

Panel on the Nonprofit Sector

Convened by INDEPENDENT SECTOR

Work Group Recommendations to the Panel on the Nonprofit Sector Posted for Public Comment January 24, 2005

#11: Tax Shelters

I. Legal Framework Work Group Recommendations

A. Statement of Problem

Charitable organizations, as well as other tax neutral persons and entities, have been involved as accommodation parties in abusive tax avoidance transactions (i.e., tax shelters). The Senate Finance Committee staff has proposed that charitable organizations which the IRS determines have accommodated “listed tax shelter transactions or reported transactions (with a significant purpose of tax avoidance)” without receiving an “affirmation that the transaction is not a listed or reported transaction” under existing federal tax law would have their section 170 status revoked for a year and be subject to a 100-percent tax on all accommodation fees or other direct benefits received. “Listed transactions” are those which the IRS has determined to be tax avoidance transactions and identified as such by notice or other published guidance.¹ “Reportable transactions” include “listed transactions” as well as other types of transactions which must be disclosed to the IRS even though there has been no determination that such other transactions are abusive.²

B. Recommendations

1. The Work Group is reviewing the applicable code provisions and regulations, as amended by the American Jobs Creation Act of 2004, and, if appropriate, will make a recommendation regarding a targeted anti-abuse provision in Phase II of the Panel on the Nonprofit Sector process.
2. Penalties for a charitable organization’s participation in a listed transaction should bear some relationship to the magnitude of the offense. The Work Group is also reviewing currently applicable penalties and, if necessary, a detailed recommendation regarding penalties will also be made by the Work Group in Phase II.

¹ See Treas. Reg. Section 1.6011-4(c).

² See Treas. Reg. Section 1.6011-4(b). It is assumed that the term “reported transactions” in the Senate Finance Committee staff discussion draft refers to “reportable transactions.”

Note: These recommendations have not yet been reviewed by the Panel on the Nonprofit Sector. They will be part of the deliberations by the Panel as it prepares its interim report.

C. Rationale

Work Group members are troubled by the participation of charitable organizations in abusive transactions, but note that the problem of tax shelter participation is not unique to charitable organizations. Therefore, the Work Group is reviewing the current legislative response to the problem of tax shelter accommodation as it relates to the broader field of tax-neutral individuals and entities. The Work Group will further study the issue of charity participation in tax shelters and, if appropriate, propose specific anti-abuse and penalty provisions in Phase II of the Panel on the Nonprofit Sector process.

The Work Group believes that appropriate penalty provisions should be related to the organization's participation in the listed transaction. For this reason, the Work Group has serious concerns about the Senate Finance Committee staff proposal to penalize participation in tax shelters through revocation of section 170 status of charities as it bears no relationship to the violation and may often result in an inappropriate penalty that is mismatched to the offense. In some circumstances, this penalty may be grossly disproportionate to the offense, depriving a charity of a major portion of its funding for a year, while in other circumstances this penalty would have no effect whatsoever (e.g., when the offending charity does not rely on tax-deductible contributions). Some Work Group members felt that the current IRS "arsenal" for combating tax shelters (including, e.g., private benefit, understatement penalties, penalties for failure to report, aiding and abetting penalties, and promoter penalties) may be sufficient.

D. Other Considerations

It was suggested that the Work Group consider a recommendation for enhanced penalties on other tax shelter participants for using a charitable organization in creating the tax shelter. This will be considered in Phase II of the Panel on the Nonprofit Sector process.

II. Expert Advisory Group Comments

The Expert Advisory Group agreed with the recommendations of the Work Group.