

Mr. COHEN. I would not like to get too much into the details of this particular investigation since it is still underway. I might say, however, that in the case of a number of foundations involved in this particular operation which has been discussed before the committee for the last several weeks, we have conducted audits of the individual members of those organizations. A number of them have already agreed with us that what they did was entirely improper and have agreed to pay the tax on the income which was allegedly transferred to the foundation. We have already closed a number of cases on that basis.

Mr. MORTON. The area that concerns me in this whole thing is that these foundations are providing services, travel, perhaps automobiles, club memberships, and other fringe benefits that normally, if the foundation did not exist, would be acquired with after-tax income. That seems to be the real crux of this matter.

Mr. COHEN. In the cases we have looked at so far, as I indicated, the taxpayer, the individual who created the foundation, has agreed with us that what he did was improper and has agreed to pay the tax on all of this income. It had been earned by him in the first instance, as if the foundation had not existed.

Mr. MORTON. If the foundation has not filed a form 1023, and if it is in operation without this ruling, what is the penalty that would be levied against such a foundation if this came to your knowledge?

Mr. COHEN. The problem there is that our law today only has—I think it was the White Queen or the Red Queen—I was reading “Alice in Wonderland” to my child this summer, and she said, “Off with her head!” and the only punishment that we have under the present law is either to bless them or curse them. You chop off their heads or nothing.

Under the foundation report, the Treasury has made recommendations for imposition of a \$10 a day penalty for every day that the proper reports are not filed. We think this type of penalty will go a long way toward improving compliance here. The problem here is that even with a valid foundation you sometimes get noncompliance in this area, and you do not want to deny exempt status for minor infractions. When we are talking about fringe operators such as the ones we’re discussing, where they are clearly beyond the statutory requirements, we disallow the exempt status and, we disallow the deduction for any contributions made to it. In appropriate cases we may tax the income of the foundation to the grantor.

He may or may not have civil penalties, and he may or may not have criminal penalties, depending on the extent of involvement.

Mr. MORTON. You make an effort to recover back taxes?

Mr. COHEN. Yes, sir; absolutely.

Mr. MORTON. Now, let me ask you this, Mr. Commissioner:

What is the annual requirement of a tax-free organization such as a foundation, as far as the IRS is concerned?

Mr. COHEN. The organizations that we are talking about, are required to file an annual form 990-A, which is an information return that gives us an outline of the activities that are carried on during the year.

Mr. MORTON. We have received some testimony here from foundation operators that indicate that they do not believe that it is necessary