most federal tax purposes, as public charities. The Pension Protection Act of 2006 added a heavy layer of additional regulation, primarily to what are known as non-functionally integrated “Type III” SOs.<sup>11</sup> Because these grantmaking Type III SOs have a more attenuated relationship with the public charities they support and do not conduct their

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10. See generally FISHMAN, SCHWARZ & MAYER, *supra* note 1, at 665-66.

11. See, e.g., I.R.C. § 509(f). For a definition of a “functionally integrated” Type III SO, see I.R.C. § 4943(f)(5); all other types of Type III SOs are “non-functionally” integrated.

own programs, they were viewed as susceptible to abuse. Left relatively untouched by the 2006 legislation were Type I SOs, a structure akin to parent-subsidiary relationship where the supported public charity has legal control through its power to appoint a majority of the SO's governing board.

A Type I supporting organization legally controlled by a community foundation with a broad grantmaking mission has become an attractive option for a handful of very wealthy donors whose financial profile makes a private foundation less desirable from a tax standpoint.<sup>12</sup> Although the public charity must appoint a majority of the governing board, these "independent" directors typically have prior (often close) personal or professional relationships to the founding donor. A notable example is the George Kaiser Family Foundation, a Type I SO controlled by the Tulsa Community Foundation, which, as of its last available Form 990, had approximately \$3.2 billion in assets. This foundation has a broad grantmaking mandate and makes a relatively small *direct* contribution to its supported community foundation. Many major community foundations, including some Jewish federations, quietly control a few very large Type I supporting organizations that engage in a broad range of grantmaking.

Donor-advised funds, a growth industry despite the modest new regulatory regime added by the Pension Protection Act of 2006,<sup>13</sup> also have come to play a major grantmaking role, even for wealthy donors. Among other things, donor-advised funds offer anonymity, for those who want it; investment flexibility; administrative convenience; and the ability to accept and hold complex assets, such as closely held stock, real estate, and even cryptocurrency without reduced tax benefits. Donor-advised funds also are not subject to a rigid annual payout requirement (at least not yet). Anecdotal evidence suggests that a new breed of younger philanthropists, many of whom derived their wealth from successful tech companies, have established very large donor-advised funds at community foundations. One only need to look at the Silicon Valley Community Foundation, which announced in early 2018 that a surge of giving (\$1.4 billion in new gifts were received in

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12. Examples of impediments that may steer a donor from a private foundation to a supporting organization are: (1) much less desirable tax benefits for gifts of low basis closely held stock (I.R.C. § 170(e)(1)(B)(ii) limits the charitable deduction for such gifts to private foundations to the donor's basis); (2) the excess business holdings divestiture requirements (I.R.C. § 4943); and (3) the prospect of self-dealing penalties on transactions with related persons even if they involve no insider economic benefit (I.R.C. § 4941).

13. I.R.C. §§ 4966, 4967.

2017) had increased its asset base to \$13.5 billion,<sup>14</sup> ranking it ahead of the Ford Foundation. More than ninety percent of the Silicon Valley Community Foundation's assets are in donor-advised funds.

Finally, consider the "philanthropic" limited liability company ("LLC"), exemplified by the widely publicized Chan/Zuckerberg Initiative.<sup>15</sup> This new kid on the Silicon Valley block has been misunderstood by many journalists and even some academic commentators. When the Chan/Zuckerberg Initiative was first formed, it was greeted with a combination of applause for the donors' generosity and cries of outrage over lack of transparency or avoidance of the private foundation restrictions. Of course, it was premature to call the Initiative philanthropy because, unlike what happens when a private foundation is funded, the Initiative's founders had not yet parted with any of their Facebook stock. (In fairness, Mr. Zuckerberg made several large donations prior to forming the Initiative.) As used by Mr. Zuckerberg and Dr. Chan and their Palo Alto neighbor, Laurene Powell Jobs, an LLC is merely a flexible management structure to organize all or part of their wealth more formally. The founders promise that, over time, the LLC will engage in a variety of activities, including charitable giving, investing in for-profit companies with a social mission, political advocacy, and more, all of which they could have done directly without the LLC wrapper. To his credit, Mr. Zuckerberg reportedly has donated more than \$1.75 billion of Facebook stock to a donor-advised fund at the Silicon Valley Community Foundation,<sup>16</sup> and in 2016 he contributed through his "CZI Holdings LLC" \$1.15 billion of

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14. Press Release, Silicon Valley Cmty. Found., SVCF Awards \$1.3 Billion to Nonprofit Organizations in 2017 (Feb. 8, 2018), <https://www.siliconvalleycf.org/press-release-february-8-2018>. The statement reported that seventeen percent of the foundation's total investments (worth about \$1.4 billion) were in publicly traded stock in one unnamed company (likely Facebook). See Kathleen Pender, *Silicon Valley Community Foundation's Assets Surged in 2017. It Won't Say Why*, S.F. CHRON. (Feb. 23, 2018, 1:43 PM), <https://www.sfchronicle.com/business/networth/article/Silicon-Valley-Community-Foundation-s-assets-12704936.php>.

15. An LLC structure also is used by Laurene Powell Jobs through her Emerson Collective. See EMERSON COLLECTIVE, <http://emersoncollective.com> (last visited Jan. 5, 2019). For an excellent discussion of the philanthropic LLC, see Dana Brakman Reiser, *Disruptive Philanthropy: Chan/Zuckerberg, the Limited Liability Company, and the Millionaire Next Door* (Brooklyn Law Sch. Legal Studies, Working Paper No. 536, 2017), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3049021](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3049021). See also Dana Brakman Reiser, Sharon C. Lincoln & Ingrid Mittermaier, *Using Non-501(c)(3) Vehicles to Accomplish Philanthropic Objectives*, TAXES, Dec. 2017, at 45.

16. See Kerry A. Dolan, *Mark Zuckerberg-Connected Charity at Risk of Implosion*, FORBES (May 2, 2018, 8:00 AM), <https://www.forbes.com/sites/kerryadolan/2018/05/02/silicon-valley-community-foundation-emmett-carson/#7b12c8615f0f>, and see *supra* note 18 and accompanying text.



Facebook stock<sup>17</sup> to the Chan Zuckerberg Foundation, a private foundation he formed several years earlier with nominal capital. Ms. Jobs also fulfilled her promise in 2016, with complete transparency, when she formed the Emerson Collective Foundation and funded it with a contribution of \$1.2 billion, of which \$813.9 million was appreciated stock of the Walt Disney Company.<sup>18</sup>

The single-member LLC structure employed by the Chan/Zuckerberg Initiative is a disregarded entity for tax purposes. It is not an income or wealth transfer tax avoidance device or an end run around the private foundation rules, and there is no urgent need to single it out for special regulation under either federal tax or state nonprofit laws. Instead, the LLC structure is, mostly, a “family office” by another name, allowing its founders to centralize their investment, philanthropic, and other personal causes and pursuits; preserve and protect control in their major business holdings while diversifying (or not); employ a staff and pay them well (or not); keep good records; act as a buffer between themselves and the horde of supplicants who want them to part with their money; and more. An LLC may also facilitate anonymous giving, or, as in Mr. Zuckerberg’s case, market the founder’s brand by polishing a halo that may or may not be deserved. Whether or not the LLC is worthy of being labelled “philanthropic” depends on what it actually does, as opposed to what it aspires to do.

From this commentator’s experience, well advised wealthy donors and families often use several different traditional grantmaking vehicles, with or without an LLC structure. Those with an entrepreneurial bent combine these tax-exempt vehicles with for-profit entities to directly conduct social enterprises or engage in what has become known as “impact investing.” Donors seeking to influence the political process can use § 501(c)(4) social welfare organizations for lobbying and limited political campaign activity. Examples include the Omidyar Network, formed by Pierre Omidyar, the founder of eBay,<sup>19</sup> and the Good Ventures and Open Philanthropy family of entities

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17. In 2016, the Chan Zuckerberg Foundation sold a portion of the donated stock in which it had a \$67,245 basis for approximately \$650 million, and the foundation paid \$6.5 million of tax (it qualified for the one percent rate under § 4940(e)) on the resulting capital gain and its other investment income. Chan Zuckerberg Foundation, 2016 Form 990-PF, Parts IV-VI (2017). This information and similar data on other organizations reported in this commentary are derived from Form 990-PFs and, for public charities, Form 990s posted on the GuideStar data base, <https://www.guidestar.org>.

18. Most of this stock was sold, generating a \$490.7 capital gain and a \$9.8 million excise tax liability for the foundation under § 4940. Emerson Collective Foundation, 2016 Form 990-PF, Part IV (2017).

19. See *Who We Are*, OMIDYAR NETWORK, <https://www.omidyar.com/who-we-are> (last visited Jan. 7, 2019).

formed by Facebook co-founder, Dustin Moskovitz and his wife, Cari Tuna.<sup>20</sup>

## II.

### DOMESTIC SOCIAL WELFARE ORGANIZATIONS AS GRANTMAKERS

Given the traditional philanthropic vehicles available to donors, why would a donor consider using a § 501(c)(4) social welfare organization instead? Miller's article makes a persuasive case to a donor like Jeff Bezos. As noted earlier, Bezos may be indifferent to the charitable income deduction because it would not save him all that much in taxes. In addition, a social welfare organization would allow Bezos to achieve flexibility in grantmaking and leeway for some private benefit; tax-free diversification without having to realize gain on his gifts of highly appreciated Amazon stock; and avoidance of those nasty private foundation rules. He would not even be required to file an application for tax-exempt status on Form 1024 (although he probably still should). A social welfare organization must only give notice of its intention to operate as such within 60 days after its formation.<sup>21</sup> Eventually, it must file annual returns on Form 990, which does not reveal to the public some of the information (e.g., identity of donors and specific investments) required by Form 990-PF filed by private foundations.

Miller notes a key development that opened the door to even having this discussion—the enactment in 2015 of § 2501(a)(6), which provides that gifts to § 501(c)(4) social welfare organizations, § 501(c)(5) labor and agricultural organizations, and § 501(c)(6) business leagues are not taxable gifts for federal gift tax purposes. Prior to this legislation, it was unclear whether these types of lifetime gifts were subject to the gift tax. Thanks to the annual gift tax exclusion, this was not a problem for small donors. But the gift tax was a great concern for very wealthy individuals who had used up their lifetime exemptions or wished to preserve them for later wealth transfers to their family. This is not the place to revisit this debate or critique the IRS's capitulation to political pressure when it shut down gift tax ex-

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20. This network includes Good Ventures Foundation (a private foundation), Good Ventures (a supporting organization of the Silicon Valley Community Foundation), with combined assets of over \$1 billion; the Open Philanthropy Project Fund (a donor-advised fund at the Silicon Valley Community Foundation); the Open Philanthropy Action Fund (a social welfare organization); and several for-profit LLCs that engage in social investing. See GOOD VENTURES, <http://www.goodventures.org/> (last visited Jan. 7, 2019).

21. I.R.C. § 506.

aminations and essentially gave up the fight.<sup>22</sup> It is sufficient to note that individuals making very large transfers to a § 501(c)(4) organization, whether they be for grantmaking or some other permissible social welfare purpose (such as political advocacy), once risked a big gift tax bill, diminishing the appeal of the vehicle that Miller's article so ably promotes.

With the gift tax problem solved, the question became—what happens when the donor dies, having retained control over his § 501(c)(4) grantmaking entity, or when the donor leaves a large bequest to an existing or newly created social welfare organization? The original draft of Miller's paper presented at the 2017 conference stated that it is an "open question" whether a bequest to a § 501(c)(4) organization could qualify for a charitable estate tax deduction. The final version in this symposium issue leans toward the right answer by concluding that bequests to social welfare organizations "do not appear" to qualify for an estate tax deduction. Miller also asks whether the value of the § 501(c)(4) organization's assets will be includible in the deceased donor's gross estate when, as is the norm, the donor retained control of the organization throughout his life. As to the first question, what is the point of all the requirements in § 2055 for an estate tax charitable deduction if an equivalent tax benefit can be achieved, without any statutory authority, for the same wealth transfer to a social welfare organization? As to the second question, Miller's article correctly concludes that the date-of-death value of the entity should be includible in the decedent's gross estate under § 2036(a)(2). In short, neither is an open question.

Several suggested workarounds minimize and may eliminate these estate tax obstacles. First, the donor could step away from any legal control after funding the § 501(c)(4) grantmaking entity and let his children or trusted consigliere make all the decisions. The viability of that solution depends on the family dynamics, but it rarely will appeal to elders in the generation that created or inherited the wealth. Alternatively, the donor's estate plan could provide that all the assets of the § 501(c)(4) organization must be transferred on the decedent's death to qualified § 501(c)(3) public charities (would the donor family's private foundation also be an option?), thus qualifying for an estate tax charitable deduction.

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22. For an excellent history and analysis, see Ellen P. Aprill, *Once and Future Gift Taxation of Transfers to Section 501(c)(4) Organizations: Current Law, Constitutional Issues, and Policy Considerations*, 15 N.Y.U. J. LEGIS. & PUB. POL'Y 289 (2012). See also Miller, *supra* note 6, at 480-91.

If these maneuvers solve the estate tax problem (the better view is that they do), the question remains whether they undercut the overall appeal of the § 501(c)(4) grantmaking alternative. As noted earlier, it depends. These solutions may be acceptable for those donors who are using § 501(c)(4) organizations to finance robust advocacy of their political views during their lifetime and are content to shift to a more traditional charitable vehicle after they die. For others, the charitable giving alternatives discussed earlier in this commentary may be a better overall choice for family harmony, discipline, and continuity.

### III.

#### FOREIGN SOCIAL WELFARE ORGANIZATIONS

Part II of Miller's article asks if a donor who is indifferent to the charitable income tax deduction might do even better by using a *foreign* social welfare organization for grantmaking. This can only be answered by slogging through an intricate web of international tax rules, all well within Miller's considerable range of expertise. It has been said that a little knowledge can be dangerous. For this commentator, a generalist's perspective can be liberating, providing the freedom to ask a few big picture questions without getting too stuck in the weeds.

The first asserted advantage of a foreign social welfare organization is that it is even more tax efficient than its domestic counterpart, since the foreign organization avoids any unrelated business income tax exposure if it borrows to buy a taxable bond. We can thank the "portfolio interest exemption" for this. A domestic social welfare organization, by contrast, would have taxable debt-financed income in the same scenario, but the cognoscenti know that the unrelated debt-financed income trap is easily avoided by investing through a foreign blocker corporation.<sup>23</sup> In any event, assuming that the organization has good reasons for its asset allocation and use of leverage, the generalist with very little specialized expertise pauses to ask: is that all there is? There must be more before one would go to all this trouble of incorporating offshore. Escaping the private foundation rules seems to be a more powerful incentive, but that can be achieved with a domestic social welfare organization or the more traditional private foundation avoidance vehicles discussed above.

Another reason to go offshore is to avoid the risk of a change in U.S. law, such as legislation to impose a tax (e.g., on investment income) on domestic tax-exempt entities. This recently happened when

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23. See Miller, *supra* note 6, at 512.

Congress decided to tax the investment income of certain large university endowments,<sup>24</sup> and an even broader tax has been suggested elsewhere by Miller and others.<sup>25</sup> This hedging against unpleasant things that could happen in the future may be attractive to some donors, assuming they are indifferent to the bad optics that could tarnish their halo when the donor's offshore meandering is the subject of a front page story in *The New York Times*.

For some, the desire for anonymity must be the driving force. Like its domestic counterpart, the foreign social welfare organization need not apply for U.S. tax-exempt status.<sup>26</sup> But if the foreign organization has U.S.-source income, it will be outed by what seems to be a fairly clear obligation to file annual Form 990 information returns. Anonymity is still possible but only after navigating through a host of landmines. To explain how privacy can be maintained, Miller's article launches its readers into orbit, with a meticulous guide on how to operate a tax-exempt foreign social welfare organization without much transparency. If the Form 990 filing requirement makes the donor unhappy, the solution is to ignore it by not filing for three consecutive years. It then will be reclassified as a *taxable* social welfare organization but apparently not pay much, if any, tax. If the IRS threatens to impose civil penalties, one must only apologize and file the past due returns. The IRS then will abate the penalties and the organization once again will be tax-exempt (but is anonymity then lost?). There are other risks, most requiring an understanding of anti-abuse provisions with acronyms like CFC, PFIC, FATCA, and FFI, but these risks are said to be surmountable.

Miller's article illustrates the type of donor who might choose a foreign social welfare organization by using a case study of a private equity manager with a plan to donate his carried interest to a grantmaking entity. The manager's desire for privacy outweighs any patriotic duty to file annual Form 990 information returns, and he has been made aware of the opportunity to pivot to a taxable social welfare organization after three years and the attendant risks and escape hatches. To avoid estate tax exposure, he will cede control of the social welfare organization to his children.<sup>27</sup> Does anybody know a private equity manager who will donate a big carried interest and then immediately cede control of his new grantmaking toy to his children?

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24. I.R.C. § 4968.

25. See Miller, *supra* note 6, at 501; Daniel Halperin, *The Tax Exemption Under I.R.C. § 501(c)(4)*, 21 N.Y.U. J. LEGIS. & PUB. POL'Y 519, 534 (2018).

26. Miller, *supra* note 5, at 425.

27. *Id.* at 433.

No doubt a handful of donors fit this profile, but probably not too many.

#### IV.

##### POLICY CONSIDERATIONS

Having explained the benefits to the mega-rich of using § 501(c)(4) organizations for grantmaking—not exactly God’s work but a masterpiece of creative lawyering—Miller’s article concludes by considering the tax policy implications and corrective measures. After noting again that for some wealthy donors the ability to avoid a taxable capital gain on a gift of highly appreciated property is more valuable than the charitable deduction, the proposed solution is to treat all donations of noncash property to *any* § 501(c) organization, even a public charity, as a taxable sale.<sup>28</sup> Various approaches to reforming the charitable deduction for gifts of appreciated property have been debated for years.<sup>29</sup> If enacted (which will not happen any time soon), Miller’s proposal would recalibrate the subsidy and dampen whatever enthusiasm there might be for using § 501(c)(4) social welfare organizations for grantmaking. Insofar as it applies to § 501(c)(3) organizations, the proposal would alter the tax economics of *charitable* giving, especially for lifetime donors to institutions, such as universities, museums, and § 501(c)(3) grantmakers, that are the most common recipients of large gifts of noncash property. A more targeted solution would be to limit the proposed rule to gifts to all § 501(c) organizations other than charities.

The opportunity for § 501(c)(4) organizations to avoid regulation and transparency also raises policy concerns. This potential for abuse suggests the need to reexamine the dichotomy between the strict private foundation limits and the less restrictive regulatory regime for public charities and other § 501(c) grantmakers. The goal would be to converge the rules to provide limited relief to private foundations, such as by relaxing some of the harsher features of the self-dealing restrictions, and by extending the more reasonable private foundation constraints and disclosure requirements to all § 501(c) grantmaking entities primarily funded by one family or a narrow group of donors.<sup>30</sup>

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28. This is currently the rule for gifts of appreciated property to § 527 political organizations. I.R.C. § 84.

29. See, e.g., Roger Colinvaux, *Charitable Contributions of Property: A Broken System Reimagined*, 50 HARV. J. ON LEGIS. 263, 318-28 (2013); Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-in Gains*, 56 TAX L. REV. 1, 35-38 (2002).

30. Lloyd Mayer’s article in this symposium issue expresses similar concerns and suggests that Congress consider extending some of the private foundation restrictions

A more sensible Congress, should one ever materialize, also might revisit the gift tax exclusion for gratuitous transfers to social welfare organizations, labor unions, and business leagues. The purpose of the gift tax is to serve as a backstop to the estate tax. The current discontinuity resulting from the enactment of the § 2501(a)(6) gift tax exclusion departs from that longstanding principle.

Finally, a more comprehensive approach, favored by a few academic commentators but opposed by what seemed to be a majority of those attending the conference, is an environmental remediation plan to clean up the “dumping ground” by repealing § 501(c)(4) and relocating its hodgepodge village of current inhabitants to other § 501(c) categories if they are worthy of tax-exempt status and, if not, by treating them as taxable corporations (or trusts).<sup>31</sup>

#### CONCLUSION

David Miller’s open letter to Jeff Bezos adds value by describing an additional “one-stop shopping” option for his grantmaking and explaining all the rewards and risks. Whether a § 501(c)(4) social welfare organization turns out to be a good fit depends on Mr. Bezos’s goals, including how much he would benefit from a charitable income tax deduction, the scope and scale of his philanthropy, his estate plan, and how he weighs factors such as privacy, transparency, and his family’s public image. This commentary serves as a second opinion for him and others in the small group of mega-donors. Most of them, and the more typical multimillionaire families next door, likely will conclude they are just as well served by one or a combination of traditional grantmaking and for-profit vehicles that have withstood the test of time.

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to § 501(c)(4) organizations that are unable to satisfy any of the grounds (e.g., broad public support) for escaping private foundation classification if they were exempt under § 501(c)(3). See Mayer, *supra* note 4, at 474-75.

31. Compare John D. Colombo, *The I.R.S. Should Eliminate 501(c)(4) Organizations*, N.Y. TIMES: ROOM FOR DEBATE (May 15, 2013), <https://www.nytimes.com/roomfordebate/2013/05/15/does-the-irs-scandal-prove-that-501c4s-should-be-eliminated/the-irs-should-eliminate-501c4-organizations>, with Doug Mancino, *Don’t Eliminate 501(c)(4) Exemption*, N.Y. TIMES: ROOM FOR DEBATE (May 15, 2013), <https://www.nytimes.com/roomfordebate/2013/05/15/does-the-irs-scandal-prove-that-501c4s-should-be-eliminated/dont-eliminate-501c4-exemption>.