

Office of Chief Counsel
Internal Revenue Service
Memorandum

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date: April 20, 2006

to: Virginia E. Cochran
Deputy Area Counsel
(Tax Exempt & Government Entities)

from: Ashton P. Trice
Branch Chief
(Procedure & Administration)

subject: Quid Pro Quo Penalty Issues

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

1. In a disguised tuition payment program, at what point does the quid pro quo penalty arise?
2. Do deficiency procedures apply to the quid pro quo penalty?
3. Does the quid pro quo penalty limitation of \$5,000 per fundraising event or mailing apply to disguised tuition payment programs, and, if so, how?
4. What "reasonable cause" would except a church from the quid pro quo penalty with respect to disguised tuition payment programs?

CONCLUSIONS

1. The quid pro quo penalty arises when a church is required to make a disclosure to a contributor regarding the value of the benefit received for the contribution.
2. The quid pro quo penalty is an assessable penalty; deficiency procedures do not apply.
3. The cap on the quid pro quo penalty applies where there is evidence of a fundraising event or a mailing.
4. A disguised tuition payment program so plainly violates the provisions giving rise to the quid pro quo penalty that it is unlikely that a church engaged in such a program can establish reasonable cause.

FACTS

Some members ("member-families") of a number of churches have made a series of contributions to their churches in a way that disguises tuition payments. Under these payment programs, a member-family contributes to the church an amount equal to or exceeding the amount of each child's tuition at a private school unrelated to the church. The school bills the church for that tuition, and the church pays it. The church keeps the funds from contributions of each of the member-families separated, and requires each member-family to contribute to the church an amount at least equal to each child's tuition plus the member-family's "regular" contribution to the church's general fund. At the end of the year, the church provides a statement to the member-family reflecting the total contributions for the year without any reduction for tuition the church has paid. The statement also says that the member-family has received nothing in exchange for the contributions except intangible religious benefits.

LAW AND ANALYSIS

Section 6115 provides as follows:

(a) Disclosure requirement.--If an organization described in section 170(c) (other than paragraph (1) thereof) receives a quid pro quo contribution in excess of \$75, the organization shall, in connection with the solicitation or receipt of the contribution, provide a written statement which--

(1) informs the donor that the amount of the contribution that is deductible for Federal income tax purposes is limited to the excess of the amount of any money and the value of any property other than money contributed by the donor over the value of the goods or services provided by the organization, and

(2) provides the donor with a good faith estimate of the value of such goods or services.

(b) Quid pro quo contribution.--For purposes of this section, the term "quid pro quo contribution" means a payment made partly as a contribution and partly in consideration for goods or services provided to the payor by the donee organization. A quid pro quo contribution does not include any payment made to an organization, organized exclusively for religious purposes, in return for which the taxpayer receives solely an intangible religious benefit that generally is not sold in a commercial transaction outside the donative context.

Section 6714 provides as follows:

(a) Imposition of penalty.--If an organization fails to meet the disclosure requirement of section 6115 with respect to a quid pro quo contribution, such organization shall pay a penalty of \$10 for each contribution in respect of which the organization fails to make the required disclosure, except that the total penalty imposed by this subsection with respect to a particular fundraising event or mailing shall not exceed \$5,000.

(b) Reasonable cause exception.--No penalty shall be imposed under this section with respect to any failure if it is shown that such failure is due to reasonable cause.

When the penalty arises

Section 6714 imposes a \$10 penalty for each contribution for which there is a required disclosure. The time at which section 6115 requires an organization to make a disclosure is a matter within the jurisdiction of your Division Counsel's office.

Assessment

The quid pro quo penalty is an assessable penalty; deficiency procedures do not apply. The Tax Court's deficiency procedures apply to deficiencies in income, estate, gift, and excise taxes under chapters 41, 42, 43, and 44. IRC § 6213(a). The quid pro quo penalty is neither a tax described above nor is it computed on the basis of such a tax. See *Medeiros v. Commissioner*, 77 T.C. 1255, 1259-60 (1981) (holding that the Tax Court's jurisdiction did not extend to a penalty imposed by section 6672 because the IRS was not required to issue a deficiency notice for the underlying tax on which the penalty was based). In contrast, deficiency procedures generally apply to penalties computed on the basis of a deficiency. See IRC § 6665. Accordingly, deficiency procedures do not apply to the penalty, and the Service may assess without following deficiency procedures.

The penalty cap

Section 6714 imposes a limitation the quid pro quo penalty of \$5,000 “with respect to a particular fundraising event or mailing.” Thus, evidence that a church conducted an actual “fundraising event” or “mailing” involving a disguised tuition program would yield a maximum \$5,000 penalty. For example, some churches may solicit pledges of contributions or mail offering envelopes to members. When this is done with the understanding that certain member-families will participate in a disguised tuition payment program, contributions to fulfill a pledge or made with offering envelopes would be subject to the \$5,000 penalty cap for contributions associated with each pledge drive or mass offering-envelope mailing.

Otherwise, evidence of a discrete fundraising event or mailing may not turn up in a disguised tuition context because the participants may hear about the program by word of mouth or may participate in the program year after year without mailings or fundraising by the church. In such cases, we do not read section 6714 as imposing a limit on the penalty.

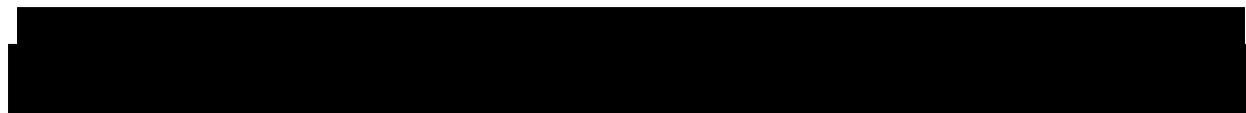
Reasonable cause

A charity that would otherwise receive a penalty under section 6714 will receive no penalty if the failure to comply with the underlying disclosure requirement was due to reasonable cause. Whether reasonable cause exists and will excuse the imposition of the quid pro quo penalty depends on the facts and circumstances of each case.

One way that a charity might establish reasonable cause is to show that it was unable to comply with its disclosure obligation due to factors beyond its control. See Treas. Reg. § 301.6651-1(c)(1) (a taxpayer who has exercised ordinary care and business prudence but was unable to file on time or was unable to pay tax on time, has acted with reasonable cause).

Another way that a church might establish reasonable cause would be to show that it made reasonable efforts to comply with the law. See Treas. Reg. § 1.6664-4(b) (regarding a taxpayer’s underpayment of tax). Under this standard, an honest and reasonable misunderstanding of fact or law might sometimes support a finding of reasonable cause. A disguised tuition payment program so plainly violates the provisions giving rise to the quid pro quo penalty that we find it difficult to imagine a scenario in which a church could establish reasonable cause based on a misunderstanding of law or fact.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS





Finally, we note that a penalty for aiding and abetting an understatement of tax under section 6701 also appears to apply to the churches that participate in the disguised tuition payment program because the churches know, or have reason to believe, that members will rely upon the contribution statements the church provides in connection with reporting their tax liability and that the reliance on those statements will result in an understatement of tax. The section 6701 penalty would be \$1,000 for each person receiving a statement per year and the penalty is in addition to any penalty applicable under section 6714.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call Allen D. Madison at (202) 622-4940 if you have any further questions.