



American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

October 19, 2012

The Honorable Max Baucus, Chairman
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Dave Camp, Chairman
House Committee on Ways & Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Orrin G. Hatch
Ranking Member
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sander M. Levin
Ranking Member
House Committee on Ways & Means
1236 Longworth House Office Building
Washington, DC 20515

RE: Request for Legislation to Exempt from the Filing Requirement of Section 6034(a)
Trusts with Charitable Deductions only from Flow-through Entities

Dear Chairmen Baucus and Camp, and Ranking Members Hatch and Levin:

The American Institute of Certified Public Accountants (AICPA) continues to encourage Congress to pass legislation that simplifies the tax compliance burden of taxpayers. To further this mission, we request that Congress enact legislation that would exempt from complying with the information reporting requirements of Internal Revenue Code section 6034(b)(1) trusts whose only charitable deductions are passed through to them from a flow-through entity (e.g., S corporation, limited liability company (LLC), or partnership).

The AICPA is the world's largest member association representing the accounting profession, with nearly 386,000 members in 128 countries and a 125 year heritage of serving the public interest. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

Present Law

Section 6034(b)(1) provides that every trust that is not a split-interest trust described in section 4947(a)(2) but that is claiming a deduction under section 642(c) for the taxable year shall furnish the information with respect to the taxable year as the Secretary may by forms or regulations prescribe, including:

1. The amount of the deduction taken under section 642(c) within the year;
2. The amount paid out within the year which represents the amount for which deductions under section 642(c) have been taken in prior years;
3. The amount for which the deductions have been taken in prior years but which has not been paid out at the beginning of the year;

4. The amount paid out of principal in the current and prior years for the purposes described in section 642(c);
5. The total income of the trust within the year and the expenses attributable thereto; and
6. A balance sheet showing the assets, liabilities, and net worth of the trust as of the beginning of the year.

Section 6034(b)(2)(A) provides an exception to the reporting requirement of section 6034(b)(1) for a trust for any taxable year if all the income for the year, determined under the applicable principles of the law of trusts, is required to be distributed currently to beneficiaries.

Under section 6652(c)(2)(A), a penalty is imposed for failure to file the information return required by section 6034(b). The penalty is \$10 a day with a maximum of \$5,000.

Trusts use [Form 1041-A](#), *U.S. Information Return Trust Accumulation of Charitable Amounts*, to satisfy their reporting obligation under section 6034(b). According to the instructions, the trustee must file Form 1041-A for a trust that claims a charitable deduction or other deduction under section 642(c) unless an exception applies. The instructions provide exceptions for (1) a trust that is required to distribute currently to the beneficiaries all the income for the tax year determined under section 643(b) and the related regulations¹; (2) a charitable trust described in section 4947(a)(1)²; and (3) for tax years beginning after 2006, a split-interest trust described in section 4947(a)(2).³ Section 642(c)(1) provides that a trust is allowed a deduction in computing its taxable income for any amount of the gross income, without limitation, that pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in section 170(c). For a trust to claim a charitable deduction under section 642(c) for amounts of gross income that it contributes for charitable purposes, generally the governing instrument of the trust must give the trustee the authority to make charitable contributions.

Reasons Supporting AICPA Proposal

Often trusts invest in partnerships that make charitable contributions. If the partnership makes a charitable contribution from its gross income, that income is never available to the trust. For federal tax purposes, however, the trust must take into account its distributive share of the partnership's income, gain, loss, and deductions, and credits. These items include the amount of income given to charity and the corresponding deduction for that contribution. The Internal Revenue Service has recognized the trust's ability to claim a charitable deduction in this situation despite the fact that the trust's governing instrument

¹ See section 6034(b)(2)(A).

² See section 6034(b)(2)(B).

³ See section 6034(a).

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does not authorize the trustee to make charitable contributions. *See* Rev. Rul. 2004-5, 2004-3 I.R.B. 295.

A similar situation arises with respect to electing small business trusts (“ESBTs”) which own stock in an S corporation if the S corporation makes a contribution to charity from its gross income. Treasury Reg. §1.641(c)-1(d)(2)(ii) provides that if an ESBT is required to take into account a deduction attributable to an amount of the S corporation’s gross income that is paid by the S corporation for a charitable purpose, the contribution will be deemed to be paid by the S portion of the ESBT pursuant to the terms of the trust’s governing instrument within the meaning of section 642(c)(1).

For many trusts that claim a charitable deduction under section 642(c), the contribution is made by partnerships, LLCs, and/or S corporations in which the trust owns an interest, and no contributions are actually made by the trust. In these situations, we recommend that the trust be exempt from the information reporting requirements of section 6034(b) and therefore not be required to file Form 1041-A. Such trusts are not accumulating any income that may be distributed to charity in the future. The current charitable deductions are based solely on the current income of a flow-through entity, which contributes it directly to charity, and are not from any prior year’s accumulation of income by the trusts.

As discussed above, the trusts themselves never received the amounts that were given to charity and never made any direct charitable contributions. Under these circumstances, being required to file Form 1041-A places an unnecessary burden on these trusts and does not yield any additional useful information for the Internal Revenue Service. Moreover, trustees and preparers frequently are unaware of this filing requirement if the trust itself normally does not make any charitable contributions but in some years has charitable contributions passed through to it from their partnership, LLC, or S corporation investments. For these trusts, the failure to file penalty can easily run to its maximum \$5,000 amount, an amount that frequently is much greater than the amount of the claimed charitable deduction. For those trustees who are aware of this filing requirement, they sometimes choose to forego claiming the deduction rather than having to file an additional tax return. We believe that an exception should be created for these trusts because charitable deductions passed through to trusts from partnerships, LLCs, or S corporations do not appear to fall within the scope and purpose of the information reporting requirement of section 6034(b).

AICPA Proposal

We suggest that an additional exception (C) be added to section 6034(b)(2) to read as follows:

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(2) **Exceptions.** Paragraph (1) shall not apply to a trust for any taxable year if – ...

(C) the trust's only deductions under section 642(c) are those attributable to charitable contributions taken into account by the trust under section 1366(a)(1) or section 702(a)(4).

* * * * *

We urge you to enact this tax simplification proposal to exempt from complying with the information reporting requirements of Internal Revenue Code section 6034(b)(1) trusts whose only charitable deductions are passed through to them from an S corporation, LLC, or partnership. We look forward to working with you on this issue to achieve simplicity, effectiveness, and efficiency as Congress considers this and other simplification legislation.

If you have any questions or if we can be of further assistance, please contact Frances Schafer, Chair, AICPA Trust, Estate, and Gift Tax Technical Resource Panel, at fran.schafer@us.gt.com, or 202 521-1511; or Eileen Sherr, AICPA Senior Technical Manager, at esherr@aicpa.org, or (202) 434-9256.

Sincerely,



Patricia A. Thompson, CPA
Chair, AICPA Tax Executive Committee