



*Office of the General Counsel*

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October 9, 2018

**Submitted Electronically**

Internal Revenue Service  
CC:PA:LPD:PR (REG-112176-18)  
Room 5203  
P.O. Box 7604  
Ben Franklin Station  
Washington, D.C. 20044

**Re: Notice of Proposed Rulemaking  
REG-112176-18  
Charitable Contributions in Exchange for State or Local Tax Credits**

Dear Internal Revenue Service:

The United States Conference of Catholic Bishops (“USCCB”) is pleased to offer this comment letter regarding the proposed treasury regulations referenced above and issued on August 27, 2018. 83 Fed. Reg. 43,563.

The USCCB is deeply troubled by the expansive reach of the proposed regulations. We urge Treasury and the Internal Revenue Service (IRS) to implement final regulations that reach perceived abuses but leave in place long-standing contribution structures that have allowed the Catholic Church in the United States to carry out its religious and educational missions.

We offer the following comments:

**Background of the USCCB**

The USCCB is a nonprofit corporation, the members of which are the active Catholic Bishops in the United States. USCCB advocates and promotes the pastoral teachings of the U.S. Catholic Bishops in such diverse areas of the nation’s life as the free expression of ideas, fair employment and equal opportunity for the underprivileged, protection of the rights of parents and children, the sanctity

of life, and the importance of education. Values of particular importance to the Conference are the protection of the First Amendment rights of religious organizations and their adherents, and the proper development of tax law jurisprudence, especially as to programs that benefit the poor and vulnerable.

### Catholic Education in the United States

Catholic schools comprise the nation's largest private educator, with more than 6,300 schools educating over 1.8 million children in the United States today, many of whom come from low-income families, keeping with Catholic schools' long-standing tradition of providing disadvantaged children with a top-quality education. The USCCB is the voice of those schools and our Catholic community before the federal government.

According to statistics from the National Catholic Educational Association, 86.5% of graduates from Catholic high schools attend college, compared to just 44% from public schools.<sup>1</sup> Not only do Catholic schools motivate young people to succeed, but by providing a high-quality education at a lower cost per pupil, they save taxpayers approximately 21 billion dollars per year.<sup>2</sup>

However, much of this would not be possible without the parental choice afforded by scholarship tax credit programs. Approximately two dozen Catholic-led scholarship granting organizations ("SGOs") specifically work with state and local partners to distribute scholarships to children in need who seek better opportunities through Catholic education. These organizations rely on generous corporate and individual donors who are committed to serving children.

### Scholarship Grant Programs

The success of these scholarship tax credit programs is in jeopardy if these proposed rules become final. Without a doubt, far fewer children will be served as a result of the proposed rules. Organizations have used past donor trends to estimate proposed rule's impact. The following statistics regarding past contributions of donors offer a compelling reason to be concerned. The IRS estimated that a mere 1% of donors to SGOs would be impacted, but our overview of data shows a very different story.

Here are just a few examples:

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<sup>1</sup> NAT'L CATHOLIC EDUC. ASS'N, ANNUAL STATISTICAL REPORT ON SCHOOLS, ENROLLMENT AND STAFFING: UNITED STATES CATHOLIC ELEMENTARY AND SECONDARY SCHOOLS 2017-18.

<sup>2</sup> *Id.*

- The Indiana program was enacted in 2009 and has five SGOs that serve almost 10,000 students. SGOs raised nearly \$25 million in 2017, and it is estimated that up to 10% of their donors will be impacted by the rule.
- Iowa’s program was enacted in 2006 and served over 10,000 students in 2017. Donors to the STO (scholarship tuition organization) program receive a state income tax credit of 65% and can submit the entire donation as a charitable donation on their Federal returns. Several STOs expect that 100% of their donors will be affected by this proposed rule.
- Pennsylvania has one of the oldest programs in the country, raising over \$116 million dollars in 2017 for nearly 50,000 students. Several SGOs reported that the majority of their donors’ contributions exceed \$10,000 each.
- In Kansas, the program is new and still getting off the ground. However, even at its outset, the program raised over \$4 million in 2017, and the average gift was \$22,000.
- In Virginia, another newer program, one SGO alone raised \$12.8 million dollars in the last five years, and the SGO estimates that 60% of their individual donors will be over the SALT (state and local tax) cap.

### Tax Policy Rationales and Objectives

The regulations propose a new bright line approach to the judicial doctrine known as “quid pro quo.” Under this longstanding judicial rule, a taxpayer’s charitable contribution deduction is reduced to the extent the taxpayer receives valuable consideration in exchange for making the contribution. In other words, the taxpayer receives an economic motivation for the gift.

Although fundraising practices vary significantly among non-profits across the country, traditional return benefits have included admissions to charitable events, bazaars, banquets, shows and athletic events. For decades, the Internal Revenue Service used administrative guidelines and safe harbors to help advise donors about the benefits received in return for contributions. *See Revenue Procedure 90-12, 1990-1 C.B. 971.* This longstanding public ruling guidance supports full charitable deductions where the return benefits consist of small items that are difficult or burdensome to value. In effect, the return benefit is inconsequential or insubstantial.

Before the proposed regulations, the Internal Revenue Service has considered state tax credits inconsequential or insubstantial. In this environment,

Catholic organizations, as well as secular and other religious organizations, have developed and implemented a wide variety of gifting programs including scholarship grant programs that are supported by state tax credits. The success of the programs has been hard-earned and successfully employed state tax incentives.

In an about face,

the Treasury Department and the IRS do not believe it is appropriate to categorically exempt state or local tax benefits from the normal rules that apply to other benefits received by a taxpayer in exchange for a contribution. Thus, the Treasury Department and the IRS believe that the amount otherwise deductible as a charitable contribution must generally be reduced by the amount of the state or local tax credit received or expected to be received, just as it is reduced for many other benefits.

83 Fed. Reg. at 43,565 (Aug. 27, 2018).

Accordingly, the Treasury Department and the IRS explained that

[d]isregarding the value of all state tax benefits received or expected to be received in return for charitable contributions would precipitate significant revenue losses that would undermine and be inconsistent with the limitation on the deduction for state and local taxes adopted by Congress in section 164(b)(6).

83 Fed. Reg. at 43,565.

#### Confusion Sown Across 18 States with State Credit Programs

Scholarship granting organizations raise funds year round, with some even having monthly donations spread across the year. Many originally assumed that the rule would only impact individual donors under Section 164 of the Internal Revenue Code. But instead, the proposed rule reference to Section 170 of the Code lumped in *all* donors to *all* organizations. The subsequent “clarification” statement on September 5, 2018 led to additional confusion, as Secretary Mnuchin stated that the “rule . . . has no impact on federal tax benefits for business-related donations to school choice programs.”

Additionally, the statement now referenced a third section of the Code—Section 162—considering donations to SGOs as a business expense rather than a charitable donation under Section 170. Program administrators still have many unanswered questions, such as:

- Does the rule impact donations from C Corporations?
- Does the rule impact donations from S Corporations?
- What is meant by the term “business-related” donations?
- When exactly is the rule in effect? The cited date is August 27, 2018, but how can a proposed rule impact donors in the middle of a tax year, and even before the comment period has ended?

#### Appropriately Targeting Revenue Loss

The proposed regulations attempted to address possible revenue loss concerns. These concerns stem from possible state tax credit techniques that seek to undermine the new federal limitations on deducting state and local taxes. But we are concerned that the scope of the proposed regulations extends far beyond this revenue concern. The broad scope stems from the proposed regulation’s cross reference to Section 170(c). Section 170(c) consists of five categories of organizations that qualify to receive tax-deductible gifts.

Section 170(c)(1) is the only category tied to state and local government gifts. In order to appropriately limit revenue loss and avoid the unintended restrictions of scholarship grant programs, the final regulations should cross-reference Section 170(c)(1). With this specific cross reference, the regulations would match the revenue loss concerns directly with state and local government gifts. Other qualified donors would thus be unaffected, and successful and long-standing gifting structures would remain unaffected. This change will correct the overly broad reach of the proposed regulations.

#### Conclusion

We appreciate the opportunity to present our serious concerns and ask that Treasury and the IRS carry out a careful and a balanced approach to these new regulations.

Respectfully submitted,

Handwritten signature of Anthony R. Picarello, Jr. in blue ink.

Anthony R. Picarello, Jr.  
Associate General Secretary & General Counsel

Handwritten signature of Hillary E. Byrnes in blue ink.

Hillary E. Byrnes  
Director of Religious Liberty & Associate General Counsel

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