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United States Senate

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October 17, 2011

The Honorable Timothy F. Geithner
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

The Honorable Douglas L. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224

Dear Secretary Geithner and Commissioner Shulman:

I appreciate the letter from Acting Assistant Secretary (Tax Policy), Emily McMahon, regarding my August 11, 2011 letter to the President on the definition of loopholes. Further to that discussion, I am writing to inform you of a loophole that I have been concerned about for many years now. That is the exploitation of the supporting organization status in the Internal Revenue Code.

Enclosed please find a copy of the February 3, 2005, letter that then-Ranking Member Baucus and I sent to Treasury Secretary John Snow. At the time, abuse of Type III supporting organizations was our primary focus. However, I had also asked my staff to review Type I and Type II supporting organizations, including those mentioned in the 1998 *Wall Street Journal* article titled "Gimme Shelter: The SO Trend: How To Succeed in Charity Without Really Giving" as well as the George Kaiser Family Foundation (GKFF).

In March, 2005, my staff reviewed GKFF's Form 990 available at that time and noted the following:

- George Kaiser Family Foundation is a supporting organization that, according to its 990, supports the Tulsa Community Foundation.
- GKFF has $364 million of assets which include $215 million of stocks and $64 million in partnership interests and natural gas swap contracts.
- In 2002, it distributed $776, 000 (.2% of assets) including $500,000 to the Tulsa Community Foundation $300,000 of which went to the Kaiser Fund at Tulsa Community Foundation.
- If subjected to the private foundation minimum distribution requirements, the Foundation would have been required to distribute close to $18 million.

The *New York Times* specifically profiled the GKFF in its April 25, 2005, front-page story titled "Big Tax Break Often Bypasses Idea of Charity". This piece highlighted that GKFF had been a private foundation before converting to a supporting organization. Private foundations are subject to several rules that aren't applicable to public charities such as supporting organizations. These rules include 1) restrictions on ownership of business interests, 2) excise taxes on investment income, 3) payout requirements and 4) lower limits on the deductibility of contributions by individuals.

In light of GKFF's investment in Solyndra, I asked my staff to review GKFF's most recent Forms 990. Their analysis is attached. The numbers are very troublesome. GKFF's basis for the more favorable public charity status is that it supports the Tulsa Community Foundation (TCF). While its assets have grown to over $4 billion since 2005, its grants for the most recent three year period is less than 2% of its total assets – about $215.4 million. Of this amount, less than 5% was allocated to the TCF, or $10,464,012. Of those funds, it is unclear how much was allocated to the Kaiser family funds at the TCF as was done in 2002.

During this same time, GKFF received over $1 billion in contributions – over one-third of which were non-cash contributions. On page 2 of GKFF's 2009 Form 990, Schedule O, GKFF states that "George Kaiser is a substantial contributor to the George Kaiser Family Foundation." Given that the foundation is named after Mr. Kaiser, this is to be expected. Assuming that he was the only contributor, Mr. Kaiser was eligible to deduct the $1 billion of contributions up to 50% of his adjusted gross income (AGI) for contributions of cash and publicly-traded securities and 30% of his AGI for contributions of non-publicly traded securities. If GKFF had remained a private foundation, those limits would have been 30% and 20% respectively.

Moreover, if GKFF had remained a private foundation, GKFF would have been required to pay-out more than an additional estimated $230 million to charities in those three years and to pay excise taxes on its investment income. In addition, GKFF likely would not have been able to hold investments in the private equity and venture funds such as Argonaut, which was a key investor in Solyndra.

Separately, during the same time, the TCF received $462,801,083 in contributions. Thus, the $10,464,012 allocated to the TCF represents less than 2% of its total contributions for those years. GKFF's low pay-out to the TCF combined with the low level of support this amount represents to the TCF raises serious questions about GKFF's status as a supporting organization and thus its status as a public charity. This is well within the power of the Internal Revenue Service to review.

In the Pension Protection Act of 2006, Chairman Baucus and I shut down abuses by certain supporting organizations by applying private foundation rules to these organizations. However, as we stated in our 2005 letter to Secretary Snow, the Tax Reform Act of 1969 established supporting organizations as a limited exception to the private foundation definition. Recognizing this, we required the Treasury Department to submit a report to the Senate Finance Committee and House Ways & Means Committees on supporting organizations and donor-advised funds. This study was due to these Committees on August 17, 2007 <u>so it is now four years overdue.</u>

The study was supposed to address the following:

(1) whether the deductions allowed for the income, gift, or estate taxes for charitable contributions to sponsoring organizations of donor advised funds or to supporting organizations are appropriate in consideration of—

(A) the use of contributed assets (including the type, extent, and timing of such use),

or

(B) the use of the assets of such organizations for the benefit of the person making the charitable contribution (or a person related to such person),

(2) whether donor advised funds should be required to distribute for charitable purposes a specified amount (whether based on the income or assets of the fund) in order to ensure that the sponsoring organization with respect to such donor advised fund is operating consistent with the purposes or functions constituting the basis for its exemption under section 501, or its status as an organization described in section 509(a), of such Code,

(3) whether the retention by donors to organizations described in paragraph (1) of rights or privileges with respect to amounts transferred to such organizations (including advisory rights or privileges with respect to the making of grants or the investment of assets) is consistent with the treatment of such transfers as completed gifts that qualify for a deduction for income, gift, or estate taxes, and,

(4) whether the issues raised by paragraphs (1), (2), and (3) are also issues with respect to other forms of charities or charitable donations.

In the summer of 2009, my office was informed that the study was awaiting review by the incoming Assistant Secretary for Tax Policy. This person was confirmed and has since resigned. Now, the position is again vacant and occupied by Ms. McMahon in an Acting capacity.

Separately, five years since the enactment of the 2006 legislation, a key component of the reforms has yet to take effect – the pay-out requirement. The study was intended to inform the Treasury as to what was an appropriate pay-out level. The idea was that the pay-out requirement should be no less than what is required of private foundations since these supporting organizations were clearly formed to skirt the private foundation rules.

If the Administration is serious about closing loopholes, it should prioritize the completion of the study and the finalization of the pay-out rules for those supporting organizations Congress deemed to be exploiting the tax code. Both of these will be helpful as Congress continues to consider tax reform. I request that my staff be briefed on the status of both of these projects as soon as possible.

Sincerely,

Chuck Grassley

Charles E. Grassley
United States Senator

CEG/tp
enclosure

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 non charitable 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 1969Act 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