

U.S. Senate Committee on Finance

For Immediate Release

Monday, April 25, 2005

Grassley, Baucus Plan to Take Aim at Abusive “Supporting Organizations” for Charities

WASHINGTON – Sen. Chuck Grassley, chairman of the Committee on Finance, and Sen. Max Baucus, ranking member, today said they plan to propose reforms to stop the use of “supporting organizations” for generous tax breaks rather than charitable purposes. The senators plan to include a crackdown on supporting organization abuse in their comprehensive charitable governance reform legislation to be introduced in the next few months.

Grassley and Baucus have learned of supporting organization abuse through their own investigation and media reports, such as the front-page story in today’s New York Times.

“This is extremely troubling,” Grassley said. “Individuals are using supporting organizations to play fast and loose with the tax rules intended to help charities and encourage giving. It’s clear Congress and the administration will have to take steps to stop this abuse and ensure that charitable donations benefit the needy. I’m deeply disturbed that with a good number of supporting organizations, people are taking multi-million dollar tax deductions for what they claim are contributions to charity, yet too often the result is a thimbleful of benefit to charity.

“Both a Congressional Research Service report and the Finance Committee’s review have made it clear that the problem isn’t limited to Type III supporting organizations. The snake oil salesmen have also figured out how to manipulate Type I and II supporting organizations for the benefit of themselves and their clients. Meanwhile, the charities are lucky if they receive enough money to buy a blanket for the homeless. While the taxpayers get bilked by this abuse, sadly the needy ultimately suffer because they’re denied the benefits intended by the tax law.

“The law intended to allow supporting organizations only for a narrow set of circumstances. Unfortunately, creative types are exploiting a loophole in the regulations by setting up supporting organizations to skirt the laws governing private foundations. You could drive a Mack truck through that loophole.”

Baucus said, “The purpose of giving taxpayers a charitable deduction is to encourage charitable works -- bestowing this tax benefit is a public trust. Unfortunately, many entities organized as supporting organizations are little more than private piggy banks for greedy individuals. I am committed to working with Senator Grassley on reforms that will ensure that all supporting organizations live up to their charitable purpose, and their public promise.”

Grassley and Baucus wrote to the Treasury Department in February to express their concerns

about supporting organizations. The text of their letter follows.

February 3, 2005

The Honorable John Snow
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Mr. Secretary:

We are writing to express our continued concern regarding the inappropriate use of charitable organizations for purposes of tax avoidance and evasion. While we are supportive of President Bush's efforts to encourage charitable giving, we would like to ensure that charitable contributions translate into actual additional assistance to those in need.

We are particularly concerned about section 501(c)(3) charitable organizations avoiding private foundation rules by claiming public charity status as a Type III supporting organization (SO) under section 509(a)(3) of the Code and section 1.509(a)-4(i) of the Treasury regulations. As a result of its own review as well as various newspaper articles, the Finance Committee is aware of the following abusive situations in which a taxpayer donates assets to a Type III SO and likely takes a charitable deduction for the claimed fair market value of the contribution:

- 1) The donated assets remain under the effective control of the donor while generating very little income for the charity. (The charity may be controlled by the taxpayer, such as a donor advised fund.) In one case, an SO with over \$300 million in assets distributed in one year less than \$1 million to the supported organization, a significant portion of which was to the donor advised fund controlled by the donor, and the SO had no other activities. This equates to a payout of approximately .3%. In contrast, a private foundation is generally required to payout 5% of the value of its noncharitable use assets annually or, in this case, \$15 million to charity.
- 2) The SO engages in offshore investment activities and, through several transactions, effectively returns the money to the taxpayer. It is our understanding that this scheme also allows the taxpayer to take a deduction and avoids tax on capital gains.
- 3) Soon after the donation, the taxpayer receives a loan back from the Type III SO up to the amount donated.

The common objective in these schemes involving supporting organizations is a very large charitable deduction for the donor with little charitable purpose served. The Finance Committee believes that often the "donation" is of assets that are difficult to value or are essentially illiquid such as stock in closely-held corporations or antiques which if donated to a private foundation and not to an SO would generate a deduction of the donor's basis and not a fair market value deduction. Such

donations also raise concerns about inflated valuations which go hand-in-hand with tax evasion and avoidance. Moreover, the supported charity that does finally receive funds from the Type III SO is often effectively controlled by the donor so that both the SO and the supported organization become vehicles to hold the assets in perpetuity. Another situation of concern to the Finance Committee is one where an SO is established to support a foreign organization. Although to our knowledge, there have not been reported abuses involving SOs and foreign organizations, the Type III form of SO could be abused to generate improper deductions for contributions to foreign organizations.

We are aware the Internal Revenue Service is currently auditing a sample of supporting organizations. We would appreciate a status report on this initiative. The report should address the situations and issues described above as well as inform us of any other abuses the IRS may have uncovered. The report should also highlight organizations that may be abiding by the letter of exempt organizations law but are violating the spirit of our laws that encourage charitable giving. We are particularly interested in any efficiencies that can be gained through the use of non-routine enforcement techniques as well as impediments that may hinder the use of such techniques.

We are troubled that even though abuses in this area were reported by the *Wall Street Journal* over six years ago there still has not been effective action taken in this area. These abuses cannot continue. Type III supporting organizations are primarily a creature of Treasury Regulations. To that end, we ask: what combination of changes to the Regulations, IRS guidance and enforcement activities and legislation is needed to curb these abuses quickly?

We strongly encourage the Department of Treasury to revisit the regulations that have created the Type III supporting organizations. The Tax Reform Act of 1969 established supporting organizations as a limited exception to the private foundation definition. As stated in the General Explanation of that Act, “religious organizations other than churches, the Hershey Trust (which is organized and operated for the benefit of a specific school for orphaned boys and is controlled by or operated in connection with that school), university presses, and similar organizations are examples of organizations expected to qualify [as supporting organizations].” Even apart from abusive situations, the use of supporting organizations under present Treasury regulations appears to have departed from the original Congressional intent. It is difficult to believe that Congress intended for the strict regulation on private foundations contained in the 1969 Act be eviscerated by the Treasury Department regulations governing Type III supporting organization.

Thank you for your time and attention to this matter. We ask for a response within thirty days given that the Finance Committee hopes to consider the President’s proposals regarding charitable contributions in the near future.

Cordially yours,

Charles E. Grassley
Chairman

Max Baucus
Ranking Member