INDEPENDENT SECTOR
A vital voice for us all

SENATE FINANCE COMMITTEE

TAX REFORM WORKING GROUP ON
INDIVIDUAL & BUSINESS INCOME TAX

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Importance of the Charitable Sector

In communities across the globe each day, charitable nonprofit organizations, among many other contributors, provide educational and economic opportunities for families in need; work to alleviate poverty and suffering at home and abroad; assist victims of disaster; enhance the cultural and spiritual development of individuals and communities; facilitate scientific advances; and foster worldwide appreciation for the democratic values of justice and individual liberty that are part of the American character.

The charitable sector is also a critical component of the nation's economy. Nearly one in 10 workers in the United States is employed by a nonprofit organization, and with 13.7 million paid workers, we are the third largest workforce in the country behind only the retail and manufacturing industries. Further, these organizations pay nearly $600 billion annually in wages and benefits, salaries that support families in communities across America. In addition, 62.6 million Americans contributed more than 8.1 billion hours of volunteer service to a formal organization in 2013, the equivalent of 5 million full-time jobs valued at approximately $163 billion.[1]

The charitable sector's broad community impact and public support is evidenced by the breadth of its funding sources. Millions of Americans make donations each year, collectively and individually giving more than $335.2 billion to support the work of charitable nonprofit organizations.[2] But charitable donations are only part of what is needed to ensure that the sector's programs and services can continue. A full 50 percent of revenue across the sector is derived from fees paid for services, ranging from tuition and patient care charges to event admission fees. More than one-third of additional nonprofit sector revenue is generated through partnering with all levels of government to deliver programs and services like after-school care, nutrition assistance, and nursing home care for elderly and disabled Americans.[3]

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[1] Urban Institute, National Center for Charitable Statistics. 2014. "The Nonprofit Sector In Brief 2014: Public Charities, Giving, and Volunteering." Brice McKeever and Sarah Pettijohn. http://www.urban.org/UploadedPDF/413277-Nonprofit-Sector-in-Brief-2014.pdf

[2] Giving USA: The Annual Report on Philanthropy for the Year 2013 (2014). Chicago: Giving USA Foundation. Note: This includes giving by philanthropic and corporate foundations.

[3] (Data is 2010) National Center for Charitable Statistics (NCCS), Urban Institute, The Nonprofit Almanac 2012. Revenue Sources for Reporting Public Charities: NCCS Calculations of IRS Statistics of Income Division Exempt Organizations Sample (2007); NCCS Core Files (2010); American Hospital Association (AHA) 2010 Survey; and the National Health Accounts, produced by CMS. p.156. .

Tradition of Giving in Tax Policy

While almost all Americans are generous contributors to causes they care about, the vast majority of donations come from taxpayers who take the charitable deduction. More than 81 percent of the 45 million Americans who itemized their tax returns in 2012 claimed the charitable deduction. These individuals and families, who represent just one quarter of all taxpayers, are responsible for more than 83 percent of individual contributions to charitable organizations.[4]

Congress has long recognized the connection between the tax code and its effect on donations to charitable organizations, dating to the inception of the charitable deduction in 1917. The generosity of Americans, further encouraged through tax incentives, has made possible extraordinary contributions of charitable organizations in local communities, large cities, rural areas and those focused abroad all dedicated to improving life for all.

Recognizing the power of the tax incentive to stimulate additional giving, in the days following the devastating January 2010 earthquake in Haiti, legislation was enacted allowing taxpayers to claim a 2009 deduction for donations made to Haiti relief efforts between the date of the earthquake and March 1, 2010. Similar extensions were enacted following the Southeast Asia tsunami of 2004, Hurricane Katrina in 2005, and storms in the American Midwest in 2008. Even in this 114th Congress, legislation passed with overwhelming bipartisan support to encourage donations to charities providing relief to the families of two slain New York City police officers, by aligning the deadline for those gifts with Tax Day.

Moreover, the power of the incentive can be seen in the timing of charitable gifts. Between 2001 and 2013, charitable organizations in the U.S. received $987 million in online donations. A third of those donations are made in December each year, with a full 10 percent made between December 29 and 31. These trends underscore the extent to which donors are aware of, and influenced by, the tax implications of their giving.[5]

The America Gives More Act

Prior to undertaking comprehensive tax reform, we urge the Senate to promptly consider and approve the America Gives More Act (H.R. 644), legislation passed by the House of Representatives earlier this year. This legislation, which makes permanent three temporary and currently expired giving incentives while also simplifying the excise tax on private foundations, will help charitable and philanthropic organizations continue to deliver much-needed programs and services to your constituents.

It is difficult to overstate the benefit to our community, and the people we serve, of extending permanently the IRA charitable rollover and the enhanced incentives for the donations of food inventory and land conservation easements. The repeated expiration and retroactive renewal of these charitable giving incentives create tremendous uncertainty for individuals, families, and businesses who want to provide donations to help their communities, and for the charitable organizations working to meet the needs of the communities they serve. Three of the provisions in H.R. 644 are outlined below.

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[4] Giving USA Foundation (2014).

[5] Network for Good. "Digital Giving Index. 2013 Year in Review." http://www1.networkforgood.org/digitalgivingindex

- IRA charitable rollover

The individual retirement account (IRA) charitable rollover tax incentive, first enacted in the Pension Protection Act of 2006, encourages older adults to make gifts to charities by enabling individuals age 70½ to donate up to $100,000 to a qualifying public charity directly from his or her IRA without incurring tax on the withdrawal, regardless of whether these individuals choose to itemize their taxes. This option helps seniors who may no longer rely on tax breaks for home mortgage payments.

While previous lapses of this provision have made data difficult to compile, according to the nonprofit Partnership for Philanthropic Planning,[6] during the first two years the IRA charitable rollover option was available, it prompted more than $140 million in charitable donations, with the median gift just under $4,500.[7] One local United Way also received nearly 75 percent of their IRA rollover gifts in the last two weeks of 2014, once the tax extenders package was renewed temporarily, indicating that donors were waiting until the tax incentive was back in effect before making their gifts. Beneficiaries of this provision have included social service providers, religious organizations, cultural institutions and schools – organizations that benefit communities and improve lives every day.

- Enhanced deduction for contributions of food inventory

Since Section 170 of the Internal Revenue Code was enacted by Congress in 1976, our nation's tax system has encouraged donations of food inventory by allowing C Corporations to earn a tax deduction for donating surplus wholesome food that has been safely handled and donated to an approved public charity.

Under this provision, the allowable deduction is the donor's basis in the donated food plus one-half of the ordinary income that would have been realized had the food been sold at fair market value (capped at twice the donor's basis in the donated inventory). Congress made this enhanced tax incentive available to all business entities as part of the Katrina Emergency Tax Relief Act in 2005. The expanded incentive has been vital, as community food pantries and other meal providers attempt to keep pace with the growing number of Americans who go to bed hungry every night. Feeding America estimates this incentive has translated to a 137 percent increase in the amount of food donated by restaurants to food banks.

- Special rules for the contributions of capital gain real property for conservation purposes

First enacted as part of the Pension Protection Act of 2006, the enhanced deduction for donation of a conservation easement increases the maximum deduction a donor can take for donating a conservation easement from 30 percent of adjusted gross income (AGI) in any year to 50 percent of AGI. It also allows qualified farmers and ranchers to deduct up to 100 percent of AGI, and permits taxpayers to carry forward excess contributions for up to 15 years.

6 Formerly the National Committee on Planned Giving
7 National Committee on Planned Giving. "Survey of IRA Distributions to Charity." March 24, 2008.

Conservation easements create a legally enforceable land preservation agreement between a landowner and a government agency or a qualified land protection organization (land trust) for the purposes of conservation. Such easements are cost-effective and voluntary, and the enhanced charitable incentive makes it possible for modest-income farmers, ranchers and other property owners to make such gifts.

Within its first two years, the enhanced incentive helped America's land trusts increase the amount of land conservation by at least 535,000 acres.[8] The nonprofit Land Trust Alliance also estimates that the provision has helped America's land trusts work with farmers, ranchers and other modest-income landowners to increase the pace of conservation by one-third, to over a million acres per year.

Permanent enactment of these incentives will end the ambiguity and uncertainty caused by repeated lapses and subsequent re-enactments that have made it extremely difficult for donors and financial advisors to develop charitable giving plans, impeding the transfer of gifts that support much-needed services. These charitable giving incentives have encouraged individuals, large corporations, and small businesses to support the development and sustainability of their communities. They have spurred contributions, for example, to build cancer centers, develop counseling programs for at-risk youth, provide housing for homeless families, conserve wilderness areas, and offer art therapy for people with developmental disabilities.

We urge the immediate consideration and approval of the America Gives More Act by the Senate.

The Charitable Deduction

While some advocates of changing the charitable deduction believe it disproportionately benefits high-income taxpayers, the facts say otherwise. Indeed, the current tax code treats every taxpayer who claims the deduction equitably, because regardless of the rate at which their income is taxed, people are not required to pay taxes on the portion of their earnings donated to charity.

Some have said that the charitable deduction disproportionately benefits those charities favored by wealthier donors. Specifically, it is suggested by some that donors claiming the charitable tax deduction primarily support organizations perceived to be well-financed at the expense of charities that provide direct service to needy individuals and families. In fact, reducing the value of the charitable deduction for higher-income taxpayers will diminish the impact of services and programs across the sector broadly. A 2012 study by the Center on Philanthropy at Indiana University found that 79.3 percent of high-net-worth households[9] (defined as having annual income greater than $200,000) donated to basic needs charities in 2011, with their average gift to basic needs organizations increasing by 17.5 percent since 2009.[10] The reality is that Americans in every income bracket give generously to all types of charitable organizations, and reducing incentives to give will hurt all charities and the causes they serve.

8 Land Trust Alliance. "The Enhanced Easement Incentive." http://www.landtrustalliance.org/policy/tax-matters/campaigns/how-the-easement-incentive-works

9 Households with annual income greater than $200,000 and/or personal wealth of at least $1,000,000.

10 "The 2012 Study of High Net Worth Philanthropy," Center on Philanthropy at Indiana University, November 2012

It is also important to keep in mind the unique nature of the charitable deduction. Unlike incentives to save for retirement or purchase a home, for example, the charitable deduction encourages behavior for which a taxpayer receives no direct tangible benefit. The charitable deduction does not subsidize personal consumption or underwrite the accumulation of personal wealth. It simply and effectively encourages taxpayers to give away a portion of their income to benefit others.

Despite the universal popularity of this tax incentive, during the past couple of years the voices considering limits on the charitable deduction have included administration officials, other public officials from both parties, and various fiscal commissions tasked with charting a course to long-term economic stability. These proposals have included imposing a hard-dollar cap on all itemized deductions, implementing a percentage-based reduction, and introducing a partial tax credit available to taxpayers whose charitable giving exceeds some arbitrary threshold.[11] Their impact would range from decreasing the value of the charitable deduction to effectively eliminating it entirely for many taxpayers.

The most active proposal to reduce the value of the charitable deduction has been the Obama Administration's effort to limit itemized deductions for taxpayers earning more than $200,000 per year at 28 percent. When top marginal rates were 35 percent, experts predicted this proposal would cause charitable giving to decline by anywhere between $1.7 billion[12] and $7 billion[13] per year. With top marginal tax rates now at 39.6 percent, capping the charitable deduction at 28 percent would likely cause an even more drastic decline in giving.

The most recent legislative proposal to limit the charitable deduction was offered by former House Ways and Means Committee Chairman Dave Camp (R-MI) in his Tax Reform Act of 2014. The legislation would directly limit the charitable deduction by eliminating the tax-deductibility of donations that fail to reach two percent of a taxpayer's adjusted gross income or exceed 40 percent. Indirectly, the proposal's expansion of the standard deduction to twice its current size would preclude the use for an estimated 95 percent of taxpayers of itemized deductions altogether, including the charitable deduction. A preliminary evaluation by the nonpartisan Urban-Brookings Tax Policy Center found that the collective impact of these proposals would reduce annual charitable giving by between 7 and 14 percent, or as much as $34 billion a year based on 2013 giving levels.[14]

We therefore strongly urge you to reject policies that would place any limitations on the charitable deduction that would undermine its critical incentive effect.

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[11] Both the National Commission on Fiscal Responsibility and Reform, also known as the Simpson-Bowles Commission, as well as the Debt Reduction Task Force, chaired by former Senator Pete Domenici and former OMB Director Alice Rivlin, called for replacing the charitable deduction with a credit.

[12] "Impact of The Obama Administration's Proposed Tax Policy Changes on Itemized Charitable Giving." The Center on Philanthropy at Indiana University, October 2011.

[13] "An Anti-Charity Tax, at the Worst Time." Martin Feldstein, *Washington Post*, March 25, 2009

[14] Urban Institute Center on Nonprofits and Philanthropy, Urban-Brookings Tax Policy Center. August 2014. "Preliminary Estimates of the Impact of the Camp Tax Reform Plan on Charitable Giving." Joseph Rosenberg, C. Eugene Steuerle, Ellen Steele, and Amanda Eng. http://www.taxpolicycenter.org/UploadedPDF/413228-Preliminary-Estimates-of-the-Impact-of-the-Camp-Tax-Reform-Plan-on-Charitable-Giving.pdf

Donor-Advised Funds

Donor-advised funds (DAFs) allow donors to contribute cash or non-cash assets to a sponsoring organization, which in turn manages the contribution for grant-making recommended by the donors. In recent years questions have been raised about the rate or amount of annual fund payout from donor-advised funds, with critics arguing that while DAFs provide an immediate tax benefit to donors, there is no requirement that these donations be paid out to charities in a timely manner.

We oppose the establishment of a pay-out rate for DAFs for a number of reasons, beginning with the fact that while the payout rate varies from fund to fund, the overall payout rate since 2007 for DAFs exceeds 16 percent, far in excess of the required 5 percent payout rate for private foundations. We are concerned that establishing a pay-out rate for DAFs would in fact drive down the payout rate and risk creating a ceiling rather than a floor.

Additionally, donor-advised funds provide a flexible mechanism for donors to make charitable contributions, and all funds put in a DAF are irrevocably committed to being used for charitable purposes. There are times when a delay in payout is warranted. For example, donors may need to take the time to become educated about various charitable options and wisely consider, in consultation with knowledgeable professionals, the highest and best use of those funds within a particular field of interest. Further, there are occasions when donors may wish to accumulate funds over time so that they can recommend a more substantial gift, such as for a capital improvement, when there is greater capacity to do so. Donors may also wish to create an endowed fund that becomes a part of the corpus of the sponsoring organization such as a community foundation the earnings of which are used to fund annual grants. Finally, some illiquid donations may require some time by the sponsoring organization to be converted to cash.

Non-cash contributions

Non-cash contributions, including gifts of art, land, stock, securities, household goods, motor vehicles, clothing, among other items, are a significant source of support for many charitable organizations. Tax laws provide incentives for such contributions by permitting taxpayers to take an income tax deduction generally equivalent to the fair market value of property and other non-cash items donated to a qualified charity. Specific rules apply to gifts of property that have appreciated in value since they were acquired by the taxpayer, while other conditions apply to gifts of conservation easements and gifts that have generally depreciated in value, such as motor vehicles, clothing, or household items. Non-cash contributions accounted for roughly $49 billion by taxpayers who itemized deductions on their federal income tax returns in 2012.[15]

Tax rules should be simplified to provide clear standards for establishing appropriate valuation of these gifts and facilitate taxpayer compliance, while retaining incentives for taxpayers to donate substantial gifts of furniture and clothing. To assist taxpayers in establishing the fair market value of donated goods, the responsibility should fall to the IRS to provide a clear standard for determining such values based on the "value guides" currently offered by many charitable organizations. Charitable organizations that are the recipients of these donations are also encouraged to make such lists available on their websites.

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15 IRS Statistics of Income data for 2012.

If Congress considers additional reforms, we encourage you to do so in a manner that balances a need for greater enforcement with providing opportunities to give back to their communities with non-monetary gifts. In the pursuit of compliance, we want to ensure that many smaller organizations whose operations are dependent upon large numbers of volunteers are not overburdened with additional requirements. Similarly, we would be cautious of any changes that place greater limitations on various vehicles outside of cash donations for Americans to demonstrate their generosity.

Complex nonprofit structures

The tax code allows organizations to be organized and operated in a variety of legal structures in order to provide flexibility for the goals and needs of the group. From a governance standpoint, tax-exempt parent entities have and should exercise oversight responsibility over their subsidiaries, in much the same way that for-profit parents have oversight over their subsidiaries.

There is nothing inherently wrong with a tax-exempt entity having one or more nonprofit or for-profit subsidiaries, as long as each entity is properly structured under the tax and corporate laws. In fact, among the reasons that public charities establish separate entities are to ensure compliance with tax law restrictions and to achieve liability protection. If Congress, whistleblowers, or others with knowledge of the operation have information of inappropriate activity, certainly that information should be provided to the IRS for investigation.

Unrelated Business Income Tax (UBIT)

As a result of persistent resource concerns, public charities have turned to a variety of revenue-generation activities in order to adequately fund their operations. In some instances, charitable nonprofit organizations capitalize on opportunities that naturally arise from their day-to-day exempt operations, and in others, strategies are implemented to devote time and resources toward new income-producing activities. In either instance, the organization's income-generating activities may or may not be substantially related to the organization's tax-exempt purpose.

Any examination of current unrelated business income tax (UBIT) rules should be careful to recognize the diversity of the sector and its activities. At this time, much of the UBIT data is published and analyzed at the "tax-exempt organization" level, rather than broken down by 501(c) subsection. There is therefore a danger that legislative proposals and policy decisions will paint all tax-exempt organizations with the same brush, and impose unwarranted requirements or increased taxes on the sector. Even modest changes to the rules could substantially increase the tax liability of particular public charities, reduce the funds available for programs and services, and create further hardship for the people they serve.

We urge Congress to engage in a dialogue with public charities and conduct thoughtful analysis to ensure that examination of the current rules structure takes into account the breadth of activities undertaken by the broader charitable community.

Electronic filing of the Form 990 series

Electronic filing of the annual information returns filed by nonprofit organizations will enhance tax compliance and transparency, improve oversight and enforcement by the IRS, and provide timelier, accurate information to the public. In general, only the largest and smallest tax-exempt organizations are required to electronically file their annual information returns, and the IRS makes the reported information publicly available in a restricted format that limits its usefulness. The IRS does not have the statutory authority to require that all tax-exempt organizations electronically file the Form 990.

Independent Sector supports expanded electronic filing of the Form 990 series, and encourages Congress to consider any proposal to mandate the electronic filing of Form 990-series returns in conjunction with other necessary considerations that will ensure an effective and reasonable implementation of the policy. Additionally, we continue to support increased funding for the IRS to provide the technology, programs, staffing, enforcement, and implementation necessary to accommodate a transition to mandatory electronic filing.

In order to best facilitate electronic filing for all tax-exempt organizations, all forms in the Form 990-series should be compatible with a streamlined electronic filing process. A waiver of the e-filing requirement would be permitted if there is limited or no access to the technology to file the returns electronically, as well as transitional relief in the form of a delayed effective date of up to three years if the requirement presents a hardship. We strongly urge Congress to evaluate whether the current structure of Form 990-series returns, accompanying schedules, and other required supplementary information would be compatible with a streamlined electronic filing process, prior to adoption of such a policy.

Good governance

We also recognize the desire to identify bad actors, and we support regulations in place to ensure that charitable organizations are operating in a manner that reflects good governance, effective stewardship of charitable resources and ethical conduct. Self-regulation by the sector is an important complement to government oversight and regulation. Independent Sector's *Principles for Good Governance and Ethical Practice*, which were updated and re-released with bipartisan Congressional support in 2015, and other resources are used by public charities and private foundations to enhance the accountability and transparency of their operations and ensure that they operate ethically.

The charitable sector also supports an array of watchdog groups, management support groups, and infrastructure organizations that collectively serve to ensure accountability, build capacity, and promote excellence within nonprofit organizations. These resources and organizations play a critical role in helping charities go beyond the requirements of the law to achieve high standards of conduct and quality. Therefore, we urge the Committee to be deliberate and judicious in its examination of the tax code so that any proposed changes would not have unintended consequences of making compliance with the law unnecessarily burdensome for charitable organizations

Thank you for the opportunity to share these views with the Committee.

Independent Sector
Americans for the Arts
Americans for the Arts Action Fund
Association of Art Museum Directors
Dance/USA
Feeding America
Girl Scouts of the USA

Land Trust Alliance
LeadingAge
League of American Orchestras
OPERA America
The Nature Conservancy
Volunteers of America