APPENDIX C
TAX SHELTER TRANSACTIONS INVOLVING EXEMPT ORGANIZATIONS

While we agree, in concept, to penalizing exempt organizations[1] that purposefully use their tax-exempt status to facilitate abusive tax shelters, any legislative proposal must be carefully structured to ensure that the obligations of EOs are clearly defined, so that EOs are not penalized too harshly for limited and innocent involvement in a transaction that is subsequently determined to be a part of an abusive tax shelter.

The proposal states that, to avoid sanction, an EO that is determined to be an "accommodating party" in a tax shelter must have received an "affirmation" that the transaction is not a listed or reported transaction. We believe that the proposal would penalize EOs for participating in transactions that have not been determined to be abusive tax shelters, and any penalties should not be imposed until the determination by the Service that a transaction is an abusive tax shelter has been subject to judicial review. If an EO participates in a transaction that the Service has determined – or later determines – is a listed transaction or that is a "reportable transaction," we suggest that it is not appropriate to impose penalties on the EO without a judicial determination that the transaction is an abusive tax shelter. The listing of a transaction by the Service is merely the Service's statement that it will challenge a particular transaction. It is not a final determination that the transaction does not "work" from a tax perspective or that it is an abusive tax shelter.

As elsewhere in this submission, we suggest that increased disclosure and transparency on the part of EOs is the answer. In our view, a more appropriate response to Congressional concerns about participation by EOs in potentially abusive tax shelters is to require EOs to disclose any participation in a listed transaction, with the EO being able to rely on an affirmation by a donor or promoter, subject to such safeguards as Congress may select, that a particular transaction is not a listed transaction or substantially similar to a listed transaction. In addition, as a safe harbor, an EO should not be subject to penalties for participating in a transaction which, at the time the transaction was completed, was not a listed transaction or substantially similar to a listed transaction.

We suggest that the following matters, at a minimum, require further study and clarification before legislation is proposed:

- How will "accommodating party" be defined?[2] If an EO receives a donation of a complex financial product or other property, for example, and the EO's role is that of

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[1] As elsewhere in this submission, "charity" refers to organizations described in Section 501(c)(3) and "EO" refers to EOs generally, including non-charitable EOs. All statutory references are to the Internal Revenue Code.
[2] Strictly speaking, a Section 501(c)(3) organization could be characterized as an "accommodating party" in every charitable contribution that it receives for which the donor takes a deduction. For example, charities facilitate avoidance of recognition of capital gain, as well as deductions offsetting gain that was never recognized and taxed, whenever they accept gifts of appreciated securities. Charities are always facilitating tax reduction for donors, because Congress, in Section 170, determined that it is in the public interest to encourage gifts to charity through tax breaks. Charities are not experts in the tax law, however, and the burden should not be on them to distinguish a proper tax avoidance transaction authorized (or permitted) by Congress from an abusive tax shelter, other than by relying on the Service's list as a safe harbor.

a passive recipient, with no knowledge, beyond the valuation of the property, of the tax implications to the donor of the contribution, the EO should not be considered an accommodating party. It may be more appropriate to define an "accommodating party" for this purpose as an EO that is an active participant in structuring and implementing the shelter transaction.

- Who must make the affirmation? If it is a donor, what level of due diligence, if any, must the EO conduct to confirm the accuracy of the affirmation? What if it is a promoter?

- If a donor or promoter provides a false affirmation to an EO, is a penalty imposed on the donor or promoter? In such a situation, is the EO at risk of sanction?

- If the EO must obtain the affirmation from a third party, will an opinion of counsel suffice? What level of independence must counsel have from the EO, the transaction, and other parties in the transaction?

- Some of the terms used in the proposal are open to interpretation (e.g., "significant purpose of tax avoidance"). In making an affirmation, what level of certainty must the affirming party have? Will a conclusion that the transaction "more likely than not" does not have a significant purpose of tax avoidance be sufficient?

- If a transaction, when completed, is not a listed transaction, but is later listed by the Service, what must the EO do, if anything, to avoid sanction by the Service? We suggest that the EO should have an obligation to disclose to the Service any transaction listed before the organization's Form 990 is filed, along with identifying information about the participants known to the EO.

We suggest that any reporting obligation imposed on an EO should be limited to its participation in "listed transactions." We consider it appropriate for any tax shelter reporting rule regarding EOs to rely heavily on the Service's list of tax shelters. Many EOs do not have the in-house expertise, or advisors with sufficient expertise, to make independent determinations about whether a transaction is a reportable transaction. In addition, an EO may not have access to sufficient information to identify reportable transactions. For example, a tax-exempt participant in a transaction may not know that another participant is claiming the requisite loss under Treasury Regulations section 1.6011-4(b)(5) or will show a significant book-tax difference as a result of the transaction, as required in Treasury Regulations section 1.6011-4(b)(6). Requiring that all transactions engaged in by EOs be put through the "reportable transaction" filter of Treasury Regulations section 1.6011-4 may be unworkable and certainly would add an unnecessary burden on nonprofits. If the Service is going to continue to list tax shelters that it considers most abusive, we believe that allowing EOs to rely on that list to identify abusive tax shelters is most appropriate.

The proposed penalties imposed for failure to comply with this rule are loss of Section 170 status for one year and disgorgement of all fees or other benefits received. In our view, loss of Section 170 status is unnecessarily harsh, absent intentional violation or a pattern of

abuse.[3] Subject to the limitations on imposition of penalties, as discussed above, for individual violations of any rule relating to participation in an abusive tax shelter, a cash penalty should be sufficient, coupled with public disclosure on the organization's Form 990 as is already required in connection with other penalties, e.g. Sections 4941 and 4958. If an EO engages in a number of abusive tax-shelters, e.g. acting as the tax-indifferent party, we believe that the IRS has the authority to penalize the organization for violating the excess private benefit prohibition or prohibition against having a substantial non-exempt purpose by revoking its tax-exempt status.

[3] Subject to very limited exceptions, non-charitable EOs cannot offer a Section 170 deduction to their supporters..