DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

DEPUTY COMMISSIONER

May 3, 2007

The Honorable Max Baucus
Chairman, Committee on Finance
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

I am responding, on behalf of Treasury Secretary Paulson, to your letter dated April 13, 2007, about a transaction involving noncash charitable contributions to tax-exempt organizations.

We first became aware of the transaction in August 2006. Later that year, the State of New York provided relevant documents to us which indicate, consistent with your letter, that in a typical transaction: (1) a piece of real property subject to a long-term lease is purchased through a tier of closely-held flow-through entities owned by a group of investors; and (2) approximately a year later, the so-called remainder interest in the property (restructured as an interest in one of the closely held flow-through entities) is donated to a tax-exempt organization at an apparently inflated value. In some cases, the donor may have reacquired the donated interest from the charity two years later at a significantly lower cost.

Last month, your staff discussed the transaction with IRS Chief Counsel Donald Korb, who promised to keep them informed about our knowledge of the transaction. Shortly thereafter, Mr. Korb's Special Counsel briefed a staff member on our actions to date. The following information provides more details about our efforts to promptly address the transaction.

To date, we have identified 48 entities participating in transactions involving deductions of approximately $271 million. Most of the entities are based in New York, but the investors in these entities appear to be geographically dispersed. We have assigned audit teams to all entities known to have contributed and claimed deductions for the 2003 tax year and have secured consents to extend the related statutes of limitation on assessment. We are working to identify all taxpayers who might have claimed charitable deductions using this type of transaction and to determine whether the transaction was actively promoted and, if so, how widely.

As you observed in your letter, in the cases under active audit the facts as developed so far have raised questions about the propriety of the charitable deductions claimed and the role some charities played in receiving the donations. All appropriate offices within

the IRS are coordinating as we seek information on additional entities involved and their investors, and linkages to charitable contribution deductions claimed after 2003. We are working with our Chief Counsel office to develop all the material facts necessary to determine the appropriate tax treatment and promptly address the transaction, including whether the transaction violates the charitable contribution and tax-exempt organization rules and whether substantial valuation misstatements of the donated property are involved.

We are confident that case development for this transaction is proceeding expeditiously. As our understanding of the transaction progresses, we will work closely with our Chief Counsel and the Treasury Department Office of Tax Policy to determine whether we need published guidance to address the transaction. We will also work with the Office of Tax Policy to evaluate legislative proposals that might address issues raised by the transaction, including the Joint Committee on Taxation's proposal for a general deduction-not-to-exceed-basis rule.

We are also working with the Office of Chief Counsel and the Office of Tax Policy to gather additional information about the transaction and about other taxpayers who may have entered into it. We are considering a listing notice under existing reportable transaction regulations or a "transaction of interest" notice under proposed regulations that we hope to finalize this summer.

We share your concern about the valuation problem this transaction presents and welcome your support as we explore ways to improve compliance in this area.

I hope this information is helpful. If you would like to discuss this further, please contact me or call Deputy Chief Counsel (Technical) Clarissa Potter, at (202) 622-3300.

Sincerely,

Kevin M. Brown
Deputy Commissioner for
Services and Enforcement