LEADING BY EXAMPLE:
BEST PRACTICES IN CHARITABLE GIVING

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Washington Update

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DC Is Talking Tax Reform

"The idea of tax reform is to get our economy going again, provide better, more economic growth, more jobs and higher wages. The way you do that is you bring down rates.

And to bring down rates, you clean out a lot of the garbage that's in there and the special interest issues that are in it.

I think we ought to have a real conversation and this is the beginning of that conversation."

– Rep. John Boehner (R-OH)

– "I think we will not be able to finish the job, regretfully. I don't see how we can." – Sen. Mitch McConnell (R-KY)

How Do Nonprofits Fit In?

"Tax-exempt organizations play a vital role in American society – providing needed assistance to millions of people every day.

However, many operate and more closely resemble taxable businesses, not tax-exempt charitable organizations."

– House Ways and Means Committee, Tax Reform Act of 2014, Executive Summary

Is the Charitable Deduction "Trash" or "Treasure"?

- Rep. Paul Ryan (R-WI) and Sen. Ron Wyden (D-OR) both favor preserving the charitable deduction. Paul Ryan said to CNBC host Paul Frank on Aug. 20, 2014:

  "This is really the one exception I make this for. Charities ought to be a tax expenditure that is still preserved because civil society is one of the most important components of American life, of getting people involved in our communities and philanthropies. I think that is a very important thing to preserve and that's pretty much as a supply side or a low tax-rate guy."

- A "**tax expenditure**" is a way of measuring the difference between theory and practice. The government has the power to tax all income, but it actually taxes considerably less than that.

Tax Reform Discussion Draft Raises Around $12 Billion from Exempt Orgs

Provision	2014-2023 ($billions)
Excise Tax on Executive Compensation Exceeding $1M	4.0
Compute UBTI Separately for Each Trade or Business	3.2
Royalties from Name and Logo Treated as UBTI	1.8
Tax on Private University Endowments	1.7
Repeal Type II and III Supporting Organizations	1.4
Impose UBIT on Income from Private Research	0.7
Repeal Exemption for Professional Sports Leagues	0.1
Donor Advised Fund 5 Year Distribution Requirement	0.05
Revisions to Charitable Deduction	*
Simplification of Private Foundation Excise Tax	(1.6)
* included in $858.4 billion estimate for modifications to itemized deductions	

Compare with Other Business Tax Reform Proposals

Provision	2014-2023 ($billions)
Reform Accelerated Cost Recovery System	269.5
Amortize Research and Experimentation	192.6
Treatment of Deferred Foreign Income	170.4
Amortize Advertising Expenses	169.0
Reform Subpart F	115.6
Financial Institution Excise Tax	86.4
Repeal Last In First Out Accounting Method	79.1
Repeal Like Kind Exchanges	40.9
Limit Cash Method Accounting	23.6
Make Research Credit Permanent	(34.1)

Tax Reform Act Provisions Affecting the Charitable Deduction

- Charitable contributions made after close of tax year deductible until April 15.
- Charitable contributions deductible only to the extent they exceed 2% of AGI.
- Percentage limitations for gifts of cash and property to public charities reduced from 50% to 40%; gifts to private foundations reduced from 30% to 25%.
- The separate, lower 30% and 20% limits for contributions of capital gain property would be repealed.
- Adjusted basis is now the starting point for determining the value of the charitable deduction, with exceptions for qualified appreciated stock, related use tangible personal property, qualified conservation contributions, etc.
- Conservation easement incentive made permanent.

> **"The economic growth in this plan will increase charitable giving by $2.2 billion annually."**
>
> -Ways and Means Committee Press Release (Feb. 26)

Others Estimate Tax Reform Act Would Reduce Charitable Giving

- **Urban Institute estimates Camp Tax Reform Discussion Draft policies would reduce individual giving approximately 7% to 14% or $17 to $34 billion**

Table 1: Estimated Percentage Decline in Individual Giving

	Percentage Point Change Due to Provisions Related to:				
Camp Tax Reform Plan	Group 1: Rate Structure	Group 2: Standard Deduction and Other Non-itemized Deduction Provisions	Group 3: Itemized Deductions Other Than Charity	Group 4: Charitable Deduction	Residual due to Interactions
7.0–14.0	0.9–1.9	0.9–1.8	1.2–2.6	2.2–4.4	1.6–3.1

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0613-3).

Donor-Advised Funds

- Proposal would require donor-advised funds to distribute contributions within five years of receipt.
- Failure to distribute results in an excise tax of 20% of the undistributed amount.
- How taxpayers might respond:
    - Reduce overall charitable giving (which would raise revenue)
    - Increase private foundation giving (which would raise revenue from investment income tax), offset by donor preference for DAFs to avoid hassle of private foundations.
    - Increase donations to non-DAF sponsoring public charities (revenue neutral)
    - Increase donations to Type I supporting organizations (revenue neutral)

College Endowment Excise Tax

- Proposal to impose 1% excise tax on net investment income of private colleges and universities with more than $100,000 of assets per full-time student (other than assets used directly in exempt activities).

- Rationale
  - "The excise tax on net investment income does not apply to public charities, including colleges and universities, even though some such organizations may have substantial investment income similar to private foundations."
  - –W&M Majority Tax Staff, Section by Section Summary

Private Foundation Excise Tax

- Proposal to reduce excise tax on private foundation net investment income to 1% and repeal exception for exempt operating foundations.

  "The net investment excise tax on private foundations has long been a source of confusion and frustration for taxpayers. Private foundations, both large and small, recommended to the Committee's Tax Reform Working Group on Charitable/Exempt Organizations that the net investment tax be reduced to a flat 1 percent to ease compliance."

–W&M Majority Tax Staff, Section by Section Summary

Supporting Organizations and Private Operating Foundations

- Proposal to eliminate Type II and Type III Supporting Organizations
  - Only Supporting Organizations that are "operated, supervised, or controlled" by a publicly supported organization would qualify.
- Proposal to eliminate special treatment for private operating foundations and exempt operating foundations.
  - Under current law, private operating foundations are exempt from the excise tax on failure to distribute income (the 5% minimum distribution requirement) and exempt operating foundations are exempt from the excise tax on net investment income.

UBTI Loss Basketing

- Each unrelated trade or business treated separately from the others for tax purposes—i.e., the business is put in a “basket” or “silo”
- Losses from one unrelated business may only be used to offset income from that unrelated business.
- This rule is similar to the way gambling winnings/losses and hobby gains/losses are treated for tax purposes.

“[T]he IRS issued a report detailing how colleges and universities were abusing the [UBIT] rules by using loss-generating business activities to shelter gain from profitable businesses. The discussion draft would modify the UBIT rules to address these and similar loopholes.”

–W&M Majority Tax Staff, Section by Section Summary

Royalties from Name/Logo License

- Tax royalties from sale/license of organization’s name or logo (including trademarks and copyrights related to such name or logo) as UBTI *per se*.

“Many organizations, such as AARP, are now earning significant profits licensing their own names to for-profit businesses (which is not taxable to an exempt organization) to avoid engaging in an active trade or business themselves.”
–W&M Majority Tax Staff, Section by Section Summary

Corporate Sponsorship

- Proposal to treat corporate sponsorship payments as UBTI if the sponsor acknowledgement refers to sponsor's product lines.
- Proposal to treat exclusive sponsorship of large events (>$25,000) as UBTI

  (a sponsor's name and logo may not be treated more favorably than others at such events)

Excess Benefit Transactions

- Proposal that disqualified persons may no longer rely on compensation consultants to avoid excess benefit transaction excise tax
- Additionally, proposal imposes 10% excise tax on organizations participating in excess benefit transactions
    - Organization may avoid the tax by following rebuttable presumption procedure.
- Proposal also expands intermediate sanctions to 501(c)(5) and 501(c)(6)
- Proposal treats athletic coaches and investment advisors treated as disqualified persons even if they work for a supporting organization

Self-Dealing Transactions

- Proposal to impose 2.5% excise tax on private foundations that engage in a self-dealing transaction, 10% when it involves compensation.

- Proposal also eliminates safe harbor for reliance on professional advice.

High Compensation Excise Tax

- Under current law, exempt organizations may pay compensation exceeding $1 million if it is reasonable.
- Proposal: 25% excise tax on compensation over $1 million
    - Payable by employer with respect to top five employees
    - Includes deferred compensation and parachute payments

"Given that exemption from Federal income tax constitutes a significant benefit conferred upon tax-exempt organizations, the case for discouraging excess compensation paid out to such organizations' executives may be even stronger than it is for publicly traded companies."

–W&M Majority Tax Staff, Section by Section Summary

Tax-Exempt Bonds

- Under current law, interest income from bonds issued by state and local governments is generally exempt from tax.
  - State and local governments are also permitted to issue tax-exempt bonds on behalf of Section 501(c)(3) organizations through conduit financing arrangements.
  - Private activity bonds (i.e., bonds issued to finance a facility that will be used by a private party rather than by a governmental entity) are not tax-exempt unless they are *qualified* private activity bonds.
  - Section 501(c)(3) bonds are a category of qualified private activity bond.
- The proposal would repeal the exception for qualified private activity bonds on a prospective basis, meaning that Section 501(c)(3) bonds could no longer be issued on a tax-exempt basis.
- The proposal would also eliminate advance refundings (i.e., issuing tax-exempt bonds to refund outstanding bonds more than 90 days in advance).

Tax Extenders - Senate

- Senate Finance Committee marked up the Expiring Provisions Improvement, Reform, and Efficiency Act of 2014 (EXPIRE) (S. 2260) and voted it out of committee on April 3, 2014. The bill extends the following through 2015:
  - deduction for contributions of capital gain real property made for conservation purposes;
  - tax-free distributions from individual retirement accounts (IRAs) for charitable purposes;
  - the tax deduction for contributions of food inventory by taxpayers other than C corporations;
  - the basis adjustment rule for stock of an S corporation making charitable contributions of property;
  - extension of modification of tax treatment of certain payments to controlling exempt organizations

Extenders – House of Representatives

- House has passed several traditional tax extenders as permanent legislation <u>without any revenue offsets</u>.
- America Gives More Act (HR 4719) contains the following provisions:
  - Extension and expansion of charitable deduction for contributions of food inventory
  - Make permanent the rule allowing certain tax-free distributions from individual retirement accounts for charitable purposes
  - Modify and make permanent the special rule for qualified conservation contributions
  - Allow charitable contributions made by an individual after the close of the taxable year, but before the tax return due date, to be treated as made in such taxable year
  - Modify the tax rate for excise tax on investment income of private foundations
- Rep. Camp's Tax Reform Act of 2014 discussion draft revises and extends only two of the charity related extenders: conservation contributions and basis adjustment for S corporations

Revenue Estimate of America Gives More Act of 2014

Provision	2014-2024 ($billions)
Food Inventory Contributions	(1.915)
Charitable Distributions from IRAs	(8.415)
Qualified Conservation Contributions	(1.177)
Charitable Contributions Until April 15 Counted in Prior Year	(2.822)
Private Foundation Excise Tax Reduced to 1%	(1.909)
Total:	(16.238)

In Other News…

- Status of Exemption Applications
  - TE/GE has closed 97% of exemption applications that were more than one-year old.
  - 577,000 exempt organizations have been auto revoked.
  - 34,000 have been reinstated.
  - 30% percent of the 80,000 exempt organization applications received last year were for reinstatement.

Source: Comments of Donna Hansberry, TE/GE Deputy Commissioner (Aug. 19, 2014)

Campaign Related Political Activity Proposed Regulations

- Proposed Regulations of November, 2013, generated over 150,000 written comments—the most comments ever received by Treasury and IRS on a proposed tax regulation.
- IRS is currently reviewing those comments.
- “Consistent with what Commissioner Koskinen has previously stated, it is likely that we will make some changes to the proposed regulation in light of the comments we have received.”
- New proposed regulations on campaign related political activity are expected “in early 2015”
- Business plan item has been revised to apply to all 501(c) organizations, not just 501(c)(4)s.