Tax Reform Act of 2014

Provisions Affecting Exempt Organizations

On February 26, 2014, House Ways and Means Committee Chairman Dave Camp (R-MI-4) released his comprehensive tax reform proposal. Intended as a discussion draft for Members of Congress, the plan makes changes to nearly every aspect of the tax code and impacts every sector of society—from multinational corporations and small businesses, to individual taxpayers, to nonprofit organizations. Among these numerous changes are provisions that impact nearly every type of tax-exempt organization, including foundations; some that will strengthen the sector and others that will inhibit our ability to advance the common good.

The Council on Foundations applauds the Chairman for putting forth a concrete plan to undertake much-needed comprehensive tax reform. We recognize that this proposal will become a critical starting point for future tax reform conversations. It is therefore imperative for the philanthropic community to be actively engaged in today's debates—to demonstrate support for provisions in the bill, to express opposition, and to craft and negotiate changes to those provisions that we oppose—because this language will have a profound influence on the tax code of the future.

The Council will continue to engage our members and other partners in the field to assess each provision and ensure that we put forward the best possible framework for the sector for future tax reform.

INDIVIDUAL GIVING INCENTIVES

2 percent floor on the charitable deduction

Under the Chairman's proposal, an individual's charitable contributions could be deducted only to the extent that they exceeded 2 percent of an individual's adjusted gross income (AGI), known as a deduction "floor." This proposal, combined with a higher standard deduction that would drastically reduce the number of taxpayers who choose to itemize and a phase-out of itemized deductions, could cause a decline in charitable giving—particularly for those donors who make smaller gifts.

AGI limitations

The bill proposes to harmonize at 40 percent the 50 percent limitation for cash contributions and the 30 percent limitation for contributions of capital gains property to public charities and certain private foundations. Also, the 30 percent contribution limit for cash contributions and the 20 percent limitation for contributions of capital gains property that apply to organizations not covered by the current 50 percent limitation rule would be harmonized at a single limit of 25 percent.

This means that contributions to organizations not currently covered by the 50 percent limitation rule would be allowed to the extent they do not exceed whichever is less, (1) 25 percent of AGI or (2) the excess of 40 percent of AGI for the tax year over the amount of charitable contributions subject to the 25 percent limitation.

Extension of deduction to April 15th of the calendar year

This provision would allow individual taxpayers to deduct charitable gifts made after the close of a tax year but before April 15th, the calendar year deadline for the filing of tax returns.

Repeal of Pease Limitation on itemized deductions

Chairman Camp's proposal repeals the Pease Limitation on itemized deductions. Under current law, the Pease Limitation reduces the total amount of otherwise allowable itemized deductions by 3 percent of the amount by which AGI exceeds a certain threshold for certain high-income tax payers.

Phase-out of itemized deductions for certain taxpayers; increase in standard deduction

The Chairman's plan phases out itemized deductions for taxpayers starting at $250,000 for singles and $300,000 for married taxpayers filing jointly, and consolidates the basic and additional standard deductions into a single standard deduction of $22,000 for joint filers (and surviving spouses) and $11,000 for other individual filers. Single filers with at least one qualifying child could claim an additional deduction of $5,500, regardless of whether or not they itemize deductions.

As a result of the proposed increase to the standard deduction, Chairman Camp estimates that 95 percent of taxpayers would choose the standard deduction, a significant decrease from the one-third of taxpayers who itemize under current law. The proposal maintains the charitable deduction but reduces its value with the 2 percent floor. But, as with current law, under the proposal only those taxpayers who itemize—5 percent, according to the Chairman's prediction—will be able to take advantage of the deduction.

Gifts of property

Chairman Camp's proposal limits the amount of a charitable deduction for most types of property gifts to the adjusted basis of the property. It limits the deduction to the fair market value of the property minus any ordinary gain that would have been realized if it was sold at fair market value, for the following types of property:

- Tangible property related to the purpose of the organization;
- Any qualified conservation contribution;
- Any qualified inventory contribution;
- Any qualified research property;
- Publicly traded stock.

IRA charitable rollover and other "tax extenders"

The bill does not include the IRA charitable rollover provision, which expired at the end of 2013 along with the other "tax extenders" provisions.

However, it does make permanent the conservation easement deduction. Deductions for conservation easements are limited to 40 percent of AGI, but farmers and ranchers would still be allowed a charitable deduction of up to 100 percent of AGI for property used in agricultural or livestock production. The bill expressly disallows a deduction for land reasonably expected to be used as a golf course.

PRIVATE FOUNDATIONS

Private foundation excise tax simplification

The bill simplifies the current two-tiered excise tax to a flat rate of 1 percent. It also removes the current exclusion for exempt private operating foundations, making them subject to the excise tax for the first time.

Tax on self-dealing

An excise tax of 2.5 percent would be imposed on a private foundation when the self-dealing tax is imposed on a disqualified person. The tax rate would be 10 percent for cases in which the self-dealing involves the payment of compensation. Additionally, foundation managers would no longer be able to rely on the professional advice safe harbor.

COMMUNITY FOUNDATIONS

Five year payout requirement for donor advised funds

The proposal would assess a 20 percent excise tax on public charities that fail to make "eligible distributions" (defined as a distribution to a public charity) from donor advised funds (DAFs) within 5 years. This means that organizations maintaining DAFs will need to payout all DAF funds within five years of receipt, or pay the 20 percent annual tax. Current law permits community foundations and other philanthropic organizations to hold and manage DAFs indefinitely and make investments into the community over a prolonged period of time.

ALL FOUNDATIONS

Repeal of Type II and Type III supporting organizations

The plan proposes to eliminate Type II and Type III supporting organizations. This means that organizations that support public charities would need to qualify as a supporting organization that is operated, supervised, or controlled by a publicly supported organization (i.e., a Type I supporting organization), or they would be treated as private foundations. Any new entities seeking to organize as supporting organizations would need to qualify as Type I supporting organizations to be eligible for tax-exempt status.

Changes to the treatment of certain unrelated business income

The proposal expands the circumstances under which the Unrelated Business Income Tax (UBIT) is triggered and changes the manner in which it is calculated by ending aggregate calculations for the net unrelated taxable income of an unrelated trade or business. This means that organizations utilizing a variety of sources of income may see their tax liability increase as more of these activities trigger UBIT. Specifically, the bill:

- Imposes a 5 percent penalty on managers when an accuracy-related penalty is applied to the organization for any substantial understatement of UBIT;
- Clarifies that UBIT applies to all organizations that are exempt under Section 501(a);
- Applies UBIT to all name and logo licensing royalties;
- Ends aggregate calculations for the net unrelated taxable income of unrelated trade or business activities;
- Applies UBIT to income from fundamental research that is not made available to the public;
- Repeals the UBIT exception for acquisitions of distressed property;
- Limits a charitable deduction for contributions made to other tax-exempt organizations to 10 percent of the contributing organization's unrelated business income—regardless of whether the organization is a corporation or a trust;
- Applies UBIT to the gain or loss from the sale or exchange of distressed property acquired by a tax-exempt organization from a financial institution that held the property in receivership or conservatorship or as a result of a foreclosure;
- Increases the specific deduction against gross income subject to UBIT for all tax-exempt organizations to $10,000;
- Modifies when UBIT is triggered by sponsorship at a recognized event. If the sponsorship refers to the sponsor's product lines, it is considered advertising subject to UBIT; and, if an organization receives more than $25,000 in qualified sponsorship payments for any one event, the sponsor's name or logo can only appear proportionate to other donors or UBIT will apply.

Electronic filing of all Form 990s

The bill requires all tax-exempt organizations required to file Form 990s to file these returns electronically, and for the IRS to make the returns publicly available electronically. As with former Senator Max Baucus's (D-MT) tax reform discussion drafts, the Camp bill provides transition relief (a "phase-in") for small organizations that are not currently required to file electronically. It also doubles the daily penalties imposed upon an organization or managers who fail to file information returns on time. This requirement would have particular consequences for small nonprofits and private foundations, which could face significant new costs associated with e-filing.

Excise tax on excess executive compensation

Chairman Camp proposes a 25 percent excise tax on executive compensation in excess of $1 million paid to any of a covered organization's five highest paid employees for the tax year. The excise tax would apply to all income, benefits, and severance packages, except for payments to a tax-qualified retirement plan and amounts that are excludable from the executive's gross income. Once an employee qualified as a covered person, the excise tax would apply to any compensation in excess of $1 million paid to that person going forward.

OTHER PROVISIONS AFFECTING TAX-EXEMPT ORGANIZATIONS

Intermediate sanctions for excess benefit transactions

This provision imposes a 10 percent tax on an organization when an excess benefit tax is imposed on a disqualified person, if an organization fails to follow reasonable standards of due diligence. It also overrides a Treasury regulation by eliminating a presumption of an organization's reasonableness. The tax would be applied beyond public charities, to labor, agricultural, and horticultural organizations under 501(c)(5) and 501(c)(6). Further, managers could no longer rely on the professional advice safe harbor.

501(c)(4) organizations

The bill requires new 501(c)(4) organizations to notify the IRS prior to commencing operations, or be subject to penalties. The bill also extends declaratory judgment relief to 501(c)(4)s for controversies involving their initial or continuing qualification as social welfare organizations. It also restricts donation reporting for 501(c)(4)s, only requiring them to report (on Schedule B only—not publicly) donors who both (1) contribute $5,000 or more (in money or property) during the current tax year, and (2) are either an officer or director of the organization or one of the five highest compensated employees of the organization for the current or any preceding tax year.

Finally, it requires the IRS to apply the current standards and definitions to determine whether an organization is operated exclusively for the promotion of social welfare—prohibiting Treasury from implementing the proposed rules on 501(c)(4) political activity.

Excise tax on certain private colleges and universities

The bill imposes a 1 percent excise tax on the net investment income of many private colleges and universities, similar to the private foundation excise tax. The tax would apply to those private colleges and universities with investment assets that exceed $100,000 per full-time student. To date, this type of excise tax, while applicable to private foundations, has not been applied to colleges and universities.

Deduction for college athletic event seating rights

This provision repeals a special charitable deduction of 80 percent of the amount paid for the right to purchase tickets to college athletic events.

Deduction for income from intellectual property

This provision disallows income from intellectual property contributed to a charitable organization as an additional charitable contribution, but maintains the deduction for the contribution of the intellectual property.

Repeal of tax-exempt status for professional sports leagues

The bill makes professional sports leagues ineligible for 501(c)(6) tax exempt status. Amateur sports leagues would continue to qualify as tax-exempt.

Repeal of tax-exempt status for qualified property and casualty insurance companies and qualified health insurance issuers

This provision repeals tax exemption for these types of organizations.

Exempt status limited for workmen's compensation insurance organizations

This provision limits tax exempt status for workmen's compensation insurance organizations to those organizations who provide only the workman's compensation insurance required by state law.