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Dual Character Contributions: A Proposed Penalty to Deter Charities from Providing Erroneous Information Regarding Deductibility

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DUAL CHARACTER CONTRIBUTIONS: A PROPOSED PENALTY TO DETER CHARITIES FROM PROVIDING ERRONEOUS INFORMATION REGARDING DEDUCTIBILITY[1]

I. INTRODUCTION

Charitable fund raising is a billion dollar industry in the United States.[2] Federal, state, and local governments, relying on increased charitable giving, have reduced their spending for charitable programs.[3] In turn, individuals have substantially increased[4] their charitable contributions.[5]

Congress has long recognized that charitable contributions are vital to many organizations.[6] To encourage donations to charities, Congress permits taxpayers to claim charitable contributions as itemized deductions. However, payments are deductible under Section 170 of the Internal Reve-

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1. The author extends his gratitude to Patricia C. Bradford, Professor, Marquette University Law School, for her continued assistance in the development of this Comment.

2. Athornia Steele, *Regulation of Charitable Solicitation: A Review and Proposal*, 13 J. LEGIS. 149, 152 (1986). In 1989, contributions to charitable organizations totaled $114.7 billion. In 1980, contributions totaled $48.7 billion. U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES: 1991, at 378 (11th ed. 1991).

3. For example, President Reagan, in formulating his economic recovery program, assumed charitable contributions would increase:

> Historically, the American people have supported by voluntary contributions more artistic and cultural activities than all other countries in the world put together. I wholeheartedly support this approach and believe that Americans will continue their generosity. Therefore, I'm proposing a savings of $85 million in the Federal subsidies now going to the arts and humanities.

Steele, *supra* note 2, at 150 n.12 (citation omitted).

4. Individuals provided $40.7 billion (83.6%) of the total $48.7 billion contributions in 1980. In 1989, individuals increased their contributions to $96.4 billion (84.6%) of the total $114.7 billion contributions. U.S. BUREAU OF THE CENSUS, *supra* note 2, at 378.

5. In 1989, charitable contributions were allocated as follows: religion (47.4%), health (9.3%), education (8.7%), human services (10%), arts (6.5%), society benefit/public (3.1%), and all other (15%). *Id.*

6. The allowance of a charitable contribution deduction has benefitted taxpayers, charitable organizations, and the government in the following ways:

> (1) taxpayers are able to satisfy their philanthropic needs by making charitable contributions that qualify for a tax deduction;
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> (2) many essential service organizations receive private contributions that have been encouraged by the allowance of charitable deductions; and
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> (3) the deduction for charitable contributions has alleviated financial pressure on the government to be the sole source of funding for organizations providing essential charitable services.

7 MERTENS LAW OF FEDERAL INCOME TAX § 31.01 (Martin Weinstein et al. eds., 1991).

nue Code[7] ("Code") only if they satisfy specified requirements.[8] One requirement is that the payment must be a contribution or a gift.[9]

Generally, a charitable contribution is not a gift if the contributor expects a substantial benefit in return.[10] In some cases, however, contributions may be both part gift and part purchase of return benefits. These types of contributions are known as dual character payments, or dual payments.[11] Congress recognized that charitable contributions would be discouraged if the substantial return benefit rule applied to all dual payments.[12] Therefore, although dual payments are not entirely deductible, taxpayers may deduct part of their payment if the contribution exceeds the fair market value of benefits received in return, and if such excess was knowingly contributed as a gift.[13]

Despite this two-part test, some charities negligently or intentionally provide erroneous information to taxpayers about what portion of a dual payment is deductible. The purpose of this Comment is to deter this behav-

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7. I.R.C. § 170 (1988). Section 170 provides in pertinent part:

(a) Allowance of deduction

(1) General rule. — There shall be allowed as a deduction any charitable contributions (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.

. . . .

(c) Charitable contribution defined. — For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of—

. . . .

(2) A corporation, trust, or community chest, fund, or foundation—

(A) created or organized in the United States or in any possession thereof . . . .

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment).

Id.

8. The percentage limitations described in § 170(b) are beyond the scope of this Comment. Such limitations provide the maximum amount of charitable contributions a taxpayer may deduct in one taxable year, known as a contribution base. *See generally* 3 BENDER'S FEDERAL TAX SERVICE § A:17.141-146 (1990). A taxpayer may deduct a charitable contribution under § 170 only if the payment is made to a qualified donee. Individuals are not qualified donees; Section 170(c), however, lists the following qualified donees: (1) governmental organizations for public purposes; (2) corporation, trust, community chest, fund, or foundation; (3) a post or organization of war veterans; (4) a domestic fraternal society, order, or association, operating under the lodge system; and (5) a cemetery company owned and operated not for profit. I.R.C. § 170(c) (1988).

9. I.R.C. § 170(c). This section does not define the terms "contribution" or "gift."

10. United States v. American Bar Endowment, 477 U.S. 105, 117 (1986).

11. *Id.*

12. *See id.*

13. *Id.*

ior and facilitate taxpayer compliance. The purpose is not to discourage contributions or impose a heavy burden on charities.

Section II of this Comment defines dual character payments and the valuation procedure used to measure the fair market value of any return benefits.[14] Section III explains the two-part test used to determine if a dual payment is deductible.[15] Section IV sets forth the guidelines charities should use if they solicit dual payments[16] and discusses the concerns of Congress and the Internal Revenue Service (IRS) that charities not provide erroneous or false information to taxpayers.[17]

Section V examines existing penalties to determine if they effectively deter charities from providing false information to taxpayers.[18] Finally, Section VI sets forth a proposed penalty, modelled after negligence penalties, to deter charities from engaging in this behavior.[19] Included in this discussion are the reasons why Congress should enact a new penalty.

II. Dual Character Payments Defined

In *United States v. American Bar Endowment*,[20] the Supreme Court defined when a dual character payment is deductible as a charitable contribution. To understand the tax law regarding dual payments, one must first define charitable contributions.

A. *Charitable Contribution Must Be a Gift*

A charitable contribution is deductible only if it is a gift.[21] The term "gift" is defined as "a payment of money or transfer of property without adequate consideration."[22] A payment or transfer is not a gift if the contributor receives or expects to receive a substantial benefit in return.[23] Thus, when a taxpayer makes a charitable contribution, it is critical to examine the return benefit, if any, received by the taxpayer.

If a taxpayer makes a payment to a charity and receives no return benefit or merely a token benefit, the entire payment is a gift. In contrast, if a

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14. *See infra* notes 20-50 and accompanying text.
15. *See infra* notes 51-76 and accompanying text.
16. *See infra* notes 77-79 and accompanying text.
17. *See infra* notes 80-88 and accompanying text.
18. *See infra* notes 89-139 and accompanying text.
19. *See infra* notes 140-162 and accompanying text.
20. 477 U.S. 105 (1986).
21. I.R.C. § 170(c) (1988). Courts have stated that the terms "contribution" and "gift" are synonymous. *See, e.g.*, DeJong v. Commissioner, 309 F.2d 373, 376 (9th Cir. 1962).
22. Dowell v. United States, 553 F.2d 1233, 1238 (10th Cir. 1977); *see* Rev. Rul. 67-246, 1967-2 C.B. 104, 105.
23. *American Bar Endowment*, 477 U.S. at 116 (citation omitted).

taxpayer makes a contribution to a charity and receives a benefit in return that is equal in value to the contribution, there is no gift. Where a payment is made to a charity in connection with a fund-raising event or the purchase of an item, a presumption arises that no gift has been made.[24] The payment is presumed to be the purchase price for the benefit received.[25] The presumption is overcome if the donation exceeds the return benefit, and the taxpayer believes that he or she is making a charitable contribution.[26]

Although the foregoing contributions generally are not considered gifts, they may be treated as part gift and part purchase if the taxpayer establishes that the payment exceeds the value of the benefit received or expected to be received.[27] Such payments are considered to be "dual character payments."[28] For example, assume that charity *X* solicits contributions to attend a fund-raising dinner. A taxpayer pays $100 and receives a ticket to the dinner. The ticket states that the value of the dinner is $25 and the excess amount, $75, is a deductible charitable contribution to *X*. Under these circumstances, the $100 contribution by the taxpayer is a dual payment. It consists of a $25 purchase price and a $75 gift.

Charitable organizations frequently solicit dual payments made in connection with admission to fund-raising activities such as charity balls, bazaars, banquets, shows, and athletic events.[29] The charity uses the event as an occasion to solicit gifts in addition to the sale of admissions or other benefits.[30]

B. Valuation of Personal Benefits

The general rule is that return benefits are valued at fair market value (FMV), based on the cost of comparable benefits.[31] The type of return benefit is irrelevant to the availability of the deduction.[32] For example, return benefits could include such items as merchandise, admission to events, and

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24. Rev. Rul. 67-246, 1967-2 C.B. 104, 105.
25. *Id.* at 105.
26. *Id.* at 107.
27. *American Bar Endowment*, 477 U.S. at 117.
28. For examples of contributions that are part gift and part purchase price, see 3 BENDER'S FEDERAL TAX SERVICE, *supra* note 8, § A:17.41(4).
29. Rev. Rul. 67-246, 1967-2 C.B. 104, 104.
30. *Id.*
31. *American Bar Endowment*, 477 U.S. at 117.
32. Richard T. Helleloid et al., *Deduction of Charitable Contributions with Personal Benefits Remains Uncertain*, 73 J. TAX'N 210, 211 (1990). The legislative history of § 170 suggests that only a financial-type return benefit will deny or decrease the deduction. "Financial," however, does not necessarily mean "monetary." *Id.*; *see infra* notes 38-46 for treatment of spiritual return benefit.

fund-raising dinners.[33] If the benefit has no similar counterpart, a reasonable estimate of the fair market value may be used.[34]

An exception applies to minor benefits such as bookmarks, calendars, mugs, and posters bearing the organization's name or logo.[35] Because the value of these items is minimal,[36] they may be disregarded in determining the amount of the contributor's gift.[37]

Historically, the valuation of benefits received from religious organizations was controversial because it was difficult to distinguish between intangible benefits, which have an indeterminate value, and more tangible benefits, such as the right to occupy a particular pew during religious services.[38] Prior to *Hernandez v. Commissioner*,[39] courts were in conflict on whether payments to a church for auditing and training sessions constitute gifts and are therefore deductible as a charitable contribution.[40] *Hernandez*

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33. For a discussion on amounts paid for a chance to participate in raffles, lotteries, or similar games, see 3 BENDER'S FEDERAL TAX SERVICE, *supra* note 8, § A:17.41(8)(c).

34. Rev. Rul. 67-246, 1967-2 C.B. 104, 106.

35. The new guidelines are contained in Rev. Proc. 90-12, 1990-1 C.B. 471, and were released as News Release IR-90-20 on February 6, 1990. For a summary of these guidelines, see *infra* note 37.

36. Generally, the cost of these items is less than $10.

37. *Full Charitable Deduction Allowed Despite Benefit*, 18 TAX'N FOR LAW. 367, 368 (1990). The guidelines contained in Rev. Proc. 90-12, 1990-1 C.B. 471, 472, are summarized as follows:

> Benefits received in connection with a payment to a charity will be considered to have insubstantial fair market value . . . if either:
>
> (a) The fair market value of all the benefits received in connection with the payment is not more than 2 percent of the payment, or $50, whichever is less, or
>
> (b) The payment is at least $25, adjusted for inflation, and the only benefits received in connection with the payment are token items (bookmarks, calendars, keychains, mugs, posters, etc.) bearing the organization's name or logo. The cost of all the benefits received by each donor must be within the limits established for low-cost articles in § 513(h)(2). An item is a low-cost article for purposes of § 513(h)(2) if its cost does not exceed $5, increased by a cost of living adjustment. For 1992, the cost cannot exceed approximately $6.48.

Id.

38. *See* Helleloid, *supra* note 32, at 214. In some circumstances, payment to a charity may provide personal and charitable benefits that are so intertwined that separate calculations are not possible. *Id.* The United States Supreme Court, in Davis v. United States, 495 U.S. 472 (1990), established the criteria for determining the deductibility of payments in these cases.

39. 490 U.S. 680 (1989).

40. *See* Ted D. Billbe II, Comment, *Should Payments to a Church for Participation in Religious Practices Be Tax Deductible?*, 25 SAN DIEGO L. REV. 739 (1988); Daniel Mitz, Comment, *Save Your Local Church or Synagogue: When Are Taxpayer Contributions to Religious Organizations Deductible Under Section 170?*, 63 N.Y.U. L. REV. 840, 861 (1988); *see also* David C. Linder, Comment, *The Deductibility of Fixed Donations Made to Churches as Charitable Contributions Under the Internal Revenue Code:* Staples v. Commissioner, 72 MINN. L. REV. 1055 (1988). *Compare* Staples v. Commissioner, 821 F.2d 1324 (8th Cir. 1987), *vacated*, 490 U.S. 1103 (1989) (holding that payments to a church with no benefit other than participation in religious practices are deductible) *with* Graham v. Commissioner, 822 F.2d 844 (9th Cir. 1987), *aff'd*,

involved a taxpayer who made contributions to the Church of Scientology and received "auditing" sessions that the Church provided.[41] No refund was allowed if the sessions were not attended. The taxpayer argued that these sessions were spiritual benefits and that their indeterminate value did not reduce the amount of his gift to the church.[42] The taxpayer also argued that "payments made for the right to participate in religious services should be automatically deductible."[43]

The Supreme Court held that such payments are deductible only if they were a gift.[44] As a result, no deduction is allowed if the taxpayer received or expected to receive a substantial benefit in return.[45] This analysis is applicable even though the benefit received is purely religious in nature.[46]

Another controversial valuation issue involved payments made to educational institutions in exchange for the right to purchase tickets to athletic events. Congress resolved this issue by enacting Section 170(l).[47] That section provides that eighty percent of a payment made to an institution of

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490 U.S. 680 (1989) (holding that where a taxpayer cannot participate in religious services unless taxpayer pays the required price, payment is not deductible).

41. *Hernandez*, 490 U.S. at 684.

42. *Id.* at 692.

43. *Id.*

44. *Id.*

45. *Id.* The plaintiffs did not argue that their payments qualified as dual payments and that they were therefore entitled to a partial deduction to the extent the payments exceeded the value of the benefit received. Consequently, the Court could not rule on whether the test in United States v. American Bar Endowment, 477 U.S. 105 (1986), applies in these cases.

46. *Hernandez*, 490 U.S. at 690. The Court held that payments to a church that generate religious benefits are not automatically deductible. Instead, the payment is deductible only if such payment is a "contribution or gift." The Court resolved the split in authority created by *Graham* and *Staples*. *See supra* note 40. For a critical analysis of *Hernandez*, see Carol A. Jones, Comment, Hernandez v. Commissioner: *The Supreme Court Forces a Square Peg into a Round Hole*, 25 WAKE FOREST L. REV. 917 (1990); David M. Phipps, Comment, *A Line Drawn by Unsteady Hands: Section 170, Charitable Contributions and Return Benefits in* Hernandez v. C.I.R., 23 AKRON L. REV. 575 (1990); *see also* Mark L. Geier, Note, *What the Good Lord Giveth, Uncle Sam Taketh Away: A Proposal Allowing Payments Made in Exchange for Religious Benefits to Be Tax Deductible,* Hernandez v. Commissioner, 13 HAMLINE L. REV. 433 (1990).

47. I.R.C. § 170(m) (1988). Section 170(*l*) (Supp. II 1990) provides in pertinent part:

> (1) In general.—For purposes of this section, 80 percent of any amount described in paragraph (2) shall be treated as a charitable contribution.
>
> (2) Amount described. For purposes of paragraph (1), an amount is described in this paragraph if—
>
> (A) the amount is paid by the taxpayer to or for the benefit of an educational organization . . . .
>
> (B) such amount would be allowable as a deduction under this section but for the fact that the taxpayer receives (directly or indirectly) as a result of paying such amount the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution.

Id.

higher learning for the right to purchase tickets to athletic events is a charitable deduction.[48] This college sports rule applies regardless of whether a taxpayer actually purchases tickets.[49] However, if any part of the payment is made to purchase tickets, it does not fall within the eighty percent rule.[50] Furthermore, the payment would not constitute a gift because the value of the ticket would equal the amount of the payment.

III. Deductibility of Dual Character Payments

The general rule regarding charitable contributions is that payments are not deductible if the contributor expects a substantial benefit in return.[51] However, in *United States v. American Bar Endowment*,[52] the Supreme Court recognized that "[w]here the size of the payment is clearly out of proportion to the benefit received, it would not serve the purposes of [Section] 170 to deny a deduction altogether."[53] Prior to that decision, the IRS and the courts were in conflict concerning how to determine whether a dual payment was deductible.

A. *Conflicting Standards Prior to the ABE Decision*

In 1967, the IRS devised a two-pronged test to determine how much, if any, of a dual payment is deductible.[54] First, the payment must exceed the fair market value of the benefit received.[55] Second, the excess payment must be made with the intention of making a gift.[56] Three years later, the tax court adopted this test in *Murphy v. Commissioner*.[57]

In the following two years, courts criticized the application of these criteria to charitable contributions because they emphasized the taxpayer's subjective motives.[58] For example, in *Singer Co. v. United States*,[59]

48. I.R.C. § 170(*l*) (Supp. II 1990).

49. *See* Helleloid, *supra* note 32, at 212.

50. *Id.* For example, assume a taxpayer paid $200 to an educational institution for the right to purchase tickets at an athletic event. In addition, the taxpayer received $20 worth of football tickets. In this case, the charitable contribution would be $180. The deduction is reduced by the fair market value of the tickets.

51. United States v. American Bar Endowment, 477 U.S. 105, 116 (1986).

52. *Id.*

53. *Id.* at 117.

54. The test appeared in Rev. Rul. 67-246, 1967-2 C.B. 104, 105.

55. *Id.*

56. *Id.*

57. 54 T.C. 249 (1970). In *Murphy*, a husband and wife made an "adoptive fee payment" to an adoption agency. The court held that the payment is deductible "only to the extent that the amount . . . exceeds the fair market value of any material benefit received in return." *Id.* at 253.

58. *See generally* Richard D. Hobbett, *Charitable Contributions—How Charitable Must They Be?*, 11 SETON HALL L. REV. 1 (1980).

the Court of Claims articulated a new standard so that the subjective approach would not have to be "wrestled with."[60] The new standard provided that if the benefits received or expected to be received are substantial, the transfer is not a deductible charitable contribution.[61] The following year, in *Oppewal v. Commissioner*,[62] the Court of Appeals for the First Circuit expressed dissatisfaction with such subjective tests and relied solely on the difference between the payment and the value of the benefit received.[63]

Six years later, the Claims Court applied the IRS's two-prong test to the facts in *American Bar Endowment v. United States*[64] and denied the four claimants a charitable contribution deduction.[65] However, the court of appeals reversed, holding that "well established principles of tax law from this circuit and elsewhere require that we reject the unitary approach of the court below."[66] The court rejected a pure motivational requirement because it placed too harsh of a burden on taxpayers.[67] Also, the court expressed dissatisfaction with an "overly precise formulaic test."[68]

B. The Supreme Court Ruling in ABE

In 1986, the Supreme Court, in *United States v. American Bar Endowment*,[69] was presented with its first opportunity to consider the deductibility of dual character payments. The Court held as follows:

> [T]he Claims Court applied the proper standard. The sine qua non of a charitable contribution is a transfer of money or property without adequate consideration. The taxpayer, therefore, must at a minimum demonstrate that he purposely contributed money or property in excess of the value of any benefit he received in return.[70]

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59. 449 F.2d 413 (Ct. Cl. 1971), *subsequent proceeding* 197 Ct. Cl. 1091 (1972).

60. *Id.* at 423.

61. In *Singer*, the Court of Claims refused to apply the two-pronged test adopted by the tax court because the test included a motivational approach. The court held that a charitable deduction is allowed only if donation exceeds the market value of the benefit received. *Id.* The court, in essence, applied only part one of a two-part test created by the Internal Revenue Service. *See supra* notes 54-56 and accompanying text.

62. 468 F.2d 1000 (1st Cir. 1972).

63. *Id.* at 1002. The court solely relied on the difference between the amount of the payment and the value of the benefit received. By doing so, the court rejected the two-part test established by the Internal Revenue Service. *See supra* notes 54-56 and accompanying text.

64. 4 Cl. Ct. 404 (1984), *rev'd*, 761 F.2d 1573 (Fed. Cir. 1985), *rev'd*, 477 U.S. 105 (1986).

65. *Id.* at 415.

66. American Bar Endowment v. United States, 761 F.2d 1573, 1579 (Fed. Cir. 1985).

67. *Id.* at 1581.

68. *Id.* at 1582. The court stated that an intention to enter into a charitable transaction is often intertwined with other motivations. *Id.*

69. 477 U.S. 105 (1986).

70. *Id.* at 118.

The facts in *American Bar Endownment* clearly illustrate the two-prong test. American Bar Endowment (ABE) is a charitable organization exempt from taxation. ABE raised money for its charitable work by providing group life insurance policies to members of the American Bar Association (ABA). Favorable group rates resulted in a substantially lower insurance cost for ABE. Rather than passing the lower cost on to ABA members, however, ABE priced its policies competitively with other insurance policies offered to the public, using the excess for its charitable purposes. Further, ABE advised its insured that each member's share of the excess fund constituted a tax-deductible contribution. Subsequently, the IRS audited ABE's tax returns and assessed a tax deficiency on ABE's net revenues from the insurance program. ABE brought an action for a refund in the Claims Court. In a consolidated suit, four individual ABE members sued the IRS for a tax refund, claiming that they were entitled to a charitable deduction for part of the insurance premiums they paid.[71]

Three of the taxpayers failed to establish that they could have purchased comparable insurance for less money. Thus, the Court held that the value of ABE's insurance to those taxpayers equaled their premium payments.[72] Because they did not demonstrate that their payments exceeded the market value of the insurance they received, the taxpayers failed part one of the ABE test.

The fourth taxpayer demonstrated that a group insurance program existed for which he was eligible and which offered lower premiums than ABE's insurance. The taxpayer failed to establish, however, that he was aware of that competing program when he purchased insurance from ABE.[73] Thus, he failed part two of the test—that he intentionally gave away more than he received.[74]

In summary, the burden is on the taxpayer to prove that the payment exceeds the fair market value of any benefit received and that the excess was intended as a gift.[75] An intention to make a gift requires the taxpayer to demonstrate that at the time a contribution was made, the contribution exceeded the value of the return benefits.[76] Thus, the second prong of the IRS's test, requiring subjective intention to make a gift, has been replaced

71. *Id.* at 106-10.
72. *Id.* at 118.
73. *Id.*
74. *Id.*
75. *Id.*
76. The intent to make a gift must be present at the time of the transfer. Mason v. United States, 513 F.2d 25, 28 (7th Cir. 1975). However, the intent to claim a deduction can arise after the transfer, such as the time a tax return is prepared. *Id.*

by an objective factual determination dependent upon the taxpayer's knowledge of the value of any benefit received.

IV. Guidelines for Charitable Organizations That Solicit Dual Character Payments

The IRS has issued guidelines for charities that solicit dual payment contributions.[77] The guidelines suggest that charities soliciting dual character payments should determine the fair market value of any benefits given to donors in return for their contributions and advise donors that this amount is not deductible.[78] Specifically, the IRS asks charities to do the following:

> In those cases in which a fund-raising activity is designed to solicit payments which are intended to be in part a gift and in part the purchase price of admission to or other participation in an event of the type in question, the organization conducting the activity should employ procedures which make clear not only that a gift is being solicited in connection with the sale of the admissions or other privileges related to the fund-raising event, but also, the amount of the gift being solicited. To do this, the amount properly attributable to the purchase of admissions or other privileges and the amount solicited as a gift should be determined in advance of the solicitation. The respective amounts should be stated in making the solicitation and clearly indicated on any ticket, receipt, or other evidence issued in connection with the payment.[79]

The IRS provided charities with additional guidelines in 1990, partly in response to Congress's concern "that charities do not accurately inform their patrons of the extent to which contributions are deductible."[80] Congress stated that it:

> anticipates that the Internal Revenue Service will monitor the extent to which taxpayers are being furnished accurate and sufficient information by charitable organizations as to the nondeductibility of payments to such organizations where benefits or privileges are received in return, so that taxpayers can correctly compute their Federal income tax liability.[81]

Shortly after Congress expressed concern in 1987, the IRS sent a message to over 400,000 charities.[82] The message asked "charities for help in informing contributors more accurately about the deductibility of contri-

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77. Rev. Rul. 67-246, 1967-2 C.B. 104.
78. *Id.* at 105.
79. *Id.* at 105-06.
80. Rev. Proc. 90-12, 1990-1 C.B. 471, 471.
81. *See id.* (citing H.R. Rep. No. 391, 100th Cong., 1st Sess. 1608 (1987)).
82. The Commissioner of Internal Revenue stated the following:

butions made in connection with fund-raising events and programs."[83] The message also contained a copy of the relevant tax laws regarding dual payments.[84]

In response, many charities suggested that the rulings were too difficult or too burdensome, especially in the case of token value benefits.[85] Previously, the charity was required to estimate the fair market value of these benefits and inform taxpayers how much of their donation was deductible.[86] In 1990, the IRS issued additional guidelines which provide a safe harbor for insubstantial items.[87] If the benefits are within these guidelines, the charity can inform donors that the entire payment is deductible.[88]

Although Congress expressed concern, it passed no new penalties for noncompliance with the IRS revenue rulings and guidelines. Thus, to determine whether charities can currently be penalized for failing to comply with the guidelines and rulings, the existing penalties will be examined.

V. Applicability of Existing Penalties to Dual Character Payments

Obviously, the IRS wants to deter charities from misleading taxpayers regarding the deductibility of dual payments. As evidenced by the guidelines issued to charities in 1988,[89] the current practice of the IRS is to monitor charities and then audit their contributors if the charity has not complied with the guidelines. The guidelines state:

> Where it is disclosed that the public or the patrons of a fund-raising affair for charity have been erroneously informed concerning the extent of the deductibility of their payments in connection with the affair, it necessarily follows that all charitable contribution deductions claimed with respect to payments made in connection with

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> I am concerned that sponsors of fundraising events have often failed to provide written information on the extent to which payments for such affairs are deductible as charitable contributions. There has been widespread misunderstanding of the limitations on the deductibility of such payments. This misunderstanding has led, of course, to erroneous tax reporting of these payments by some patrons.

U.S. Dept. of Treasury, Internal Revenue Service, Pub. No. 1391, Deductibility of Payments Made to Charities Conducting Fund-Raising Events (1988).

83. Rev. Proc. 90-12, 1990-1 C.B. 471, 471.

84. Publication 1391 was issued in June 1988 and contained a message from the Commissioner of Internal Revenue and a copy of Revenue Ruling 67-246, 1967-2 C.B. 104.

85. Rev. Proc. 90-12, 1990-1 C.B. 471, 472.

86. *Id.*

87. *See supra* note 37.

88. Rev. Proc. 90-12, 1990-1 C.B. 471, 472.

89. *See supra* notes 77-79 and accompanying text.

the particular event or affair will be subject to special scrutiny and may be questioned in audit of returns.[90]

Deficiencies may be assessed against any contributor who has deducted the entire amount of a dual payment. Additionally, in appropriate cases the IRS may impose underpayment penalties on the contributors.[91]

Monitoring charities and assessing deficiencies against their contributors is less efficient than directly deterring charities from issuing erroneous and false information to contributors regarding the deductibility of their dual payments. Utilizing existing penalties or enacting new penalties that can be assessed directly against charities would be a more effective deterrent and would also facilitate taxpayer compliance.

A. Penalty for Failing to Disclose Nondeductibility of Contributions

Taxpayers may deduct charitable contributions only if made to qualified organizations.[92] Some tax-exempt organizations, such as political organizations, are not eligible to receive tax-deductible contributions.[93] Congress expressed concern that some of these tax-exempt organizations mislead taxpayers by implying that donations are deductible when in fact they are not.

In the Revenue Act of 1987, Congress attempted to correct this problem by enacting new disclosure requirements. Under Section 6113, these organizations must disclose in a conspicuous and easily recognizable statement that contributions are not deductible for federal income tax purposes.[94] Under Section 6710, a penalty is imposed on the organization for each day of noncompliance.[95] The maximum penalty is $10,000 per calendar year.[96] However, this limitation does not apply if there is intentional disregard of these rules; the daily penalty may be more.[97]

Section 6113 should help solve the issue Congress was addressing. The problem, however, is that Section 6113 is extremely limited; the disclosure

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90. Rev. Rul. 67-246, 1967-2 C.B. 104, 106.

91. I.R.C. § 6662 (Supp. II 1991).

92. Organizations must be a qualified donee. *See* I.R.C. § 170(c) (1988); *see also supra* note 8.

93. However, any organization described in § 170(c) is eligible to receive tax-deductible contributions.

94. The disclosure requirement applies to all solicitations, regardless of whether the organization labels the payments as contributions, donations, gifts, membership dues or fees, or whether the solicitation is for money, stock, property, or for services. A. Mark Christopher, *Political Activities Become More Risky for Tax-Exempts Due to RA '87*, 68 J. TAX'N 136, 136 (1988).

95. I.R.C. § 6710 (1988).

96. I.R.C. § 6710(a) (1988).

97. I.R.C. § 6710(c) (1988).

requirement does not apply to all tax-exempt organizations.[98] Organizations eligible to receive tax-deductible contributions, which are the focus of this Comment, are exempt from the Section 6113 requirements.[99]

B. *Penalty for Aiding and Abetting Understatement of Tax Liability*

In 1982, faced with a huge compliance gap,[100] Congress enacted a new arena of Code provisions under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).[101] The most important objective of TEFRA was to improve compliance with the existing tax laws, which meant adding penalties for failing to comply.[102] One of the penalties created by TEFRA was Section 6701, "Penalties for Aiding and Abetting Understatement of Tax Liability." The next section will examine the focus of Section 6701 to determine what constitutes a violation. This section will also examine whether Section 6701 can be used to penalize charities that intentionally or negligently advise taxpayers that the entire amount of their dual payment contribution is deductible.

1. The Focus of Section 6701

Section 6701[103] imposes a penalty for aiding and abetting in the understatement of a tax liability. The penalty is imposed on any person who:

> (1) aids or assists in the preparation or presentation of a return or other document;
> (2) knows (or has reason to believe) that such portion will be used in any material matter; and
> (3) knows that such portion (if so used) will result in an understatement of the person's tax liability.[104]

As explained in the Senate Finance Committee Report (the "Senate Report"),[105] Section 6701 has four purposes:

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98. Section 6113 applies only to organizations that are not described in § 170(c) but are described in § 501(c) or § 501(d) and that are political organizations. I.R.C. § 6113(b)(1) (1988).

99. I.R.C. § 6113(b)(1).

100. The compliance gap refers to "the total annual revenue lost to the United States Treasury due to taxpayers' underreporting of income, overstatement of deductions, and failure to file any tax returns at all." Jordan H. Mintz, *Guess Who Uncle Sam Wants Now: An Analysis of the Tax Advisor Aiding and Abetting Penalty*, 63 TAXES 221, 221 (1985). In 1985, the compliance gap had reached nearly $100 billion, and nonfilers were estimated at over six million. *Id.* at 222.

101. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (1982).

102. Mintz, *supra* note 100, at 222.

103. I.R.C. § 6701(a) (Supp. III 1991).

104. *Id.*

105. S. REP. No. 530, 97th Cong., 2d Sess. 266, 275, *reprinted in* 1982 U.S.C.C.A.N. 781, 1021.

> to permit more effective enforcement of the tax laws by discouraging tax preparers from aiding taxpayers in fraudulent underpayment of taxes, to provide equivalent civil penalties for tax preparers as exist for taxpayers, to provide noncriminal penalty for tax preparers, and to protect taxpayers from tax preparers who would lead them into fraudulent conduct.[106]

"Thus, the overriding intent in enacting Section 6701 was to deter the filing of fraudulent or false tax returns."[107]

By enacting Section 6701, Congress attempted to fill a gap in the civil penalty provisions of the Code. The Senate Report stated:

> Present law provides a criminal penalty for willfully aiding, assisting in, procuring, counseling or advising the preparation or presentation of a false or fraudulent return . . . or other document under the internal revenue laws. . . . There is no comparable civil penalty on persons who aid or assist in the preparation or presentation of false or fraudulent documents. However, income tax return preparers who willfully attempt to understate the liability for tax for any person are subject to a penalty of $500 per return.[108]

Thus, Section 6701 imposes civil penalties for the preparation of fraudulent documents and attempts to fill the gap between criminal liability and willful attempts to understate tax liability on a return.[109] "Although section 6701 does not literally require intent . . . to defraud, the Senate Report strongly suggests that Congress intended that the new aiding and abetting penalty would apply only . . . where a false or fraudulent return document is filed with knowledge that [it] will result in an understatement of tax."[110]

2. What Constitutes a Violation Under Section 6701

The first element of Section 6701 requires assistance in return or document preparation. Although most cases arising under Section 6701 involve penalties imposed on tax preparers, Congress intended for the penalty to apply in many situations. The Senate Report refers to a similar criminal penalty[111] that has been interpreted to apply to a variety of cases.[112] Specif-

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106. Sansom v. United States, 703 F. Supp. 1505, 1509 (N.D. Fla. 1988), *motion denied*, 707 F. Supp. 1296 (N.D. Fla. 1989).

107. *Id.*

108. S. REP. NO. 530, *supra* note 105, *reprinted in* 1982 U.S.C.C.A.N. at 1021-22.

109. *Sansom*, 703 F. Supp. at 1510.

110. Mintz, *supra* note 100, at 224.

111. The comparable penalty is § 7206. "In connection with § 6701, it appears that Congress specifically intended to create a provision to penalize aiding and abetting conduct similar to that conduct punished under § 7206." Mattingly v. United States, 924 F.2d 785, 788 (8th Cir. 1991).

112. *Cf.* S. REP. NO. 530, *supra* note 105, *reprinted in* 1982 U.S.C.C.A.N. at 1022.

ically, the Senate Report refers to a case in which the defendants, who were neither taxpayers nor tax preparers, were charged with supplying to a taxpayer documents that they knew contained materially false matters.[113] By analogy, a charity assists in federal tax document preparation every time it issues a receipt to a taxpayer indicating the amount of the donation that is deductible.

Section 6701 also requires that a person know, or have reason to believe, that the document will be used in any material matter. Although "material" has not been defined under Section 6701,[114] it has been defined under a comparable criminal penalty.[115] In general, any "false statements relating to gross income, irrespective of the amount constitute a material misstatement in violation of Sec. 7206(1)."[116] As a result, "any failure to report income is material."[117] The underlying concern in these cases is that unreported gross income results in an understatement of tax liability.

By analogy, when a taxpayer overstates a deduction, the result is an understatement of tax liability. Consequently, when a charity informs a taxpayer that the entire dual payment is deductible, it is a material matter under the Internal Revenue laws regardless of the amount of the donation. Further, Treasury Regulation section 1.170A-13[118] provides that charitable deductions must be substantiated. Receipts issued by charities satisfy this requirement.[119]

The third element in Section 6701 requires that a person "know" that, if so used, the document will result in an understatement of the tax liability of another person. The use of the word "know" is unique to this penalty. "All other penalty provisions refer to 'negligence,' 'intentional disregard,'

113. United States v. Siegel, 472 F. Supp. 440, 443 (N.D. Ill. 1979), *cert. denied*, 445 U.S. 989 (1982). In *Siegel*, the defendants were floor brokers in a foreign exchange. The court held that the defendants' claim that the case was unique because neither the taxpayer nor the tax preparer had been charged was simply a distinction without a difference. *Id.* at 444.

114. One exception is Warner v. United States, 726 F. Supp. 1287 (S.D. Fla. 1989). In *Warner*, the defendant argued that individual deductions claimed by the plaintiff were material. The deductions ranged from $114 to $69,357. The court stated that the plaintiff provided no evidence or authority to prove that the deductions were not material. Further, the court held that the deductions were sufficiently substantial to constitute a material matter. *Id.* at 1290.

115. *See supra* note 111.

116. United States v. DeGroote, 122 F.R.D. 131, 143 (W.D.N.Y. 1988).

117. United States v. Holland, 880 F.2d 1091, 1096 (9th Cir. 1989). The court is less concerned that trivial mistakes will be prosecuted because of the requirement of specific intent to violate the law. *Id.*; *see also* United States v. Young, 804 F.2d 116, 119 (8th Cir. 1986) (Omission of any information to complete gross income is material.).

118. Treas. Reg. § 1.170A-13 (as amended in 1992).

119. *Id. See generally* Jacquin D. Bierman, *Revenue Service Issues New Rules on Substantiating Gifts*, 62 J. TAX'N 186 (1985).

or 'willfulness' in determining whether the particular penalty should apply."[120]

The scienter requirement of Section 6701 was first analyzed in *Sansom v. United States.*[121] *Sansom* involved an accountant who was a tax preparer.[122] The issue was whether the plaintiff "knew" that his action would result in an understatement of tax liability for his client.[123]

The court concluded that actual knowledge is necessary to prove a violation under Section 6701.[124] In reaching this conclusion, the court looked to the plain language of the statute, the legislative history of the statute, and the statutory scheme established by Congress. First, the court addressed the plain meaning of the statute:

> The plain language of the statute ("knows") indicates that actual knowledge is necessary. . . . Simply put, "know" requires knowledge — awareness of the facts and the ultimate result of the conduct. . . . Congress, however, wrote Section 6701 to require actual knowledge, excluding the "conscious disregard" standard, and there is no evidence in the statute that such a standard should be inferred by this Court.[125]

Second, the court rejected the application of a willful standard, stating that "both the Senate and House reports indicate that Section 6701 is not intended to apply if the tax preparer is subject to the penalty for negligence or intentional disregard of regulations."[126]

Finally, the court stated that the higher standard of proof of scienter is consistent with the overall statutory scheme of income tax penalties.[127] Congress provided a gradation in the amount of penalties that is dependent on the scienter requirement. For example, Section 6701 imposes a $1,000 penalty[128] upon the preparer, compared to a $100 negligence penalty[129] and a $500 willful penalty.[130]

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120. Mintz, *supra* note 100, at 225.

121. 703 F. Supp. 1505 (N.D. Fla. 1988), *motion denied*, 707 F. Supp. 1296 (N.D. Fla. 1989).

122. Sansom was penalized because he failed to investigate the results of a client's audit for several years to determine whether the client was eligible for income averaging. *Id.* at 1509.

123. To impose a penalty under § 6701, the burden is on the government to prove that the plaintiff had knowledge that his conduct would result in an understatement of tax liability. *Id.* at 1508. *See infra* note 132, for a discussion on the standard of proof required.

124. In *Sansom*, the government's position was that the scienter element of § 6701 is equivalent to a willfulness standard. *Sansom*, 703 F. Supp. at 1510.

125. *Id.*

126. *Id.* at 1511.

127. *Id.*

128. I.R.C. § 6701(b) (Supp. III 1991).

129. *See, e.g.*, I.R.C. § 6694(a) (Supp. III 1991).

130. *See, e.g.*, I.R.C. § 6694(b) (Supp. III 1991).

Three years later, *Mattingly v. United States*[131] addressed the scienter requirement in Section 6701. The court confirmed the *Sansom* requirement: "[W]e believe actual knowledge, as opposed to the less stringent willful blindness, is required. Some cases have been brought to our attention which support this conclusion, and we are aware of none which directly disputes it."[132]

3. Difficulty of Imposing a Section 6701 Penalty on Charities

The government bears the burden of proof in aiding and abetting penalty cases.[133] To impose the penalty on a charitable organization, the government must prove actual knowledge—awareness of the facts and the ultimate result of the conduct.[134] Thus, the issue arises as to when, if ever, the penalty can be imposed on a charity.

Assume that the following three individuals work at charity *X*:[135] the president, a solicitor, and a worker. The solicitor conducts solicitation on the telephone by offering tickets to a fund-raising dinner valued at $25 in return for a $100 contribution. Further, the ticket or receipt states that the entire payment is tax deductible.

The government would have difficulty in imposing a penalty for aiding and abetting an understatement of tax liability in this scenario. First, the organization[136] could be held liable only if the president or solicitor had *actual* knowledge that the receipt would be used to substantiate a charitable deduction and, if used, would result in an understatement of a contributor's tax liability. To carry this burden, the government would have to prove that the president or solicitor was familiar with the related dual payment revenue rulings and case law. Not only would this be difficult and cumbersome to prove, but "actual knowledge" may be lacking in many cases be-

131. 924 F.2d 785 (8th Cir. 1991).

132. *Id.* at 791. Although courts agree that actual knowledge is required to prove a violation under § 6701, courts disagree on the standard of proof required. *Compare* Warner v. United States, 700 F. Supp. 532, 533 (S.D. Fla. 1988) (holding that the government should be held to a stringent level of proof, namely the clear and convincing evidence standard) *with In re* Mitchell, 109 B.R. 434, 436 (Bankr. W.D. Wash. 1989) (deciding that a preponderance standard is the proper standard to apply because courts in the same district apply that standard to § 6700 and § 6702).

133. I.R.C. 6703(a) (1988).

134. *See supra* notes 124-25 and accompanying text.

135. For other examples that illustrate how much and what kind of dual character payments are deductible, see Rev. Rul. 67-246, 1967-2 C.B. 104; *see also* 3 BENDER'S FEDERAL TAX SERVICE, *supra* note 8, § A:17.41(4).

136. One issue is whether the organization would be held liable or whether the president and solicitor would be held liable. Under the 1986 version of the Code, a person includes an organization as well as an officer or employee of a corporation.

cause many contributors do not itemize their deductions and therefore are unable to deduct their charitable contributions. It is unlikely that the president or solicitor would know which contributors itemize their deductions as opposed to those who claim the standard deduction. A more typical scenario would be that president or solicitor negligently or intentionally disregarded the rules, in which case a Section 6701 penalty could not be imposed.

Even if a court held that actual knowledge of a taxpayer's reliance on the charity's erroneous receipt is not required,[137] utilizing this penalty is complicated by the fact that different people may be involved in preparing the receipt and soliciting the contribution.

The fact that a ministerial employee types a receipt which states that the entire payment is deductible does not absolve others from the penalty. Liability depends on whether any person with knowledge directed the preparation of the receipt or failed to prevent its preparation.[138] The penalty "does not apply to any person who merely furnishes typing . . . or other mechanical assistance in preparation of the return."[139]

VI. Proposed Solutions

Existing penalties do not effectively penalize charitable organizations that erroneously or falsely advise taxpayers that their entire dual payment is deductible.[140] To deter charities from engaging in this behavior, a new penalty is needed.[141]

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137. The court would be relying on the language in § 6701(a)(2) that "any person . . . who knows (or has reason to believe) that such portion . . . would result in an understatement . . . shall pay a penalty." The "has reason to believe" language was added to § 6701 in 1991. I.R.C. § 6701(a)(2) (Supp. III 1991).

138. Section 6701(a) imposes a penalty on any person who procures the preparation of any document. The legislative history indicates that the term "procures" includes ordering or otherwise causing a subordinate to do an act subject to this penalty, or knowing of and not attempting to prevent participation of a subordinate. S. Rep. No. 530, *supra* note 105, at 266, 275, *reprinted in* 1982 U.S.C.C.A.N. at 1022.

139. I.R.C. § 6701(e) (1988).

140. *See supra* notes 133-39 and accompanying text.

141. Most states have passed legislation regulating charitable organizations. The regulation is aimed at the prevention of fraud practiced by persons pretending to represent legitimate concerns as well as making the charities more efficient in their spending of public contributions. Karen S. Quandt, Comment, *The Regulation of Charitable Fundraising and Spending Activities*, 1975 Wis. L. Rev. 1158, 1171. The statutes require registration of charitable organizations. *Id.* at 1164. Information such as the name, address, and purpose of the charity must be disclosed. *Id.* at 1165. The statutes attempt to prohibit fraud and deceptive solicitation. For example, Wisconsin empowers the attorney general to bring an action against a charity that "employed in any solicitation any device, scheme, or artifice to defraud . . . by means of any false pretense, representation or promise." Wis. Stat. § 440.41(8)(b) (1991-92). However, such provisions have been

The penalty proposed in this Comment[142] is modelled after a negligence penalty that is imposed on taxpayers who understate their tax liability.[143] The penalty would place the burden of proof on the charity and would act as a deterrent. Because charities may find it burdensome to determine the fair market value of benefits contributors receive, the proposed penalty would apply only if the charity indicated that any portion of a contribution was deductible. Thus, if valuation is burdensome, the charity need only refrain from stating that any part of the contribution is deductible. Prior to proposing a new penalty, an alternative that modifies an existing penalty will be considered.

A. *Broaden the Scope of Section 6113*

Under Section 6113, certain organizations must disclose that contributions or gifts to such organizations are not deductible for federal income tax purposes.[144] A penalty of $1000 is imposed on the organization for each day that it fails to comply.[145] The maximum penalty is $10,000 per calendar year.[146] However, the section only applies to an organization "which is not described in Section 170(c)" and which is described in Section 501 and which is a political organization.[147] In summary, charities eligible to receive tax-deductible contributions are exempt from this section.

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strictly interpreted and have not been used to prosecute charities that legitimately exist as fundraising organizations. Quandt, *supra*, at 1172. Certain groups are exempt from registration and regulation. These groups include religious groups, educational institutions, and groups that solicit contributions solely from their membership. *See, e.g.*, WIS. STAT. § 440.41(3).

142. The proposed penalty would not violate the Constitution's Establishment Clause. First, the penalty would treat all religious and nonreligious charitable organizations alike. *See* Larson v. Valente, 456 U.S. 228, 244 (1982) (stating that the clearest command of the Establishment Clause is that one religious denomination cannot be preferred over another); *see also* Carl H. Esbeck, *Establishment Clause Limits on Governmental Interference with Religious Organizations*, 41 WASH. & LEE L. REV. 347 (1984). Second, several existing penalties are imposed on tax-exempt organizations. *See* I.R.C. §§ 6113, 6711 (1988).

143. I.R.C. § 6662 (1991). In 1989, Congress passed the Improved Penalty Administration and Compliance Tax Act (IMPACT), Pub. L. No. 101-239, § 7721, 103 Stat. 2106, 2395 (1989) (codified as amended at 26 U.S.C. § 6662 (Supp. III 1991)). Section 6662 is applicable to returns with due dates after December 31, 1989. *Id.* Under IMPACT, negligence or disregard of rules or regulations is generally defined as under prior law. Thus, the old negligence § 6653(a) is useful in analyzing what actions constitute negligence under the current negligence penalties of § 6662(c). *See generally* Richard C. Stark, *IMPACT Makes Fundamental Changes in Civil Penalties*, 72 J. TAX'N 132 (1990).

144. I.R.C. § 6113(a) (1988). The organizations are not eligible to receive charitable contributions regardless of whether the donation is a dual payment.

145. *See supra* notes 95-97 and accompanying text.

146. *Id.*

147. I.R.C. § 6113(b) (1988).

Congress could broaden the scope of Section 6113 by deleting the words "which is not described in section 170(c)."[148] The alternative section would require all charities to disclose to contributors that contributions are not deductible if the taxpayer receives a benefit equal in value to the contribution. The new section would be inapplicable, however, when charities solicit dual payment contributions that consist of part gift and part return benefit.[149]

B. Proposed Penalty

The penalty could be modelled after Section 6662 of the Code, "Imposition of Accuracy-Related Penalty."[150] For example, the proposed penalty could read as follows:

> (a) If any organization described in Section 170(c) negligently furnishes erroneous or false information in a fund-raising solicitation regarding deductibility of contributions solicited, a penalty of $500 per occurrence shall be assessed.
>
> (b) If any organization described in Section 170(c) intentionally furnishes erroneous or false information in a fund-raising solicitation regarding deductibility of contributions solicited, a penalty of $1,000 per occurrence shall be assessed.
>
> (c) For purposes of this section, the term "fund-raising solicitation" means any solicitation of contributions or gifts as part of a coordinated fund-raising campaign or event which is made:
>
> > (1) in written or printed form; (2) by television or radio; or (3) by telephone.
>
> (d) For purposes of this section, the term "per occurrence" refers to the coordinated fund-raising campaign or event and not to each communication made to individual contributors.

Under parts (a) and (b), the proposed penalty would apply only to charities that affirmatively indicate that all or part of a contributor's payment is deductible. It is designed to deter charities from making erroneous or false statements regarding deductibility. The penalty is not burdensome[151] because charities can avoid it by not stating that a contribution is deductible.

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148. *Id.*

149. If a taxpayer makes a contribution to a charity and receives a benefit in return that is equal in value to the payment, the contribution is not deductible. In dual payment cases, part of the contribution is deductible under the two-part test adopted in *American Bar Endowment*. *See supra* note 70 and accompanying text.

150. I.R.C. § 6662 (Supp. III 1991).

151. Charities have suggested that current guidelines are sometimes burdensome. *See supra* notes 85-88 and accompanying text.

Since the option of silence is provided,[152] there is little, if any, justification for a charity's affirmative erroneous or false statement.

Also, the option of silence protects charities when the value of return benefits varies among contributors. This option is important for charities, such as the American Bar Endowment (ABE), that solicit contributions as part of a group insurance plan. Since the determination of the deductible portion of these payments depends on whether the contributor was aware of a plan offering lower premiums,[153] ABE cannot accurately determine what portion of each contributor's payment is deductible. To avoid the proposed penalty, ABE and other charities that use similar fund-raising techniques will need to refrain from asserting that a definite portion of the payment is deductible. Only the contributor has the necessary facts to make this determination.

The proposed penalty uses the terms "negligently" and "intentionally" as they are used in other penalty provisions and as they have been defined by case law.[154] "Negligence is lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the circumstances."[155] Penalties based on intentional disregard apply when a person "who is aware or should be aware of a rule or regulation chooses to ignore its requirements."[156]

Good-faith reliance on professional advice is a defense to negligence.[157] Because of the good-faith requirement, however, a professional advisor cannot be carelessly selected. Thus, no penalty would be imposed if a charity hired a professional to value return benefits, even if the advice given was erroneous.

Under part (a) of the proposed penalty, a $500 penalty is imposed if the charity negligently provides erroneous or false information to a contributor. Negligence includes carelessly computing the market value of the return benefit or carelessly relying on professional advice. The penalty does not

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152. The current IRS guidelines require charities to affirmatively indicate the amount of a contribution that is deductible. *See supra* notes 77-79 and accompanying text. The guidelines would need to be modified to indicate the possibility of silence.

153. The contributor must have knowledge of lower premiums at the time of transfer. *See supra* note 76 and accompanying text.

154. *See supra* note 143.

155. Marcello v. Commissioner, 380 F.2d 499, 506 (5th Cir. 1967), *cert. denied*, 389 U.S. 1044 (1968).

156. *Id.*

157. Betson v. Commissioner, 802 F.2d 365, 372 (9th Cir. 1986) (hiring an attorney or accountant does not insulate the taxpayer from negligence penalties, but good-faith reliance on professional advice concerning tax laws is a defense).

apply if a charity can show that a reasonable basis was used to determine the fair market value of any return benefits.[158]

Under part (b), a $1,000 penalty is imposed if erroneous or false information is intentionally provided. The higher penalty applies when the charity knew, or should have known, of the requirements in this penalty but made no attempt to determine the fair market value of the return benefit.

The proposed penalty would be inapplicable when the return benefit was insubstantial, such as a bookmark, mug, or calendar bearing the charity's name or logo. These types of benefits may be disregarded in determining the amount of the deductible contribution.[159] Additionally, the penalty under this section would be imposed per fund-raising campaign or event because it would be cumbersome to account for the vast number of written or other communications issued by charities.

The penalty amounts are merely suggestions. For organizations that solicit and collect large sums, the penalty amounts may be too low. For example, in *American Bar Endowment*,[160] over 55,000 American Bar Association members participated in the group insurance program.[161] Over the years that the insurance program has been in effect, American Bar Endowment has netted $81.9 million in dividends, $63 million of which it devoted to its charitable endeavors.[162] When setting the penalty amounts, Congress may determine that because funds raised by charities vary, the amount of penalties should be a percentage of the revenues raised from solicitations involving false or erroneous information regarding the deductibility of contributions.

CONCLUSION

Charitable contributions have become a big business in America. Taxpayers can claim these contributions as itemized deductions. However, dual payment contributions are deductible only to the extent that the payment exceeds the fair market value of any benefit received and if the excess was intended to be a gift. Due to the latter requirement, the contributor must know that their contribution exceeds the market value of the return benefit when the payment is made.

158. The IRS guidelines merely require that a reasonable estimate of fair market value be used. *See supra* notes 31-34 and accompanying text.

159. *See supra* notes 35-37 and accompanying text.

160. 4 Cl. Ct. 404 (1984), *rev'd*, 761 F.2d 1573 (1985), *rev'd*, 477 U.S. 105 (1986).

161. *American Bar Endowment*, 4 Cl. Ct. at 406.

162. *Id.* at 408.

Nevertheless, some charities erroneously or falsely advise contributors that their entire dual payment is deductible. Furthermore, some charities ignore the current IRS guidelines providing that charities should determine the fair market value and indicate that this portion of the contribution is not deductible.

Existing penalties do not effectively deter charities that ignore these guidelines. Rather, Congress is relying on charities to voluntarily educate their members regarding the relevant tax laws. Congress is also depending on the IRS to monitor the charities' compliance. The only existing deterrent is indirect. That is, charities may refrain from issuing erroneous or false receipts if they fear that future fund-raising campaigns will be hurt if their contributors are audited and assessed deficiencies against them. This is a minor deterrent because few taxpayers are actually audited and the contributors are unlikely to communicate among themselves.

To facilitate taxpayer compliance, Congress should enact an additional penalty. The penalty proposed by this Comment is modelled after a negligence standard. A penalty would be imposed for each occurrence and the amount would depend on whether the charity negligently or intentionally furnished erroneous or false information to contributors regarding the deductibility of their donations.

The proposed penalty is intended to serve primarily as a deterrent. It can easily be avoided by ascertaining the fair market value of return benefits and using the fair market value to accurately inform taxpayers of the amount of the deductible contribution. It is not overly burdensome, because it can be avoided by not affirmatively stating how much of the payment is a deductible contribution. The proposed penalty protects taxpayers from misrepresentation and is a more efficient deterrent than the current IRS policy of monitoring charities.

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