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August 6, 2007

The Honorable John Lewis
Chairman
Subcommittee on Oversight
Committee on Ways & Means
U.S. House of Representatives
343 Cannon House Office Building
Washington, D.C. 20515

The Honorable Jim Ramstad
Ranking Member
Subcommittee on Oversight
Committee on Ways & Means
U.S. House of Representative
103 Cannon House Office Building
Washington, D.C. 20515

Re: Comments in Response to the Request of the Subcommittee on Oversight of the Ways and Means Committee Regarding the Provisions of the Pension Protection Act of 2006 Affecting Tax Exempt Organizations

Dear Chairman Lewis and Congressman Ramstad:

Enclosed are comments in response to the request of the Subcommittee on Oversight of the Ways and Means Committee regarding the provisions of the Pension Protection Act of 2006 affecting tax exempt organizations. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

The American Bar Association Section of Real Property, Probate and Trust Law also has prepared comments on this matter. While the Section of Taxation's comments address several different issues there is also overlap in some areas. Where there is overlap, each Section brings its expertise to the analysis and discussion. Each Section's comments, therefore, should be reviewed individually on its merits.

Sincerely,

Susan P. Serota
Chair

Enclosure

cc: Representative Charles B. Rangel, Chair, House Committee on Ways and Means
Representative Jim McCrery, Ranking Member, House Committee on Ways and Means
John Buckley, Democratic Chief Tax Counsel, House Ways and Means Committee
Jon Traub, Republican Chief Tax Counsel, House Ways and Means Committee
Russell Sullivan, Staff Director, Senate Finance Committee
Kolan Davis, Republican Staff Director, Senate Finance Committee
Thomas Barthold, Acting Chief of Staff, Joint Committee on Taxation
Eric Solomon, Assistant Secretary of the Treasury (Tax Policy)
Michael J. Desmond, Tax Legislative Counsel, Department of the Treasury
Kevin Brown, Acting Commissioner, Internal Revenue Service

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**Statement of the
American Bar Association Section of Taxation**

**Subcommittee on Oversight
Committee on Ways and Means
United States House of Representatives**

**Request for Written Comments on
Provisions Relating to Tax-Exempt Organizations in the Pension Protection Act of 2006**

Monday, August 6, 2007

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (“Tax Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Executive Summary

The Pension Protection Act of 2006¹ (the “PPA”) contained numerous provisions affecting tax-exempt organizations described in section 501(c)(3).² On June 12, 2007, the Subcommittee on Oversight of the Ways and Means Committee of the United States House of Representatives issued an Advisory, inviting comments on those provisions of the PPA, including on how these provisions may affect charitable efforts and the difficulties that have arisen in implementing these provisions. We welcome the Oversight Subcommittee’s consideration of these issues and their impact on donor advised funds, supporting organizations, their donors and the organizations they support.

In reaction to reports of abuses by a few organizations, the PPA imposed a great many new restrictions and penalties on donor advised funds and supporting organizations. Most of those reported abuses violated pre-PPA Code provisions, which suggests that at least certain of the PPA’s changes may not have been necessary. The PPA places significant new compliance burdens on donor advised funds, supporting organizations, their donors, and the organizations they support. These provisions are discouraging many well-accepted and commendable charitable activities. The PPA also places significant additional demands on the Service’s limited enforcement resources. We welcome the Oversight Subcommittee’s consideration of the need for balance between correcting abuses and placing additional burdens on legitimate, nonabusive charitable activities, and commend the Oversight Subcommittee to do so in a transparent manner through public hearings and open comments.

¹ The Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006).

² References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated, and references to regulations are to the Treasury Regulations.

Our most significant Comments can be summarized as follows:

1. The PPA imposes new automatic excess benefit transaction rules on donor advised funds and supporting organizations that are more stringent than the self-dealing rules applicable to private foundations, add undue complexity to the tax laws, and are uncertain in their treatment of section 501(c)(3) organizations as disqualified persons.
2. The PPA makes it more difficult for charitable trusts to qualify as Type III supporting organizations and may adversely affect a significant number of nonabusive charitable trusts.
3. The PPA's new rules distinguishing functionally integrated from non-functionally integrated Type III supporting organizations are a source of significant complexity and should be reconsidered. At a minimum, the effective date of these rules should be postponed until the Treasury Department issues final regulations clarifying the scope of these rules.³
4. The PPA's treatment of charitable contributions of undivided interests in tangible personal property is punitive and affects a great many nonabusive situations.
5. The PPA's change in the treatment of S corporation charitable deductions is consistent with longstanding tax policy favoring charitable contributions of appreciated property, promotes parity in the tax treatment of S corporations and partnerships, and should be made permanent.
6. The goal of the PPA's provision requiring the public disclosure of section 501(c)(3) organizations' Forms 990-T could be achieved more simply by expanding the disclosure of unrelated business activity on Form 990.
7. A technical correction appears necessary to ensure that the penalty abatement provisions apply to new sections 4966 and 4967; and
8. The PPA's changes to section 512(b)(13) should be made permanent in order to put tax-exempt organizations on parity with taxable entities.

³ An Advance Notice of Proposed Rulemaking (REG 155929-06) issued on August 1, 2007 details several factors the Treasury Department and the Internal Revenue Service (the "Service") anticipate including in proposed regulations, and requests public comment by October 31, 2007.

Comments

In light of the breadth of the PPA's provisions affecting tax-exempt organizations, these Comments focus on those areas that present the most significant concerns. The Tax Section's views on the PPA also are reflected in comments⁴ to the Service dated June 4, 2007 in response to Notice 2006-109,⁵ and comments⁶ to the Service dated July 31, 2007 in response to Notice 2007-21.⁷ As requested by the Notices, those submissions commented only on the provisions of the PPA that affect supporting organizations and donor advised funds and include recommendations for regulations and other guidance.

1. The Automatic Excess Benefit Transaction Rules Applicable to Supporting Organizations and Donor Advised Funds

Background. Private foundations defined in section 509(a) have long been subject to an excise tax under section 4941 that penalizes "self-dealing" transactions with "disqualified persons." Section 4941 generally prohibits financial transactions between a private foundation and a disqualified person, but contains several exceptions, including one in section 4941(d)(2)(E) that allows a private foundation to pay reasonable compensation to a disqualified person for services provided to the private foundation.

Since September 14, 1995, transactions between public charities⁸ and their disqualified persons have been subject to an excise tax found in section 4958, often called the "intermediate sanctions" excise tax. Prior to the PPA, section 4958 did not prohibit financial transactions between a public charity and a disqualified person, but instead subjected them to an arm's length reasonableness standard. Section 4958 penalized only "excess benefit transactions" in which a disqualified person received an excessive economic benefit. Prior to the PPA, supporting organizations and donor advised funds, which are classified as public charities, were subject to the intermediate sanctions restrictions of section 4958 rather than the private foundation self-dealing restrictions of section 4941.

Comment on Automatic Excess Benefit Transactions. The PPA effectively establishes a third excise tax on transactions between a charity and its disqualified persons. It does so by creating a new type of *automatic* excess benefit transaction in section 4958(c)(2) and (3) that

⁴ Comm. on IRS Notice 2006-109, ABA Tax Sec. *Comments in response to IRS Notice 2006-109 on the application of the Pension Protection Act of 2006 to donor advised funds and supporting organizations*, (June 4, 2007).

⁵ Notice 2006-109, 2006-51 I.R.B. 1121

⁶ Comm. on IRS Notice 2007-21, ABA Tax Sec. *Comments in response to IRS Notice 2007-21 on Treasury Study on donor advised funds and supporting organizations*, (August 1, 2007).

⁷ Notice 2007-21, 2007-9 I.R.B. 611.

⁸ The term "public charity" is not defined in the Code and is used here to mean those tax-exempt organizations described in section 501(c)(3) other than private foundations. Section 4958 also applies to organizations described in section 501(c)(4) and their disqualified persons.

applies exclusively to supporting organizations and donor advised funds.⁹ Section 4958(c)(2) applies to donor advised funds and imposes the section 4958 excise tax automatically on any “grant, loan, compensation, or other similar payments” by donor advised funds to donors, advisors, and certain related persons. The Joint Committee Report states that “other similar payments” include expense reimbursements but not sales or leases.¹⁰ Section 4958(c)(3)(A)(i)(I) creates comparable automatic excess benefit transaction rules for payments by supporting organizations to their substantial contributors and certain related parties. Section 4958(c)(3)(A)(i)(II) creates a third, broader category of automatic excess benefit transaction for a loan by a supporting organization to any “disqualified person,” not just substantial contributors and related parties.

The PPA thus establishes new rules for supporting organizations and donor advised funds that are more stringent than those that apply under either the private foundation self-dealing rules or the general section 4958 intermediate sanctions rules (both of which allow the payment of reasonable compensation and expense reimbursements to disqualified persons). It is not clear why supporting organizations and donor advised funds should be subject to a more stringent rule. Implicit in this change must be the view that payments of compensation or expense reimbursements to disqualified persons by supporting organizations or donor advised funds are more likely to result in abuse than similar payments by private foundations. However, we are not aware of any substantial evidence to that effect.

The PPA also reverses the priorities of section 4941 by prohibiting the payment of compensation but allowing sales and leases. Congress previously had determined in enacting section 4941 that sales and leases were more susceptible to abuse than compensation for services, but the PPA takes a contradictory approach. The rules under section 4941 already were subject to much criticism for their complexity, and by prohibiting the payment of all compensation by supporting organizations and donor advised funds the PPA effectively creates more traps for the unwary.

We encourage the Oversight Subcommittee to consider whether it would be more appropriate to apply either the private foundation self-dealing model or the public charity intermediate sanctions model, in lieu of these new restrictions which add further complexity to the Code. If the Oversight Subcommittee concludes that a more restrictive penalty tax regime on donor advised funds and supporting organizations is appropriate, we respectfully submit that a less complex approach would be to subject donor advised funds and supporting organizations to the self-dealing rules of section 4941, much as the PPA has subjected them to other private foundation provisions in sections 4943 and 4945.

Comment on Failure to Exclude All Section 501(c)(3) Organizations. The PPA also may establish more restrictive rules for transactions between section 501(c)(3) organizations. Prior to the PPA, transactions between section 501(c)(3) organizations were excluded from the scope of both the private foundation self-dealing excise tax and the intermediate sanctions excise

⁹ The PPA also adds new sections 4966 and 4967, which impose penalties on other donor advised fund activities.

¹⁰ Staff of the Joint Committee on Taxation, Technical Explanation of H.R. 4, The “Pension Protection Act of 2006,” as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006, at 467 (2006) (the “Joint Committee Report”).

tax, regardless of whether they were private foundations or public charities. This exclusion was accomplished in the regulations by excepting all section 501(c)(3) organizations from the definition of “disqualified person.”¹¹ The PPA’s automatic excess benefit rule for loans by supporting organizations to disqualified persons in section 4958(c)(3)(A)(i)(II), however, creates by statute a limited exclusion that applies only to public charities described in section 509(a)(1), (2) and (4). This express statutory provision may foreclose the Treasury Department from expanding that exclusion by regulation to allow a supporting organization to make a loan to another supporting organization or to a private foundation that is a disqualified person, even though the transaction is between two section 501(c)(3) organizations. If this result is what Congress intended, it represents a material departure from the pre-PPA policy of excluding all transactions between section 501(c)(3) organizations from the application of the self-dealing and intermediate sanctions excise taxes.

The limited statutory exclusion in section 4958(c)(3)(A)(i)(II) also clouds the Treasury Department’s regulatory authority with respect to the other automatic excess benefit transaction rules in section 4958(c)(2) and (c)(3)(A)(i)(I). Although neither of these latter provisions contains the same limited statutory exclusion, the language in closely related section 4958(c)(3)(A)(i)(II) may cast doubt on the Treasury Department’s regulatory authority to extend the pre-PPA exclusion for all section 501(c)(3) organizations to the new automatic excess benefit transaction rules. The Treasury Department could view the limited statutory authority for loans to disqualified persons as an indication of Congressional intent toward automatic excess benefit transactions more generally.

The policy reflected in the private foundation self-dealing rules of excluding all section 501(c)(3) organizations from self-dealing penalties has withstood the test of time. A more restrictive approach under the automatic excess benefit transaction rules creates further complexity and more traps for the unwary. Accordingly, we respectfully suggest that the Oversight Subcommittee reconsider this aspect of the PPA.

2. The Treatment of Perpetual Charitable Trusts as Supporting Organizations

Background. Prior to the PPA, a trust described in section 501(c)(3) could qualify as a Type III supporting organization under section 509(a)(3) if it met the “responsiveness test” and the “integral part” test in Treasury Regulation section 1.509(a)-4(i)(2) and (3). Under Treasury Regulation section 1.509(a)-4(i)(2)(ii) a trust could meet the responsiveness test if it was a charitable trust under state law, named each supported organization in its governing instrument, and was subject to a state law that gave the beneficiary organization(s) the power to enforce the trust and compel an accounting. PPA section 1241(c) overruled this regulation. The Joint Committee Report states as follows:

In general, under [this] provision, a Type III supporting organization that is organized as a trust must, in addition to present law requirements, establish to the satisfaction of the

¹¹ Reg. §§ 53.4946-1(a)(8) and 53.4958-3(d)(1).

Secretary, that it has a close and continuous relationship with the supported organization such that the trust is responsive to the needs or demands of the supported organization.¹²

We understand that the PPA included this provision in response to reported abuses of donors' "parking" assets in a charitable trust and retaining effective control of them due to a failure of oversight by the supported organization. Such abusive "parking" of assets is designed to avoid dedicating the assets to charitable purposes and use. However, this PPA provision is very broad in scope and affects a significant number of charitable trusts where there is no hint of abuse. For example, it is not uncommon for a donor to create a separate trust with a bank or other independent trustee to serve as an external endowment for a named charity. Donors do so for a number of reasons, including concerns that future officers of the charity will not honor the donor's intent, that the endowment should be protected from the charity's creditors, that the charity might otherwise make imprudent invasions of principal, or that the charity lacks investment expertise. Having a trust serve as an external endowment avoids these concerns and serves legitimate charitable purposes. The establishment of such trusts stands in sharp contrast to the abuses at which the provision is aimed; yet, the PPA provision applies to them as well.

Comment. We assume that Congress did not intend the PPA to have the effect of revoking the supporting organization status of the significant number of nonabusive charitable trusts described above. However, there is no assurance that the Treasury Department's regulations will adequately constrain the scope of PPA section 1241(c) to avoid the unnecessary conversion of many nonabusive charitable trusts into private foundations.¹³ Accordingly, we respectfully suggest that the Oversight Subcommittee reconsider the scope of PPA section 1241(c) to ensure that it clearly reflects its intent and is not applied more broadly than intended.

3. Non-Functionally Integrated Type III Supporting Organizations

Background. The PPA imposes new restrictions directed at Type III supporting organizations that do not qualify as "functionally integrated" under section 4939(f)(5)(B), including rules that (1) deny qualified distribution treatment for grants to them by private foundations, (2) impose excess business holdings rules, (3) require private foundations that make grants to them to exercise expenditure responsibility, (4) disqualify them from administering donor advised funds eligible to receive deductible charitable contributions, and (5) impose new payout requirements to be set by the Treasury Department.¹⁴

¹² Joint Committee Report at 362. The Advance Notice of Proposed Rulemaking (REG 155929-06) issued on August 1, 2007 addresses this charitable trust issue only preliminarily and requests further comment.

¹³ The breadth of PPA section 1241(c) is discussed at pages 62-66 of the Tax Section's June 4, 2007, comments to the Service. Those comments recommend steps that the Service and the Treasury can take to ameliorate the overbreadth of PPA section 1241(c).

¹⁴ I.R.C. §§ 4942(g)(4)(A)(i), 4943(f)(3)(A), 4945(d)(4)(A)(ii) & 170(f)(18)(A)(ii); PPA § 1241(d). The Tax Section's June 4, 2007, comments to the Service, at 51-56, discuss these provisions and make recommendations regarding the definitional issues the Service and the Treasury face with respect to functionally integrated Type III supporting organizations.

Under these new provisions, non-functionally integrated Type III supporting organizations are treated more harshly than private foundations. A grant from one private foundation to another private foundation can be a qualifying distribution that counts against the grantor's minimum distribution requirement if the grantee serves as a conduit for the grant under the "out of corpus" rules of section 4942(g)(3). However, no such flexibility is allowed for grants by private foundations to non-functionally integrated Type III supporting organizations.

Comment. The PPA's rules creating the new categories of functionally integrated and non-functionally integrated Type III supporting organizations are a source of significant complexity and have resulted in significant confusion. The statutory definitions are ambiguous, and the Service has suspended issuing determination letters on whether a Type III supporting organization is functionally integrated.¹⁵ It has been reported that many private foundations are simply refusing to make grants to any Type III supporting organization as a result of these new rules. The punitive denial of the "out of corpus" rules for grants to non-functionally integrated Type III supporting organizations has added to private foundations' concerns. The reaction of private foundations is creating problems for all Type III supporting organizations. Given the many unanswered questions, we encourage the Oversight Subcommittee to reconsider these rules. If Congress decides to retain these rules, the Oversight Subcommittee should monitor how the Treasury Department carries out its broad regulatory authority to ensure that these provisions do in fact address the reported abuses that led to their enactment. Finally, the effective date of these rules should be postponed until the Treasury Department issues final guidance clarifying the scope of these rules.¹⁶

4. Gifts of Partial Interests in Tangible Personal Property

Background. The PPA made several changes to the rules governing deductions for charitable contributions of tangible personal property. The changes that have caused the most concern involve new valuation and recapture rules for gifts of undivided interests in tangible personal property under sections 170(o), 2055(g) and 2522(e). Where a donor contributes an undivided interest in tangible personal property to charity, these new PPA rules: (1) limit the donor's deduction for any subsequent gift of an undivided interest in the same property for income, gift and estate tax purposes by basing the subsequent deduction on the lesser of the property's fair market value at the time of the initial gift or its fair market value at the time of the subsequent gift; (2) require the recapture of both income tax and gift tax deductions, plus interest, if either (i) the donor does not contribute all of the remaining interest in the property

¹⁵ Memorandum from Acting Director, EO Rulings and Agreements, Feb. 22, 2007.

¹⁶ The Advance Notice of Proposed Rulemaking (REG 155929-06) issued on August 1, 2007 ("ANPRM") makes several constructive proposals regarding functionally and non-functionally integrated supporting organizations, but does not address all of the concerns with PPA's new restrictions and leaves many questions unanswered. The ANPRM requests comments by October 31, 2007, and only after that date will proposed regulations be issued. The ANPRM states that new rules will not be effective until temporary or final regulations are issued; in the interim, exempt organizations will be forced to continue to grapple with the PPA's statutory restrictions and penalties without definitive guidance.

before¹⁷ the earlier of the donor's death or 10 years after the initial contribution or (ii) the donee charity does not have substantial physical possession of the property and does not use the property for a tax-exempt purpose during the period it has partial ownership; and (3) impose a 10 percent addition to both income and gift tax attributable to such recapture.

Comment. Gifts of undivided interests are a valuable and legitimate way that many museums acquire works of art. We question whether the reported abuses of such gifts justify the PPA's attempts to discourage them. Moreover, the PPA's valuation and recapture rules do not simply discourage such gifts, but in fact punish them harshly. For example, assume that a donor contributes a 50 percent undivided interest in a painting worth \$1 million to a museum on July 1, 2007, and gives the remaining 50 percent to the same museum ten years later on June 30, 2017, at a time when the value of the painting has appreciated to \$2 million. Under the PPA, the donor's income tax deduction for the second gift is limited to \$500,000 instead of \$1 million. Limiting the donor's gift tax deduction to \$500,000 forces the donor to pay out of pocket \$200,000 of gift tax just to make the subsequent charitable contribution within the time frame prescribed by the PPA (assuming a 40 percent effective gift tax rate in 2017). The subsequent gift may well cost the donor more in gift tax than the donor will save in income tax.

The recapture rules pile on yet more penalties. The first recapture rule, based on a donor's failure to contribute the remaining undivided interest within the time permitted, would be triggered by a donor who forgets to amend his will and then dies before making a subsequent gift. That donor would be penalized by recapture for mere inadvertence. Recapture of the income tax, along with interest and an addition to tax, is itself a penalty. Requiring gift tax recapture as well, plus interest and addition to tax, compounds the penalty. The second recapture rule, based on a donee charity's not having substantial physical possession of the property and not putting the property to a related tax-exempt use, again is excessively punitive by requiring recapture of the gift tax as well as the income tax.¹⁸ Because donors do not view the gift tax charitable deduction as an affirmative benefit, any gift tax recapture is particularly punitive and would discourage the making of such charitable gifts.

5. S Corporation Charitable Deductions

Background. Charitable deductions of an S corporation pass through to its shareholders under section 1366(a)(1)(A). Prior to the PPA, when an S corporation contributed appreciated long-term capital gain property to charity, the shareholders were required to reduce the basis of their stock in the S corporation by their proportionate share of the property's fair market value under section 1367(a)(2)(B). This pre-PPA rule contrasted with the partnership rule where partners are required to reduce their basis in their partnership interests only by their proportionate share of a contributed asset's basis.¹⁹

¹⁷ Presumably the use of the word "before" in the statute does not require a donor to foresee the date of his death, so that a bequest of the remaining interest would avoid recapture if the donor dies within 10 years.

¹⁸ The second recapture rule presents separate issues, including its inconsistency with the PPA's other related-use recapture rule for tangible personal property in section 170(e)(7).

¹⁹ See Rev. Rul. 1996-11, 1996-1 C.B. 140.

The partnership approach is consistent with the general policy of section 170 of encouraging charitable contributions of appreciated property by allowing taxpayers to claim a deduction for the property's full fair market value. The prior S corporation rule had the effect of depriving shareholders of the advantage of a fair market value charitable deduction afforded other kinds of assets because the larger basis reduction increased the shareholders' gain or reduced the shareholders' loss upon a later disposition of the S corporation stock. It also discouraged gifts of highly appreciated property, such as conservation easements, because shareholders often had insufficient basis to absorb the deduction. PPA section 1203(a), which expires at the end of 2007, added flush language at the end of section 1367(a)(2) that effectively establishes parity between S corporations and partnerships for this aspect of entity-level charitable contributions of appreciated property.²⁰ This temporary PPA change allows S corporation shareholders the same advantage for entity-level charitable contributions that individual donors have.

Comment. Because this PPA change (a) is consistent with the long-standing tax policy of allowing charitable deductions for the full fair market value of appreciated property and (b) establishes parity in the treatment of entity-level charitable contributions by S corporations and partnerships, it should be made permanent.

6. Public Disclosure of Form 990-T

Background. Prior to the PPA, no taxpayer had been required to publicly disclose federal income tax returns. Consistent with this policy, tax-exempt organizations were not required to publicly disclose their tax returns (Form 990-T), although they were subject to public disclosure requirements with respect to their information returns (Form 990). The PPA added section 6104(d)(1)(A)(ii) to require section 501(c)(3) organizations, but not other tax-exempt organizations, to disclose their Forms 990-T in addition to their Forms 990.

Comment. The PPA's provision requiring the public disclosure of Form 990-T raises several concerns. It treats tax-exempt organizations less favorably than for-profit businesses, which are not required to disclose their tax returns. It treats section 501(c)(3) organizations less favorably than other tax-exempt organizations. It forces churches, which do not file Form 990 but do file Form 990-T, to disclose information about their operations for the first time, a mandated disclosure that implicates First Amendment concerns. It has the potential for turning away private joint venture partners and co-investors who prefer not to subject their activities to public disclosure. Its effectiveness is open to question because it often can be readily avoided by transferring an unrelated business to a taxable subsidiary corporation. Finally, because the Form 990-T is also used for purposes other than reporting unrelated business activity, such as claiming refunds of withholding and excise taxes, information with no bearing on unrelated business

²⁰ Differences in the computation of basis for S corporation stock and partnership interests also affect the amount of the charitable contribution that an owner can deduct, but such differences are beyond the scope of these Comments to the PPA.

activity may be disclosed.²¹ An alternative approach would largely avoid these concerns, while achieving the disclosure Congress seeks. Instead of subjecting the Form 990-T to disclosure, additional disclosure of unrelated business activity could be required on the Form 990. The Form 990 already requires some disclosure of unrelated business activity, and that disclosure could be expanded.

7. Extending Abatement Rules to Sections 4966 and 4967

Background. Excise taxes imposed on private foundations and public charities under Chapter 42 of the Code are generally subject to the Service's authority to abate them under sections 4961-4963, except for the first-tier excise tax on self-dealing of section 4941(a) and the excise tax on tax-shelter transactions of section 4965. The PPA did not extend the Service's abatement authority to the new excise taxes imposed on donor advised funds under sections 4966 and 4967. This failure may have been an oversight because the excise taxes under 4966 and 4967 are included in the definition of "first tier taxes" in section 4963(a) but are omitted from the list of "qualified first tier taxes" eligible for abatement in section 4962(b). Moreover, the Joint Committee Report states that the excise taxes under sections 4966 and 4967 "are subject to abatement under generally applicable present law rules."²² The excise taxes under sections 4966 and 4967 are complementary to the excise tax under section 4958, which is subject to abatement.

Comment. There appears to be no reason to exclude the excise taxes under sections 4966 and 4967 from the possibility of abatement. A technical amendment should be enacted to ensure eligibility for abatement.

8. Payments to Controlling Exempt Organizations

Background. PPA section 1205(a) amended section 512(b)(13) to provide that, for certain payments received or accrued in 2006 and 2007, tax-exempt organizations would not be subject to unrelated business income tax on interest, rents, royalties and annuities received from certain related organizations to the extent that such payments reflected an arm's-length, fair market value standard. This change conforms the treatment of tax-exempt organizations with the treatment of taxable enterprises, making both subject to an arm's-length standard under section 482. The earlier rule, which caused tax-exempt organizations to be subject to unrelated business income tax automatically on such payments, encouraged tax-exempt organizations to favor transactions with unrelated parties instead of related entities.

Comment. Consistent with prior comments of the Tax Section, the substantive changes to section 512(b)(13) made by the PPA should be made permanent. Inflated pricing in related-party transactions would remain taxable (with a penalty), while arm's-length dealings could continue. This approach would place tax-exempt organizations on the same footing as taxable entities and would no longer penalize transactions between tax-exempt organizations and their related organizations.

²¹ Interim guidance was provided in Notice 2007-45, 2007-22 I.R.B. 1320, which states that a Form 990-T filed solely to claim a refund of telephone excise tax does not have to be made available for public inspection, but otherwise a Form 990-T must be disclosed "in its entirety."

²² Joint Committee Report at 349-50.