July 6, 2017

CERTIFIED MAIL—RETURN RECEIPT REQUESTED

Internal Revenue Service
Exempt Organizations Examinations
Attn: ****

Re: X
EIN: **
Tax Periods Ended December 31, 2013, 2014, 2015

Dear ****:

This is in response to the closing letter in this case, dated ****. The addendum to the letter identified, as a "deficiency," X's failure to disclose to dues payers the portion of their "quid pro quo contribution" that is not deductible as a charitable contribution. This "deficiency" (quoted here) is legally incorrect.

> 3 – X is a membership organization with over **** members. [Certain] members pay annual dues in the amount of $****. [Other] members pay discounted dues of $****. Members receive certain benefits in exchange for dues[,] including free subscriptions to X's journals. X's membership application and other materials and information furnished to members or posted on its website do not contain any written disclosure regarding the substantiation of membership dues as charitable contributions. As described in IRS Publication 1771, Charitable Contributions – Substantiation and Disclosure Requirements, the IRS imposes disclosure rules on charities that receive certain quid pro quo contributions.[1] Charitable organizations are required to provide a written disclosure to a donor who receives goods and services in exchange for a payment in excess of $75. The written disclosure statement must satisfy the following provisions:
>
> --Inform the donor that the amount of the contribution that is deductible for Federal income tax purposes is limited to the excess of money (and the fair

[1] In fact, the disclosure rule is imposed by §6115 of the Internal Revenue Code, not by the IRS.

> market value of property other than money) contributed by the donor over the value of goods or services provided by the organization; and
>
> --Provide the donor with a good faith estimate of the fair market value of the goods or services.
>
> An organization must furnish a disclosure statement in connection with either the solicitation or the receipt of the quid pro quo contribution. The statement must be in writing and must be made in a manner that is likely to come to the attention of the donor. X's membership dues structure and benefits do not meet the "token exception" or the "membership benefits exception" to the written disclosure statement [sic] as described in Publication 1771. Furthermore, X cannot claim the "no donative element" exception to the disclosure statement requirement since there is no obvious lack of donative element associated with the payment of dues by X members. A disclosure statement printed with sufficiently sized type in the membership application distributed by X and posted on its website will satisfy this requirement. X will be subject to the applicable penalty ($10 per contribution) if it fails to meet the written disclosure requirement.

This "deficiency" is simply incorrect. It is predicated on the erroneous *assumption* that dues payments—required to be paid as a condition of obtaining membership in an association that provides substantial benefits to members, including subscriptions to journals, reduced prices for meeting registrations, governance rights (for some members), and access to other benefits, including benefits provided by third parties—are "quid pro quo contributions," within the meaning of §6115 of the Internal Revenue Code, because "there is no obvious lack of donative element associated with the payment of dues."

This standard---"no obvious lack of donative element"—has no basis in the law, and there are no regulations, revenue rulings, or relevant private letter rulings or technical advice memoranda under §6115. More correctly, the dues payment is *not* a quid pro quo contribution because there is "no obvious donative element": this is certainly closer to the standard set forth in Rev. Rul. 68-432 (emphasis added):

> Whether payments in the form of membership fees or dues to an organization described in section 170(c) of the Code are in whole or in part contributions is a question of fact and will depend on such considerations as the objectives and activities of the organization and the nature and extent of the benefits or privileges conferred upon its members. *If any reasonably commensurate return privileges or facilities are made available by reason of the membership payment, such payment is not a charitable contribution within the meaning of section 170 of the Code.*

> * * * *
>
> It is recognized, however, that there may be instances where an organization may offer a type of membership for an amount substantially exceeding the value of any benefits or privileges offered. Whenever the discrepancy between the size of the membership contribution and the potential monetary benefit is so great as to make it reasonably clear that the payment is of a dual character, the Internal Revenue Service will give due consideration to the possible separation on a uniform basis of that portion of the total payment that may properly be treated as a charitable contribution under section 170 of the Code.

See also Rev. Rul. 67-246 (emphasis added):

> Thus, where consideration in the form of admissions or other privileges or benefits is received in connection with payments by patrons of fund-raising affairs of the type in question, *the presumption is that the payments are not gifts*. In such case, therefore, if a charitable contribution deduction is claimed with respect to the payment, the burden is on the taxpayer to establish that the amount paid is not the purchase price of the privileges or benefits and that part of the payment, in fact, does qualify as a gift.

Definition of "quid pro quo contribution"

In pertinent part, §6115(b) defines a "quid pro quo contribution":

> For purposes of this section, the term "quid pro quo contribution" means a payment made partly as a contribution and partly in consideration for goods or services provided to the payor by the donee organization.

Neither X nor any member has suggested that a dues payment, required to obtain membership in X, is "partly . . . a contribution and partly in consideration for goods or services provided to the payor" by X. If an individual wishes to be a member of X, he or she must pay the amount of dues required for the pertinent class of membership. This is a purely commercial transaction, no different than the registration fees required by X to attend its meetings and educational seminars. (The IRS acknowledges that such payments are not charitable contributions: "Program service revenue includes . . . registration fees received in connection with a meeting or convention." 2016 Instructions for Form 990, page 38.) The dues payment is simply not paid "partly as a contribution and partly in consideration for goods or services provided to the payor."

The IRS already recognizes this conclusion. The instructions for the 2016 Form 990 state, on pages 37 and 38-39:

> Membership dues that aren't contributions because they compare reasonably with available benefits are reported on line 2, Program Service Revenue.
> * * * *
> Common Types of Program Service Revenue:
> * * * *
> Membership dues and assessments received that compare reasonably with the membership benefits provided by the organization. Organizations described in section 501(c)(5), (6), or (7) generally provide benefits that have a reasonable relationship with dues. Examples of membership benefits include:
>
> Subscriptions to publications,
> Newsletters (other than one only about the organization's activities),
> Free or reduced-rate admissions to events sponsored by the organization,
> Use of the organization's facilities, and
> Discounts on articles or services that members and nonmembers can buy.

In X's opinion, its membership dues are not contributions because they "compare reasonably" with the value of the benefits provided to members.

This conclusion is also supported by the Supreme Court's decision in *United States v. American Bar Endowment*, 477 U.S. 105 (1986), in which the undersigned participated at trial as counsel for the Government.[2] In that case, the Court decided that the amount of an experience rating refund paid by an insurance company in connection with a group insurance policy was not a deductible contribution by the individual insureds because the Endowment required participating insureds to assign their right to the refund to the Endowment as a condition of purchasing the insurance.

> A payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return. S. Rep. No. 1622, 83rd Cong., 2d Sess., 196 (1954); *Singer Co. v. United States*, 196 Ct. Cl. 90, 449 F.2d 413 (1971). However, as the Claims Court recognized, a taxpayer may sometimes receive only a nominal benefit in return for his contribution. Where the size of the payment is clearly out of proportion to the benefit received, it would not serve the purposes of §170 to deny a deduction altogether. A taxpayer may therefore claim a deduction for the difference between a payment to a charitable organization and the market value of the benefit received in return, on the theory that the payment has the "dual character" of a purchase and a contribution. See, *e.g.*, Rev. Rul. 67-

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[2] *American Bar Endowment v. United States*, 4 Cl.Ct. 404 (1984).

246, 1967-2 Cum. Bull. 104 (price of ticket to charity ball deductible to extent it exceeds market value of admission); Rev. Rul. 68-432, 1968-2 Cum. Bull. 104, 105 (noting possibility that payment to charitable organization may have "dual character").

Id., at 116-117.

Here, X members receive substantial benefits in return for their dues payments, the amount of the dues payment is not "clearly out of proportion to the benefit received," and there is therefore no "dual character." X is selling memberships for their fair market value, and X does not represent or contend that any part of the purchase price (dues payment) is a charitable contribution.

Section 6115 was enacted in 1993, and this is the first time in 24 years (during all of which the undersigned has been representing §501(c)(3) membership associations) that the IRS has been known to suggest that dues charged by a membership association in exchange for substantial membership benefits are a quid pro quo contribution described in Code §6115(b). Because of the number of membership associations potentially affected by this interpretation, if the IRS intends to maintain this position, it should do so by issuing proposed regulations interpreting §6115(b). To adopt this position in the course of an audit is unfair to both the organization being audited, and to all §501(c)(3) organizations that charge dues in exchange for substantial membership benefits.

Should you wish to discuss this issue, please call me at your convenience.

Yours truly,

Charles M. Watkins

cc: Sunita Lough, Commissioner, TE/GE
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