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ABUSES IN THE AREA OF CHARITABLE SOLICITATION

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I was reminded coming here to the Peabody in Orlando that my first talk on the subject of charitable solicitation was last October, also here at the Peabody, to a group of business officers of the Council on Jewish Federations. As I was being escorted to the podium by my host, he turned to me and said, “By the way, I want you to understand that I don’t think we’re going to be asking you too many questions after your talk is over. We’re trying to determine what our strategy in this area should be for the coming year.” I then proceeded, this being the first talk on the subject, to give an impassioned speech. I had it all written down and my arms were flailing. This was my first opportunity to talk about a subject which was near and dear to my heart. And, sure enough, after I finished my talk, there weren’t any questions from the audience.

As I was leaving the room, several people came up to me and started asking me private questions, indicating that it was agreed within the group ahead of time that they wouldn’t ask any questions as a group but that they would mention individual situations to me and ask my views. Then, as I was leaving, my host said, “You know, I didn’t really expect an Assistant Commissioner to come to talk to us. Usually, you send us a group manager from one of your local offices, and they speak on the topic of auditing one of our organizations or something of that sort. So, when you accepted the invitation to come down and said you wanted to speak on this topic, we were really flabbergasted, and we realized that we couldn’t withdraw the invitation. But, we want you to know that this is a subject that’s of some concern to us as business officers, because we know that we have problems within our organization.” I have no idea whether the same applies to the Catholic Church or, if it does, whether you folks, as opposed to the business officers or financial officers, are the ones who would be concerned with these matters. But, in any event, once again, I like to talk about it. I have moderated my talk, so that I don’t talk with
my hands and don't become excited. Remember, everything is generic here and I'm not indicating when I make a statement that I know that something of this sort necessarily goes on in your organization.

As Deirdre mentioned, last summer the Commissioner of Internal Revenue, Larry Gibbs, sent a letter out to about 400,000 charities on our Master File. I believe you have a copy of that letter. What I would like to do at this point is read portions of the letter because it explains why the Service is engaged in a program to look at charitable solicitations. The third paragraph of Larry Gibbs' letter indicates that Congress has evidenced concern in this area, and that the House Budget Committee, in its Report on the Omnibus Budget Reconciliation Act, states that it "is concerned that some charitable organizations may not be making sufficient disclosures, in soliciting donations, membership dues, payments for admissions or merchandise, or other support, of the extent (if any) to which the payor may be entitled to charitable contribution for such payments." And the Report goes on to say that "the Committee 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." This, by the way, if you haven't located it, is called Publication 1391, Deductibility of Payments Made to Charities Conducting Fundraising Events, and it's a letter from the Commissioner.

In any event, the Report also says that the Committee "anticipates that groups representing the charitable community will further educate their members as to the applicable tax rules and provide guidance as to how charities can provide appropriate information in this regard." Then, Larry indicates on the next page of his letter, "because of this expression of Congressional interest, as well as the continued concern of IRS, I shall institute a Special Emphasis Program for the 1988 tax year. It will focus on the fundraising practices of charitable organizations, as well as organizations that perform fundraising functions for charities." He then mentions that the basic presumption in the law is "that the total amount paid represents the fair [market] value of benefits received in return—thus eliminating any charitable contribution deduction." Then he stated the law and attached to this letter a twenty-year-old revenue ruling from 1967 that set forth certain examples to show how the tax law applies in the area of charitable contribution deductions.

The Gibbs letter is the document that sets the framework for our program. I might also mention that when the Congress inserted this Committee Report language, it also passed legislation with regard to noncharities. I'm not sure whether you are aware of this or not, but non-501(c)(3) organizations are now required to indicate in their solicitation material,
membership dues statements, and, basically, in all of their public contacts with their membership and with the public, the fact that contributions they receive are not tax deductible. I think it's fair to say that the question now is whether the results of the Program I'm about to describe to you will convince the Congress one way or the other that it needs to enact legislation of the same sort for the charitable sector. Hopefully, that will not be the case and you will not have to indicate the extent of the deductibility of every contribution that is made to you some time in the future. I can't imagine that sort of burden being placed on the charitable sector unless, once again, as we get into this area and do our examinations, we find that there are significant problems.

The Special Emphasis Program that the Commissioner described consists of two parts: an educational phase, and an examination or audit phase. The educational portion consists of having sent out Publication 1391 to each of the exempt organizations on our Master File, as I indicated, and also consists of various representatives of the Service giving speeches to groups. I have given a dozen or perhaps fifteen to twenty speeches, and members of my staff have given several speeches. All of this is a prelude to an examination program that is just getting underway.

The examination program consists of two elements. The first major element, in terms of numbers of cases to be reviewed, which will begin in October of this year, involves taking the 1988 Form 990s that are filed, and putting them through our computer scoring system, as we always do. Then, with regard to those Form 990s of charities that we wind up examining pursuant to the scores that emerge from our computer scoring system, our agents will be paying special attention to the charitable solicitation practices of the charity. Our agents in recent years really have not paid much attention to charitable solicitation practices when they audit a charity. This will be a major departure for them and, obviously, for the charity. This phase of our examination program will begin in October of this year and proceed for about a year. As we go along, we will be making notes and will be assembling the results of the audits that we do with the idea of reporting back to the Congress whatever it is that we find.

The second element of our examination program is more targeted and has already begun. Many practitioners in the field who know me, who know the Service's interest in this area, and who care about the charitable sector, are bringing to my attention instances of abuse that they have noted during the course of their practice or as individuals who receive troublesome charitable solicitations themselves. We also have other ways of getting information. We are targeting certain organizations that we know have questionable practices. We have begun perhaps half a dozen audits at this point. We will begin others over the next few months. Once again, these will be fairly fertile audits, fertile in the sense that we know that there is a questionable charitable solicitation practice involved. The
issue for us will be to determine whether there is anything under current law that we can do about it, because essentially we are asking for voluntary cooperation.

There are not an awful lot of penalties that apply to organizations that engage in aggressive or abusive charitable fundraising practices. We have a penalty under the Code for aiding and abetting understatement of tax that we have not used yet. I suppose, if we find the right case, we might try to litigate that sort of an issue with regard to a charity. However, it's hard for me to imagine in all but the most abusive case that, for example, the charitable fundraising practices of an organization could result in that organization's disqualification or loss of exemption. On the other hand, maybe as we get into this further and if a remedy of some sort is needed, some type of tax could be proposed for abusive practices.

Information reporting is another prospect if Congress takes a look at the results of our examinations. I don't know where this will lead, but there are obviously a number of abuses out there—some of them more serious than others. At this point, the essence of our effort is a voluntary one.

In those cases where we have had an abuse brought to our attention, one of the things we have been doing is sending out letters of concern to the particular charity involved, indicating that such and such a piece of information that they have published has come to our attention, mentioning to them our problem with it, and asking them what their reaction is. Surprisingly, many charities contacted in this manner tell us that they had no idea that the practice that we described to them was a problem, that they will change it right away, and that, in effect, they don't want any trouble with us. In those cases, we generally work with the charity and help them in correcting the problem and, unless there is some other reason to audit the organization, we do not proceed further with that organization. On the other hand, there are some organizations who have abusive practices, to whom we write letters of concern, that do not give us satisfactory explanations. We do, in fact, go out and audit them.

We have established a special hotline within our office to answer questions that charities raise with regard to valuation questions. This is an area of concern in many situations because of the quid pro quo nature of the arrangement, with a contribution in exchange for some sort of benefit.

What are some examples of charitable solicitation practices that you may or may not have thought come within the purview of the definition? One area is celebrity golf events, where you make a fairly substantial donation to a charity in exchange for which you golf with the pro and have lunch. I would imagine that in virtually every case, the entire amount of the contribution made was being deducted by the individual on that individual's Form 1040. Now we are saying, "No, that's not the way the law
reads and we want you to change that sort of practice.” Another example is art auctions. This often happens in the church and synagogue sector, where you have profit-making organizations coming in and conducting auctions where the checks are made out to the charity. Obviously, if you’re getting a piece of art in exchange for your contribution, your contribution is not deductible.

Thrift stores—we are about to hold a thrift store summit in Washington in a couple of weeks. Thrift store arrangements work in a variety of ways, as I’m sure you are aware. All too often the charity gets very little out of the operation that’s done by a for-profit firm. The charity, if it’s fortunate, will get five, six, eight percent of the proceeds. There is a lot of concern that there is abuse with regard to thrift store operations. I assume in the church area that you do have a number of thrift stores. I have a feeling that most of those you are familiar with are run on the up and up, and you don’t deal with for-profit operators. But, when you start dealing with for-profit operators, then there is a potential problem. Having raised this topic in a number of talks, we suddenly find ourselves in the position of holding a thrift store summit in a few weeks with a number of the national outfits that do this on a large scale.

Travel programs—this is an area of particular concern to us. I don’t know whether you receive from your law school alumni association, as I do, solicitations for travel programs, and if so whether there is any indication as to tax deductibility. Certainly I’ve seen a number of solicitations, particularly where I’m invited to join some sort of a travel tour program to a foreign country to meet my legal counterparts, with an indication that all or much of the trip is tax deductible. In fact, you probably spend a total of four to eight hours on a ten or twelve-day trip meeting with your counterparts, with the remaining time being spent on travel and tours. These tours are often deducted under section 170 or under section 162 as a trade or business expense. This is an area where we see significant abuse.

An offshoot of the travel abuse is the straight for-profit travel organization. We have a couple of those in operation around the country. Those that exist operate on a fairly large scale. The for-profit organization, really a travel firm, establishes arrangements with law school professors or sometimes representatives of bar associations or others, to write a letter soliciting folks to go on a foreign tour to meet their legal counterparts, or in case of doctors, to meet their medical counterparts, and geologists to meet their counterparts. I’ve seen them all. In one case I’m thinking of, they guarantee tax deductibility. They say that if IRS happens to audit you (I think we audit one percent of the 1040 these days), and you happen to lose your tax deduction, we will pay for you. Well, we weren’t too thrilled seeing that sort of language. Even though that’s not a charitable contribution abuse, it’s related. And so we are getting after folks on the
for-profit side of the fence, too.

One area that may or may not be of some interest to you is the area of inflated appraisals. I know when my daughter was applying for college and started receiving brochures last summer and fall, we received one from a local state school in Maryland, where I live, that included all sorts of information about the college. One of the items was a newspaper put out by the publicity department with the headline “Gift Boats Keep College Fleets Afloat.” This article went on to describe in excruciating detail how the donor to the college of that year’s largest and most luxurious yacht had been in a situation of not being able to sell his yacht on the open market for $125,000, but, having obtained a $200,000 appraisal, he donated it to the college. And then, the article went on to describe how this same yacht five years before had been donated to the Naval Academy, and then resold back on the open market by the Naval Academy. The recycled yacht arrangement was a new one to me. I don’t think the publicity department of this college realized who they were sending the brochure to, but it hit me at the wrong time.

Another area that is receiving a lot of publicity is the area of sweepstakes solicitations. You were here yesterday in this room, so you are probably not aware that the Washington Post had a front-page article on the Watson & Hughey organization which was mentioned in some of your handouts. It is a for-profit organization that operates out of Alexandria, Virginia. They specialize in sweepstakes promotions, and have contracted with a number of charities, very often on terms very favorable to Watson & Hughey as opposed to the charity—much like the thrift store situation—to do all of the mail solicitations, using mailing lists that Watson & Hughey has built up over the years. Watson & Hughey’s for-profit publishing subsidiary prints up all the materials. The solicitations are actually run by Watson & Hughey. To the extent that the charity organization gets more back than it costs them to put this material out, they have money to use for charitable purposes. Usually in the first few years, they don’t get much back, if anything, and Watson & Hughey, in effect, eats any losses. Many small charities have done fairly well under these programs and the Watson & Hughey organization has grown as a result.

This is an area where states have been attempting, through disclosure provisions, to impose some sort of discipline, but have not been successful. I received my first sweepstakes solicitation from the local public television station in Washington, which was a surprise to me because it’s a sign of desperation, in my view, for a respectable organization or respectable charity, such as a public television station, to resort to this sort of fundraising practice. But, obviously, it is very successful, and their materials were not misleading. Watson & Hughey’s materials have a sweepstakes which implies that you’ve won $5,000 or some such figure, whereas the public television sweepstakes solicitation was different.
These are expensive mechanisms which show the tremendous competition for charitable dollars these days. In some of my prior speeches, I mentioned the highly competitive nature of raising funds these days because of the fact that government funding has been cut back so drastically, as you well know, in the last eight or nine years. There are real problems raising money these days, and everybody is competing for the same dollar.

To give another example of a charitable solicitation practice that may or may not be apparent to you, we have had discussions with representatives of public television and public radio. We have reached an agreement with public radio wherein they will do two things. They will, on a voluntary basis, air tax messages indicating, in effect, that when they are handing out premiums as part of their fundraising pitches, they will mention at some appropriate point the fact that not everything is tax deductible. In addition, after the on-air solicitation, when they send out written materials as a follow-up to those who have called in, they will give appropriate tax information. This had never been done in the past. We are discussing with public television an on-air message of some sort. We are having a bit more of a problem with them in getting agreement. They have not followed up with any sort of tax information, surprisingly to me, when they have corresponded with folks who have responded to their television appeals, so that there have been problems here. There has not been a lot of tax-related information passed out by these highly visible charities. I think that’s one of the reasons many members of Congress feel something had better be done.

An educational effort is one aspect of the problem. And auditing charities is another aspect. But if you don’t audit Form 1040 and the Schedule A as well, nothing is accomplished. We have a couple of ways of doing this. As I mentioned before, the Service audits only about one percent of the Form 1040 returns. I think these days, if I’m not mistaken, with recent changes in the law, about sixty percent of people do not itemize, so you don’t have an itemization problem because they’re filing Form 1040A or 1040-EZ. For the remaining forty percent, we don’t look at too many of the Form 1040s and the Schedule A that individuals file. The detailed information on a Schedule A is not that great, such that even if we were to look at them, we would not necessarily notice a problem with regard to charitable solicitations.

We are doing two things. First, when we come across a particularly abusive situation with regard to a charity, we are telling that charity that we want to see their list of donors. In the case of a travel outfit, for example, we say we want to see the list of twenty or thirty people that took such and such a trip, which we don’t think is tax deductible because we think it’s largely a disguised vacation. Anytime you mention donor lists to charities, I think you know the reaction: “This is a first amendment right.
The Government doesn't have any business asking for lists of donors, and we're not going to give it to you." We feel that we have a right to it, particularly in abusive situations, and we will litigate in those few situations where we think we need that sort of information.

The other way we have of going about looking at the Form 1040 and Schedule A is that the Service conducts detailed examinations which it calls "Taxpayer Compliance Measurement Program Examinations," TCMP for short. These are very detailed examinations of randomly selected returns that are aimed at helping us identify which lines on the tax return result in tax abuse, if you will. We use that information to derive our computer scores to select returns for examination in subsequent years. In the Schedule A area for 1988, the Service will do TCMP examinations on about 50,000 Form 1040s and Schedule As. The auditors and agents doing those examinations will ask a number of very detailed questions regarding the charitable contributions that are claimed on the Schedule A. Once again, our approach is two-fold. It is aimed at talking this problem over with exempt organizations, explaining the problem, asking for their help in ascertaining whether they have appropriate fundraising practices, whether there are any problems that they can identify and correct. Also, we are following up on the individual side by examining 50,000 Schedule As and perhaps more. We're having our tax auditors pay special attention to this area on the returns they're examining that aren't part of the TCMP, to see if we can identify and ask questions to assure that a charitable contribution that's claimed is appropriate.

Let me repeat again, this is a voluntary program. There is nothing in the law that requires a charity to look at its fundraising practices and advise the donors what the tax consequences are. So we are asking something that is not required by the law. But, we are afraid that unless you take heed to our call to look at your practices and, where appropriate, to make changes, down the road Congress might legislate in this area. I don't think that Congress or we view this as an area to raise revenue. It's more a tax compliance area, where we feel there is existing abuse and that things are getting out of hand in some respects. We are asking the charities to adopt more conservative fundraising practices, where called for.

The last item on my agenda is called Church Fundraising Abuse Examples, but this is really the audience participation part of the program. I don't have any idea what types of abuses you have, or if there are practices that you have questions about. I am aware of stories of parishioners making checks for their parochial school tuition out to the church. One always hears of those situations, and of the art auction situation. I asked my staff before coming down here to give me some examples from their own experience as to things they have noted. But, really, the purpose here is to just explain to you the nature of the problem, to describe some examples by way of showing you how broad an area the term "charitable
solicitation” covers, and to see if you think you might have any situations that pose a problem for you. So, with that, I think I would like to conclude, and to ask if any of you have any questions or have any concerns, and maybe get a sense from you whether you think this is an area that’s a problem or whether in fact there is no real problem that you’re aware of. I’ll be happy to take questions.

CAMILE ABOOD: Where a donor contributes real estate to the parish or diocese, and he obtains an appraisal in compliance with the Code provision relative to charitable gifts, is the onus concerning the accuracy of the appraisal as far as the value of the gift on the donor, or does IRS look to the recipient charity to verify the value of the gift?

MR. BRAUER: You know, I received that same question from the Council on Jewish Federations six months ago and it’s obvious that it’s a common problem. In terms of a legal obligation on the representative of the charity, I’m not sure that there is one. By the same token, the Independent Sector (are you familiar with the Independent Sector, an umbrella group of 501(c)(3) organizations?) has just set up a task force on ethics with regard to charitable solicitations. They invited me to join as a member, and my counsel told me that it would be a conflict of interest, so I had to decline. But I’m going to be assisting them in whatever way I can. One of the things they are concerned about is this very sort of a problem. What is the ethical obligation of a representative of the charity who has reason to believe that the appraisal, even though obtained exactly as provided by the law, is inflated? I think that’s a question they will be grappling with, among others, over the next year or two. In terms of present legal obligation, unless you have knowledge rather than a “guesstimate” that there is a problem here, I am not aware that there is a legal obligation on your part as representative of a charity. Other questions?

SISTER JUDY MURPHY: On your outline you had the Mirror Program for section 162. What is that, please?

MR. BRAUER: That was the program that I mentioned with regard to the travel agency. Where a for-profit organization, rather than a charity, conducts a travel program that either implies or outright states that you are entitled to a deduction under section 162 as a trade or business expense for a particular trip, that may be a problem. As we began to look at this problem, we realized that if we only asked charities who conduct travel programs to look at their practices and change them, if necessary, it wouldn’t be fair. We’d also have to look at the for-profit sector, which conducts comparable programs, and see if in fact their practices are appropriate. That’s what I mean by a “Mirror Program under 162.” Any other questions?

QUESTION: In your special reports you have a question that we get asked a lot about. The Church or a group in the Church wants to have a raffle or a drawing. Your materials say that if a purchaser gets something
of value, none of it is deductible. In the State of Florida, such raffles are illegal, so we have coached all of our churches, if they're going to do this sort of thing, to say, just like the fast food chains, "no purchase necessary." If someone comes up and asks you for a ticket and does not care to make a donation, you give it to them, and that has happened. So, in light of that, if you set it up as a "no purchase necessary" and it truly is a donation, is it still a nondeductible item?

MR. BRAUER: Well, this goes to the question of quid pro quo nature of the transaction. A lot of these areas are very gray, and I would suggest that there is a question as to whether there is a problem there. David Jones, whose number I gave you, can help you with particular situations and will give you an honest answer. If he feels that, based on the information you give him, it isn't really a raffle within our technical rules, he will tell you. I think there are ways around the raffle situation that can cause you to be in the clear, in effect, and certainly that's true in many of these other situations. Often, it's a matter of just knowing how to structure the transaction. For example, if you're holding a dinner-dance or something of that sort, by structuring it with a tiered pricing mechanism, rather than just implying that the whole contribution for the dinner is deductible, you can accomplish your purpose and, at the same time, be operating within our technical framework. Once again, that's the reason why we have set up the hotline to help you out in these situations.

BOB ROBINSON: Would you be willing to discuss what you consider some of the major problems with these thrift organizations? For example, when people are making donations of substantial nature or even a lesser nature to these organizations, they receive in return sometimes an appraised value for their contribution. In the case of books or art objects or even gifts to thrift organizations, the responsibility, I take it, is totally on the thrift organization to make accurate appraisals and give them back. Somehow or another, it seems to me that in most instances they're slightly inflated from what might be (you know, your example of the $125,000 yacht coming back at $250,000). Well, you reduce that considerably to a set of books or certain other objects that are given to charitable organizations who give back appraisals. Now, let's say that we assume that you represent a charitable organization, is it likely that the Service is going to be concerned about series of inflated appraisals on the basis of large amounts of donation being given?

MR. BRAUER: Generally in a thrift store operation that I'm familiar with, the appraisal, because they are items of relatively small value, is done by the individual. The organization often states that the individual is responsible for assigning a value. You're talking about, I take it, larger value objects in a thrift store?

MR. ROBINSON: In the case of a thrift situation, you generally get, even in giving an extra set of law books to libraries and things of this nature,
some sort of advice back on what they consider the value to be, which is considered to be a deduction. Thrift organizations give the same sort of thing for items and articles and things of this nature. If the organization depends considerably on that, it seems to me totally self-serving to allow the donor to make the appraisal. Your reference to that gives me pause to remark about what Camille Abood had to say about the real estate. I can recall many instances in which we had contributions of land given to the Church with the request that the Church set a value and in each instance we have refused to set the value, but indicated that the gift will be accepted and appreciated. But we look to the donor to obtain the valuation because we don’t want to go on record establishing an inflated value for this particular piece. We know very well that the donor is very anxious to get as high an appraisal as he possibly can. I think your answer to Camille states that as long as we’re not engaged in any conspiracy to accomplish that, it’s not our responsibility. But, you’ve just mentioned that in the thrift situation the donor is looked to to make his own appraisal. That seems a little bit odd.

MR. BRAUER: To the best of my knowledge, the donor in most situations with small-value items is called upon to establish the value, and that has traditionally been the case and probably will continue to be the case.

MR. ROBINSON: If you go to Goodwill or the Salvation Army or any church, they will give you a little chit indicating the sofa is worth $135.

MR. BRAUER: Maybe a church organization will, but the Salvation Army and Goodwill do not.

MR. ROBINSON: They don’t?

MR. BRAUER: No, so that’s part of the problem I think. But, once again, with the small-value items, I don’t know that there is a major concern, except to the extent that they mount into large numbers overall. But the large, single item—it seems to me that here you are in a position to question something of that sort. Even if you have no legal obligation, I would hope that from an ethical point of view, in appropriate cases you would question, as I think you have indicated you do, that sort of a donation.

MR. ROBINSON: We refuse to set the value.

MR. BRAUER: You refuse to set the value, which is, I’m sure, entirely appropriate here.

WARD SHANAHAN: Mr. Brauer, I’ve got a problem that has to do with what I consider a gap in perhaps administration by IRS. I’ve got a mission church that we had converted into an historic site. It was abandoned as an active church and a new church was built and this historic site was taken over by lay board for the purpose of qualifying for some State historic preservation grants. There are three ladies of advanced middle age like myself, who are operating this purely as volunteers, and they set up a trust board and they have a little bookstore they operate in connection
with this church. But, when I applied for a 501(c)(3) for this site about three years after they got into operation, they then became deluged by a machine-gun effect from the IRS—letter after letter telling them they were in violation of the law and that they were going to have to pay taxes and almost constant telephone calls, which proved to me that no good deed goes unpunished. What I'd like to know is, is this guy whose telephone number you gave me the guy I call when I get into this situation? MR. BRAUER: That's a rhetorical question. Your problem is obviously not one involving charitable solicitation. But you do, obviously, have a practical problem of some significance and, if you'll drop me a line, I'll be happy to look into the matter for you. Do you have your letter, at least? MR. SHANAHAN: Well, it does have to do with solicitation because what the Service is after is what they collected from the time they were organized to the time I made the application for the 501(c)(3). That happens to be a total of $1,261.13.

MR. BRAUER: And, I take it that you haven't received your exemption letter yet. Is that correct? Maybe there is a de minimis amount below which we won't grant an exemption. I'm not sure. But, once again, seriously, if you're having a continuing problem that is not of your making and if you'll drop me a line, I will be happy to have our District take a look at it.